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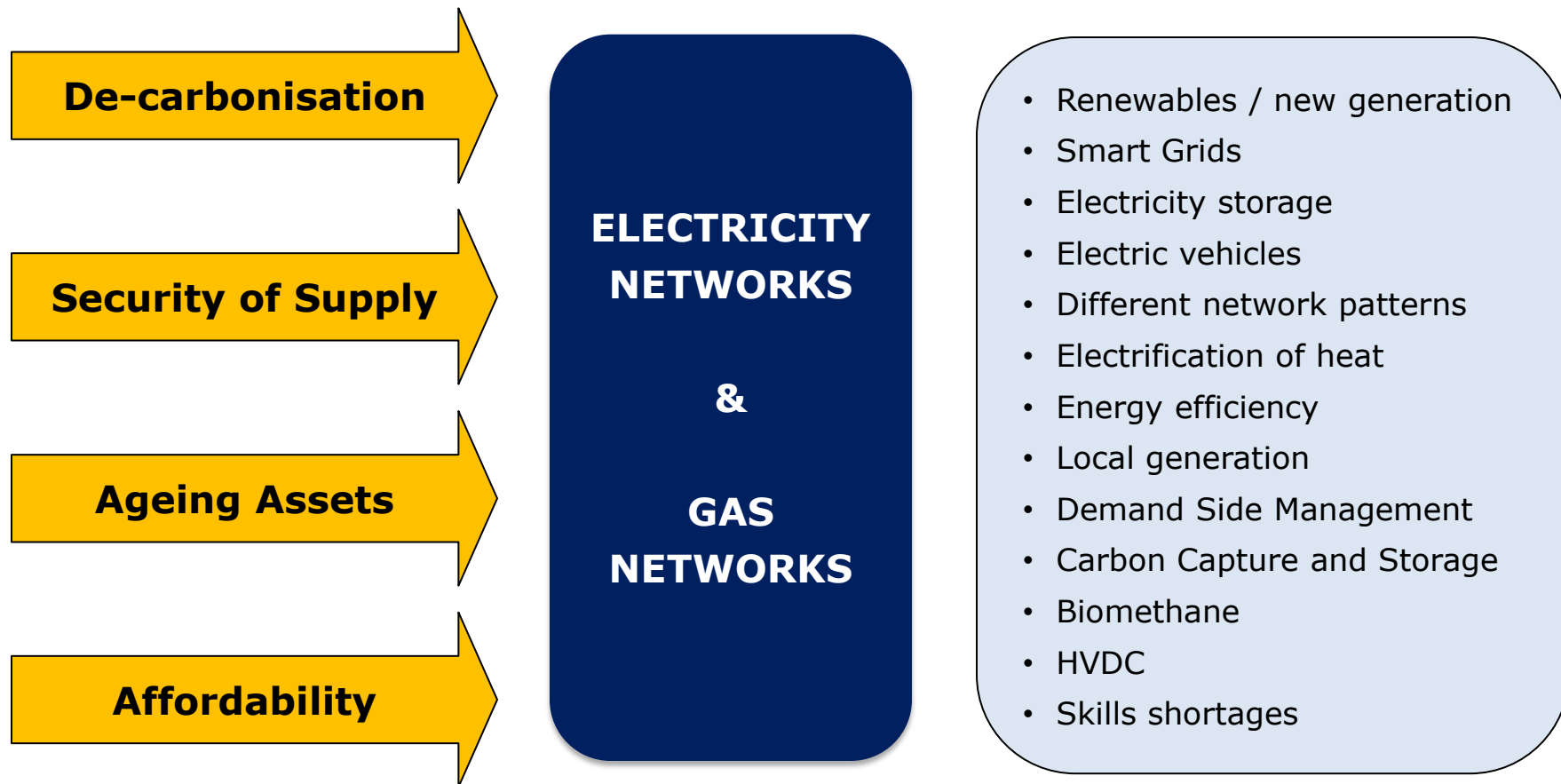
RIIO | ED1

