RIIO/Gas Charging

NTS CMF 2nd February 2012

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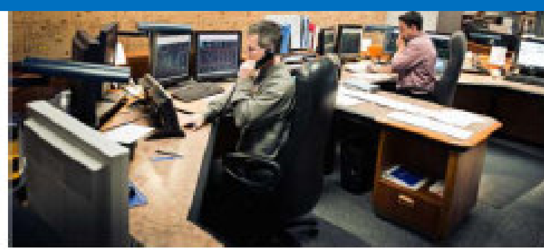
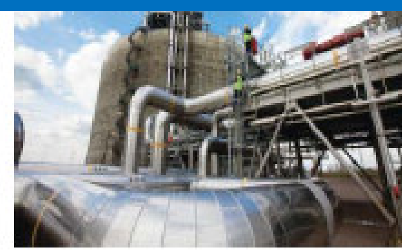




RIIO: what's different

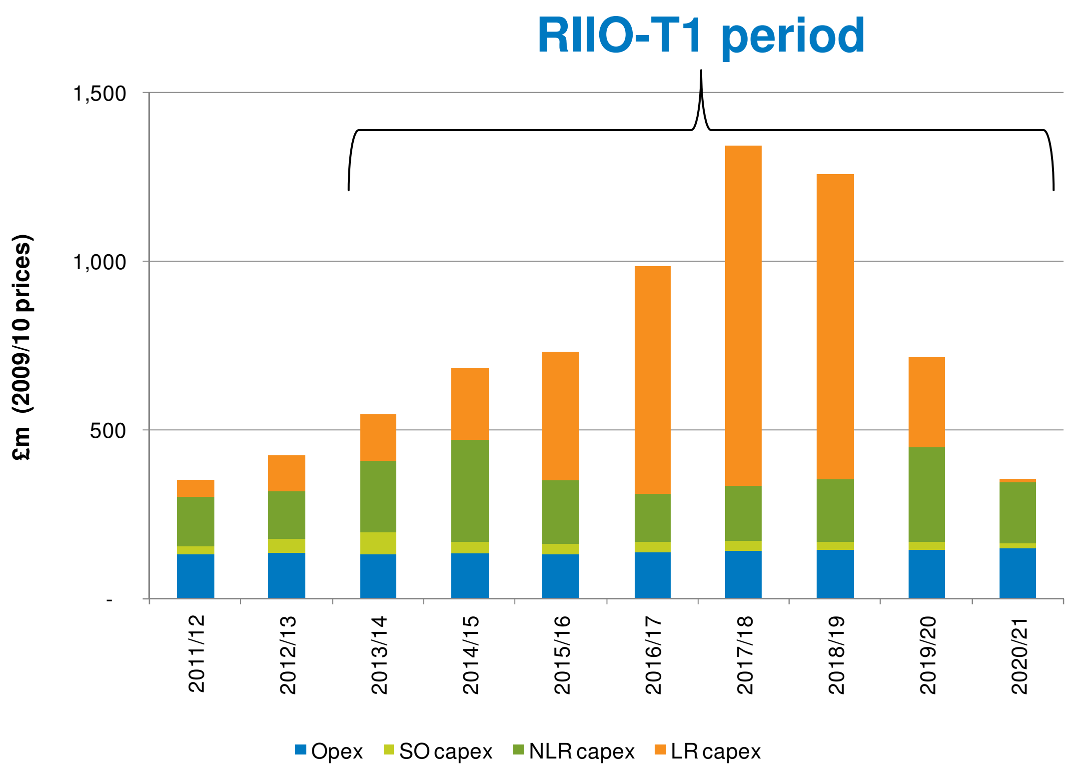
Revenue	=	Incentives	+	Innovation	+	Outputs

- Not just the name… a whole new framework
- Efficiency is no longer the only consideration
- RIIO will be an 8 year control
- Networks need to produce 'well-justified business plans'
- Incentives to focus on outputs (rather than inputs) and a new incentive on forecast accuracy
- Supported by enhanced stakeholder engagement

RIIO: A mindset change

- What used to be ‘add-ons’ are becoming central…
  - Incentivised outputs
    - Reliability & availability (& capacity)
    - Safety
    - Environment
    - Customer connections and satisfaction
  - Stakeholder engagement
    - Showing how this has influenced business plans
  - Uncertainty mechanisms
    - 8 years is a long time. Uncertainty mechanisms need to work.

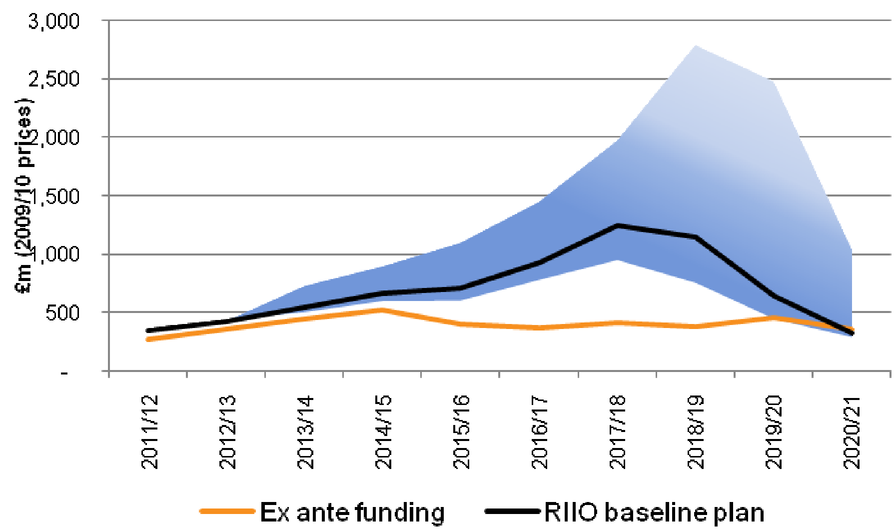
Baseline plan expenditure (July 2011)



Capex		Opex		'Totex' over RIIO-T1 period
£5.6 bn	+	£1.1 bn	=	£6.7 bn

Uncertainty Mechanisms

Our July 2011 baseline RIIO-T1 plan is only one view of the future…



Mechanisms we propose:

- allow the regulatory control to adapt to an uncertain future
- ensure the RIIO-T1 package remains appropriate across a wide range of potential outcomes
- allow us to deliver desired outputs in future scenarios outside what is currently considered credible through the use of specific and targeted 're-openers'

RIIO Stakeholder feedback

- Broad support for uncertainty mechanisms but requested more details – we'll address this in the March 2012 RIIO submission.
- Concerns expressed re the application of the capitalisation rate of 72%/28% "slow money/fast money" proposal to all spend (including incremental entry/exit capacity).
- Keen to understand the effect on charges and hence this session today.
- We will cover the TO issues here.
- The SO incentives are covered by Ofgem and NGG under a separate workarea/group.

