

Chapter 12

Efficient and affordable

I want you to be
efficient and affordable

**Gas
Transmission**

nationalgrid

12. I want you to be efficient and affordable

Summary

National Grid Gas Transmission delivers an essential service across Great Britain. One of our key priorities is keeping energy affordable. We strive to keep our impact on domestic and industrial consumer bills low and we work with our customers to keep energy affordable.

The services we provide add about £9¹ to the annual average domestic energy bill. In a time of rising energy bills, it is vital that we play our part in keeping costs down for all consumers, especially those who are vulnerable. Overall, we will continue to focus on carrying out our activities as efficiently as possible for the benefit of end-consumers.

We apply this principle across all our business activities and it informs how we will meet our stakeholder priorities.

What our stakeholders tell us

Stakeholders tell us that we have a part to play in keeping energy affordable for domestic and commercial consumers. They expect us to manage costs and risk in the interest of our direct customers and wider consumers.

We invest to make sure that our network provides the service that our stakeholders need and expect. Stakeholders see us as the experts managing the gas transmission system. They are also clear that we must do this economically and efficiently. More broadly, stakeholders want us to build both transparency and trust.

Direct stakeholder feedback:

"All the consumer cares about is the impact on their bill and security of supply."

"I don't know if we have the right to say the price is expensive or not, at the end of the day it comes down to trust."

Consumers care about keeping their energy bills affordable. They see energy networks as dependable. This reflects well on how we have managed risk on consumers' behalf in the past. We must continue to do so in future.

Our activities and current performance

The existing RIIO framework includes the 'totex incentive mechanism'. This gives us a strong incentive to deliver target outcomes as efficiently as possible. We must achieve these outcomes within cost allowances set by Ofgem. However, we must not cut costs at the expense of customer service.

To make our performance transparent, we publish annual information on the outputs and forecast spend against our allowances.

Throughout RIIO-1, our outputs were strong across all the categories. To continue to deliver a safe and reliable network in RIIO-1 we have been investing more in our asset health and our asset management capabilities. This is vital in managing safety and the reliability risks of ageing assets. It is also in the longer-term interests of consumers.

'Uncertainty Mechanisms' are used to adjust our scope of work and allowances when circumstances change. In some cases, previously expected work has been deferred or is no longer needed.

In other cases, extra work has been added compared with the original baseline. Examples include upgrading the physical security of our sites and replacing a crucial section of pipeline beneath the river Humber.

Ofgem has scrutinised these changes to ensure they are in consumers' interests and that the additional costs are appropriate.

We are engaging with Ofgem and our stakeholders to ensure there remains a strong totex incentive mechanism in RIIO-2. In our view this should include the right use of uncertainty mechanisms to safeguard both investor and consumer interests.

¹ Illustration based upon analysis of the average 2016/17 consumer bill, using Ofgem methodology.

Our direction of travel

Demonstrating efficiency and value for money in our plan

It is our responsibility to show how we are carrying out our activities at the right cost for consumers, providing value for money to all energy users. Many of the approaches, methods and models we use will be agreed with Ofgem.

We expect to prove value for money in our RIIO-2 business plan in several ways:

- We will listen to our stakeholders and take account of their views on where and how they think we could be more efficient.
- We will build in to 'business as usual' the cost efficiencies we have already achieved. This will ensure that consumers can continue to benefit.
- We will benchmark our asset unit costs against our historical and current costs. We'll include improvements that we are achieving over time. We will also compare our asset unit costs with evidence from independent experts. This will highlight where there is room for improvement.
- We will benchmark our business support expenditure against other organisations. This includes what we spend on human resources, finance, IT, regulatory compliance, procurement, insurance and property management.
- Where possible, we will continue to market test much of our spending through competitive tendering. This means we can test the market for the latest techniques and prices to achieve the best outcomes for consumers.
- We will carry out cost benefit analysis (CBA) and share what we find to explain our proposed spending plans. We want to be transparent about the alternative options we have considered and how we have maximised the benefits for consumers. For key areas of our plan, we aim to explore with stakeholders the merits of options such as different target levels for network reliability.
- We will show how we have optimised asset and non-asset solutions to meet consumer outcomes effectively. Asset solutions are where we install new assets or alter existing assets. Non-asset solutions are where we look to put in place commercial arrangements or change regulations.

Stakeholder challenge of our plan

Our goal is to deliver a truly stakeholder-led plan that delivers what our stakeholders want at an acceptable cost.

The stakeholder engagement process requires us to develop an overall package for RIIO-2 that reflects our stakeholders' views and represents value for money. The work we're doing will be reviewed by the [Stakeholder Group](#) and Ofgem's [Challenge Group](#).

Is our plan acceptable to customers and consumers?

We plan to survey domestic and commercial consumers on their willingness to pay e.g. for alternative service levels, such as reducing the risk of interruptions to gas supplies, that we could target in our RIIO-2 plan. This will better inform us about how much consumers value elements of what we do. We are also planning to survey consumers on whether they find our overall draft plan meets their needs. We will do this when we are closer to submitting our draft plan to Ofgem's Challenge Group.

Stakeholders tell us that volatility in our charges to direct customers could have adverse knock-on effects for wholesale energy prices. We will explore if there are ways for us to do things differently to bring benefits for consumers.

Clear output targets and fair adjustment mechanisms

Under RIIO, Ofgem identifies clear outputs that we need to deliver. These outputs help us to be efficient in what we do. There are two benefits to this approach. It holds us to account while also allowing us to get on and deliver target outputs at best value. We will engage with Ofgem and stakeholders to identify clear output measures for the future.

