

Electricity Transmission

Welcome to the webinar on our RIIO-2 output delivery incentives (ODIs)

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Before we start...



We're covering the electricity transmission owner part of our business, not the system operator or gas transmission



This webinar should last approximately one hour



All callers will be placed on mute



We are asking questions during the presentation



You can message us via the webex chat function

Agenda for the next hour

Part 1: What are output delivery incentives (ODIs)?

Part 2: Ofgem's "common" ODIs for transmission owners

Part 3: Our proposed "bespoke" ODIs

Focus of
today's webinar

Part 4: Next steps and questions

1

What are
ODIs?



What are outputs and output delivery incentives (ODIs)?



Outputs

An **output** is something that an energy network company can deliver to benefit its stakeholders, customers or consumers. An output can be, for example, a service level, a volume of work or a particular project.



Output delivery incentives (ODIs)

Output delivery incentives (ODIs) are incentives for energy network companies to deliver their outputs.

ODIs involve reputational or financial penalties for not delivering an output. They also involve reputational or financial rewards for outperforming outputs.

Why do you need ODIs?

For most of our outputs we do not have ODIs. Instead we have a licence obligation or a “price control deliverable” requiring us to deliver an output, with a consequence if we do not.

The **benefits of ODIs** for certain outputs are:

- ▶ ODIs **promote innovative approaches** as network companies strive to outperform their targets.
- ▶ ODIs **focus management attention** on delivering a target, and outperforming it if possible.
- ▶ ODIs **promote long-term service level improvements for customers, stakeholders and consumers**

Ofgem's RIIO-2 framework includes common and bespoke ODIs

Common ODIs

- Common ODIs apply to all three electricity transmission companies.
- Ofgem decided what the common ODIs are in its May 2019 sector-specific methodology decision.
- Ofgem is working with stakeholders on the design of the ODIs.

Bespoke ODIs

- Bespoke ODIs are specific to individual companies.
- They allow network companies to reflect their stakeholders' specific preferences.
- Ofgem has decided on the criteria it will apply to bespoke ODIs.
- Ofgem will review our bespoke ODIs as part of its assessment of our final business plan.

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Common ODIs



The common ODIs for RIIO-2

The four common financial ODIs applying to the three transmission owners are:

Quality of connections survey

This ODI encourages companies to improve their service quality for customers connecting to their networks.

Energy not supplied (ENS)

This ODI encourages companies to reduce the amount of energy they do not supply.

SF₆ and other insulation and interruption gases (IIG) leakage

This ODI encourages companies to reduce their leakage of insulation gases that contribute to global warming.

Timely connection offers

This ODI encourages companies to provide connection offers to customers on time.

Ofgem will propose the value of the incentives package in its draft determinations in June 2020.

Electricity
Transmission

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Our bespoke
ODIs

proposals

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Our proposed bespoke ODIs

Area	Proposed ODI
1. Environment	An environmental scorecard ODI or Three separate environmental ODIs on specific issues.
2. Whole system (SO:TO optimisation)	ODIs on providing an enhanced service to the system operator (SO). Note: this is a fallback approach if we cannot create a market-based system.
3. Satisfaction with outage management	An ODI on customers' satisfaction with outage management Note: this might be included in Ofgem's common ODI.
4. Connection cost and date	An ODI to encourage us to reduce our connection costs and to provide connection dates that suit our customers.

The environment – two options

Our stakeholders want us to improve our environmental performance. We are considering an ODI or a number of ODIs to encourage us to improve the environment beyond the already stretching commitments in our environmental action plan.

Two Options

Option 1:

A “scorecard” ODI to encourage us to deliver and outperform seven of the targets in our environmental action plan.

Option 2:

Three environmental ODIs covering:

- 1) Controllable carbon footprint (excluding SF₆)
- 2) The carbon intensity of construction
- 3) Natural environment improvements

Option 1 – An environmental scorecard (slide 1)

The environmental scorecard ODI covers the measurable parts of our environmental action plan (EAP).

