

RIIO-2 Draft Determination

National Grid response

London, 7 September 2020

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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

Greater levels of supporting evidence provided

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

Need to revisit decision making timelines and automatic openers

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

Pressing for a more balanced appraisal of allowed return national**grid**

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

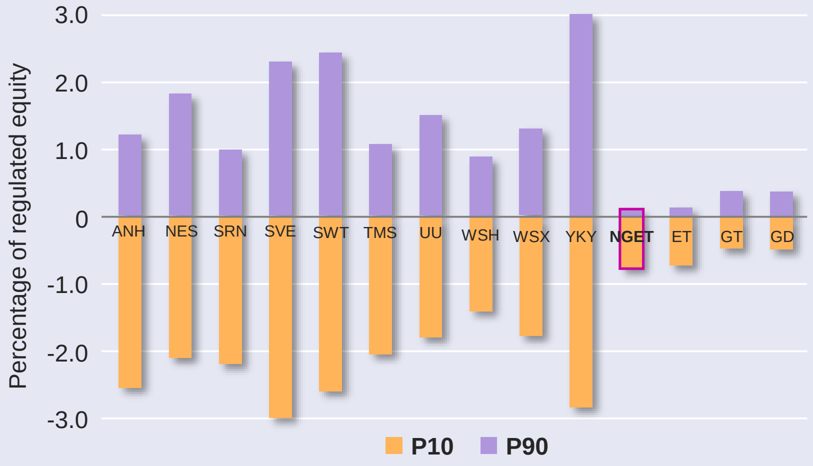
- Proposed equity return is below UK water
  - DD offers limited reward to drive better performance
- Ofgem's low returns come primarily from three errors:
  - Reduction to TMR – uses a flawed inflation back-cast data set;
  - Outperformance wedge - unjustified and contains multiple errors;
  - Beta 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

Limited reward available for ET or GT

NGET expected RoRE range of ODIs (P10 to P90) compared to 10 largest water companies and energy sectors

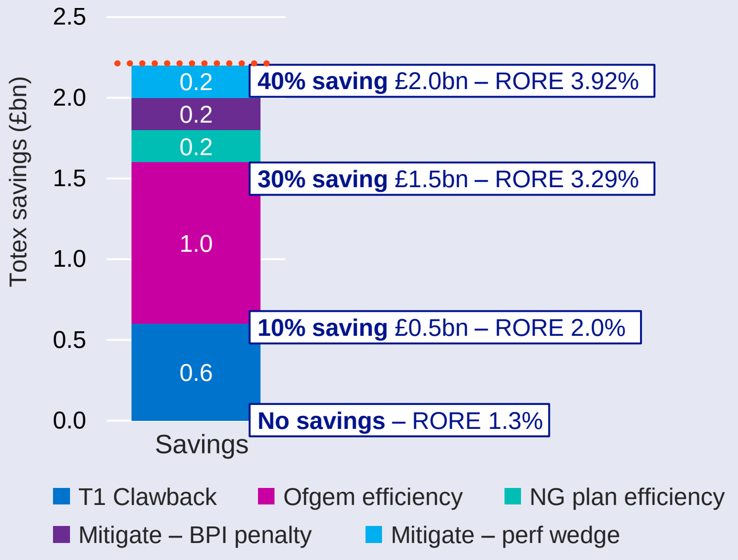


Source: Ofwat for water companies:, KPMG for energy sectors and NGET calculations for NGET nationalgrid

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



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