

RIIO-GD2 Year Two Strategic Performance Overview

July 2023



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Strategic performance overview

Chief Executive's update

I'm pleased to present the second-year report of the RIIO-GD2 price control period, looking back on another challenging year for our business.

The ongoing cost of living crisis and wider economic and geopolitical issues have collectively brought disruption on a scale not imagined just a few short years ago.

However, I am pleased to say that as a business we have risen to the challenge – all down to the fantastic efforts of our people. Our continued excellent delivery for customers across Wales and south west England is a testament to their efforts and something that I, alongside my leadership team, are proud of.

In this second year we have achieved all our Guaranteed Standards of Performance and have the appropriate operational resources in place. However, we anticipate significant challenges over the rest of the price control period, not least based on the financial pressures facing the business from the inadequate price control settlement, and the impacts of the wider economic and political issues we are all facing.

At the start of RIIO-GD2 we undertook a number of actions to respond to the cost challenges associated with the price determination. This included a fundamental review of our work and how we do it, leading to a major organisational restructure, the insourcing of our mains replacement work and a significant headcount reduction across the business.

We also took the opportunity to update our business ambition and priorities. This resulted in an enhanced focus on sustainability, something all our stakeholders told us was important.

Some of our notable achievements in the year include:

- **Demanding Safety Always:** We continue to respond to over 97% of gas emergencies within 1 hour, even with an abnormally cold and protracted winter period which was our busiest for 12 years. We have replaced more than 440 kilometres of old metal gas pipes in the year – further removing risk from the network. For the tenth year in a row, we have been awarded the RoSPA Gold award, achieving the President's award, another first in our sector.
- **Driving Outstanding Service:** We have continued to provide excellent customer service achieving incentive rewards for our annual scores. We are also proud to have achieved Institute of Customer Service ServiceMark 'Distinction' status something achieved by only 20 of its 400 leading business members, and to be in the first 9 companies worldwide to be awarded the new ISO22458 Inclusive Service standard by the British Standards Institute (BSi). The Vulnerability & Carbon Monoxide Allowance has allowed us to give further support to those most in need during the cost of living crisis through partnerships with organisation such as Citizens Advice, National Energy Action, SCOPE, Fuel bank Foundation and Warm Wales.
- **Delivering Value for Money:** we continue to keep our charge within the customer bill flat, however there are some one-off cost increases recovered through our charges which are not



within our control. The overall customer bill has increased by £28 to £157¹, £25 of which is driven by Supplier of Last Resort costs as a result of the unprecedented failure of a significant number of energy suppliers in 2021 & 2022, and £5 increase for exit capacity costs. These are both costs we collect on behalf of other organisations as pass-through allowances.

- **Providing Sustainable Energy:** We recognise that delivering Net Zero carbon emissions across the energy system and the economy more widely requires a huge effort around engagement, collaboration and delivery. We are proud to be working with forward thinking organisations across the areas we serve, for example the South Wales Industrial Cluster in the development of their plan, which was launched in March 2023. We are also partners in nationally significant projects such as the Redcar Hydrogen Community with NGN, which is looking at converting some 2,000 homes and small businesses to hydrogen from natural gas.
- **Designing our Future:** Like many organisations we have been impacted by a significant increase in the turnover in our people, peaking at c.13%. Whilst by national standards this is still low, to ensure we remain 'an employer of choice', we revamped our recruitment and onboarding processes, and have restarted our development programmes and supported the wellbeing of our colleagues by launching a financial wellbeing programme. Following these interventions we have seen our turnover decrease to 7%, in line with our historic average, and are also proud to retain our Investors in People Silver Level accreditation. We are also developing the skills needed to transition to a hydrogen gas future.

The global threat from climate change could not be starker. 2022 was one of the six warmest years on record globally, and the warmest on record for the UK. As the Committee on Climate Change has summarised,² these impact not only our environment but also our health, and our economies. 2023 is also shaping up to be another relatively warm year, and future projections are for warmer overall temperatures; increased frequency of hot spells, and changes to rainfall patterns including increased likelihood of wetter winters.³

As the world responds to a changing climate and moves away from fossil fuels, considerable changes will affect our colleagues, customers and business. We are proud to have published our first Sustainability Strategy⁴, which puts our customers and stakeholders at its centre. We recognise that we have a vital role to play in the transition to a low-carbon economy, and we will need to work closely with a wide range of partners to deliver the system-wide changes required to support the UK's net zero carbon commitments.

Our innovation and future of energy activity is helping us understand the transition required across the UK and in particular in the areas we serve. We are working collaboratively with other energy networks on national projects to establish the feasibility of a transition to hydrogen for a range of customers and communities, and to deliver the fundamental evidence required for policy decisions and our own delivery activity.

We have once again achieved our Standards of Performance in the year, and forecast to meet all of our RIIO-GD2 regulatory outputs. However, we expect to face continued challenges in terms of our financial performance due to inadequate allowances and the price pressures we are all facing. Our 2022/23 Totex outperformance of 3.2% is a timing benefit with some work deferred into later years of the price control; in particular in Capex for a specific high pressure pipeline project, which is still expected to be delivered in RIIO-GD2, but later than the timing of allowances. We also continue to embed the efficiencies made in

¹ In 18/19 prices

² [Progress in reducing UK emissions - 2023 Report to Parliament \(theccc.org.uk\)](https://www.theccc.org.uk/2023/03/23/progress-in-reducing-uk-emissions-2023-report-to-parliament/)

³ [ukcp18_headline_findings_v4_aug22.pdf \(metoffice.gov.uk\)](https://www.metoffice.gov.uk/news/2023/08/22/ukcp18-headline-findings-v4-aug22.pdf)

⁴ <https://www.wwutilities.co.uk/media/4824/sustainability-strategy-2023.pdf>

the utilisation of our skilled workforce but this is more than offset by the above inflation costs we continue to experience, in particular associated with our mains replacement programme where we are seeing increases in contract labour, materials and traffic management costs. In the past twelve months for example the cost of pipe & fittings has increased by 47% (c.£3m), the cost of traffic management has increased by 70% (c.£1.5m). Such significant cost increases, coupled with the challenge which already existed as a result of the inadequate RII0-GD2 price determination allowances makes delivery within those allowances extremely challenging. All this influenced our decision to appeal to the Competition & Markets Authority (CMA) against the determination.

That said our focus remains unchanged; meeting the high standards of delivery and service that the customers and communities we serve expect whilst preparing for a greener tomorrow which will benefit future generations.

Graham Edwards – Chief Executive

Board Statement

We are pleased to share this report which summarises the second year of the RIIO-GD2 regulatory control period, a year which has continued to embed the organisational changes implemented in the prior years, changes that ensure we have a sustainable, resilient and fit for purpose organisation that meets the challenges of the evolving energy future and the UK government's commitment to net zero.

