Consultation

RIIO-3 Draft Determinations Overview Document

Publication date:	1 July 2025
Response deadline:	26 August 2025
Contact:	Network Price Controls
Telephone:	020 7901 7000
Email:	RIIO3@ofgem.gov.uk

The next set of price controls for the Electricity Transmission (ET), Gas Distribution (GD) and Gas Transmission (GT) sectors will cover the five-year period from 1 April 2026 to 31 March 2031 (RIIO-3). In December 2024, the network companies in these sectors submitted their RIIO-3 Business Plans for this period to us. We have now assessed these plans.

This document, and others published alongside it, set out our Draft Determinations for the RIIO-3 price controls. These are for consultation, and we would like views from people with an interest in RIIO-3 by 26 August 2025. We particularly welcome responses from consumer groups and energy industry network users. We also welcome responses from other stakeholders and the public.

Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at ofgem.gov.uk/consultations. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

Contents

Foreword

We are at a defining moment for Great Britain's energy system. The government has recently approved the largest expansion in civil nuclear power for decades, alongside the significant planned expansion in renewable power, carbon capture and energy storage to achieve a Clean Power system by 2030. The Industrial Strategy also set out plans to reduce electricity costs for business, streamline grid access for major investment projects, with increased investment in growth industries including clean energy. Given Britain's current exposure to volatile and high international gas prices, we agree it is in consumers' interests to replace expensive imported gas with more secure domestically-produced energy. Our RIIO-3 Draft Determinations set out the regulatory arrangements needed to deliver a clean power system by 2030, with all remaining projects identified by the National Energy System Operator as necessary to achieve this now approved and clear on expectations around their next phase of development.

Capital investment in electricity transmission may exceed £80 billion over the RIIO-3 period. Some of this investment is being approved now - with upfront funding to ensure network companies have the confidence to act early, securing supply chains and focusing on rapid delivery. The remaining funding will be approved through in-period regulatory mechanisms, once project costs are more certain.

The gas networks continue to be of enduring importance, however the transition away from natural gas means that we will work closely together with government on its work to consider of the future of the gas system, including looking at how best to pay for gas infrastructure. We know that, without action, the fixed costs of paying for the gas network risk falling unfairly on a smaller population of future consumers. So, pending the outcome of the government's future of gas work, we are taking steps to mitigate this risk by proposing that all new gas distribution network investment is paid back by consumers by 2050. This is a proportionate approach to a complex issue and aligns with actions to start accelerating depreciation being taken internationally, including Austria, the Netherlands and Germany.

Our proposals also include a set of adjustments to ensure that the wider RIIO-3 regulatory package reflects the investment environment network companies are operating in, while embedding protections for consumers from inefficient costs. These include an increase in the cost of capital to reflect higher interest rates and the greater scale of capital needed, and measures to prevent excessive network company gains (and shield consumers) should substantial inflation increases return.

We remain focused on delivering value for consumers. We have applied a rigorous approach to test network companies' plans thoroughly - avoiding unnecessary spending

and setting a strong efficiency challenge for the industry. Our regulatory approach continues to drive innovation, reward efficiency, and hold companies to account for timely delivery. Collectively, this will help keep costs as low as possible.

The scale of investment with our proposals across electricity transmission and gas networks combined means that, for typical domestic households, network charges on bills for these sectors will rise - from £220 per annum today to around £274 in 2026, and to around £324 by 2031. This does not mean that we expect overall energy bills to rise by an equivalent amount as this investment will deliver real savings for consumers. First, it will allow us to make better use of clean, renewable energy and reduce reliance on expensive gas-fired generation. Second, it will reduce constraint costs payments made to electricity generators when the grid cannot transmit their power. We estimate that cost savings to domestic consumers could be around £80 per annum from these two sources alone by 2031. For non-domestic customers, who face a different cost base, these benefits should also mean that electricity bills for most businesses should fall as a result of the network investment being made.

Crucially, this investment will also protect consumers from future gas price shocks. If we were to face another gas price spike in 2030 like the one in 2022, our reduced dependence on gas for electricity generation, enabled by the increased investment funding through our RIIO controls, could halve the impact on electricity bills.

The higher electricity transmission network charges under RIIO-3 are mostly recovered through higher electricity standing charges. We understand this is an important issue for consumers, especially as the standing charges particularly impact lower income and vulnerable households at an already challenging time. We are committed to finding a fairer, more efficient way of recovering these costs from energy consumers. In the short term, we are responding to this by consulting on giving consumers the option of zero standing charge tariffs. In the medium term, we have recently launched our Energy Cost Allocation and Recovery review to look comprehensively at how energy system costs are recovered.

These proposals mark a decisive step in supporting the delivery of a cleaner, more secure energy system - protecting the interests of current and future consumers while keeping costs as low as possible. We look forward to engaging with all stakeholders before finalising our decisions later this year.

Akshay Kaul
Director General for Infrastructure

Executive Summary

A Strategic and Adaptive Framework

As we enter the RIIO-3 price control period, we stand at a pivotal moment for Great Britain's (GB's) energy networks. The decisions we make now will shape the infrastructure that underpins our clean energy future—ensuring that consumers, both today and tomorrow, are protected and well-served.

RIIO-3 is unlike any previous regulatory cycle. The challenges facing electricity and gas networks are diverging, and the deadline to deliver a clean power system by 2030 is fast approaching. Clear government objectives, alongside the strategic plans of the independent National Energy System Operator (NESO), have brought clarity to the requirements from the transmission network to meet the mission. We are working across the energy system, alongside government, NESO and industry, to support consumers through this transition.

RIIO-3 is our opportunity to implement a regulatory framework for energy networks that will help GB accelerate its transition to a clean power system by 2030. It supports the delivery of critical infrastructure that has been identified as essential through national strategic plans. It ensures companies can access efficient sources of financing to help fund the investment. And most importantly RIIO-3 will protect consumers—both now and in the future - in supporting a resilient, secure, efficient and affordable energy system.

These are our Draft Determinations for RIIO-3 and we present them for consultation.

Making efficient investment decisions to fund the future

The totality of spend on GB's electricity transmission (ET) and gas networks that we expect to occur over the RIIO-3 period (2026-2031) will be far in advance of anything seen in previous price controls. Most of this will be in the electricity transmission sector, however the majority of this is not being decided now and will need to be settled during the price control period.

This will require an unprecedented increase in investment in the energy sector and we know that this comes at a time when many households are facing financial challenges. We must create the conditions that enable the investment to be made, but we must also apply a robust process to ensure that the costs are fair and efficient and the investments are the right ones and will benefit customers in the longer-term.

In total, companies requested £32.7bn of upfront funding. We subjected these requests to a rigorous test of investment need and cost efficiency to drive companies to embrace new and innovative ways to deliver to keep costs as low as possible for consumers.

Our Draft Determinations are proposing to allow expenditure of £24.2bn, which is around 26% lower than the spending plans proposed by the companies. There are three broad factors that explain the variation at this stage.

The first reflects our robust assessment of projects, including unit costs and applying a sharp but achievable efficiency challenge, or in some instances disagreeing outright with the need for the project.

The second is where the needs case for investment may be understood and agreed but where additional clarity is required to ensure those investments are properly coordinated and deliver best value for consumers. This is a key focus for this consultation, soliciting the data and information needed for these investments to be settled.

The third reflects our view that a decision to allow additional funding is best made later, during the price control period, when there is more certainty on the specific network interventions needed and their costs. Under these circumstances consumers are protected from committing too early to investments that are immature in scope and cost whilst also providing a credible route to funding for companies when they are better developed.

Stakeholders, including Transmission Owners (TOs), have previously encouraged a reduction in the use of in-period mechanisms and to settle more of the allowances upfront; as recently as June 2025 the House of Lords Industry and Regulators Committee recommended that "Ofgem should reduce the proportion of investment provided for through uncertainty mechanisms in future price control periods".[1]

We aim to simplify the RIIO price controls wherever possible, including putting more reliance on upfront mechanisms to support delivery. In 2022, we introduced the new Accelerated Strategic Transmission Investment (ASTI) framework to allow transmission network owners earlier access to project funding. In 2025, we introduced the Advanced Procurement Mechanism (APM) enabling TOs access to significant funding to secure supply chain capacity in advance of securing full project approval.

However, for RIIO-ET3 the TOs asked us to settle the costs for the majority of their load programme during the RIIO-ET3 period when they would have more clarity on project scope and market prices. We had hoped to give larger baseline allowances and the lack of maturity of projects in the ET business plans was disappointing. This is reflected in our BPI assessment of 'ambition'. Given the current maturity of these projects, we consider that at this time this is a prudent measure, and avoids exposing both consumers and the TOs to an unnecessary and avoidable risk.

[1] Power struggle: Delivering Great Britain's electricity grid infrastructure

Therefore, the level of our upfront funding is not the end of the story. We have designed the RIIO-3 framework to be adaptive, enabling the industry to meet the emerging requirements and policy developments as they become clearer over time. We have however taken into account the likely totality of expenditure across the period in our assessment of the impact that RIIO-3 will have on customers' bills.

Sector overviews - electricity and gas in focus

We are setting RIIO-3 at a time when there is increasing divergence in the roles of electricity and gas networks.

Electricity transmission (ET)

In ET, to transform the connections processes, generate more clean power, and boost energy security and resilience we must expand the grid at an unprecedented scale and pace. Investment to deliver the 80 projects identified in the government's Clean Power 2030 (CP2030) plan, as well as the expansion of civil nuclear and renewable power and carbon capture and energy storage, will help to reduce pressure on consumers' energy bills through avoided constraint costs and lessening our dependence on gas while also enabling a more resilient and cleaner electricity system.

In recent years, through our network price controls, we have supported this by rapidly approving significant new investment in transmission infrastructure - projects that will be operational by 2030 to support the decarbonisation of the grid. We are continuing this in RIIO-ET3 by giving the TOs firm backing for the ET investment required to bring down bills further and improve longer-term energy security. Through a combination of RIIO-ET2 funding that will roll forward and our proposals in these Draft Determinations, we will ensure the TOs have access to the funding to deliver these projects.

We will make sure costs are as low as they can be and we will hold the TOs to account for the efficient and timely delivery of investment. But for RIIO-ET3 our regulatory approach must continue to evolve - we have to prioritise speed, efficiency, and adaptability over traditional, granular assessments of need. Where projects have already been approved in CP2030 then we will not re-assess the need for them and where we do scrutinise the design and cost of individual schemes more closely, we will do so in a way that does not delay their delivery.

Alongside the investment in new capacity, we are continuing to drive the TOs to maintain world class levels of resilience and reliability through effective stewardship of all assets, old and new, and act responsibly in relation to their impact on the environment and local communities.

Key proposals for ET:

- £8.9bn of upfront funding in baseline totex allowances to support the delivery of essential transmission infrastructure, with immediate access to a further £0.5bn of allowances for associated indirect expenditure essential for CP2030 delivery.
- An expanded use of flexible mechanisms to make a potential seven-fold increase to allowances available when required during the period, operating alongside the APM, to give network companies the confidence to act early.
- A high-powered package of incentives to focus TOs on delivering their plan on time, supporting the connection of renewable generation and deploying other bold and innovative ways to help bring down energy bills for consumers.
- Targets for further reductions in unplanned outages and power cuts, with an increased focus on cyber and climate resilience, to maintain world class levels of network reliability.
- Strengthening the arrangements to minimise the impact of ET activities on the environment and the communities that host their infrastructure.
- Innovation support and new cost sharing arrangements to drive cost efficiency while protecting companies and customers against significant changes in market prices and scope.

Total expenditure in RIIO-ET3 could exceed £80bn by the end of the price control (2031). The TOs have allocated most of this expenditure to a 'pipeline' of potential investment requiring a decision on funding to be made during the ET period, rather than settled now in their baseline allowance.

To reflect this, we propose to set baseline allowances at £4.2bn for NGET, £1.6bn for SPT, and £3.1bn for SHET. In total this is a 26% lower than the companies' submitted costs, after exclusions. However, this percentage difference doesn't take account of the additional non-baseline allowances that we are making available to TOs from the start of the price control to support delivery.[2] The detail of the additional upfront funding available to the TOs is provided in the company annexes. These upfront allowances will sit alongside the APM and a framework of in-period mechanisms that will ensure the TOs have timely access to the revenues required to deliver essential infrastructure.

Gas

We recognise the enduring importance of gas networks - as a vital source of heat for homes, for powering businesses and industry, and as a key pillar of energy security. Yet the uncertain pace of the transition away from natural gas presents challenges in ensuring that different generations of consumers pay fairly for the services they receive.

[2] These non-baseline allowances include Use-It-Or-Lose-It (UIOLI) allowances and pass-throughs which are not subject to the Totex Incentive Mechanism (TIM), as well as Real Price Effects (RPEs).

RIIO-3 will take the first steps to address this challenge as well as drive higher levels of company performance.

For Gas Transmission (GT) our proposed funding, an increase in investment compared to RIIO-2, recognises the network's key role in security of supply. Unabated gas will continue to play a back-up role throughout the transition to clean power. This means that we will retain sufficient network capacity and capability until a low carbon solution is in place.

Key proposals for GT:

- £2.5bn of investment to maintain a network that is resilient, secure, and meeting all environmental and safety requirements.
- Ensuring GT is adapting, and adaptable, to changing network usage patterns. We are funding new capacity to accommodate the growing west-to-east gas flows driven by LNG. National Gas' plans and our Draft Determination are also aligned with NESO's long-term strategic planning.
- Minimising the impact of the GT on the environment, including through new financial incentives for reduction of GHG emissions and stronger focus on NTS shrinkage energy management.
- Making sure the gas system is operated as efficiently as possible and delivers excellent standard of capacity constraint management, demand forecasting, maintenance and residual balancing services to National Gas' customers.

Whilst resiliency, including appropriate investment to maintain and improve asset health, remains paramount, interventions must nevertheless be robust, fully justified, efficient and timely. We have been clear in a number of instances where we accept investment need exists, but additional evidence or optioneering is needed to ensure long term consumer value.

In Gas Distribution (GD), our proposed funding maintains a strong focus on safety, asset health and consumer focused outputs. This investment package is balanced against a sharp, but achievable, focus on efficiency incentives - which includes the application of robust comparative cost benchmarking to ensure less efficient companies catch up with industry leaders, and removing spending that we do not consider essential.

Our accelerated depreciation proposal (which means all new GD investment under RIIO-GD3 will be recovered more quickly) aims to fairly distribute the cost of historical network investments between current and future consumers. It also maintains investor confidence and aligns with the government’s broader net zero strategy. We are working closely with government to support their work to consider the future of the gas sector in

the context of the energy transition and to ensure our regulatory framework can adapt to future government decisions.

Key proposals for GD:

- Maintaining a safe and reliable network with £13bn of upfront allowances which continue to support all necessary investment, including replacing deteriorating pipes.
- Introducing accelerated depreciation for all new RIIO-GD3 investment to reflect the potential for shorter economic lives of gas networks and to ensure fair treatment between current and future consumers.
- Supporting the GDNs in minimising their direct impact on the environment, including further driving down methane leakage by introducing a new financial incentive to repair methane leaks in a timely manner.
- Delivering high quality services that meet consumers' needs by incentivising the GDNs to achieve customer satisfaction scores above 9/10 and promoting collaboration with other utilities to minimise disruption from streetworks.
- Supporting GDNs' in prioritising the most vulnerable consumers with funding to support projects worth £165m, alongside additional vulnerability funding included in companies' upfront allowances.

Our three RIIO-3 sector annexes, covering ET, GT and GD, each provide further details of what all our proposals mean for consumers, network companies and wider stakeholders.

Financial Framework - Ensuring Stability and Confidence

The RIIO-3 financial framework has been carefully designed to provide long-term stability, support the scale of investment needed across both ET and gas, and maintain affordability for consumers. It strikes a fair balance between attracting capital and ensuring value for money, while adapting to evolving market conditions and investor expectations.

We have introduced new tools and refinements to ensure the framework remains robust, transparent, and capable of supporting the energy transition. This includes updated allowances for equity and debt, a new focus on investability, and measures to strengthen financial resilience across the energy network companies, reduce unintended financial outperformance and improve fairness and legitimacy.

Key finance proposals:

- Cost of Equity: A proposed allowance of 6.04% (60% gearing) and 5.64% (55% gearing):

  - Reflecting current market conditions such as higher gilt yields and international benchmarks. This ensures equity investors are fairly rewarded for the risks they undertake.
  - Embedding investability testing, to ensure through benchmarking that the RIIO-3 package can attract the scale of investment required.
- Cost of Debt: The allowance remains indexed to market conditions, with two key enhancements:
  - A nominal allowance for fixed-rate debt, addressing inflation-related windfalls seen in RIIO-2.
  - Tailored allowances per sector to reflect borrowing dynamics more closely and fairly.
- The combined cost of equity and debt results in a Weighted Average Cost of Capital (WACC) of 5.09% for gas, and a range of 5.52% – 5.73% (sector average 5.62%) for ET.

Assessing the impact of RIIO-3 on bills

Impact on domestic consumer bills[3]

We recognise that the increased investment needed during RIIO-3 comes at a time of significant cost pressure on households and businesses. Our Draft Determinations reflect a strategic choice to invest now to avoid higher costs later. We think that acting now will accelerate the shift to renewables, reduce long-term costs, strengthen energy security, create jobs, and help meet our net zero goals - ultimately protecting future generations.

We estimate that RIIO-3 will increase network charges for ET, GD and GT (excluding electricity distribution network charges, which is not subject to these RIIO-3 Draft Determinations) for typical domestic households from £220 per annum today to around £324 by the end of RIIO-3 (March 2031) - an increase of £104.[4] This includes:

- £44 for business-as-usual (BAU) spending. This includes the costs associated with operating and maintaining the gas networks, rolling over previously approved funding commitments from RIIO-2, and updating aspects of our financial framework (including the approach to inflation to better align with network companies' actual costs).

[3] All bill impacts are presented in 25/26 prices. These figures are estimates. Actuals will depend on things like risk-free rate, incentive performance, and timings of additions made through in-period adjustment mechanisms like re-openers.
[4] Network charges in the first year of RIIO-3 (26/27) (excluding electricity distribution) are forecast at £274.

- £8 for accelerated depreciation for gas distribution - to keep charges reasonable for both current and future consumers.
- £52 for renewing and upgrading the electricity transmission grids to strengthen resilience and help enable CP2030, and ensuring the scale of capital injection required is both investable and financeable.

However, this does not mean that our decisions will increase consumers' total energy bills by £104 over the RIIO-3 period compared to what they pay now. We expect that increased ET capacity will enable more green generation - especially offshore wind - to connect to the grid, reducing wholesale prices by displacing more expensive gas-fired generation. We expect wholesale costs to fall by around £25 as a result of this increased capacity.

