NGM Pricing Consultation

Stakeholder Forum

21 May 2013

St Johns Hotel, Solihull

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National Grid Metering

Pricing Consultation Stakeholder Forum

Tuesday 21 May 2013

Agenda

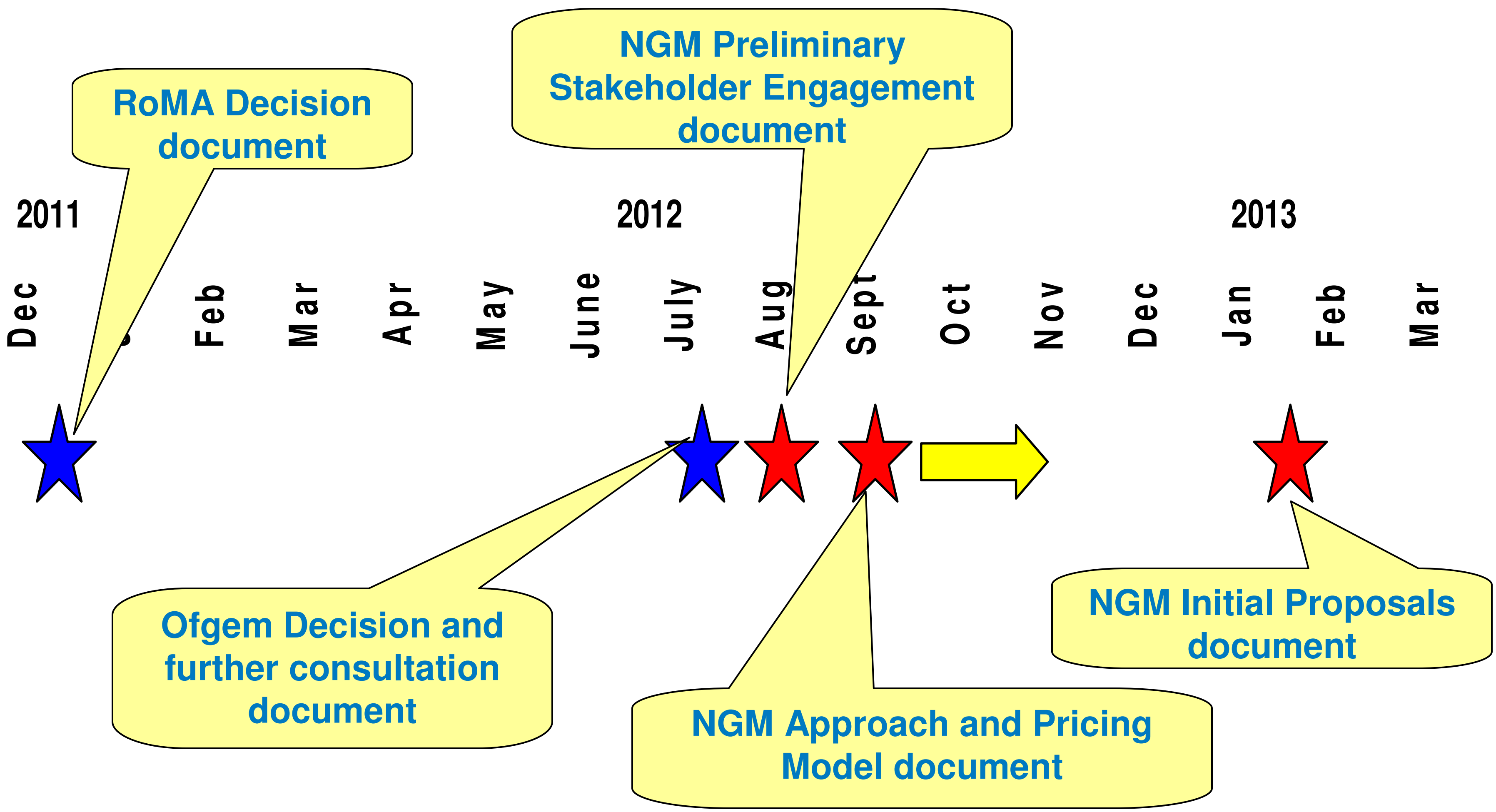
Welcome and Introductions	10:30	Abby Cardall
NGM Final Proposals update	10:35	Eric Fowler
Ofgem – Review and Next Steps	11:15	Steve Rowe
Q&A	11:45	All
Summary	12:15	Abby Cardall