Number	Metric	Values for Year 5				
		Penalty level 2	Penalty level 1	RIO-2 target	Reward level 1	Reward level 2
1	We will replace 60% of our operational fleet with low carbon alternatives.	52%	56%	60%	64%	68%
2	We will have 75% of our top 250 suppliers with carbon reduction targets.	65%	70%	75%	80%	85%
3	We will recycle 60% of our operational and office waste	50%	55%	60%	65%	70%
4	We will reduce the waste we create at our offices (waste tonnage) by 20%	10%	15%	20%	25%	30%
5	We will reduce our water use by 20%	10%	15%	20%	25%	30%
6	We will increase the value of natural capital on our non-operational land by 10%	6%	8%	10%	12%	14%
7	We will deliver Net Gain in environmental value (including biodiversity) on all construction projects (including those delivered by third parties)	-10%	-5%	1%	5%	10%

Option 1 – An environmental scorecard (slide 2)

There is a scoring system to turn our performance into a score each year:

Scoring system:

2 points for being above reward level 2

1 point for being above reward level 1

0 points for being between reward level 1 and penalty level 1

-1 point for being below penalty level 1

-2 points for being below penalty level 2

There is a penalty or reward based on our performance / score each year.

Score	-14 to -11	-10 to -8	-7 to -5	-4 to -2	-1 to +1	+2 to +4	+5 to +7	+8 to +10	+11 to +14
Penalty / reward	-£4m	-£3m	-£2m	-£1m	£0m	£1m	£2m	£3m	£4m

Option 2: Three individual environmental ODIs (slide 1)

Option 2 involves three individual ODIs on elements of our environmental action plan:

Controllable carbon emissions (excluding SF₆)

This ODI encourages us to reduce our controllable carbon emissions (excluding SF₆) beyond the target in our environmental action plan. SF₆ is covered by an Ofgem common ODI. The incentive rate would reflect the cost of carbon.

Carbon intensity of construction

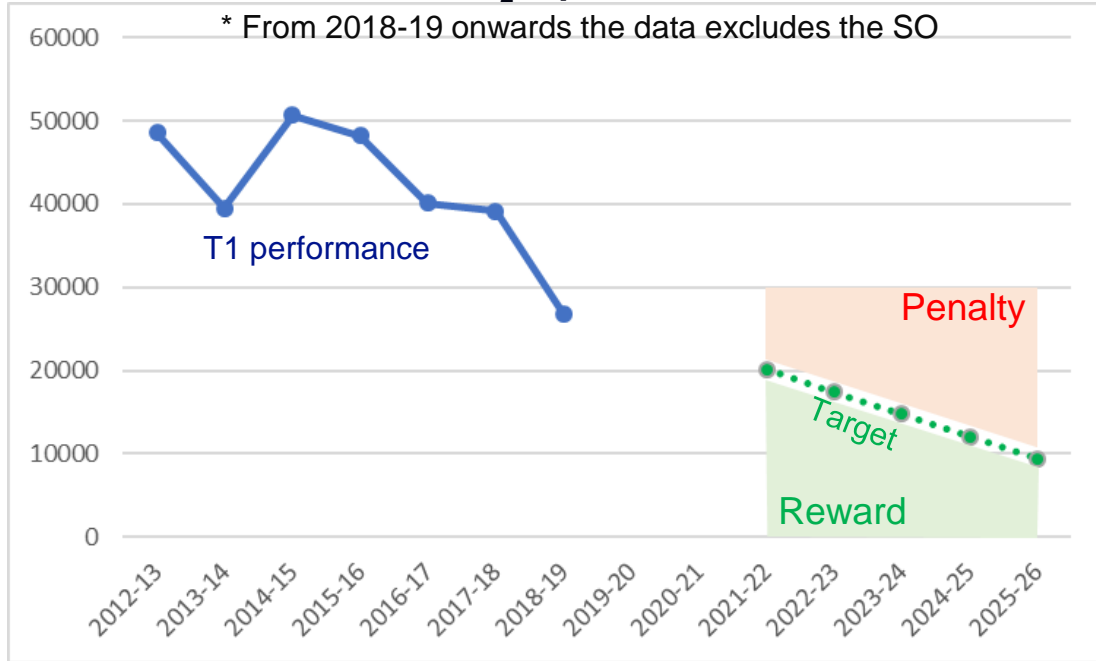
This ODI encourages us to deliver our carbon neutral construction target through fewer carbon emissions and less offsetting. The incentive rate would reflect the cost of carbon.

Natural capital improvements

This ODI encourages us to increase the natural capital of our non-operational land by more than the 10% target in our environmental action plan. The incentive rate would reflect the value of the natural capital.