As a Group we continue to strive towards our ambition to be *'Trusted to expertly serve customers and communities with safe, reliable and affordable energy services today, whilst investing wisely to create a sustainable, greener future.'*



The role and effectiveness of the Board

Our Board is responsible for ensuring leadership through effective oversight and review. Supported by its principal committees – Audit, Health & Safety, Remuneration, Treasury and the recently established Environmental, Social & Governance ('ESG') committee – the Board continues to set the strategic direction and aims to deliver sustainable shareholder value over the longer term. The work of the Board complements, enhances and supports the work of Wales & West Utilities' Executive Committee and leadership team.

We believe that effective governance is realised through leadership and teamwork. Collaboration across all levels within the Board structure drives a culture of continuous improvement. Operating performance is managed daily by the local Executive and leadership team who are committed to meeting the RIIO-GD2 price control deliverables, and delivering what customers need. They are also committed to delivering their part of the UK government's net zero future.

It is with sadness that we report the death of Michael Pavia, a long standing independent Non-Executive Director, during the year. Michael was committed to his role, fully participating in Board and Committee meetings, offering valuable independent advice from his many years of financial and business experience to management and the Board over 11 years. He will be sorely missed by all those who knew him.

We are however pleased to announce the appointment of Mr Mike Davis, on 1 April 2023, as the replacement independent Non-Executive Director.

Andrew Hunter - Chairman

Performance Summary

Our key deliverables for customers are set out below and discussed in further detail in the supporting sections.



The customer bill impact quoted is in 18/19 prices

Our Year Two Totex Performance

In year two we have, once again, out-performed the allowance by £7.9m (3.2%) against adjusted allowances⁵. However, this out-performance is largely the result of unavoidable delays in the timing of expenditure compared to when it was expected to be incurred at allowance setting, in particular in Capex for a specific high pressure pipeline project which is still forecast to be delivered in RIIO-GD2 but later than the timing of allowances. Adjusting for this results in an underlying £2.8m under-performance in 2022/23 due to insufficient allowances being awarded for Repex – this is set out in the waterfall over the page.

The section below explains the underlying variances in our totex year two performance. However, this one year cannot be viewed in isolation with our overall performance spread across the 5 years (2021-26) and a large proportion of our price control deliverables being cumulative targets, rather than individual year targets. We discuss the 5-year position following the second year performance section below.

The allocation of allowances across Opex, Repex and Capex activities included in this document remain draft as we continue to work with Ofgem and the other GDN's to finalise the disaggregated allowances for RIIO-GD2.

Our key messages for the year 2 outperformance are:-

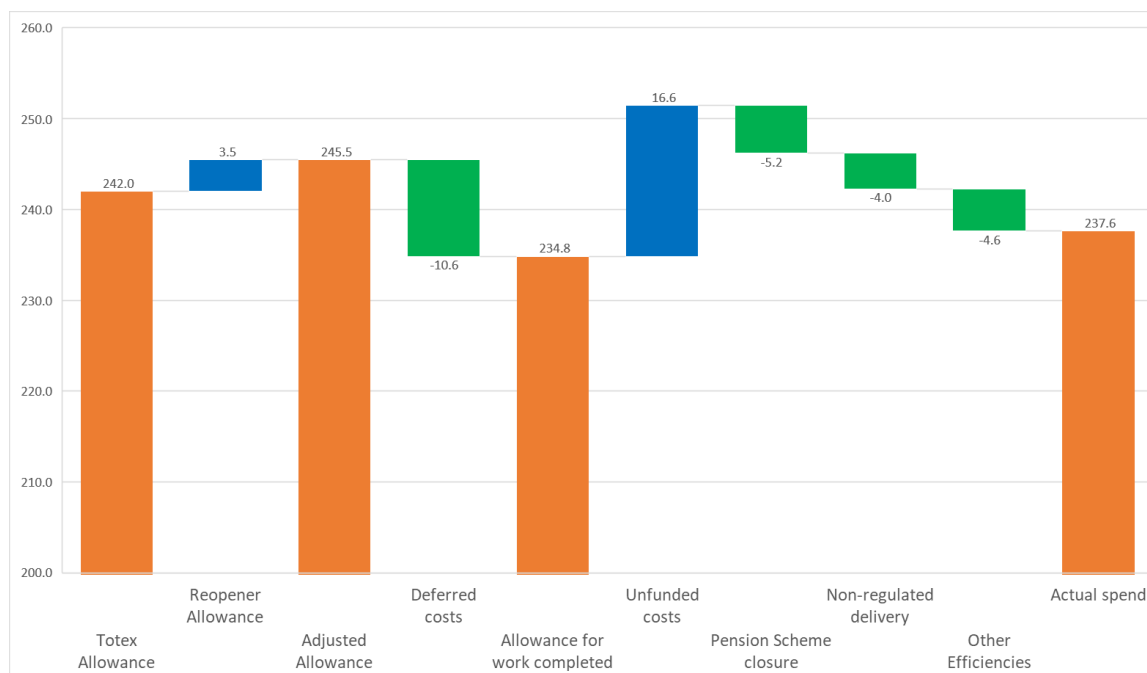
- We have the appropriate resources to continue to achieve our standards of performance and deliver our price control regulatory outputs, however we face growing cost pressures
- Utilisation of our workforce on non-regulatory work has reduced Opex costs to the benefit of customers
- Our Capex outperformance is largely driven by receiving allowances for work not yet completed and therefore expenditure not yet incurred; this is planned to be delivered later in the price control
- Underlying Repex costs continue to underperform due to insufficient allowances set at Final Determination, validating our appeal to the Competitions and Markets Authority (CMA).

£m 18/19 prices	Actual	Allowance	(Out)/Under	%
Opex	88.1	98.5	(10.4)	(10.6%)
Capex	51.3	56.4	(5.1)	(9.0%)
Repex	98.2	87.0	11.2	12.9%
Totex	237.6	242.0	(4.4)	(1.8%)
Reopener Adjustment	-	3.5	(3.5)	-
Adjusted Allowance³	237.6	245.5	(7.9)	(3.2%)

Our true underlying position

The waterfall below shows our true underlying position for year two; a £2.8m under-performance once recognising that part of our year two performance relates to allowances where certain work has not been completed and where further costs to deliver it will be incurred in later years of the price control. However, we still expect to deliver all the work in this price control period.

⁵ Adjusted Allowances is our assumption of allowances uplifted for reopeners assumed at 100% recovery matched to costs included in the forecasts and actuals, in the year which they are incurred – not the revenue reopener windows.



Re-opener allowance (£3.5m) recognises that our actual spend includes £3.5m of cost relating to Cyber IT & OT resilience, large load connections and development claims which we expect to recover through the re-opener mechanisms (see Variant Allowance section later for further explanation).