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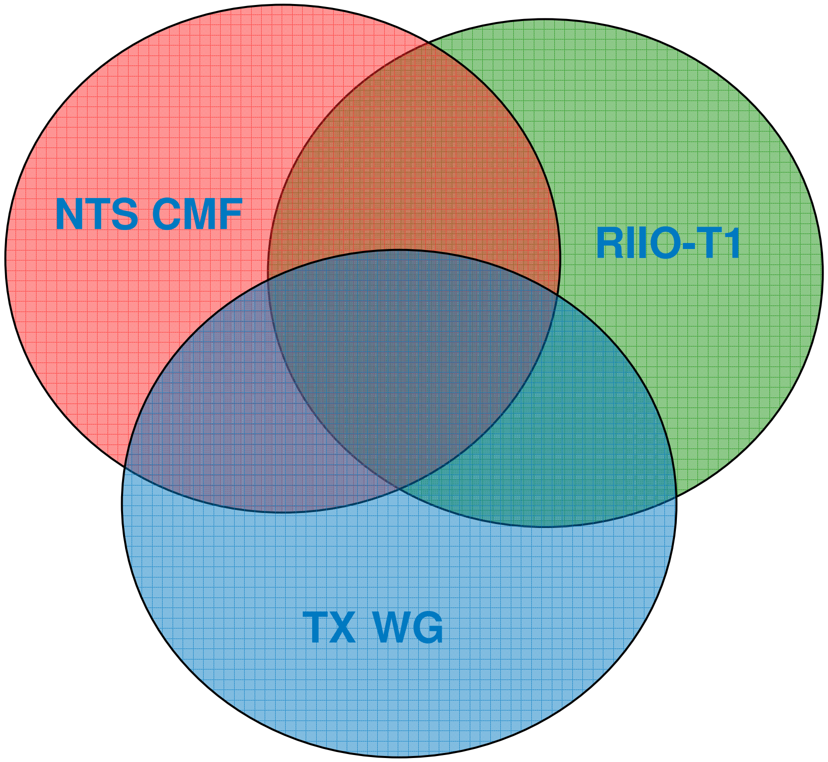
Discussions taking place …

- RIIO-T1 process for setting allowed revenues
- Transmission workgroup for the commercial regime
- NTS CMF for charging
- But there are naturally overlaps between these
- Don't want to prejudge the charges and/or commercial regime via the RIIO-T1 debates
- We do need to acknowledge that RIIO-T1 process provides an opportunity to review current commercial framework.
- The RIIO-T1 process also provides a vehicle to change the regulatory aspects affecting the commercial regime and charging (such as the split capitalisation rate).



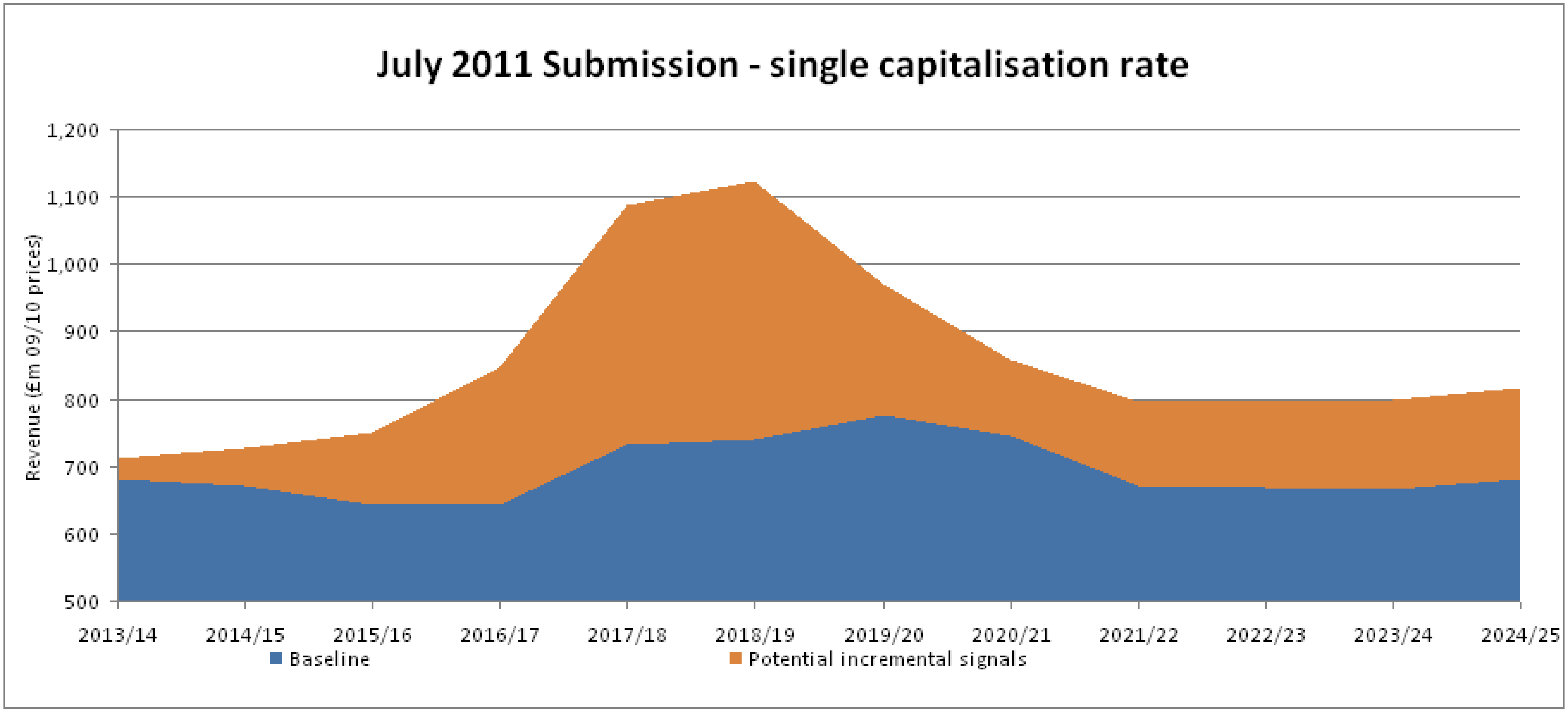
Key milestones for RIIO-T1 process

29th July 2011	• Transmission RIIO-T1 submission	✓
24th October 2011	• Ofgem feedback on T1 submission	✓
28th November 2011	• TPCR4 Rollover final proposals	✓
2nd March 2012	• Updated T1 submission to Ofgem	
26th July 2012	• T1 initial proposals from Ofgem	
December 2012	• Final proposals from Ofgem	

So what does this mean for charges?