Option 2: Example of an individual ODI

NGET controllible carbon footprint (excluding SF6) in tonnes of CO₂ equivalent



We use the target in the environmental action plan.

If we do not achieve our target in any year we will incur a penalty scaled for the size of the underperformance.

If we outperform our target in any year we can earn a reward scaled for the size of the outperformance.

The incentive rate would be based on the non-traded carbon price.

Environment ODIs question

Advantages of Option 1 (a scorecard ODI)

- It encourages us to deliver more of our environmental action plan.
- The incentive links to an overall view of how we are performing on our environmental action plan.

Advantages of Option 2 (separate environmental ODIs)

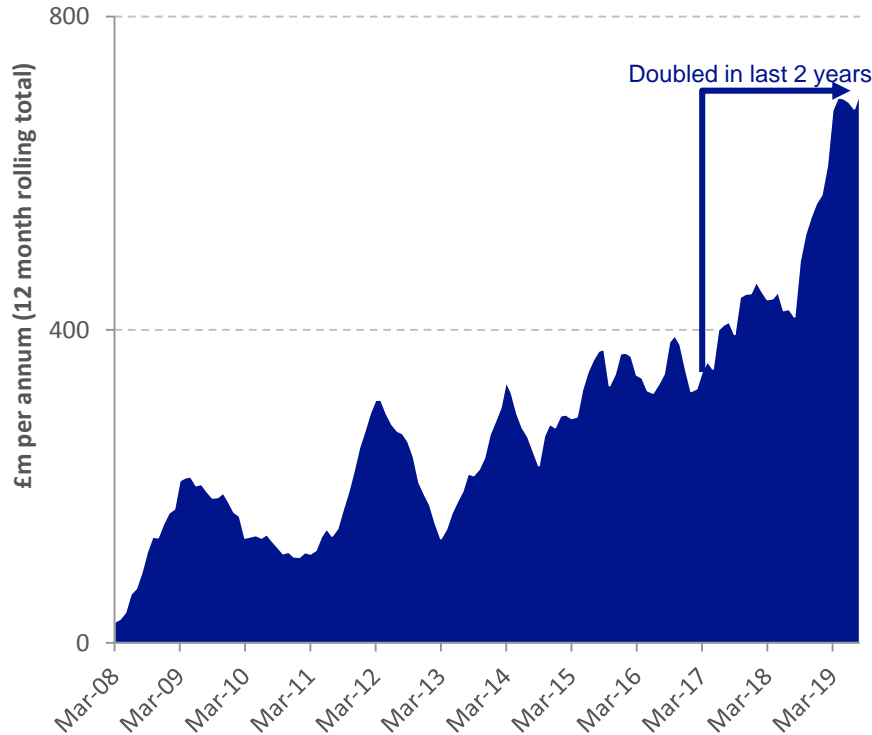
- They are easier to understand.
- The incentive rates can be linked more directly to the value of performance

Question 1:

Do you prefer Option 1 (a scorecard ODI) or Option 2 (separate environmental ODIs)?

- a) Option 1 (a scorecard ODI)
- b) Option 2 (separate environmental ODIs)
- c) No strong preference

Whole systems - SO:TO optimisation



Constraint costs have been increasing over the last 12 years and have doubled in the last 2 years. This represents a large amount of value we can unlock for consumers.

We, as a transmission owner (TO), could provide enhanced services to help the SO to reduce these constraint costs. Coordination has improved in the T1 period.

The regulatory framework gives us a strong incentive to reduce our own costs. We need a mechanism to encourage us to incur costs to reduce whole system costs for consumers.

SO:TO optimisation – two options

We are considering two options for us to unlock the whole system savings of SO:TO optimisation for consumers.

Two Options

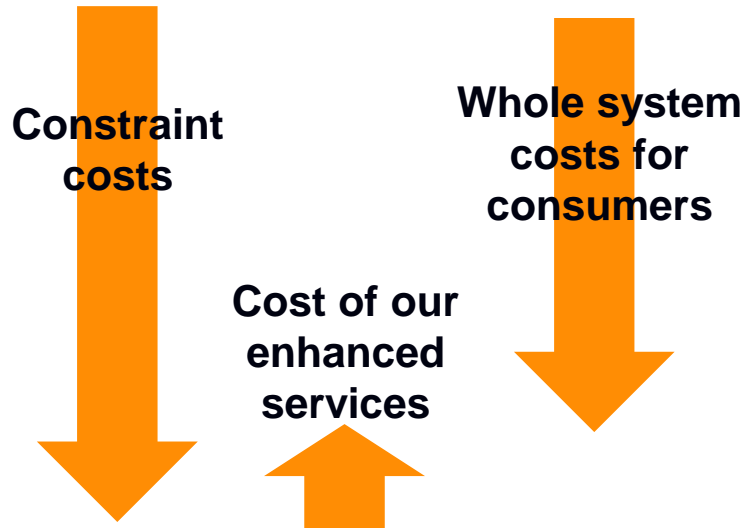
Option 1:

Our preferred approach is a **market-based system for SO:TO optimisation** where the SO can make payments directly to us when it wants to use enhanced services.

Option 2:

An alternative is to use **ODIs** to incentivise us to incur the costs of providing enhanced services, which are then available to the SO.

SO:TO optimisation – A market-based approach



What ?

We offer enhanced services to the SO above the baseline service we have been funded to provide.

Why ?

It will assist the SO to reduce the cost of managing the UK power system. The SO will only use our service when it reduces costs by more than the price of our service.

Barrier

The current processes are rarely used due to the administration involved and the tight cap on the costs that TOs can recover.

How?

Introduce a market-based mechanism to allow us to recover the price of our enhanced services to enable the SO to reduce whole system costs.

SO:TO optimisation – ODIs

In the absence of a market-based approach ODIs could start to unlock some of the potential value for consumers and they fit better into the RIIO-2 regulatory framework. They provide an incentive for us to incur the costs to work differently and provide enhanced services to reduce whole system costs.

	ODI	Objective
1	Reduce planned system access	To encourage us to reduce the time we plan to make the system unavailable while we maintain and upgrade the network.
2	Develop shorter planned emergency return to service (ERTS) times	To encourage us to provide options to allow the return of a circuit to service more quickly when the SO calls for it.
3	Improve the return time for unplanned outages	To encourage us to reduce the duration of unplanned network outages.
4	Provide flexibility above asset design conditions	To encourage us to provide flexibility to the SO for assets to go beyond their design conditions for a defined period.

SO:TO optimisation question

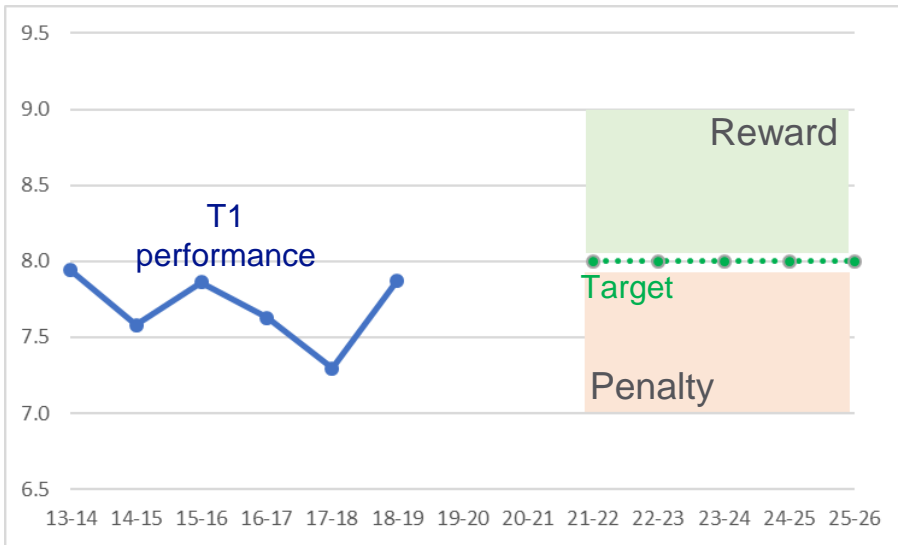
Question 2:

What should the annual financial cap on any rewards from SO:TO optimisation ODIs be?:

- a) £50m
- b) £20m
- c) £10m
- d) £5m
- e) £1m
- f) No rewards

Satisfaction of customers with outages

We can save our customers significant costs by improving how we communicate and manage outages. We are proposing an ODI based on a survey on how well we have done this.



Using data on our performance in the T1 period we could set a target of perhaps 8.0 for our customers' satisfaction with outages for the T2 period.

