RIIO-2 Draft Determination

National Grid response

London, 7 September 2020
Cautionary statement

This presentation contains certain statements that are neither reported financial results nor other historical information. These statements are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include information with respect to National Grid’s (the Company) financial condition, its results of operations and businesses, strategy, plans and objectives. Words such as ‘aims’, ‘anticipates’, ‘expects’, ‘should’, ‘intends’, ‘plans’, ‘believes’, ‘outlook’, ‘seeks’, ‘estimates’, ‘targets’, ‘may’, ‘will’, ‘continue’, ‘project’ and similar expressions, as well as statements in the future tense, identify forward-looking statements. These forward-looking statements are not guarantees of National Grid’s future performance and are subject to assumptions, risks and uncertainties that could cause actual future results to differ materially from those expressed in or implied by such forward-looking statements. Many of these assumptions, risks and uncertainties relate to factors that are beyond National Grid’s ability to control, predict or estimate precisely, such as the impact of COVID-19 on its operations, employees, counterparties, funding and legal and regulatory obligations, but also more widely in terms of changes in laws or regulations, including any arising as a result of the United Kingdom’s exit from the European Union; announcements from and decisions by governmental bodies or regulators, including proposals relating to the RIIO-T2 price control, as well as increased political and economic uncertainty resulting from COVID-19; the timing of construction and delivery by third parties of new generation projects requiring connection; breaches of, or changes in, environmental, climate change and health and safety laws or regulations, including breaches or other incidents arising from the potentially harmful nature of its activities; network failure or interruption, the inability to carry out critical non-network operations and damage to infrastructure, due to adverse weather conditions including the impact of major storms as well as the results of climate change, due to counterparties being unable to deliver physical commodities, or due to the failure of or unauthorised access to or deliberate breaches of National Grid’s IT systems and supporting technology; failure to adequately forecast and respond to disruptions in energy supply; performance against regulatory targets and standards and against National Grid’s peers with the aim of delivering stakeholder expectations regarding costs and efficiency savings; and customers and counterparties (including financial institutions) failing to perform their obligations to the Company. Other factors that could cause actual results to differ materially from those described in this presentation include fluctuations in exchange rates, interest rates and commodity price indices; restrictions and conditions (including filing requirements) in National Grid’s borrowing and debt arrangements, funding costs and access to financing; regulatory requirements for the Company to maintain financial resources in certain parts of its business and restrictions on some subsidiaries’ transactions such as paying dividends, lending or levying charges; the delayed timing of recoveries and payments in National Grid’s regulated businesses and whether aspects of its activities are contestable; the funding requirements and performance of National Grid’s pension schemes and other post-retirement benefit schemes; the failure to attract, develop and retain employees with the necessary competencies, including leadership and business capabilities, and any significant disputes arising with National Grid’s employees or the breach of laws or regulations by its employees; the failure to respond to market developments, including competition for onshore transmission, the threats and opportunities presented by emerging technology; the failure by the Company to respond to or meet its own commitments as a leader in relation to climate change development activities relating to energy transition, including the integration of distributed energy resources; and the need to grow the Company’s business to deliver its strategy, as well as incorrect or unforeseen assumptions or conclusions (including unanticipated costs and liabilities) relating to business development activity. For further details regarding these and other assumptions, risks and uncertainties that may impact National Grid, please read the Strategic Report section and the ‘Risk factors’ on pages 227 to 230 of National Grid’s most recent Annual Report and Accounts. In addition, new factors emerge from time to time and National Grid cannot assess the potential impact of any such factor on its activities or the extent to which any factor, or combination of factors, may cause actual future results to differ materially from those contained in any forward-looking statement. Except as may be required by law or regulation, the Company undertakes no obligation to update any of its forward-looking statements, which speak only as of the date of this presentation.
Our response

John Pettigrew
Chief Executive
Listening to our stakeholders

• We are extremely disappointed with Ofgem’s draft determinations as they stand
• NG business plans based on the widest consultation of stakeholders
  – Proposed £10bn of totex across electricity and gas
• Stakeholders supported our plans
  – c.90% of consumers agreed with our approach to net zero
• Working with Ofgem to ensure inclusion of stakeholder feedback
Implications from Draft Determinations

**Reduces reliability and resilience**
- 80% of proposed asset health investment disallowed
- This will increase network risk profile, and reduce network resiliency
- Delivering nearly 6,800 fewer replacement and refurbishment interventions
- 24% rise in risk levels over 10 years for ET; 19% for GT