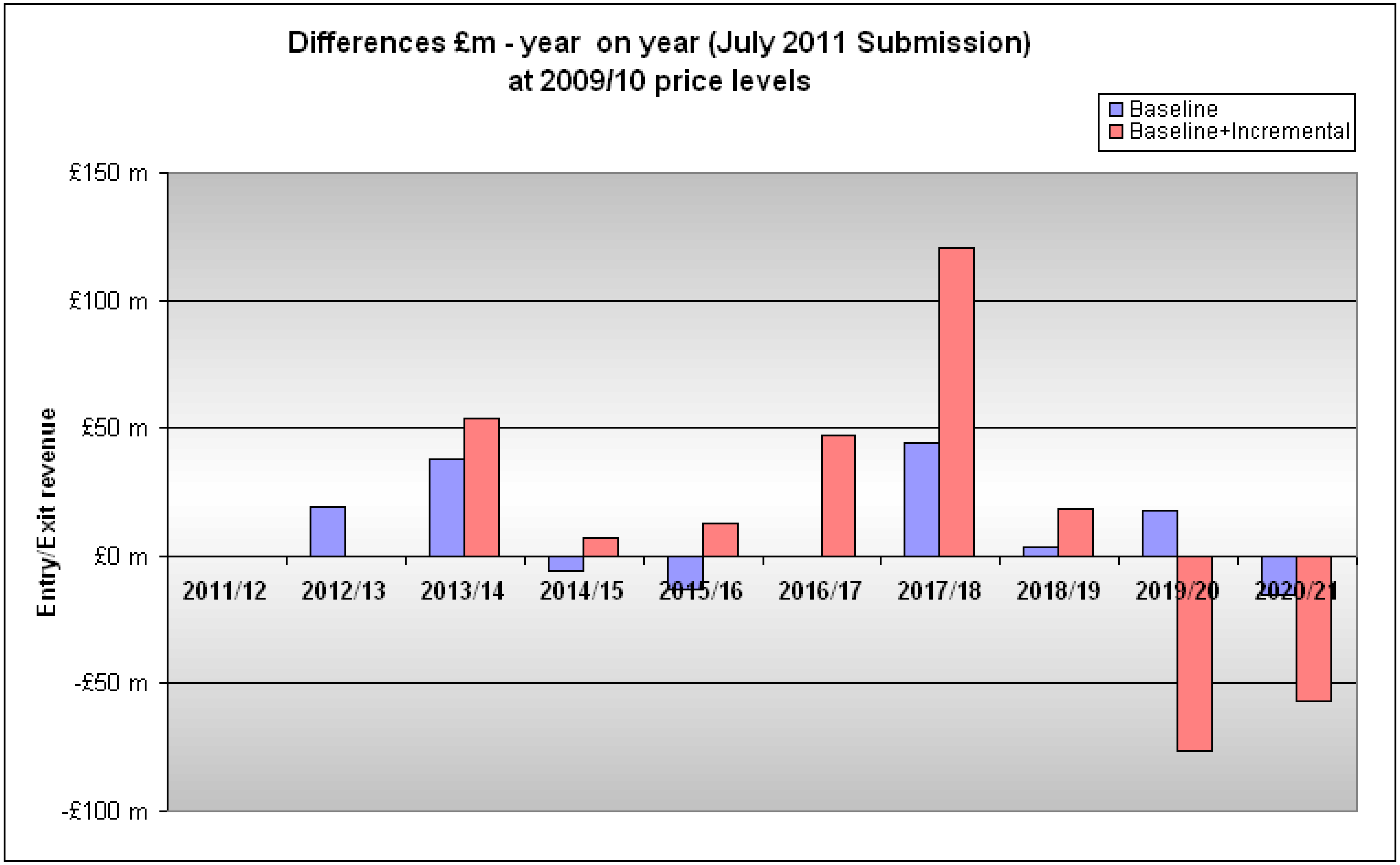
- RIIO-T1 provides a different mechanism to calculate the allowed revenue – ‘totex’ framework
- Given the potential signals which could be seen over the RIIO-T1 period, retention of existing mechanism of 5 year rolling SO incentive, then transfer to TO control to fund incremental capacity will not provide NGG with allowed revenues in timely manner
- Proposal is therefore to move away from incremental capacity being initially funded in SO to funding via TO control alone
- Note that if incremental capacity is funded via the TO control then there will be no funding within the SO control.
- This would ensure that RIIO-T1 principles apply equally to all spend and also results in simpler arrangements
- Our business plan submission in July was made on this basis …

TO Revenue – July Submission

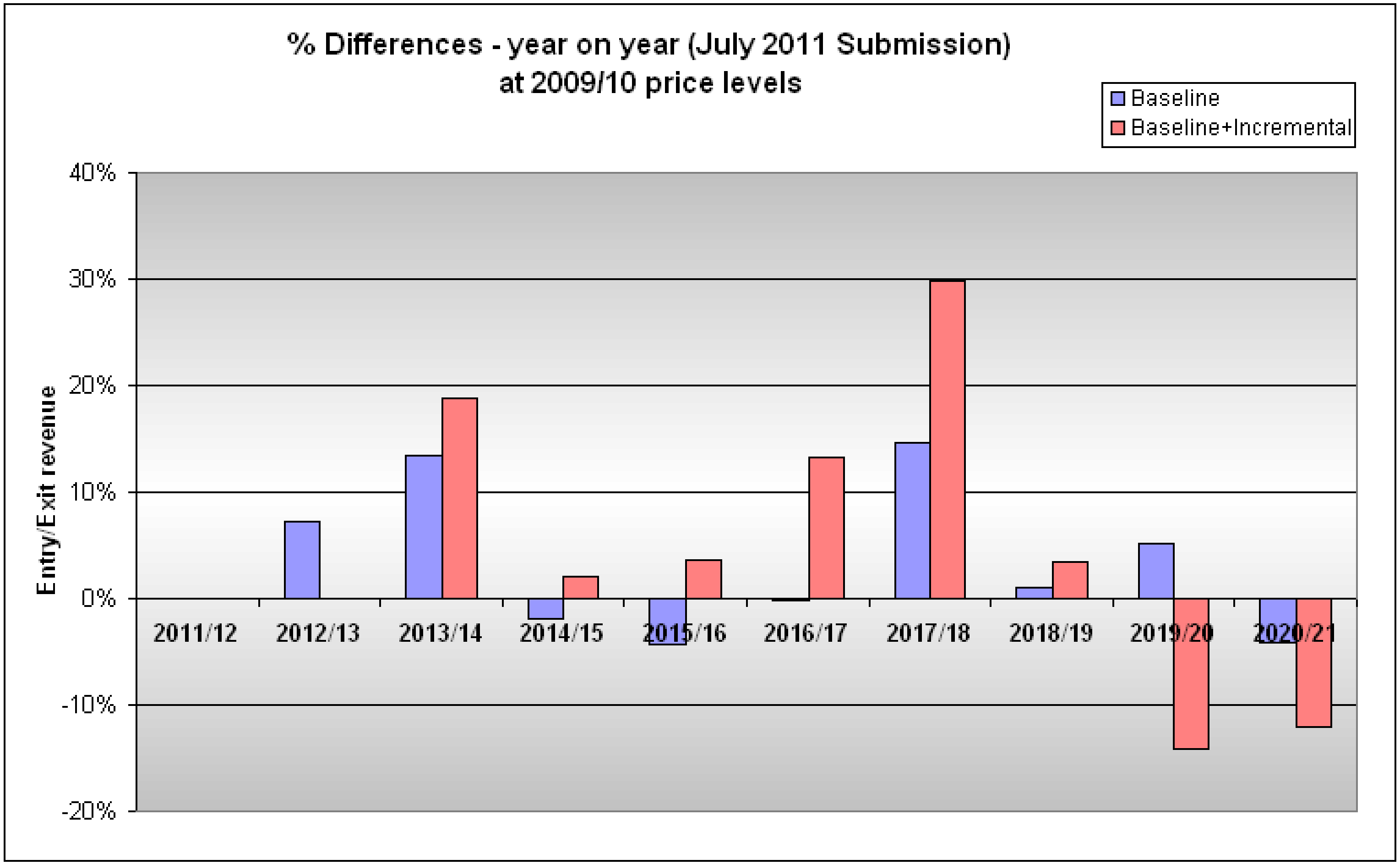


Graph shows split between proposal for up-front funding (or "baseline") and then impact of potential incremental capacity funded via the Uncertainty Mechanism

