

City Briefing

30 July 2014

ofgem

Agenda

- **Welcome and opening remarks**
 - David Gray, Chairman
- **Chief Executive's Update**
 - Dermot Nolan, CEO
- **RIIO-ED1 Slow-Track Draft Determinations**
 - Maxine Frerk, Senior Partner – Distribution
- **Q&A Panel**
 - David Gray, Dermot Nolan, Maxine Frerk, Rachel Fletcher
- **Closing remarks and finish**

Ofgem Board and Senior Management

Gas and Electricity Markets Authority

David Gray Chairman	Dermot Nolan Chief Executive	Andrew Wright Group Finance Director	Sarah Harrison Executive	David Harker Non-Executive
Jim Keohane Non-Executive	David Fisk Non-Executive	John Howard Non-Executive	Keith Lough Non-Executive	Paul Grout Non-Executive

**Chief Executive
Ofgem Group
Dermot Nolan**

**Smarter Grids and
Governance:
Transmission**
Martin Crouch
Senior Partner

**Smarter Grids and
Governance:
Distribution**
Maxine Frerk
Senior Partner

Markets
Rachel Fletcher
Senior Partner

**Sustainable
Development**
Sarah Harrison
Senior Partner

Corporate Functions
Andrew Wright
Group Finance
Director

E-Serve
Robert Hull
Managing Director

Chief Executive's Update

Dermot Nolan
CEO

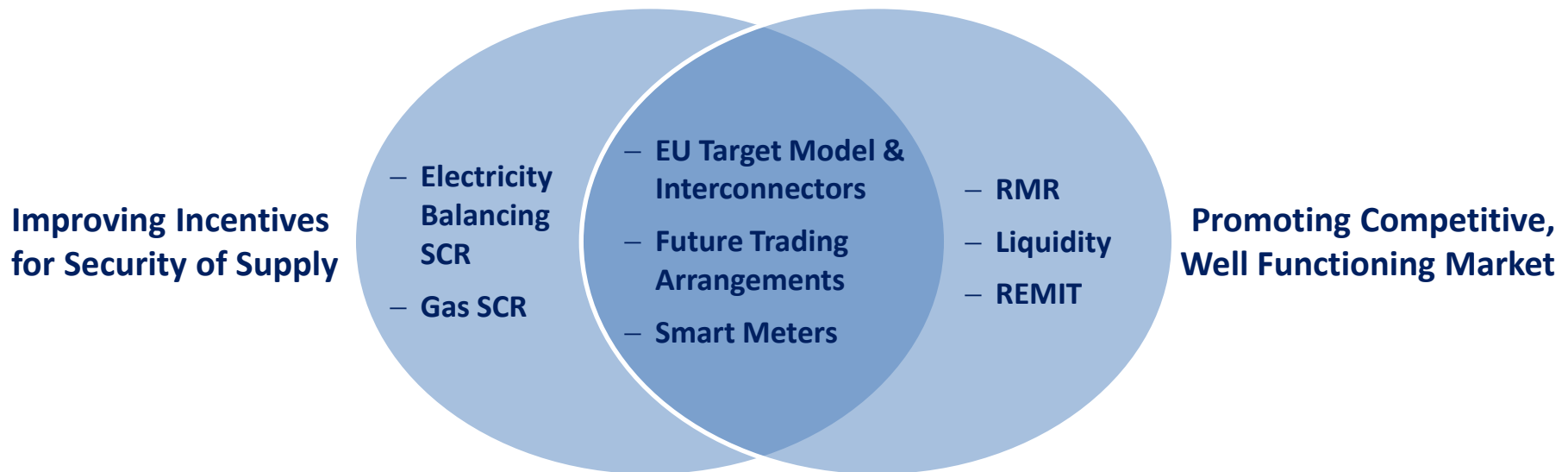
ofgem

CMA Investigation

- **CMA energy market investigation**
 - Identify features of the market that cause an adverse effect on competition
 - Seek to remedy them if remedies are required
- **Characteristics of energy sector**
 - Energy is an essential product; sector will change significantly
 - Heavily regulated sector (including from Brussels)
 - Specific factors affect domestic consumers' ability to engage in the market
- **What to expect from Ofgem during the investigation**
 - Continue to work to make market better for consumers
 - Track and report on developments in retail competition
 - Submit evidence and offer the CMA independent expertise, analysis and information

