

Pricing Consultation Launch & Customer Update



19 September 2012
Hogarth's Hotel

National Grid Metering **Pricing Consultation Launch Event**

Wednesday 19 September 2012

Agenda for the morning

Welcome and Introductions	10:00 – 10:15
Ofgem overview of RoMA and Decision document	10:15 – 10:45
Q & A session	10:45 – 11.00

Break

NGM Approach to Pricing Proposals	11:30 - 12:00
Introducing Engage	12:00 – 12:15
Q & A session	12:15 – 12:30

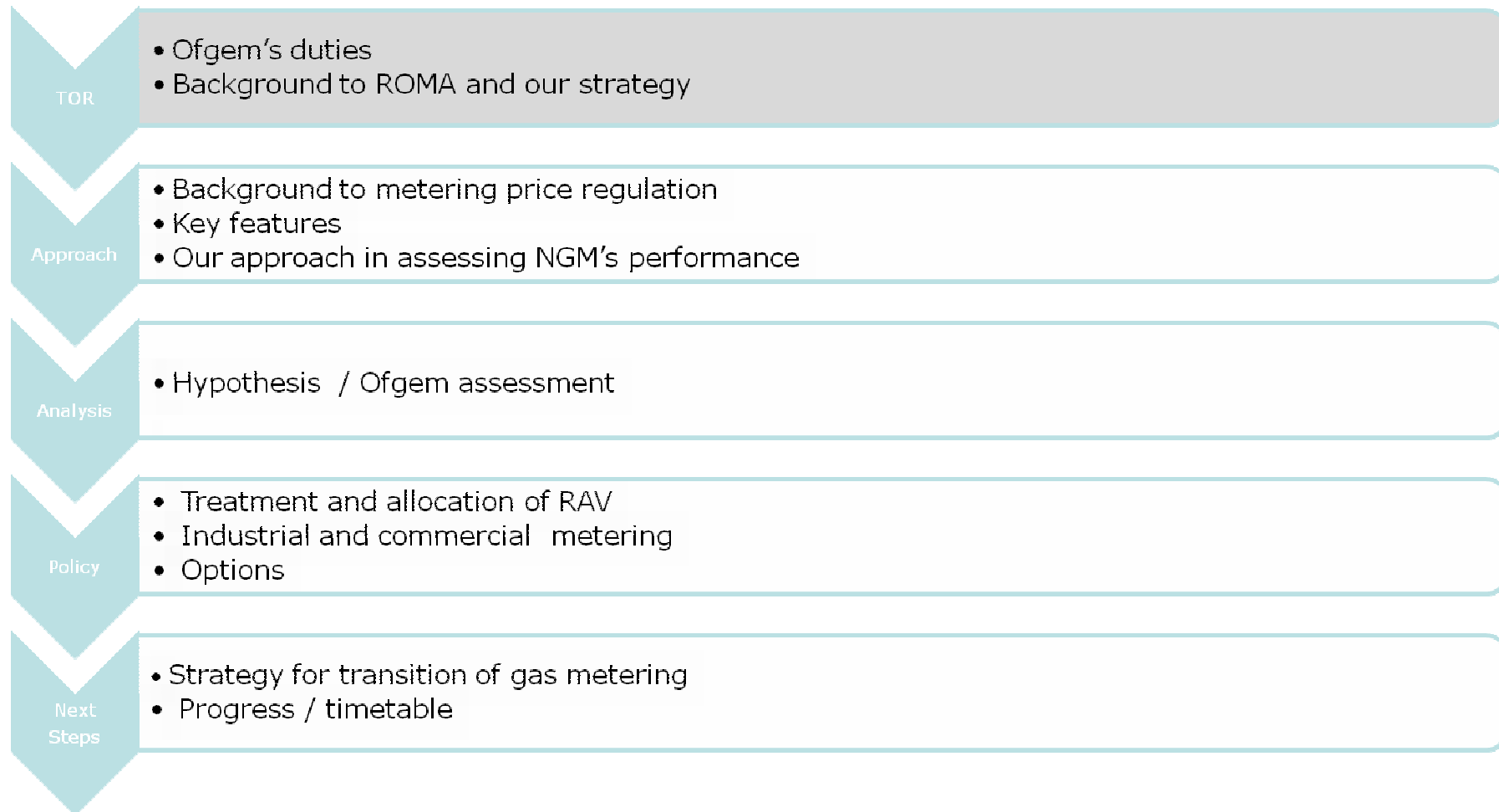
Lunch

The regulation of gas metering in the transition to smart metering

Steve Rowe

19 September 2012

Setting the scene




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 ROMA

- Review of metering arrangements kicked off in 2009/10 – review the metering market in advance of smart metering.
- Concluded December 2011, setting our position for
 - Commercial interoperability
 - MPOLR and PPM cross subsidy
 - Small suppliers access to smart meters
 - Strategy for the transition of traditional gas metering into smart metering


 Promoting choice and value
for all gas and electricity customers

Review of Metering Arrangements: Decision and consultation on transition to smart meters

Decision and further consultation

Reference:	175/11	Contact:	Steve Rowe, Paul Fuller
Publication date:	December 2011	Team:	Smarter Markets
		Tel:	020 7901 7468
		Email:	steve.rowe@ofgem.gov.uk

Overview:

This document sets out final decisions and proposals relating to the regulation of certain electricity and gas metering services. The focus is on 'traditional' meters, i.e. 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.

