

Interim Board Statement



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As Chair of the Board, I am pleased to provide an initial statement of the Board's support for the RIIO-ED2 business plan developed by Electricity North West (ENWL). We would particularly like to highlight the efforts that the team have gone through to ensure the ED2 business plan is genuinely led by customer and stakeholder views, undertaking its most extensive engagement exercise to date.

ENWL is committed to playing a key role in supporting the UK in meeting its net zero targets. However, we recognise the challenges facing a regulator setting a price control at a time of substantial change within the sector. As a Board, we have driven as comprehensive and ambitious a business plan as possible, recognising areas of work that remain to be finalised, providing challenge throughout the process and engaging widely as a Board.

Based solely on Ofgem's working assumptions for cost of capital allowances, we do not believe that ENWL's ED2 business plan is currently financeable on a notional or actual capital structure basis. However, at this stage, we are still awaiting the outcome of the RIIO-2 Energy appeals to the Competition and Markets Authority (CMA) and our expectation is that certain adjustments to the financing framework may well be required. We would hope that any arising amendments will be brought forward as soon as possible.

ENWL has a track record of constructive engagement with Ofgem and provides pragmatic and balanced solutions to issues identified. As a Board, we expect to continue this engagement over the coming weeks and months. We remain, as a Board, committed to submitting an ambitious, efficient, affordable and robust Final Business Plan to Ofgem in December. This will continue to reflect feedback from the RIIO-2 Challenge Group, the independent ENWL Customer Engagement Group (CEG) and our customers and stakeholders, as well as other developments over the next few months. We are looking to ensure ENWL remains well positioned to deliver an innovative and customer-focussed service that supports the North West in its transition to net zero during ED2 and beyond.



Alistair Buchanan,
Chair

As a Board, we support this submission to Ofgem and its RIIO-2 Challenge Group, confident that the team at Electricity North West have worked hard to develop a Business Plan centred on and calibrated to the priorities of its customers and stakeholders, that is ambitious, efficient and affordable and that has been robustly and effectively assured.

We recognise ED2 will be a period of change as we support our customers and stakeholders to transition to Net Zero and our role as a Distribution System Operator (DSO) increases. Flexibility will be key to respond effectively to the pace of these changes. We also note that work is still to be completed by Ofgem on the use of uncertainty mechanisms for ED2 and we therefore acknowledge that amendments will be needed prior to the Final Business Plan being submitted in December 2021. We look forward to hearing feedback on how this uncertainty can be managed.

Financeability does present challenges for Electricity North West. We have taken time to consider this throughout our business planning process and have proactively engaged with Ofgem on how these issues can be resolved. We have been open and transparent with Ofgem throughout the process on our concerns and have shared a range of reports and advice over the last three years. We have provided further thoughts below, in section 5, as to our concerns over financeability and the measures we have tried to incorporate to mitigate our financeability situation. We look forward to ongoing dialogue with Ofgem on this and other issues over the coming weeks and months.

ED2 presents exciting and novel challenges for Electricity North West, the sector and wider industry. As a Board, we believe that Electricity North West's Business Plan demonstrates that ENWL is an ambitious, efficient and robust organisation, that understands its customers and stakeholders needs and priorities and is able to facilitate them through this period of change. Whilst there are areas to be resolved, we believe this Business Plan to be a great plan for the people of the North West.

2 Framework for developing our plan

Achieving net zero is a key challenge facing the energy sector. In developing its thinking as how best to support the energy transition, ENWL started early, listening to its customers to understand how crucial electricity is to their lives. This engagement which has actively involved the Board has then gone through a series of iterative stages, leading to new learning and understanding, and these insights have been shared with us as a Board. We recognise the significance of our role in ensuring appropriate governance is maintained to deliver day in, day out for the many households, businesses and other organisations served throughout the North West (including our vulnerable customers and those in fuel poverty).

Whilst this engagement commenced in 2019, a significant element has taken place against the backdrop of COVID-19. This has proved a challenging and thought-provoking time to undertake this work. It has provided a deeper understanding of our customers' and stakeholders' priorities as all involved have considered the ramifications of the pandemic in terms of both very immediate and pressing matters and consideration of the longer-term impacts.