(Ofgem category: not applicable)

Deferred costs (£10.6m) represents allowances in year two but the cost is now expected to be incurred later in the price control. This includes:

- Our high-pressure pipeline replacement project, HN039, which will be delivered in future years in a different phasing to our allowances (c.£8m), due to delays during planning this complex replacement e.g. ecological surveys and obtaining planning consents.
- A continuation of the delay of vehicle delivery, moving expenditure into future years due to supply issues and purchasing lead times. These vehicles are on order, and we will incur this c.£2m cost next year.

(Ofgem category: External factors 20%, Provision in the price control settlement 80%)

Unfunded costs (£16.6m) represents specific areas of totex spend that are outside of our totex allowance. This includes:

- A significant adverse price variance on mains replacement given the price increases and cost pressures we have experienced, which are in excess of the allowances awarded. We have referenced these cost pressures in the next section.
- The cost of building our new Bristol depot which was not part of our business plan
- An increased cost base above allowances of delivering our strategic investment in IT.

(Ofgem category: Provision in the price control settlement 100%)

Pension Scheme closure (£5.2m) is the estimated savings of closing the Defined Benefit section of the pension scheme to future accrual in July 2021 with the existing Defined Contribution section of the scheme now operational across the organisation.

(Ofgem category: Efficiency 100%)

Non-regulated delivery (£4.0m) represents non-regulatory work (Metering and third party work) where we have targeted the productivity of our workforce, especially our Emergency First Call Operatives (FCOs) who are required to maintain a headcount sufficient to manage the demand of an emergency service, requiring sufficient FCOs to be employed to support “on call” availability 24/7/365 in case they are required to respond to an emergency across our network. FCO’s are delivering Metering work, Repex purge and relights and surveys to ensure the necessary, but unproductive element of their role is utilised on value adding activities wherever possible. Third party contracts are short term and end within the RIIO-GD2 period.

(Ofgem category: Efficiency 100%)

Other efficiencies (£4.6m) includes incremental cost reductions across totex where we continue to utilise our workforce across all activities to reduce the expenditure and reliance on external contractors while ensuring we maintain an efficient and skilled workforce.

(Ofgem category: Efficiency 100%)

Cost pressures

We continue to experience significant cost pressures across all major cost categories with a particular impact on our Mains Replacement activities. These include:

Contract Labour – contract labour constitutes a quarter of our Build and Repair workforce following the insourcing of the Repex Tier 1 contractor workforce in 2022. The contractor labour market continues to be turbulent, with teams threatening to leave on a weekly basis - in year two we have seen a 23% turnover rate in this contract labour headcount. Our contract partners are not only being approached by other GDNs who have significant recruitment drives underway to recover backlogs in their own work, but also by other industries (electric, water and telecoms). Their financial demands continue to increase, particularly those that work within the M4 and M5 corridors or close to the Hinckley Point C construction site. We continue to closely manage the risk of losing contractors, focusing on maintaining strong relationships with locally based contractors. As we enter year three of the price control we have adequate local resources to deliver all of our RIIO-GD2 outputs.

WWU industrial staff – we continue to experience an 7% churn of industrial staff, down from a peak of 13%, which is unlike anything we have seen previously. This level of turnover in a skilled workforce that takes years to build competency is creating a skills-drain, programme disruption and increased cost of on-boarding & training. Of concern is the continuation of skilled labour moving out of our industry completely. We have tackled this by revamping our recruitment and retention processes, increasing our recruitment, and escalating our training programme. We have also agreed a long-term five-year CPI-H linked pay deal with the unions which provides our employees with certainty over pay for the whole of RIIO-GD2.

Vehicles – the global backlog of new vehicle availability has impacted on our underlying cost base; it has resulted in both increased servicing/repairing of older owned vehicles and in many areas of our business we are hiring vehicles/assets at a high market price whilst waiting for deliveries of vehicles with 12-18

month lead times. We are hoping that in year three the delivery of new vehicles will ease this pressure, however our delivery timings continue to be pushed outwards.

Pipe and fittings – We have seen a 47% increase (c.£3.5m) in the price of pipe and fittings over the 12-month period. At the moment we are only contracting on a 12-month basis given the price fluctuations. There are very few pipe and fittings producers/suppliers, limiting our competitive opportunity to keep costs down.

Reinstatement – the labour and material price increases incurred by our contractors continue from last year. Only 6 months after starting new contracts in year one of RIIO-GD2, we had to change the way in which we compensate our contractors for the work they deliver. We now pay “cost plus” for a large geographical area as we’re unable to secure any other arrangements within the geography in which we operate. With all other reinstatement contractors we are having to review cost increases outside of the contract mechanisms in place which include labour, materials and (e.g. slabs, kerbs, edging, cement, sand) tipping costs (e.g. hardcore, subsoil, tarmac). Most recently we have experienced price increases of c.9% which follows a c.10% increase at the start of the year, a £1.6m price variance. We maintain a good commercial relationship with our reinstatement contractors and do not foresee operational risks as a result of these pressures.

Materials – in the current economic environment it is well reported that raw/building material costs have seen unprecedented increases. We have experienced a year-on-year increase of c.50% (£1.8m increase), well in excess of inflation.

Street works and Traffic Management – Our traffic management costs have increased by 70% (c.£1.5m) year on year, this includes price increases but we also continue to experience an increasingly tough stance being taken by Highways Authorities on the requirement for manned traffic management lights, and in particular manning lights for 24 hours. This is across the network with a focus on areas with a permit regime in place such as Bristol, with the costs for these schemes increasing substantially. We are seeing more and more local authorities reviewing the introduction of permitry both in England and Wales. Therefore there is a high likelihood that we will apply for a reopener for this unforeseen substantial increase.

Adverse winter – in the December 2022 to March 2023 period all GDNs experienced severe cold spells, with three distinct cold snaps, resulting in a sharp increase in reported gas escapes and resultant repairs across the network – the highest level for some 12 years. At the same time, these repairs included a higher volume of larger diameter leaking mains which are more complex, time consuming and costly to repair. We deployed our internal workforce to manage this significant increase in workload and complexity incurring additional labour costs (including at premium overtime hours) along with higher material & reinstatement costs. We were extremely pleased to maintain all of our standards and demonstrate the benefit of our in-house delivery model, showing our ability to quickly move our industrial workforce between activities to meet these demands. However, our Opex costs during this period were c.£1.5m higher than the same period in the prior year showing the impact of this weather on our cost base.