We have also examined what would happen to bills if we did not approve the additional investment to increase grid capacity. Of the £104 increase in network charges, £52 would be necessary in all scenarios in order to maintain resilience and reliability in our gas networks, and the continued operation of the electricity network. The remaining investment supports the renewal and upgrading of the ET grids to enable clean power. This investment produces £80 of saving for consumers from lower gas use (£25 as above) and lower constraint costs (around £55). That means that bills would be around £30 lower than they would have been if we did not make the investment. Another way of saying this is that if we did not approve the investment in the electricity grids, then network charges would be lower by around £52 by 2031, but overall energy bills would be higher by £30 due to increased gas use and higher system balancing costs, including higher constraint costs.

Note our assessment reflects the bill effect alone from the network investment (compared to a no investment scenario) and does not include increasing benefits from a deeper penetration of domestic renewables and lower constraint costs beyond the RIIO-3 period (post 2031), or wider expected benefits derived from the investment. This would include wider environmental benefits, contributions to wider economic growth, and the long-term benefits to users of reduced exposure to international gas prices. Nor does it make assumptions on wider factors that could reduce wholesale gas prices. By 2030, a cleaner power grid will support the electrification of transport, heating, and industry. The actual effect on consumers is also subject to uncertainty - for example higher (or lower) gas prices means higher (or lower) benefits from switching from gas generation to renewables.

Our draft Impact Assessment, published along our suite of RIIO-3 Draft Determinations, provides more detail on these sensitivities, and under what circumstances our RIIO-3 decisions could result in higher or lower bills.

We will continue to work to refine these estimates ahead of Final Determinations.

Standing Charges

ET network charges are mostly recovered through consumers' standing charges. Standing charges are a particularly important issue for consumers because they are paid regardless of how much energy is used. This can disproportionately affect lower-usage households, including vulnerable or low-income consumers, who may see less immediate benefit from the investment but still face higher fixed costs. To recover the higher ET network charges under RIIO-3, we project that electricity standing charges could rise from £196 per annum today to around £230 by 2026, and £275 by 2031.[5]

To address this, as part of our wider work programmes we:

- are consulting on introducing zero, or low, standing charge tariff options in the short term.[6]
- recently launched a comprehensive review of energy cost allocation and recovery, to ensure fairness and efficiency in the medium term.[7]

Impact on non-domestic customers

Overall, we think that RIIO-3 plays an important role in making electricity prices more affordable and predictable for non-domestic customers. It also aligns with the government's recent Industrial Strategy[8], which aims to reduce electricity costs and boost industrial competitiveness.

There is no single 'typical' non-domestic energy consumer, as usage patterns and charging structures vary widely across businesses. This diversity makes it difficult to provide a simple, universal estimate of RIIO-3's impact on non-domestic bills. However, assuming the expected savings in constraint and wholesale electricity costs are realised (same reasons as for domestic consumers above), the overall net impact on electricity bills is likely to be relatively modest for most non-domestic users. We can be more confident about the benefits for energy-intensive industries (EIIs), where better data is available.

[5] There is no impact on the gas standing charges from RIIO-3 as gas network charges are recovered through the unit rate.
[6] https://www.ofgem.gov.uk/consultation/introducing-zero-standing-charge-energy-price-cap-variant
[7] https://www.ofgem.gov.uk/blog/recovering-costs-energy-infrastructure-investment-customers
[8] Industrial Strategy - GOV.UK

RIIO-3 is expected to help support meaningful bill reductions for EIIs, with savings that more than offset the costs of the price control investment programme. As for domestic consumers, these benefits are driven by avoided network constraint costs and lower wholesale electricity prices - outcomes that RIIO-3 helps to unlock. However, the impact of lower wholesale electricity prices is particularly strong for EIIs, as:

- they make up a larger share of their bills compared to other users; and
- they do not pay higher contract for difference costs, that result from lower wholesale prices.

Therefore, we expect net benefits for EIIs with, or without, the government's Industry Supercharger scheme[9] - though those receiving this extra support could see greater gains. Further detail is available in our Impact Assessment.

[9] As part of its new Industrial Strategy, the government will expand the British Industry Supercharger scheme for EIIs through increased exemptions and network charge discounts. This will help to lower electricity bills too.

1. Introduction

Purpose of this document

1.1 This document sets out our Draft Determinations for the next electricity transmission (RIIO-ET3), gas transmission (RIIO-GT3) and gas distribution (RIIO-GD3) network price controls.

1.2 These RIIO-3 price controls cover the five-year period from 1 April 2026 to 31 March 2031. All figures are in 2023/24 prices unless otherwise stated.

1.3 In preparing these Draft Determinations we have duly considered all stakeholder feedback from each phase of the programme. The proposals reflect feedback provided from the network companies and wider stakeholders, including representations made in our recent Call for Evidence on the network companies' business plans[10], and the individual network company Independent Stakeholder Groups (ISGs). Our approach to embedding the consumer voice in RIIO-3 is discussed later in this chapter.

Navigating the RIIO-3 Draft Determinations

1.4 Our suite of Draft Determinations publications is set out in Figure 1 below. This document is the Overview Document and sets out the strategic context which has informed our Draft Determinations and our view on what our package of proposals looks like as whole. It also contains topics where our approach to aspects of RIIO-3 is common to all sectors. For example: our approach to setting outputs and uncertainty mechanisms; our approach to assessment of company business plans with respect to the Business Plan Incentive; our cross-sector proposals on resilience; and innovation funding levels.

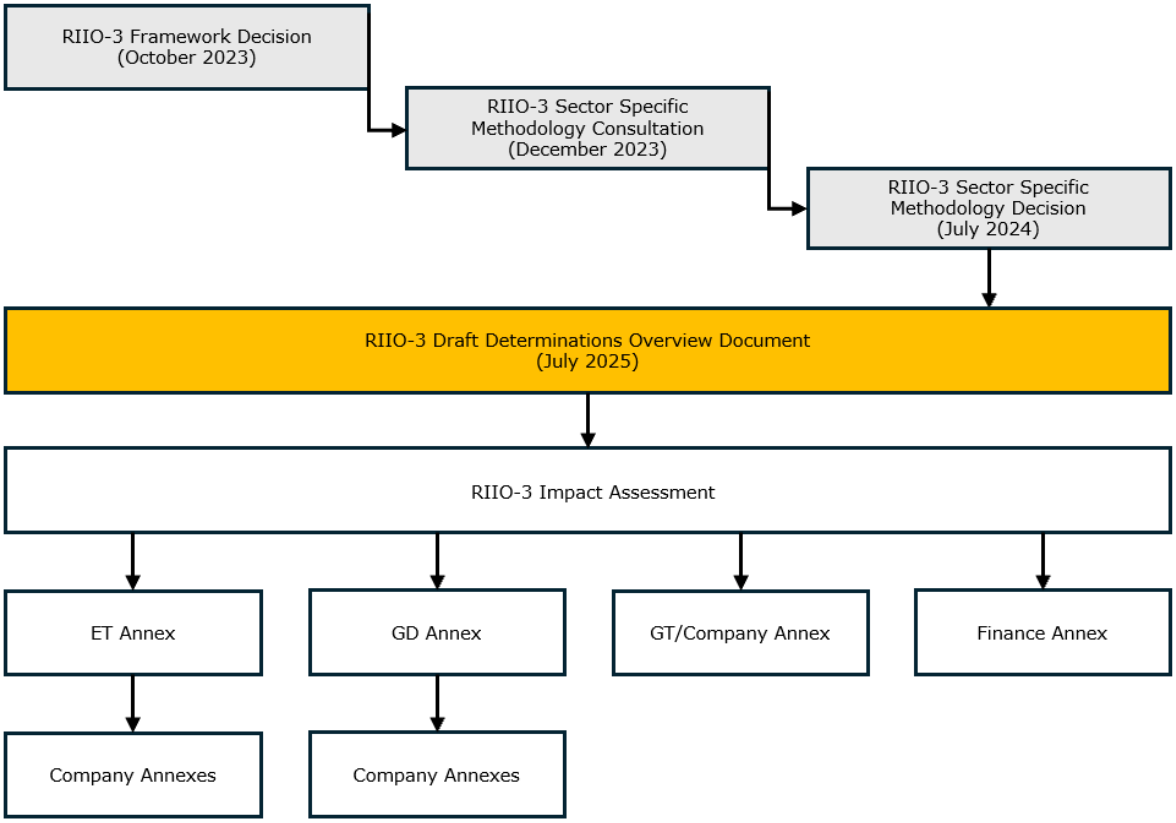
1.5 This Overview Document should be read alongside the following Draft Determinations documents:

- ET, GT and GD Annexes - these contain our proposed approach to topics that are specific to each sector, such as load-related funding mechanisms in ET, or replacement expenditure (repex) in GD.
- Finance Annex – this contains our Draft Determinations proposals on the regulatory finance package that we believe will ensure companies can attract the necessary capital and finance their operations. In general, these apply across all sectors with sector and/or company-specific considerations identified in this document.

[10] Call for evidence on the electricity transmission, gas transmission and gas distribution business plans for RIIO-3 | Ofgem

- Company Annexes – these contain our Draft Determinations proposals specific to each individual network company.
- Impact Assessment – this sets out our assessment of the likely impact of these Draft Determinations proposals on consumers and the network companies.

Figure 1: RIIO-3 Draft Determinations Map



Ofgem's duties

1.6 Ofgem is GB's independent energy regulator. We work to protect energy consumers, especially those who are vulnerable, by ensuring they are treated fairly and benefit from a cleaner, greener environment.

1.7 We operate in a statutory framework set by Parliament. This establishes our duties and gives us powers to achieve our objectives. We are governed by the Gas and Electricity Markets Authority ('GEMA'), which determines our strategy, sets policy priorities and makes decisions on a wide range of regulatory matters, including price controls and enforcement.

1.8 Our Draft Determination proposals are guided by a need to balance our wider statutory duties. Our principal duty is to protect the interests of current and future gas and electricity consumers, including their interests in security of

supply and the UK achieving its net zero targets. Our decisions also consider broader statutory duties, including having regard to promoting economic growth and regard to the need to secure that efficient network companies can finance their regulated activities.

Stakeholder engagement and consumer voice

1.9 We expect network companies to put consumers at the heart of the way they run their businesses and recognise the importance of effective ongoing engagement throughout the price control process. Under RIIO-3, each company was required to demonstrate effective stakeholder engagement and establish an ISG. These groups challenged companies to develop business plans that reflect stakeholder needs and deliver value for money. Final business plans were submitted in December 2024.

Our Call for Evidence and broader engagement

1.10 To support our RIIO-3 engagement, we launched a Call for Evidence in December 2024, which closed in February 2025. This invited stakeholders to express support for, or challenge to, aspects of the network companies' business plans. We received 534 responses, including ISG reports, all of which are published on our website.[11]

1.11 Our wider engagement included policy workshops on most policy areas across the three sectors, cost assessment working groups, extensive discussions with government and devolved administrations, and dedicated sessions with ISG Chairs and investors.

How this engagement informed our Draft Determinations

1.12 ISGs played a critical role in shaping company plans and providing independent assurance of their quality and focus. Thanks to their commitment and input, company business plans had been evidently well tested and scrutinised before submission to us. This level of constructive engagement between each ISG and their respective company is generally reflected in the formers reports to us, which broadly supported companies' final business plan proposals and did not highlight major areas of disagreement.

1.13 Most (~70%) of the Call for Evidence responses came from groups and households opposing new ET overhead lines, raising planning and engagement concerns largely outside our remit. However, we recognise the strength of

[11] https://www.ofgem.gov.uk/call-for-input/call-evidence-electricity-transmission-gas-transmission-and-gas-distribution-business-plans-riio-3

feeling and expect TOs to improve the quality of their engagement with the communities impacted by their infrastructure. We hope that our enabling of the government's Community Benefit Funding proposals through the next ET price control will aid TOs in this engagement.

1.14 Other key themes from ISG reports and Call for Evidence responses included:

- The need for Ofgem to carefully manage bill impacts, including expressing concerns about the potential impact of accelerating depreciation for the gas sectors;
- Broad support for load-related investment in ET; albeit some concerns about supply chain and resource capacity to deliver it, as well as the challenge of navigating planning processes in a timely manner;
- A strong emphasis on environmental performance - particularly reducing gas shrinkage and SF6 emissions; and
- Continued support for funding to assist vulnerable consumers in GD.

1.15 Where appropriate, we have reflected ISG and Call for Evidence feedback in our Draft Determinations and explained how it informed our positions.

Next Steps

1.16 Following publication, we will hold bilateral meetings with companies and wider stakeholders to discuss initial reactions and clarify our proposals. We will also continue targeted stakeholder working groups on policy and cost assessment to support the development of Final Determinations.

1.17 We think that ISGs have a vital ongoing role to play in the price control process. Looking ahead, we will work with companies and their ISGs to define their role in holding companies accountable for delivery throughout RIIO-3. We will also consider any lessons that can be learnt from the process to support future price control reviews. This includes to support the next electricity distribution control (ED3) which will see business plans submitted at the end of 2026.

Question

OVQ1.	We would welcome any views on the enduring role of the ISGs during RIIO-3 and for future price controls.

Consultation stages and next steps

1.18 This consultation on our Draft Determinations will run for 8 weeks and close on 26 August 2025. All proposals published as part of these documents are Draft Determinations, subject to consultation.

1.19 Following consideration of all stakeholder responses to this consultation we will confirm our Final Determinations for RIIO-3 by the end of this year. We will implement our Final Determinations by modifications to the companies' licences, after further consultation on licence drafting. RIIO-3 will then come into effect on 1 April 2026.

How to respond

1.20 We want to hear from anyone interested in this consultation and have asked for your feedback on a number of questions set out in this and the wider suite of RIIO-3 Draft Determinations documents.

1.21 Please send your response to RIIO3@ofgem.gov.uk and respond as fully as you can to each one.

1.22 We will publish non-confidential responses on our website (see Appendix 1 for details regarding how to respond and use of data).

2. Scene Setting

Decarbonising the energy system

2.1 The energy system transition is underway, driven by the United Kingdom (UK), Scottish and Welsh governments' legislative commitments to net zero, carbon budgets, and the policies underpinning these, including CP2030. The pace of change needed to meet government targets is rapid and we are setting RIIO-3 at a time when there is increasing divergence in the roles of electricity and gas networks.

2.2 Electricity demand is rising as it replaces other fuels (eg in vehicles and heating buildings). Meeting government targets requires significant new, and differently located, electricity supply - necessitating unprecedented levels of new transmission infrastructure to meet evolving and accelerating demands.

2.3 While electrification is central to net zero, we do not expect large-scale changes to the natural gas network during the RIIO-3 period. Maintaining safety and resilience remains paramount. However, the transition away from natural gas is gathering momentum, albeit at an uncertain pace. Future decisions - such as repurposing assets for hydrogen, carbon capture, biomethane, or decommissioning - will depend on national and devolved energy policy, including around heat decarbonisation.

2.4 These differing policy contexts for electricity and gas networks present distinct challenges (set out below) that we have considered when setting RIIO-3.

Electricity transmission

Modernising Infrastructure for CP2030 and Beyond

2.5 The ET system's core purpose is to ensure that the flow of electricity supply and demand is balanced in real time, across GB. Historically, the power flowed in one direction – from predominately fossil fuelled power stations to local distribution networks – and stayed largely within our national system boundaries.

2.6 The requirements of the ET system have changed over the past decade. This change is accelerating. Output from fossil-fuelled power stations has reduced, replaced with low carbon generation sources that connect directly to both the transmission and distribution networks. Transmission assets have thus had to be built in different locations, eg in coastal areas where wind resources are high. Power flows on the system are now multi-directional across the transmission

system, and also to and from the distribution system, resulting in upgrades to existing assets and additions of new assets to manage this change.

2.7 In November 2023, government published its transmission acceleration action plan (TAAP)[12] aimed at reducing the time it takes to build ET network infrastructure. Its recommendations have featured heavily in our considerations around designing RIIO-ET3, particularly those that relate to removing Ofgem from the critical path for project development and enabling early supply chain engagement. Our introduction in spring 2025 of the Advanced Procurement Mechanism (APM) in the ET sector (for RIIO-ET2 and, subject to this consultation, RIIO-ET3) is one of the steps that we've already taken to action those recommendations.

2.8 The pace of change has not slowed. Since the submission of the RIIO-3 Business Plans, government set out its ambition to decarbonise the energy sector in its CP2030, which aims for the electricity system to operate at 95% through low-carbon generation by 2030. Helping to enable CP2030, and the consumer benefits it will deliver, has been key to our assessment of the RIIO-ET3 load plans.

The connections challenge

2.9 We are working closely with NESO to drive reform to the connections process in GB to address the growing backlog of connection applications, which has surged to over 700GW of contracted projects. This has strained existing processes and led to delays to connecting low carbon generation.

2.10 To tackle these issues, NESO proposed to prioritise projects that are ready to proceed, which we recently approved.[13][14] By ensuring that connection processes are streamlined and projects stay on track with key milestones, this approach supports the broader goals of CP2030, especially helping to ensure that there will be a marked increase in renewables ready to use the increased network capacity that will be funded through RIIO.

The evolving role of strategic network planning

2.11 The way that the ET network is planned and designed is also changing, with increased direction from government, coupled with new investment need increasing linked to strategic plans.

[12] https://www.gov.uk/government/publications/electricity-networks-transmission-acceleration-action-plan
[13] https://www.neso.energy/document/316446/download
[14] Decision on Connections Reform Package (TM04+) | Ofgem

2.12 The first milestone in this process was the Holistic Network Design (HND)[15] in June 2022, which provided an offshore and onshore design to facilitate the government's ambition of 50 GW of offshore wind by 2030. This resulted in our decision in December 2022 to introduce the Accelerated Strategic Transmission Investment (ASTI) framework to rapidly approve funding for large, strategic onshore electricity transmission projects to deliver this ambition. The HND is now referred to as the first transitional Centralised Strategic Network Plan (tCSNP1).

2.13 The NESO published the second transitional CSNP (tCSNP2) in March 2024,[16] and we published our decision on funding to accommodate the changes in December 2024.[17] NESO is now developing an update, the tCSNP2 refresh, due to be published in early 2026 to take account of CP2030 and other changes to network planning.

2.14 In December 2023 we decided[18] that the new independent NESO should develop the first Centralised Strategic Network Plan (CSNP), expected by December 2027, to identify enduring onshore and offshore transmission network planning needs. We are working with NESO and government on the Strategic Spatial Energy Plan (SSEP), which will be a key input into the CSNP.[19] The interaction of the RIIO-ET3 framework with both the SSEP and CSNP has been an essential part of our policy development.

Gas Distribution and Gas Transmission

Investment for CP2030 and the future role of strategic planning

2.15 Alongside the importance of the ET network, CP2030 also emphasised the importance of the GT network in supporting electricity system security (particularly during low wind and solar conditions) and its ongoing importance for industry and households during the transition to net zero.

2.16 Therefore, RIIO-3 has to enable National Gas to operate and invest to deliver energy system resilience, aligned with NESO's long-term strategic view.

