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RIIO|T1

RIIO|GD1

STRATEGY DECISION

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City conference call
18 March 2011

Key messages

- First milestone in the implementation of the RIIO model
- We remain committed to ensuring efficient companies are able to raise equity and debt finance
- The companies now need to deliver high quality business plans and specific financeability proposals by July
- Double-digit returns available for good performers – final calibration of overall package with business plans
- Network companies to play a full role in delivering a sustainable energy sector and long-term value for money

First milestone in RIIO implementation

- Initial Strategy consultation December 2010-February 2011
- Wide feedback from range of stakeholders, including investment community

FAST-TRACKED	TIMING	NON FAST-TRACKED
Strategy Consultation	Dec 2010	Strategy Consultation
Strategy Decision	Mar 2011	Strategy Decision
Business Plans	July 2011	Business Plans
Consultation on BPs	October 2011	Consultation on BPs
Fast track Consultation	Dec 2011	-
Fast track Decision	Feb 2012	-
-	July 2012	Initial Proposals
-	Dec 2012	Final Proposals

TODAY: HIGHLIGHTS OF GEMA DECISION. FULL DECISION DOCUMENT END OF MARCH

Financeability Decisions - Summary

	DECEMBER	MARCH
COST OF EQUITY	4.0% – 7.2%	6.0% - 7.2%
COST OF DEBT	Bloomberg Sterling Corporates indices (10yrs, A & BBB rating)	iBoxx non-financials (10+ yrs, A and BBB ratings)
ASSET LIVES	Electricity: From 20yrs to 45-55yrs	Electricity T & D: 45yrs for new assets only
	Gas: No change (45 years)	
CHANGES TO DEPRECIATION	Gas Distribution: New assets front-end loaded	Gas Distribution: All post-2002 assets front-end loaded
REPEX	From 50% to 100% capitalisation	

Revenue - Narrower cost of equity range

6.0% to 7.2% range (post-tax, real)

Consistent with risk profile

- **Risk-free rate: 1.7-2.0%.** Reflects recent regulatory precedent & average 10-yr ILGs over 10yrs
- **Equity Risk Premium (ERP): 4.75-5.5%.** Future of financial markets remains uncertain
- **Equity Beta: 0.9-0.95.** Large capex programme risk

PREVIOUS DETERMINATIONS	COST OF EQUITY (%)
DPCR5	6.73
GDPCR1	7.25
TPCR4	7.00

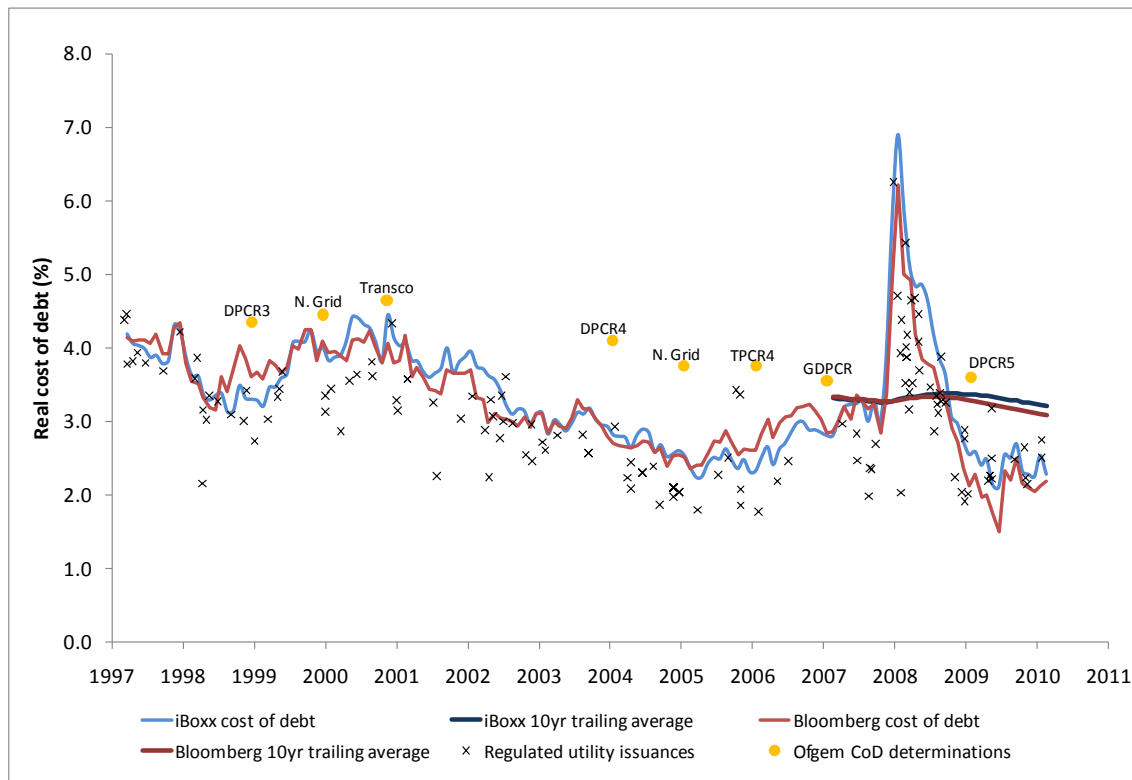
Need to consider the overall package including transitional arrangements, uncertainty mechanisms and incentives.