ENWL operates in line with the UK Corporate Governance Code as issued by the Financial Reporting Council to ensure that best practice in corporate governance is adhered to by all representatives of the organisation. This creates the foundation for a well-established and robust approach to corporate governance, internal control, risk management and assurance that we, as the Board of ENWL, form part of and oversee. This framework, in conjunction with our extensive engagement, underpins the development of the ED2 business plan.

As a Board, we have been actively involved in the development of our business plan, in line with our standard approach to business planning for the organisation. We set the strategy for the business and this includes ensuring that the strategy for the business plan aligns with the wider business strategy and is focussed on meeting the needs of our customers and stakeholders. Whilst this five-year period forms the focus of the plan, our consideration extends beyond this to ED3 and beyond, and many of our stakeholders have aspirations or targets that focus on these longer time periods.

We have been comprehensively briefed by members of the Executive Team and Senior Leaders throughout the process to ensure we are abreast of the specific requirements of Ofgem to feed into this process and we have received regular updates on key developments since the RIIO-ED2 process commenced. Throughout the process, we have challenged the team, to ensure that the plan sets out what ENWL needs to deliver to enable our customers and stakeholders to achieve their aspirations. This requires balancing the needs of the different groups served by the organisation to support the transition to net zero, whilst ensuring no one is left behind.

This framework does not operate in isolation and we have sought to ensure ENWL embraces best-practice by actively engaging with peers throughout the energy networks sector and beyond to understand and learn from the thinking and experiences of others in developing robust, customer-centred plans. Examples include: NGN, United Utilities and Anglian Water on developing effective customer and stakeholder engagement approaches; Thames Water on providing support to vulnerable customers; and PWC who advised two Gas Distribution Networks and 6 water companies in relation to their recent price controls.

Taking account of the above framework, the involvement of a strong, experienced and dedicated team, detailed consideration of the assurance undertaken and having provided appropriate challenge to the team, we passed a resolution at the Board meeting on 3 June to support our draft ED2 business plan and its submission to Ofgem and the RIIO-ED2 Challenge Group.

