Balfour Beatty

Akshay Kaul
Acting Executive Director
Network Price Controls Team
Ofgem
10 South Colonnade
London
E14 4PU

RIIO2@ofgem.gov.uk

Balfour Beatty plc
Kingsgate
62 High Street
Redhill
Surrey
RH1 1SH

www.balfourbeatty.com

28 February 2019

Dear Akshay,

I write as Chief Executive of Balfour Beatty's Rail and Utilities business in response to the consultation on the sector methodology for the next price control (RIIO-2).

One of the priorities outlined in the consultation is to achieve a better balance of risk and return in RIIO-2 with the aim of improving value for consumers and potentially lower bills. While we support these overarching objectives, we believe that the proposed approach is unlikely to deliver them. Over the long-term, it may in fact increase the costs for consumers.

In particular, the proposed cost of capital range for RIIO-2 does not fully reflect the risks in the sector. Operating in a constantly changing environment such as the energy sector brings with it a level of uncertainty that businesses must manage in order to survive and prosper. Teamed with the knock-on impact on the ability to access finance, there is a risk that the proposed capital range will destabilise the supply chain.

While at first glance this may seem like a problem for individual companies rather than the industry as a whole, there is a mutual dependency on the supply chain which must be better understood. For example, the UK supply chain has been at the forefront of cutting-edge innovation. However, remaining so requires the ability to support the key drivers of investment in innovation and skills on a continuous basis: innovation to ensure current and future needs of customers are being met efficiently and that system operation is constantly being optimised; and investment in the skilled people needed to drive innovation and efficiencies and ensure capability and knowledge are maintained. This is especially the case in key areas such as new power generation and storage technologies; where the proving and developing of the technologies lies with private companies and the supply chains that support them.

The proposed capital range is therefore likely to in fact drive up financing costs for consumers in the longer term and hold back innovation in the sector.

Innovation is further likely to be further negatively impacted by the proposals to lessen the scope and strength of incentives on companies in addition to the significant reduction in the allowed cost of equity. This differs significantly from the approach being taken by Ofwat, which is to increase the

Balfour Beatty plc
Registered office: 5 Churchill Place, Canary Wharf, London E14 5HU
Registered in England and Wales under Company No. 01982627
An agent of Balfour Beatty Group Limited registered in England and Wales under Company No. 101073
with its registered office at 5 Churchill Place, Canary Wharf, London E14 5HU

Balfour Beatty

role of incentives in the returns available to water company investors at the 2019 Price Review, and is something Balfour Beatty believes should be reconsidered.

Without a strong incentive to invest and innovate and with less available capital to do so, the current pace of innovation is likely to slow rather than increase, to the detriment of consumer bills. This will also make it more difficult to address other priorities such as requirements to decarbonise and improve environmental outcomes. The incentives for companies to innovate should, we believe, be strengthened.

Balfour Beatty encourages a more strategic view of the UK companies and individuals that make up the supply chain, allowing investment in the network and in innovation to reduce costs sustainably, which is what we believe will ensure long term benefits to the consumer. A stable, sustainable supply chain is more productive and therefore represents better value for consumers.

Yours sincerely,

Mark Bullock

Chief Executive Officer, Rail and Utilities