Under our Review of Metering Arrangements (ROMA), we have reviewed various aspects of how the current regulatory framework for traditional metering operates – and whether this operates in the interests of consumers. We have concluded that many aspects of current arrangements are fit-for-purpose, and should not be changed. This document sets out our conclusions and reasoning, which in effect conclude the ROMA process.

This document also consults on elements of a strategy for managing the decline of traditional meters consequent to smart meter rollout, with particular focus on the role of regulated providers of traditional metering services. We set out and seek views on a range of options for changing the obligations on Gas Distribution Networks (GDNs) and for reviewing the associated framework of price regulation. Our objective is to ensure that the transition out of traditional metering is managed efficiently, and that consumers are protected in terms of the continuing availability of metering services.

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Features of regulated gas metering

- Metering separated from gas distribution to create metering competition
- Opening RAV of £1.4 billion for National Grid Metering
- 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)
- Tariff caps set "on the basis of allowed revenue for 2002/03 and 2003/04"

Key features of price control

Revenue restriction model
Sets tariff cap for DCM and PPM
Three box approach (RAV – ROR – Depreciation)

- Tariff caps rolled forward with RPI (with minor adjustment for formula rates)
- Ofgem approve the form of tariff and have annual regulatory oversight
- NGM operates, P&M & MSA contract
- MSA's - Opportunities for review of tariffs overtaken by Competition Act proceedings, until now
- Persistent question of whether effective competition in gas metering
- Tariffs also apply to GDNs for MPOLR
- Smart metering is supply led, there transition strategy required

National Grid's assessment of tariff controls

- NGM regulatory accounts indicate no excess profits to date
- Looking forward, scale of stranding issue in domestic is substantial
- Domestic business should be considered separately (RAV allocation already 'approved' by Ofgem)

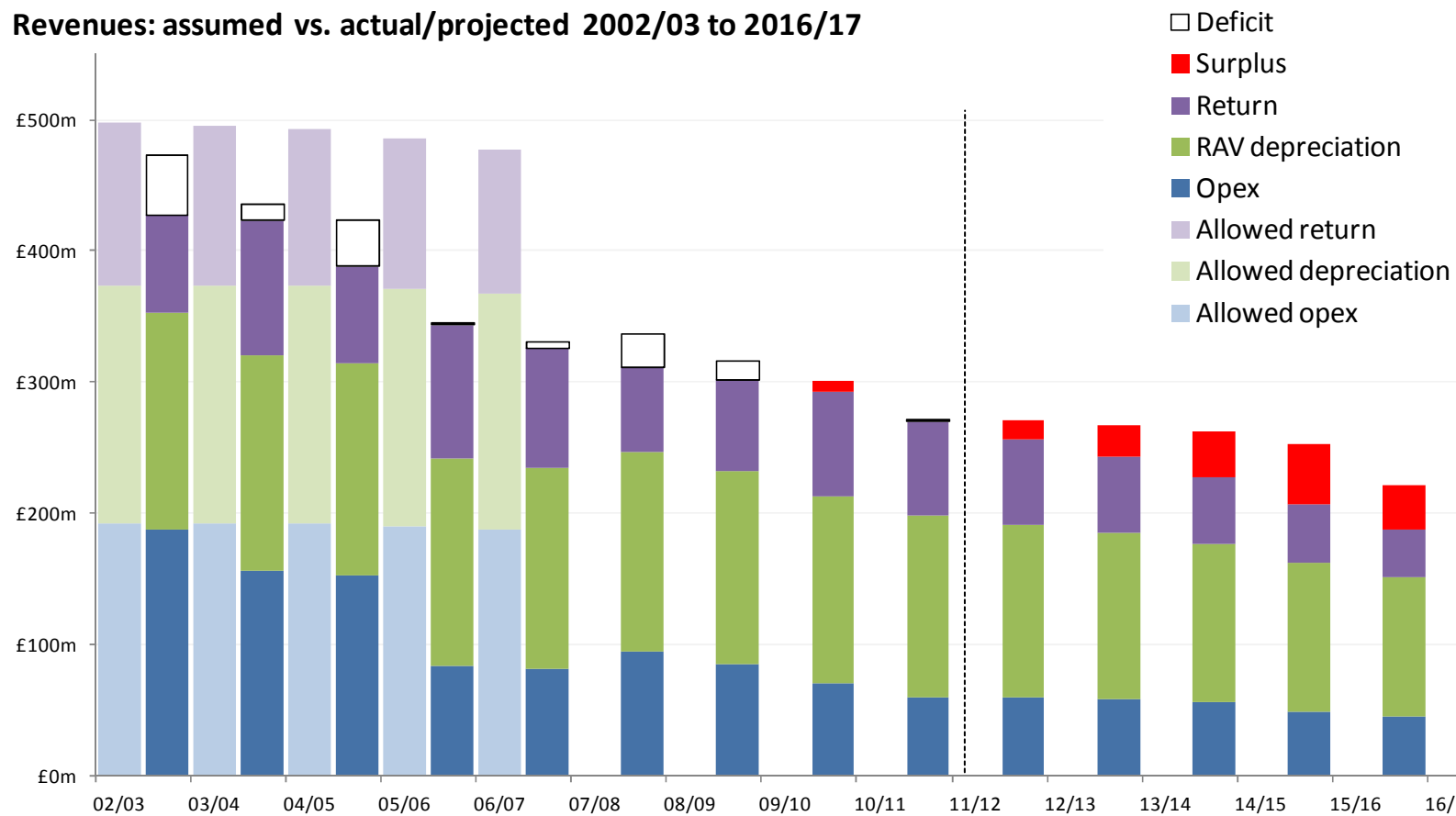
However:

- Despite all of this, NGM may be able to avoid increases in tariffs
- Our analysis has looked at historical and forward looking financial performance

- Our analysis has utilised the original E&Y model
- Analysis of NGMs regulatory accounts
- Analysis of NGMs business planning assumptions – 2019

Historical perspective on returns

Revenues: assumed vs. actual/projected 2002/03 to 2016/17



Source: NGM model (plus Ofgem extrapolations for I&C), restated to RPI 09/10

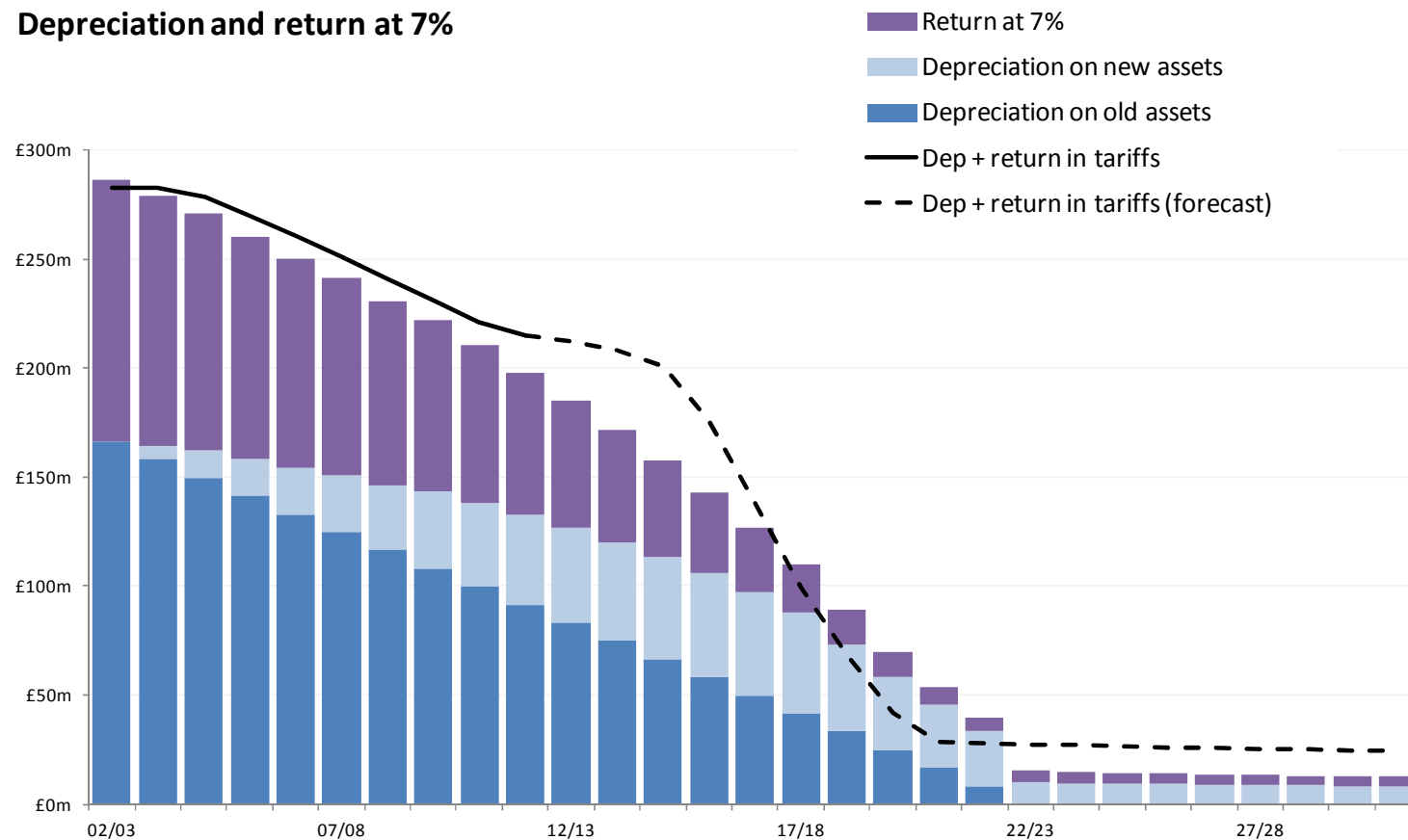
Historical perspective on returns

Observations

- Initial deficit – 02/03 revenues lower than Ofgem assumed
- Continuing revenue reductions from 02/03 caused by market share losses
- Dramatic reductions in opex, especially 2005/06
- Still, generally under-performed vs. 7% rate of return until now
- Some surpluses projected over the next few years
- Perhaps just enough to avoid stranding-driven price increases