Cost mitigation

These cost pressures continue to increase despite the significant steps over the last two years to attempt to mitigate them, including:

- Full review and rationalisation of the organisational structure right across all areas: the back office, operational support and front-line management structures. For instance, a one-off voluntary redundancy scheme was carried out in readiness for this tough price control, and the inclusion of best practice and compliance First Line Managers in the new operational organisational structure is providing tangible benefits
- Transitioned to an in-house managed Mains Replacement programme, as above. With a larger directly employed labour workforce and greater control of all spend categories, we now have greater visibility and flexibility to tackle issues as they arise. This also reduced the cost of contractor fees and associated costs by c.£4m per annum.
- The introduction of a financial incentive scheme across operations, focused on driving and rewarding our staff for incremental operational productivity and efficiencies.
- Agreed a CPI-H linked five year pay deal with the unions covering RIIO-GD2.
- Continued commercial retendering and negotiation of key contracts that drive our cost base including reinstatement, pipe and fittings, traffic management and plant hire. In the current economic climate we are only contracting for a maximum of 12 month periods.

The net impact of the cost pressures despite our ability to mitigate them is an increasing cost base above inflation, and we anticipate further real cost pressures to come. We note that these are not seeing an equivalent increase reflected in the Real Price Effect allowance adjustment.

Our RIIO-GD2 Totex Forecast

As mentioned in the totex annual performance section all totex spend needs to be looked at in conjunction with the 5-year allowances and deliverables – this section sets out our forecast for the full price control.

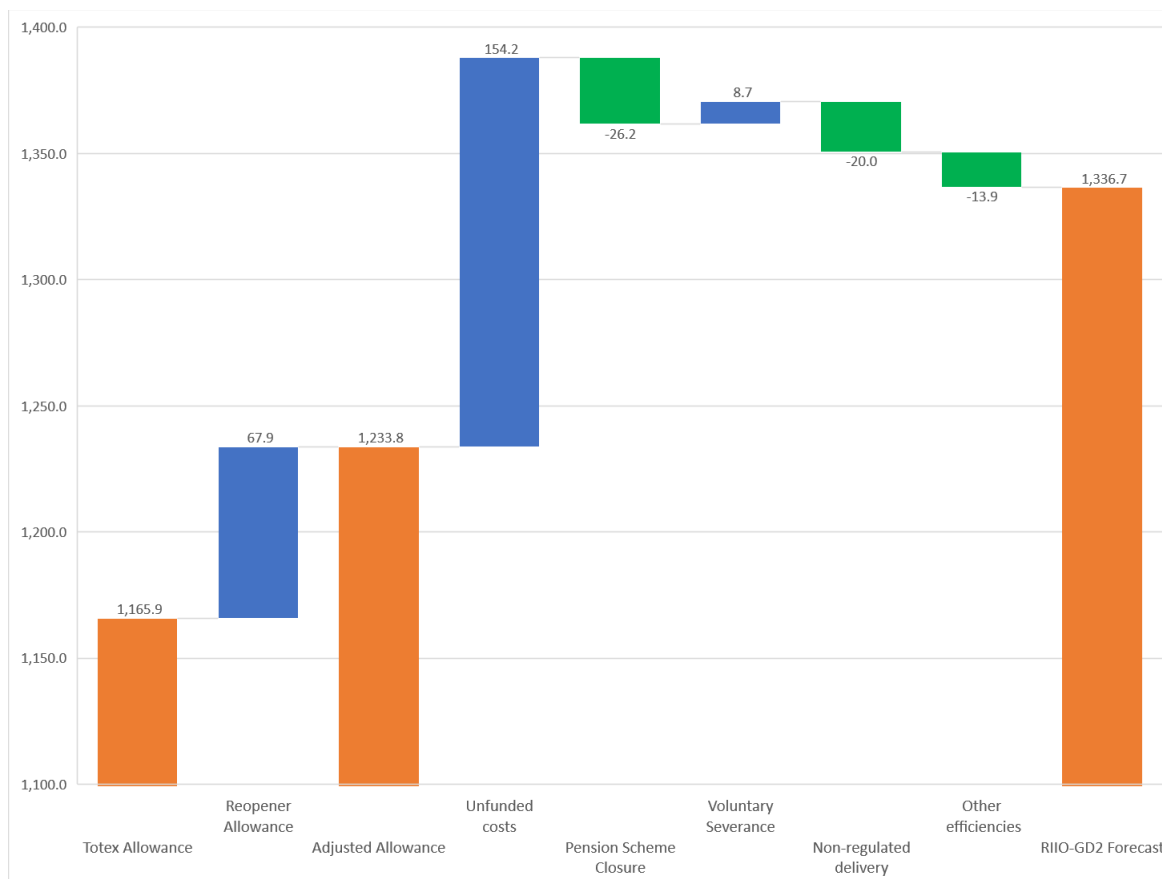
Our key messages with this 5-year forecast are:

- We are well set to achieve our Standards of Performance and are on track to achieve all of our Price Control Deliverables
- Expenditure deferred from the first two years will be spent in the final three years; for instance the cost to deliver the HNO39 pipeline project, and replacing aging vehicles
- We continue to experience cost pressures in excess of the RPE uplift and expect these cost increases to continue
- We are forecasting to overspend the 5yr allowances by £103m (8.3%) after anticipated reopener adjustments. £71m of this is in Repex
- Allowances are reflective of the base allowances including RPE's adjusted for forecast performance on Price Control Deliverables (PCD's) (Totex forecast and Allowances include Net Zero "Use it or Lose it")

£m 18/19 prices	Actual 2021/22	Actual 2022/23	Forecast 2023/24	Forecast 2024/25	Forecast 2025/26	Total
Opex	84.6	88.1	99.1	98.0	99.8	469.5
Capex	56.8	51.3	97.0	86.0	75.7	366.7
Repex	71.8	98.2	110.9	110.4	109.3	500.4
Totex	213.2	237.6	306.9	294.4	284.7	1,336.7
Allowance	253.2	242.0	222.8	223.4	224.5	1,165.9
(Out)/Under Perf.	(40.0)	(4.4)	84.1	71.0	60.2	170.8
% Perf.	(15.8%)	(1.8%)	37.8%	31.8%	26.8%	14.7%
Reopener Adjustment	1.1	3.5	19.6	21.5	22.2	67.9
Adjusted Allowance	254.3	245.5	242.4	244.9	246.8	1,233.8
(Out)/Under Perf.	(41.1)	(7.9)	64.5	49.5	37.9	102.9
% Perf.	(16.2%)	(3.2%)	26.6%	20.2%	15.4%	8.3%

Totex performance over the price control is forecast to be an under-performance of £170.8m (14.7%) against the allowances. We have adjusted our Totex allowances to recognise forecast spend of £67.9m against which we expect to trigger reopener allowances. Achieving these reopener allowances will reduce our under-performance against the allowances to £102.9m (8.3%) across the price control.

Below is an explanation of the main variances included in our 5 year forecast:



Re-opener Allowance (£67.9m) recognises that our actual spend includes the cost relating to Cyber IT & OT resilience, large load connections, development claims and Net Zero small projects which we expect to be reimbursed through the re-opener mechanism criteria (see later for further explanation).