Based on the incentive rate in Ofgem's T1 incentive we could incur a penalty of £0.6m for a satisfaction score 0.1 below target, with a reward of £0.6m for being 0.1 point above the target.

Note: If Ofgem includes outages in its quality of connections common ODI we expect to drop this ODI.

Satisfaction of customers with outages question

Question 3:

Which form of target do you prefer for our satisfaction of customers with outages ODI?:

- a) A target set in advance that is flat for the 5 years of the T2 period
- b) A target set in advance that increases over the 5 years of the T2 period
- c) A target that adjusts based on performance during the T2 period
- d) No preference

Connection costs / dates

Our customers want us to deliver connections at low cost on a date that suits them. An ODI could encourage us to do this.

Costs: Currently we pass the outturn costs of connections to customers. This contrasts with the rest of our cost base, where if we reduce costs we and our customers share the savings. We could target an ODI on savings costs or on increased cost certainty.

Dates: The government's net zero target requires an acceleration in low carbon generation connecting to our network. We could target an ODI on speeding up connection times or making connections as close to customers' preferred dates as possible.

Connection costs / dates question

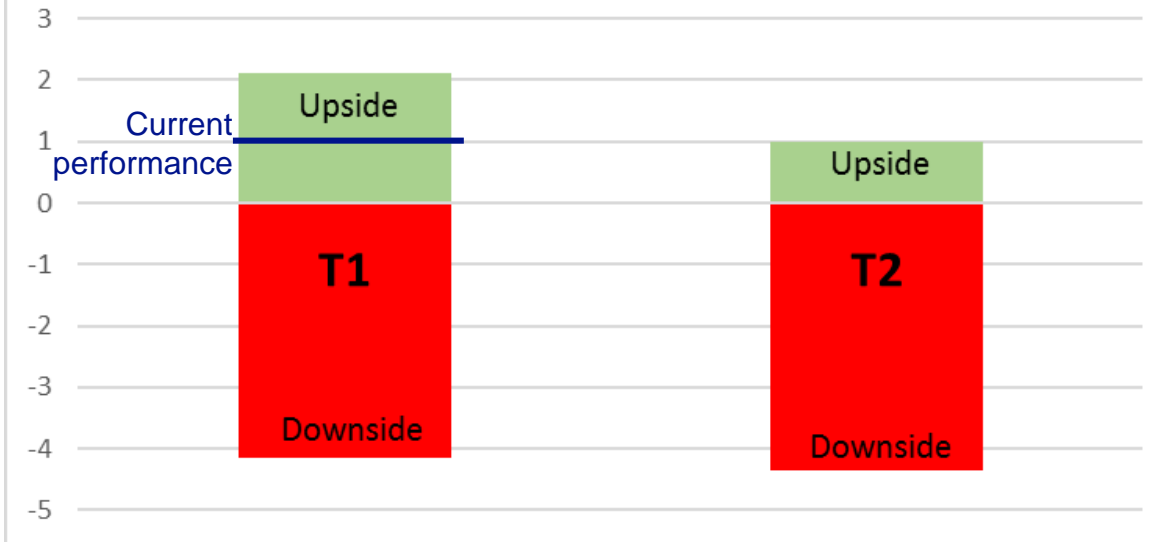
Question 4:

What is your priority for a connection?:

- a) Lower costs
- b) More certain costs
- c) Quicker connection dates
- d) Connection dates close to your preference
- e) No strong preference
- f) Not applicable to my organisation

Overall size of the incentive package

Estimated maximum value of common ODIs in T1 and T2 period (% of annual revenue)



We estimate the maximum reward on the common ODIs has halved to around 1% of our revenue in the T2 period. The targets will also be harder to achieve.

Overall size of ODI package question

Question 5:

Do you think our overall ODI package (common and bespoke ODIs) should be:

- a) Bigger than in the T1 period
- b) About the same as in the T1 period
- c) Smaller than in the T1 period
- d) No strong preference

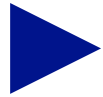
In this question we are referring to both penalties and rewards.

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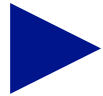
Next steps and questions



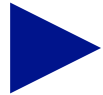
Next steps



We will take account of your feedback in the bespoke ODIs we propose in our **final business plan on 9 December 2019**.



Ofgem will provide its views on our proposals and the common ODIs in its **draft determinations in June 2020**.



Ofgem will decide on all the ODIs in its **final determinations in November 2020**.

Answering your questions

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