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NGM Pricing Consultation



Stakeholder Forum

07 February 2013

Holiday Inn Birmingham Airport

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National Grid Metering

Pricing Consultation Stakeholder Forum

Thursday 07 February 2013

Agenda

Welcome and Introductions	10:00 – 10:05	Abby Cardall
NGM Initial proposals	10:05 – 10:45	Eric Fowler
Q & A session	10:45 – 11.15	All

Break

Ofgem Policy Decisions & view of NGM Initial Proposals	11:45 - 12:25	Steve Rowe
Q & A session	12:25 – 12:55	All
Completing The Process	12:55 – 13:00	Abby Cardall

Lunch & Close

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NGM Initial Proposals

Eric Fowler
National Grid Metering

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Pricing Consultation - Areas of Treatment

1. Positioning our Domestic and I&C businesses

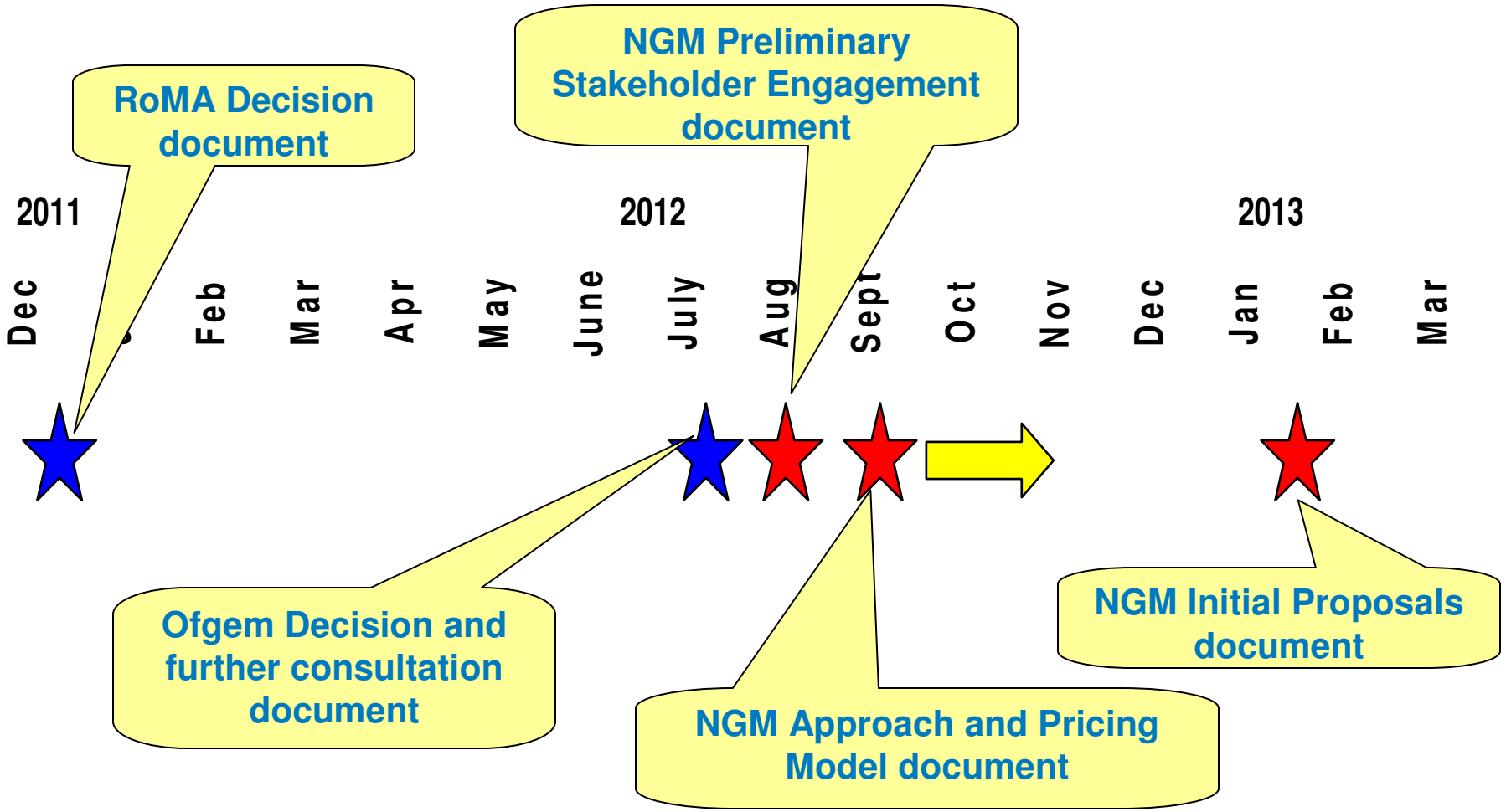
2. Duration of B-MPOLR and NMM obligations and any pricing periods

3. Traditional meter displacement rates

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

5. RAV assessment and rate of return

Activities to date



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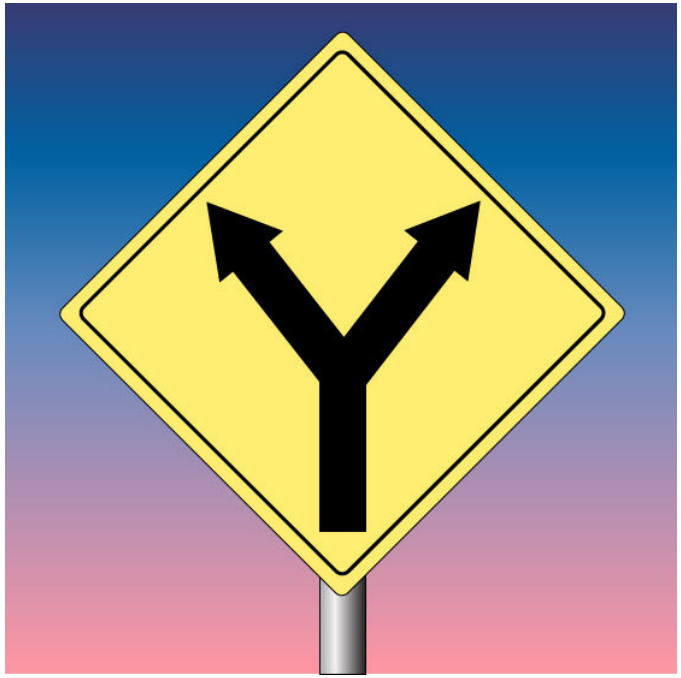
1. Regulation and I&C market

Approach document:

- Active, competitive market which drives services
- Differing path to Domestic to meet smart criteria
- Regulatory controls beyond competition law no longer necessary



Feedback:

- NG portfolio dominance remains an issue
- Competition acknowledged but not yet sufficiently widespread
- Greater regulatory oversight unwelcome
- Variation in estimates of market sector size

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1. Regulation and I&C market

Initial proposals

- Accept existing regulatory controls continue “as is”
- However, market is in transition and its value is changing:
  - AMR, new service requirements and offerings