Lunch & close

NGM Final Proposals Update

Eric Fowler
National Grid Metering

Activities to date



Pricing consultation areas of treatment

1. Positioning our Domestic and I&C businesses

2. Duration of B-MPOLR and NMM obligations and any pricing periods

3. Traditional meter displacement rates

4. Domestic workload, requirements for other services, operating costs and capital expenditure

5. RAV assessment and rate of return

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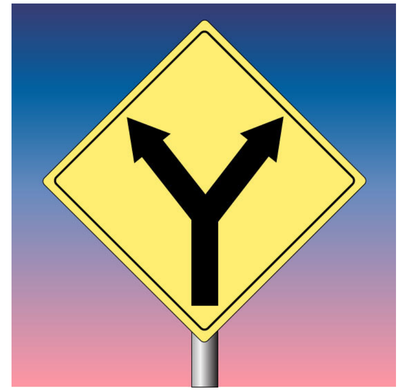
IP to FP comparison

Area	Initial Proposals	Final Proposals
I&C Regulation	As Is + Open Letter	Unchanged
B-MPoLR & NMM	Link to smart dates	Revised DECC timeline
Asset Transfer	Open to all + timebound	Open to all, NMM duration
Displacement Rate	DECC Lower-bound case	Jan 2013 CERG-OI
PEMS	Commercial terms + NMM adoption	Unchanged
Tariff Caps/Cross Subsidy	Both retained	Unchanged
Pricing Adjuster	20% deviation at Dec 2016	No adjuster
Workload	Ratios to installed assets	Unchanged
Rate of Return	6.5% pre tax, real	4.42% post tax, real
RAV Allocation	Methodology 2	Unchanged
DCM Tariff Cap	£16.29	£15.38 (2012/13 prices)

Areas retained from IPs

I&C Regulation

- Accept continuation of current controls
- Increasing competition in I&C market
- Open letter to Ofgem to determine how/when regulation could be lifted



PEMS

- Numbers largely dependent on smart start date and supplier readiness to install smart meters
  - Meters adopted by NMM to be offered under NGM's existing contracts (MSA or P&M)
- NGG intend to continue to offer PEMS under commercial terms but for traditional meters only – Suppliers remain free to choose who to dispatch to undertake work

Areas retained from IPs

Use of tariff caps and cross-subsidy

- Provides pricing stability
- Risk of later PPM displacement in roll-out
- Redistributive effect on participants with different ratios of PPMs

Workload / Other Services

- Retains approach laid out in Initial Proposals, modified to reflect revised displacement rates
- Volumes modelled assume the same ratios to NG portfolio as currently
- 24/7 contact centre, complaint and query handling – As Is level of service to be maintained
- Potential for mass rollout to create additional contacts – addressed through rate of return risk element