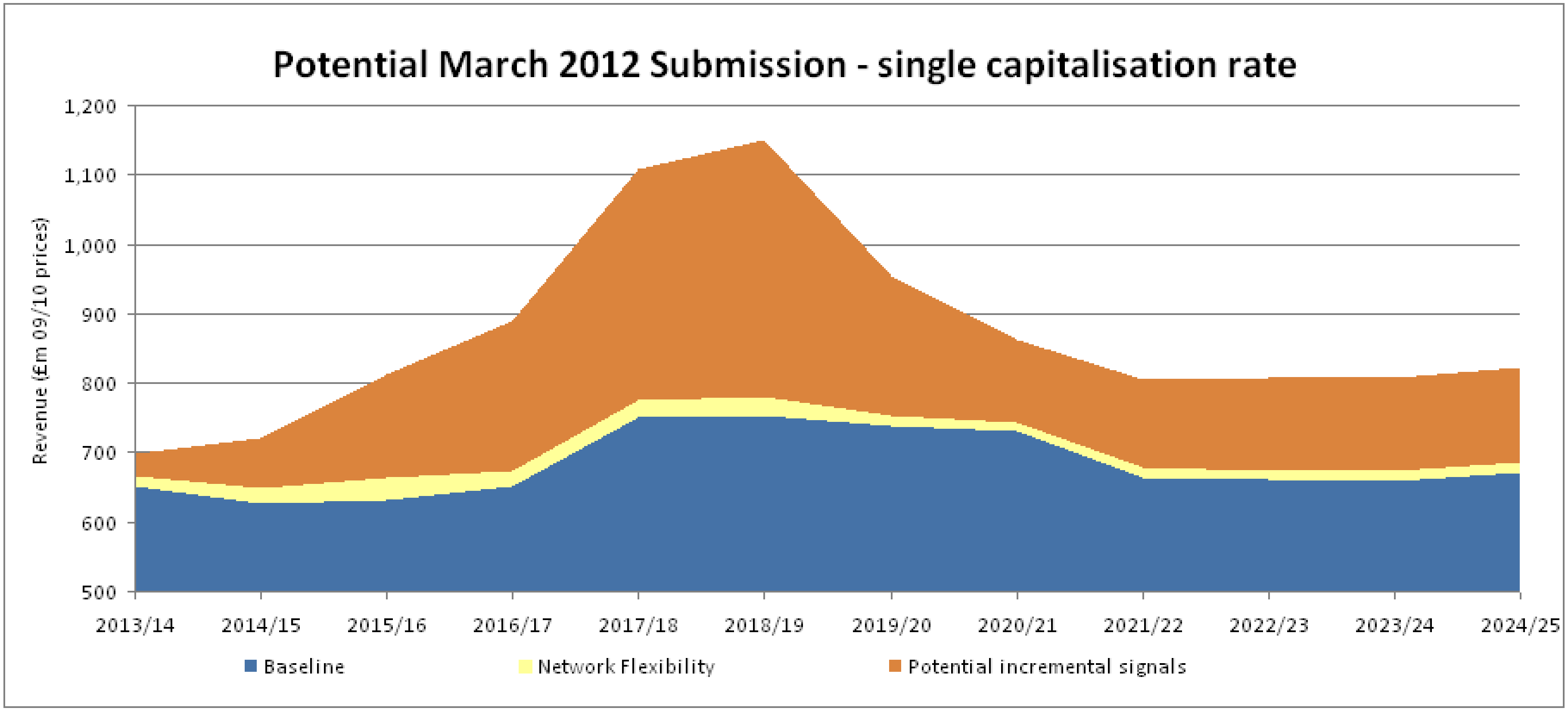
July 2011 Submission – differences in TO Revenues £m