Open letter to Ofgem to:

- Define the market
- Establish the size of the non-domestic market to determine true market share
- Determine how/when regulation could be lifted
  - market forces
  - specific criteria
  - timing

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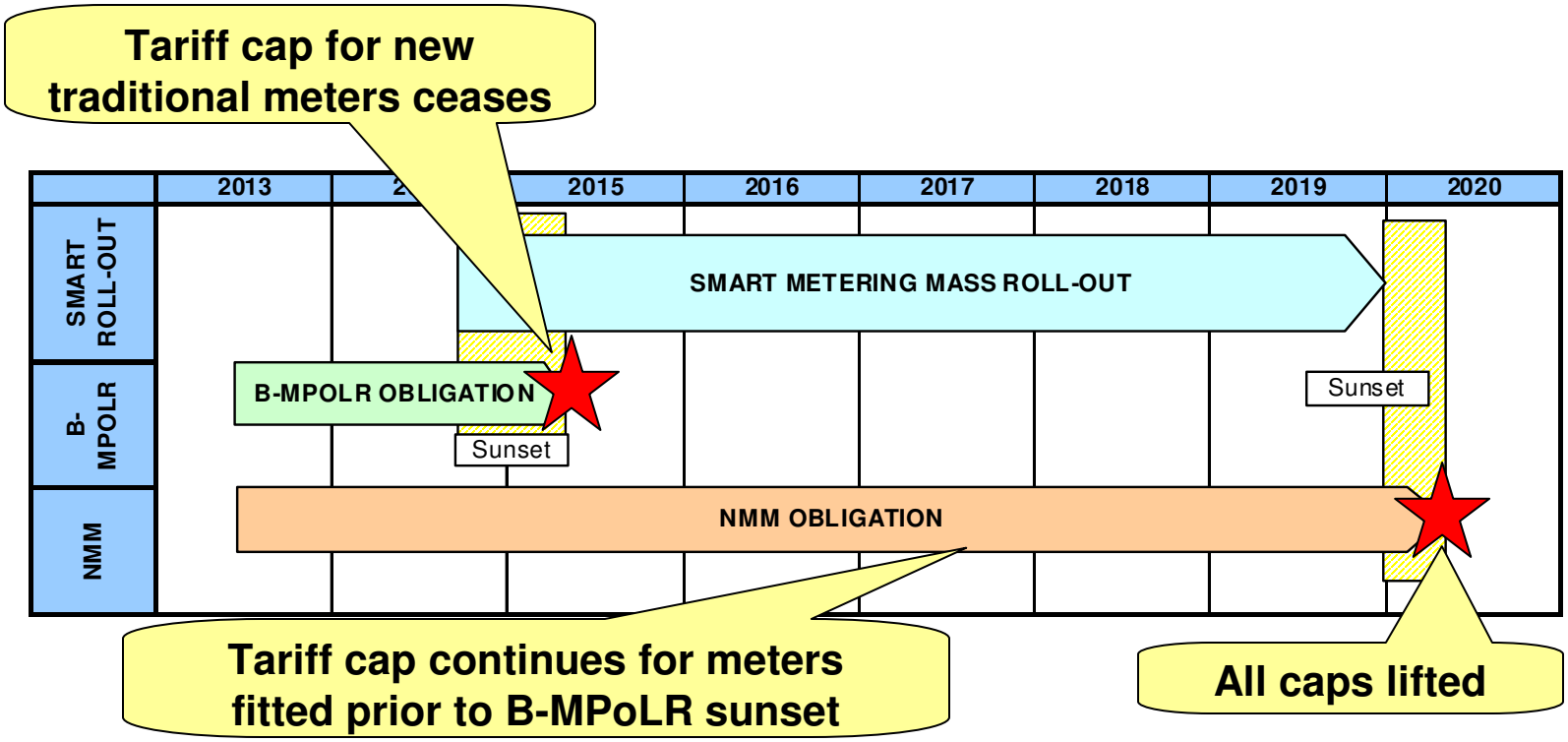
2. B-MPoLR & NMM



- B-MPOLR and NMM obligations for traditional meters only
- Tied to smart roll-out key events – any slippage in these assumed to impact obligations such that linkages remain

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2. Asset Transfer

- Stakeholder concern regarding eligibility
- Potential for “gaming” through partial portfolio transfers and unconstrained duration for transfers
- Uncertainty caused by ongoing discussions regarding universal application of tariff caps

Initial Proposals

- Open to all but bounded by duration of B-MPOLR obligation
- Mechanism to agree transfer value
  - Technical criteria (make, model, age, location, etc)
  - Estimated future cash flows prior to displacement based on present value
  - Assets provided under existing MSA or P&M contracts

2. PEMS

- Extent of PEMS requests are largely dependent on start date of smart mandate & supplier readiness to install smart meters
  - Meters adopted by NMM to be offered under NGM's existing contracts (MSA or P&M)
  - Uncertainty over number of meters likely to require adoption
- NGG intend to continue to offer PEMS under commercial terms but for traditional meters only
- Supplier remains free to choose who to dispatch to undertake work

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2. Tariff Caps & Cross-Subsidy

	Cross-subsidy retained	Cross-subsidy unwound
DCM tariff cap	**£17.02**	**£14.29**
PPM tariff cap	**£37.49**	**£57.27**

Methodology 3 and RoR 6.5%

Continue to propose that caps and cross-subsidy remain in place:

- Provides pricing stability
- Some desire for more cost-reflective charges but unwinding cross-subsidy results in significant PPM price increase – likely to result in considerable challenge
- Risk of later PPM displacement in roll-out
- Redistributive effect on participants with different ratios of PPMs

3. Dealing with Uncertainty

- Possible variations in smart timeline
  - Start data and duration of obligations
  - Likely volumes of MPOLR & B-MPOLR fits and requests to undertake asset transfers
- Traditional meter displacement rates
  - Technical and operational challenges (DCC implementation, “dark” metering, etc)
  - Risk of delayed PPM displacement
  - Potential for greater volumes of installation and maintenance work
- Ongoing consultation on implementation and exemptions