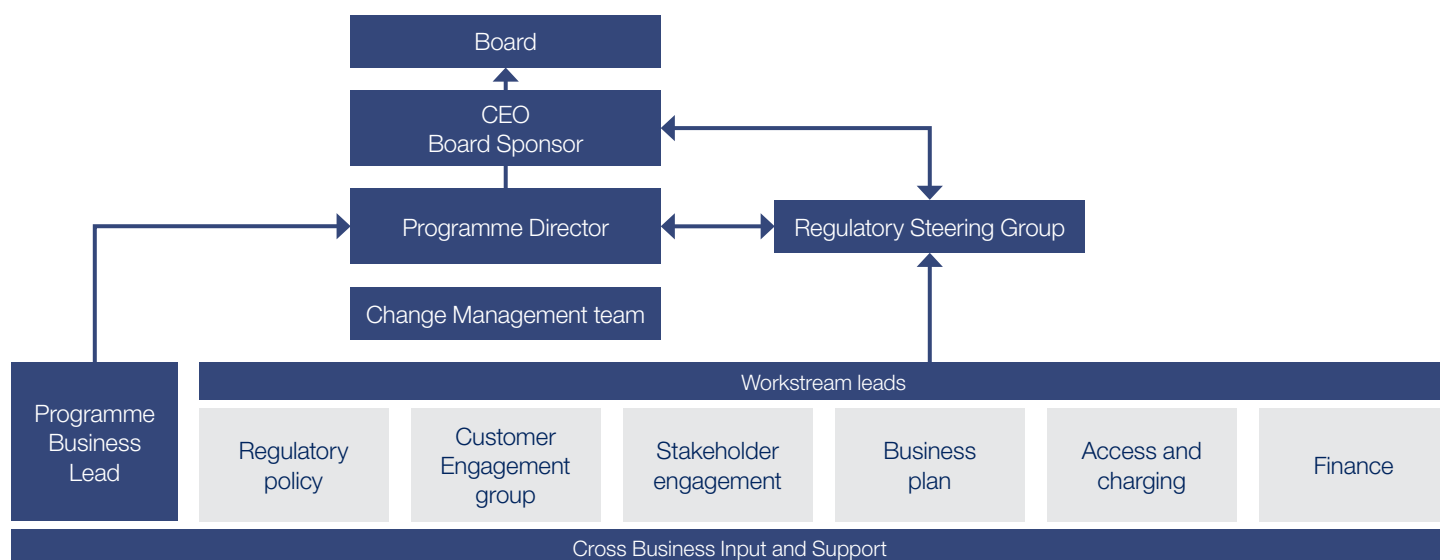
3 Involving the right people

Whilst ENWL is the smallest of the DNOs, it is able to draw on a strong team of individuals from the Board level down. They have been tasked with supporting the development of the plan and challenging the underpinning research and analysis to ensure it is robust, efficient and ambitious.

Role of non-executive directors: As members of the Board, our non-executive Directors have played key roles in the development and challenge of the business plan. Our Audit Committee consists solely of our non-executive directors and they, with support from the Chair of the Board, have been tasked with overseeing the assurance of the ED2 business plan to ensure it is sufficiently robust and in line with Ofgem's expectations.

In seeking greater understanding and challenge to the assurance process, the Non-Executive Directors have been engaged in a number of additional activities, that enables them to better challenge and understand the business. Rob Holden, Anne Baldock and Susan Cooklin have joined events with customers and stakeholders during the last year to ensure they properly understand the concerns and issues facing our customers. Anne has been appointed as the Board's vulnerable customer champion and Susan as our employee champion. The members of the Audit Committee have also had the chance to meet with the CEG team as part of planned Board engagement activities.

Regulatory Steering Group: The detail of the ED2 business plan has been developed by Senior Leaders under the leadership of the Executive Team and with oversight from the Regulatory Steering Group. Membership of the Regulatory Steering Group consists of the CEO, CFO, Regulation and Communications Director, Engineering and Technical Director and the leads for the ED2 workstreams as set out below.



RIIO-ED2 Price Control Team: The RIIO-ED2 Price Control Team consists of the Regulation and Communications Director, in the role of Programme Director; Head of Economic Regulation, as Programme Business Lead; Workstream leads, responsible for delivering the key elements of the RIIO-ED2 project as shown above; and RIIO-ED2 Project Manager. It is tasked with working across the business and has drawn on contributions from a wide range of business areas to support the task including Customer and Stakeholder Engagement, Financial Control, Reporting and Planning; Investment Management; Distribution System Operation (DSO); Safety, Health and Environment; IT; Operations; and HR.

Assurance framework: a detailed exercise was undertaken to risk assess the various elements of the business plan and the thinking that underpins it. The approach used is described in more detail in part four of this statement. This has been developed and overseen by the Head of Risk, Control and Assurance who is independent from the RIIO-ED2 Price Control Team. A range of assurance, provided by internal and external subject matter experts, has been undertaken and is complemented by a range of input and advice from recognised leaders in the field.

Board approval: throughout the process, the Board has endeavoured to act in a manner that is robust and balanced, seeking to satisfy our duties to both the shareholders of the organisation and to our customers and stakeholders. We have sought to ensure consideration is given to the long-term consequences of the proposals within the ED2 business plan for the organisation and those it serves; to understand and respond to the needs of the wide range of our customers and stakeholders, including employees; and to uphold the high standards of business conduct that we believe are essential in all of our activities.

Customer Engagement Group: from its initial proposal, ENWL has proactively sought challenge and constructive debate with our Customer Engagement Group (CEG), chaired by Jeff Halliwell. We have engaged throughout the process with the CEG and have valued their insight. There has been regular and ongoing dialogue between our Chair and the CEG's Chair, as well as more formal CEG to Board engagement. Whilst not part of the assurance framework, this engagement has also informed our view that the process that has been followed in the development of the ED2 business plan is robust, ambitious and efficient.