July 2011 Submission – differences in TO Revenues %

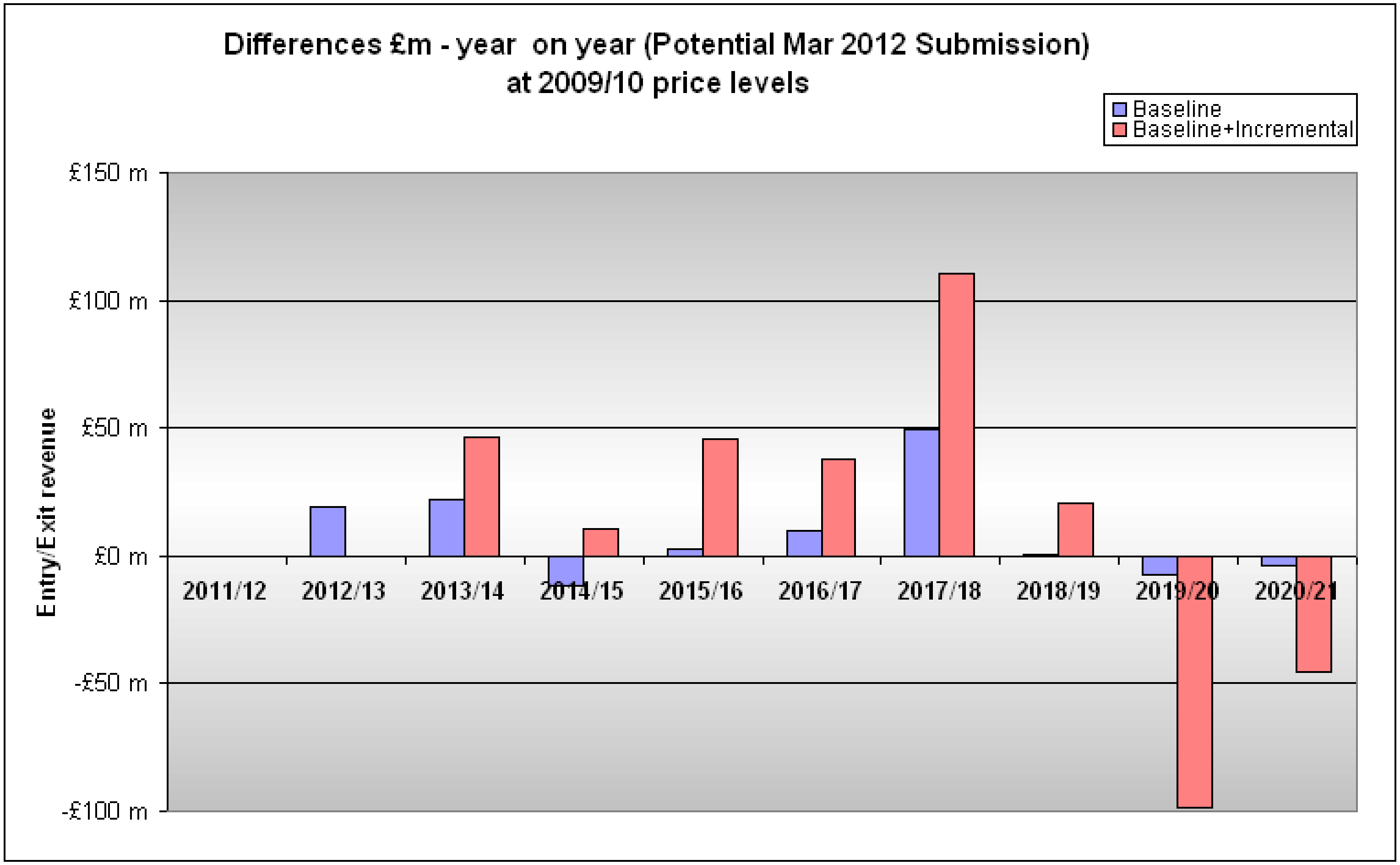


TO Revenue – Potential updated March 2012 submission

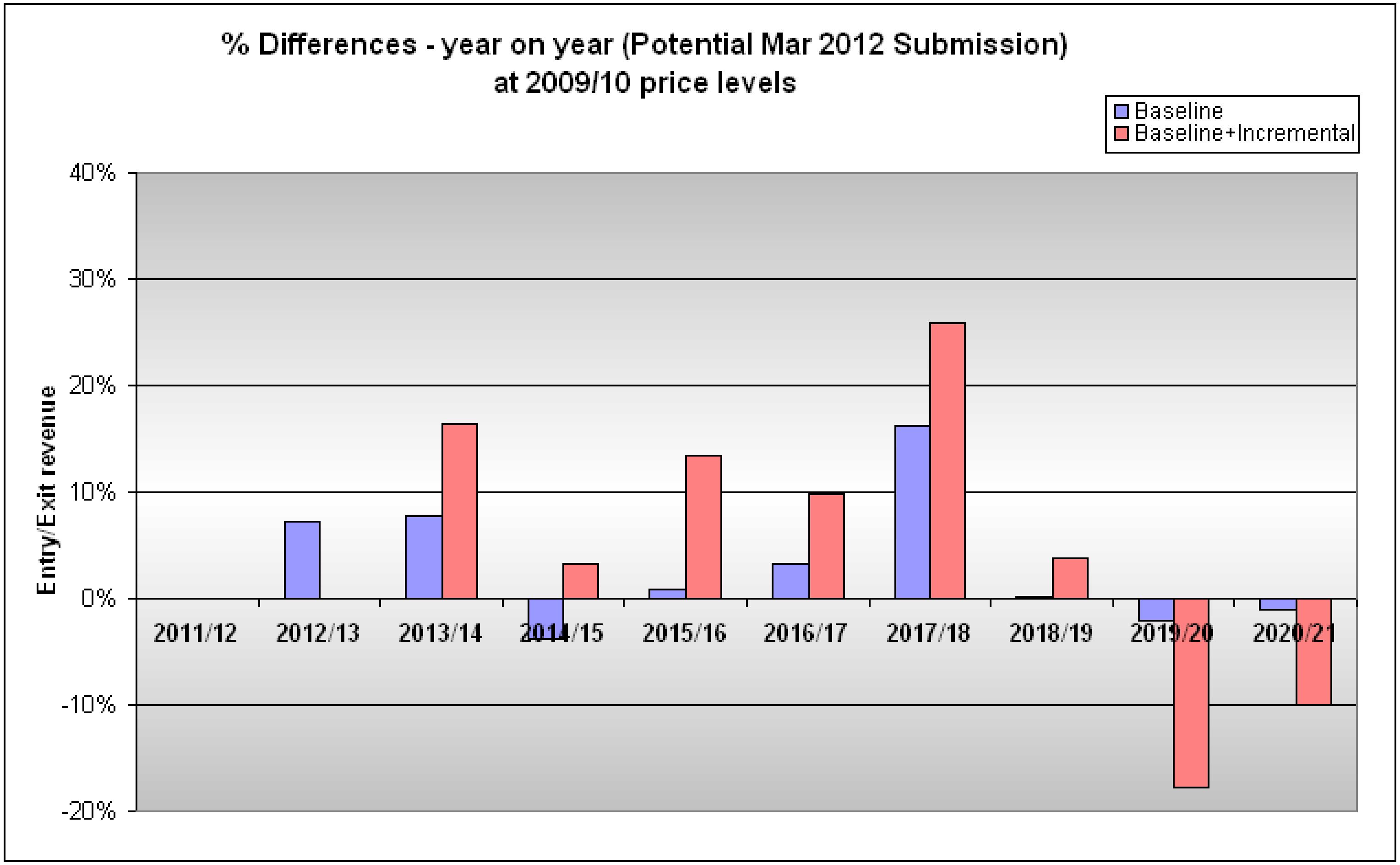


Following Stakeholder feedback, we're now proposing to remove majority of "Network Flexibility" spend from up-front allowance as it will be triggered by an Uncertainty Mechanism

Potential March 2012 Submission – differences in TO Revenues £m



Potential March 2012 Submission – differences in TO Revenues %



Capitalisation Rate within price control settlement

- Capitalisation rate at TPCR4 was different between base TO funding and incremental capacity (when in SO control):
  - TO settlement was 61% (excl. MH spend)
- Consider effect of different rates in RIIO-T1 control, compare:
  - All funding using 72% (July submission)
  - Split rate of 52.5% (base TO funding) and 90% (for incremental)

Capitalisation rate – effect on incremental capacity funding (TPCR4 capex phasing)

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- Based on TPCR4 capex phasing assumption of 20%/80% in yr t-2/t-1, the profile of revenues for a project costing £100m would be:
- 72% capitalisation rate:

	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5	t+6	...
Assumed Cost profile	20.00	80.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Fast money	5.60	22.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Slow money	14.40	57.60	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Depreciation	0.00	0.32	1.60	1.60	1.60	1.60	1.60	1.60	1.60	
Return	0.44	2.64	4.35	4.26	4.16	4.06	3.96	3.86	3.76	
Allowed Revenue	**6.04**	**25.36**	**5.95**	**5.86**	**5.76**	**5.66**	**5.56**	**5.46**	**5.36**	

- 90% capitalisation rate:

	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5	t+6	...
Assumed Cost profile	20.00	80.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Fast money	2.00	8.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Slow money	18.00	72.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Depreciation	0.00	0.40	2.00	2.00	2.00	2.00	2.00	2.00	2.00	
Return	0.55	3.30	5.44	5.32	5.20	5.07	4.95	4.83	4.71	
Allowed Revenue	**2.55**	**11.70**	**7.44**	**7.32**	**7.20**	**7.07**	**6.95**	**6.83**	**6.71**	

Capitalisation rate – effect on incremental capacity funding (TPCR4 capex phasing) (2)

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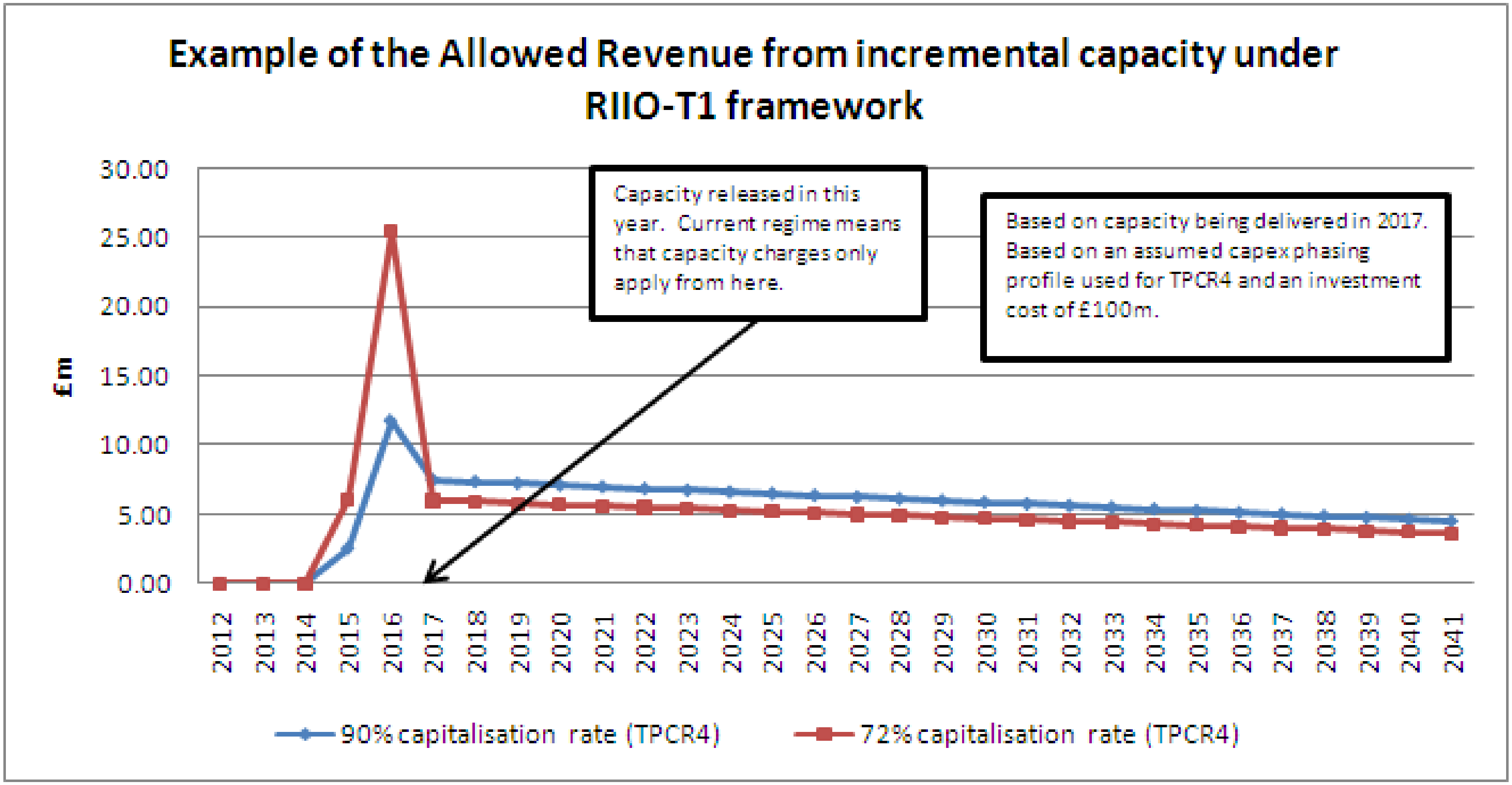