Some of these outputs may need to change during RIIO-2, for example if external circumstances change. Such changes can be handled by adjustment mechanisms like 're-openers' and 'uncertainty mechanisms'.

We have used these adjustment processes during RIIO-1. We will engage with Ofgem and stakeholders to agree the right mechanism to use in future.

Incentivised to always find a better way

A core principle of the RIIO framework is incentives. Across our total spending in RIIO-2 we expect to be incentivised to continually look for ways to deliver outputs more efficiently and at lower costs. Whenever we find a better way, the totex incentive mechanism ensures consumers start to benefit from our cost reductions during the current price control period, rather than waiting until the next price control.

We are engaging with Ofgem and our stakeholders to ensure there remains a strong totex incentive mechanism in RIIO-2.

Impact on consumer bills

As we develop our business plan, we will think hard about the potential impact on current and future bills. We calculate our consumer bill impact using Ofgem’s consumer bill methodology. This splits costs into segments including wholesale, environmental and network charges.

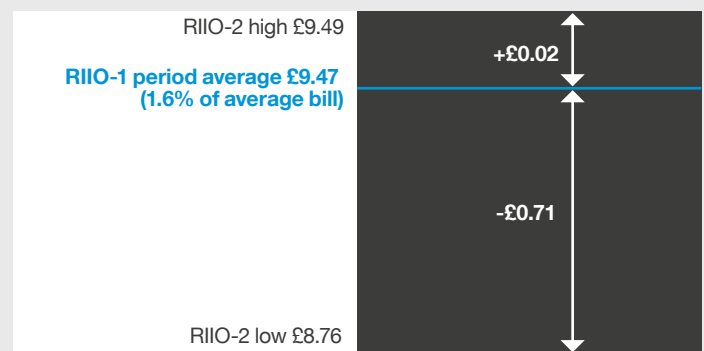
About half of our total revenue comes from the charges paid by our direct customers. This covers specific services as well as when they put gas onto the transmission system. This is considered part of wholesale market prices.

The remaining half of our total revenue is recovered as network charges when gas is taken off the system. This element is currently around £9² per year of the average domestic dual fuel bill.

Other things being equal, a plus or minus £100m per year variance in RIIO-2 totex could affect the gas transmission part of a typical domestic consumer bill by plus or minus 40 pence.

The impact of our provisional RIIO-2 totex range on consumer bills would be between a reduction of 71 pence and an increase of 2 pence on the average household gas bill. This is based upon a like-for-like comparison with RIIO-1 e.g. excluding output incentive revenue and not considering changes in finance parameters.

Figure 12.1 Indicative consumer bill impact



In this illustration we have not considered other factors that can have an impact on consumer bills such as cost of capital for RIIO-2 and future inflation.

For more information on the breakdown of an average consumer bill, please refer to our [website](#)³.

What it could cost


We deal with how we’re improving our processes in other chapters of this document. All these efforts contribute to the goal of being efficient and affordable.

However, we also need to factor in the other costs of running our business. Like any other large organisation this includes our business support activities such as human resources, finance, information technology and property management.

Being part of a larger group allows us to maximise efficiencies by using a shared services model where these core functions provide services to other National Grid companies.

² Illustration based upon analysis of the average 2016/17 consumer bill, using Ofgem methodology.

³ <https://www.nationalgridgas.com/about-us/breaking-down-your-bill>



What it could cost

T1 annual spend £68m

Low £60m T2 annual spend range High £75m


Key drivers for the changing trend and range:

- Organisational and other efficiencies from RIIO-1 have been embedded for RIIO-2.
- The extent of our support function costs will be influenced by the size of our overall RIIO-2 work plan.
- Our range is based on our current level of efficiency. As we develop the detail of our plan, we expect to share our ambition to deliver future efficiencies.

Initial planning assumptions

We are basing our initial planning on the following assumptions:

- **Efficiencies.** The efficiencies we have achieved during RIIO-1 will form the basis of our costs in RIIO-2. We will identify and commit to more efficiencies that we believe we can achieve during RIIO-2 when we submit our final business plan.



We welcome your views:

Chapter:
Efficient and affordable

Question:
16. What are your views on the methods we have proposed to demonstrate efficiency and value for money in our plan?

Submit your feedback online [here](#):

How to use this document

We want your feedback

Who is this consultation aimed at?

We are interested in the views of all stakeholders who are impacted by what we do and shaping the future of gas transmission. This includes the views of gas consumers, government and regulatory bodies, energy industry professionals and members of the public.

Tell us what you think

This consultation is open until 31 March 2019. You may give us feedback in the ways outlined below. We particularly seek your views in response to the specific questions we have posed. These are summarised on page 12. You may respond to all questions or just those relevant to your specific views.

Ways to feed back:

Make notes

Throughout the document, we have provided space for you to read and make notes at the start of each chapter (opposite). You can then type up your notes and send them in an email or submit them online.



Interactive pdf notes

Alternatively, we will be sending out editable pdf versions of this document with note fields for you to type directly into.

Email

We have a dedicated email address specifically for your feedback to this document. We welcome your thoughts at:

jennifer.pemberton@nationalgrid.com



Alternatively, you can put your thoughts in writing and send to: Jennifer Pemberton, National Grid House, Warwick Technology Park, Gallows Hill, Warwick. CV34 6DA.

Online

You can go directly to the website and submit your comments [here](#).



**Please share
your thoughts:**