2.17 NESO will play an increasing role in both resilience planning and long-term strategic planning for GT. In December 2024, NESO published its first Gas Network Capability Needs Report (GNCNR) setting out the physical capability

[15] A Holistic Network Design for Offshore Wind | National Energy System Operator
[16] Beyond 2030 | National Energy System Operator
[17] Ofgem tCSNP2 decision
[18] Decision on the framework for the Future System Operator's Centralised Strategic Network Plan | Ofgem
[19] Strategic Spatial Energy Plan: commission to NESO - GOV.UK

required of the National Transmission System (NTS) under future energy scenarios. By the end of this year, NESO will advise us, through the Gas Options Advice Document (GOAD), on long-term options that could meet the needs identified in the GNCNR. The conclusions will feed into the NESO's first CSNP.

2.18 We are working closely with NESO and National Gas to integrate, and operationalise, the increased role strategic planning will play during the price control, and have included funding mechanisms to fund NESO-driven investment work where needed.

2.19 It is vital that the GDNs continue to provide a secure, uninterrupted supply of gas to the 22 million homes and businesses, industrial users and power stations currently connected to their networks. Better system planning is needed to manage the transition away from natural gas use while maintaining resilience for gas consumers.

2.20 The introduction of the Regional Energy Strategic Plan (RESP) will support this transition and inform strategic investment at the distribution level in electricity and gas. Reduction in GD network capacity must not precede reduction in demand. As such in our April RESP framework decision we said that we will work closely with NESO to define an appropriate time delay for GDNs to align with RESP. We expect RESP to play an increasing role in future price controls.[20]

Managing the uncertain future of gas

2.21 The speed, timing and overall balance of repurposing, decommissioning and retaining natural gas assets will be influenced by future government decisions on how to reach the statutory net zero target and five-year carbon budgets. In particular, in the short term, they will be influenced by the UK government's:

- development of a Hydrogen Transport Business Model (HTBM) to facilitate and support the development of hydrogen pipeline infrastructure;
- ambition to make a strategic decision on whether to use hydrogen for heating in 2026; and
- decision on blending up to 20% hydrogen into the existing gas network.

2.22 The uncertainty regarding the medium to long term future of gas presents several distinct challenges that impact our approach to regulation in RIIO-3, and beyond. Consequently, we are working closely with government to help ensure the transition away from natural gas is fair and at the lowest possible cost.

[20] https://www.ofgem.gov.uk/decision/regional-energy-strategic-plan-policy-framework-decision

2.23 The UK Government Gas Update to Market published on 30 June, identifies three strategic challenges facing the gas system:

- resilience of gas supply and infrastructure;
- balancing infrastructure investment and affordability; and
- managing a planned and orderly operational transition.

2.24 We welcome this update and will support the government in responding to these challenges. Our Draft Determinations reflect this context. In particular, our proposals for gas depreciation (see Chapter 7 of this document and Chapter 8 of the Finance Annex) take into account the government's commitment to publish a call for evidence on gas network investment and affordability in the autumn. This will seek views on alternative cost recovery options to help ensure the impacts on current and future consumers are fair.

2.25 We are also working closely with government to design and implement the HTBM and to regulate Carbon Capture Usage and Storage (CCUS) transport and storage networks. To ensure RIIO facilitates the repurposing of natural gas assets for hydrogen and CO_2, we are separately consulting on our proposed asset valuation methodologies for the transfer of natural gas assets between the regulatory asset bases.[21]

[21] https://www.ofgem.gov.uk/consultation/ofgems-proposed-asset-valuation-methodology-repurposing-natural-gas-assets-consultation

3. RIIO-3 Strategic Design of the Framework

Introduction

3.1 Across successive RIIO price controls, we have developed a suite of different tools to implement a price control framework. While each sector has its own specific set of price control arrangements, and indeed each company may have elements of its settlement that are bespoke, they are underpinned by the application of common tools and mechanisms that we apply across each sector.

3.2 We are using these tools for RIIO-3 to best protect the interests of current and future consumers. This involves retaining elements of previous price control frameworks that serve that interest, simplifying and streamlining arrangements where possible, but also adapting and evolving new elements to reflect the distinct challenges and opportunities we now face.

3.3 In this section we describe these 'cross-sector' tools that build our framework.

Setting outputs and incentives

3.4 Through the RIIO model we use outputs to reflect the attributes of network service quality that are of most value to current and future consumers (including those in vulnerable situations). Outputs should be specific, measurable and substantively within the control of network companies to deliver.

3.5 As a general rule, we expect the delivery of a target level of an output to be funded through baseline allowances. Where there is value (or loss) to the consumer of service quality improvement (or degradation) an **Output Delivery Incentive (ODI)** can be applied to measure how far from the target level the company has performed. ODIs can then be linked to a financial reward and/or penalty (ODI-F). In some areas, rather than a financial incentive, we may use a reputational incentive (ODI-R) to drive company performance. We are more likely to use these where we have less certainty on our ability to robustly set targets, measure performance and clearly align financial value to the consumer.

3.6 In contrast to ODIs, **licence obligations (LOs)** reflect minimum standards expected of companies and the company. These must be met. If a company fails to do so they may face formal enforcement action from Ofgem.

3.7 We also use **Price Control Deliverables (PCDs)** to attach funding provided in baseline totex to the delivery of specific projects. PCDs allow us to return money to consumers in the event that the output is not delivered. There are two types of PCD:

- Mechanistic PCDs are set in cases where the cost and scope of a high-volume activity is well understood. In such cases, the recovery of any non-delivery of work is automatic.
- Evaluative PCDs are used for large projects which have clearly defined scopes. This type of PCD allows for an assessment of the output delivered and an adjustment to allowances, if necessary, to protect consumers.

Setting baseline totex allowances

3.8 We aim to set baseline totex allowances that, in conjunction uncertainty mechanisms, ensure the licensee has sufficient, but not excessive funding to deliver its outputs and other deliverables over the control period. To determine that the allowances are sufficient but not excessive, we make our best estimate of what a notional company of average efficiency (that has operated its network economically and efficiently in the past) would need to spend in the period to run its business and to deliver the relevant outputs.

3.9 Our assessment of companies' cost proposals is informed by the Engineering Justification Papers (EJPs) that we require companies to submit which set out the scope, costs and benefits for major projects or aggregated investment programmes. These act as a decision support tool that we consider alongside other justifications provided for investment decisions.

3.10 Our assessment of efficiency takes into account the productivity improvements that we consider even the most efficient company can achieve. This is referred to as Ongoing Efficiency (OE) and setting a suitably stretching OE challenge ensures value for money for consumers by incentivising companies to continue to deliver productivity improvements over time.

3.11 In setting allowances, we also make adjustments, known as Real Price effects (RPEs) to reflect changes in input prices experienced by companies over the price control period. The use of RPEs reduces the risk of material external cost fluctuations that would not otherwise be captured in the broader measure of inflation,[22] that we apply in the price control.

Uncertainty Mechanisms (UMs)

3.12 A core principle of a RIIO price control is that revenues are set up front so that companies can finance themselves efficiently and put in place plans to deliver their investment programme within, or below, the budget that we have allowed.

[22] Consumer Prices Index including owner occupiers' housing costs (CPIH)

This requires the setting of allowances up front (or "ex ante") and sharing any over or underspend against those allowances between companies and consumers. This should drive the company to innovate and drive down costs as well manage the risk of cost over-runs.

3.13 However, there are some activities where the associated costs cannot be forecast with any great accuracy at the time of setting a price control. Where this is the case, setting an ex ante allowance could lead to companies being significantly under or over funded. In either instance, this is likely to cause detriment to consumers.

3.14 Where this is the case, we use uncertainty mechanisms (UMs) to adjust allowances during the period once there is more certainty. This helps to reduce risk, but has the potential to make the price control framework more complex and slow down investment while we decide on the appropriate level of funding. To avoid this, for RIIO-3 we have placed more focus on making these UMs as automatic and streamlined as possible, while also ensuring that the consumer interest is protected by only adjusting companies' funding for efficient costs.

3.15 Where there is material uncertainty in the evolution of prices at the start of the control period, we may use **indexation** to avoid forecasting errors.

3.16 Where there is material uncertainty in the evolution of quantities (but unit rates are stable) at the start of the control period, we may use **volume drivers** to adjust allowances within the control period.

3.17 Where there is material uncertainty as to both prices and quantities (and/or the economic needs case is not proven, or the scope of expenditure is unclear) at the start of the control period, we may use **a re-opener** mechanism during the control period to consider variation in allowances.

3.18 Where the specific nature of work to deliver an output will be decided within period and the total amount of expenditure is expected to be relatively low materiality we may provide companies with a **Use It Or Lose It (UIOLI) allowance**, that provides them with flexibility on how best to use the allowance without the time and resource burden of seeking further approval from us.

3.19 We allow companies to **Pass-through costs** for expenditure that is entirely outside their control.

Totex Incentive Mechanism (TIM)

3.20 The TIM is a means through which any over or underspends incurred against baseline allowances are shared between the company and consumers. This

incentivises companies to seek out efficiencies to lower cost and retain a share of this benefit and avoid cost increases. Both these behaviours are in the consumer's interest. The TIM also provides some protection to investors from the risk of significant cost over-runs which helps to lower the cost of financing the companies. Again, this is also in the consumer's interest. By incentivising companies to deliver more efficiently, because they share the benefit of doing so, in subsequent price controls we are able to set ever more stretching efficiency targets, driving more value for consumers over time.

3.21 The proportion of the share of over or underspend that companies retain is called the incentive rate. We set this to take into account a number of factors, including the level of confidence we have in our estimate of costs, and the likelihood and impact of changes in cost.

Innovation

3.22 Price controls encourage companies to undertake innovation using their totex revenue as part of their everyday activities (ie BAU innovation). Dedicated innovation funding is also used to promote research, development and demonstration projects that payback over timeframes longer than the price control period, or projects that do not deliver direct financial benefits to the network company but are nevertheless in the interests of future consumers.

3.23 Innovation funded through the price control requires network companies to operate transparently, collaborate and work towards a strategic industry-wide direction, avoid duplication, share learnings from projects, and track the benefits that spending is delivering. Innovation activities are joined up with government innovation funding (including UKRI); and enable third parties to play a large role in bring forward new projects.

Business Plan Incentive (BPI)

3.24 The Business Plan Incentive (BPI) was developed to overcome information asymmetries between us and the companies and to motivate companies to develop high-quality, ambitious business plans that embed efficiency and represent value for money for consumers.

3.25 The BPI rewards companies where, in our view, their business plan represents genuine additional value for money compared to business-as-usual and provides information that helps us to set a better price control. In contrast, inefficient, lower quality Business Plans are subject to financial penalties.

Network Asset Risk Metric (NARM)

3.26 Energy network companies are the guardians of essential national infrastructure. A failure of their networks can lead to profound consequences for the functioning of our society. We therefore expect strong asset stewardship to safeguard the reliability of the energy network. This involves an understanding of the risk to their network assets, so that they can take the necessary actions to improve and maintain the resilience of old, new and future energy infrastructure.

3.27 Network asset risk refers to the likelihood of a network asset failing and the potential consequences of such a failure. If a network company does not maintain, replace, or refurbish its assets, the likelihood of failure - and the associated risks - will generally increase over time. To keep network asset risk within reasonable bounds, network companies receive funding to carry out asset management activities such as replacement or refurbishment.

3.28 The NARM has been developed to quantify the consumer benefit of the network companies' asset management activities and holds the companies accountable for their investment decisions.

Data and digitalisation

3.29 Digitalisation means improving the way we use data and digital technologies to generate value for consumers. The future energy system will require higher quality and more easily accessible data than is currently available. This is because the management of capacity across networks, the proliferation of millions of distributed assets, the interconnected nature of different systems and operators, and the need for decentralised flexibility requires reliable and standardised data transfer to operate effectively. As such, digitalisation and better use of data is needed to decarbonise and maintain resilience at least cost; by improving the way we use data and digital technologies.

Cyber resilience

3.30 As networks become smarter and more automated, network companies will increasingly rely on interconnected technologies and systems to deliver services to customers. There is a necessity for ongoing investment to ensure energy networks and information systems are adequately protected to detect and prevent cyber-attacks. Network companies are also required to be compliant with Network and Information Systems Regulations (NIS Regulations).[23]

[23] https://www.gov.uk/government/collections/nis-directive-and-nis-regulations-2018

Financial parameters

3.31 Alongside remunerating companies for the costs that they incur in operating and developing their networks, price control allowances also include the costs associated with financing the companies. There are various parameters associated with this and full details are provided in the Finance Annex. Key financial parameters include the cost of capital, depreciation and capitalisation.

3.32 We set a cost of capital allowance to enable a notional efficient operator to maintain an investment grade credit rating, and generate an expected return to equity that fairly reflects the risk facing investors in energy networks that are subject to price controls under our regulation.

3.33 The depreciation allowance (the rate at which the regulated asset value (RAV) is 'repaid' to investors) should be set, so that different generations of consumers pay for network services broadly in proportion to the value of the services they receive, whilst having regard to balancing affordability, financeability and the interaction between depreciation and capitalisation.

3.34 The capitalisation rate (the proportion of totex added to the RAV each year) should reflect the broad balance between capital and non-capital expenditure, whilst having regard to balancing affordability, financeability and the interaction between depreciation and capitalisation.

3.35 One way in which we assess the potential impact of our Draft Determinations is by estimating the range of Return on Regulatory Equity (RoRE) that investors in a company might earn, depending on how well that company performs in delivering against its allowances, ODI-Fs and other financial parameters.

4. Outputs and incentives

Introduction

4.1 In this Chapter, we set out our decisions for the RIIO-3 outputs framework that are common across sectors. This includes our approach to mitigating the impact of network companies on the natural environment and ensuring the ongoing resilience and asset health of the networks.

Cross-sectoral outputs

Environmental Action Plan and Annual Environment Report ODI-R

Purpose: Ensure network companies outline their environmental commitments for RIIO-3 and report on their performance against these commitments annually.

Benefits: A more environmentally sustainable network which focuses on mitigating emissions, limiting impact on the natural environment, and ensuring efficiency in operations.

Background

4.2 In our SSMD, we decided to retain both the Environmental Action Plan (EAP) and Annual Environment Report (AER) for RIIO-3, whilst removing the separate Business Carbon Footprint (BCF) ODI-R - which will be absorbed into the AER.

4.3 We also decided the AER would be split into a primarily qualitative commentary section and a primarily quantitative key performance indicator (KPI) section. This is to ensure ease of access to data and a high level of comparability across the network.

4.4 In our Call for Evidence, several responses highlighted the responsibility of network companies to manage their environmental impact. Much of the feedback was on specific environmental issues and so will be referenced where relevant in the sector annexes. One response highlighted the importance of consistent environmental reporting in the AER and the transparency benefits of Ofgem reporting publicly on performance in an annual report or equivalent.

4.5 For our consultation position on network company EAP commitments made as part of RIIO-3 business plans, please see respective sector annexes.

Consultation position and rationale

Summary of consultation position

Output type: ODI-R and Licence Obligation.

Reporting to stakeholders: The network company will publish its AER on its website for stakeholders to access freely.

Delivery date: The AER must be published by the 31st of October each year.

Measurement: Annual monitoring of AERs by Ofgem.

Scope: Requirements will be set out in the RIIO-3 Environmental Reporting Guidance**.**

Applied to: GD, GT and ET**.**

Measurement

4.6 The AER will be assessed by Ofgem's RIIO-3 monitoring team on an annual basis following the publication of the report. Reports across the network will be analysed and the progress made in each area compared against the EAP commitments and other network companies.

4.7 Assessing the AERs will enable us to make an assessment as to the quality of the submission and the performance of the network company in question. In order to hold network companies to account for their performance, we will monitor their AERs and may use our RIIO-3 annual report to comment on companies' progress.

Scope

4.8 Both the commentary and the KPI sections will have a set of minimum requirements which we expect network companies to adhere to. These requirements will be outlined in the RIIO-3 Environmental Reporting Guidance document, which will be consulted on following our Final Determinations.

4.9 The Environmental Reporting Guidance document will outline which KPIs network companies must include in their reports, along with any information they must include in the commentary sections including acceptable formats and other relevant details. Sections pertaining to only one sector (such as transmission losses or shrinkage), will be outlined accordingly in the guidance.

4.10 We received feedback from one ISG that "environmental" guidance alone is not broad enough to capture all related issues, and that "sustainability" would be a more inclusive framing. In response, we note that the requirements set out in the Environmental Reporting Guidance will not be exhaustive. If network

companies want to expand upon certain areas or provide information not included in the guidance, they are free to do so.

Question

OVQ2.	Do you agree with our proposed position on the Environmental Action Plan and Annual Environmental Report ODI-R for RIIO-3?

Operational Transport Emissions Reduction PCD

Purpose: To facilitate the rollout of Zero Emission Vehicles (ZEV) and associated Electric Vehicle (EV) charging infrastructure during RIIO-3.

Benefits: Reduced carbon emissions associated with operational transport, contribution towards network company BCF targets, and continued modernisation of vehicle fleets.

Background

4.11 In RIIO-2 we implemented two PCDs associated with network company efforts to reduce transport emissions:

- the bespoke NGET Operational Transport Carbon Reduction PCD; and
- the Commercial Fleet Electric Vehicle PCD which applies to all GDNs.

4.12 So far in RIIO-2, the network companies have made varied progress against ZEV fleet transition targets. Some network companies are on track to transition significant amounts of their fleet during RIIO-2 to ZEVs. Other network companies have highlighted issues with vehicle availability and suitability for their operations, resulting in limited progress (primarily in GD and GT). We received some ISG feedback encouraging network companies who have struggled to achieve ZEV targets to consider the different strategic approaches other network companies have used successfully.

4.13 In our SSMD, for ET we stated our intention to retain the PCD for NGET in RIIO-3, depending on the volume of work it needs to deliver after RIIO-2. We also stated we did not consider it necessary to expand the PCD to other TOs, given the low materiality of funding requests in RIIO-2. For GD, we decided to remove the commercial fleet PCD for the GDNs as we considered this activity to be BAU.

Consultation position and rationale

PCD type: Mechanistic.

Output to be delivered: Target number of ZEVs and associated charging infrastructure, which will be set in our Final Determinations.

Baseline cost allowance: Baseline allowance for each network company based on specific volumes and common unit costs.

Reporting: Annual Regulatory Reporting Packs (RRP) and AERs.

Delivery date: 31 March 2031.

Applied to: ET and GD.

PCD type and applied to

4.14 For RIIO-3, we propose to establish a mechanistic PCD across ET and GD applied to costs associated with ZEVs and related charging infrastructure. This will be applicable to all TOs and GDNs.

4.15 This is a departure from our SSMD position. Our review of business plans highlighted ongoing uncertainty regarding ZEV availability, which will continue to pose problems for network companies in RIIO-3. Additionally, some funding requests have become more material compared to RIIO-2. We therefore think a PCD is appropriate as it will ensure consumers only pay for what is delivered and strengthen delivery accountability.