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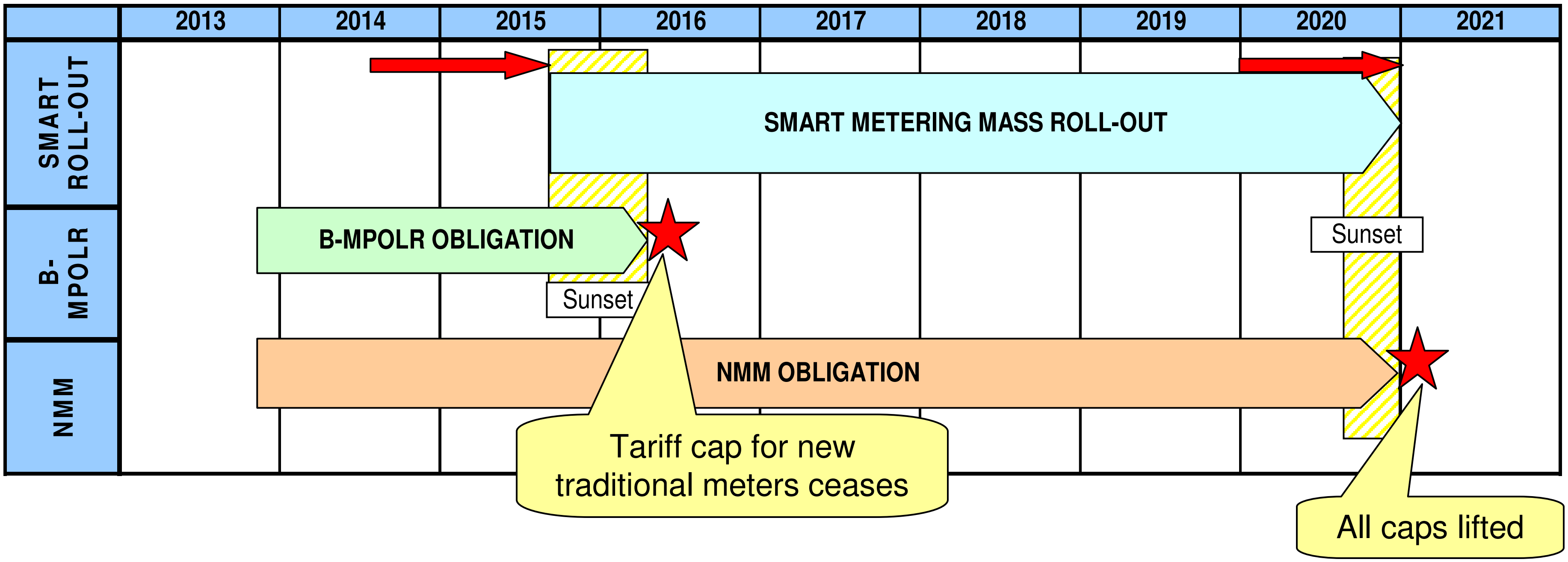
Areas retained from IPs

Meter Maintenance

- Activity & cost modelling based on current ratios to installed asset base projected forward against CERG-OI rollout rates
- Increased volume of PEMS adoptions due to smart timeline delay - uncertainty of asset transfer volumes and portfolio mix
- Risk that PPM displacement may be back-loaded, resulting in larger maintenance volumes for longer, impacting workloads and operating costs. Estimate made of potential effect and likelihood – translated into component in rate of return