(Ofgem category: not applicable)

Unfunded costs (£154.2m) represents specific areas of totex spend that are outside of our totex allowances. This includes:

- A significant adverse price variance on mains replacement as allowances are insufficient for efficient costs incurred, exasperated by the price increases and cost pressures we have experienced subsequently. We have referenced these cost pressures in the section above.
- The cost of new property developments replacing aged existing sites
- An increased cost base above allowances of delivering our strategic investment in IT

(Ofgem category: Provision in the price control settlement 100%)

Pension Scheme Closure (£26.2m) the estimated savings of closing the Defined Benefit section of the pension scheme to future accrual in July 2021 with the existing Defined Contribution section of the scheme now in place across the organisation.

(Ofgem category: Efficiency 100%)

Voluntary Severance (£8.7m) the cost incurred in 2021/22 of carrying out a voluntary severance exercise, resulting in 126 employees leaving the business.

(Ofgem category: Efficiency 100%)

Non-regulated delivery (£20.0m) represents non-regulatory work (Metering and third party work) where we have targeted the productivity of our workforce, especially our Emergency First Call Operatives (FCO's) who are required to maintain a headcount sufficient to manage the demand of a 24-hour emergency service, requiring FCOs to be on call 24/7/365 in case they are required to respond to an emergency across our network. FCO's are delivering Metering work, Repex purge and relights and surveys to ensure the necessary, but unproductive element of their role is utilised on value adding activities where possible. Third party contracts are short term, not guaranteed contracts which end within the RIIO-GD2 period.

(Ofgem category: Efficiency 100%)

Other efficiencies (£13.9m) includes incremental cost reductions across totex where we continue to utilise our workforce across all activities to reduce the expenditure and reliance on external contractors while ensuring we maintain an efficient and skilled workforce. It also includes the additional underlying cost we are experiencing from a reduction of connections work, which is leading to stranding of back-office resources.

(Ofgem category: Efficiency 100%)

Variant Allowances

The level of variant allowances in this price control is significantly higher than previous price controls. This section explains the variability under each regulatory mechanism; Reopeners, Volume Drivers & PCDs.

Reopeners

The below table summarises our current view of the areas where it is considered likely that we will make future re-opener submissions.

Reopener	Likelihood
Cyber Resilience IT	●
Cyber Resilience OT	●
Net Zero Pre-construction and Small Projects	●
Pipeline Diversions (non-Rechargeable) and Loss of Development Claims	●
New large load connection(s)	●
Non-operational IT and Telecoms Capex (including digitalisation)	●
Tier 1 iron stubs	●
Specified street works	●
HSE policy changes (including fatigue)	●
Net Zero	●
Physical Security (PSUP)	●
Multi occupancy buildings (MOBs) safety	●
Coordinated Adjustment Mechanism	●
Heat policy and energy efficiency	●
Smart meter rollout costs	●

● High ● Medium ● Low

High likelihood reopeners

Cyber resilience IT and OT non-baseline – we have a clear and pro-active plan to continually improve the cyber resilience of our network, with a combined cost of c.£24m across the price control. We are in consultation with Ofgem for the costs included in our January 2023 submission and we plan to submit further applications at the next re-opener window in January 2024.

Net Zero Pre-construction and Small Projects – on a quarterly basis we share with Ofgem the details of our net zero projects, within which there are several pre-construction hydrogen projects that would be funded through this re-opener. These include initial feasibility and studies costs associated with potential hydrogen pipelines.

Pipeline Diversions (non-rechargeable) and Loss of Development Claims - we continue to receive requests for significant projects that meet the criteria of the development claim re-opener, with our RIIO-GD2 total spend now forecast at c.£18m. Notably, this includes several significant development claims delivered within the year relating to Transport for Wales train-line adaptations which, under the easements we inherited in 2005, require us to divert our mains network at our cost.

New Large Load Connections – we have connected and have forecast a number of new power generation or non-domestic connections which fall within this reopener, currently forecast at £7.6m across the price control.

Non-operational IT and Telecoms Capex – we are investing to meet the demands of a fast-paced and continually evolving IT & telecoms environment. For instance, in line with our licence obligations and under consultation with Ofgem we are building a centralised digitalisation team and fit for purpose digital infrastructure to open data up for use in the transformation to net zero and supporting our customers through that journey. Similarly in Telecoms, we are undertaking a multi-year initiative in response to the industry-wide challenge presented by the nationwide withdrawal by BT of their copper communication lines. We have over 1,500 lines supporting a combination of control systems, communications lines and security systems which are being replaced with an alternative solution in line with BT's plan to withdraw copper lines from service by 2025. These initiatives among others form our reopener submission in this area.

Tier 1 iron stubs – in this price control we do not have an allowance for replacing historic tier 1 iron stubs. Replacement of these pipes must be completed by the end of 2032 as mandated under the Iron Mains Replacement Programme; given this fast-approaching deadline tackling these at the earliest opportunity is preferable. We welcome Ofgem's decision to create a re-opener application window in October 2023 which we intend to utilise.

Specified street works – as explained in the cost pressures section above, we are experiencing unforeseeable increases in the costs of working in the roads in our network. These are driven largely by the requirements imposed upon us by Highways Agencies. Should costs continue in the same way as 2022/23 then we intend to utilise this reopener to recover this difference.

HSE policy changes (including fatigue) – the HSE are currently reviewing the working practices of the industrial workforce specifically in relation to fatigue management. Given the ongoing dialogue and consultation between the HSE and GDNs, we are not yet clear on any additional or more onerous requirements that the HSE may place on our workforce, which could be substantial. As such, we have not included any indicative figures yet, but will notify Ofgem of the potential impact and intention to claim under this re-opener once the HSE has made its position clear.

Net Zero – this reopener is directed by Ofgem and is likely to follow the outcome of the Net Zero Pre-construction and Small Projects work, for instance for the delivery phase of Hydrogen Village or Hydrogen Town trials.

Physical Security (PSUP) – maintaining and improving the physical security of our critical national infrastructure assets is extremely important given the ever-heightening security threats. We intend to continue to upgrade security at our sites and will look to the reopener to fund these necessary improvements considering the heightened security threat. At this early stage we expect to include the cost to upgrade the physical security of our sites within our cyber security re-opener unless advised by Ofgem to claim those costs under this reopener instead.

Volume Drivers

There are three areas where our allowances increase/decrease dependant on the volume delivered. These are:

Volume Driver	Likelihood of allowance reduction
Fuel Poor Network Extension Scheme	●
Domestic Connections	●
Tier 2A Mains Replacement	●

● Low ● Medium ● High

Fuel Poor Network Extension Scheme (FPNES) - with ECO4 not supporting new gas heating systems, and the end of the National Grid Warm Homes Fund, connections under the Fuel Poor Network Extension Scheme totalled just 245 in 2022/23 and we are forecasting significantly reduced volumes across the rest of RIIO-GD2. We have worked with Ofgem and agreed the FPNES will continue with a lower output, with allowances transferred to the Vulnerability and Carbon Monoxide Allowance (VCMA). If the forecast minimal volumes of fuel poor services do not happen then we will see a reduction to allowances, but this is minimal given the low level remaining.

