

Welcome to the webinar on our response to Ofgem's RIIO-2 Draft Determinations and the next steps



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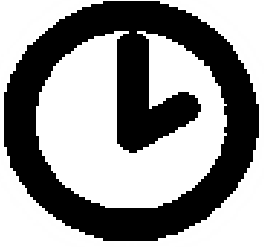


Kate
Willis

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Before we start...



This webinar should last approximately one hour



All callers will be placed on mute



You can message us via the webex chat function and we will take Q&A at the end of the presentation.


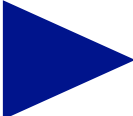
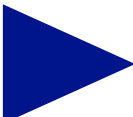

1

Welcome

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Agenda

-  **1. Welcome**
-  **2. Overview of the RIIO-2 process and our business plan**
-  **3. Ofgem's Draft Determinations (DD) for NGET**
-  **4. Our response to Ofgem's Draft Determinations**
-  **5. Next steps and questions**

2

Overview of the RIIO-2 process and our business plan

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The RIIO-T2 price control sets outputs and funding from 2021 to 2026

RIIO (Revenue= Incentives + Innovation + Outputs)

	Activity	Date
2018/19	Iterative enhanced engagement process	Draft submissions in July and October
	Electricity Transmission final business plan submitted	9 December 2019
	Independent User Group report published	19 December 2019
2020	RIIO-2 Challenge Group report published	24 January 2020
	Draft Determinations published	9 July 2020
	Draft Determinations consultation closed	4 September 2020
	Open meeting	16 October 2020
	Final Determinations	December 2020
	RIIO-2 starts	1 April 2021
2021		

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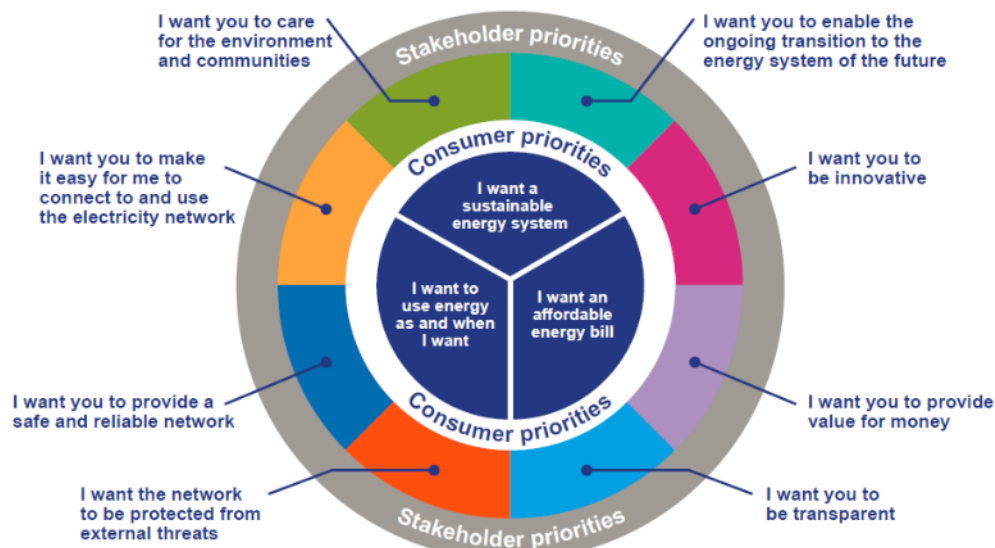


Independent User Group		
	Trisha McAuley OBE (Chair) Consumer Expert	
	Eddie Proffitt Major Energy Users Council	
	Zoe McLeod Independent Consumer Expert	
	Jade Kirk Robin Hood Energy	

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We are grateful for your help in developing our stakeholder-led plan



In building our plan we engaged with over 1,000 individuals covering all our main stakeholders, over 11,000 household consumers and over 750 business consumers.

In the summer 2020, **Populus consumer study**, the highest priority for the general public was to invest in network **reliability and resilience**, followed immediately by **green investment**. Investing purely based on **cost reductions was the lowest priority** on the list offered, even for those who are struggling financially.

3

Ofgem's Draft Determinations (DD) for NGET

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We have concerns with Draft Determinations and its consequences

Whilst we share Ofgem's stated objectives for RIIO-2, the DD currently moves substantially away from the principles of RIIO, does not meet the needs of our customers and stakeholders and is not in the interests of current and future consumers because it:

- 1. Reduces the reliability and resilience of the UK's electricity supply**
- 2. Jeopardises the pace of progress towards a net zero energy system**
- 3. Erodes regulatory stability and investor confidence in the sector**

We welcome that Ofgem has signalled the DD as a consultation and indicated that stakeholders can provide input.

