

Gas Distribution Price Control Review

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centrica

taking care of the essentials

What are our concerns?

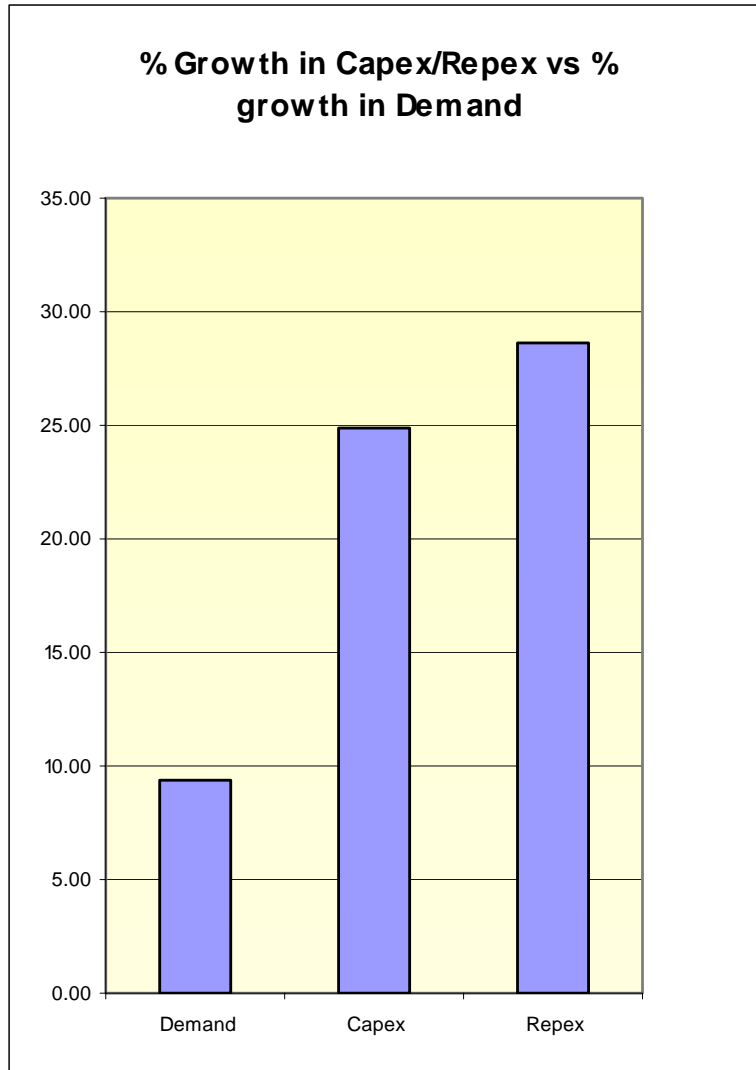
- At the moment – we have questions and concerns
....but no answers
- We are only part way through the process
- Ofgem is sharing its thoughts on policies and has set out a timeline
- But as a major supplier, we lack information and certainty
- And that carries risk

Cost of Capital....

Date	Dec 2006	Dec 2006
	Ofgem	CAA
Cost of Debt		
Risk Free Rate	2.50%	2.00%
Debt Risk Premium	1.25%	1.00%
Pre tax Cost of Debt	3.75%	3.00%
Post tax Cost of Debt	2.63%	2.10%

- Ofgem: TPCR final proposals, December 2006
 - CAA: Initial proposals for CAA, Heathrow airport, December 2006
 - Gaps in Cost of Debt components
 - How can this be explained?
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- Uncertainty in the Cost of Equity estimate:
 - wide range of market returns on equity
 - use of different methodologies (CAPM vs. market return)
 - post DN Sales, risks in the gas distribution sector need to be assessed

Forecast Expenditure vs. Forecast Demand



- The average change in demand over 2005/6-2007/8 vs 2008/9-2012/13 from the Ten Year Statement 2006
- The average change in Capex/Repex over the same period, forecast by DNs in the 3rd consultation document
- How can this be explained?

Information Transparency

- During the process – to aid robust and helpful responses
- More information is needed from the DNs
 - Can see massive changes in spend – but not why??
- Presumption of confidentiality by the companies -
 - Confidentiality must be respected, where justified
 - but is it being used as an excuse?
- Looking at other industries – is there another way?

Constructive Engagement

- We believe there is an opportunity to improve the regulatory process
 - based on principle of transparency & data sharing
 - Negotiations between DNs and Users on range of issues
 - e.g. Service Quality, Investment, Efficiencies & Incentives
 - real dialogue with a broad range of stakeholders
- Ofgem could use the GDPCR as an opportunity to establish approach and principles
- Centrica is willing to participate actively in the process
 - e.g. by leading the process of grouping suppliers' view

Information Transparency – after the process

- Historically, uncertainty of charges, k factors and nasty shocks such as £840m overspend in the last control
- Going forward?
 - Reporting of target vs actual revenues
 - Expand mod 698 reports to include reasons and updated forecasts including expected K
 - Reporting of target vs actual spends
 - Reporting of progress on efficiencies
 - No nasty surprises!
- Five years – or even one year is too long to wait – more frequent indications are needed

DN Sales – what has changed?

- There must be some comparative data from the different companies – it should be used now for customers' benefit
- The companies are likely to have different financial structure – some will be more efficient than others – use the most efficient to set key parameters such as cost of capital
- At present we see a paradox
 - There were supposed to be benefits for customers, but DNs say everything is going up !
 - NAO identified savings which should be available without sale £800m+
 - We support CPA view which says 3% efficiencies per annum should be the starting assumption