4.16 Although our SSMD set a £15m materiality threshold for PCDs, we consider a PCD is appropriate for all companies with ZEV related investment because:

- uncertainty regarding output delivery is a common issue;
- the mechanistic PCD approach means there is a minimal resource burden to expanding it to all companies; and
- broader inclusion enables more robust benchmarking.

4.17 NGT did not request any ZEV related investment, so our consultation position is that the PCD will not apply to it. However, we are open to proposals from NGT to ensure it is on track to hit its BCF target.

Output to be delivered

4.18 We propose to set a target number of ZEVs and associated charging infrastructure in our Final Determinations against different categories of ZEVs and associated infrastructure. To do this, we require further information from the network companies in response to this consultation.

4.19 The network company commitments are summarised in Table 1 below. Network companies submitted varied ZEV vehicle replacement commitments, with different levels of detail and quality of information provided.

Table 1: Network company operational transport EAP commitments summary

Network company	**EAP commitment**
NGET	Ensure 100% of fleet purchases for light duty vehicles will be ZEVs (where technology availability and delivery timescales allow), equating to 37/40% of remaining Internal Combustion Engine (ICE) fleet, plus supporting electric vehicle (EV) charging infrastructure.
SHET	Installation of 28 electric vehicle chargers across 14 sites to support ambition to convert operational fleet to electric vehicles (note: no specific EAP commitment on operational fleet).
SPT	Decarbonise fleet by 2030 - electrifying 100% of feasible vehicles and implementing lower carbon alternatives for all other vehicles (where an electric alternative is not feasible for operational or technological reasons).
Cadent	70% of commercial fleet will be EV by 2031- maintain an EV first responder fleet of 50% and explore hybrid options for 3.5 tonnes vehicle replacement, should they be available.
NGN	Achieve net zero emissions from fleet by 2031 - replace 557 vehicles on a like for like basis and expand EV charging network with rapid chargers (50kww+) across properties to ensure resilience of business operations.[24]
SGN	Reduce emissions from fleet by 23% - transition 13% of commercial fleets to electric and remainder as new diesel and provide charging points at regional depot hubs.
WWU	30% of operational vehicles will be ultra-low emission vehicles (ULEV) by 2031. Provide charging infrastructure at head office and main depots.
NGT	No related RIIO-3 EAP commitment (based on availability considerations following RIIO-2 EAP delivery).

4.20 Most network companies highlight continued ZEV operational suitability and market constraint issues in RIIO-3. There is generally consensus that larger van types, specialty vehicles (eg 4x4s), and HGVs are the most challenging areas for ZEV availability. However, NGET predicts that EV 4x4's may be available in RIIO-3.

4.21 There are also differing views regarding the suitability of small and medium panel EV vans, which make up a significant proportion of many vehicle fleets.

[24] NGN considers that net zero emissions from its fleet may be achieved either by offsetting emissions (at its own expense) or by compensating any emissions through outperformance in other BCF emissions areas.

For example, NGET and Cadent identify EV medium panel vans as available in RIIO-3, whereas other GDNs and TOs typically predict to convert only smaller vehicles to ZEVs.

4.22 Given the varied information in the business plans, we want more evidence on why certain vehicles are not appropriate for individual network companies' operations and more granular information regarding vehicle categories to inform output definition. We will also consider how the outputs can be defined to allow suitable flexibility for companies to overcome the risk of market constraints in RIIO-3.

4.23 In addition to ZEVs, we also received proposals to fund supporting EV charging infrastructure, primarily from SHET and NGET. In comparison, the costs submitted from GDNs on this are minimal. We support the build of charging infrastructure to enable EVs. We will seek more information from the GDNs in response to this consultation on what has informed their comparative lack of investment.

Baseline cost allowance

4.24 We propose that baseline cost allowances will be set for each network company based on specific volumes and common unit costs. We propose the common unit costs will:

- be the incremental cost difference of ZEVs compared to Internal Combustion Engine (ICE) vehicles, allowing company flexibility to purchase ICE vehicles in the instances ZEVs are not available (as per the RIIO-GD2 EV PCD); and
- only include capex costs, as we consider associated opex costs less uncertain (as with the RIIO-2 PCDs for NGET and GDNs).

4.25 We found issues with the quality of ZEV data in the business plans, so we do not currently have enough information to set the PCD unit rates. We therefore require all network companies to provide information as part of their response to our Draft Determinations. We have set out the costs and volume data that we consider is required in the bullet points below:

- Breakdown of small panel, medium panel, large panel vans, and all other ZEV types to be replaced and/or added in RIIO-3. Categorisation must detail vehicle type(s)/model(s) and weight.
- Expected number of each ZEV type that will be purchased or leased (reported separately), on an annual basis where possible across RIIO-3.
- Unit costs of all vehicles within the provided categorisations as above, with ZEV and ICE comparison on an annual basis where possible across RIIO-3.

- Supporting commentary explaining how unit costs were derived, including indicating any discounts and justifying changes from unit costs in RIIO-2, where applicable.
- If applicable, commentary for each vehicle category where ZEVs are considered not operationally viable.
- For GDNs, details of EV charging strategy and costs (including charger category breakdown if applicable).

4.26 Table 2 below shows the costs network companies submitted in the business plans - which varied significantly. We expect any allowances that we will set at Final Determinations to change relative to what shown in Table 2 as a result of the responses we are seeking from this consultation.

4.27 Despite the variation in ZEV proposals, almost all network companies submitted increased vehicle allowances compared to RIIO-2. The reasons for this are:

- Increases to network company vehicle fleet size in comparison to RIIO-2. In ET, this is driven by increased operational activity (eg SHET and SPT target 50% increased fleet size). In GD, all GDNs plan to increase their fleet sizes to meet their operational needs (eg to attend to repairs and emergencies). Some GDNs also highlighted the need for additional vehicles to support compliance with HSE guidance on fatigue management;
- Instances of ZEV and other vehicle unit rate costs increasing;
- Instances of increased availability of ZEV vehicles in larger, more expensive vehicle categories compared to RIIO-2 (eg medium panel vans); and
- Instances of forecasts using ZEVs despite delivery uncertainty, resulting in higher costs due to higher unit rates compared to ICE vehicles.

Table 2: ZEV and charging infrastructure submitted costs in RIIO-3[25]

Company	EV total cost (£m)	Total vehicle costs (£m)	Charging costs (£m)
NGET	£39.32	£45.62	£16.47
SHET	£67.57	£74.23	£14.99
SPT	£11.87	£15.63	-
Cadent	£46.32	£207.95	£0.23
NGN	£1.48	£47.37	-
SGN	£11.00	£193.27	-
WWU	£0.90	£145.71	£0.67

Question

OVQ3.	Do you agree with our consultation position to create a new common mechanistic PCD for ZEV and associated infrastructure costs?

Network Asset Risk Metric (NARM)

Purpose: The NARM allows us to quantify the benefit to consumers of the network companies' asset management activities.

Benefits: The NARM ensures that network companies remain safe, secure and reliable and that network risk is kept within reasonable bounds.

Background

4.28 Network resilience involves several critical components which help safeguard the stability and reliability of the energy networks. One key component is asset health. Our core network regulation approach to asset health comes through the Network Asset Risk Metric (NARM). Network asset risk refers to the likelihood of a network asset failing and the potential consequences of such a failure. If a network company does not maintain, replace, or refurbish its assets, the likelihood of failure and the associated risks will generally increase over time. The NARM quantifies the consumer benefit of the network companies' asset management activities in risk pounds (R£m). To keep network asset risk within

[25] GD EV costs are based on either purchasing or leasing schemes and total vehicle costs are based on the total costs of vehicles (capex and opex) that were submitted in the business plans. All ET costs and outputs are based on the vehicle submission in the business plans, including purchasing and leasing.

reasonable bounds, network companies receive funding to carry out asset management activities such as replacement or refurbishment.

4.29 In our SSMD, we decided to retain and build on the RIIO-2 NARM incentive regime. This has led to our recent decision to amend the Clearly Identifiable mechanism, to ensure that allowances are reflective of actual costs at RIIO-2 close out.[26]

4.30 We also decided to improve NARM in four key areas: standardisation, asset coverage, assurance, and the reporting framework. Collectively these aim to drive greater consistency, transparency and accountability across the sectors. We outlined a delivery framework to introduce common methodologies (CMs) by April 2027 and asset data systems which align with the CMs by April 2029.

4.31 Building on our SSMD we have set out proposals to:

- set Baseline Network Risk Outputs consistently across all sectors;
- ensure network companies' Baseline Network Risk Outputs reflect efficient costs;
- implement the Funding Adjustment and Penalty Mechanism, to hold network companies accountable for their investment decisions and apply a penalty for any unjustified under-delivery; and
- provide a granular plan and timings to improve the NARM framework.

Summary of consultation position

Output type: PCD,ODI-F and ODI-R.

Measurement: Baseline Network Risk Outputs defined using the long-term risk measure.

Targets and funding: Baseline Network Risk Outputs with associated baseline costs.

Funding adjustment and Penalty Mechanism: Financial adjustments and penalties depending on the network company's delivery of its Baseline Network Risk Outputs.

Improving the NARM framework: Development of standardised NARM methodologies. and consistent data collection practices.

Reporting to Ofgem: RRPs.

Delivery date: 31 March 2031**.**

Measurement: Annual monitoring and through RIIO-3 close out by Ofgem.

[26] The Clearly Identifiable mechanism is an ex post assessment for projects which are identifiable as driving Over-Delivery or Under-Delivery.

Applied to: GD, GT and ET.

Submitted monetised risk estimates

4.32 As part of their business plans, the ET, GT, and GD network companies submitted their estimates of the NARM long-term monetised risk benefit that will be delivered through their proposed asset management investments, as well as current and forecast views of asset category risks for their entire asset portfolios. The submitted monetised risk values were all derived in accordance with the network companies' relevant NARM methodologies.

4.33 Both the long-term risk benefit and single-year risk benefit calculations assume that all RIIO-3 interventions take place by 2030/31. The period over which the long-term risk is calculated is determined by expectations of when a subsequent intervention will be required.

Measuring Baseline Network Risk Outputs

4.34 We propose that GDNs define their Baseline Network Risk Outputs using a long-term risk measure, to align with other sectors. This marks a change from RIIO-2, where GDNs used a single-year risk measure due to the need for further development in long-term risk modelling. Since then, GDNs have made progress in improving these models. This shift also supports our goal of achieving greater consistency and comparability across sectors. A long-term risk measure better captures the impact of different intervention options on asset degradation over time, leading to asset management decisions that more accurately reflect long-term consumer value.

Baseline Network Risk Outputs and baseline funding

4.35 We propose that Baseline Network Risk Outputs are associated with full project costs, including costs associated with interventions on secondary assets (ie non-NARM Assets) as well as indirect costs, such as project management. We have not yet aligned the proposed Baseline Network Risk Outputs with the associated baseline costs. We intend to set this out in our Final Determinations.

4.36 We maintain the funding categories set out in the NARM Handbook. The Funding Categories allow us to capture different types of asset interventions that have an impact on monetised risk. This includes asset replacement and refurbishment interventions where the primary driver is to reduce asset risk, but also other types of intervention such as new connections and reinforcement and work on iron mains replacement in gas distribution.

4.37 To set the Baseline Network Risk Outputs, we used each network company's unique Risk Output Unit combinations to align the monetised risk data submitted

in the NARM Business Plan Data Template (BPDT) with the volume data submitted in the business plan and our proposed allowed volumes. Our view of the Baseline Network Risk Outputs is based on the network companies' submitted proposals and adjusted to reflect any proposed volume changes associated with each Risk Output Unit.

4.38 Where we could not achieve full alignment, we considered it necessary to apply reasonable assumptions. The degree of alignment that we could achieve varied across sectors. For ET and GT, alignment was relatively high. However, for GD, the datasets are less aligned and therefore we had to apply a much greater degree of assumptions.

4.39 Table 3 below summarises the results of our assessment and the proposed Baseline Network Risk Outputs. The Baseline Network Risk Outputs relate to the Monetised Risk Benefit delivered through a network company's asset interventions during RIIO-3. A more detailed breakdown for each network company can be found in the company annexes.

Table 3: Proposed Baseline Network Risk Outputs (R£m) per network company

Sector	Company	Network	Company proposed (R£m)	Movement from other mechanisms (R£m)	Removed due to disallowed volumes (R£m)	Draft Determinations proposal (R£m)
ET	NG	NGET	24,718.8		- 5,554.4	19,164.4
ET	SSE	SHET	153.8	1,283.2	-	1,437.0
ET	SPEN	SPT	23,101.7	-	- 14,394.2	8,707.5
GT	NG	NGT	13,707.9	-	- 21.1	13,686.8
GD	Cadent	EoE	423.3	-	- 188.8	234.6
GD	Cadent	Lon	504.7	-	- 300.7	204.0
GD	Cadent	NW	573.6	-	- 254.8	318.8
GD	Cadent	WM	274.7	-	- 151.2	123.5
GD	NGN	NGN	1,593.7	1,550.0	- 72.9	3,070.8
GD	SGN	Sc	1,127.9	- 230.7	- 270.4	626.9
GD	SGN	So	1,852.6	- 156.3	- 894.5	1,259.8
GD	WWU	WWU	2,499.9	95.1	- 37.3	2,557.8

4.40 We acknowledge that our adjustments to the submitted Baseline Network Risk Outputs, based on proposed volume changes, involve a degree of approximation and may not be fully accurate at this time. This is primarily because the data we

used to derive our view of Baseline Network Risk Outputs was at a much more aggregated level than available to the network companies, and that which will be used to derive the final values. However, we consider this acceptable, as the adjustments are based on reasonable assumptions. Reaching a final view of Baseline Network Risk Outputs may involve several recalculations by the network companies, and we will work closely with them to achieve this.

Funding Adjustment and Penalty Mechanism

4.41 The mechanism by which network companies are held to account for their Baseline Network Risk Outputs delivery during RIIO-2 is known as the NARM Funding Adjustment and Penalty Mechanism. Under this mechanism, some financial adjustments and penalties are applied depending on the network company's delivery versus its Baseline Network Risk Outputs and the extent to which any over-delivery or under-delivery is deemed to be justified. This will be assessed at RIIO-3 close out.

4.42 The NARM Funding Adjustment and Penalty Mechanism is principally designed to work by anchoring ex post funding adjustments to pre-determined ratios between baseline funding (£m) and Baseline Network Risk Outputs (R£m), called the Unit Cost of Risk Benefit (UCR). Details on how the NARM Funding Adjustment Mechanism will work is outlined in the NARM Handbook. We propose to maintain this mechanism in RIIO-3.

4.43 Network companies will be expected to justify deviation in delivery from their output targets at the end of the price control. We propose to continue the use of a deadband around the Baseline Network Risk Outputs within which justification will not be required. We set out the size of the deadband at ±2% for ET and ±5% for GT and GD.[27]

4.44 We propose to continue the use of the Clearly Identifiable Over or Under Delivery (CIO/UD) Mechanism alongside the NARM Funding Adjustment and Penalty Mechanism in RIIO-3. This mechanism is designed to provide bespoke funding adjustments in instances of over- or under-delivery that would not be appropriately compensated through the Automatic Funding Adjustment Mechanism. The CIO/UD Threshold Decision and NARM Handbook are the key publications related to this proposal.

4.45 We consider that a Clearly Identifiable UCR threshold of ±5%, as used in RIIO-2, is suitable to manage risk within acceptable bounds for RIIO-3. This was

[27] The lower deadband for ET reflects the relatively higher cost of the individual investments.

calibrated following our analysis which justifies the use of the same threshold as RIIO-2 for 'clearly identifiable' qualification, in order to manage the risk of non-cost-reflective allowances (either positive or negative). We propose a symmetrical target is appropriate to limit the risks consistently, ie the threshold should be the same for both under and over deliveries.

4.46 Feedback from network companies highlighted concerns about the proposed Funding Adjustment Mechanism, with the main concern being the CIO/UD threshold potentially resulting in more projects going through a bespoke review at close out, increasing regulatory burden due to the volume of assessments required. We consider maintaining this mechanism in RIIO-3 is appropriate and effective for adjusting network companies network risk outputs delivered during the price control. As set out in our SSMD, we will continue to engage with network companies on whether any further adjustments are required as we move towards Final Determinations.

Improving the NARM framework

4.47 We will continue to work closely with network companies through working groups to support the development of standardised approaches across NARM. We maintain our commitment to enhancing consistency and transparency in how network companies manage and report asset data.

4.48 We expect network companies to collaborate in the development of common methodologies that underpin consistent asset management practices. We acknowledge that achieving alignment across diverse networks will require careful judgement and, in some cases, compromise. However, establishing a shared foundation is essential to ensure comparability, fairness, and improved regulatory outcomes.

4.49 For example, in the development of consistent models for asset probability of failure, our objective is not uniformity for its own sake, but rather a shared methodological foundation. This will ensure that similar interventions on comparable asset types, under similar conditions, yield equivalent risk benefit outcomes within the NARM framework. We consider this approach supports fairer benchmarking and more robust regulatory comparisons across network companies.

4.50 We propose to introduce new licence conditions to require network companies to produce the following documents within specific timelines:

- Common Methodology: the development work will focus on enhancing input quality (eg fixed asset data), improving asset systems, refining sampling

strategies, and advancing data disaggregation methods. A common methodology has already been established in GD, and we will continue to collaborate with stakeholders to further develop and refine this approach. While National Gas is in a sector of one, we still expect both GT and GD sectors to work together to identify areas of commonality and share best practices. Network companies are obliged to submit draft versions of their common methodologies by April 2027. A final version will be submitted by summer 2028 for regulatory approval, and this will form a key component of the RIIO-4 business plan submissions.

- Engineering Guidance Document: we require network companies within a sector to collaborate to produce a common engineering guidance document on data input to the NARM framework. This guidance should establish a consistent approach for describing asset condition points which are key inputs into the NARM methodologies, across all asset classes within NARM, thereby improving alignment and ensuring consistency in reported asset condition data. Network companies will need to submit the Engineering Guidance Document by April 2028.
- Information Gathering Plans: we require network companies to produce Information Gathering Plans (IGPs) for data which is input to the NARM methodology. The initial IGPs should reflect the network company's current data gathering practices. The IGPs should include existing data sources, collection methods, asset inspection frequencies, data storage and management and any data quality assurance processes currently in place. The initial IGPs are expected to be submitted in April 2026, with updated IGPs to be submitted in April 2028 to reflect the outcomes of the common methodology and Engineering Guidance Document developments.

4.51 The IGPs and Engineering Guidance Documents will be essential to developing and enhancing our audit processes. They will provide the foundation for ensuring that the data required by the NARM is accurate, complete, and collected in a timely manner.

4.52 To ensure the timely delivery of this comprehensive framework, we expect network companies to collaborate and set out a work plan that is agreed by us. This will help ensure that the development, implementation, and validation of common methodologies and asset data practices are robust, fair, and fit for purpose.