**Jeopardises net zero progress**
- Proposed uncertainty mechanisms are inflexible
- Bureaucratic hurdles could add 12-24 months delays to projects
- Will slow down or deter investment
- Potential uncertainty around customer bills

**Erodes regulatory stability**
- No mechanism exists for £500m clawback
- Baseline return below comparable European peers
- Unjustified business plan penalties
- Rejects incentives supporting net zero
- Incentives package risk and reward skewed to downside

Greater levels of supporting evidence provided

Need to revisit decision making timelines and automatic openers

Pressing for a more balanced appraisal of allowed return
Financial Impact

Andy Agg
Chief Financial Officer
Assessing cost of capital and returns

• We recognise that changes to the financial framework are required in RIIO-2 to improve stakeholder legitimacy
  – Appropriate that returns are lower in RIIO-2 vs RIIO-1

• Overall financial package remains key consideration

• At present, we do not see the Draft Determination financial package as the solution

• We have three main areas of concern:
  – Inadequate allowed equity returns
  – Real challenges in achieving those returns, and
  – An overall weakening of financial resilience
Inadequate equity returns

- Proposed equity return is below UK water
  - DD offers limited reward to drive better performance

- Ofgem's low returns come primarily from three errors:
  - Reduction to TMR – uses a flawed inflation back-cast data set;
  - Outperformance wedge - unjustified and contains multiple errors;
  - Beta calculation is too low – no separation of our US and UK businesses.

- Energy is higher risk than water
  - More complex capital programmes and uncertainty from energy transition

- We continue to argue for a more balanced appraisal of allowed equity return and the removal of the flawed outperformance wedge
Limited RORE incentives

- We would start RIIO-2 with a gap to the allowed return
  - Driven by excessive efficiencies, clawbacks, penalties and outperformance wedge
- DD proposes incentives for Electricity Transmission that are skewed towards penalties, away from consumers
  - Discourages innovation
Ability to achieve the allowed equity return

- £2.2bn savings required at start of RIIO-2 to close the gap with allowed return
  - Equivalent to 40% totex savings
- Impact on return through BPI, clawback, steep efficiencies and outperformance wedge:
  - ET: 1.3% achieved equity return
  - GT: 2.7% achieved equity return
- Excessive efficiency challenge
  - Ofgem errors on allowance reductions
  - Incorrect flexing of indirect costs
- Not the return we expect to earn
  - Continue with our cost efficiency programme
  - Removal of business plan penalty, RIIO-1 clawback

### Savings required to close starting Electricity Transmission RoRE gap of 260bps

<table>
<thead>
<tr>
<th>Savings</th>
<th>Totex savings (£bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No savings</td>
<td>0</td>
</tr>
<tr>
<td>10% saving</td>
<td>£0.5bn – RORE 2.0%</td>
</tr>
<tr>
<td>30% saving</td>
<td>£1.5bn – RORE 3.29%</td>
</tr>
<tr>
<td>40% saving</td>
<td>£2.0bn – RORE 3.92%</td>
</tr>
</tbody>
</table>

- T1 Clawback
- Ofgem efficiency
- NG plan efficiency
- Mitigate – BPI penalty
- Mitigate – perf wedge
Weakening of financial resilience

- We have three key areas of concern on financial resilience
  - Financeability ratio methodologies inconsistent with those of ratings agencies.
  - Financeability assessment does not stress test whether RIIO-2 can support net zero investment levels
  - No assessment of the financeability impact of the cashflow risk arising from the time delay between spend and revenue recovery

- We are therefore urging Ofgem to:
  - Undertake a financeability assessment factoring in delays between spend and revenue
  - Provide additional ex ante allowances for uncertainty mechanism expenditure and apply forecast of outputs for allowances subject to reopeners
  - For Electricity Transmission, define a deliverable contestable framework for the RIIO-2 timeframe and assess the totex that could come from this
Next steps

John Pettigrew
Chief Executive
Next steps

- We view the current draft determinations as unacceptable
  - Increase the risk profile of our networks,
  - Jeopardise the UK’s transition to net zero,
  - Dampen innovation through lower returns

- CMA option remains if no appropriate financial framework at FD

- We believe we can still reach a sensible outcome
  - Working closely with Ofgem
  - Submitting greater levels of data than before
  - Provided remedies in our consultation response
  - Continue to work with stakeholders to make their views heard
Q&A