Markets Overview

- Focus on improving markets today and in the future but against backdrop of change

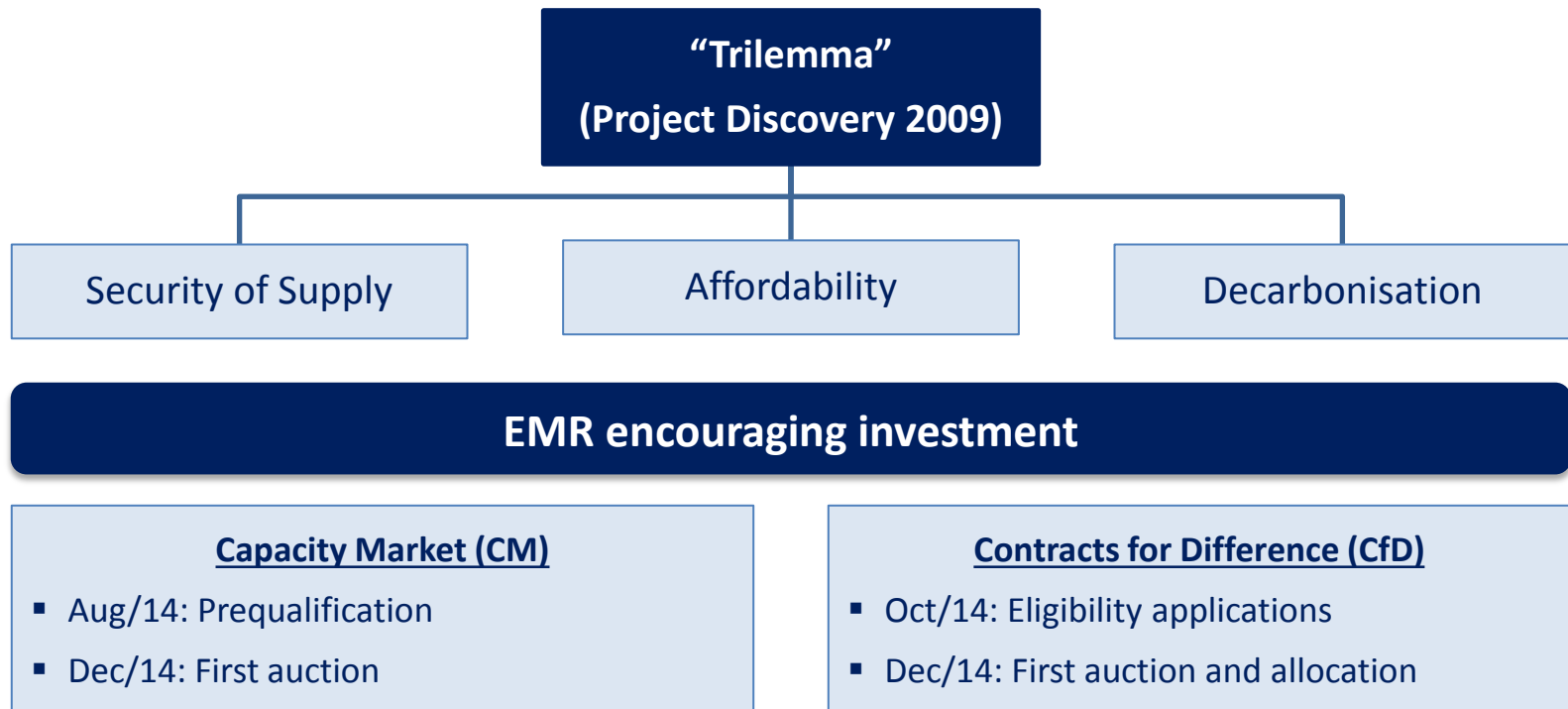


- Markets are not static and will change – continuing work by Ofgem

Electricity Security of Supply

- **Ofgem Capacity Assessment 2014**
 - Tightening margins: 2–8% in 2015/16
 - Uncertainty: Based on NG's Future Energy Scenarios with sensitivities
- **New Balancing Services in the short-term**
 - Reduced risk of disruption to customer supplies
- **Capacity Mechanism in the medium-term**
- **Electricity Balancing Significant Code Review to give better incentives for flexible generation plant**
- **Increased work on energy efficiency and demand-side response**