3 Involving the right people

At ENWL, we have a team of talented and dedicated professionals who bring fresh insights and challenge to our business and to their roles to serve our customers on a daily basis. We recognise this is more important than ever as we face the challenge of driving the energy transition and delivering net zero.

Having joined ENWL from the Drax Group in 2016, development of the ED2 price control has been a new challenge for me so I have sought to ensure that, alongside David Brocksom as our CFO, we are supported by a strong, capable and dynamic team who are passionate about delivering the right plan to allow us to meet our customers' needs during the ED2 period and beyond.

I have sought to bring together a wide range of experience and knowledge in the ED2 Team, combining ENWL's experience from RIIO-ED1 and previous controls in our Regulation and Communications Director (Paul Bircham) and Head of Asset Management (Jonathan Booth), with insights and experience from across the sector including our Head of Economic Regulation (Paul Auckland, who joined in 2017 from National Grid) and Head of Risk, Control and Assurance (Jen Carter, joined from SSE in 2015). Between these four executives, we can draw on experience from 11 price controls and large regulatory assessments, across electricity distribution, transmission and water. We have also sought to capitalise on experience from outside the sector, with our Head of Corporate Finance and Investor Relations (Danny Clarke) joining in 2017 with over 20 years' experience in corporate finance.

This is supported by the diverse portfolio of experience and interests represented within our Non-Executive Directors and through the fresh and relevant insights brought by the range of assurance providers we have engaged to challenge and assist our thinking, including Chris Watts and Grant McEachran (S & C Electric) who are both former members of Ofgem's team and have been providing advice and assistance to the Audit Committee, as they have overseen the assurance of our ED2 business plan.

In addition, we have made a tremendous effort to make the CEG challenge process work effectively, using the group to challenge the ambition of our programme and test the robustness of the customer and stakeholder input. To enable this, we spent a full 12 months (April 2019 to April 2020) inducting and training the CEG to understand the details of our business and our region. They have used this knowledge to really challenge the Executive to produce an ambitious and customer centred ED2 proposal. In my view, this has been a tough but helpful process.

Our customers and stakeholders have been key to this work. Engaging with them during the uncertainty introduced by COVID-19 has given me and the team more of an emotional, as well as very practical, insight in the challenges faced by some of the people we serve. As people have struggled to juggle working from home, with home-schooling children and worries about loved ones, it has been a very real reminder of the important role we play in serving our communities.



Peter Emery
CEO

4 Approach to assuring our plan

As a Board, we support Ofgem's challenge to DNOs to ensure the ED2 business plan is robust as we believe this serves the interests of our customers and stakeholders by allowing their views and needs to be effectively expressed. Robust and accessible regulatory submissions assist the regulator to undertake its role effectively and ensure we remain transparent and accountable in our activities.

ENWL has a well-established approach to assuring regulatory submissions, in line with Ofgem's Data Assurance Guidance, which is built on the foundations of our 'three lines of defence' assurance model. This is a common approach, adopted by many large organisations, and tailored to meet the specific needs of ENWL. This approach to assurance is overseen by the Audit Committee and led by the Head of Risk, Control and Assurance, who reports to the CFO and the Chair of the Audit Committee to ensure appropriate independence is maintained.

Innovation and creativity are encouraged in all functions at ENWL and this includes assurance. Drawing on previous regulatory experience, our Head of Risk, Control and Assurance developed a bespoke risk assessment methodology to consider the likelihood and impact of issues associated with both the development of the business plan and the thinking that underpins it. This resulting risk assessment has been used to drive a tailored and efficient approach to assurance, prioritising areas of potential significance to our customers and stakeholders; GEMA and Ofgem as our regulator; and us as the Board.

