Promoting choice and value
for all gas and electricity customers

Embedding financeability in a new regulatory framework

Session 1

5th March 2010

What did we say in Emerging Thinking (1)?

Financing duty

•Whatever regulatory framework is in place - our financing duty must be embedded within it,

•Will continue to ensure that efficient network operators can access finance on reasonable terms,

•Poor performing companies can earn below average (or even negative) returns,

•Strong performing companies can earn above average returns.

What did we say in Emerging Thinking? (2)

The "Straw Man"

- **Cost of capital / Allowed return**
  - Allowed return reflects the riskiness of a company's revenue / cost streams,
  - Allowed return could vary between companies - reflecting individual risk factors e.g. size of investment programme.

- **RAV additions / depreciation**
  - We will review the total expenditure (totex) + fast money/slow money approach used in DPCR5 and aim to establish an appropriate capitalisation policy for future price controls.
  - Depreciation policy should reflect average expected economic life of the assets.

What did we say in Emerging Thinking? (3)

The "Straw Man"

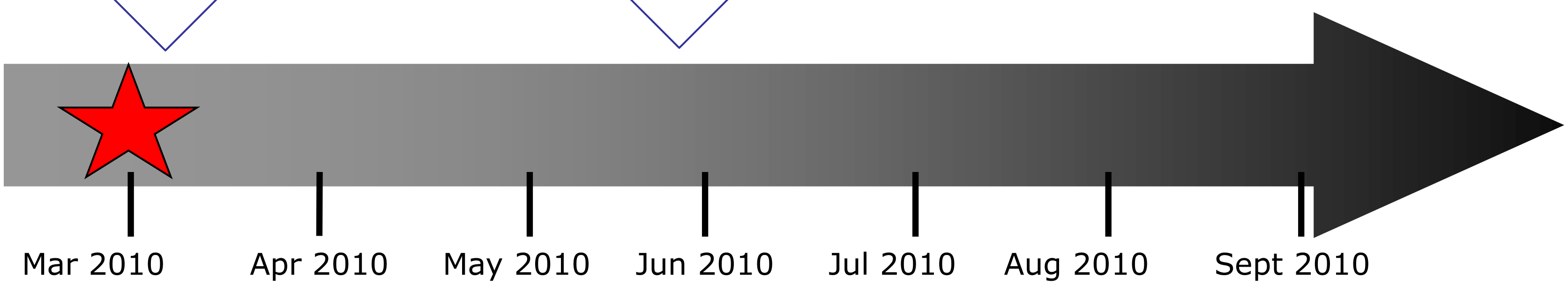
- **Calibrating the price control:**
  - We need a measure of company performance against the price control,
  - This may or may not be by Return on Regulatory Equity (RoRE),
  - Aim is to ensure that the overall impact of incentives, capitalisation / depreciation policies, cost of capital are transparent and widely understood.

- **Assessing financeability**
  - We will continue to assess the expected impact of a price control package on a company's financeability,
  - This may or may not include relying on cash flow ratios calculated by the credit rating's agencies.
  - We aim to rule out "arbitrary" financeability adjustments e.g. accelerated depreciation and/or other uplifts but recognise transitions may be required.

Financeability workstream timetable

February – April: Have appointed CEPA to consider the "straw man" proposals

End May: aim to publish a working paper of updated thinking on financeability alongside CEPA's report



9th April: Emerging Thinking consultation period ends

Autumn consultation: Main consultation along with the rest of RPI-X@20 policy areas

Questions for this session

1. Is there merit in providing differentiated allowed rates of return for companies within a given class/sector?

2. What is an appropriate way of assessing financeability in future price controls? What are the potential implications of moving away from cash flow ratios typically used by Ratings Agencies?

3. How should we strike an appropriate balance between the interests of current and future consumers in determining the approach to capitalisation and depreciation? What are the potential implications of changing our approach on asset lives?

4. Is the approach taken in DPCR5 of using RoRE analysis to calibrate the regulatory package appropriate going forward?

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