B-MPoLR & NMM



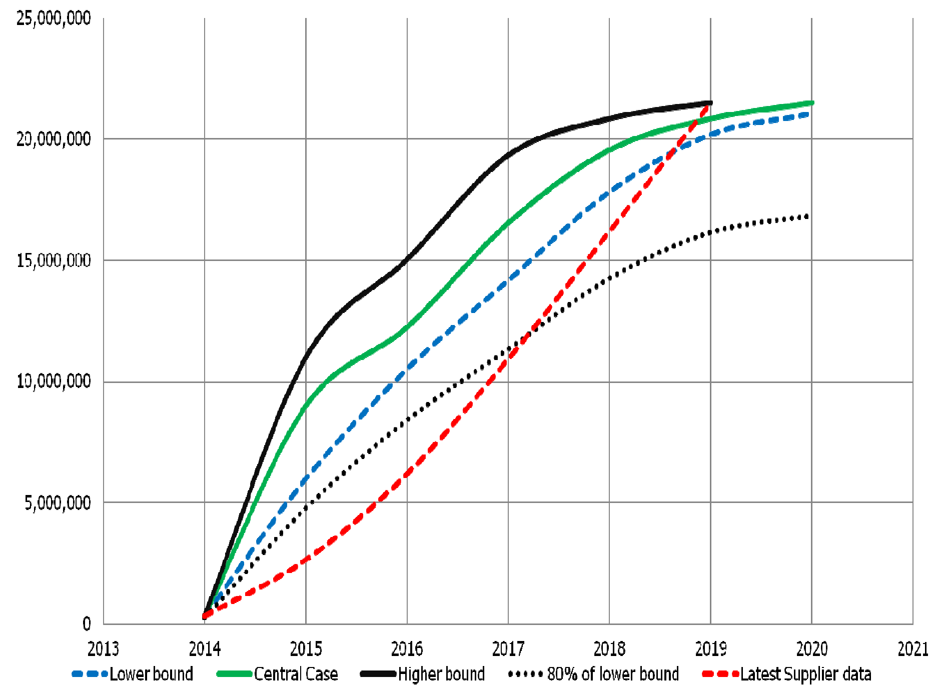
- B-MPoLR and NMM obligations extended in line with revised smart timeline
- Relationships with tariff caps unchanged from Initial Proposals

Asset Transfer

- Previously proposed transfer period timebound by duration of B-MPOLR obligation
- Slower displacement rates reduce impact of later transfers
- Now propose asset transfer open to all and available throughout NMM obligation
- Mechanism to agree transfer value remains consistent
  - Technical criteria (make, model, age, location, etc)
  - Existence of warranties and maintenance history
  - Estimated future cash flows prior to displacement based on present value
  - Assets provided under National Grid's contracts

Displacement rate

- DECC Lower bound-case used for Initial Proposals
- Latest Supplier estimate of smart installation rate published by CERG-OI in January 2013
- Demonstrated a slower start to mass rollout and only low levels of displacement prior to 2015/16
- Ofgem and stakeholders keen that we remodel using this revised profile



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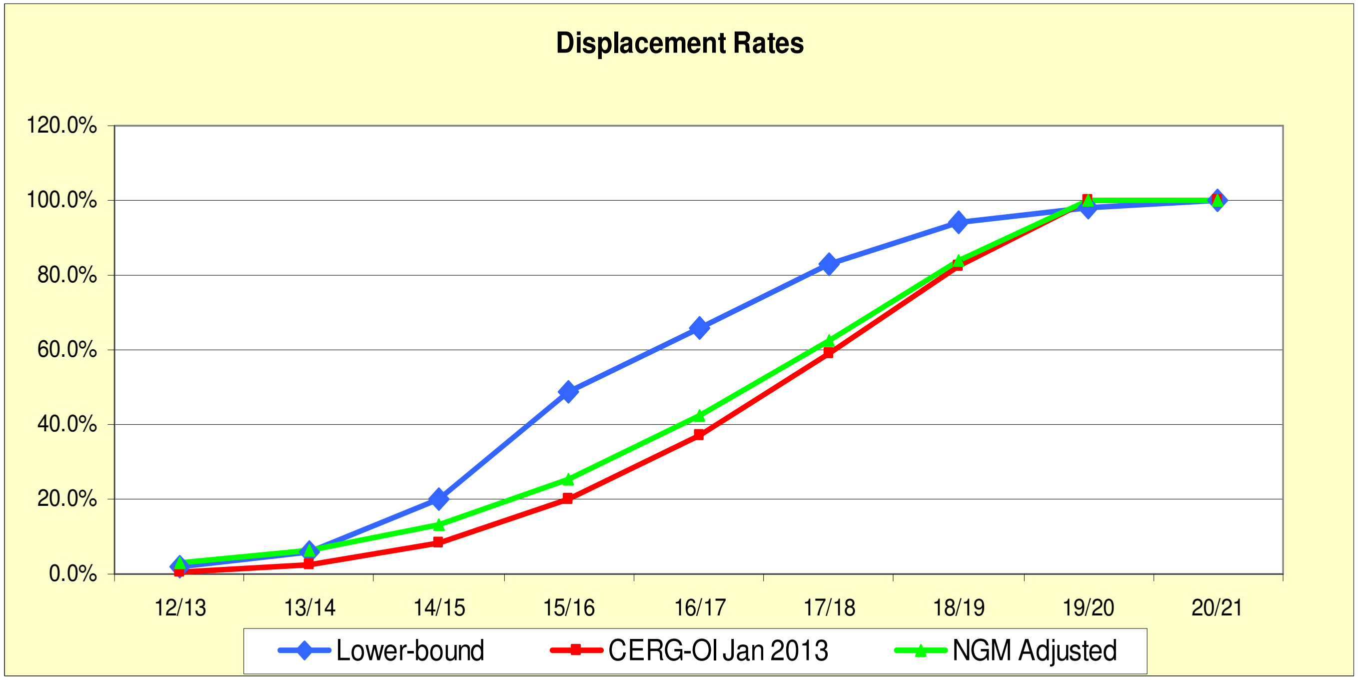
Displacement rate