4.53 The objective of the work plan above is to ensure that by April 2031, all network companies will have fully adopted a common methodology, and the data used in

regulatory submissions will be demonstrably reliable, comparable, and aligned with the established best practices.

Questions

OVQ4.	Do you agree with our proposed approach to measuring Baseline Network Risk Outputs and our application of the NARM mechanism?
OVQ5.	Do you agree with our proposed approaches to calculating the funding adjustments and to the application of penalties?
OVQ6.	Do you agree with our proposed approaches to improving the NARM framework?

Physical Security PCD - ET and GT

Purpose: To ensure network companies deliver physical security upgrades at sites designated Critical National Infrastructure (CNI).

Benefits: Allowances are returned to consumers in the event of changes to the CNI list that mean network companies are not required to deliver the outputs.

Background

4.54 Network companies own assets and sites that are designated as Critical National Infrastructure (CNI). Physical security can be defined as costs associated with responding to government mandated security changes, for new sites and to replace IT and Technical assets during the price control. The Resilience Re-opener (see Chapter 6 of this document) allows network companies to request additional funding in response to government mandated security changes.

4.55 In RIIO-2, for CNI sites that required an asset refresh and where the scope was known, we provided efficient baseline funding. This funding was subject to ongoing monitoring as part of PCDs for the ET and GT sectors.

Consultation position and rationale

PCD type: Evaluative.

Output to be delivered: Upgrades at sites designated CNI**.**

Baseline cost allowance: Baseline allowance for each network company.

Reporting to Ofgem: RRP.

Delivery date: 31 March 2031.

Applied to: ET and GT.

Output to be delivered

4.56 The requirement to implement physical security solutions at CNI sites is externally determined by government and could potentially change during the price control. Therefore, we propose to attach a PCD to the associated funding to ensure that companies are only funded for work that is actually delivered.

4.57 The scope of the PCD includes network companies upgrading the physical security of their CNI sites. If a site is removed from DESNZ's CNI list and no longer requires a physical security solution, it falls outside the scope. In such cases, the network company must return the full amount of any unspent allowance.

Baseline cost allowance

4.58 We have set baseline allowances based on cost assessment carried out on totex costs for CNI sites submitted in the BPDTs. Our assessment approach for ET and GT is set out in Chapter 5 of each sector annex.

Applied to

4.59 This PCD will be applied to all network companies in ET and GT with costs associated with CNI sites, regardless of the size of the baseline cost allowance.

Question

OVQ7.	Do you agree with our proposal for the physical security PCD?

Other policy areas

4.60 Alongside asset health and cyber security, the areas of climate, workforce and supply chain resilience are critical components of overall network resilience. They each play a vital role in safeguarding the stability and reliability of the energy networks now and in the future. While they do not relate to specific RIIO-3 outputs, they are integral part of network companies' business plans. The following section sets out our views, and next steps on these areas.

Climate Resilience

Purpose: To ensure network companies consider the risks and impacts of climate change to their networks and take appropriate steps for mitigation and adaptation.

Benefits: Ensures security of supply is maintained, even in adverse weather conditions.

Background

4.61 Because of climate change severe weather events are expected to increase in intensity and frequency. It is essential that all network companies are well prepared and ensure their infrastructure can withstand a variety of climate-related risks, both now and in the future.

4.62 Network companies are responsible for identifying and addressing these climate risks. This responsibility is a key part of maintaining resilient networks. In RIIO-3, network companies will receive support through baseline funding for measures like flood mitigation to help strengthen their resilience against climate impacts.

4.63 In our SSMD, we decided that the climate resilience principles proposed at SSMC should be integrated into energy network and system investments and integrated into climate resilience strategies submitted by the companies.[28]

Approach to reviewing climate resilience strategies

Assessment of strategies

4.64 We have reviewed the Climate Resilience Strategies submitted by each network company. While the depth and detail varied, all network companies met our minimum expectations. Overall, the network companies demonstrated a good understanding of their climate-related risks and effectively referenced relevant documents supporting their resilience efforts. There was a mixed level of response on the costs relating to a recent climate event, alternative financial assessment tools and the barriers to making a viable business case.

4.65 In GD, we observed strong case studies that illustrated incidents driven by climate events such as storms and prolonged rainfall. These examples provided valuable context around the causes of the incidents, their impact on customers, and, in most cases, the associated costs. This offered new insights into the financial implications arising from climate-related incidents. Cadent, NGN, and SGN demonstrated a solid understanding of the vulnerabilities within their networks and proposed adjustments to their RIIO-3 work plans accordingly. WWU have also incorporated similar approaches as the other GDNs into its business plan and continue to maintain an approach to climate risk management, focusing on inspections and maintenance operations as part of its active strategy.

[28] RIIO-3 Sector Specific Methodology Decision – Overview Document, pg. 60

4.66 In GT, we observed a well-defined breakdown of the investment categories identified by NGT in relation to climate resilience. These included: climate resilience as a primary driver, climate resilience as a secondary driver, and climate resilience impact studies focused on risks associated with specific sites or hazards. NGT demonstrated a strong understanding of the expected costs driven by climate resilience. This reflects a clear alignment between its Climate Resilience Strategy and business plan, integrating both reactive and proactive measures over the price control period.

4.67 In ET, we observed varying areas of focus among the network companies. NGET concentrated on the detailed integration of climate resilience into its operations, while also highlighting opportunities for future investment and innovation. SPT offered a thorough overview of the climate risks affecting its network, employing an adaptation pathways methodology to outline potential actions they could take to reduce risks and enhance resilience. SHET also adopted an adaptation approach, emphasising the outcomes of its Climate Risk Assessment to identify risk areas and assess residual risks in light of existing controls. Building on this, SHET also presented an overview of its investment proposals, detailing both the value and budget allocations.

Next steps

4.68 We think these strategies show clearly how network companies are responding to climate resilience. We remain committed to our SSMD expectation that network companies will provide updates on their progress in climate scenario planning, stress-testing for high-impact, low-probability climate hazards, and adaptation pathways as part of their annual reporting. These updates should be completed by the second annual reporting submission in 2028, as outlined in the SSMD and BPG.

4.69 We are developing associated guidance for how we think network companies should carry out and report on the climate resilience activities noted above in order to develop their knowledge of their risk profiles and embed climate resilience across the price control. However, we do not expect this guidance to be ready for publication by the start of the RIIO-3 period. As a result, we are not introducing a new licence obligation at this stage but propose these requirements become part of the licence during the RIIO-3 period. This approach will allow stakeholders to engage in a consultation process and provide feedback on the draft guidance before final guidance and licence modification are enacted.

4.70 We will continue to work closely with network companies throughout the development of this guidance to ensure it is both practical and achievable within the defined parameters, including the proposed timescales. We will continue to work with network companies to bolster our regulatory reporting on climate resilience as we progress the work outlined above.

Question

OVQ8.	Do you agree with our approach taken to review of the Climate Resilience strategies?

Workforce Resilience

Purpose: To encourage network companies to strategically plan what actions may be necessary to ensure their ongoing resilience to workforce constraints.

Benefits: Ensures that network companies are able to operate effectively without being impacted by current or future constraints in the workforce.

Background

4.71 In our SSMD, we decided to require network companies to submit a Workforce Resilience Strategy. We did not prescribe the precise content of the strategy but asked that network companies consider how their approaches would lead to upskilling and multi-skilling of their workforce. We also asked them to think about how to improve workforce satisfaction and retention.

4.72 Recognising the value of increasing the transparency of networks companies' workforce resilience data through consistent external reporting, we noted the work of Energy & Utility Skills and the network companies on improving workforce data and metrics. We requested that network companies continue to work with industry to improve robustness and transparency of these metrics.

4.73 Feedback from our Call for Evidence suggests that stakeholders are supportive of the network companies' Workforce Resilience Strategies. Several respondents were supportive of plans to attract a more diverse workforce, and to promote the wellbeing of existing staff. Several respondents thought that workforce challenges that the network companies are facing are significant, and encouraged efforts to collaborate with industry and government to address these challenges. However, no major concerns were flagged regarding the overall suitability of network companies' strategies.

Consultation position and rationale

4.74 We welcome network companies' Workforce Resilience Strategies, which we consider to have met the requirements we specified in our SSMD.

4.75 In line with the feedback to our Call for Evidence, we encourage network companies to continue to collaborate with industry and government to address outstanding areas of significant challenge. This includes the longer-term skills pipeline, building a diverse workforce, and retention of the existing workforce whilst mitigating the impact of retirement of staff on capacity.

Question

OVQ9. Do you agree with our views on the Workforce Resilience Strategies?

Supply Chain Resilience

Purpose: To encourage network companies to strategically plan what actions may be necessary to ensure their ongoing resilience to constraints in the supply chain.

Benefits: Ensures that network companies are able to operate effectively without being impacted by current or future constraints in the supply chain, which may detrimentally impact consumers.

Background

4.76 In our SSMD, we decided to require network companies to submit a Supply Chain Resilience Strategy, setting out the steps they are taking to preserve their long-term ability to deliver the work required to fulfil their obligations.

4.77 We recognised that supply chain challenges are most acute in ET. This was reflected in our decision at SSMD to provide development funding in two areas for RIIO-ET3: Pre-Construction Funding (PCF) and the Advanced Procurement Mechanism (APM).[29]

4.78 We also noted that the current supply environment (ie a lack of factory slots for equipment, and increased demand costs across key asset classes) could result in increases to prices that network companies face, going beyond general inflationary increases. These additional increases could be captured through the further cost allowance adjustments we make (RPEs), subject to network companies providing robust evidence of the types of supply chain spend affected

[29] The APM also applies to the last year of RIIO-ET2.

by particular inflationary pressures, and on what would be a well-calibrated basket of indices.

4.79 Feedback from our Call for Evidence focused network the companies' Supply Chain Resilience Strategies. Respondents were broadly supportive of the strategies and raised no major concerns. However, several respondents noted that supply chain conditions remain challenging.

Consultation position and rationale

Supply Chain Resilience Strategies

4.80 We welcome the inclusion by network companies of Supply Chain Resilience Strategies in their business plans. We think these meet the requirements specified in our SSMD. We note that none of the network companies proposed specific measures in relation to supply chain resilience. We urge all network companies to do more and, where appropriate, collaboratively in this space.

4.81 We encourage network companies, when implementing their strategies, to take a strategic approach to mitigating supply chain pressures - particularly those arising from long lead times for materials and components. Where appropriate, network companies should bring forward procurement activities including building relationships, capacity booking, pre-ordering, buying in bulk and strategically increasing stock levels to secure sufficient materials in advance.

ET development funding approach & Advanced Procurement Mechanism

4.82 In line with our SSMD, we will provide development funding via two mechanisms: PCF and APM.

4.83 Per our March 2025 decision,[30] the APM is an enduring mechanism operating across price control periods in ET. The APM consists of ~£4bn UIOLI allowance and a re-opener. It allows TOs to spend on procurement of equipment and related services up to a pre-agreed cap without requesting further approval from us. The aim of the APM is to derisk the TOs in securing supply chain capacity in bulk at a much earlier point in the project development cycle by accelerating a portion of future funding.

Question

OVQ10. Do you agree with our views on the Supply Chain Resilience Strategies?

[30] https://www.ofgem.gov.uk/decision/electricity-transmission-advanced-procurement-mechanism

5. Business Plan Incentive (BPI)

5.1 In this chapter we provide an overview of company performance against the BPI and details of our assessment approach. Our assessment of individual company performance against each Stage is set out in the company-specific annexes.

Results of the BPI

5.2 The proposed results of the BPI are set out in Table 4. These are provisional results, which are subject to consultation and therefore may change. This is particularly relevant if we receive updated cost information which may impact our Stage B assessment.

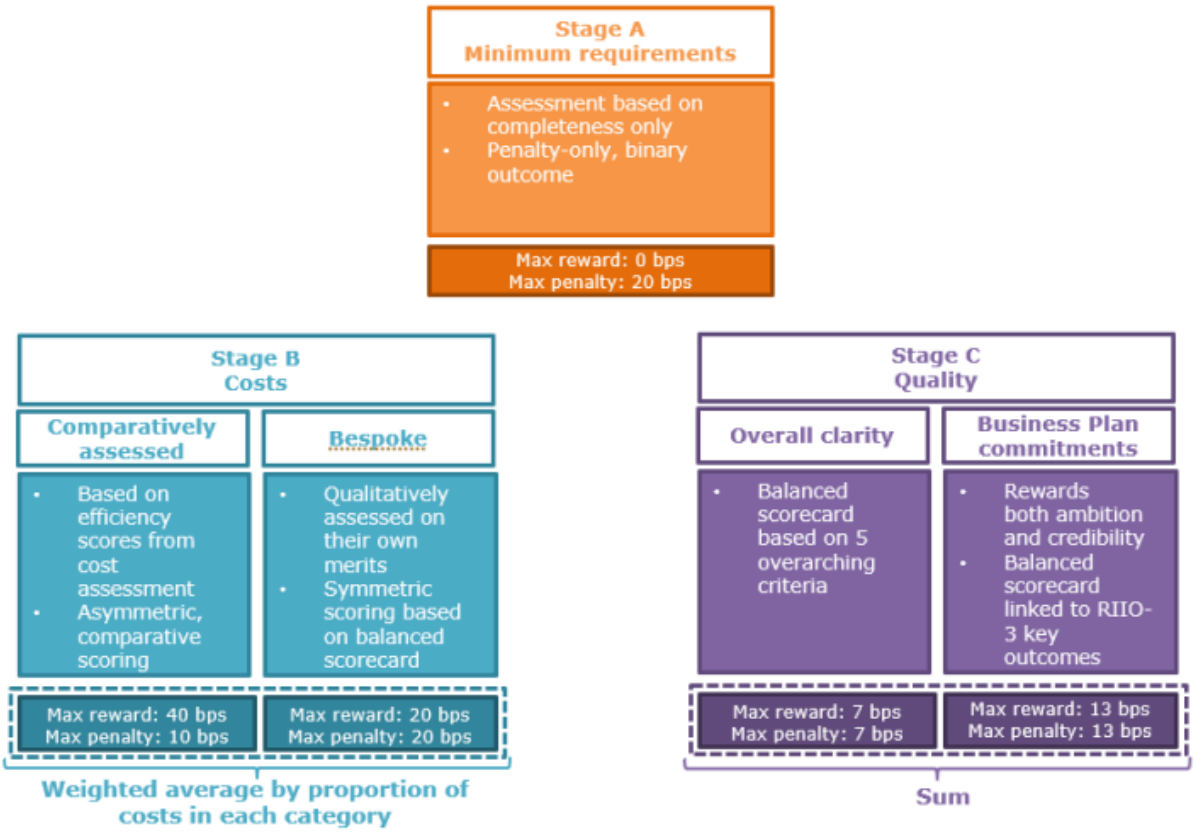
Table 4: Proposed BPI results (basis points (bps) of RoRE, unless stated)

Company	NGET	SHET	SPT	Cadent	NGN	SGN	WWU	NGT
Stage A	0	0	0	0	0	0	0	0
Stage B - Comparative	7.14	-1.71	-3.16	-4.88	37.33	-8.06	-6.22	-0.36
Stage B - Bespoke	-1.41	-0.93	3.8	0.71	0.28	0.09	-0.33	-2.03
Stage C - Clarity	0	1.4	1.4	4.20	-1.4	-2.8	-2.8	5.6
Stage C - Commitments	-2.6	0	2.6	0.65	6.18	-1.63	-0.98	3.25
Total bps	3.13	-1.24	4.64	0.68	42.39	-12.40	-10.33	6.46
Total 5-year monetary equivalent (£m)	13.3	-2	4.4	1.6	24.2	-17.5	-5.9	8.4

Business Plan Incentive assessment

5.3 In our Sector Specific Methodology Decision (SSMD), we set out that there are three stages of assessment under the BPI. These are set out in the figure below.

Figure 2: Overview of the RIIO-3 BPI three stages of assessment



5.4 In our SSMD, we decided to determine BPI rewards and penalties using basis points (bps) of RoRE against the equity portion of the RAV. The monetary value of the BPI will be calculated in our Final Determinations and applied annually. The annual values will be calculated ex ante as the assessed total reward or penalty measured in basis points of RoRE (capped at ±60 basis points), multiplied by the equity portion of the forecast NPV-neutral RAV for the respective year, based on the relevant notional gearing assumption for each licensee.

5.5 The NPV-neutral RAV for the purpose of the BPI will be derived from the baseline RIIO-3 totex set at Final Determinations, excluding RIIO-3 re-openers, RIIO-2 re-openers (eg ASTI, LOTI and MSIPs), use it or lose it allowances (UIOLI), opex escalator, ongoing efficiency and RPEs, but including volume drivers with baseline volumes. The total monetary value of the BPI for the RIIO-3 price control period will be the sum of the respective annual values.

5.6 The following sections outline our approach to assessing company performance for the purposes of BPI.

BPI Stage A assessment - minimum requirements

5.7 The purpose of Stage A is to assess whether a business plan contains the minimum amount of information required for us to set the price control effectively. It only focuses on the completeness of the submission. Failing to pass Stage A will result in a company receiving a penalty of 20bps of RoRE.

5.8 We assessed each business plan against each of the minimum requirements specified in Table 3 of the Business Plan Guidance (BPG).[31] Each minimum requirement has been assessed individually on a pass/fail basis. Where our assessment found that a business plan had not met one or more of the minimum requirements, we carried out a proportionality assessment. Our assessment of proportionality took account of the nature of the minimum requirement/s not met and the impact that the gap/s have had on our ability to set the price control effectively.

5.9 Our assessment of individual company performance against Stage A is set out in the company-specific annexes.

BPI Stage B assessment - costs

5.10 The purpose of Stage B is to assess the extent to which cost submissions in the business plans are efficient and well justified. As set out in our SSMD, we have used two distinct methodologies to assess comparatively assessed costs and bespoke costs. Where a network company is responsible for more than one network, Stage B is assessed and calculated at the level of each network, consistent with the cost assessment process.

5.11 The overall maximum reward for Stage B is +40 bps of RoRE, while the maximum penalty is -20 bps of RoRE. The reward/penalty is calculated by taking a weighted average between the reward/penalty for comparatively assessed and bespoke costs, using the proportion of total submitted costs falling into each category as weights.

5.12 The maximum reward and penalty for comparatively assessed costs is +40 bps and -10 bps of RoRE, multiplied by the relevant weight. The maximum reward and penalty for bespoke costs is ±20 bps of RoRE multiplied by the relevant weight. The maximum reward for Stage B as a whole (+40 bps of RoRE) can therefore only be attained by a company with 100% of its costs falling into the comparatively assessed category. Similarly, the maximum penalty (-20 bps of

[31] Table 3: RIIO-3 Business Plan Guidance

RoRE) can only be attained by a company with 100% of its costs falling into the bespoke category.

