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10 February 2020.

Dear Julie,

**Call for Evidence on the Electricity Transmission, Gas Transmission, Gas Distribution and Electricity System Operator Business Plans for RIIO-2 – Efficiency and Financeability.**

Thank you for the opportunity to respond to the above call for evidence. This is a non-confidential response on behalf of the Centrica Group.

This aspect of our response focuses on issues relating to the transmission and gas distribution sectors (excluding the Electricity System Operator). We present our findings below. In summary:

- **Companies have proposed significantly higher equity costs even though they appear financeable if Ofgem's working assumptions were applied.**
- **The proposed efficiency gains appear modest relative to the forecast RIIO-1 under-spend.**

**Companies have proposed significantly higher equity costs even though they are financeable if Ofgem's working assumptions were applied:**

The RIIO-2 Challenge Group's review of the companies' financeability assessments highlights that all companies are financeable on a notional basis assuming the baseline cost of equity of 4.3%. All companies except NGET, NGGT and SSEN appear to be financeable on a notional basis without mitigating actions required assuming the cost of equity includes the 0.5% outperformance wedge. The Challenge Group considers that the mitigating actions proposed by NGET, NGGT and SSEN are not efficient. All companies except WWU appear to be financeable on an actual basis, assuming the baseline cost of equity of 4.3% and with the 0.5% outperformance wedge applied.

All companies have proposed higher equity values, as shown below. Four of the eight companies appear to be financeable on a notional and actual basis assuming the baseline cost of equity of 4.3% and with the 0.5% outperformance wedge applied. One of those companies – SGN – proposes a cost of equity that is 260 basis points higher than Ofgem's working assumption.

*Table 1: Cost of equity proposed by the companies*

| Company | Proposed Cost of Equity (%) |
|---|---|
| Cadent | 5.6 |
| NGN | 5.0 |
| NGET | 6.5 |
| NGGT | 6.5 |
| SGN | 6.9 |
| SPT | 6.5 |
| SSEN | 6.5 |
| WWU | 6.1 |

- **The proposed efficiency gains appear modest relative to the forecast RIIO-1 under-spend.**

All companies except NGGT are expected to under-spend their RIIO-1 allowances by between 3.3% and 21%. NGGT is expected to over-spend by almost 10%. Proposed efficiency gains are generally of a lower order.

*Table 2: Forecast RIIO-1 under-spend and proposed RIIO-2 efficiency gains*

| Company | Forecast under-spend (%) | Proposed efficiency gains |
|---|---|---|
| Cadent | 3.3 – 12.0 | 0.94% gain per annum |
| NGN | 11.6 | 0.5% gain per annum |
| NGET | 21.0 | 1% gain per annum |
| NGGT | -9.9 | 1.1% opex gain and 0.8% capex gain per annum |
| SGN | 13.4 – 18.8 | 1% gain per annum |
| SPT | 3.0 | 1% gain per annum |
| SSEN | 6.0 | £100m efficiency saving overall (circa 0.3% of Totex |
| WWU | 19.0 | 0.5% gain per annum |

We hope you find these comments helpful. Please contact me if you have any questions.

Yours sincerely,

Andy Manning
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**Centrica Regulatory Affairs, UK & Ireland**