We are now planning how we can best invest the additional £13.2m of allowances transferred from the Fuel poor Network Extension Scheme to the VCMA in Licence changes, to do even more to tackle fuel poverty and support our most vulnerable customers during the remainder of RIIO-GD2. We expect to achieve the revised outputs agreed by Ofgem.

Domestic connections – the volumes of domestic connections continue to reduce year on year; requests for new connections to domestic properties were 9% down in 2022/23 compared to 2021/22. We forecast to see a steady drop in volumes through RIIO-GD2 with current incentives for low carbon heating, cost of living crisis and developers starting to make the switch ahead of the proposed 2025 stop on gas connection to new build homes. The allowances within this commentary already account for the allowance reduction resulting from the significantly reduced forecast volumes, therefore the risk to further allowance reductions is only if domestic connections reduce further. Due to the volume driver mechanism in place, a c.£23m allowance reduction compared with those set at Final Determinations has been included.

Price Control Deliverables (PCD)

The following are the PCDs where WWU could experience an adjustment to allowances:

PCD	Likelihood of allowance reduction
Tier 1 Mains decommissioned	●
Tier 1 Services delivered	●
Capital projects	●
Commercial fleet	●
Cyber resilience OT & IT	●
Net zero	●

● Low ● Medium ● High

We are not forecasting any significant fluctuations to our PCD variant allowances.

The **Commercial Fleet** variant allowance could be at risk of reduction given there are currently no suitable electric alternatives to diesel commercial fleet vehicles. This is largely because the current electric only vans available in the market have insufficient payload and/or range capabilities for our operational requirements. We continue to proactively review and test new vehicles as they become available and look for alternative solutions that would meet the operational demands on these vehicles (i.e. hydrogen fuelled vehicles), but have not found a viable offering to date. The financial impact of not fully achieving this PCD is minimal given the total allowance is £2m across the price control.

Workload Forecast

As mentioned in the totex annual performance section all workload forecasts need to be looked at in conjunction with the 5 year workloads and deliverables.

Our key messages with this 5 year workload forecast are:-

- Our workload forecasts are broadly in line with our Price Control Deliverables which we plan to achieve for GD2
- The downturn in the number of connections including a reduction in Fuel poor connections continues
- We have recovered the Covid impacted year one under-delivery of Mains Replacement total length. We have the capacity and are well set to deliver against our associated output commitments in the remaining years of RIIO-GD2.
- Mains and service condition reporting follows the assumption of an 'Average' winter

	Unit	Actual 2021/22	Actual 2022/23	Forecast 2023/24	Forecast 2024/25	Forecast 2025/26	Total	Allowance
Mains condition reports	No.	4,105	4,541	4,399	4,399	4,399	21,843	30,102
Service condition reports	No.	5,779	5,803	5,638	5,638	5,638	28,496	28,547
No. of holders removed	No.	0	2	1	0	0	3	5
Mains reinforcement	Km	15.4	14.9	24.4	24.4	24.4	103.4	93.8
New housing services	No.	3,008	2,466	2,500	2,000	500	10,474	19,903
Existing housing services	No.	3,628	2,579	2,750	2,650	2,550	14,157	23,243
Fuel poor services	No.	1,177	245	120	110	100	1,752	2,500
Governor intervention*	No.	26	26	0	0	0	52	0
T1 length decommissioned	Km	282.1	312.5	324.5	324.5	324.5	1,568.0	1,568.0
T2a length decommissioned	Km	2.5	0.0	0.3	0.3	0.3	3.3	3.3
T2b length decommissioned	Km	10.9	27.1	35.2	35.2	35.2	142.7	142.7
T3 length decommissioned	Km	0.1	1.8	3.1	3.1	3.1	11.0	11.0
Diversions decommissioned	Km	24.5	7.0	0.0	0.0	0.0	31.5	0.0
Steel length decommissioned	Km	58.6	72.9	37.5	37.5	37.5	243.9	243.9
Other length decommissioned	Km	33.837	23.827	25.523	25.523	25.523	134.2	156.8
No. of services transferred	No.	12,168	14,496	18,781	18,781	18,781	83,007	83,007
No. of services re-laid	No.	14,010	13,190	19,830	19,830	19,831	86,691	86,691

Our forecasting considers our business plan workload, the final proposals and then overlays our best view of workloads. We are undertaking a review of our length decommissioned 5 year forecast with specific focus on non-tier one work; recognising that we are finding a higher level of ≤ 2 " steel mains associated with the mandatory tier one programme than expected, something that is unavoidable. The NARM mechanism provides the ability to trade risk across asset groups. We forecast achieving our RIIO-GD2 NARM output target by utilising the trading methodology to manage movement of work between asset groups. We will discuss the outcomes of this review with Ofgem in due course.

We utilise customer quotes, asset management systems and mapping data to inform our forecast each year. We are forecasting to achieve workloads linked to price control deliverables for RIIO-GD2.

Outputs Summary

The following table sets out our view of delivery of outputs by the end of the price control.

Our key messages for the 5 year outputs forecast are:

- We are on track and forecasting to meet all outputs apart from Fuel Poor Connections
- We worked with Ofgem and other GDNs to update our forecast fuel poor connections and transfer any unused allowances to VCMA (confirmed in July 2023 WWU Licence Changes).

Output	Output	RIIO-GD2 view
Meeting the needs of consumers and network users	Consumer vulnerability minimum standards	●
	Fuel poor connections (no.)	●
	Complaints metric	●
	Guaranteed standards of performance	●
	Emergency response - 97% controlled gas escapes	●
	Emergency response - 97% uncontrolled gas escapes	●
	Loss of supply – number of unplanned interruptions	●
	Loss of supply – duration of unplanned interruptions	●
	Loss of supply – number of planned interruptions	●
	Loss of supply – duration of planned interruptions	●
	Planned interruptions survey (score out of 10)	●
	Emergency response and repair survey (score out of 10)	●
	Connections survey (score out of 10)	●
Maintaining a safe and resilient network	Repex – tier 1 mains replacement	●
	Repex – tier 1 services	●
	Capital projects	●
	NARMs	●
Delivering an environmentally sustainable network	Shrinkage and environmental emissions	●
	Biomethane connections information	●
	Environmental action plan and annual environmental report	●
	Business Carbon Footprint (BCF) reporting	●
	Carbon monoxide awareness	●
	Introduce distributed gas entry standards (scmh connections)	●

