

First informal licence drafting consultation (Appendix 3)

Comments in relation to the consultation document relating to the Electricity Transmission and Gas Transporter – Price Control Financial Handbook

Paragraph Reference	Comments
6.12	<p>We note the comment that the handbook and the detailed methodologies are still under development and should be regarded very much as a work-in-progress, subject to change.</p> <p>Our comments are based on the current drafting published for Initial Proposals.</p> <p>As the licences, handbooks and models develop there is an ongoing requirement to consult on the respective contents. Validity and consistency checks between the three documents will be required until all three are final.</p>

First informal licence drafting consultation – supporting document 1

Comments in relation to the consultation document relating to the Electricity Transmission and Gas Transporter – Price Control Financial Handbook (supporting document 1)

No.	ET Para Ref	GT Para Ref	GD Para Ref	Comments	Suggested alternative drafting (please use tracked changes wherever possible)
1	All	All	All	The Price Control Financial Model is defined in the Introduction as 'PCFM'. As there are different versions of the model it would be more specific if the acronym could read 'GT1 PCFM', 'ET1 PCFM, etc in the respective handbook version, with any following references throughout the documents replaced with the correct acronym.	
2	All	All	All	All references to "Ofgem" should be changed to "Authority".	
3	All	All	All	Generic references to a year are used with differing terminology as "year", "formula year", "relevant year" and relevant formula year". These should be rationalised if appropriate, the remainder defined and then used consistently within the licences, handbooks and PCFMs to avoid confusion.	
4	All	All	All	The terms "licensee business basis" and "licensee level" are used. These should be defined and used consistently within the licences, handbooks and PCFMs.	
5	1.3	1.3	1.3	The formula contains terms for "base revenue" and "opening base revenue". These should be defined and used consistently within the licence, handbook and the model. It would be helpful to give the "base revenue" term a prefix of "updated" to distinguish it from the opening base revenue.	
6	1.4	1.4	1.4	Change the wording " works predominantly in a constant" to "calculates revenues in"	

7	1.4	1.4	1.4	<p>Create new paragraph and change wording “Indexation is provided for in the base revenue formula set out in the special conditions” to “To calculate allowed revenues indexation is provided for in the formulae in the licence sections: calculation of base allowed NTS transportation owner activity revenue (TOBRt) for GTO, calculation of Base NTS System Operation Internal Revenue (SOBRt) for GSO, calculation of Base Transmission Revenue (BR) for ETO, calculation of Base SO Internal Revenue (SOBR) for ESO and calculation of base Distribution Network Transportation Activity Revenue (BRt)for GD.</p> <p>This will ensure the reader does not think that the indexation factors referred to are used within the model.</p>	
8	1.5	1.5	1.5	<p>Change wording to “All calculations in the ‘Finance&Tax’ tab in the [GT1/ET1/GD1] PCFM use nominal prices based on embedded RPI forecast data contained in the ‘Input’ tab. These include a section for Net Debt, Regearing, Financing Costs and Tax Allowances. The ‘Tax Pools’ tab also calculates capital allowances in nominal prices in order to ensure that calculations accurately reflect the profile of tax expenses of the licensee. The tax allowance data is deflated to 2009-10 prices in the revenue calculations.”</p> <p>Add paragraph “The financial statements are presented in nominal prices”.</p>	
9	1.6	1.6	1.6	<p>Change the wording “the TOMOD term is used to adjust the opening base revenue..” to “ the TOMOD term is used to create an update value which is used to calculate the updated base revenue...”.</p> <p>Can all references re ‘temporal convention’ in the licence and handbook use exactly the same definition for MOD?</p>	
10	1.9	1.9	1.9	The reference to the foot note reads 6 – this should be 4.	
11	1.10	1.10	1.10	The 14 days notice is limited.	
12	1.11	1.11	1.11	Third bullet point – first sub bullet – add the word “updated” to base revenue.	
13	1.12	1.12	1.12	Is the first sentence correct – MOD is calculated referencing the opening base revenue per the licence definition? Can the word “recalculated” be replaced with “updated” when it refers to the revenue update calculated by an annual iteration?	
14	1.12	1.12	1.12	Change words in second sentence “... the licensee will be in the same position as if adjustments...” to “.. the licensee will receive the same revenue in real terms as if updates...”	