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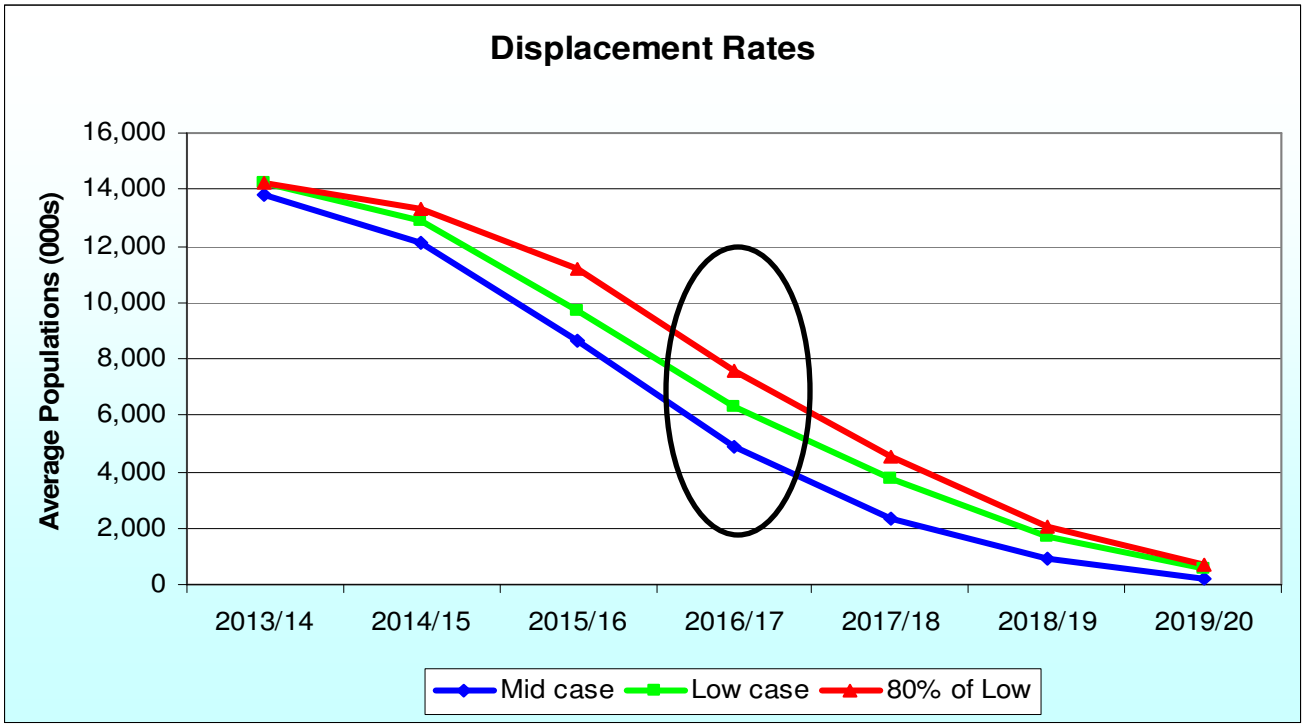
3. Displacement rate

- Use of DECC Lower bound-case generally accepted
- Feedback that roll-out could be slower or back-loaded…but largest NGM portfolio holder disagreed
- DCC PPM service availability questioned – view that DCM displacement will be earlier
- Stakeholder concern that slower smart displacement rate could result in over-recovery
  - Desire for a mechanism to review displacement rates and tariff caps

% Meters Installed	DECC Low bound
Dec 2016	49%
Dec 2017	66%
Dec 2018	83%
Dec 2019	94%
Dec 2020	98%

3. Price adjuster



- Triggered by 20% deviation from Lower bound-case
- Assessed at mid-point of roll-out (Dec 2016) from DECC reports

- Recalculation based on completed numbers and projected rate for smart completion plus actual workload undertaken (reflecting additional CAPEX and costs)
- Any unused risk element relating to roll-out pace returned

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4. Meter maintenance

- Current modelling of activity and cost based on current ratios to installed asset base projected forward against Lower-bound case
- Unknown volumes of PEMS adoptions and asset transfers under NMM obligation
- Risk that PPM displacement may be back-loaded, resulting in larger maintenance volumes for longer, impacting on workloads and operating costs –
  - Currently addressed via rate of return and risk element
  - Potential to review PPM displacement rates as part of pricing adjuster (2016/17)

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4. Workloads / Other Services

- Customer-requested work expected to decline up to 2015, then cease altogether
- PME volumes expected to follow a similar pattern
- Volumes modelled against Lower bound-case progress and resulting NG portfolio – assumes the same ratios as currently
- 24/7 contact centre, complaint and query handling services valued – clear requirement for existing standards to be maintained
  - As Is level of service to be maintained
  - Potential for mass roll-out to create additional contacts (both customer and consumer) – uncertainty addressed through rate of return risk element

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5. Rate of return and risk element

- Proposed rate derived from RIIO-GD1 proposed post-tax real rate of 4.8% *
- Consistent with Ofgem Decision doc (July '12) but contrary to stakeholder suggestion of independent consultant's view
- Includes risk element of 0.72% largely due to uncertainties surrounding the smart roll-out
- Final pricing proposals will align with RIIO, once agreed

	Pre-Tax Real %
RIIO GD1 Proposal	**5.77**
Metering Risk	**0.72**
RoR Proposed	**6.5%**

Element	% Required
Displacement faster than Low bound-case	**0.51**
PPM displacement slower than DCM	**0.18**
Displacement rate peaks create additional call and query volumes	**0.03**
	0.72%

* Ofgem RIIO Final Proposal - 4.2% (post-tax).

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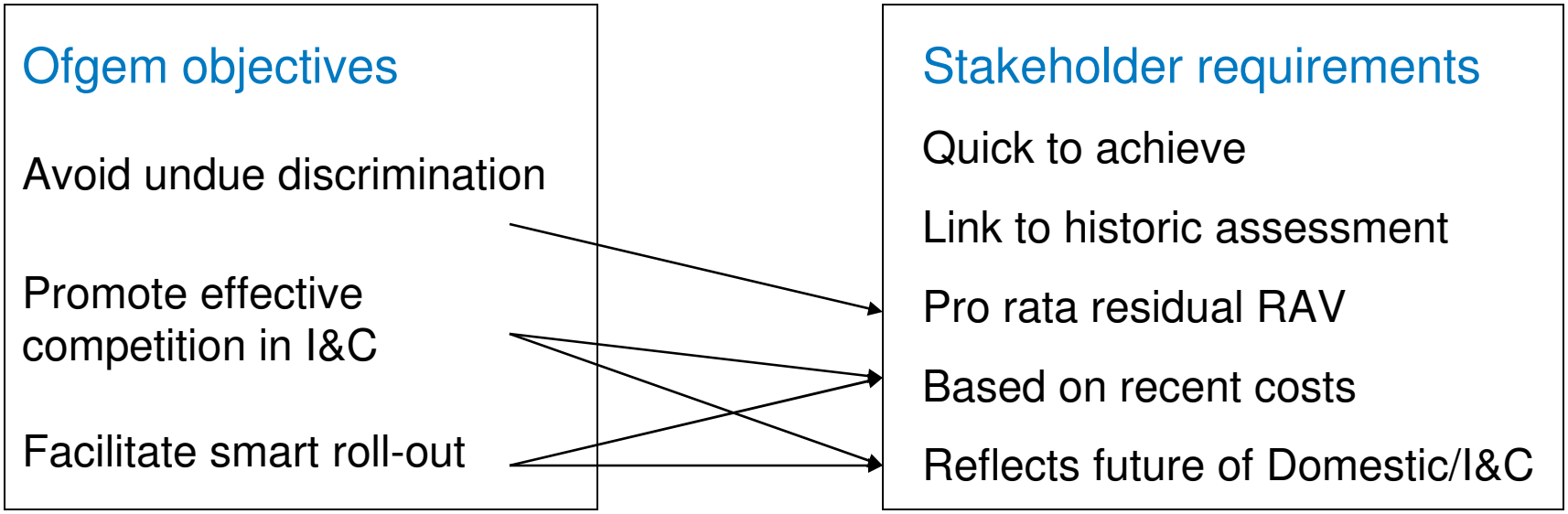
5. RAV Allocation Methodology