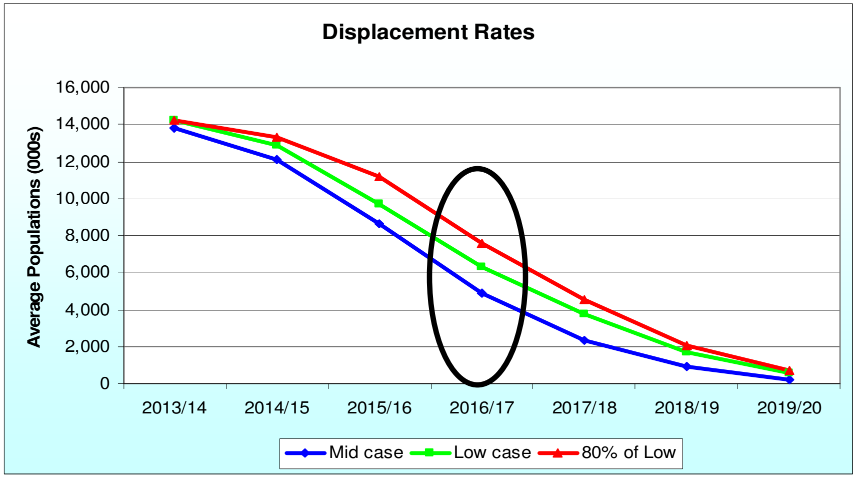


- Final Proposals based on a modification of the CERG-OI profile
- NG displacement may be faster than national average
  - Proportionately older meters
  - Differing early removal charges

Price adjuster

- Initial Proposals included price adjuster triggered by 20% deviation from Lower bound-case

- Assessed at mid-point of roll-out (Dec 2016) from DECC reports based on completed numbers and projections for remaining smart displacement plus actual workload



- Pricing adjuster no longer required because

  - CERG-OI rollout estimates slower in early years – less than 50% of exchanges expected to be completed by 2017/8. Reasonable deviation from projected rate will be difficult to assess until much later in the rollout.

  - Potential for rollout to be faster but Final Proposals absorb this risk

Rate of return and risk element

	Post Tax, Real %
RIIO-GD1 settlement	4.24
Metering risk element	0.18
Total Rate of Return proposed	**4.42%**

- Proposed rate 4.42% - derived from RIIO-GD1 post-tax real rate of 4.24%, with additional risk element

- Risk element of 0.18% reflects uncertainties in PPM displacement and potential impact on back office services of differing Supplier strategies

Element	% Required
PPM displacement slower than DCM	0.15
Displacement rate peaks create additional call and query volumes	0.03
	0.18%