We have provided supplementary evidence to support our December business plan and Ofgem in aligning their proposals with stakeholders' interests.

4

Our response to Ofgem's Draft Determinations

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Reduces the reliability and resilience of the UK's electricity supply

Large reductions in asset health investment would have long-term consequences on the reliability of the network

- ❶ • **An 80% reduction in investment for asset health has long-term consequences**
 - Less than 30% of historic investment levels; Ofgem proposed £643m against our proposed allowance of £3,347m
 - Doesn't reflect stakeholders' views
- ❷ • **Network risk and failure rates would increase at these investment levels**
 - Network risk would increase by 24% over the next 5 years
 - Failure rates in overhead lines could increase, resulting in us being more reliant on maintenance & protection systems
- ❸ • **The longer-term impact could increase consumer bills by 2030**
 - Ofgem's proposed reductions could save consumers £1.20 per year on their bills, however the longer-term impact could lead to increases of up to £1.80 per year by 2030
 - Future constrained system access caused by catching up on reliability, could have impacts on delivery of net zero

Remedies

- Provision of an additional 157 supplementary evidence reports by NGET
- Increase investment to ensure minimum levels of reliability, with further increases to meet stakeholder requirements
- Already working constructively with Ofgem to deliver a shared objective for consumers and stakeholders

Progress towards a net zero energy system at minimum cost to consumers

RIO-2 is heavily reliant on uncertainty mechanisms to facilitate net-zero*

The suite of mechanisms set out in the DD would not provide the right level of funding, at the right time and with enough certainty to invest with confidence

1 Funding at the right level:

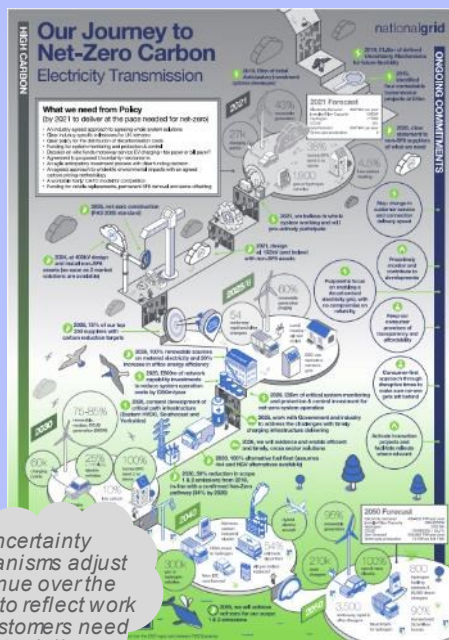
- Unit cost allowances for generation and demand connections systematically underfund many connection types
- Categories of 'externally-driven' investments eligible for re-openers excludes crucial net-zero enablers
- Financeability assessments have not considered all likely net-zero investment needs

2 Funding at the right time:

- Reopener window timing and true-up of pre-construction funding (PCF) provides funding far after costs incurred
- Process for large projects (LOTI) adds time for regulatory scrutiny and precludes efficient programmes of work

3 Funding with enough certainty:

- Reliance on end of period assessments & PCD's specifying inputs removes efficiency incentive
- The extensive breadth of Net Zero reopener increases risk and uncertainty and only Ofgem can trigger it



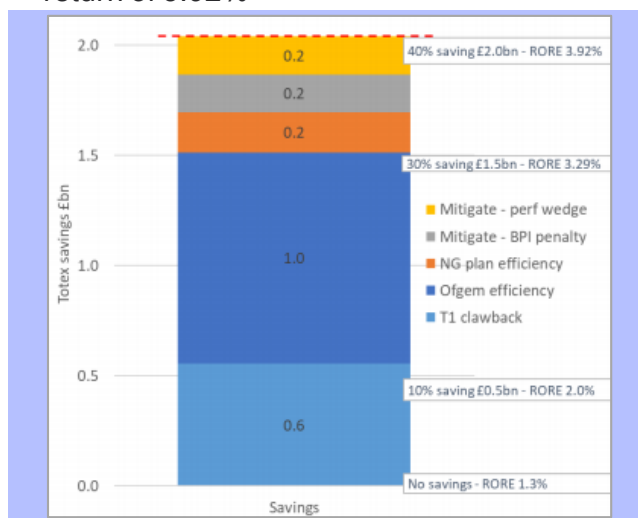
Remedies

- Revisit reopener criteria, including for pre-construction and large projects, to ensure funding is provided in a timely manner for all investments that deliver consumer value
- Use automatic unit cost allowance based mechanisms to fund medium sized projects and correct the underpinning analysis to properly fund new connections
- Provide certainty with ex-ante allowances and drop ex-post regulatory assessments
- Ensure NGET is financeable for a likely range of future expenditure consistent with net-zero

