

21 March 2019

Simon Wilde
Senior Financial Advisor
Ofgem
10 South Colonnade
London E14 4PU

Dear Simon,

RIIO-2 ENGAGEMENT WITH ENA FINANCE WORKING GROUP: EVIDENCE

I am writing on behalf of our members, in particular those who sit on our ENA RIIO-2 Finance Working Group ('the group').

ENA-Ofgem engagement sessions

Firstly, we would like to express appreciation to you and your team for continuing to engage with and contribute to the work of the group on the many and important financial aspects of the RIIO-2 Framework. Over the course of these engagement sessions, at total of eleven since last September, a number of leading independent experts have presented their analysis covering a number of the key financial components, with it being subject to scrutiny, challenge and debate. This has been welcomed and is fundamental to the overarching objective of the group and the engagement sessions, which is to develop a comprehensive, up to date and robust evidence base that will inform and assist Ofgem in the RIIO-2 policy and decision-making process.

Oxera Reports

The session last week included detailed presentations, review and discussion of work by Oxera on **(i) Estimation of beta and gearing and (ii) Asset risk premium and debt risk premium**. It was agreed Oxera review their analysis and undertake additional work to take account of the discussion. You helpfully confirmed it was acceptable for this to be submitted after 14 March consistent with the agreed engagement plan and questions you and your team had in relation to the work. The first of the two reports is provided with this letter, the other will follow shortly. The remainder of the further analysis you requested on 14 March is being undertaken as a matter of urgency, and will form addenda to the above Oxera reports. This will be available shortly, and together with other material provided under cover of this letter, is being provided well in advance of your decision on the consultation, allowing you to opine on this analysis/evidence.

Also provided is a note by Oxera '**Infrastructure fund discount rates**' that reviews the range of infrastructure funds' discount rates used by Ofgem in the RIIO-2 sector-specific methodology decision as a cross-check to determine the upper bound of the cost of equity range derived from the CAPM.

Inflation in the context of real TMR


At the session on 27 February Frontier economics presented their work on allowed v expected returns, Ofgem's approach and currently proposed range for the TMR and inflationary index was discussed with the Frontier team including Phil Burns, a co-author of the published UKRN work on the cost of equity. This led to an important point of clarification on the UKRN work. To assist we requested Frontier provide more comprehensive explanation of its view on Ofgem's approach to interpreting inflation evidence when estimating TMR, in particular in the light of its decision to use CPIH as its inflation assumption at future price controls. A copy of Frontier's note '**Inflation in the context of real TMR**' is provided with this letter.

Future engagement with ENA Finance Working Group

I hope you agree that the engagement sessions have continued to provide a valuable forum for these important issues to be considered in depth. However, the group continue to believe there is scope to improve engagement, particularly around Ofgem engaging with the group at an early stage when commissioning new analysis as opposed to sharing material only once finalised. The group believe that securing their early input will assist Ofgem to maximise the quality and value of the work. We will of course continue to engage with Ofgem at an early stage and encourage Ofgem to continue to respond to analysis and evidence presented to it as thoroughly as possible.

We look forward to continuing to work constructively with you and your team.

Yours sincerely,

A handwritten signature in blue ink that reads 'David Smith'.

David Smith
Chief Executive

A copy of this letter goes to Akshay Kaul