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Post tax treatment

- Final Proposals utilise a post tax, real approach
- Pre tax treatment does not enable Metering to finance its regulated activities, given future tax liabilities and revised displacement rates
- Post tax treatment consistent with RIIO-GD1 settlement
- Ofgem approach to calculating cost of capital in controls since 2003
- Larger business may have benefitted from accelerated capital allowances prior to 1997
  - Metering did not have a separate capital allowance pool until 2005/6
  - Earlier data therefore includes other activities
- Metering capital allowance pool now higher relative to the RAV that in either 1997 or 2001
- Continuation of pre tax approach for Metering after Distribution and Transmission controls switched to post tax in 2006 has already resulted in decreased allowed revenues of around £187m

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RAV Allocation Methodology

Ofgem objectives

Avoid undue discrimination

Promote effective competition in I&C

Facilitate smart roll-out

Stakeholder requirements

Quick to achieve

Link to historic assessment

Pro rata residual RAV

Based on recent costs

Reflects future of Domestic/I&C

Final Proposals utilise Methodology 2

- Meets Ofgem objectives for RAV allocation
- Consistent with stakeholder requirements

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DCM Tariff Cap

Initial Proposals

Final Proposals

Initial Proposals	Final Proposals
Methodology 2	Methodology 2
Dom RAV	Dom RAV
£692m	£677m
I&C RAV	I&C RAV
£187m	£200m
DCM Cap	**DCM Cap**
£16.29	**£15.38**

- Technical asset lives
- Revised displacement profile
- Revised workload, CAPEX and OPEX
- Post tax treatment

2012/13 prices

Summary

Final Proposals cover many stakeholder requirements:

- Facilitation of smart metering roll-out
- Adoption of January 2013 displacement profile
- Pro rata RAV allocation utilising latest costs and evaluations
- Reduction in tariff cap level
- Robust and transparent consultation process
- Secure arrangements for traditional meter populations to 2020

NGM Final Proposals Update

Steve Rowe

Ofgem

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National Grid Final proposals for the regulation of traditional gas metering (RTGM)-key issues

Steve Rowe

21st May 2013

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for all gas and electricity customers

Contents

Introduction

- Ofgem's duties
- Background to the review

Scope

- The new responsibilities that we have created for NGM
- The shape of National Grid's proposals

Key developments

- Pre or post tax
- Capital allowance pool
- National Grid's view
- Ofgem's thought on the key issues

Next Steps

- Timetable
- Key factors
- Decision

Our duties

- Protecting consumers is our **first** priority.
- We do this by **promoting competition**, wherever appropriate, and **regulating the monopoly companies** which run the gas and electricity networks.
- Our strategy for regulating gas metering seeks to deliver these objectives by:
  - a) **introducing regulation** where appropriate
  - b) setting **regulated tariffs**
  - c) creating **competition** for metering services

Background to the review

- Metering separated from gas distribution to create metering competition
- Opening RAV of £1.4 billion for National Grid Metering
- Allocation of RAV used current cost of replacing assets
- National Grid retained domestic meters (c.21 million)
- Newly formed GDNs required to provide meters under the MPOLR and the regulated rate (which was set for Transco)
- Metering business regulated with combination of tariff caps for specific services (domestic) and a non-discrimination condition for other services (I&C)
- Domestic tariff caps set “on the basis of allowed revenue for 2002/03 and 2003/04”

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Ofgem policy proposals July 2012

- Consolidation of gas metering P&M
  - Drives efficiency from scale and scope
  - Single GDN to delver this function
  - Ensure continuity of supply
- Create the concept of a National Metering Manager
  - Offer B-MPOLR to GDNs
  - Provision of meters up until mass rollout
  - Maintenance until 2019
  - Domestic meters at a regulated rate
- Review of metering tariffs
  - Price tariff consultation – domestic meters
  - Led by National Grid
  - Scope and Scrutiny of Ofgem

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Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