15	1.13	1.13	1.13	Change wording “Changes to base revenue...” to “Updates to opening base revenue..” Add final sentence which confirms that any retrospective updates are made in the MOD term in the next available ‘t’ year annual iteration .	
16	1.15	1.15	1.15	What is the appeal process in the event of an error in the calculation of the MOD term?	
17	1.17	1.17	1.17	What is the relevance of applying the value for TOMODt-1 if there is a delay in the notification as this has no relation to the next year? A more appropriate value would be the value calculated by the actual submission data that feeds into the annual iteration pending the direction. This paragraph should cover what the process is once the direction is made.	
18	1.22	1.22	1.22	Remove the word “unlikely”.	
19	1.22	1.22	1.22	Second bullet point – provide description of what “NPV neutral basis” means.	
20	1.29	1.29	1.29	There must be adequate provision for licensees to represent themselves at the meeting, eg state invited with 21 days notice	
21	1.30	1.30	1.30	The quorate should allow for representation by both Ofgem and each licensee.	
22	2.12		2.12	Replace the first sentence with “The ET1/GD1 Price Control Financial Methodologies describe the normal formula year timing differences for each PCFM Variable Value”. (per wording in GT1 handbook)	
23	2.5	2.5	2.5	The list in table 1 can only be validated for consistency upon the model being updated with all terms to be enable a cross check between licence, handbook and model terms.	
24	All (Tax Chapter)	All (Tax Chapter)	All (Tax Chapter)	What if there is an HMRC interpretation change but we do not agree with their interpretation and propose to ignore it for our tax comp. Do we notify of the category B event (to register the potential), calculate the impact it may have but then comment that one of our mitigating measures is to challenge it? Or do we only notify when we have lost our argument which may be years later? Who decides if the notional adjustment should be allowed if we are not even using it in our comps?	

25	All (Tax Chap ter)	All (Tax Chap ter)	All (Tax Cha pter)	Our understanding, based on the model meetings, is that there is no intention to update the capital allowance allocation assumptions in the model during the RIIO period. Consequently these inputs are not in the 'blue box' variable values table. Given that adjustments to such assumptions would generate changes in the tax liability allowances a statement that these things will not be updated should be reflected in the document so the intent is recorded in the handbook. This could be part of an overview section or possibly included within the tax trigger section (as an adjustment is not intended to be made).	
26	Chap ter 3	Chap ter 3	Cha pter 3	Almost all the elements of these proposals are affected by the Deficit Allocation Methodology, which has yet to be developed and agreed. Depending on what is agreed we would anticipate that the corresponding text in this document would be likely to change as a result.	
27	3.21	3.21	3.21	It would be useful to include a brief worked example here or 'demo' as it is not clear which years are impacted by the various valuations. While this is clearer when viewed from a Licence Model perspective, the handbook should have the same level of clarity.	
28	3.4	3.4	3.4	The threshold is commented on in our main response. It is disproportionate and unjustified. There is no case for any threshold.	
29	3.8	3.8	3.8	Remove the word "distribution" in the first sentence.	
30	3.9	3.9	3.9	The pension principles are stated in a simplified form, this paragraph should reference the RIIO-T1 Strategy Document where they are set out in full.	
31	3.11	3.11		Replace "... table x above .." with "...Table 3.1 above..".	
32	3.13	3.13	3.13	Remove "and the pension principles" from the second sentence.	
33	3.15	3.15	3.15	".. the deficit allocation methodology, attached as appendix 2,..." – it is not clear what this means.	
34	3.21- 3.28	3.21- 3.28	3.21 - 3.28	The pension deficit true-up should be calculated from the difference between actual spend and the allowances that applied in the revenue. This does not appear to be the effect of 3.21 to 3.22, and the approach here is different from that at 3.24 to 3.27. It would be helpful to discuss in more detail how the calculation will work and where it will be performed.	
35	3.27	3.27	3.27	Paragraph reference to 1.25 and 1.26 should be '3.25' and '3.26 and 3.22'.	
36	3.34	3.34	3.34	Change wording in the first sentence "... at the outset of the price control in Final Proposals" to "...at the first review".	
37	3.35	3.35	3.35	Replace "will spread" with "will be spread".	