STRATEGY DECISION

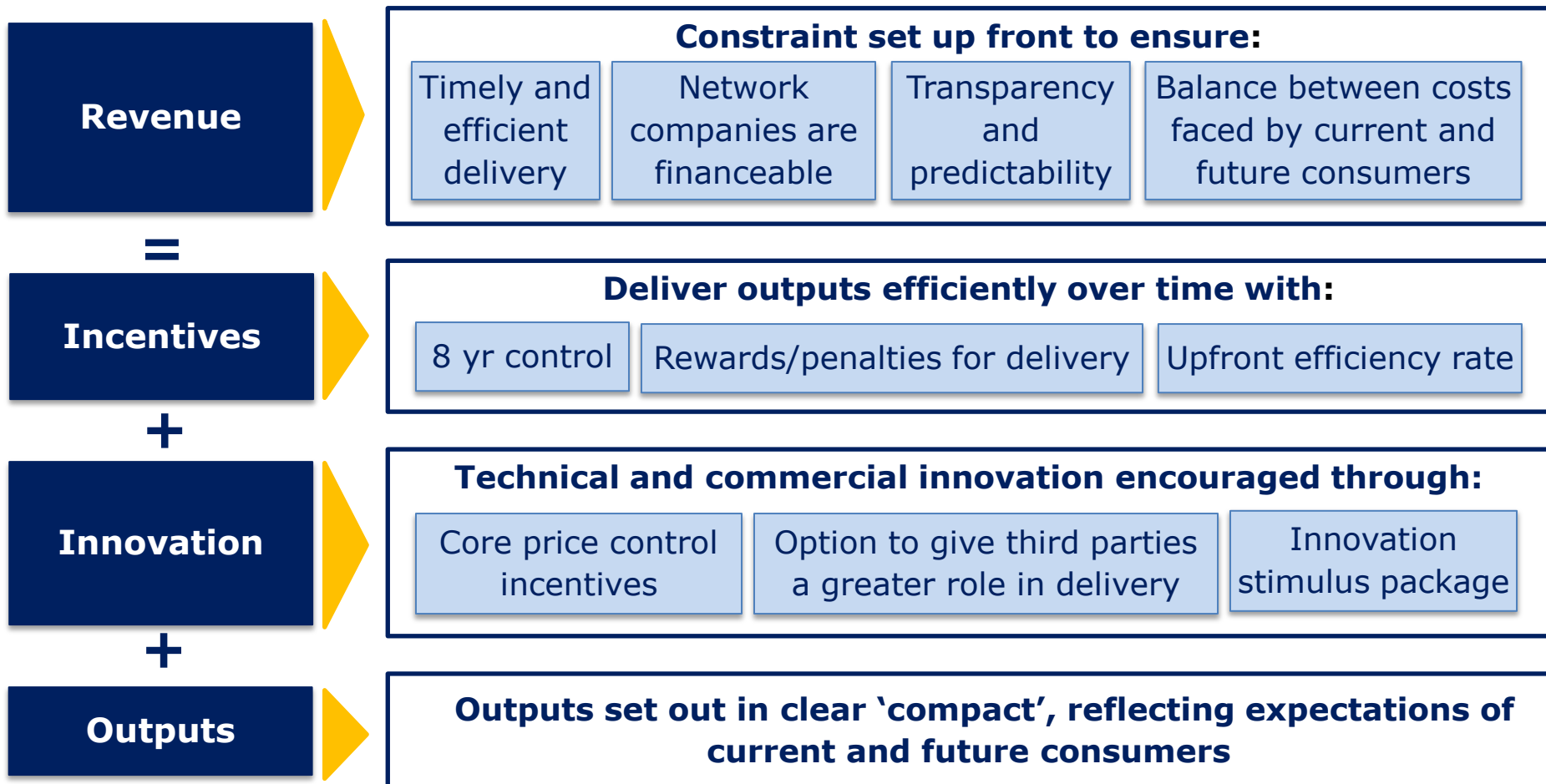
Hannah Nixon
Senior Partner, Distribution

March 2013

The industry is facing unprecedented change



RIIO - A new approach to Network Regulation



RIIO - Financeability: Our duty

Financeability duty

- **Ofgem's Principal objective:** to protect the interests of existing and future consumers
- Must also "have regard to the need to secure that licence holders are able to finance the activities which are the subject of obligations on them"

- In the interest of consumers that efficient network companies can secure finance in time and at reasonable cost
- No bail-out if financial distress is due to own behaviour
- No reward of inefficiency or unwarranted returns
- Capital structure remains the responsibility of network companies' management

Regulatory commitment: Transparency, predictability, transitional arrangements (no sudden impact on cash flow)

RIIO – Investors have a role to play

We rely on investors to:

- Keep pressure on management teams not to underperform
- To support management teams to appeal Ofgem's decisions if they believe them wrong.

