



“Ofgem’s proposals have improved in all areas since September...”

...overall we are confident that we can provide an attractive return for investors.”

Steve Holliday  
Chief Executive Designate



National Grid has today accepted Ofgem’s final proposals for the UK Transmission Price Control for the five years from 1 April 2007.

This fact sheet gives an overview of the price control and highlights the key features.

## ACCEPTANCE OF THE PRICE CONTROL

Ofgem’s final proposals for the five-year transmission price control have improved in all areas compared to their updated proposals issued in September.

There are five key components of the UK Transmission Price Control. While elements of the proposals result in some specific challenges, taken together they form an acceptable balance of risk and reward.

**Rate of return:** UK electricity and gas transmission assets have been allowed a return of 4.4% post-tax real, consistent with the current allowed return on our UK electricity transmission assets.

This allowed return is applied to our regulatory asset base, which Ofgem have set at £8.9bn at 1 April 2007.

**Opex:** Ofgem propose a controllable opex allowance for the price control of £1,239m, representing an assumed 3% nominal annual reduction in controllable opex. This allowance represents a challenge for National Grid over the price control period.

However, the proposals include ‘logging up’ mechanisms, a new and positive feature, that allow the recovery of specific uncertain costs that may exceed headline allowances. These costs will be recovered during the following price control period, including an adjustment for financing costs.

**Incentives & adjustments:** In September, Ofgem’s proposals for the various UK transmission incentive schemes would have increased the businesses’ risk exposure in an asymmetric way. Ofgem now propose a more symmetrical suite of incentive arrangements, for example:

- Roll-over of the current electricity loss of supply incentive.
- Collared losses for gas entry and exit capacity incentives.
- Gas transmission delivery incentives limited to the final 18 months of the price control period.
- Gas operational capacity buy-back collar reduced and set only for the first two years of the price control.
- Reward only incentive for SF6 gas management.

These are a welcome improvement in Ofgem’s proposals.

**Capex:** Ofgem has proposed a capex allowance of £4.4bn for the price control period. We project that our transmission regulatory asset base will grow by over 40% over the 5 years to 2011.

As a result of this review we will substantially increase investment in our transmission networks, although some of the investment which we had proposed will be deferred until the following price control period. This mainly relates to non-load related electricity transmission and Ofgem’s proposals set out that under their modelling approach this results in a deferral of investment by about 2 years, relative to our submission.

In relation to historic capex overspend, Ofgem has allowed all historic electricity spend into the regulatory asset base. They have also allowed 75% of the historic capex relating to entry capacity at St Fergus, a significant improvement on their September position.

Other features include ‘logging up’ mechanisms that allow for the recovery of capex spend above Ofgem’s base allowance in specific asset areas, for example, on underground electricity cable tunnels. As with opex, these costs will be recovered during the following price control period, including an adjustment for financing costs.

**Pensions:** Ofgem’s pension proposals allow full funding of our ongoing contributions, and recovery of the majority of our current pension deficit, based on current actuarial valuations.

**Overall:** These proposals will result in:

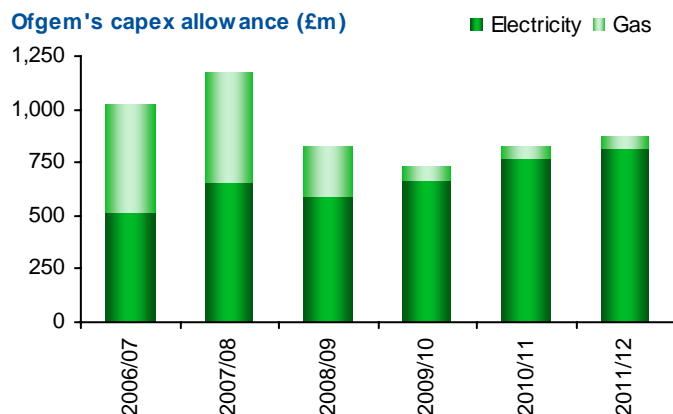
- A 7% real increase in National Grid Electricity Transmission Owner revenue for 2007/08 (this follows a 7% real increase in 2006/07) and annual increases of 2% plus inflation for the 4 years to 31 March 2012.
- A 17% real increase in National Grid Gas Transmission Owner revenue for 2007/08 and inflationary increases for the 4 years to 31 March 2012.

Overall, on the basis of these proposals, we are confident that we can provide an attractive return for investors, while meeting our licence obligations.