Regulatory stability and investor confidence in the sector

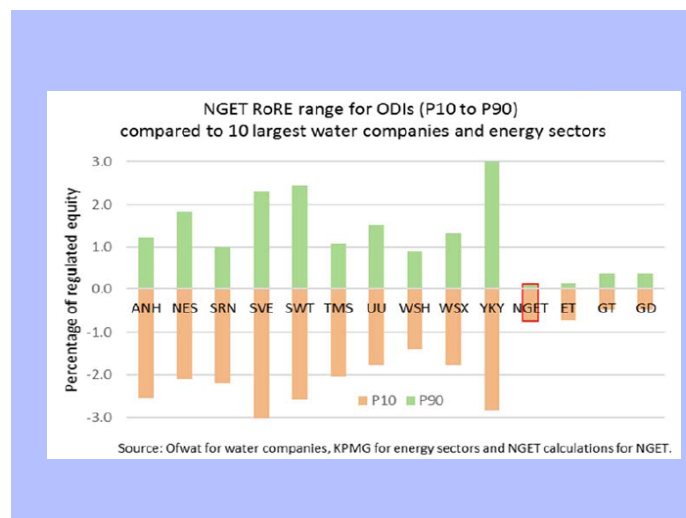
① Allowed returns:

- Financial market conditions will naturally lead to lower returns than T1
- Cumulative effect of multiple DD mechanisms and efficiencies leave substantial gap to allowed equity return
- 40% efficiencies required to achieve allowed return of 3.92%



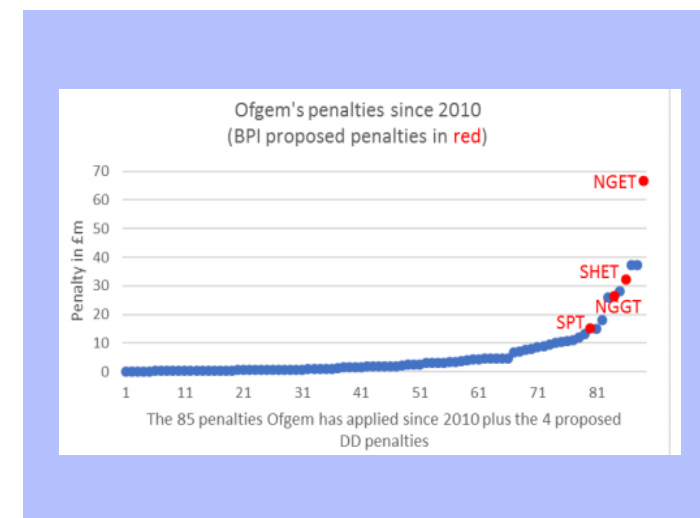
② Efficiency and output delivery incentives:

- Weak TOTEX efficiency incentive strength for Transmission and undermining efficiency incentives by defining many project level 'inputs' instead of outputs
- Discretionary use of ex-post intervention to make subjective adjustments to incentive outcome



③ Clawbacks and penalties

- Ex-post re-opening and clawback of settled T1 allowances
- Punitive and disproportionate penalties resulting from a business plan incentive applied incorrectly and inconsistently



Remedies

- Adjust the overall risk and reward package to provide a fair return for investors, removing the clawback of RIIO-T1 allowances, dropping the BPI penalty and addressing issues with efficient cost assessment methodologies
- Revisit proposals for net zero incentives and drop ex-post regulatory intervention and adjustments to totex incentive outcomes
- Develop a more balanced appraisal of allowed equity return and remove the flawed outperformance wedge

We have estimated the significant customer impacts of Draft Determinations

Our analysis expands on narrow scope of Impact Assessment and is published alongside our response*

In summary:

Key aspects DD proposals

- Reduction in non-load related totex (~70% cut of NGET business plan)
- Reduction in load-related totex (dependency on uncertainty mechanisms)
- Reduced incentives (skewed to downside)



Consequential customer impacts:

- Increased risks to reliability & resilience (+ required future catch-up will be barrier to critical Net-Zero work)
- Work programme less compatible with achieving Net-Zero
- Less flexibility for NGET to innovate

Overall consumer impact:

Quantifiable impacts	<p>£1.50/yr bill <u>reduction</u> (T2)</p> <p>Comprised of:</p> <ul style="list-style-type: none"> • Cut to volume of asset health work £1.20/yr • Reduction in customer driven work £0.10/yr • Other areas £0.20/yr 	£2.90/yr consequential T2 bill <u>increase</u>	£2.20/yr consequential T3 bill <u>increase</u>
	<p>Comprised of:</p> <ul style="list-style-type: none"> • Operational costs from reduced resilience (assuming gradual build up) £0.60/yr • Delays to Net-Zero required works £2.00/yr • Dampened innovation £0.30/yr 		<p>Comprised of:</p> <ul style="list-style-type: none"> • Operational costs from reduced resilience (assuming fast work catch up) £1.80/yr • Dampened innovation £0.40/yr
Not quantified	<ul style="list-style-type: none"> • Low probability, high impact supply fails (consumers and wider society) • Delays to achieving Net-Zero • Disruption to supply chains (jobs & UK competitiveness) • Low probability, high impact safety issues 		

Engaging constructively to ensure RII0-T2 delivers for stakeholders

Reliability and resilience of the UK's electricity supply

- We have provided supplementary evidence with a view to increasing allowances and associated output commitments
- Working constructively with Ofgem to deliver the shared objective of a reliable and resilient network

Pace of progress towards a net zero energy system at minimum cost to consumers

- Baseline allowances for pre-construction and boundary reinforcements to be updated to reflect latest ESO Network Options Assessment recommendations
- Work ongoing to ensure re-opener uncertainty mechanisms, such as MSIP and LOTI, allow projects to continue along an efficient timeline and exploring application of volume drivers
- Discussions ongoing on how PCDs are defined and how to minimise need for ex-post intervention

Regulatory stability and investor confidence in the sector

- Constructive discussions on output delivery incentives ongoing (e.g. SO/TO optimisation)
- Working with Ofgem to resolve issues in cost assessment process
- Consideration of upcoming PR19 CMA outcome

5


Next steps and questions

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Licence Drafting: the process of translating the price control into a contract is underway

- **What the licence drafting consultation is for:** Seeks views on draft licence conditions (some new and some changes to existing conditions) that will give effect to the RII02 price control.
- **What the timelines are:** Ofgem published its RII0-2 Informal Licence Drafting Consultation on 30th September with a four-week consultation period, ending on 28th October.
- **What is in the licence:** At this stage, the licence drafting reflects the policy position as set out in Ofgem's Draft Determinations; several guidance documents are also expected
- This, and ongoing Licence Drafting Working Groups with Ofgem, will provide input into the statutory licence consultation (expected in December).
- **The final stage:** This statutory consultation will seek views on the proposed final licence conditions that will give effect to Ofgem's Final Determinations which are also expected in December.



Consultation

RIIO-2 Informal Licence Drafting Consultation

Publication date	30 September 2020	Contact:	Eilidh Alexander James Santos-Mansur
		Team:	Systems and Networks, RII0 Price Controls
Response deadline	28 October 2020	Tel:	020 3263 2768
		Email:	Eilidh.Alexander@ofgem.gov.uk James.Santos-Mansur@ofgem.gov.uk

We are consulting on our proposed modifications to the licence conditions required to implement the RII0-ET2, RII0-GT2 RII0-GD2 and RII0-ESO price control settlements.

Within this document, we outline our proposed licence changes together with the reasons why we propose to make these changes and their intended effect. The proposed draft licence conditions are set out in Annexes to this consultation.

This document outlines the scope and purpose of the consultation, questions and how you can get involved. Once the consultation is closed, we will consider all responses.

OFG1161

Open Meeting (16th October) - your last chance to have a say before the Final Determinations and outcomes

What they are for: These meetings are in place to discuss “key areas of contention and raise areas for clarification ahead of Ofgem’s Final Determinations.”

Why get involved: This is an excellent opportunity for stakeholders’ voices to be heard alongside our own.



How to get involved: you can submit questions on key themes on Ofgem's [event page](#) and you can email any questions you may have to stakeholders@ofgem.gov.uk clearly stating that your question relates to National Grid Electricity Transmission or NGET.

Ofgem has said: **"....the questions will be considered as part of our Final Determinations"**

Next steps

- ▶ Ofgem's informal consultation on licence changes
- ▶ Ofgem's open meeting on 16 October
- ▶ Final determinations in December 2020
- ▶ Formal licence changes consultation ends in January 2021
- ▶ RIIO-2 period starts on 1 April 2021

Questions?

Please get in touch to discuss further

Get in touch -

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Visit us at -

www.nationalgridet.com

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