Five candidate methodologies proposed:

- M 1 – discounted by all stakeholders
- M 2 - basis for Initial Proposals, consistent with majority of stakeholder requirements
- M 3 – basis for Approach and Pricing Model, consistent with stakeholder requirements and previous regulatory treatment
- M 4 - assesses I&C RAV and leaves residual in Domestic. Not pro rata RAV
- M 5 - assesses I&C RAV and leaves residual in Domestic. Subjective and not pro rata RAV

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5. RAV Allocation Methodology

Stakeholder Requirement	RAV Allocation Methodology			
	2	3	4	5
Quick to achieve	✗	✓	✗	✗
Retains link to historic assessment	✗	✓	✗	✗
Pro rata of residual RAV	✓	✓	✗	✗
Based on most recent costs	✓	✗	✓	✓
Reflects future divergence of Domestic and I&C	✓	✗	✗	✓

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5. RAV Allocation Methodology

- Methodologies 2, 3 and 5 meet Ofgem objectives and the majority of stakeholder requirements
- Considered each against:
  - Low-bound case displacement rate
  - Projected OPEX / CAPEX requirements and workloads linked to resulting meter populations
  - Projected future income
  - Applied 6.5% RoR

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Initial proposal

Methodology 2	Methodology 3	Methodology 5
Dom RAV	Dom RAV	Dom RAV
£692m	£714m	£655m - £713m
I&C RAV	I&C RAV	I&C RAV
£187m	£165m	£166m - £224m
DCM Cap	**DCM Cap**	**DCM Cap**
£16.29	**£17.02**	**£15.03 - £17.00**

Summary

- National Grid Metering Initial Proposals issued 30th January 2013
- Stakeholders to provide feedback by 22nd February 2013

- Ongoing discussions with Ofgem on:
  - Technical asset lives
  - Asset transfer duration
  - RAV allocation methodology
  - Final rate of return

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Break

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for all gas and electricity customers

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

Steve Rowe

7th February 2012

Setting the scene

Introduction
- Ofgem's duties
- Background to the review

Scope
- The new responsibilities that we have created for NGM
- The scope of the review

Policy
- Our reaction to the National Grid Initial Proposals
  - Policy proposals
  - RAV allocation
  - Impact on tariffs
  - Sensitivities

Next Steps
- Questions that our analysis raises
- Progress / timetable

Our duties

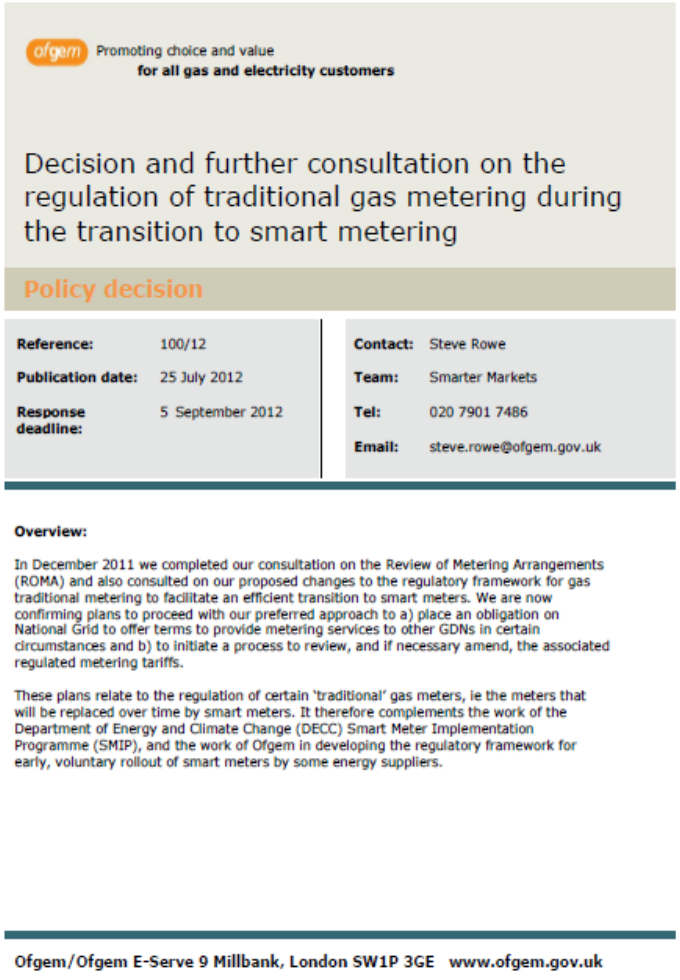
- Protecting consumers is our **first** priority.
- We do this by **promoting competition**, wherever appropriate, and **regulating the monopoly companies** which run the gas and electricity networks.
- Our strategy for regulating gas metering seeks to deliver these objectives by:
  - a) **introducing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

Context - RTGM

- 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"

Our policy proposals – RTGM

- 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.

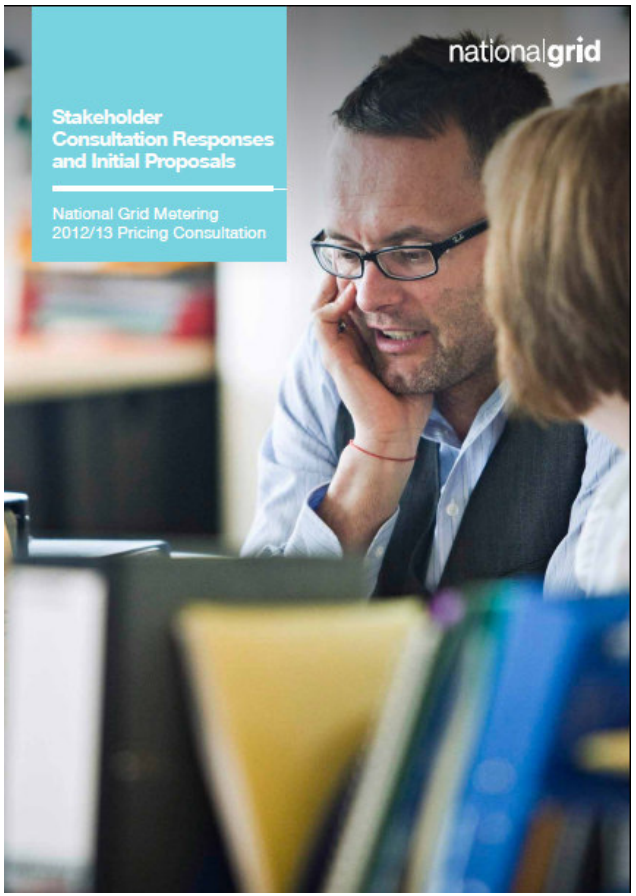
Ofgem/Ofgem E-Serve 9 Millbank, London SW1P 3GE www.ofgem.gov.uk