Capitalisation rate – effect on incremental capacity funding (RIIO-T1 capex phasing)

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- Based on RIIO-T1 capex phasing assumption for a typical pipeline project:

Assumed Capex phasing	t-5	t-4	t-3	t-2	t-1	t	t+1
Investment weighting	2%	5%	5%	5%	35%	46%	2%

- The profile of revenues for a project costing £100m would be:

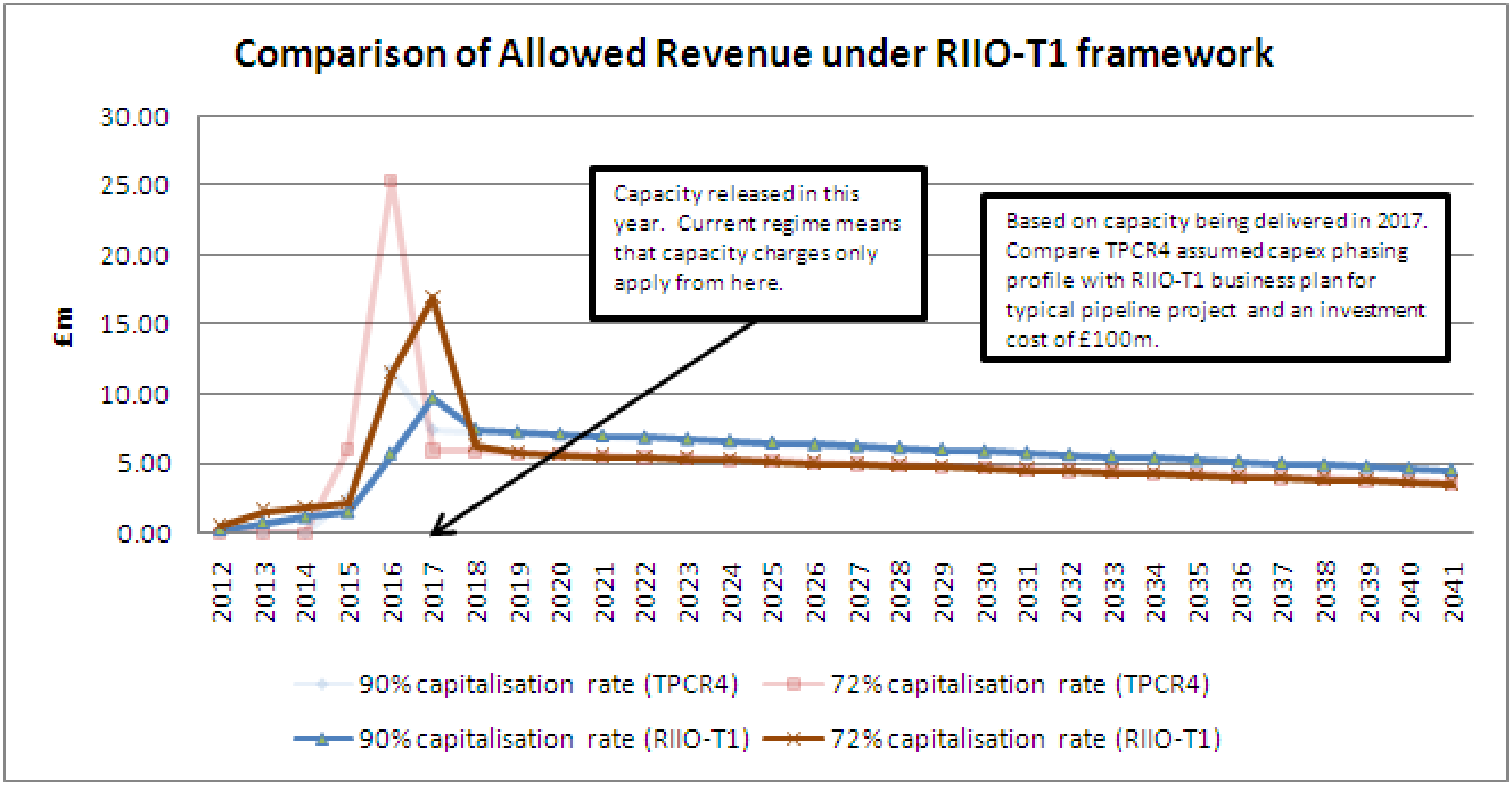
- 72% capitalisation rate:

	t-5	t-4	t-3	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5	t+6	...
Assumed Cost profile	2.00	5.00	5.00	5.00	35.00	46.00	2.00	0.00	0.00	0.00	0.00	0.00	
Fast money	0.56	1.40	1.40	1.40	9.80	12.88	0.56	0.00	0.00	0.00	0.00	0.00	
Slow money	1.44	3.60	3.60	3.60	25.20	33.12	1.44	0.00	0.00	0.00	0.00	0.00	
Depreciation	0.00	0.03	0.11	0.19	0.27	0.83	1.57	1.60	1.60	1.60	1.60	1.60	
Return	0.04	0.20	0.41	0.63	1.50	3.25	4.24	4.19	4.09	3.99	3.89	3.80	
Allowed Revenue (Fast money, Depreciation &	**0.60**	**1.63**	**1.93**	**2.22**	**11.57**	**16.97**	**6.37**	**5.79**	**5.69**	**5.59**	**5.49**	**5.40**	

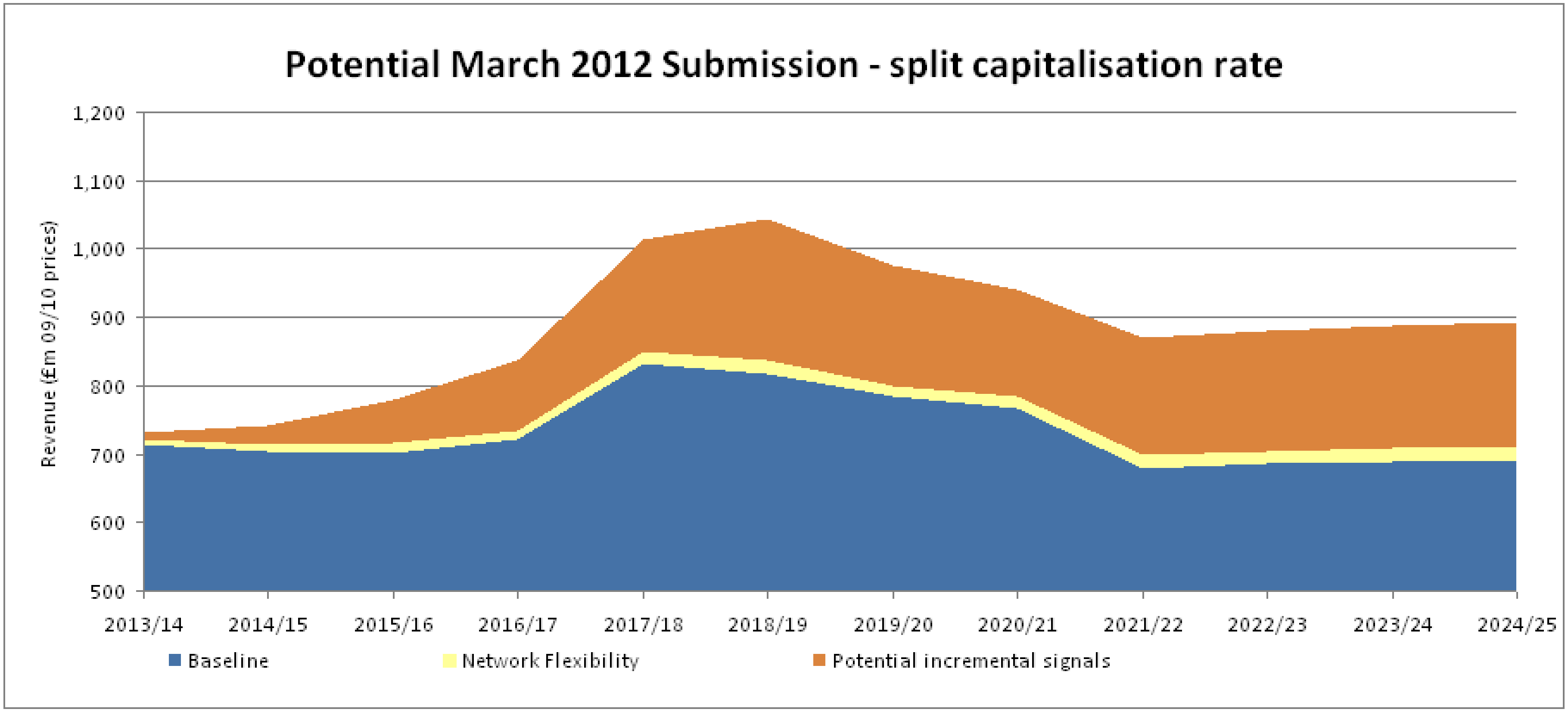
- 90% capitalisation rate:

	t-5	t-4	t-3	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5	t+6	...
Assumed Cost profile	2.00	5.00	5.00	5.00	35.00	46.00	2.00	0.00	0.00	0.00	0.00	0.00	
Fast money	0.20	0.50	0.50	0.50	3.50	4.60	0.20	0.00	0.00	0.00	0.00	0.00	
Slow money	1.80	4.50	4.50	4.50	31.50	41.40	1.80	0.00	0.00	0.00	0.00	0.00	
Depreciation	0.00	0.04	0.14	0.24	0.34	1.04	1.96	2.00	2.00	2.00	2.00	2.00	
Return	0.06	0.25	0.52	0.78	1.87	4.07	5.30	5.24	5.11	4.99	4.87	4.74	
Allowed Revenue (Fast money, Depreciation &	**0.26**	**0.79**	**1.16**	**1.52**	**5.71**	**9.71**	**7.46**	**7.24**	**7.11**	**6.99**	**6.87**	**6.74**	

Capitalisation rate – effect on incremental capacity funding comparison

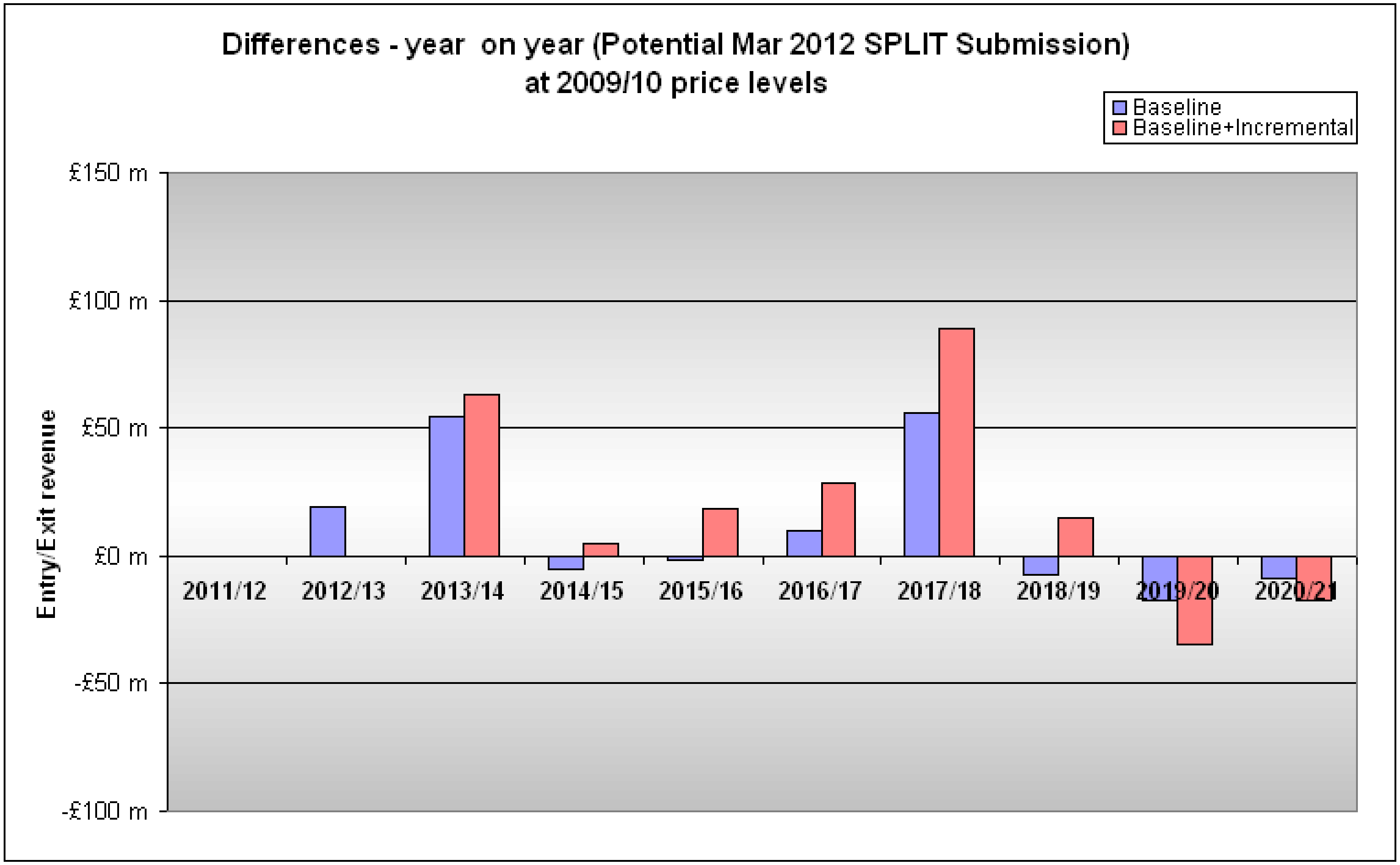


TO Revenue – Potential March Submission – split capitalisation rate

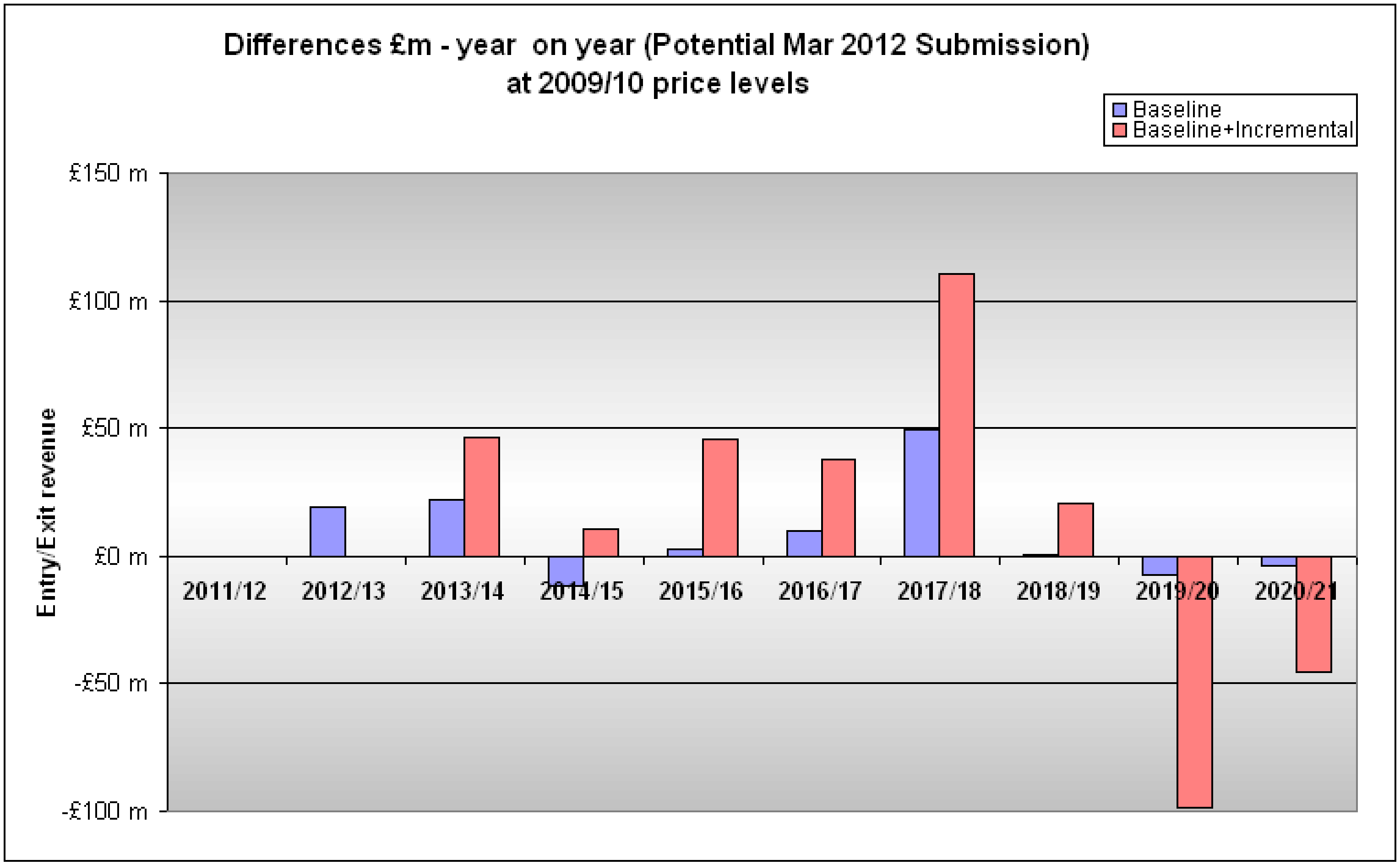


Graph shows impact of applying different capitalisation rates to up-front funding and incremental capacity signalled expenditure – flatter profile

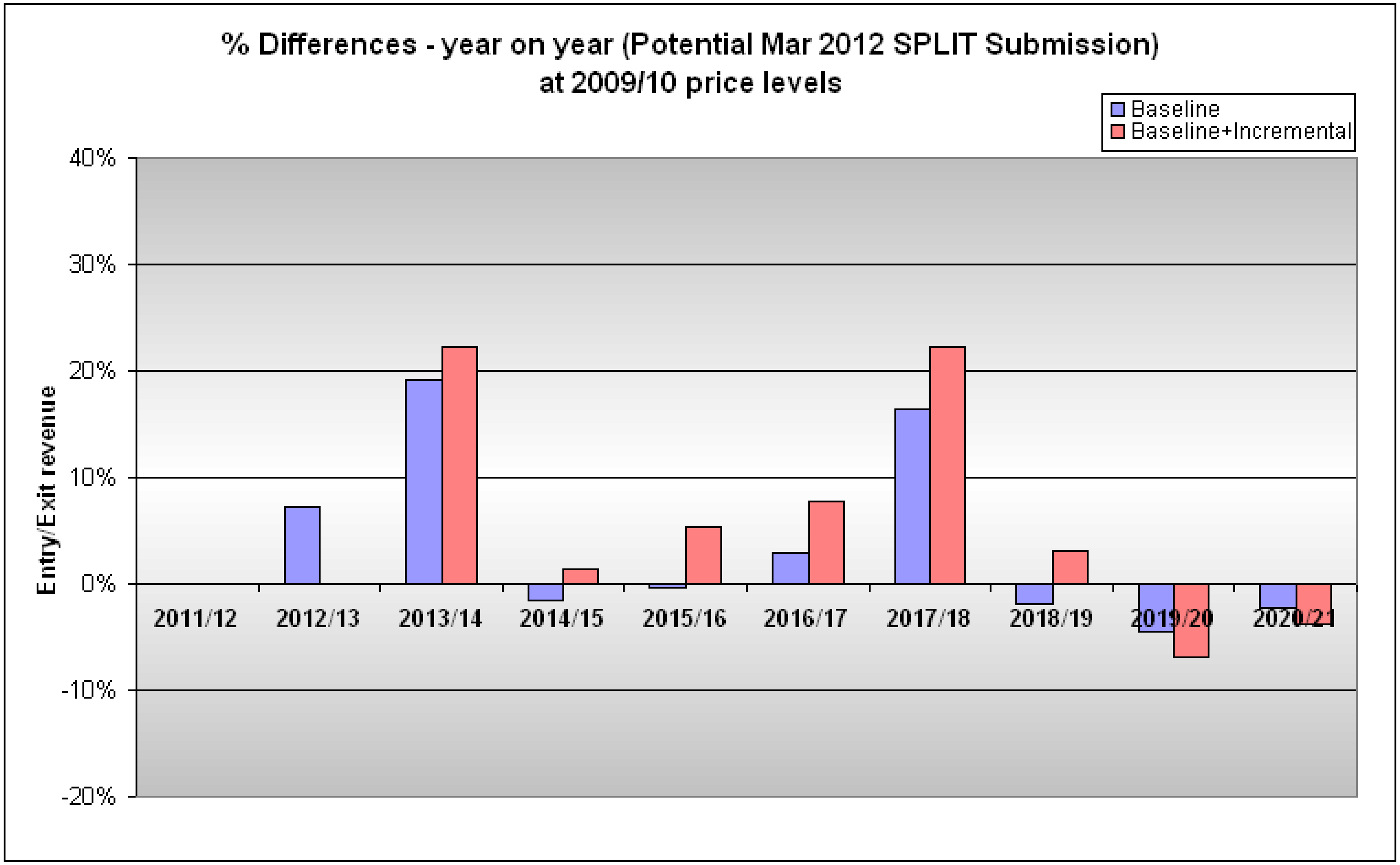
Potential March 2012 Submission – differences in TO Revenues £m - split capitalisation rate



Potential March 2012 Submission – differences in TO Revenues £m - single capitalisation rate for comparison



Potential March 2012 Submission – differences in TO Revenues % - Split capitalisation rate



Price Sensitivity v Allowed Revenue
(Prevailing NTS Charging Methodology)

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<u>Total (Entry & Exit) TO Allowed Revenue</u>

- Change of +/- £100m revenue per annum equates to
  - +/- 0.0050 p/kWh on the TO Entry Commodity Charge, and
  - +/- 0.0025 p/kWh/day on TO Exit Capacity Charges

+/- £1.86/year on the typical domestic bill

NB Prices are set to 4 decimal places hence 0.0001 p/kWh is the smallest price change

Potential issues for charging

- Variability/Predictability of Charges – which is more important?
- Cost reflectivity of charges – under the proposed new arrangements, incremental revenues will be reflected in the allowed revenue stream ahead of incremental capacity bookings/flows
  - How much of these revenues can be/should be recovered from developers?
- Linkage with Mod 373 on Connection processes