Total portfolio: Depreciation profile for supported market share losses

Depreciation and return at 7%

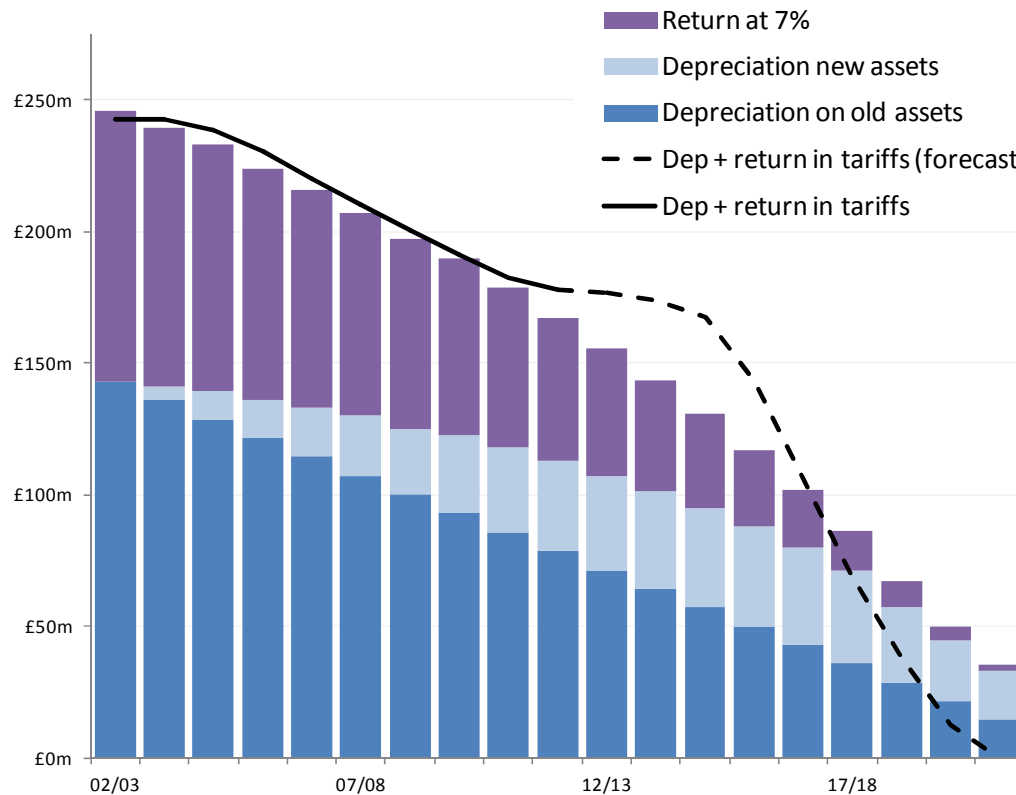


Source: NGM model, with no adjustment to depreciation for premature termination, Ofgem extrapolation, RPI 09/10 prices