Developing the proposals

- National Grid accepted our invitation (August 2012)
  - Operate the B-MPOLR & NMM
  - Consult on price tariff
  - Consulted on approach for engagement

- Developing the proposals
  - Business planning assumptions
  - Set out approach to RAV allocation
  - Costs base
  - ROR
  - I&C metering strategy
  - Implication for tariffs

National Grid published their Initial Proposals January 2012



Initial Proposals – Summary (1)

- **MPOLR**: applicable to traditional meters only for defined period. Commence in Quarter 3 of 2013, with the B-MPOLR obligation falling away at the start of the mass roll-out of smart meters

- **NMM**: will remain in place for the duration of the roll-out, with the sunset for this obligation linked to the end-date, rather than the start-date

- **Asset Transfer**: **c**ommercial basis through a transparent and non-discriminatory process. Open to all meter operators, with the asset transfer value on the present value of expected future cash flows from the meters being transferred

Initial Proposals – Summary (2)

- **Uncertainty mechanism:** triggered by a 20% negative deviation from the smart installation cumulative completion rate as detailed in the DECC Lower-bound case. It would be triggered during 2016/17, with any resulting changes applied from April 2017, this would result in the tariffs being reduced

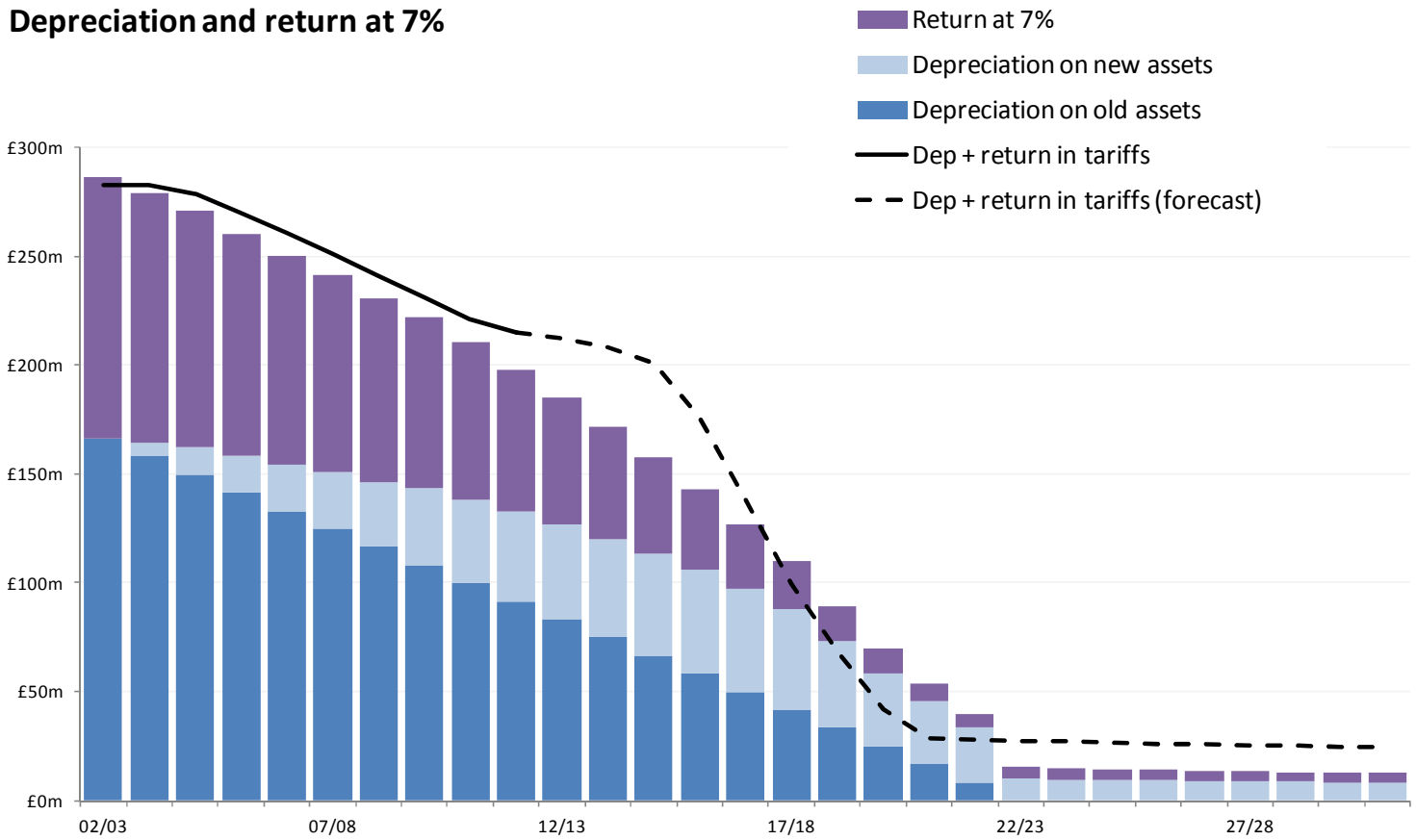
- **Risk premium:** seeks to address three main risks 1) accelerated rollout, 2) PPM displacement and 3) additional costs, query / callout. (0.72%)

- **Rate of return:** tracks WACC as defined in RIIO-GD1 final proposals, 4.2% vanilla*

*The vanilla WACC consists of pre-tax cost of debt and post-tax cost of equity, weighted by a notional gearing i.e. the relative share of debt) assumption.

RIIO-GD1 final proposals - http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/1_RIIOGD1_FP_overview_dec12.pdf
Review of Transco's Price Control from 2002 Final Proposalshttp://www.ofgem.gov.uk/Networks/Trans/Archive/Transco/Documents1/325-26sep01_pub1.pdf