38	4.1	4.1	4.1	The clause numbering is incorrect. Sub-paragraphs “(c), (d) and (e)” should be re-numbered “(a), (b) and (c)”.	
39	4.2	4.2		This paragraph does not provide any recognition of Part B of GTC65/ETC65 in relation to SO. Please clarify, especially having regard to paragraph 2.5 which sets out that this should apply to TO and SO.	
40	4.2	4.2	4.2	In lines 5 and 6, delete “in respect of “ and replace with “to” in order to be consistent with the reference in this paragraph to 4.1(a) and (b).	
41			4.2	Paragraph 4.2 refers to sub-paragraphs 5.1(a) and (b) and sub-paragraph 5.1(c). It should refer to paragraphs 4.1(a) and (b) and 4.1 (c)	
42				Paragraph 4.2 refers to sub-paragraphs 5.1(a) and (b) and sub-paragraph 5.1(c). It should refer to paragraphs 4.1(a) and (b) and 4.1 (c)	
43	4.3	4.3	4.3	This definition should be removed, or better still replaced by a reference to the relevant licence condition (see paragraph 5.6). The licence dominates but there is a difference between these words and the licence which has the potential to make this paragraph misleading. Note also it does not recognise GTC65 and SOMOD.	
44	4.4	4.4	4.4	Rather than referring to “updating”, having regard to paragraph 4.2 which refers to “adjustments”, suggest this should be “adjusting”? In relation to the second bullet point, as the first bullet point refers to “tax trigger events”, for consistency the second bullet point should instead refer to “tax clawbacks”. The reference in this paragraph to “regulatory tax losses” is unclear without an express reference being made to paragraph 4.10 (which sets out what regulatory tax losses are).	
45	4.5	4.5		This paragraph does not recognise Part B of ETC 65 / GTC 65.	
46	4.5	4.5	4.5	We suggest the deletion of “for each relevant/formula year” on the second line.	
47	4.6	4.6		This paragraph does not recognise Part B of ETC 65 / GTC 65 re SOMOD.	
48	4.6	4.6	4.6	Reference to “regulatory tax losses” is unclear without an express reference being made to paragraph 4.10.	
49	4.6	4.6	4.6	It needs to be clear what ‘base revenue figures’ means – a reference to the relevant licence condition would be useful.	