Electricity Market Reform (EMR) – Government Energy Policy (DECC)



Enforcement Activities

- **Enforcement action is important to incentivise energy companies to abide by their various regulatory obligations**
- **Enforcement approaches should be clear, stable and predictable**
- **Ofgem has enforced in the past, is conducting a number of investigations currently, and will continue to enforce, if necessary**
- **REMIT (EU Regulation on Wholesale Energy Market Integrity and Transparency)**
 - New powers to monitor, investigate and take action
- **Chairman's Letter – The Authority's position on future financial penalties**
 - Likely significant increase in level of penalty, greater emphasis on deterrence

Transmission

- **Electricity Interconnection – proposed ‘Cap & Floor’ regulation**
 - Lack of investment under current ‘exempt’ approach
 - Protection against downside for investors
- **Project TransmiT – improvements to charging methodology**
 - Reflect modern realities of GB generation mix
 - Enable more efficient investment decisions to be made
- **Integrated Transmission Planning & Regulation (ITPR)**
 - Gradual expansion of onshore competition
 - Potentially expand role of SO
- **Strategic Wider Works (RIIO-T1)**
- **Offshore Transmission: £1.4bn has reached financial close**

RIIO Framework for Network Regulation

- **RIIO framework objectives**

- Drive real benefits for consumers by providing companies with strong incentives to meet the challenges of delivering outputs efficiently
- Provide a transparent and predictable framework that rewards timely delivery and encourages innovation

- **RIIO so far**

- The fast-track process
- Increased and diverse stakeholder engagement
- Cost savings to consumers

- **Going forward**

- Annual iteration process
- Reporting/monitoring
- Investors continue to play important role

RIIO-ED1 Slow-Track Draft Determinations

Maxine Frerk
Senior Partner, Distribution

ofgem

RIIO-ED1 Key Messages

- Fast track process successful – £700m savings identified by DNOs in revised business plans
- Ofgem scrutiny has identified further savings – networks are changing
- Ensuring companies can finance their activities
- It's not just about the money

New investment – better service – lower overall cost

RIIO-ED1 – Business plan assessment – fast-track summary

DNO Group	DNO	Process	Outputs	Resources – efficient costs	Resources – efficient finance	Uncertainty and risk
Western Power Distribution	WMID	Green	Green	Green	Green	Green
	EMID	Green	Green	Green	Green	Green
	SWALES	Green	Green	Green	Green	Green
	SWEST	Green	Green	Green	Green	Green
Electricity North West Ltd	ENWL	Green	Green	Yellow	Green	Green
Northern Powergrid	NPgN	Green	Green	Yellow	Green	Green
	NPgY	Green	Green	Yellow	Green	Green
UK Power Networks	LPN	Green	Yellow	Red	Green	Green
	SPN	Green	Yellow	Yellow	Green	Green
	EPN	Green	Green	Red	Green	Green
SSE Power Distribution	SSEH	Green	Red	Yellow	Green	Red
	SSES	Green	Yellow	Yellow	Green	Red
SP Energy Networks	SPD	Yellow	Red	Red	Green	Yellow
	SPMW	Yellow	Red	Red	Green	Yellow

WPD Fast Tracked – Final Determination February 2014

Cost Assessment – Ofgem’s view of efficient cost

- Comparative cost benchmarking – DNOs could reduce expenditure by £650m
- Our forecast of real price effects (RPEs) £850m lower than DNOs’
 - Ofgem using more recent data than was available to DNOs
- DNOs can save around £400m more using smart grids and smart metering than they have forecast
 - Based on range of industry and government analyses

Acknowledge need for more investment – networks are changing

RIIO-ED1 Slow-Track Draft Determinations Totex

(£m 2012-2013 prices)	First Business Plan	Revised Business Plan	Ofgem DD Allowance	% Diff. (Revised Plans vs. DD)
ENWL	1,900	1,877	1,794	-4.4%
NPg	3,224	3,172*	2,928	-7.7%
UKPN	6,726	6,584	5,995	-8.9%
SPEN	3,960	3,491	3,206	-8.2%
SSEPD	3,720	3,635	3,398	-6.5%
Total	19,531	18,760	17,321	-7.7%