Policy decision

Reference:	100/12	**Contact:**	Steve Rowe
Publication date:	25 July 2012	**Team:**	Smarter Markets
Response deadline:	5 September 2012	**Tel:**	020 7901 7486
		Email:	steve.rowe@ofgem.gov.uk

Overview:

In December 2011 we completed our consultation on the Review of Metering Arrangements (ROMA) and also consulted on our proposed changes to the regulatory framework for gas traditional metering to facilitate an efficient transition to smart meters. We are now confirming plans to proceed with our preferred approach to a) place an obligation on National Grid to offer terms to provide metering services to other GDNs in certain circumstances and b) to initiate a process to review, and if necessary amend, the associated regulated metering tariffs.

These plans relate to the regulation of certain 'traditional' gas meters, ie the meters that will be replaced over time by smart meters. It therefore complements the work of the Department of Energy and Climate Change (DECC) Smart Meter Implementation Programme (SMIP), and the work of Ofgem in developing the regulatory framework for early, voluntary rollout of smart meters by some energy suppliers.

Ofgem/Ofgem E-Serve 9 Millbank, London SW1P 3GE www.ofgem.gov.uk

The proposals

- National Grid accepted our invitation (August 2012)
  - Operate the B-MPOLR & NMM
  - Consult on price tariff
  - Consulted on approach for engagement
  - Consulted on Initial proposals (February 2013)
  - Scrutiny of Ofgem

- National Grid is finalising their Final Proposals
  - Business planning assumptions
  - Costs base
  - New functions
  - Set out approach to RAV allocation
  - Used CERG-OI for rollout profile
  - ROR
  - Moving from pre to post tax approach
  - Plan to issue and open letter in respect of I&C metering strategy
  - Tariff implies a reduction in domestic tariffs of £0.91 / meter / year (subject to annual adjustment to WACC and RPI)

Allowing for tax in price controls

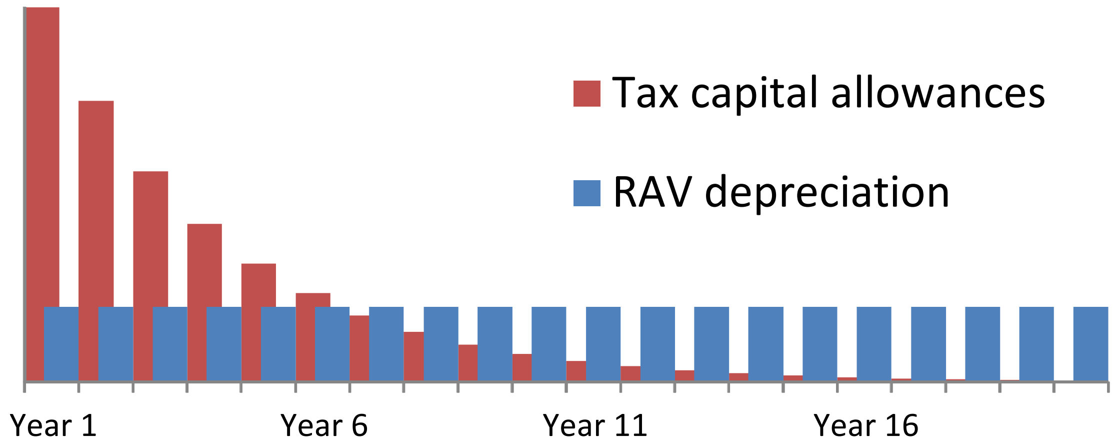
- Up to the Transco 2002 review, when metering tariffs were last reviewed, Ofgem adopted a 'pre-tax' method for allowing for tax costs: using the mainstream rate of tax rather then the effective (actual) rate
- This approach probably did not have the status of 'policy'

  "Ofgem is currently minded to use the mainstream rate, rather than the actual rate. However, it is for consideration which approach produces an appropriate amount of cash to meet the corporation tax liabilities associated with Transco's business." Ofgem, June 2001

