

Overview of draft determinations

RIO-ED1 Price Control Review Forum

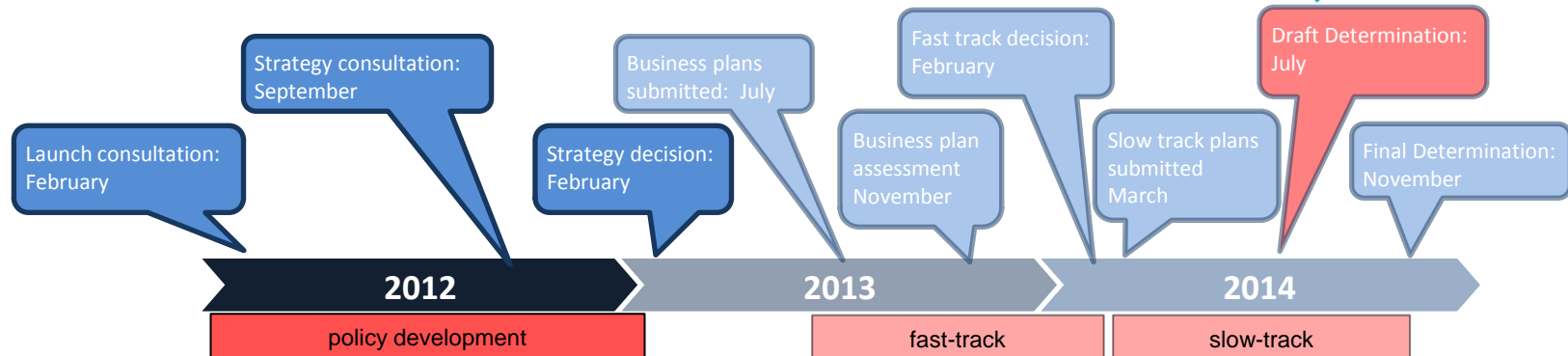
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10/09/14

ofgem

Slow-track draft determinations - summary:

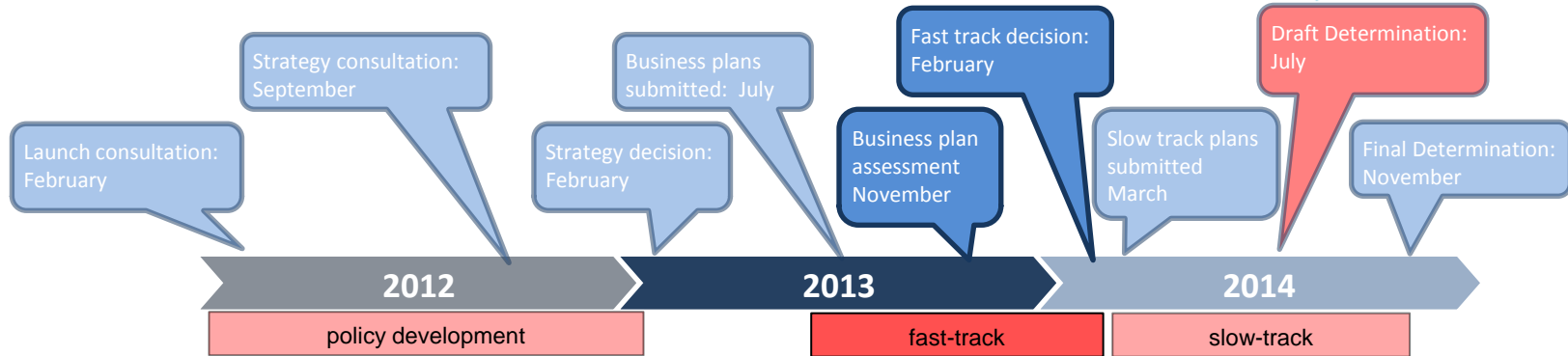
- Accepted outputs and uncertainty mechanisms
- Reduced DNOs' allowed total expenditure by £1.4bn over RIIO-ED1, from their proposed amounts
- Retained minded-to cost of equity, with revised cost of debt index – overall package means efficient DNOs can finance their activities
- Reduction of approx. 5.5% of allowed revenues vs DPCR5
- Underlying reduction of approx. £12 in typical household bill over RIIO-ED1

DNOs' 2015-16 base revenues fixed at the draft determination levels. Any difference between draft & final determinations to be recovered over RIIO-ED1.