* NPg has included an additional £61m in its slow-track plan for costs associated with Network Rail's electrification programme. We are proposing an uncertainty mechanism for these costs. We have therefore not included this amount in our assessment

RIIO-ED1 Slow-Track Draft Determinations Totex = £17bn

RIIO – Cost of Capital

- Cost of equity of 6% – in line with February 2014 minded-to position
- Consistent with Competition Commission determination for NIE
- Cost of debt: proposing a “trombone” index starting at 10 years and increasing to 20 years
- Result: better fit for forecast interest costs and substantial reduction in exposure to market interest rate uncertainty

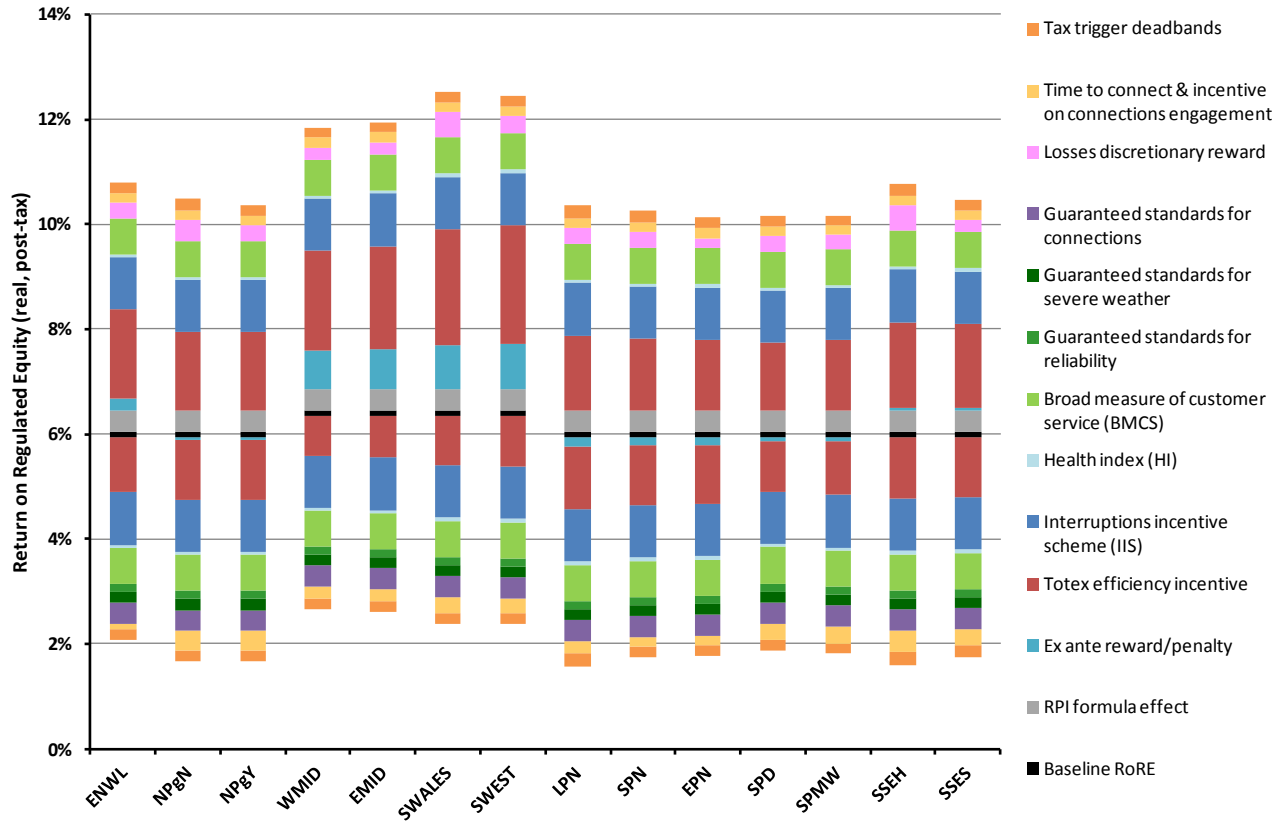
Cost of Debt proposed “trombone” index

RIIO – Financeability

- Financeability duty – must “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 consumers’ interest that efficient network companies can secure finance in time and at reasonable cost
- Enhanced analysis on actual cost of debt and financial resilience beyond rating agency metrics
- Capital structure remains the responsibility of network companies’ management
- Company can request changes to revenue profile to help address particular issues