* 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

Domestic: depreciation* and market share losses

Domestic: depreciation and return at 7%



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

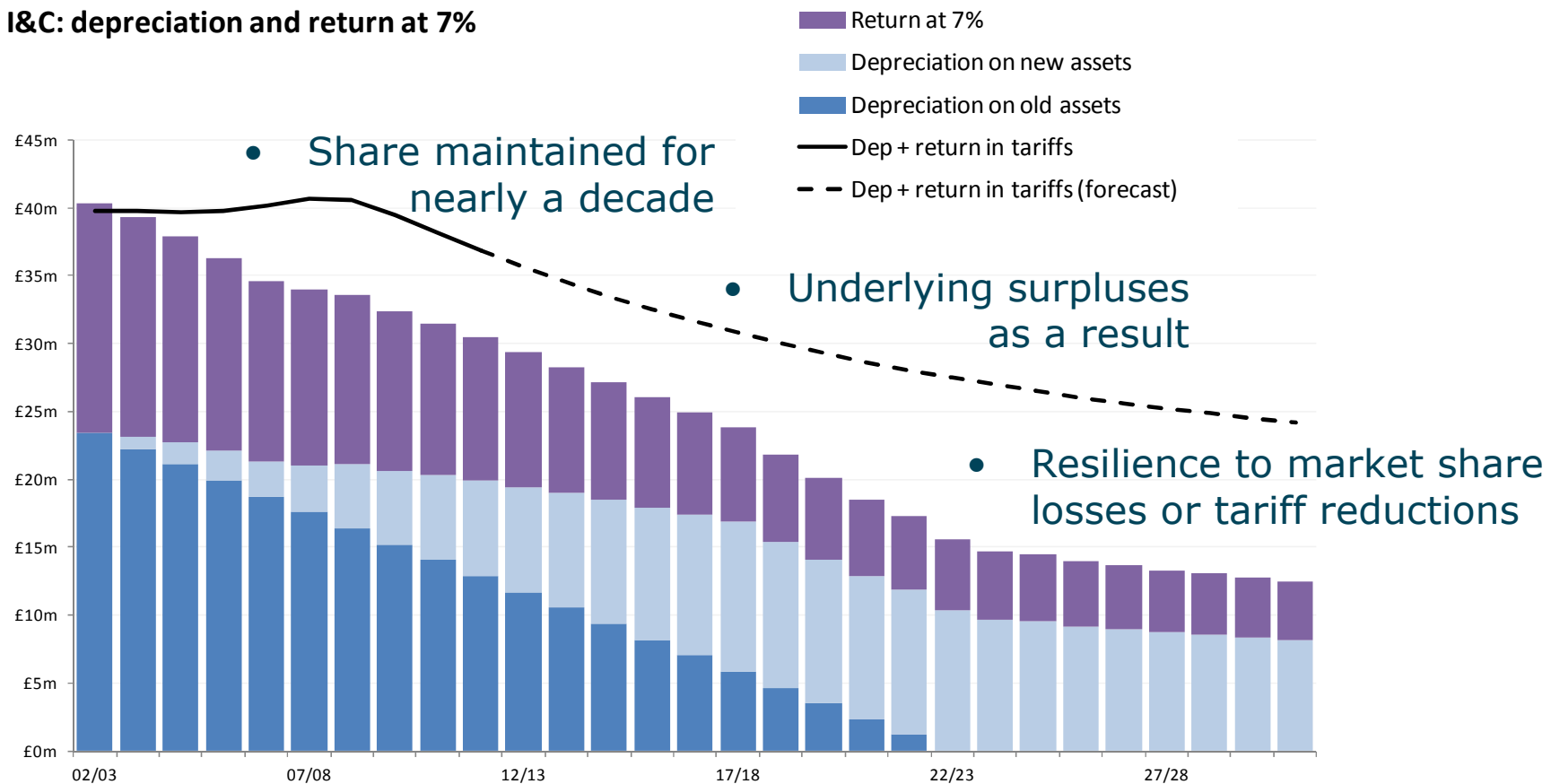
Domestic

- Surprising match between depreciation and market shares
- Projected slow-down in loss of share from 11/12 provides basis for surplus to offset deficits arising from rollout from about 2016
- Domestic RAV computed on NGM split
- PRCs and old asset depreciation mean net RAV practically zero at end of 20/21

* The depreciation profile provided for in the modelling for the 2001 Final Proposals, based on NGM split of RAV; black lines = meter populations x average depreciation + return for 02/03 & 03/04

I&C: depreciation* and market share losses

I&C: depreciation and return at 7%



Source: NGM model, Ofgem extrapolation, RPI 09/10 prices

* The depreciation profile provided for in the modelling for the 2001 Final Proposals, based on NGM split of RAV; black lines = meter populations x average depreciation + return for 02/03 & 03/04

Key features & messages

- I&C still formally part of regulated business
 - Analysis indicates I&C tariffs high relative to regulated costs (on RAV split proposed by NGM)
 - I&C non-discrimination concept becomes problematic once smart rollout is factor in determining domestic charges
- Policy options:
 - I&C tariffs continue to be regulated, and reduced
 - tariff reductions shared across I&C and domestic under revised non-discrimination principle
 - I&C taken out of economic regulation
 - RAV split on different basis

Policy issues arising

- RAV allocation is a key factor in setting appropriate tariffs
 - Identified candidate methodologies
 - Opportunity to create competition in I&C
- Main uncertainty is speed of smart metering rollout
 - Outside of NG's control
 - Incentive for NGM may conflict with rollout policy objectives
 - High scenario, NGM may not recover sufficient revenues
 - Low scenario, NGM will recover greater revenues
 - Policy question how best to deal with this?
- Scope for uncertainty mechanism?

Summary of analysis – implications for policy

Consumer protection

Consumers need to be protected in the transition

Industry argues that existing obligations are onerous

Regulating monopolies

Maintaining a three box approach to price control, via regulated tariffs


Our initial analysis suggests that the tariffs can be reduced and maintain 7% return

Creating competition

NGM have significant I&C portfolio and their strategy is to remain in the this market
beyond 2019

Our policy proposals

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



Promoting choice and value
for all gas and electricity customers

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.

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Stakeholders views

- Strong support overall for the strategy
 - Protects consumer
 - Manages obligations / network's risks for MPOLR
 - Provides efficient and economical p&m of meters
 - Networks raised specific question regarding approach
- Timing
 - Is appropriate given certainty around rollout of smart metering
- Ongoing engagement
 - Significant interest
 - Seeking active participation

Progressing the review

- Our approach
 - Clear strategy based upon evidence
 - Set clarity about expectations
 - Regular engagement / oversight
- National Grid accepted our invitation (August)
 - Operate the NMM
 - Conduct a price control
 - Consulted on approach for engagement
- Developing the approach document
 - Set's out approach to RAV allocation
 - Business planning assumptions
 - Costs base
 - ROR
 - I&C metering strategy
 - Implication for tariffs



Progressing the review – Next steps

- Initial proposals (November)
 - Setting out RAV split
 - Detailing and refinements to the modelling assumptions
 - I&C metering strategy / link to regulation
 - Implications for tariffs
- Final Proposals (December)
 - Submitted to Ofgem for approval
 - ROR
 - I&C metering strategy / link to regulation
 - Implication for tariffs
- Consider proposals (December to February)
 - Review recommendations
 - Further consultation / stakeholder engagement on decision



Promoting choice and value
for all gas and electricity customers

Break



NGM Approach to Pricing Proposals

Eric Fowler
National Grid Metering

Our role

“Helping to guide the orderly transition from traditional meters to smart technologies”

Review of current regulatory arrangements (RoMA)