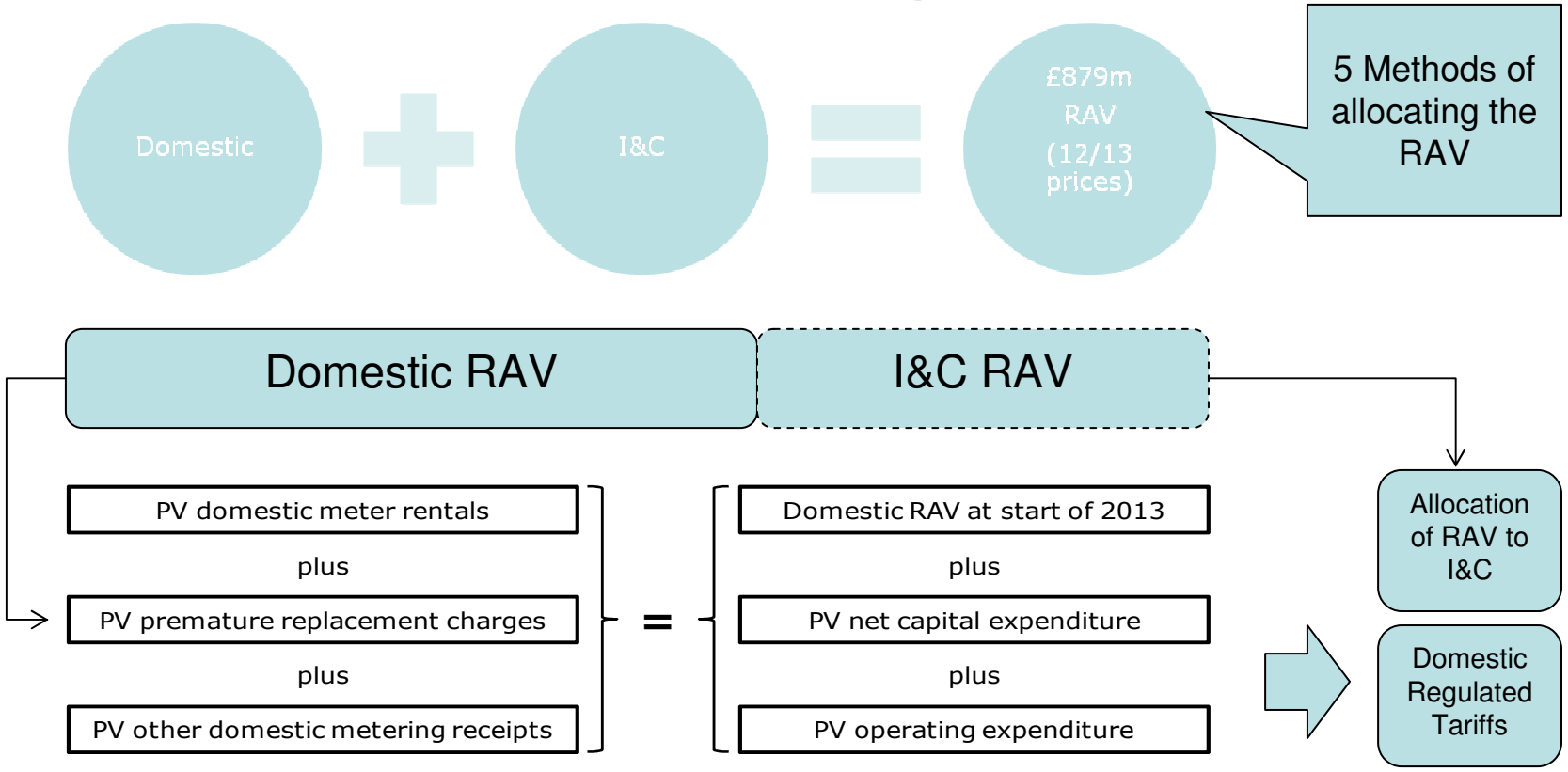
Total portfolio: Depreciation profile for supported market share losses



Source: NGM model, with no adjustment to depreciation for premature termination, Ofgem extrapolation, RPI 09/10 prices

* The depreciation profile provided for in the modelling for the 2001 Final Proposals; black lines = meter populations x average depreciation + return for 02/03 & 03/04

Approach to reviewing the tariffs



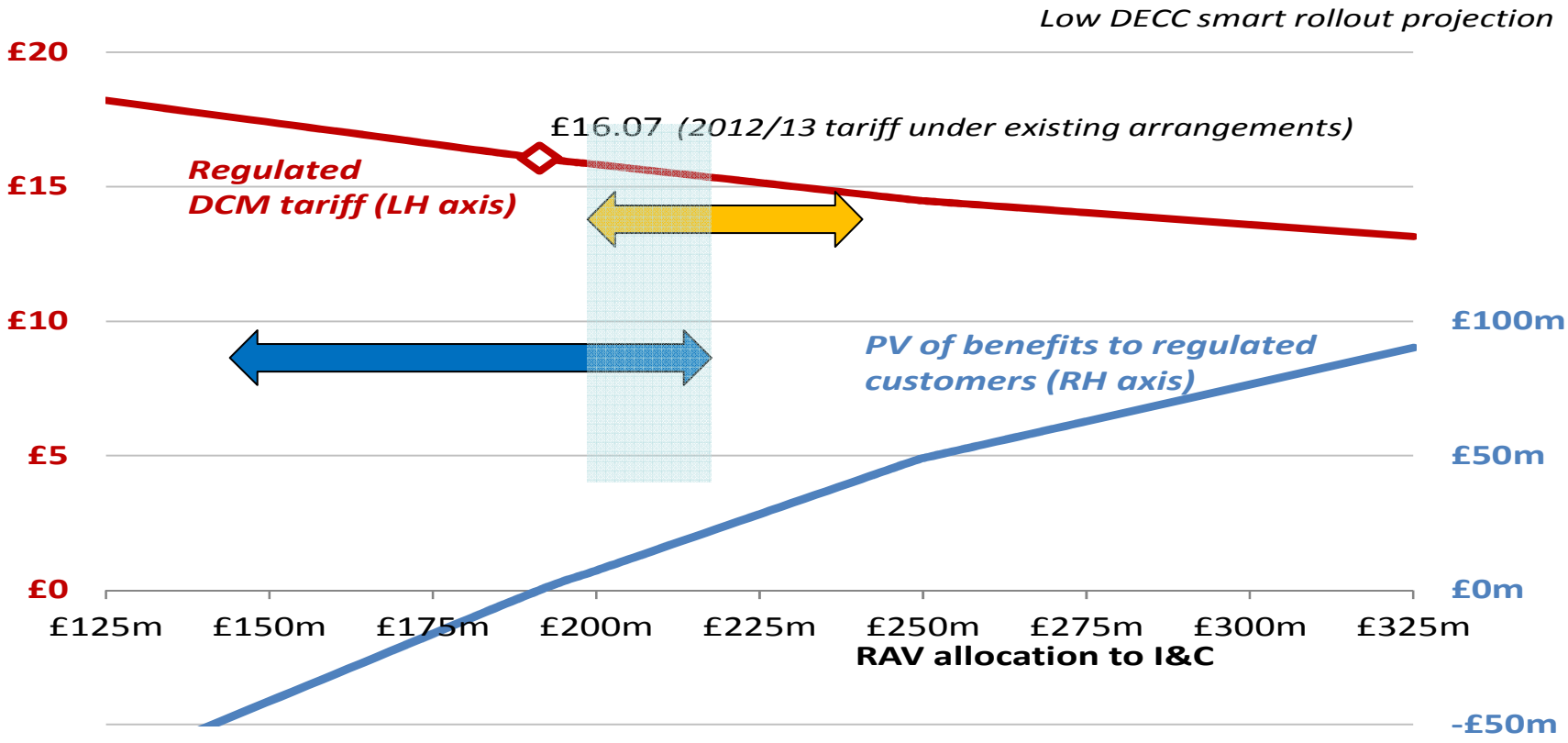
1. Avoidance of undue discrimination between domestic and I&C customers;
2. Promotion of effective competition in the I&C market; and
3. Facilitation of smart meter rollout programme