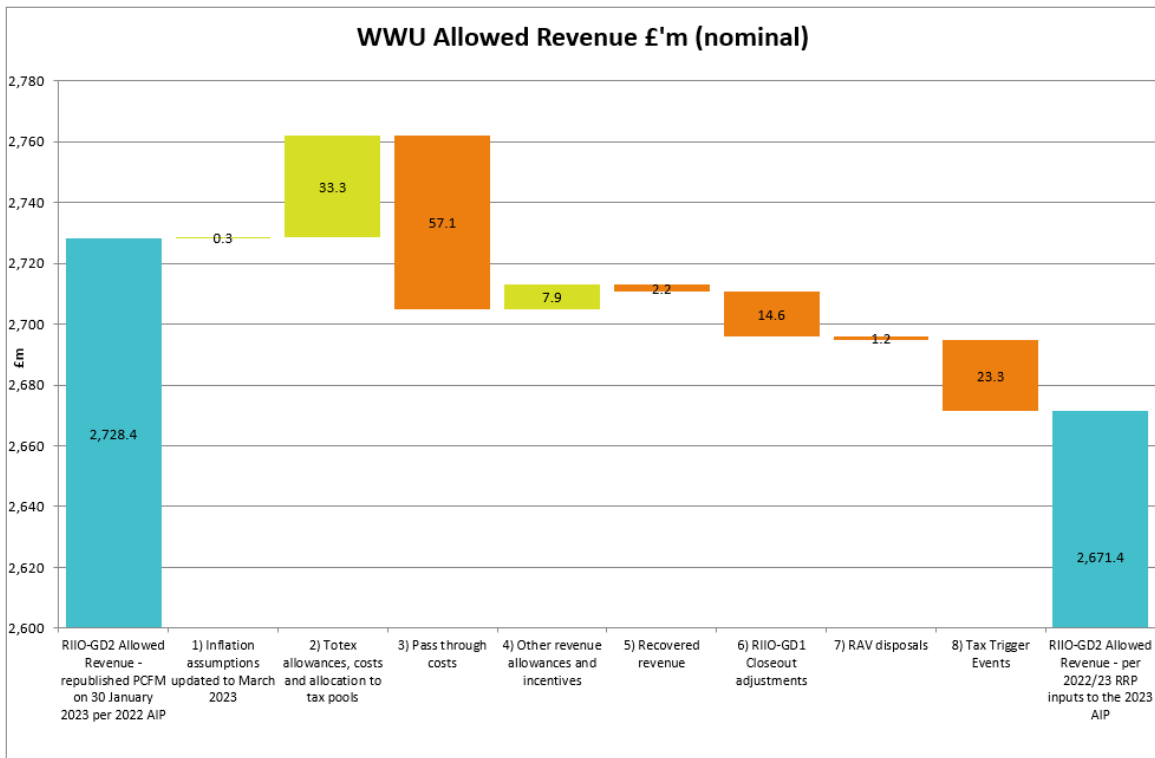
● On track ● At risk ● Not on track

Fuel Poor Network Extension Scheme (FPNES) – as noted previously, working with Ofgem, volumes have been revised downwards and allowances transferred to VCMA. Delivery of fewer services will be dealt with through the Volume Driver mechanism.

Financial performance

Allowed revenue versus allowance

Our allowed revenue performance for RIIO-GD2 is set out below. This shows the difference in RIIO-GD2 Allowed Revenue between the re-published PCFM as at 30 January 2023 following the 2022 AIP and the latest PCFM that has been prepared based on the 2022/23 RRP inputs that will be used for the first Dry Run of the 2023 AIP. This shows a nominal decrease in allowed revenue of £57.0m across the price control.



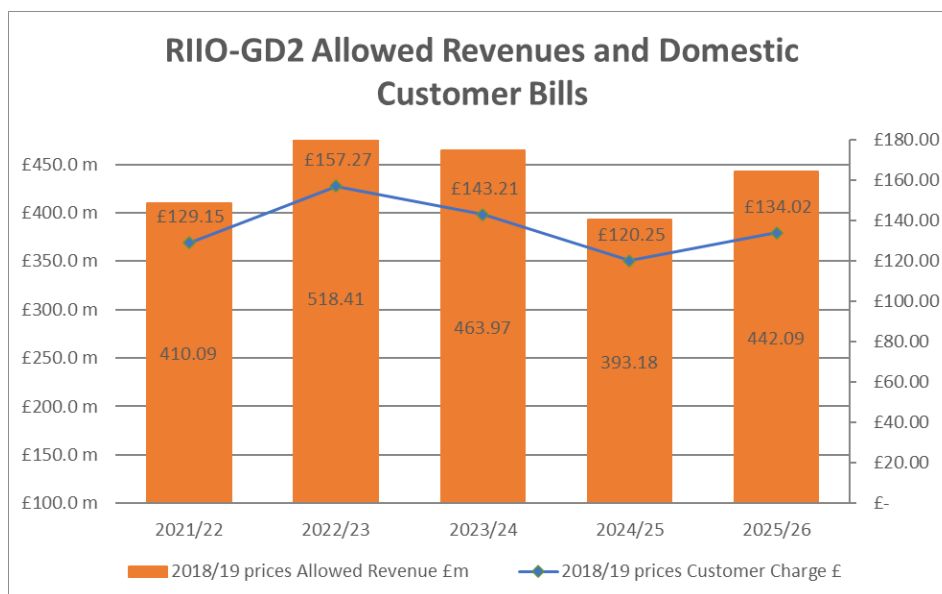
- Inflation** - £0.3m increase to Allowed Revenues arising following updates to the inflation assumptions; including actuals to March 2023 and revised predictions to March 2026.
- Totex** – Updates to non-variant and variant Totex allowances leading to increased Allowed Revenue of £2.0m and £17.2m respectively and a £14.1m Allowed Revenue increase arising from updated actual and forecast Totex costs and the allocation of Totex to tax pools for the purpose of calculating the notional Tax Allowance.
- Pass through costs** - £57.1m Allowed Revenue reduction predominantly as a result of reduced Shrinkage, Exit Capacity and Business Rates actual outturn for 2022/23 and forecasts for 2023/24 through 2025/26 of broadly £41m, £10m and £6m, respectively. Shrinkage volatility has continued since the 2022 AIP and latest forecast gas prices are now much lower than market data previously indicated. The Exit Capacity reduction predominantly relates to updated rates published by National Gas Transmission on 31st May 2023 effective from 1 October 2023. Business rates have been updated to reflect the outcome of the latest review by the Valuation Office Agency.