Smart meter roll-out creates differing paths for Domestic and I&C

As populations decline:

- Maintaining appropriate services to customers and consumers
- Loss of economies of scale

As meter returns increase:

- Greater volumes of hazardous waste
- Larger recycling and disposal volumes

Differing paths

Domestic

- Sterile market for non-smart
- Potential benefits in aggregation
- Timebound
- Defined smart solution
- Regulation of charges

I & C

- Active market
- Highly Competitive
- Differing smart solutions
 - Retro-fit to existing
 - Full smart (U6)
- Market drives services

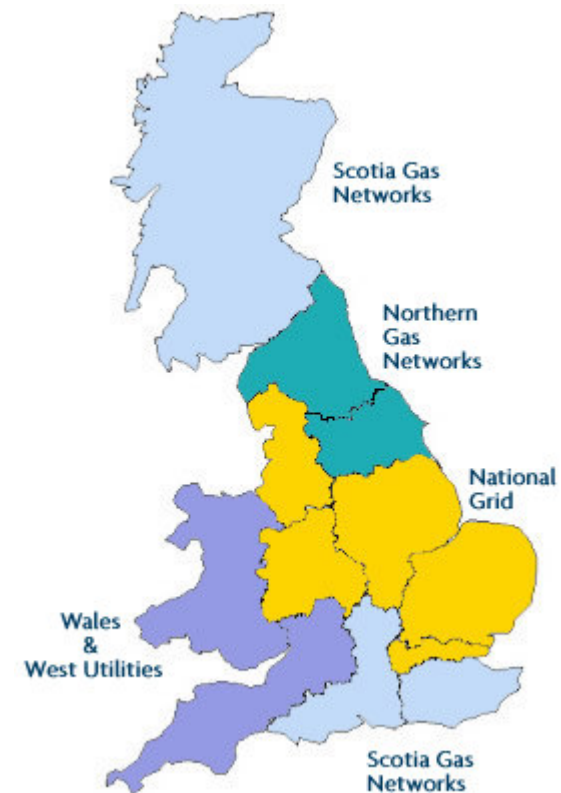
Sectors becoming increasingly different
and smart will reinforce this

Pricing Consultation - Areas of Treatment

- Positioning our Domestic and I&C businesses
- Duration of B-MPOLR and NMM obligations and any pricing periods
- RAV assessment, allocation and rate of return
- Traditional meter displacement rates
- Domestic workload, requirements for other services, operating costs and capital expenditure

Backstop Meter Provider of Last Resort

- Meters installed by the B-MPOLR owned and maintained by NMM
- National backstop metering provider supporting existing MPOLR arrangements
- Obligation owned by NGG
- Allows other Distribution networks to back-off their MPOLR obligations – provides exit strategy for those not wishing to undertake metering
- Obligation sunsets with the start of smart mass roll-out
- Uncertainty over possible installation volumes and ratio of PPM to DCM



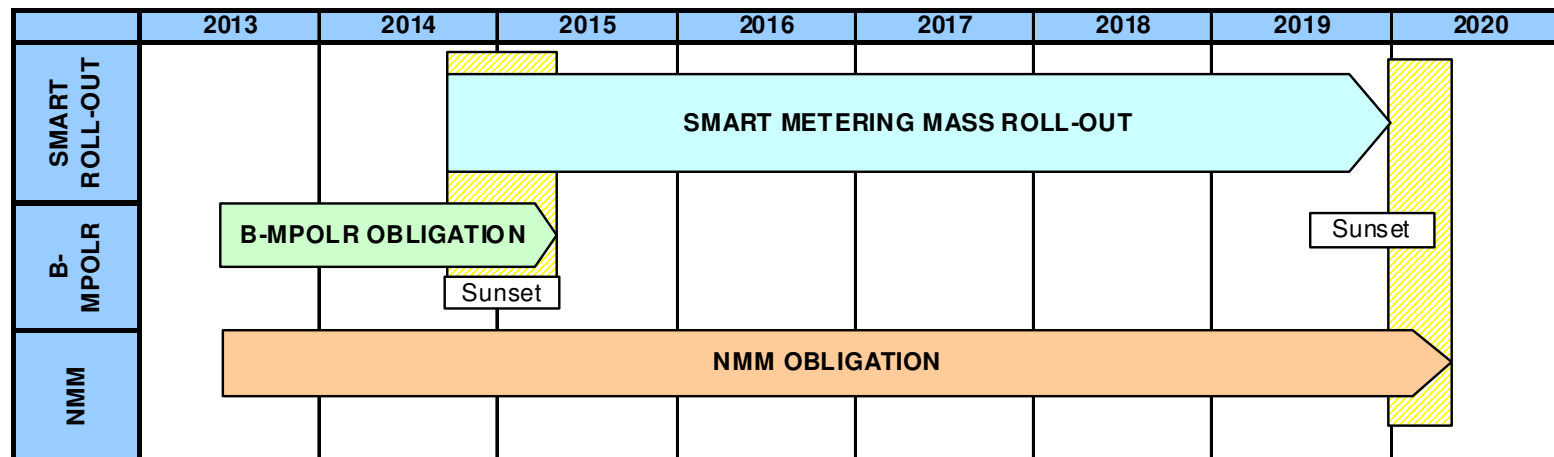
The role of the National Metering Manager