5.13 Chapter 9 of the BPG sets out the methodologies used for comparatively assessed costs and bespoke costs.[32]

5.14 Our assessment of individual company performance against Stage B, including the split of costs assessed under each methodology is set out in the company specific annexes. The detail on the methodology for the company assessments is set out in the sector annexes.

BPI Stage C assessment - quality

5.15 The purpose of Stage C of the BPI is to assess the overall quality of a company's business plan. The Stage C assessment is split into two components:

- the clarity of the business plan; and
- the ambition and credibility of the commitments included in the business plan.

5.16 Both components of Stage C are assessed qualitatively using the balanced scorecards in Annex 5 of the BPG.[33] The assessment of clarity will account for up to ±7 bps of RoRE and the assessment of commitments will account for up to ±13 bps RoRE. This assessment will therefore result in a maximum reward or penalty of ±20 bps of RoRE.

5.17 Our assessment of individual company performance against Stage C is set out in the company-specific annexes.

Consultation position and rationale - Stage C balanced scorecard weightings

5.18 In the BPG we said that we would assess both components of the Stage C BPI in the round using the balanced scorecards set out in Annex 5 of the BPG.

5.19 The 'clarity scorecard' contains 5 individual criteria, with one overall description rating. The 'Business Plan Commitments scorecard' contains 4 individual ratings with one overall description rating. The 'Business Plan Commitments scorecard' is used to assess the commitments mapped to each of the three outcomes. Information relating to the weighting of the outcomes is set out in the section below.

[32] Chapter 9: RIIO-3 Business Plan Guidance
[33] Annex 5: RIIO-3 Business Plan Guidance | Ofgem

5.20 To calculate the resulting bps for each component of Stage C, we weighted each underlying criteria/rating equally. The relative weights against each component of Stage C are set out in Table 5 and Table 6 below.

Table 5: 'Clarity scorecard' criteria weighting

Criteria	**Weight**
Layout and structure	20%
Accessibility and conciseness	20%
Relevance of the information provided	20%
Clarity of information that supports the demonstration of value to consumers	20%
Coherence and justification	20%
Overall description for rating	-
Total	100%

Table 6: 'Business Plan Commitments scorecard' rating weighting

Rating	**Weight**
Deliverability	25%
Consumer value and additionality	25%
Stretching performance	25%
New company proposals	25%
Overall description for rating	-
Total	100%

5.21 For both components of Stage C we have equally weighted the criteria/rating and added up the resulting bps to come to an overall result for the component. For both components we did not assign a numeric weighting to the 'overall description of rating' - instead, we consider these descriptions provide context when considering the other criteria. We consider that weighting the criteria/ratings equally provides an objective, transparent and fair way to calculate an in the round result.

Consultation position and rationale - Stage C commitment outcome weightings

5.22 In the BPG we said that we would set the relative weights for each of the three outcomes used to assess the business plan commitments following the review of the business plans and that as a result the weighting of the outcomes may differ across the sectors. However, we said the overall maximum reward or penalty for

the Stage C assessment of business plan commitments would remain at ±13 bps of RoRE. Table 7 sets out the relative weights used for the three outcomes for each sector.

Table 7: 'Outcome' Sector weightings used for Stage C - Business Plan Commitments assessment

RIIO-3 BPI Stage C Business Plan Commitment 'Outcome'.	**Electricity Transmission weights**	**Gas Transmission weights**	**Gas Distribution weights**
Infrastructure fit for a low-cost transition to net zero	40%	20%	30%
Secure and resilient supplies	40%	50%	40%
High quality of service for regulated firms	20%	30%	30%
Total	100%	100%	100%

Rationale for ET outcome weightings

5.23 The priorities for ET sector are building infrastructure to deliver a low-cost transition to net zero and ensuring that the infrastructure is resilient. We see these two outcomes as equally important for the ET sector because the two areas are so interlinked: delivering the network needed for net zero will increase network resilience, and decarbonisation of areas such as heat and transport will require a resilient network. We have therefore weighted them equally. For a high-quality service, we see this as slightly less important in ET because the TOs have fewer direct interactions with consumers than the other sectors, and therefore it is weighted lower.

Rationale for GT outcome weightings

5.24 Secure and resilient supplies are the top priority for GT and therefore we have weighted it at 50% of the total. We think a prioritisation of secure and resilient supplies is appropriate as the importance of maintaining a safe and resilient network remains paramount. We weight infrastructure fit for a low-cost transition to net zero lower as we see National Gas still enabling this objective by maintaining secure and resilient supplies.

Rationale for GD outcome weightings

5.25 Generally, there is an overall balance between the three outcomes for GD. However, we think a slight prioritisation of secure and resilient supplies is appropriate as the importance of maintaining a safe and resilient network remains paramount and the replacement of old and deteriorating gas mains and

services is the predominant driver of costs and workloads in RIIO-GD3. We have therefore weighted this slightly higher than the other two outcomes.

Questions

OVQ11.	Do you agree with the equal weightings applied per criteria/rating for the 'Clarity scorecard' and the 'Business Plan Commitments scorecard' for the Stage C assessment?
OVQ12.	Do you agree with the weightings applied per outcome for each sector for use in the Stage C - Business Plan commitments assessment?

6. Managing uncertainty

6.1 This Chapter sets out our proposals for the cross-sector Uncertainty Mechanisms (UMs) that will apply to all sectors during the RIIO-3 price control period. Business plans and price controls are based on a set of assumptions on what is required over the forthcoming period. There may be significant uncertainty over some of these assumptions, and where appropriate it may be better to use mechanisms that adapt certain elements of the price control during the period. These are referred to as UMs.

6.2 While UMs help to protect consumers and companies from significant variations between forecast and actual costs they can add to the complexity of the framework. Therefore, where possible, we aim to reduce the number of UMs and include as much as possible in upfront baseline allowances. However, where they are needed we want them to be streamlined and, where appropriate, automatic in their delivery - here, we may use volume drivers or UIOLI allowances. In some instances however, the size and complexity of the uncertainty may require a process of re-opening elements of the price control settlement to decide on the appropriate allowance and/or output.

6.3 Details on the UMs that relate to innovation, cyber resilience, and data & digitalisation are in the relevant chapters in this document. For details of our proposals for UMs which only apply to a single sector, see the sector annexes. For details of our proposals for UMs which only apply to a single company, see the company annexes. In our SSMD, Chapter 8, we set out our position on cross-sector pass-through mechanisms.

General re-opener design

6.4 A re-opener UM enables us to re-open elements of a price control settlement during the price control period. This may be instigated by us ('the Authority') or by an application made by a company. While our aim is to seek to administer these re-openers quickly and efficiently their use is time consuming for ourselves and the network companies. It is important for us to consider the number, and timing, of application windows we provide through which companies can request a re-opener. Where relevant, we have set out proposals for application window timings based on the specific policy need for each individual re-opener. However, we acknowledge that more work is needed to consider their interaction as package, and across sectors. This is to ensure that the pipeline of applications can be managed efficiency by us and the network companies. This will be a priority for us over the summer. We will also consider,

and develop, a RIIO-3 re-opener pipeline (based on what we have in place for RIIO-2) to monitor the flow of expected applications over the price control period as a whole.

Materiality threshold

6.5 Setting an appropriate materiality threshold for re-openers is important to ensure that re-openers are not over-used and to ensure companies manage some of their cost risk (which is also covered by the TIM). Applications must be for material areas that have a strong consumer benefit to pursue to avoid unnecessary regulatory burden on us and the companies.

6.6 Therefore, we propose to retain the default position for the materiality threshold that was set out in RIIO-2. This means that companies' re-opener applications to adjust their allowed revenue will only be considered by the Authority if the proposed adjustment, when multiplied by the TIM rate, exceeds 0.5% of annual average ex ante base revenue. Where the default position is not followed, our rationale is discussed within the specific re-opener.

6.7 Chapter 11 of the Finance Annex sets out how this is calculated. We recognise that the precise figure will change at Final Determinations. Table 8 sets out the default materiality threshold based on the Draft Determinations.

Table 8: Default materiality threshold per network area

Licensee	Annual average ex-ante base revenue (23/24 prices)	Default Materiality Threshold (23/24 prices)
EoE	£820.2m	£4.1m
LDN	£582.6m	£2.9m
NW	£557.3m	£2.8m
WM	£425.4m	£2.1m
NGN	£572.8m	£2.9m
SC	£428.1m	£2.1m
SO	£914.6m	£4.6m
WWU	£582.9m	£2.9m
NGGT	£1,034.5m	£5.2m
NGET	£2,544.6m	£12.7m
SHET	£1,111.7m	£5.6m
SPT	£737.5m	£3.7m

OVQ13. Do you agree with the use of a default materiality threshold and its level?

Cross-sectoral uncertainty mechanisms

Net Zero Re-opener

Purpose: To provide a means to amend the price control in response to changes connected to the meeting of the net zero targets, which have an effect on the costs and outputs of network companies.

Benefits: To allow for necessary amendments within the RIIO-3 period, as opposed to waiting until the settlement of the subsequent price control.

Background

6.8 In our SSMD, we decided to retain the Authority-only triggered Net Zero Re-opener, to ensure adaptability of the price control to changes relating to meeting net zero targets which are not captured by other RIIO-3 mechanism. We also decided that amendments to its design or scope were not required for RIIO-3.

6.9 The key design features we decided at the SSMD are set out in the summary table below. Because we're not re-opening SSMD decisions on it, we have not provided any further discussion or consultation questions on it.

UM type: Re-opener.

Scope: A wide range of net zero developments, such as changes in national or local government policy, recommendations made by the RESPs in GD, or changes in the pace or nature of the connection of new low carbon generation and the uptake of low carbon technologies.

Ability for Authority to trigger: Yes, Authority only.

Re-opener windows: N/A, authority trigger only.

Materiality threshold: 0.5% of ex ante base revenue - in line with the default set out in this chapter.

Applied to: ET, GD and GT.

Whole Systems Co-ordinated Adjustment Mechanism (CAM) Re-opener

Purpose: To facilitate the transfer of activities and associated revenues from one network company's price control to another.

Benefits: To protect consumer interests by enabling the reallocation of responsibility for, and revenue associated with, an output or project from one network company to another who can deliver that output or project with greater overall value for consumers.

Background

6.10 In our SSMD, we decided to retain the Whole Systems Coordinated Adjustment Mechanism (CAM) for RIIO-3, despite its lack of use in RIIO-2. We set out three potential options for encouraging its further use in RIIO-3:

- removing the annual window to allow submissions to be made on an ad hoc basis;
- allowing a single network company to unilaterally submit an application, subject to the CAM proposal being verified and supported by the NESO; and
- the Authority being able to trigger a re-opener on the NESO's advice about a CAM proposal/opportunity that would be in consumers' interests.

Consultation position and rationale

UM type: Re-opener.

Scope: Any output where the reallocation of responsibility for, and revenue associated with, that output from one network company to another can deliver greater overall value for consumers.

Ability for Authority to trigger: Yes.

Re-opener windows: None.

Materiality threshold: None.

Applied to: ET, GD and GT.

6.11 To increase the flexibility of the re-opener and the likelihood of it being used, we propose to remove the re-opener windows and allow network companies to make a submission under the CAM at any time during RIIO-3.

6.12 We also propose to introduce an Authority trigger to the CAM which we could use where the NESO has provided a recommendation which we wish to action, and which all affected network companies' support.

6.13 We propose not to action the other area discussed at SSMD, which was to allow a single network company to unilaterally submit an application without the support of the partner network company. Our rationale is that creating a potential element of antagonism between the network companies in this way would be very unlikely to result in positive consumer outcomes.

Question

OVQ14. Do you agree with out proposed amendments to the CAM for RIIO-3?

Net Zero and Re-opener Development (NZARD) UIOLI - GD and GT

Purpose: To enable GDNs and NGT to fund early design and pre-construction work for net zero related projects and undertake small net zero facilitation projects.

Benefits: Ensures the GDNs and NGT can act quickly to respond to changing demands on the energy system from the net zero transition.

Background

6.14 In our SSMD, we decided to retain the NZARD UIOLI allowance for all sectors in RIIO-3 to fund:

- small net zero facilitation capital projects in the gas sectors;
- shrinkage-related activities in the gas sectors; and

- early development work on projects that network companies intend to bring forward under specific re-openers.

6.15 For the gas network companies, we decided to retain the RIIO-2 allowances for RIIO-3, but asked network companies to use their business plans to justify if their allowances should be higher than RIIO-2. Given the inclusion on shrinkage-related activities, three of four GDNs requested for their NZARD allowances to be substantially increased, with the £2m maximum spend per project either removed or substantially increased.

6.16 In ET, we decided in our SSMD that the NZARD would only fund work for projects that would come forward through the Net Zero Re-opener and that it will have a value of £0 at the start of the price control.

Consultation position and rationale

UM type: UIOLI.

Scope: Small net zero facilitation capital projects, including RESP-related projects in GD; shrinkage-related activities; and early development work on projects that network companies intend to bring forward under specific re-openers.

Maximum spend per project: £2m.

Funding levels: Total funding of £39.8m across all GDNs and £10.3m for NGT.

Reporting: Annual RRP. Additional requirements set out in the NZARD Governance Document.

Governance document: NZARD Governance Document.

Applied to: GD and GT.

Scope

6.17 We propose that the NZARD allowance should only apply to GD and GT, and not ET.

6.18 The position for ET is a change from our SSMD. We have taken this approach because we consider it very unlikely that the Net Zero Re-opener will need to be triggered in RIIO-ET3, given the comprehensive suite of UMs we're establishing in that sector. If the need for the Net Zero Re-opener were to arise in ET, we would work with the relevant TO(s) to establish the best approach to funding development work - for example, this may be through the Pre-Construction Funding Re-opener, or through increased Net Zero Re-opener allowances.

6.19 We propose to keep the scope of the NZARD UIOLI that we outlined in our SSMD for gas network companies, with the inclusion of RESP coordination for GD. This will enable funding for lower materiality RESP-related investments, such as preparatory investments or projects that support the work of the RESPs. We consider this coordination and preparatory work to be beneficial as it will ensure that the GDNs have the agility and adaptability to respond to the RESP's recommendations efficiently and at pace.

6.20 The GDNs outlined projects they expect to fund through the NZARD in RIIO-GD3 in their business plans. We have proposed that some of SGN, NGN and WWU's outlined projects should not be funded through the NZARD due to their prospective non-compliance with the eligibility criteria. Where we consider these projects could be appropriate to be funded through RIIO-GD3, we have set out alternative funding mechanisms. These specific proposals are outlined in Chapter 4 of the respective company annexes.

Maximum spend per project

6.21 We propose to maintain the project maximum of £2m per project for the NZARD UIOLI. This protects consumers from inefficient spending for larger projects, which can instead be brought forward under other regulatory mechanisms, such as the NZASP Re-opener.

Funding levels

6.22 We propose that RIIO-3 NZARD allowances are set using the RIIO-2 funding levels, adjusted for inflation. While this is a change from our SSMD decision, we consider it is appropriate to increase the allowances to reflect inflation.

6.23 Three of the four GDNs requested greater allowance increases through their business plans to account for shrinkage-related projects. However, many of the projects submitted by the GDNs were above the project maximum of £2m so are not appropriate to include in the NZARD.

6.24 We also note that the gas networks have used a significant amount of their RIIO-2 NZARD to fund hydrogen-related projects which are not currently in scope for RIIO-3.[34] We therefore do not consider larger allowances are required. We encourage the gas network companies to be efficient with their NZARD spending, and to use the Net Zero Pre-Construction and Small Projects (NZASP) Re-opener for justified projects over £2m.

[34] Our SSMD decided not to provide capex and devex funding related to hydrogen transport infrastructure, and not to provide funding for hydrogen blending or heating projects until after there are government decisions to roll out hydrogen in these areas.

Table 9: Our proposed RIIO-3 NZARD allowances, compared to RIIO-2 allowances and the gas network companies' RIIO-3 business plan proposals

Network	RIIO-2 Allowances (£m, 18/19 Prices)	Gas network RIIO-3 Proposals (£m)	Our proposed RIIO-3 allowances (£m)
Cadent	19.80	19.80	24.66
NGN	4.50	12.50	5.60
SGN	10.80	44.60	13.45
WWU	4.70	37.90	5.85
NGT	8.30	10.00	10.34

Question

OVQ15. Do you agree with our proposed design of the NZARD UIOLI?

Net Zero Pre-Construction and Small Projects (NZASP) Re-opener - GD and GT

Purpose: To allow gas network companies to undertake design and pre-construction work that is too material for the NZARD UIOLI, and to progress small- to medium-sized net zero facilitation projects.

Benefits: Enables companies to progress small value, but high impact, net zero work in an agile way.

Background

6.25 The NZASP is an Authority-only triggered re-opener for the gas sectors that was introduced in RIIO-2. The materiality threshold for this re-opener is £1m per project. The materiality threshold may be met through anticipated costs. For small net zero projects, the funding provided per project under the NZASP may not exceed £100m.

6.26 In our SSMD, we decided to retain the NZASP re-opener and its RIIO-2 design features in RIIO-3. We decided not to widen the scope of the re-opener, including for costs related to NESO strategic planning.

Consultation position and rationale

UM type: Re-opener.

Scope: Net zero-related pre-construction work and small net zero facilitation projects that are too material for the NZARD UIOLI, including shrinkage activities, Digital Platform for Leakage Analytics (DPLA) for GDNs and RESP coordination costs for GDNs.

Ability for Authority to trigger: Yes, Authority only.

Materiality threshold: £1m.

Applied to: GD and GT.

Scope

6.27 We propose to widen the scope of the re-opener to include shrinkage activities. For GD only, we also propose to include the rollout of the DPLA and RESP coordination as eligible cost areas. This is because the business plans included uncertain proposals in these areas which could benefit consumers but exceeded the £2m NZARD project maximum. Given the materiality of these potential projects, we think they should warrant increased scrutiny as part of the NZASP re-opener.

Materiality threshold

6.28 We propose to retain the materiality threshold of £1m per project for this re-opener and the project maximum of £100m because we consider these thresholds have worked well in RIIO-2.

Question

OVQ16. Do you agree with our proposed design of the NZASP re-opener?

Resilience Re-opener

Purpose: To adjust allowances where government or NESO require network companies to undertake resilience-related activities not anticipated at the start of RIIO-3.

Benefits: Timely funding to support system security and compliance with national risk and resilience standards.

Background

6.29 In our SSMD, we decided to introduce a Resilience Re-opener for RIIO-3 to ensure that network companies can respond effectively to evolving risks and resilience requirements. We recognised that resilience must be upheld not only in physical infrastructure but also across organisational systems and operational capabilities. Therefore, we also decided that this re-opener should also include Critical National Infrastructure (CNI) physical security measures which align to the provisions of the physical security re-opener under RIIO-2 alongside a broader range of additional resilience areas.

Consultation position and rationale

UM type: Re-opener.