RECAP - Strategy/policy development:

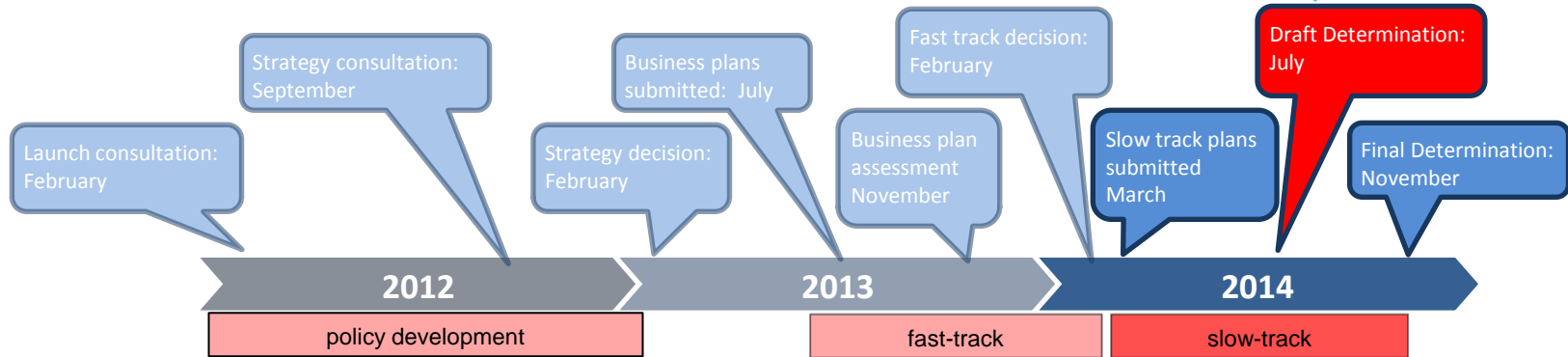
- The framework on which DNOs based their business plans
- Set out the outputs and incentives in 6 primary categories:
 - Safety
 - Reliability and availability
 - Environment
 - Customer satisfaction
 - Connections
 - Social obligations
- Set out the key financial parameters and Ofgem views on uncertainty and risk
- Developed with input from working groups including DNOs and stakeholders



RECAP - fast-track:

- One group, WPD, judged strong across all criteria – fast-tracked

DNO Group	licensee	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	Red	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



Slow-track:

- Remaining 5 companies submitted revised plans in March – identified £700m further savings
- We judged all plans to be delivering suitable outputs, and handling uncertainty and risk satisfactorily
- But weaknesses in efficient cost and finance.

DNO Group	Licensee	Process	Outputs	Resources – efficient costs	Resources – efficient finance	Uncertainty and risk
Electricity North West Ltd	ENWL			*		
Northern Powergrid	NPgN			*		
	NPgY			*		
UK Power Networks	LPN			*		
	SPN			*		
	EPN			*		
SP Energy Networks	SPD			*		
	SPMW			*		
SSE Power Distribution	SSEH			*		
	SSES			*		

Cost assessment:

- Comparative cost benchmarking – DNOs could reduce expenditure by further £650m
- Our forecast of real price effects (RPEs) £850m lower than DNOs'
- We believe DNOs can save ~£400m more using smart grids and smart metering than they forecast

Finance:

- Cost of equity: 6% - in line with our February 2014 minded-to position
- Cost of debt: proposing a “trombone” index moving from 10 – 20 years
- No surprises from City/investor reactions