- Role developed by Ofgem through RoMA
- National role in traditional domestic metering
- Endures to the end of mass roll-out
- Last resort provision for new/replacement meters and maintenance prior to exchange, ensuring safety and integrity
- Possible adoption of assets – potentially in variable condition
- Decreasing meter density as roll-out progresses



Initial Assumptions

1. Duration of obligations or pricing restrictions



- Assume B-MPOLR and NMM obligations commence mid-2013
- B-MPOLR falls away March 2015, following the smart mandate implementation in Q3 2014
- NMM obligation endures to March 2020 and the end of mass roll-out
- Expectation that tariff caps lifted for new installations occurring after B-MPOLR sunset

Initial Assumptions

2. Rate of Return

- Metering rate of return proposed derived from Distribution return proposed in RIIO-GD1
- Licence obligation rests with Distribution so logical to maintain this link
- Includes risk factor of 0.75% recognising inherent risks in metering, largely due to uncertainties surrounding the smart roll-out

	Pre-Tax Real %
RIIO GD1 Proposal	5.77
Metering Risk	0.75
RoR Proposed	6.50

Initial Assumptions

3. DECC lower-bound displacement rate

% Meters Installed	Lower bound	Central case	Higher bound
Dec 2016	49%	57%	70%
Dec 2017	66%	77%	90%
Dec 2018	83%	91%	97%
Dec 2019	94%	97%	100%
Dec 2020	98%	100%	100%

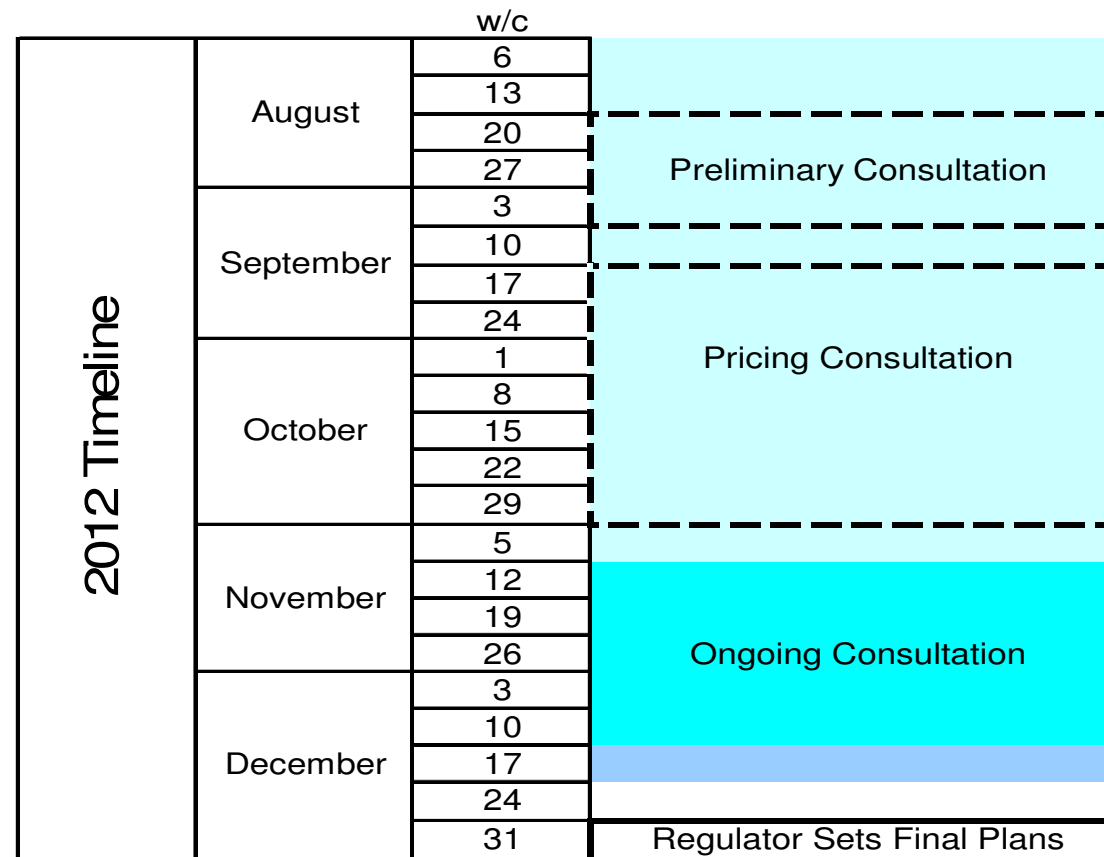
- Uncertainty remains over exact start date of mass roll-out
- Modelling approach consistent with current DECC expectations
- DCM and PPM displacement spread evenly and in proportion to portfolio

Dealing with Uncertainty

- Possible variations in smart timeline
 - Duration of obligations
 - Likely volumes of MPOLR & B-MPOLR fits
 - Requests to undertake asset transfers
- Traditional meter displacement rates
- Consumer attitudes to smart metering
- Ongoing consultation on implementation and exemptions
- Outcome of Pricing Consultation
 - seeking views on key assumptions



Pricing Consultation Timeline



- Develop Business Plans
- Discuss Detailed Plans with Regulator
- Deliver Final Proposals