Scope: Decided at SSMD. CNI physical security and to a range of resilience-related areas, such as changes in national government policy, recommendations made by the NESO (and endorsed by government), or changes to engineering and resilience standards, emergency protocols, and actions arising from the National Risk Register.

Ability for Authority to trigger: Yes, Authority for all areas within scope and Licensee trigger for CNI physical security.

Re-opener windows: April 2028 and April 2030 for CNI physical security.

Materiality threshold: 0.5% of ex ante base revenue, in line with the default set out in this chapter.

Applied to: ET, GD and GT.

Re-opener window and triggers

6.30 We consider that an Authority-only trigger provides flexibility to respond to uncertain and evolving circumstances across both scopes. However, for CNI physical security, we propose a re-opener window of April 2028 and April 2030 to ensure that companies' applications are timed together to promote efficiency of assessment. This is a change to our SSMD position.

Materiality threshold

6.31 We propose to apply a materiality threshold, consistent with the default threshold set out earlier in this chapter. This approach ensures that only materially impactful policy changes are considered, minimising regulatory burden from immaterial costs. Where costs fall below the materiality threshold, we consider these can be addressed at RIIO-3 closeout or in the next price control review.

Scope

6.32 In our SSMD, we decided on the scope of the re-opener. We are working with government and the network companies (through the LDWG) to ensure the scope fully addresses both new challenges and any changes to existing arrangements that may arise during the price control period.

Question

OVQ17. Do you agree with our design proposal for the resilience re-opener?

Real Price Effects (RPEs)

Purpose: To adjust revenues to reflect changes in input prices experienced by companies over the price control period.

Benefits: The use of RPEs helps reduce network and consumer risk by reflecting material external cost fluctuations in companies' revenue.

Background

6.33 In our SSMD, we decided to broadly maintain our RIIO-2 approach to RPEs for RIIO-3. This is where further adjustments to allowances are made based on forecasts for the indices making up the RPE index. Allowances are adjusted or 'trued up' annually based on outturn differences between CPIH and the RPE index.

6.34 One design change we considered was whether it is appropriate to apply a materiality threshold on the total value of RPEs adjustments. We said we would consider evidence provided to determine whether this is needed. We also said that we would continue to consider options to improve and/or simplify any underlying methodological aspects, including indices selection and their weighting.

Consultation position and rationale

UM type: Price indexation**.**

Scope: Adjustments to cost allowances to account for changes to input prices for labour and materials (all companies) and plant & equipment (SHET and NGET), based on a sector-specific (GD) or company specific (GT and ET) weighted average RPE index. Adjustments occur automatically and are made on an annual basis.

Materiality threshold: We propose to retain a materiality threshold to determine which cost categories are included within the RPE index for each sector or company, but we are not proposing to apply a materiality threshold on the outturn value of the RPE adjustment.

Applied to: GD, GT and ET.

Scope

6.35 We propose to include adjustments for RPEs for all network companies based on forecasts of input price indices in upfront allowances. We will "true up" RPE adjustments annually based on out-turn differences between CPIH and input price indices. We propose that this will apply to the cost categories of labour and

materials for all network companies, and plant and equipment for SHET and NGET only. Companies were broadly supportive of continuing to index-link RPEs adjustments in RIIO-3.

Index Selection

6.36 We propose to incorporate additional indices into the RPE model for RIIO-3.

6.37 In their business plans, each of the network companies proposed alternative indices to either replace, or be used alongside the current indices used in RIIO-2. It was claimed that the indices used in RIIO-2 did not accurately reflect the cost pressures they face, and that the newly proposed indices are more suitable.

6.38 We assessed each of the proposed indices based on the criteria CEPA established in RIIO-ED2 for index selection, including accuracy, timeliness, and transparency among other criteria.[35] We propose rejecting some of proposed indices for not meeting one or more of the assessment criteria. Table 10 sets out the new indices we propose to include within the RPEs index calculation for RIIO-3.

6.39 NGET suggested that our existing approach to RPEs does not adequately account for costs associated with high-demand, specialist labour. It noted that it had not been possible to identify a suitable index for tracking costs associated with attracting and retaining additional labour. We consider this to be an issue that is largely within management control and therefore does not align with the principles of RPE indexation. We think these proposed additional costs are hard to robustly quantify, and any measure of these would be strongly influenced by the companies themselves, potentially leading to perverse incentives.

6.40 SGN, NGN and NGT suggested that using lagged indicators within the RPE index could better reflect the timings of cost increases as they are incurred by companies. They note that contracts can contain fixed unit costs, meaning that costs are not necessarily passed on immediately. Applying a lagged approach would require analytical choices about which indices to lag and what the appropriate lag is, which may vary by company, depending on individual cost structures, commercial arrangements and business models. In our view, adding lagged indicators would introduce both additional complexity and greater inconsistency into the RPE mechanism. Therefore, we have not adopted this for our proposed approach for RIIO-3.

[35] See CEPA's 'RIIO-ED2: Cost Assessment - Frontier Shift methodology paper' report for further explanation of the assessment criteria. Available at: RIIO-ED2 Draft Determinations | Ofgem.

Table 10: Proposed indices added into RPE index methodology for RIIO-3

Index name	**Category**	**Companies applied to**
4/CE/EL/01 Electrical Engineering Labour	Labour	NGET, SHET, SPT
PPI INDEX INPUT - C Inputs into production of Manufactured products, excluding Climate Change Levy 2015=100 (GHIP)	Materials	GDNs
3/58 Pipes and Accessories: Copper	Materials	GDNs
4/CE/25 Aluminium Products	Materials	GDNs
4/CE/26 Metal Structures	Materials	GDNs
90/12 Timber	Materials	GDNs
NOCOS Resource Cost Index of Building Non-housing: Materials NOCOS	Materials	GDNs
Construction Output Price Indices (COPI)	Materials	GDNs
70/2 Plant and Road Vehicles: Providing and Maintaining	Plant & equipment	NGET, SHET
Purchased Plant Including depreciation and maintenance (4/CE/04)	Plant & equipment	NGET, SHET
90/2 Plant and Road Vehicles Operatives and fuel are not included	Plant & equipment	NGET, SHET

Index Weighting

6.41 In RIIO-2, the final RPE index composition was determined by the weights for each cost category and the weights of the individual indices within each category. Each category was weighted according to its share of efficient costs, while the indices within each category were equally weighted.

6.42 For RIIO-3, we propose to maintain the same approach to weighting categories and indices. We propose to use a notional company cost structure for GD and company-specific cost structures for ET and GT. For the purposes of Draft Determinations, we have calculated cost structures using cost forecasts submitted by companies in their business plans. These will be updated at Final Determinations to reflect our final views of the cost structures associated with company cost allowances, rather than those based on company cost forecasts. We think this will ensure the final RPE index mechanism is more accurately aligned to the companies' cost structures for RIIO-3.

6.43 Alternative approaches to applying weights would require more granular forecasts of individual expenditure for each input type, which is not available on a consistent and robust basis. We consider that adopting alternative approaches

therefore risks creating methodological inconsistencies in the way RPEs are applied to different companies.

6.44 A minority of network companies proposed changing the weighting of indices in the model. Some networks suggested that when a network company is forecasting a different spending profile in RIIO-3, especially if capital spending is considerably higher than in previous price controls, the weighting assigned to materials should be higher.

6.45 Some GDNs also opposed the RIIO-2 modelling assumption whereby all inputs within the same cost category are equally important and thus have identical weights. For example, one material input could account for a higher proportion of their costs than another and should be given greater weight. WWU suggested that we should consider a regional-specific approach, to reflect each company's specific factors, workloads and structures. NGN disagreed, noting regional wage adjustments are already accounted for within our totex benchmarking approach, and that applying a notional structure ensures fairness and robustness across the industry.

6.46 We consider that using weightings based on notional company spend profiles for GD avoids creating an overly complex methodology, and is consistent with our overall approach to benchmarking modelling which seeks to determine totex for the notionally efficient company. Additionally, using a notional cost structure avoids potentially rewarding inefficient cost structures. We agree with NGN on the potential risk of double counting with regional wage adjustments applied within the totex modelling. Therefore, we propose to maintain our approach of applying notional company weights to RPEs for RIIO-3.

6.47 Table 11 sets out our proposed RPE input price indices and proposed weights for the GD sector, NGT and each TO, including the additional indices proposed for RIIO-3 (as described in the Index selection section above).

Table 11: Proposed RPE input price indices and weightings

	GDNs	**NGT**	**NGET**	**SHET**	**SPT**
Labour					
AWE: Private Sector Index: Seasonally Adjusted Total Pay Excluding Arrears (K54V)	33%	33%	20%	20%	20%
AWE: Construction Index: Seasonally	33%	33%	20%	20%	20%

	GDNs	NGT	NGET	SHET	SPT
Adjusted Total Pay Excluding Arrears (K553)					
Electrical Engineering Labour (BEAMA)	0%	0%	20%	20%	20%
4/CE/01 Civil Engineering Labour	33%	33%	20%	20%	20%
4/CE/EL/01 Electrical Engineering Labour	0%	0%	20%	20%	20%
Materials					
4/CE/24 Plastic Products (Including Pipes)	10%	0%	0%	0%	0%
3/S3 Structural Steelwork - Materials: Civil Engineering Work	10%	50%	0%	0%	0%
4/CE/EL/02 Electrical Engineering Materials	0%	0%	50%	50%	50%
FOCOS Resource Cost Index of Infrastructure: Materials FOCOS	10%	50%	50%	50%	50%
PPI INDEX INPUT - C Inputs into production of Manufactured products, excluding Climate Change Levy 2015=100 (GHIP)	10%	0%	0%	0%	0%
3/58 Pipes and Accessories: Copper	10%	0%	0%	0%	0%
4/CE/25 Aluminium Products	10%	0%	0%	0%	0%
4/CE/26 Metal Structures	10%	0%	0%	0%	0%
90/12 Timber	10%	0%	0%	0%	0%
NOCOS Resource Cost Index of Building Non-housing: Materials NOCOS	10%	0%	0%	0%	0%
Construction Output Price Indices (COPI)	10%	0%	0%	0%	0%
Plants & Equipment					

	GDNs	NGT	NGET	SHET	SPT
70/2 Plant and Road Vehicles: Providing and Maintaining	0%	0%	25%	25%	0%
C28 Machinery and Equipment	0%	0%	25%	25%	0%
Purchased Plant Including depreciation and maintenance (4/CE/04)	0%	0%	25%	25%	0%
90/2 Plant and Road Vehicles Operatives and fuel are not included	0%	0%	25%	25%	0%

Materiality threshold

6.48 In RIIO-2, we used a materiality threshold to ensure that only cost categories with a material impact on total expenditure were included in the RPE index. We applied two materiality thresholds:

- Primary threshold: An RPE adjustment is applied if a cost category constitutes at least 10% of Totex.
- Secondary threshold: If a cost category accounts for at least 5% of Totex, an RPE adjustment is only applied if the expected real price movement in that cost category is expected to impact Totex by at least 0.5%.

6.49 We propose to maintain our existing approach to materiality thresholds for RPEs in RIIO-3. We think this allows material variations in input costs to be accounted for, while continuing to provide companies with strong incentives to effectively manage price volatility over time where possible.

6.50 Applying this approach to RIIO-3 results in the plant and equipment category now passing the materiality tests for NGET, as these costs account for over 10% of submitted totex in RIIO-3. Therefore, we propose to incorporate plant and equipment RPEs within the RPE index calculation for NGET in RIIO-3. We tested the GDNs, NGT and SPT against the secondary threshold for plant and equipment as forecast submitted costs account for at least 5% of totex, but found the expected cost movement to be less than 0.5% of totex. Therefore, we do not propose to incorporate plant and equipment within the RPE indices for the GD sector, NGT or SPT in RIIO-3.

6.51 The gas network companies proposed removing the materiality threshold, considering it to be arbitrary, and that it risks an input category that is relevant

being excluded. They also note regulatory precedent for removing the materiality threshold for RPEs (eg the Utility Regulator in Northern Ireland).

6.52 We tested removing the materiality threshold from the analysis, and found there to be only a minimal impact on the output. However, its inclusion potentially adds significant complexity to the calculation of the RPE index, particularly as doing so would require a number of new categories to be added into the analysis, each requiring appropriately robust indices to be identified.

6.53 Table 12 sets out the share accounted for by each category based on submitted costs. Following application of the materiality threshold, we propose RPEs are applied to labour and materials for all companies, and to plant and equipment for the GDNs and SHET.

Table 12: Share of submitted costs by category (% of submitted costs)

Cost category	**GDNs**	**NGT**	**NGET**	**SHET**	**SPT**
Labour	60.1%	29.7%	35.5%	59.8%	71.0%
Material	12.4%	19.9%	32.2%	20.2%	16.0%
Plant & equipment	9.6%	5.0%	14.9%	13.6%	6.0%
Other (not covered by RPEs)	18.0%	45.4%	17.4%	6.5%	7.0%

Forecasting

6.54 In RIIO-2 we made forecasts for each of the indices. For the labour indices, we used the OBR's forecast for earnings, and for the other indices we used long-term average growth rates. We propose maintaining this approach for RIIO-3.

6.55 Some network companies noted that in our existing approach, there is an implicit assumption that material prices will immediately return to their long-term average growth rates following significant deviations. They argue that supply shocks can often have effects that last a number of periods, and this risks forming a wedge between forecast and outturn RPEs. They suggested changes to our approach to forecasting RPE indices, including considering embedding an assumption of price stickiness following periods of high inflation and using macroeconomic forecast scenarios to inform price indices forecasts. However, most network companies supported the continued application of the RIIO-2 forecasting approach in general.

6.56 While it is possible to try to account for price stickiness in forecasts, for example by using an autoregressive modelling process which would take into account the previous period's price when forecasting the next period's price; or the use of

more advanced modelling techniques, there are significant drawbacks in practice. These include:

- inconsistencies in forecasting methods for each input, creating inconsistency in application and methodology; and
- volatile input prices making some models (and model tests) unsuitable because they are not statistically robust.

6.57 We think the scope for using macroeconomic forecasts to inform our RPE index forecasts is very limited. This was also acknowledged by some of the licensees in their business plan submissions. Therefore, it is not clear that adopting this approach would improve the overall accuracy of the indices forecasts in RIIO-3.

6.58 Cadent suggested that following periods of volatile inflation, the true-up profile could be reviewed, to lessen the short-term impacts on consumers. Our RPEs approach is designed to mechanistically adjust costs based on outturn data. This approach risks adding unnecessary complexity to the mechanism, and could make it less mechanistic in nature. Therefore, we are proposing to maintain our existing approach to true-up profiling for RIIO-3.

Uncertainty mechanisms

6.59 SPT proposed the introduction of a symmetrical re-opener to capture material deviations between RPE adjustments and outturn costs. SHET proposed the adoption of a mechanism to adjust allowances where TOs can demonstrate higher costs that they consider to be outside of their control and which are additional to RPE allowance adjustments.

6.60 We consider our proposed approach of using RPE-indexation to be the most effective type of UM design to manage forecasting uncertainty for input costs. We do not consider that a re-opener or an additional adjustment mechanism are appropriate for managing cost input uncertainty, as both add complexity and risk, removing incentives for companies to effectively control input costs where they can. NGET suggested that the project-specific Price Adjustment Mechanism, which is currently used for some ASTI projects should be applied to all ASTI projects and other re-openers where the costs of the project are above the smallest value ASTI project. It also suggested more generic RPEs should be applied to all other re-openers, taking into account materiality. In our SSMD, we recognised that re-opener applications are very heterogeneous in scope and scale, and that a case-by-case approach may be warranted with respect to applying both RPEs and ongoing efficiency. We are still considering the metrics

of whether RPEs should be applied to re-openers in RIIO-3, and welcome evidence through consultation responses on this issue.

RPE interaction with TIM

6.61 SPT suggested that RPEs alone may not mitigate all forecasting and delivery risks and argued that changes to RPEs should be considered alongside applying a stepped approach to the TIM. It noted a stepped TIM would prevent TOs facing severe penalties in cases of significant overspend, which could be partially due to differences between input costs and RPEs. We note that through the TIM, companies already receive a degree of protection against RPEs being higher than forecasted, with the impact of any overspends shared between companies and customers. We consider that it is still important that companies are incentivised through the TIM to effectively control input costs where they can, and avoid fully passing price risk onto customers. See the TIM section in Chapter 5 of the ET Sector Annex document for further details on our proposals for a stepped TIM in RIIO-3.

Other proposals

6.62 In its Business Plan, SHET proposed a Market Capacity Adjustment Allowance of £177m but suggested this could be withdrawn if these costs were accounted for through RPEs. As we set out in Chapter 5 of the ET Annex, we do not consider these costs have been justified and therefore have rejected these costs in our Draft Determination, including through any adjustment to our proposed RPE approach. Table 13 below summarises our proposed RPEs forecasts for RIIO-3.

Table 13: Proposed RIIO-3 RPE forecasts

Network	**2026/27**	**2027/28**	**2028/29**	**2029/30**	**2030/31**
GDNs	0.30%	0.45%	0.56%	0.74%	1.13%
NGT	1.07%	1.23%	1.29%	1.38%	1.57%
NGET	1.52%	1.89%	1.96%	2.05%	2.23%
SHET	1.45%	1.79%	1.90%	2.04%	2.35%
SPT	1.30%	1.56%	1.66%	1.83%	2.20%

Question

OVQ18. Do you agree with our proposed approach to RPEs?

7. Gas depreciation

Introduction

7.1 In this Chapter, we set out our proposals for regulatory depreciation in the gas sectors.

7.2 Regulatory depreciation is a building block of the revenue that network companies are allowed. It is comprised of an assumed asset life (or lives) and an assumption of the profile(s) of usage across the asset life (or lives). The regulatory depreciation assumptions determine the speed that RAV additions are paid for by consumers as part of the return of capital to investors.

7.3 This decision is particularly relevant in RIIO-3, as we consider how to manage the uncertainty around the future of gas to protect current and future consumers, while also managing the perceived risk of asset stranding for investors.

7.4 As outlined in Chapter 2, our proposals align with the UK government's long-term programme of work to address the strategic challenges facing the gas system. As part of this programme, government is exploring long-term options to maintain investor confidence and support continued investment, while ensuring the fair and equitable recovery of costs from a declining gas consumer base. To support this work, government plans to publish a call for evidence on gas network investment and affordability in the autumn, following its June gas Update to Market.

7.5 Pending the outcomes of this we are starting to address this issue by proposing to fully depreciate new investment in GD by government's net zero target date (2050). This builds on our established approach of front-loading gas asset depreciation in prior regulatory periods. Around the world, other regulators are making similar decisions, faced with the same strategic challenges. For example, in 2023, Austria shortened depreciation periods from 30 to 20 years for new gas pipeline investments to reflect the anticipated decline in gas demand.[36] The Netherlands has also acted to accelerate depreciation by a factor of 1.2 for GD.[37] In Germany, the regulator provides gas network companies the flexibility to depreciate their assets by either 2045 or earlier to meet regional or municipal decarbonisation targets.[38]

[36] E-Control Gas DSO regulatory regime for the fourth regulatory period
[37] Report on Regulatory Frameworks for European Energy Networks 2023 - CEER
[38] Bundesnetzagentur - More flexible depreciation arrangements for gas networks

7.6 Our consultation positions on gas depreciation are summarised below, with more detail and consultation questions provided in Chapter 8 of the Finance Annex.