Responsibility for the oversight of the resulting assurance plan was delegated to our Audit Committee, who were tasked with assessing the robustness of the approach and advising the Board on the quality of the assurance and the process undertaken. To date, the Audit Committee has held an additional seven sessions; sought advice from the Chair of the Board in light of his prior experience; and is being supported and advised by both the Head of Risk, Control and Assurance and external advisors from S&C Electric Holdings Limited. In addition, external assurance has been undertaken by a range of subject matters experts from a number of organisations including: KPMG, WSP, Frontier Economics, Gartner and Rothschild & co. This has been supported by detailed input from NERA, Oxera, Arup and PWC.

The Customer Engagement Group, whilst not a formal part of our assurance process, has played an important role in challenging and scrutinising many aspects of the plan and the underpinning thinking and providing feedback to the Audit Committee and the Board on areas of concern.

On the basis of this and the report provided to us by the Chair of the Audit Committee, we are satisfied that a robust and effective assurance exercise has been undertaken to date, recognising that further assurance will continue to be required as we update areas where inputs or assumptions from Ofgem are pending or amend in response to feedback on our draft business plan.

As Chair of the Audit Committee, I am pleased to report that we have provided a thorough challenge to the assurance undertaken by ENWL and are supportive of the submission of the draft business plan. Since November 2020, the Audit Committee has held an additional seven sessions to be able to scrutinise and challenge the team, been provided with progress reports in relation to the assurance undertaken and challenged areas where further work was considered to be beneficial.

We take our work seriously, as we know that this assurance provides the bedrock for ENWL to pursue its leadership in innovation and net zero, whilst giving comfort that the basics are being done to the highest standards. I can confirm that we, as an Audit Committee, are not finished in our work and we will continue to scrutinise and challenge the process during the period between the submission of this draft business plan and the final business plan, at the end of the year.

Rob Holden, Chair of the Audit Committee



5 Statement of progress

The ENWL team always envisaged providing the Board with a near-final business plan for approval prior to making its Draft submission to Ofgem and the RIIO-2 Challenge Group. However, there are a number of material elements of the ED2 Framework that we, as a Board, have sufficient concerns about. This has meant that we have not felt it possible or appropriate, at this stage, to fully satisfy ourselves on the entirety of the business plan.

Stakeholder Led

The Board acknowledges and applauds the extensive work undertaken by ENWL to date, particularly the most comprehensive customer and stakeholder engagement exercise that ENWL has ever undertaken and the introduction of ongoing triangulation to ensure all customer and stakeholder views have been weighed transparently and fairly to inform our understanding of our customers' and stakeholders' needs and priorities. ENWL continues to lead the sector in terms of innovation, with proposals to fully embed a number of key projects into BAU during ED2 including those which are focussed on making it easier for low carbon technologies to connect and to promote energy efficiency by reducing energy demand (such as 'Smart Street') and technologies to allow latent capacity within the network to be made available as a means to balance the network ('CLASS'). We challenge the rest of the sector to take similar steps. The ambitious draft Plan builds on ENWL's commitment to enabling the transition to Net Zero, supported by our customers and stakeholders, recognising ENWL cannot do this in isolation and whole system interaction is essential to its effective delivery.

Ambitious and Efficient

We are also confident that our ED2 business plan is ambitious, efficient and affordable, and provides value for money for all our customers. We recognise that a significant number of our customers face vulnerable circumstances and that approximately 13% of households through the North West are faced with fuel poverty. Significant consideration has gone into our business plan as to how service levels and cost can and should be balanced to ensure value for money for those who pay for our activities. Whilst individual proposals are set at the levels that our ambitious customers and stakeholders are prepared to support, ENWL have continued to look at areas to mitigate bill increases, recognising the bill impact on those we serve.

We are content that the ambition and service levels in this plan meet the expectations of our customers and stakeholders whilst ensuring that the bill impact is significantly less than they have indicated they would be willing to pay.

Affordable and Value for Money

The willingness to pay and acceptability testing research that we have undertaken showed that 80% of customers would be willing to pay an additional £9.80 on their bills for the package of improvements in this plan. In order to deliver the outcomes requested by our customers and stakeholders, we will need to invest almost £2bn over the ED2 period. However, we are pleased to note that as a result of the efficiency and effectiveness of the business, counter-balancing bill changes mean that the current bill impact of this plan is only £2.03 per year. This is a level of bill increase that 97% or more of customers have said they are willing to pay and means that the plan is clearly affordable.