NG Initial Proposals - RAV allocation

- **Method 1**: preserves the current relationship between tariffs for domestic and I&C metering services
- **Method 2 :** - pro rata portfolio depreciated replacement costs. Domestic £692m I&C £187m Tariff £16.29*
- **Method 3** : - Rolled forward based upon 2002 metering RAV and depreciated replacement cost values of the domestic and I&C assets in 2002. Domestic 714 I&C 165 Tariff £17.02*
- **Method 4** : - depreciated replacement costs I&C, residual with Domestic £741m I&C £138m Tariff £17.94*
- **Method 5** : - Fair valuation of I&C. Domestic 655 to 713 I&C 166 to 224 Tariff £ 15.03 to 17.00*

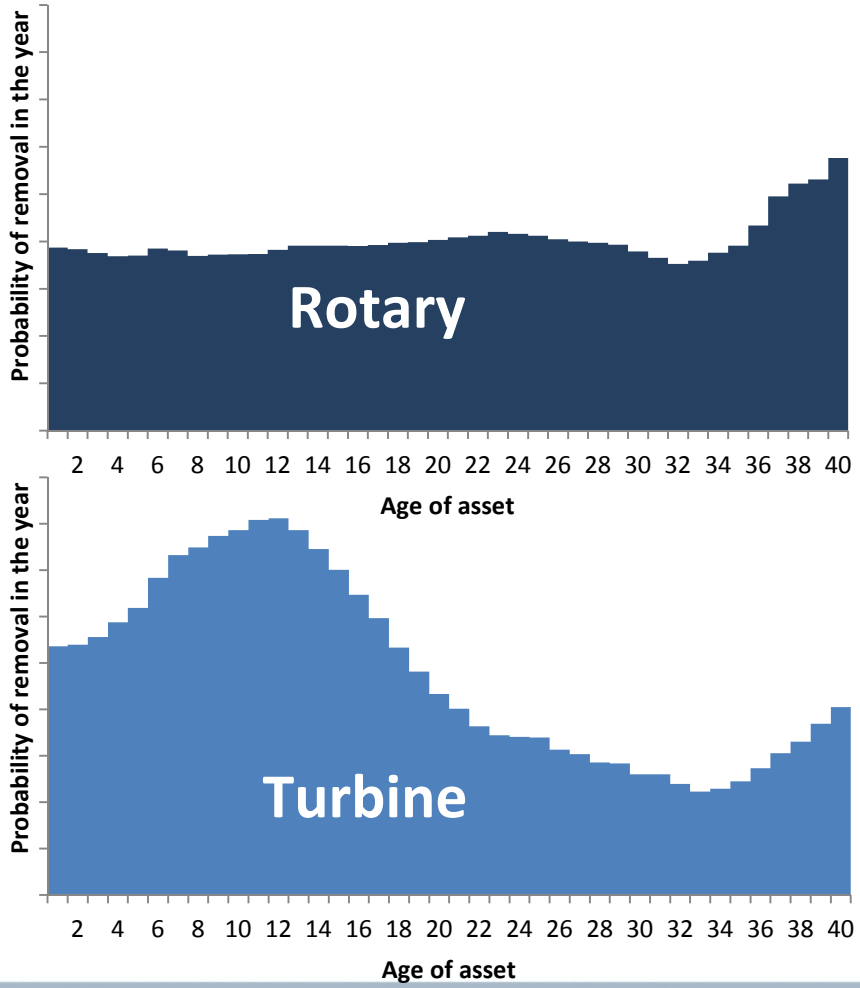
* NG has calculated tariff rates on 7% rate of return – the new WACC will be incorporated into the FP