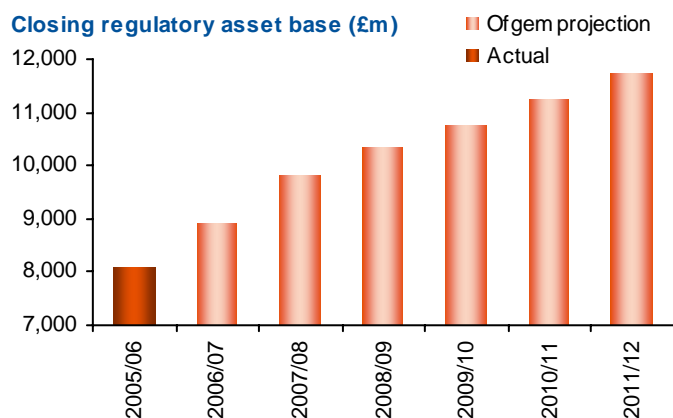
*All figures, either quoted or in charts, are nominal unless otherwise stated.*

## KEY DATA

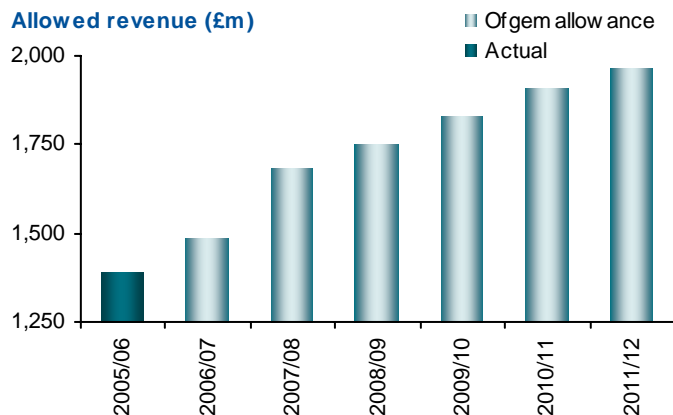
### Ofgem's capex allowance (£m)



### Closing regulatory asset base (£m)



### Allowed revenue (£m)



## THE REGULATORY FORMULA

The UK transmission owner price control proposals define the level of revenue that National Grid is allowed to recover from its customers.

The regulatory process derives this from an estimate of operating expenditure, capital expenditure, financing costs and corporation tax for the relevant period, in this case 2007/08 to 2011/12.

These inputs are used, together with the regulatory asset value i.e. the value ascribed by Ofgem to the capital employed in the regulated transmission business, to calculate the allowed revenue. The regulatory asset value is adjusted each year to reflect asset additions, depreciation and the rate of inflation.

The allowed revenue is then profiled across the price control period, determining the immediate change in revenues in the first year of the price control (or 'P0') and the path of revenues over the remaining year (or 'X'), with two key considerations being the financial profile of the businesses and the longer term trend in revenues.

## THE PRICE CONTROL IN CONTEXT

In our 2005/06 results our UK transmission owner revenues contributed around 15% of National Grid's revenues, and around 25% of National Grid's operating profit. Ofgem's proposals will clearly result in significant growth in both the transmission owner regulatory asset base and revenues, as shown in the charts on the left.

However, this price control is just one aspect of National Grid's growth prospects. Other factors expected to drive growth, that we have previously announced, include:

- Investment in our UK regulated gas distribution networks (this investment is central to our discussions with Ofgem on the Gas Distribution Price Control Review 2008-2013).
- The agreed acquisition of KeySpan (we have received 5 of the 7 regulatory clearances required for this transaction – remaining approvals include authorisation by each of the New York Public Service Commission and the New Hampshire Public Utilities Commission – filings requesting approval were made during the summer of 2006).

Further information on these and other drivers can be found in our results announcements or annual reports on our website: [www.nationalgrid.com](http://www.nationalgrid.com).

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## FURTHER INFORMATION:

Documents relating to the review can be found on the Ofgem website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk).

### Final proposals:

[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/17916\\_20061201\\_T\\_PCR\\_Final\\_Proposals\\_in\\_v71\\_6\\_Final.pdf?wfrom=/ofgem/work/index.jsp&section=/areasofwork/transpcr](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/17916_20061201_T_PCR_Final_Proposals_in_v71_6_Final.pdf?wfrom=/ofgem/work/index.jsp&section=/areasofwork/transpcr)

### Final proposals – supplementary appendices:

[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/17915\\_20061129\\_T\\_PCR\\_FP\\_Supplementary\\_Appendices\\_in\\_final.pdf?wfrom=/ofgem/work/index.jsp&section=/areasofwork/transpcr](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/17915_20061129_T_PCR_FP_Supplementary_Appendices_in_final.pdf?wfrom=/ofgem/work/index.jsp&section=/areasofwork/transpcr)

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