Introducing Engage

Tom Hainey
Engage Consulting

Introduction to Engage

**Independent Specialist
Consultancy**

**Experts with years of
experience**

**Breadth of energy and
utilities knowledge**

Energy & Utilities Consulting

**Smart Metering
& Smart Grids**

**Revenue & Margin
Assurance**

**Energy &
Utilities IS**

**Industry Insight &
Strategic Business
Advice**

**Project
Management &
Assurance**

**Business Process
Improvement &
Operational
Support**

**Software as a
Service & Bespoke
Development**

Overview of our work across industry



Objectives

- Stakeholder Feedback on NGM's Initial Charging Proposal
 - Structured & Transparent
 - Engaging & Valued
 - Effective & Timely
- Enable NGM to:
 - Produce final pricing proposal
 - Having engaged fully with Stakeholders
 - Complete Consultation to Ofgem's and Stakeholders' satisfaction

Process

nationalgrid

Initial Charging Proposal



Event to present Initial Charging Proposal & assumptions



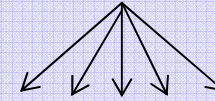
Workshops to distil key issues, views, opinions



Bilateral meetings to get detailed views



Workshop Output



Meeting Output

Consolidated Report

Engage Support

Final Charging Proposal



Approach

Workshops

- Explain key proposal components in more detail
- Discuss related issues
- Distil and capture various views
- Circulate workshop records

Bilateral Meetings

- Arranged on request - Agenda agreed in advance
- Prepared questions as a guide. Not a prescriptive list
- Explore areas of concern and understand reasons. Look for options / alternatives
- Capture views in meeting notes with opportunity to review meeting notes
- Confidentiality agreed and respected as required

Consolidated Report

- Independent
- Balanced reflection of Stakeholder views
- Clear journey from proposal to findings, issues, themes and conclusions
- Confidentiality respected

NGM will issue invitations for these sessions as required.
Plan first 2 Workshops in first week of October

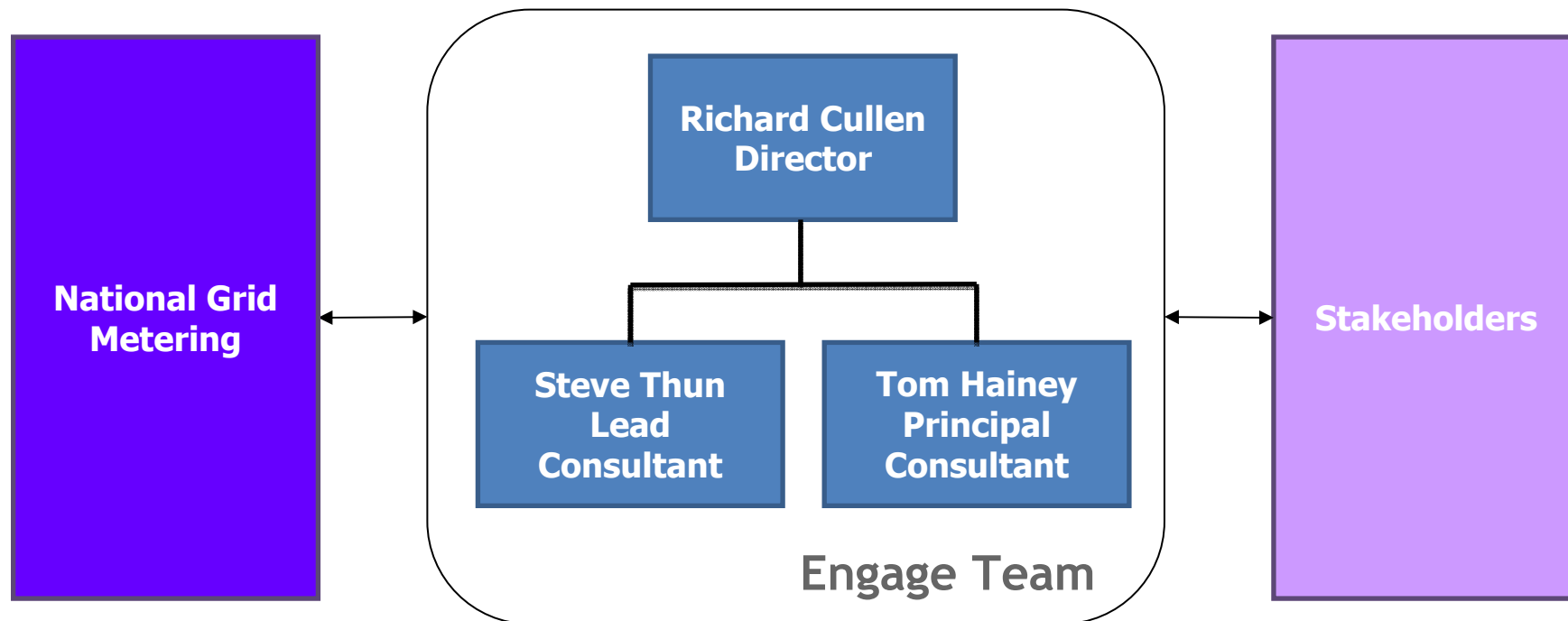
Contact Engage who will set-up these sessions at
ngm.consultation@engage-consulting.co.uk

20th Sep

3rd Nov

32 Working Days

Delivery Team





Any Questions?

Lunch