We discuss these in more detail in the following slides

Cost assessment – comparative benchmarking

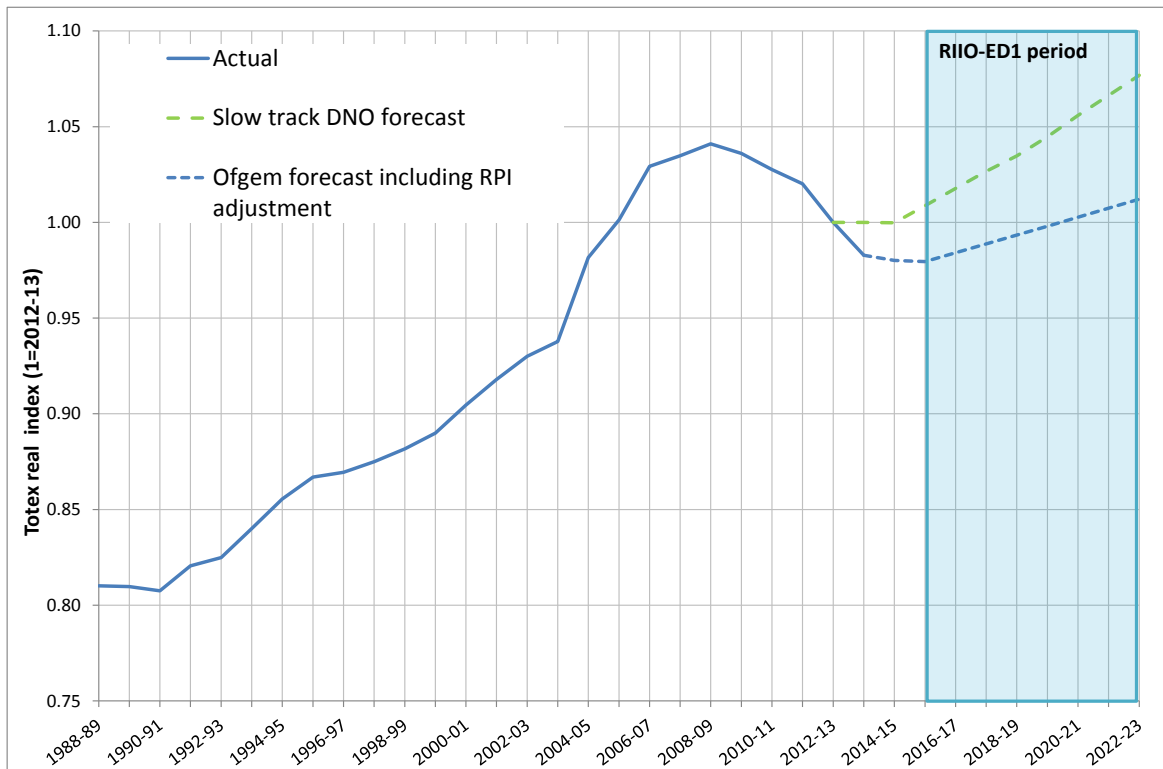
- Toolkit approach
 - Top-down (totex) cost models
 - Bottom-up (disaggregated) cost model
 - Qualitative assessment with technical and economic consultants
- WPD looks less efficient – not surprising given slow-track DNOs got to reduce costs and improve justifications, with view to “beating” WPD. Most of gap is due to work volume - WPD tied to delivering the work it proposed in its plan

*changes from fast-track
reflect improved data,
better justifications,
stakeholder comments*

Cost assessment - RPEs

Differences between our assessment of future cost movements, relative to economy-wide inflation, and DNOs assessment is driven principally by two factors:

- our view of the short term (to 2015-16) movement in costs; and
- our subtraction of 0.4% p.a. to account for RPI over-estimating economy-wide inflation



However, there's uncertainty in any forecast. Is the uncertainty now material enough to apply a different mechanism to deal with RPEs?

Consultation on alternative ways of treating RPEs was published 28 August.