Regulatory commitment: transparency, predictability, objectivity

Estimated RoRE ranges in RIIO-ED1



Double digit returns achievable by best performing companies

RIIO-ED1 Next Steps

30 July 2014	Slow-Track Draft Determinations
Sept 2014	Consultation closes
Nov 2014	Slow-Track Final Determinations
1 April 2015	RIIO-ED1 commences First year revenue based on draft determinations Annual iteration and monitoring

Contact

For further information please contact:

Brenda Tanis

Head of Investor Relations

020 7901 7009

brenda.tanis@ofgem.gov.uk

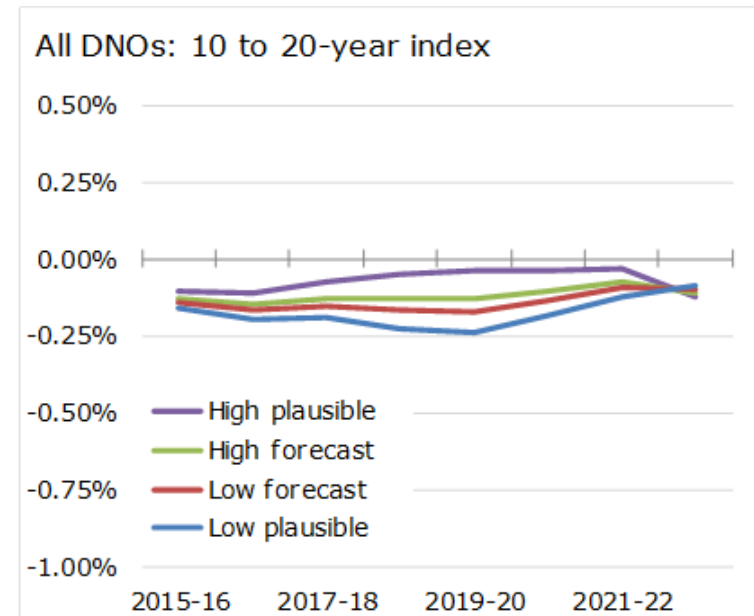
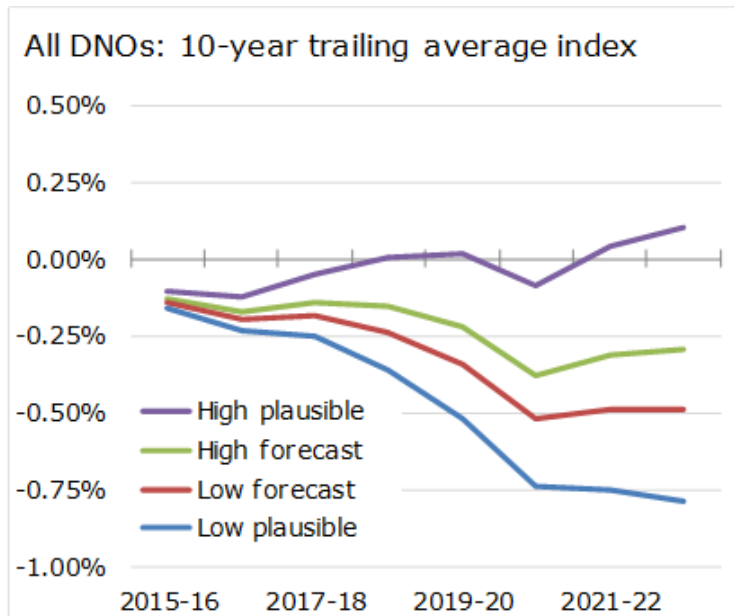
Harry Rippon

Investor Relations Manager

020 7901 7460

harry.rippon@ofgem.gov.uk

Annex: Cost of Debt with 10yr Iboxx index vs 10yr to 20yr “Trombone” Iboxx index



Significantly decreased interest rate risk

Ofgem is the Office of Gas and Electricity Markets.

Our priority is to protect and to make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes.

We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.