Reservations over the Current Draft Plan

The Boards' key concern with the business plan at this stage is that it struggles to fit within Ofgem's current working assumptions for cost of capital allowances. If these remain unaltered, we consider ENWL's ED2 business plan may well not be financeable on a notional or actual capital structure basis.

The ENWL team have demonstrated to us that ENWL is not financeable for ED2 using Ofgem's working assumptions and have gone on to consider what steps might need to be taken to achieve a financeable plan.

Firstly, we looked at the scale of ambition in our plan, which we refer to above and explored whether a reduced scope and expenditure would make a material change to the key financeability metrics. Our findings in this area showed that taking such action does not have a significant impact on the financeability of the plan and that taking these mitigating measures will not make any material change to its financeability.

Secondly, we looked at what economically feasible steps might be open to us to assist in the financeability of our plan. Our modelling has shown that whilst it will improve the situation somewhat, even taking the economically feasible mitigating step within ENWL's control of foregoing dividends for the full five-year period (a step which is equivalent to an equity injection of in excess of £150m) is insufficient in itself to make the plan financeable. In order to achieve financeability we believe that this measure should be coupled with an adjustment to

- the Cost of Equity (to at least reflect the outcome in the recent CMA appeal on the price controls for the water sector ('PR19')) and to the Cost of Debt (to ensure efficiently incurred debt costs are met).

As a Board, we believe that we have exhausted all economically feasible options available to us prior to resorting to an increase in costs for customers.

As we submit this report, we are of course, awaiting the outcome of the RIIO-2 Energy CMA appeals which may well conclude that adjustments to the financing framework are required. We are keen to see the outcome of these appeals and hope that any measures arising from or highlighted by these are brought forward as soon as possible. In the meantime, we will continue to engage with Ofgem to share our concerns and how we believe the steps identified above remedy the situation, without transferring undue risk or costs to our customers.

The financeability concerns outlined above, coupled with other material areas still in development such as the detail of uncertainty mechanisms, of the Charging and Access Reform, mean that we, as a Board, and on the advice of our Audit Committee, are unable to fully endorse the ED2 business plan at this stage. We know further amendment will be necessary as we go through the ED2 process and believe that the issues we currently have are capable of resolution as we continue to work with Ofgem through the process. Whilst it is not possible to provide full assurance of our ED2 business plan at this stage, the Audit Committee has advised us as a Board and we are content that the assurance work undertaking in respect of the plan to date is thorough, well planned and executed and provides comfort that this submission is as accurate, complete and as robust as possible at this stage in the process.

6 Alignment of management remuneration and plan outputs

As a Board, we believe it is important that there is a clear alignment between remuneration and delivery against the outputs set out in our business plan to ensure ongoing delivery in line with our customers' and stakeholders' expectations. ENWL has operated a scorecard approach to remuneration for the Executive Team for a number of years.

Progress against this scorecard is reviewed by the Remuneration Committee, on behalf of the Board, on a regular basis and pay and benefits packages are intrinsically linked to this scorecard. The scorecard will be revised in light of the final settlement reached with Ofgem and approval of the ED2 scorecard will require this clear linkage between remuneration and delivery in line with our customers' and stakeholders' expectations.

As Chair of the Remuneration Committee, I want our customers and stakeholders (including the members of GEMA) to know that we have taken concerns expressed around ensuring pay is linked to performance with the utmost seriousness. Our pay policies are aligned with tough KPI's, that draw on Ofgem's guidance, especially recently with regard to climate change challenges.

Further, we are committed to revisiting these pay-performance linkages as Ofgem's thinking on net zero develops further and welcome further dialogue on this.

Sion Jones, Chair of the Remuneration Committee





Electricity North West

Borron Street

Portwood

Stockport

SK1 2JD

www.enwl.co.uk