OPEN TO COMPELLING ARGUMENTS FOR VALUES OUTSIDE THIS RANGE

Revenue - Adopting iBoxx index with a longer focus

Cost of Debt

- **Traditional approach** - fixed rate based on embedded debt and cushion
- **New approach** - cost of debt indexation
- **iBoxx 10+ yrs (non-financials)** - more transparent and representative (maturities & GB)



PROTECTS INVESTORS AND CONSUMERS

Revenue – Asset lives & depreciation

- Removing 'fudge' – creating long-term sustainable financeability
- Extending lives for new electricity assets only
- Gas distribution assets front-loaded

	Asset Lives		Depreciation	
Network	December	March	December	March
Electricity Transmission	45 – 55yrs	45yrs, new assets only	Straight Line	
Electricity Distribution	45 – 55yrs	45yrs, new assets only	Straight Line	
Gas Transmission	45yrs No change		Straight Line	
Gas Distribution	45yrs No change		Front-loaded post 2013 assets	Front-loaded, post 2002 assets*

* Gas Distribution assets pre-2002 are already subject to front-end loading depreciation

COMPANIES TO PROPOSE & JUSTIFY ADDITIONAL TRANSITIONAL ARRANGEMENTS

Revenue – Transitional arrangements

Committed to financeability duty

- Decisions on asset lives and depreciation significantly reduce impact on cash flow:
 - New asset lives applied to new assets only
 - Depreciation for all post-2002 gas distribution assets front-end loaded
- Well-justified business plans give companies opportunity to present arguments and proposals for additional and specific transitional arrangements.
- Do not rule out transition over more than one price control period, if justified.

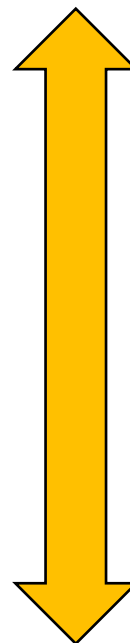
CONSISTENT WITH RIIO COMMITMENT TO AVOID SUDDEN CHANGES

Outputs - Companies to play a full role

SIX OUTPUT CATEGORIES



A RANGE OF INCENTIVES



- Symmetric Financial Incentives
- Asymmetric incentives (reward only / penalty only)
- Discretionary awards
- Reputational Incentives

PLUS INCENTIVES TO BE EFFICIENT AND TO BE HONEST

Incentives – Significant scope for outperformance

Current best estimate, based on assumptions and historical trends. Full calibration following business plans

Cost performance / efficiency

+/- c£2bn

Environmental, Consumer & Other Incentives

- Well-justified business plans
- Emissions & business carbon footprint
- Losses
- Connections
- Customer satisfaction
- Visual amenity

+/- c£1bn

DOUBLE-DIGIT RORE AVAILABLE FOR GOOD PERFORMERS. CLEAR DOWNSIDE FOR POOR PERFORMERS

Innovation - Additional funding available

- Innovation inherent in outputs-led, longer term price controls
- Where the commercial benefit may not be clear, time-limited innovation stimulus package, building on the Low Carbon Network Fund
- Annual allowance plus competitive allocation of funds



Electricity Distribution	Electricity Transmission	Gas
£64m per annum	£30m per annum	At least £20m per annum

ADDITIONAL £400m AVAILABLE OVER THE PRICE CONTROL PERIOD

It's time for the companies to deliver

Companies

- Continue stakeholder engagement
- Produce well-justified business plans that demonstrate how they will innovate and deliver required outputs
- Develop proposals for further uncertainty mechanisms
- Propose specific financing (eg gearing) and additional transitional arrangements (if required)

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- Continue to engage with stakeholders
- Assess the companies' business plans and publish our views
- Fine-tune incentives in light of companies' plans
- Progress our evaluation of Fast-track companies

OUR FOCUS WILL NOW MOVE TO THE COMPANIES' PLANS

Contact

- For further information please contact:

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The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

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Promoting choice and value
for all gas and electricity customers