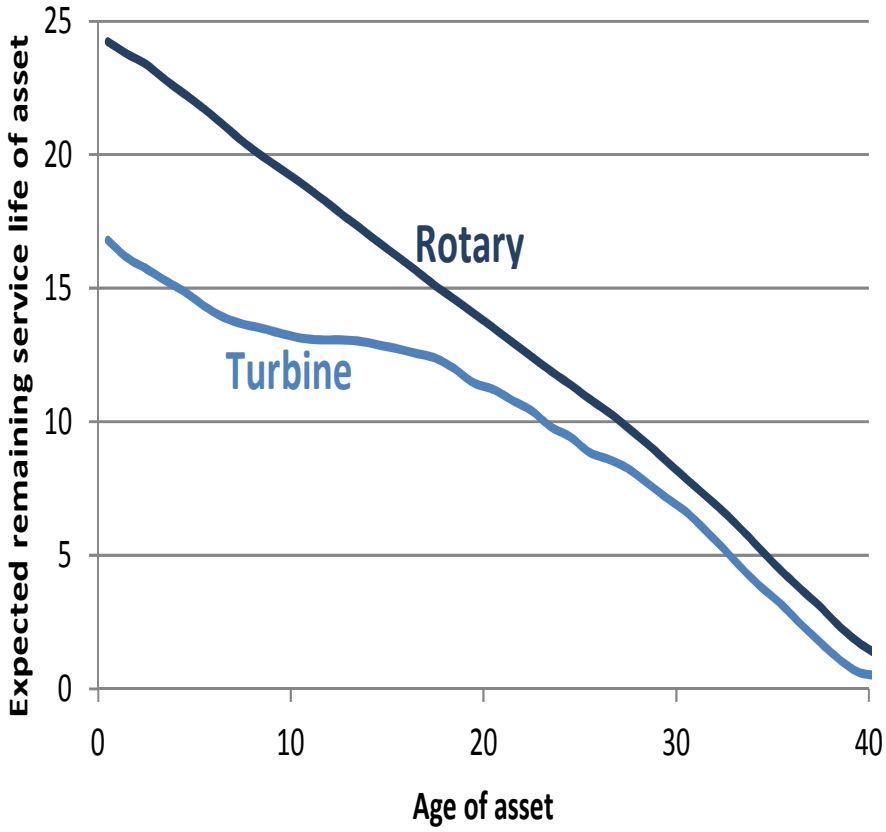
Impact of RAV on domestic tariffs



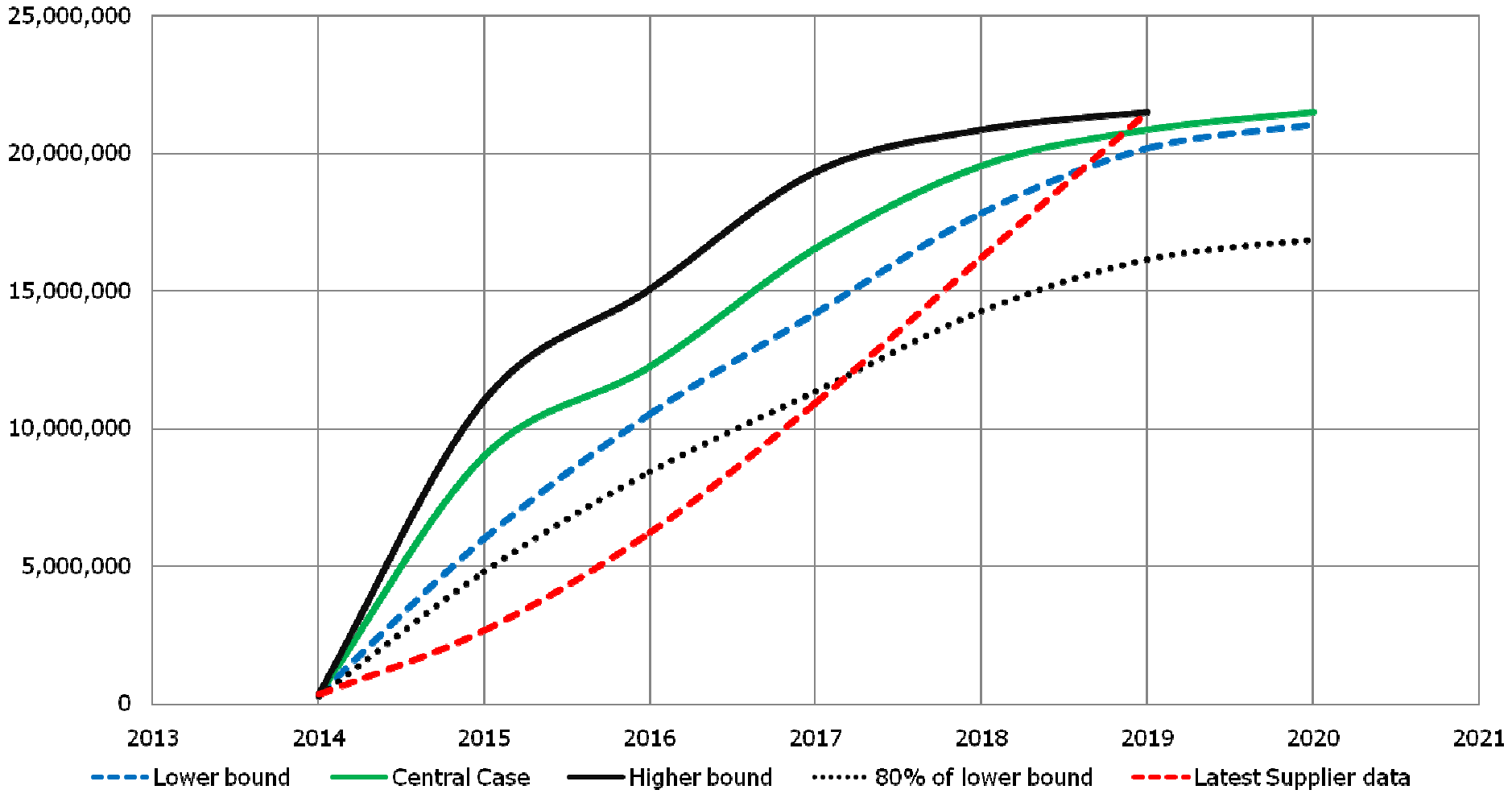
***RAV allocations are sensitive to:**
Asset age assumptions & Depreciation method – we will continue to consider this with NGM

Impact of asset Life





Rollout profile



Key questions that this raises

1. Which approach to allocation of the RAV do you consider best meets the relevant objectives?
2. What do you consider is an appropriate approach to establishing asset life?
3. Welcome your views on whether it is appropriate to treat replacement costs (current replacement Vs historical) differently between domestic and I&C meters
4. Based upon the latest information, which rollout profile do you consider should be used for the purpose of modelling
5. Do you consider that NG's approach strikes the right balance between protecting domestic / I&C consumer groups

Next Steps

- National Grid to provide further analysis to Ofgem on assessment of asset life
- Ofgem to consider whether the tariffs should apply universally
- National Grid to consider responses to their Initial Proposals consultation
- Submit Final Proposal to Ofgem in March
- Ofgem decision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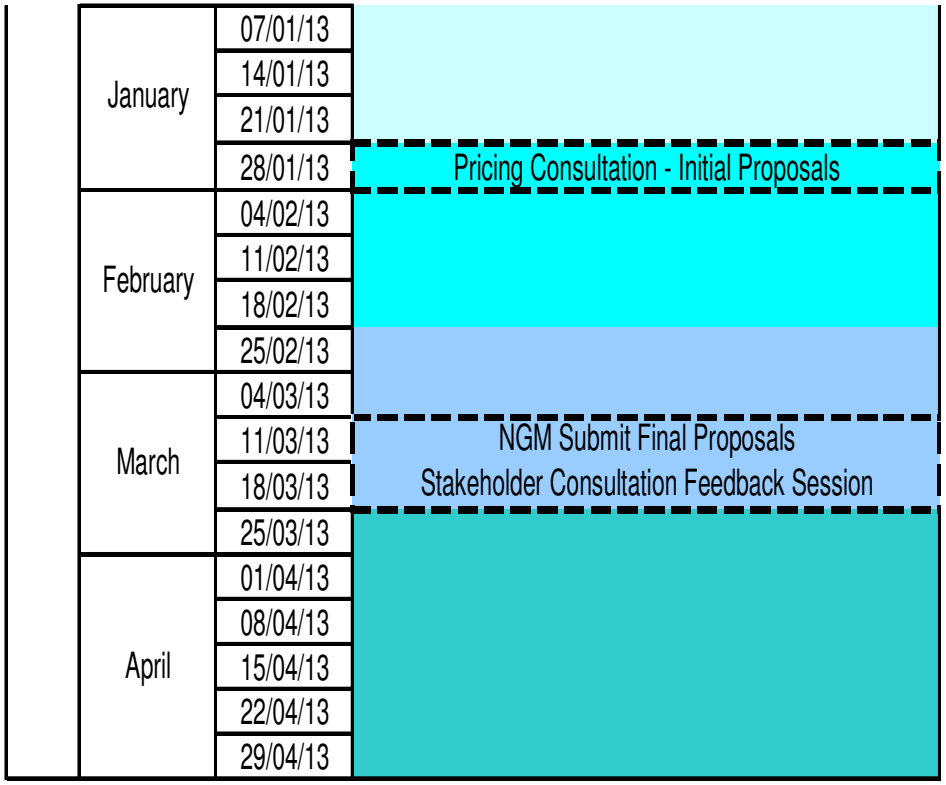
Completing the process



- Responses to Initial Proposals required by **Friday 22nd Feb**
- Aiming to submit Final Proposals to Ofgem in March 2013
- Ofgem consultation and subsequent licence changes follow
- Now expect B-MPoLR and NMM obligations to go live in December 2013

Lunch