50	4.6	4.6	4.6	The handbook should explain that it is the vanilla WACC that will be used for the time value of money adjustment. A simple illustrative formula may also be useful.	
51	4.7	4.7	4.7	“Underlying tax liability allowances” is unclear to those less familiar with the process. We suggest a reference to the relevant row in the licence model would help.	
52	4.8	4.8	4.8	The “works in constant” phrase should be clarified. We would suggest “the majority of the calculations are performed in 2009/10 prices, with...”	
53	4.8	4.8	4.8	There needs to be greater clarity on how data will be converted to 2009/10 prices for use in the model. This is an important generic issue. Presumably we will take outturn numbers from the RRP and deflate them using the actual average formula year RPI for the relevant year (which should be known by the time the RRP is completed). This process should be outlined in the handbook.	
54	4.9	4.9	4.9	It should be clearer as to where the RPI numbers are set out – a reference to the model sheet and row perhaps.	
55	4.10	4.10	4.10	The derivation and application of tax losses should be in line with the PCFM, i.e. tax losses are applied against first available taxable profits. Paragraph 4.10 suggests that the negative tax allowance will be the tax loss and will be applied against a future tax allowance. These alternate methodologies may not produce the same result especially if corporation tax rates change. We believe the paragraph should say “the price control treatment is to model a zero allowance and to record the tax loss arising in the period as a “regulatory tax loss” figure, to be deducted from the taxable profits before the tax is calculated for any tax liability allowances which would otherwise be allocated to the year concerned or to later years.”	
56	4.10	4.10	4.10	The reference to “the licensee should receive a negative allowance” on the second line should instead refer to “ the licensee could receive a negative allowance ”.	
57	4.10	4.10	4.10	In paragraph 4.10 it states that where there is a loss, instead of a negative allowance being given “the price control treatment is to model a zero allowance and to record what would have been the negative allowance as a “regulatory tax loss” figure, to be deducted from any tax liability allowances which would otherwise be allocated to the year concerned or to later years.” This would seem to imply that the negative allowance would be calculated using the tax rate applicable to the period in which the loss arose and this negative allowance would reduce the positive allowance when it arises. This is not our understanding of the methodology Ofgem are adopting. We think it should say “the price control treatment is to model a zero allowance and to record the tax loss arising in the period as a “regulatory tax loss” figure, to be deducted from the taxable profits before the tax is calculated for any tax liability allowances which would otherwise be allocated to the year concerned or to later years.”	

58	4.11	4.11	4.11	We agree with the need for the first bullet however the second one is not absolutely necessary in the handbook. The model operates in a relatively simplistic way and it would be impractical to list all of the items that are disregarded by the model. If the bullet remains then Ofgem should consider what other adjustments may need to be recorded in the handbook which will then be disregarded in the allowances.	
59	4.13	4.13	4.13	Rather than referring to “updated”, having regard to paragraph 4.2 which refers to “adjustments”, suggest this should be “adjusted”?	
60	4.13	4.13	4.13	The reference to shareholders is not applicable as any ‘reimbursement’ is to the licensee.	
61	4.14 / 4.22	4.14 / 4.22	4.14 / 4.22	Why are the words in section 4.22 different to those in 4.14? They should be identical to avoid any potential ambiguity or confusion – what happens if a ‘HMRC interpretation of legislation’ is not a ‘HMRC policy’ for example.	
62	4.15	4.15	4.15	Can more clarity be provided on the intended meaning of “capital allowance pools”? We are not sure how this fits in with the adjustment process.	
63	4.15	4.15	4.15	The reference to “updated” should be changed to “adjusted”.	
64			4.15	The paragraph ends with a comma which should be replaced with a full stop.	
65	4.18	4.18	4.18	“0,33” should be replaced with “0.33”.	
66	4.18	4.18	4.18	“period of the price control” should be replaced with “price control period” which is a defined term.	
67	4.20	4.20	4.20	We suggest that it is made clear here that any change will not have any retrospective effect on a previously directed value of the MOD term.	
68	4.22	4.22	4.22	Insert a full stop after the forth bullet point.	
69	4.24	4.24	4.24	What happens if Ofgem does not notify the licensee in time?	
70	4.24	4.24	4.24	Why wait until 30 September for the Type A trigger event notification? Aren’t these known by 31 March?	
71	4.25	4.25	4.25	To be consistent with this paragraph and paragraph 4.14, this should read, “...corporation tax rate change(s) or capital allowance rate changes...”.	
72			4.26	Paragraph 4.26 refers to paragraph 5.20. It should refer to paragraph 4.24 and not 5.20	
73	4.27	4.27	4.27	Can we adjust t-2 after 30 Nov in t-1?	