You will have:

- Enough regular information to make these judgements
- An awareness that all companies could outperform in theory (ie No "median theory" is in play)

- Investors to be alert: ineffective, lazy or poor management will be found out under RIIO
- GB Network Regulation was never intended to be risk free
- There is now a wider template for risk/reward

Consumers and Investors have common interests

RIIO – So far so good

First price controls under RIIO have achieved:

- ✓ Fundamentally changed behaviour and Board discussions at companies
- ✓ Significant step-up in stakeholder engagement to present well thought-out, detailed and better justified business plans
- ✓ Ofgem staying true to RIIO principles:
 - ✓ Framework and key parameters clearly set out early on
 - ✓ Transparency of approach from early on– No 'black box' dates
 - ✓ Increased stakeholder engagement – including investors
 - ✓ Proportionate treatment
 - ✓ Higher level of scrutiny focused on areas not well justified
 - ✓ Two Scottish TOs fast-tracked
 - ✓ Flexibility in allowed costs ensure customers pay only for necessary expenditure
 - ✓ Financeability not compromised – transition where needed

Balancing huge investment needs and costs to consumers

RIIO-ED1 - Timetable

Timing	
Date	RIIO-ED1
Feb 2012	Launch consultation
Sept 2012	Strategy consultation
Mar 2013	Strategy decision
July 2013	Business Plans
Oct 2013	Initial Assessment; Fast-Track decision (& Initial Proposals)
Feb 2014	Fast-Track Final Proposals
Mar 2014	Non-Fast-Track Business Plans resubmitted
July 2014	Non-Fast-Track Initial Proposals
Nov 2014	Non-Fast-Track Final Proposals
1 April 2015	RIIO-ED1 commences

Ofgem published
4 March 2013



DNOs to submit

RIIO-ED1 - Key issues

- New types of generation
- New and unusual demand
- Uncertainty of take up of new technologies
 - local generation
 - heat pumps
 - electric vehicles
- Greater use of smart grid technology & Demand-side response (DSR) to maximise network flexibility at minimum cost



Timely and cost-effective connection of new low-carbon technologies

RIIO-ED1 - Financeability

	RIIO-ED1 Strategy Decision	DPCR5
COST OF EQUITY	6.0% - 7.2%	6.7%
COST OF DEBT	iBoxx non-financials (10+ yrs, A and BBB ratings)	3.6%
NOTIONAL GEARING	Will be assessed on cash flow volatility and DNO business plans	65%
ASSET LIVES	45 years for new assets, straight-line depreciation	20 years, straight-line depreciation

DNOs to justify transitional arrangements needed

RIIO-ED1 – Next steps

DNO Business Plans – July 2013

Well justified business plan

- Robust process followed
- Delivery of required outputs
- Efficient costs for delivery of outputs
- Efficient financing arrangements proposed
- Key uncertainties & risks addressed

**All or parts of business plan
need further scrutiny**

**Fast-track Initial Proposals –
October 2013**

**Resubmit Business Plans –
March 2014**

The ball is on DNOs' court now

Contact

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Annex: RIIO-T1 & GD1 Final Proposals

	SHETPLC	SPTL	NGET TO	NGGT TO	GDNs
	(Fast-tracked)				
Cost of Equity	7.0%	7.0%	7.0%	6.8%	6.7%
Cost of Debt	iBoxx 10 year trailing average				
Notional gearing	55%	55%	60%	62.5%	65%
Asset lives transition	16 yrs	8 yrs	8 yrs	na	na
Capitalisation rate	All: 90%	All: 90%	All: 85%	Base: 64% Increm: 90%	Stepped capitalisation 36-66% (depending on GDN)
Revenues growth	212%	42%	30.5%	28%	4.7%
RAV growth	263%	77%	69%	42%	6.7%
Totex	£4.2bn	£2.1bn	£14.5bn	£4.9bn	£14.4bn

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