4. **Other revenue allowances and Incentives** – The increase of £7.9m in Allowed Revenue is mainly as a result of increases in RIIO-GD2 Network Innovation and Vulnerability and Carbon Monoxide allowances based on revised planned spend and licence updates to the VCMA Expenditure Cap.
5. **Recovered Revenue** – £2.2m decrease in Allowed Revenue because Recovered Revenue for 2022/23 outturn was higher than originally anticipated.
6. **RIIO-GD1 Closeout adjustments** – Revised estimates have been included in respect of the values of the RIIO-GD1 Closeout adjustments for pre and post-vesting RAV disposals, FPNES, the iron mains risk reduction programme and Tax Clawback for WWU, resulting in an Allowed Revenue reduction of £14.6m. These values will remain provisional and subject to change until directed by Ofgem.
7. **Disposals** – Updated RAV disposals have been included based on actual outturn to March 2023 and result in a reduction to Allowed Revenue of £1.2m.
8. **Tax Trigger Events** – Allowed Revenue reduction of £23.3m following updates to reflect the Chancellor's Spring Budget 2023 changes to capital allowances from 1 April 2023 – 31 March 2026; being full expensing for the general pool and extension of 50% first year allowances for the special rate pool.

Company view of customer bills

Customer bill movements fall into two elements; movements in our "Allowed Revenue" and changes in customer numbers and volumes of gas flowing through our network each year i.e., if there is an increase in the number of customers, then the revenue to be collected from each customer will decrease.

As the annual quantity of customer numbers and volumes is expected to remain broadly consistent across RIIO-GD2, the change in estimated and actual customer bills is mainly due to the current volatility within the gas market and economy as a whole. Supplier of Last Resort Payments, exit capacity costs, wholesale gas prices and legislative changes are the main elements that impact Allowed Revenue and therefore customer bills.



2021/22 to 2022/23: Customer bills increased by £28.12 from £129.15 to £157.27 between 2021/22 and 2022/23. This is mainly the result of increases in respect of SoLR (£24.78 increase) and Exit Capacity costs (£4.82 increase) which are non-controllable.

2022/23 to 2023/24: Customer bills decrease by £14.06 from £157.27 to £143.21 between 2022/23 and 2023/24. This represents a decrease of £22.51 in respect of SoLR and Exit Capacity costs which are non-controllable. The balance, an increase of £8.45, is primarily driven by an increase in Totex fast money and return, higher allowances for NIA and VCMA, an increase in the Tax Allowance following the increase in the statutory corporation tax rate from 19% to 25% from 1 April 2023 and higher shrinkage costs driven by wholesale gas prices.

2023/24 onwards: The decrease in customer bills from 2023/24 to 2024/25 of £22.94 from £143.21 to £120.25, net of a decrease in of £8.32 in respect of non-recurring SoLR costs and Exit Capacity costs, predominantly relates to a reduction in 2024/25 Allowed Revenues that have arisen as a result of:

1. legacy RIIO-GD1 adjustments
2. the Chancellor's 2023 Budget announcements in respect of capital allowances reducing the revenue allowance for tax from 2024/25 and
3. and 2022/23 and 2023/24 other non-controllable costs that were forecast to be much higher when prices were set (largely shrinkage due to volatile wholesale gas prices turning out lower than expected and Business Rates which were also lower than anticipated following the Valuation Office Agency review).

Below is a walkdown of customer bills over the period adjusting for SoLR costs and Exit Capacity costs. This demonstrates that underlying allowed revenues have retained largely flat across the price control.

Walkdown of domestic customer bills excluding SoLR and Exit Capacity (18/19 prices)	2021/22	2022/23	2023/24	2024/25	2025/26	RIIO-GD2 Average
Total domestic customer bills	£129.15	£157.27	£143.21	£120.25	£134.02	£136.78
Exclude SoLR element	£0.00	-£24.78	-£7.34	£0.00	£0.00	-£6.42
Exclude Exit Capacity costs	-£6.22	-£11.04	-£5.96	-£4.98	-£8.68	-£7.37
Customer bills excluding SoLR & Exit Capacity	£122.93	£121.45	£129.90	£115.27	£125.34	£122.98

Future of Energy and Innovation

At Wales & West Utilities we are committed to doing everything we can to help our network and our customers meet Net Zero carbon emissions in the most efficient, and least disruptive way possible. The projects we undertook in 2022/23 helped increase understanding of the implications of the energy system transition for our communities; build the evidence base for managing hydrogen conversion; and understand the opportunities and implications for consumers.

Our key messages within this section are:

- We are undertaking a range of activities and projects to deliver a Net Zero energy system and support customers through the transition
- We participate in national programmes to support key activities such as research and trials of hydrogen, alongside work focussed on options for the communities we serve
- We work with partners across the industry and use our strategy and priorities to guide our activity

Strategic Themes and Priorities

Our innovation activity is guided by the themes and priorities we identified to safely and securely deliver the Energy System Transition, support our customers, and protect the environment. Our long term vision and targets are set out in our Sustainability Strategy (this can be downloaded from [our website](#)⁶) which we published in 2023. We developed our thinking in our RIIO-GD2 business plan and the Energy Networks Innovation Strategy and have also identified priority areas for our network. These are communicated with our innovation stakeholders, for example through our annual innovation report, to help guide future activity.

Our Sustainability Strategy sets out our vision for our role in a Net Zero energy system, and sets near and long term targets across our priorities:

- Doing all we can to provide sustainable energy
- Driving outstanding service
- Demanding safety always
- Designing our future
- Delivering value for money

Our RIIO-GD2 Business Plan (this can be downloaded from [our website](#)⁷) guides the areas we focus on, within the RIIO-GD2 regulatory allowances:

- Meeting the needs of consumers and network users; support projects that bear uncertainty or where benefits are valid to society but difficult to commercialise
- Delivering an environmentally sustainable network; deliver customer benefits and provide the lowest cost pathway to heat decarbonisation
- Maintaining a safe and resilient network; support projects that help our business to adapt to a changing environment that will be fit to provide energy for generations to come

The ENA Strategy (this can be downloaded from the [ENA website](#))

- Data and Digitalisation
- Flexibility and Market Evolution
- Net Zero and the Energy System Transformation

⁶ <https://www.wwutilities.co.uk/media/4824/sustainability-strategy-2023.pdf>

⁷ <https://www.wwutilities.co.uk/media/3567/3-wwu-business-plan-december-2019.pdf>

- Optimised Assets and Practices
- Supporting Consumers in Vulnerable Situations
- Whole Energy System

Our Priority Areas:

- Hydrogen: this includes the role of hydrogen at blended and 100% levels e.g., research, evidence building, practical demonstration and delivery of commercial solutions such as through the development of hydrogen village trials
- Data and Modelling: future evidence for forecasting and capacity, sharing of data, alongside data to support local area planning using our Pathfinder whole systems model
- Transport: understanding and exploring the role of gas in transport and investigating fuel choices, particularly our own fleet, to provide consumer choice and fuel solution options, particularly around hydrogen.
- Consumer Heating Solutions: exploring consumer options for use of hydrogen to support hybrid heat development
- Biomethane: includes new production capacity on our network.

We have a strong pipeline of projects to build on this work and are working collaboratively with other network licensees and wider stakeholders to develop this further and deliver against our strategic themes and priorities.