74	4.27	4.27	4.27	State the timing of this PCFM – must be between Oct 31 and 30 Nov?	
75	4.28	4.28	4.28	To be consistent the reference to “reported” should be “notified”.	
76	4.28	4.28	4.28	This paragraph should note that the revision is required to take place by 30 November in relevant year t-1 (as quoted in 4.24).	
77	4.29	4.29	4.29	Note that if NGG fails to notify Ofgem of any increase in tax liability, it will not be made retrospective. Thus NGG would have to keep a constant watch on changes of legislation, case law and HMRC determinations. This should be carefully considered. Then, if NGG fails to notify Ofgem of a reduction in tax liability, this may be a breach of licence. This is not consistent with paragraph 4.28 which states “events it becomes aware of”, thus this paragraph provides a breach whether or not NGG is aware of the breach. This needs to be clarified.	
78	4.29	4.29	4.29	Ofgem have agreed not to use the wording “taken all reasonable steps” can these be replaced?	
79	4.32	4.32	4.32	References to “Limited scope audit procedures” or “agreed upon audit procedures” are used. Is there a standard term that should be applied consistently for ‘audit’ work or is there an intentional difference? Clear definitions should be provided.	
80	4.34	4.34	4.34	Will the licensee have a right of reply to Ofgem’s decision to change or defer a liability?	
81	4.36	4.36	4.36	The paragraph says that the ‘final quantification and adjustment for any type B trigger event will be deemed to have occurred when the licensee and HMRC conclude the agreement of the licensee’s tax liabilities for the relevant Formula Year.’ Can you include an example here to understand when MOD would be impacted.	
82	4.35	4.35	4.35	Will the licensee have a right of reply to Ofgem’s inclusion of a Type B trigger event?	
83	4.38 - 4.43	4.38 - 4.43	4.38 - 4.43	National Grid are unsure as to exactly how the tax trigger works. The forthcoming model meeting is planned to demonstrate the tax trigger functionality in the model and it would be a good idea to run through the text in these paragraphs at the same time. Areas of uncertainty include things like whether the inputs for costs are the new inputs that will be used in the new iteration of the model or the ones from the previous year iteration and confirmation as to how steps (i) to (xi) are correct.	
84	4.39	4.39	4.39	“User Interface sheet” should be followed by “of the licence model”	

85	4.39	4.39	4.39	The numbering should be in the form of “(a) through (k)”, rather than (i) through (xi).	
86	4.40	4.40		This paragraph does not recognise ETC65 / GTC65.	
87	4.42	4.42	4.42	Please confirm what is meant by “including for years later than year t” and why the statement is required.	
88	4.43	4.43		This paragraph does not recognise ETC65 / GTC65.	
89	N/A	N/A	4.46	Is the handbook solely talking about adjustments for claw back relating to gearing (and interest costs) in the RIIO period? If so, it may help if the handbook clarifies the dates where the review first takes place. National Grid believes the rules are slightly different between TPCR4 and RIIO.	
90			4.50	Paragraph 4.50 refers to paragraphs 5.39 and paragraph 5.41(iii). It should refer to paragraphs 4.46 and 4.48(iii).	
91			4.54	Paragraph 4.54 refers paragraph 5.41(ii) and paragraph 5.41(i). It should refer to paragraphs 4.48(ii) and 4.48(i)	
92			4.55 - 4.56	Paragraphs 4.55 and 4.56 refer to paragraph 5.47. They should refer to paragraph 4.54	
93			4.64	Paragraph 4.64 refers to paragraph 5.45. It should refer to paragraph 4.56.	
94	5.9	5.9		Footnote number 16 refers to paragraph 6.11 however chapter 6 yet to be drafted.	
95			5.8	Footnote number 16 refers to paragraph 6.11 however chapter 6 yet to be drafted.	
96	5.8 (step 3/4)	5.8 (step 3/4)	5.8 (step 3/4)	Step 3 is not necessary as the inflation zero coupon rate is available from Bank of England, no calculation is required. The term π should be defined as “Yield From British Government Securities, 10 Year Real Inflation Zero Coupon – series reference IUDMIZC”	
97		5.8 (step 4)	5.8 (step 4)	The first paragraph in step 4 should finish as follows....’using the following formula: $COD = (1 + i_{Boxx}) / (1 + \pi) - 1$	

98			Section 5	Should be made more consistent with the equivalent chapter in the Transmission handbook.	
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