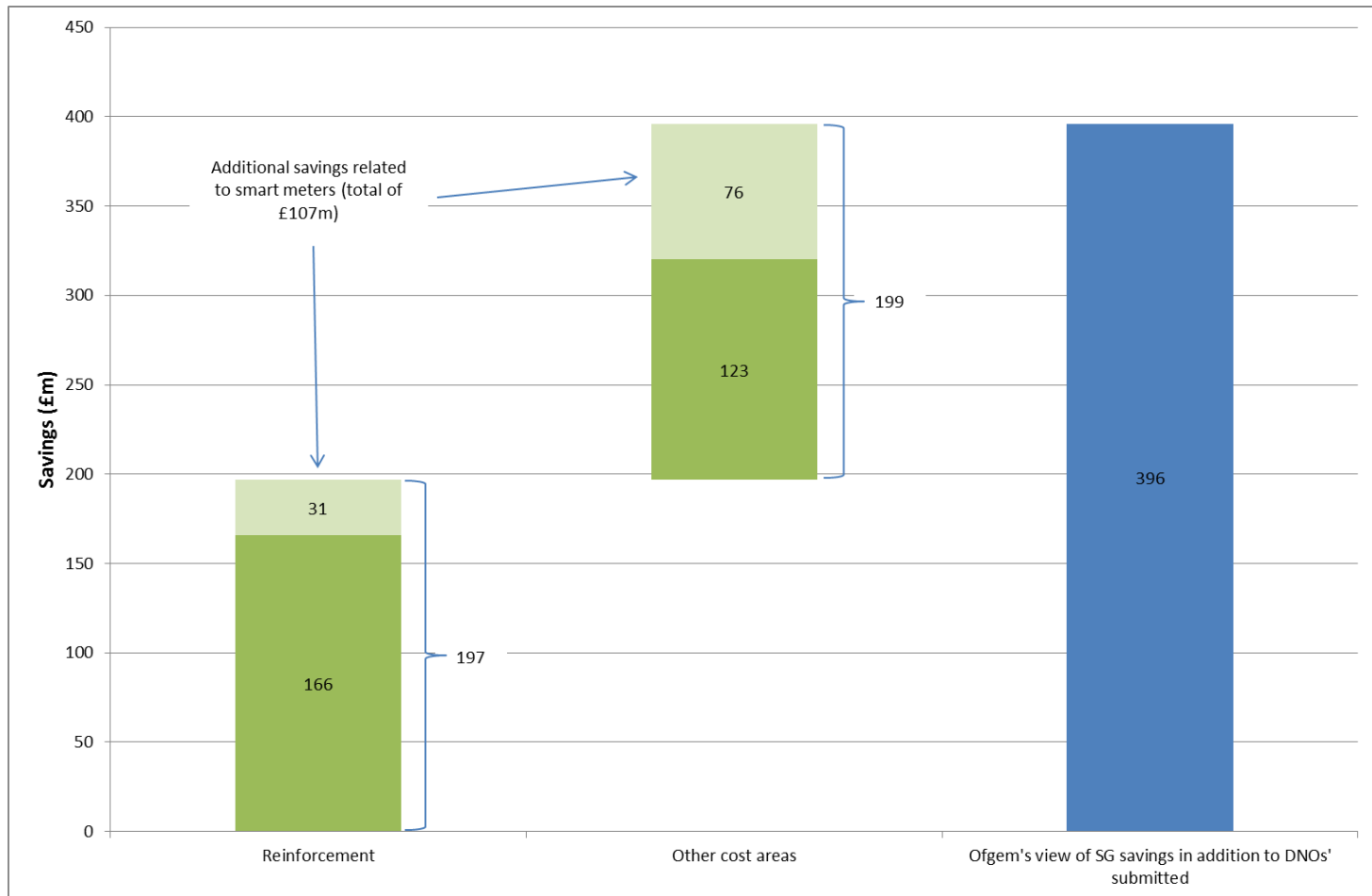
It asks for your views on alternatives

- indexation
- true up (based on an index derived at the start of the price control)

Workshop: 16 September

Cost assessment – smart grid/smart meter savings

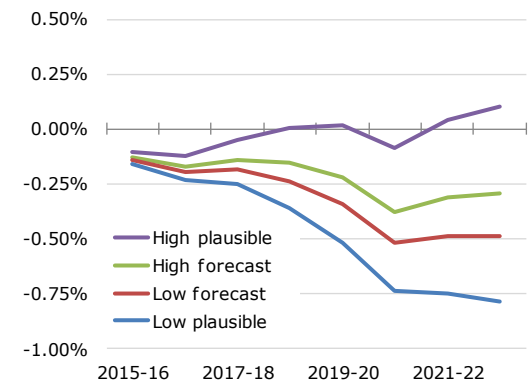
Ofgem's view of Smart Grids savings in addition to DNOs' submitted (excluding WPD)



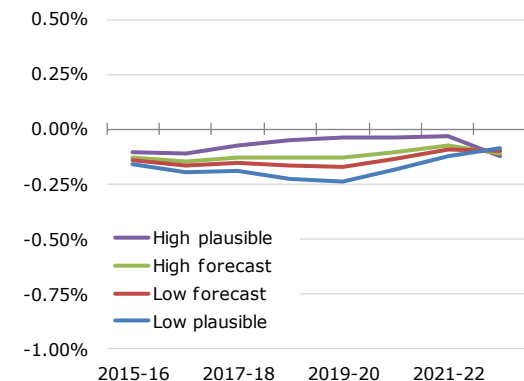
Finance assessment

- Cost of debt
 - Recognised 10-year index risked significantly underfunding DNOs on average
 - Proposing “trombone” index which starts with 10-year index, and moves to 20 years
 - New index still slightly underfunds, but this is covered by headroom in cost of equity
- Financeability
 - Have regard to DNOs being able to finance activities
 - Analysed using range of indicators.
 - Recognised ratings of some DNOs might be downgraded, but not out of investment grade

All DNOs: 10-year trailing average index



All DNOs: 10 to 20-year index



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