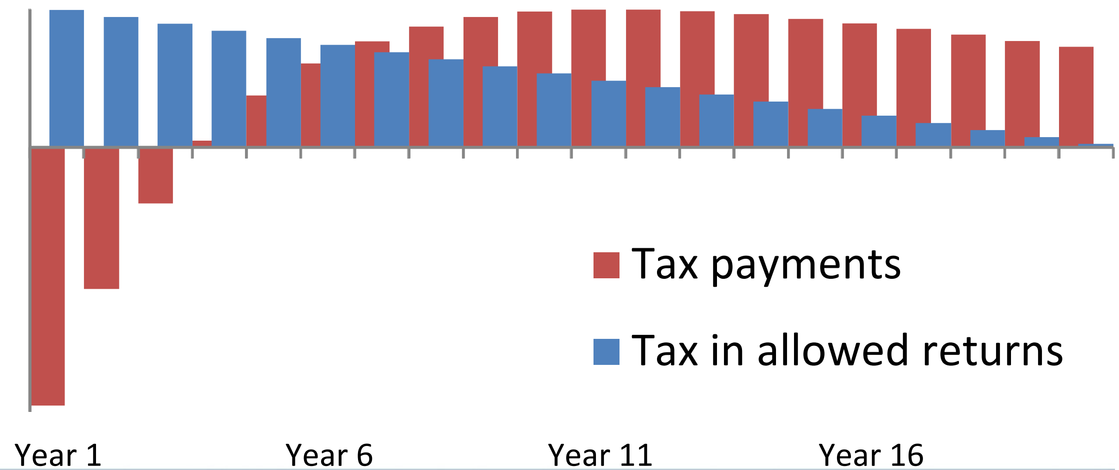
- Ofgem has used a post-tax method since 2002 for network controls, providing revenues to cover actual tax, i.e. effective rate
- National Grid proposes a post-tax method for metering.
- Is it fair and appropriate?

Allowances for tax: pre-tax approach

- Depreciation vs.
  tax capital allowances



- Tax in allowed returns vs.
  tax payments



Tax since 2002

- NG's assets are significantly weighted towards older assets, so capital allowances have been relatively low for some years
- NG calculate that it has paid some £137 million of tax in excess of mainstream rate tax provided for in the 2002 Transco review since 2007
- Revenues to conclusion of smart meter rollout implies further estimated £132 million of tax payments in excess of mainstream rate

Tax before 2002

- Identifying metering portion of tax position pre-2002 not possible
- But MAR depreciation after privatisation indicates some benefit accrued to the company
- We are considering the value of benefit paid since 2002

Conclusion on tax

- NG calculate that they will have to pay substantial tax on metering profits through to 2020, substantially above mainstream corporation tax rate
- Pre-tax method adjusts cost of equity to reflect corporation tax
- Post-tax method recognises this additional tax cost for the company as a separate cost
- Post tax method is consistent with policy at last review
- We are examining the extent to which NG has benefitted since privatisation

Next steps

- NG to consider stakeholder views on the key issues that have changed since their IP
- NG to reflect on stakeholder views and finalise proposals
- Submit to Ofgem for consideration
- Ofgem consider proposals
  - Consider settlement in the round, key issues are:
  - RAV allocation between domestic and I&C metering
  - Smart metering rollout profile / progress
  - Approach to treatment of tax
  - Policy approach for iDNs

- Aiming to publish our decision in the summer ofgem

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Q & A

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Completing the process

- Keen to hear stakeholder opinion of Final Proposals, particularly regarding areas which differ from Initial Proposals:
  - **Revised displacement rates**
  - **Amendments to B-MPoLR and NMM**
  - **Rate of return and post tax treatment**
- Responses to be submitted to our mail box account by **Friday 7th June**

ngm.priceconsult@nationalgrid.com

- Expect to publish Final Proposals in June 2013

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Lunch