Gas depreciation

Purpose: Regulatory depreciation rates determine the speed that RAV additions are repaid by consumers.

Benefits: Appropriate rates of depreciation help ensure, over time, that consumer charges are fair for both current and future consumers. Depreciation rates can reflect the economic and technical lives of the underlying assets.

Background

7.7 We expect natural gas demand to decline to meet the statutory net zero target and five-year carbon budgets. This decline in demand creates a risk that a smaller number of future natural gas consumers could be left repaying the largely fixed cost of historical and ongoing network investment.

7.8 In our SSMD, we decided to accelerate depreciation for gas network companies during RIIO-3. While we acknowledged that this would increase depreciation charges during RIIO-3, we considered that not acting could lead to a rapid increase in future consumers bills as well as the possibility of unpaid gas Regulatory Asset Value (RAV) remaining by the statutory net zero target date (2050).[39] We also considered that accelerating depreciation would provide confidence to network companies and investors that we are taking steps to mitigate the perceived asset stranding risks.

7.9 We decided to target paying back additions to the GD RAV in line with the statutory net zero target date and said that we would consider through our Draft Determinations whether to apply this to the entire RAV or only to new RAV additions from RIIO-GD3.

7.10 We did not make a decision on whether to target paying back the GT RAV by the net zero statutory target date as we considered there are likely to be more potential opportunities to retain or repurpose the GT network. We also noted the potential consumer bill impact of accelerating depreciation in GT is significantly lower than in GD as the GT RAV is smaller. Instead, we said we would consider evidence submitted through NGT's Business Plan to evidence where its network is most likely to be repurposed or retained beyond 2050.

[39] The RAV is the amount of investment in the network not yet paid for by consumers.

7.11 In their business plans, gas network companies stated that accelerated depreciation could not solve the range of interconnected challenges declining natural gas usage poses for gas networks in the energy transition. They considered that we should work with government to provide the regulatory frameworks and government policies and support to minimise the perception of asset stranding. They also stated the importance of clear commitments from us and the government on the repayment of the RAV to maintain investor confidence in the sector and ensure long-term financeability and investability. However, they all had different views on the implementation of accelerated depreciation ranging from doing more than we had proposed in our options at SSMD, to doing nothing and maintaining the RIIO-2 approach.

7.12 Feedback from our Call for Evidence suggests that stakeholders thought we should engage with government on wider issues around the future of gas, including disconnection costs, the potential of hydrogen, regional differences in disconnection rates and affordability. Respondents stated the uncertainty surrounding the future use and value of the gas network and raised concerns with the potential bill impact of accelerated depreciation.

Consultation position and rationale

Summary of consultation position

Interaction with government's work to consider of the future of the gas system: We will support the government in its future of gas programme of work and adapt our policies to the outcomes, as appropriate, in line with our statutory duties.

Stranding risk and RAV recovery: We will continue to set regulatory policy to ensure efficient firms can finance their functions, and that network assets are depreciated over their useful economic lives.

GD depreciation: Accelerate depreciation for new assets only. Depreciate new assets by the net zero statutory target date.

GT depreciation: Retain the RIIO-GT2 45-year, front-loaded depreciation policy.

Interaction with government's work to consider the future of the gas system

7.13 As outlined in Chapter 32.23, government provided an update on 30 June regarding its long-term work on the future of gas and how that programme will be progressed. We expect the outcomes of this programme to give further clarification on the speed and scale of any transition, as well as consider government policy direction on cost recovery, and so is highly relevant to decision areas for which we are responsible. Accordingly, any decisions we take

for the RIIO-3 period and beyond, including with respect to regulatory depreciation and economic asset lives for the gas sector, must be able to adapt to the outcomes of this future of gas policy review in line with our statutory duties.

Stranding risk and RAV recovery

7.14 We will continue to set regulatory policy to ensure efficient network companies can finance their functions, and that network assets are depreciated over their useful economic lives.

7.15 In setting allowed revenues to enable efficient firms to finance their functions, we will take into account the extent to which incremental spending is necessary to ensure safety and security of gas supply. We will expect network companies to avoid any spending that is not essential for this purpose, including in relation to proposals submitted in response to uncertainty mechanisms (for example, the Net Zero Re-Opener and the GD Heat Policy Re-opener).

7.16 In setting depreciation policy and assessing useful economic lives, we will take account of the need to incentivise reuse or repurposing of these assets wherever possible, so as to extend longevity of use.

7.17 We will also take into account the extent to which network assets are likely to be used and useful for consumers and, acting reasonably, reserve the right to disallow any spending that does not meet this test.

GD depreciation

7.18 For the start of the RIIO-GD3 period we propose to leave depreciation policy for existing assets unchanged. We propose to set a new policy to accelerate depreciation for new additions to the RAV, based on a sum-of-digits approach with asset lives set such that the new investment is fully depreciated by the government net zero target date.

7.19 We have recognised the interdependence between this regulatory approach and the future of gas programme being led by government and we consider our proposal strikes an appropriate balance. Where new information becomes available that could alter our assessment of the policy and the consumer interest, then we will consider whether any intervention may be required during the RIIO-GD3 period. Otherwise we will revisit our approach to GD depreciation as part of the new price review process that will inform the regulatory framework applicable for the period from April 2031.

GT depreciation

7.20 We propose not to further accelerate GT depreciation and retain the current 45-year sum-of-digits profile in RIIO-GT3. We consider this is appropriate as the potential impact of waiting until after the conclusion of government's review of network investment and affordability is lower than for GD. The GT RAV (~£7bn) is significantly smaller than the GD RAV so we would not expect to see significant increases in consumer bills until the mid-2040s using our current depreciation approach. We also continue to see higher repurposing and reuse potential of GT compared to GD.

Questions

7.21 Our consultation questions on gas regulatory deprecation are set out in Chapter 8 of the Finance Annex, along with further detail on our position.

8. Cost of service

Introduction

8.1 The scale of investment proposed for RIIO-3 is unprecedented, and the corresponding totex allowances we propose to provide through these Draft Determinations will have a material impact on customers' bills. It is therefore essential that we ensure these investments are the right ones for consumers, being delivered at the right time and at a price that is efficient and fair for consumers.

8.2 In this chapter, we provide an overview of the allowances we are providing to each company following our assessment of their submitted costs.

8.3 Differences between the costs requested by companies and the allowances we set can arise for several reasons. In some cases, they reflect our assessment of cost efficiency, where we apply a range of tools to ensure consumers receive value for money. In other instances, the variance is due to the need for further information or clarification from network companies to fully understand their proposed investments. Finally, there are situations where we agree that the expenditure is likely to be needed, but consider it more appropriate to set the allowance during the price control period - once there is greater certainty about the specific investment required.

8.4 The specific approach to determining the level of efficient cost varies by each sector. Further details on the approach taken is therefore presented in the relevant sector and company annexes. There are two aspects to this assessment, however, that are common to all sectors which we are set out in this chapter.

8.5 The first common aspect is our appraisal of the Engineering Justification Papers (EJPs) that companies submit for major schemes or programmes that sit apart from the day-to-day running costs of the networks. Through these EJPs, network companies set out the need for the investment, the different options that have been considered, the rationale for the preferred option and further detail on its scope and cost.

8.6 The second common aspect is our assessment of the Ongoing Efficiency (OE) that we expect all companies to be able to achieve. OE is a means through which we can ensure that, in delivering their investment, network companies continue to apply innovation to drive for the efficiency gains that we think are reasonable to expect for companies operating in these sectors.

Headline figures

8.7 Table 14 sets out a summary of our proposed efficient totex allowances for each company for RIIO-3. Chapter 5 of the relevant sector specific annexes provides a detailed explanation of how we arrived at these proposed costs for each sector. Submitted totex is presented on a net basis and excludes RPEs and OE. Our proposed efficient totex is presented on a net basis and includes our proposed OE challenge, but excludes RPEs.

Table 14: A summary of our proposed efficient totex allowances for each company, £m

Sector	Company	Submitted totex	Ofgem proposed efficient totex	Difference (%)
ET	NGET	5,827	4,249	-27.1%
ET	SHET	4,141	3,074	-25.8%
ET	SPT	2,071	1,589	-23.3%
GT	NGT	4,054	2,456	-39.4%
GD	Cadent	8,020	6,283	-21.7%
GD	NGN	1,837	1,568	-14.6%
GD	SGN	4,546	3,430	-24.5%
GD	WWU	2,190	1,502	-31.4%

Engineering Justification Paper (EJP) reviews

Background - the evolution of the EJP Assessment

8.8 In RIIO-2, we introduced EJPs to support our assessment of the RIIO-2 business plans. The EJP is a tool that combines multiple data drivers into individual documents to demonstrate the needs case for an investment. This creates a clear interface between engineering and cost assessment. At its core these submissions allow us to understand if the investments proposed are the optimal investments to address the needs cases identified. In parallel, they also allow us to understand the long-term consumer benefits which these investments either do, or do not, bring.

8.9 As part of developing RIIO-3, we considered the effectiveness of the EJP in RIIO-2 and its relationship to the investments and decisions licensees were proposing to make. The quality of RIIO-2 EJPs and subsequent submissions were mixed in some cases, resulting in difficulty achieving timely assessments. To address these issues, we provided updated guidance for the RIIO-3

submissions. The guidance provides more specificity to the EJPs, with the intention to drive improved quality and clarity of submissions.

8.10 The three sectors face differing challenges, outlined in the sector specific annexes. As a result, the gas sectors retained a similar format to RIIO-2, whereas, a new approach was adopted for ET that required the completion of a suite of four EJP templates.

8.11 The templates for Major Projects and Portfolio (referred to as Asset Health in the GT and GD sectors) were used in all sectors. The Atypical, and NESO Driven templates only applied to ET. The Portfolio EJPs were data driven, while the remaining EJPs were narrative based.

8.12 The move to portfolio EJPs was designed to provide a holistic overview of intervention needs across various asset classes. It draws on condition data and risk assessments for individual assets to highlight where intervention is, or is not, required. This enabled us to assess the investment proposals in the context of the rest of the asset fleet, which is something we have not previously had the ability to do.

8.13 Having access to the asset fleet data has enabled us to take a comparative view of wider asset condition, when looking at the investment proposals. In the long-term this will support our SSMD intent to standardise the NARM system and work towards enhanced monitoring of licensee performance.

EJP Assessments

8.14 We have reviewed all EJPs submitted to us. Where we have required additional information, and where it will influence our decisions, we have used the supplementary questions (SQ) process.

Understanding our Assessment

Overview

8.15 Our review of the Engineering Justification Papers (EJP) focussed on four areas:

- **Needs Case** – we considered if the investment is needed, and if it is needed now or in the future.
- **Optioneering** – we assessed evidence to determine whether the licensee had considered sufficient options, and whether it had then developed those options to a detailed enough level to assure us that the proposed option was the optimal economic and efficient solution, whilst considering environmental and community impacts.

- **Scope Confidence** – we assessed the scope of the proposed solution to ensure that it was clearly defined, with the risks to delivery identified and mitigated.
- **Cost Confidence** - our assessment of costs in EJPs was limited to building an understanding of the cost drivers for the project or programme. It was imperative that the licensee provided costs that had a sufficient breakdown to make an effective assessment possible.

Outcomes

8.16 Our EJP assessment feeds through to the Policy and Cost models, particularly in relation to the projects' inclusion in our determinations and associated volumes. In some cases, there are linkages between the EJP assessment and the cost outcome. In other cases, it influences areas such as uncertainty mechanisms or other controls.

8.17 For the Needs Case and Optioneering, where the company has provided a convincing narrative, combined with a data trail that underpinned the argument, we adjudged the submission to be Justified. Where the company provided a good needs case without the data, or data without a compelling narrative, we have adjudged that to be Partially Justified. Where a company has not provided either a good needs case or data, the submission has been marked as Unjustified.

8.18 For Scope and Cost confidence, where the company has provided a high level of relevant detail supporting their claims, we have marked that as High Confidence. Conversely, where insufficient information was provided, we have marked that as Low Confidence.

8.19 Generally, where either the Needs Case or the Optioneering has been deemed to be Unjustified, this resulted in reductions to the allowances proposed in our determinations. This is on the basis that most of the consumer benefit realised through our engineering review comes from these two elements, ie ensuring the need is well justified and the optimal solution for addressing that need is put forward. Where we have concerns over the scope of the proposed solution, this impacted our confidence over cost and/or deliverability, potentially requiring an uncertainty mechanism.

8.20 For each of the assessment components there were 3 possible outcomes of our review:

- Positive Recommendation - Justified, or High Confidence

    - Where we considered that the information provided is sufficient and robust enough for us to provide a positive recommendation.
- Concerned Recommendation - Partially Justified, or Medium Confidence
    - Where we considered that further evidence is required to justify the need and/or efficacy of the proposed intervention(s)
- Negative Recommendation - Not Justified, or Low Confidence
    - Where we considered that the information provided suggests that this investment may not be in the consumers interest and may result in detriment if delivered as planned.

8.21 We have assessed EJPs that related to proposed re-openers as well as baseline funding. Our view on these re-opener EJPs at this time should be taken as an indicator of quality of submission only. Where we have a view that they are Partially Justified or Unjustified, licensees should address our concerns during the formal submission of these re-openers.

Ongoing Efficiency

Background

8.22 An ongoing efficiency (OE) challenge reflects the productivity improvements that we consider even the most efficient company can achieve. Setting a suitably stretching OE target - reflecting the scale of new investments, as well as efficiency gains and innovation in the wider economy - helps ensure value for money by encouraging continued efficiency improvements.

8.23 In our SSMD, we set out that:

- we would apply OE in RIIO-3;
- a wide range of evidence, including EU KLEMS database, would inform our analysis;
- we would assess whether a 1% annual OE target is still reasonable for RIIO-3; and
- network companies should include an OE assumption within their business plans and provide an explanation of how it has been derived.

Consultation position and rationale

OE target: Set OE at 1.0% per annum at RIIO**-**3.

Scope and application: Apply the OE target to our view of efficient modelled costs as a post-modelling adjustment. It is applied from the first year of forecast costs (ie 2024/25) and compounded across the remainder of the forecast to the end of RIIO-3 (2030/31).

Applied to: GD, GT and ET.

Ongoing efficiency

8.24 We are proposing to set an OE target of 1.0% per annum for baseline totex in RIIO-3. We are still considering whether to apply OE, in certain cases, for UMs.

8.25 Our proposed target reflects our in-the-round assessment of different sources of evidence, taking into account both quantitative analysis and qualitative considerations. First, we considered the outputs of the quantitative analysis in order to establish a broad range from which to select an OE target. We then considered the analytical choices and qualitative considerations to determine a reasonable point within this range as our proposed OE target for RIIO-3.

8.26 There is no agreed consensus on the preferred approach or methodology for determining OE. Therefore, as a regulator, we must make an informed judgement on the appropriate OE target to set companies in RIIO-3. In our view, this needs to account for the range of available evidence, and factors in both quantitative and qualitative considerations.

8.27 As an input to this, we commissioned consultants (Grant Thornton) to assess OE evidence submitted within the company business plans, and provide a report with recommendations for the appropriate OE range and level for RIIO-3. The Grant Thornton report (GTh Report) is published alongside our suite of Draft Determination documents.

8.28 As well as forward-looking productivity forecasts for the UK economy and other recent regulatory decisions in GB and Northern Ireland, Grant Thornton undertook a quantitative growth accounting analysis to determine a broad range of 0.1%-1.3%, based on historically observed productivity growth, derived from EU KLEMS. This range reflects its analytical judgements by applying the Gross Output (GO), considering a full historical time-period (covering 1970-2019) and applying an unweighted approach to comparator sectors. We think this represents a sensible starting point from which to determine a potential range for OE in RIIO-3. See the GTh Report for further details on its methodological approach.

8.29 However, for the purpose of setting an OE target at RIIO-3, we consider this range to be too broad to reflect the specific factors that we consider are relevant for the energy sectors. We have sought to identify a narrower plausible range that is more relevant to the context of RIIO-3. One factor that we have considered is where the OE targets proposed by the network companies in their

business plans sit within this initial broad range and the supporting evidence they have provided.

8.30 There were a range of OE proposals provided across the companies. NGET was the most ambitious company, proposing OE of 0.7% per annum for RIIO-3. All gas companies (ie GDNs and NGT) proposed an OE challenge of 0.5% per annum,[40] while SPT proposed an OE challenge of 0.4% per annum. SHET was the least ambitious, proposing 0.2% per annum OE on 'business as usual' costs (equivalent to 0.1% per annum across baseline totex). We note that all network companies proposals are within the initial broad range.

8.31 As noted in the GTh Report, all companies have the same opportunity at the start of the price control to deliver OE improvements during RIIO-3, given they all operate within the wider GB economy and have the same opportunities to access the available technologies and markets. Regulated companies and their consultants also all have an incentive to aim down in their OE proposals and to make analytical choices which favour lower growth accounting outcomes. In our view, the bottom half of the range identified in the GTh report, including the proposals made by the majority of companies, is not sufficiently challenging for a company operating in a regulated environment and would represent a significant departure from regulatory precedent.

8.32 We consider that a range of 0.7%-1.3% better reflects the potential for above-average technological change and also the need to provide a sufficiently strong incentive to improve productivity. Our proposed OE target sits within this range.

Proposed RIIO-3 target

8.33 We continue to consider that a growth accounting approach to OE using EU KLEMS data is a useful source of information on productivity trends in the UK, consistent with our position in RIIO-2 and RIIO-ED2. While this approach has strong regulatory precedent, we recognise that relying solely on historical productivity data has limitations when forecasting future gains. Therefore, we have considered a range of factors in coming to the proposed OE target for RIIO-3, including:

- The potential for both embodied and disembodied technical change; taking into consideration that (GO-based) Total Factor Productivity (TFP) growth rates calculated from the EU KLEMS database may underestimate the total potential for cost savings that can be achieved by network companies when

[40] All four GDNs and NGT jointly commissioned an independent report from consultants Economic Insight, which directly informed the proposals put forward in each companies' business plan.

quality improvements in the factor inputs are considered. Embodied technical change is important in the context of the RIIO-3, where technological change is anticipated.

- The potentially lower measurement in the value added (VA) metric, which tends to return higher estimates of TFP ranges in growth accounting analysis (all else equal). There is recent regulatory precedent for giving consideration to VA when setting OE (including RIIO-2, Ofwat and UREGNI).
- Companies' strong ambition to deliver significant technological change through their IT&T and data and digitalisation activities in RIIO-3. Companies have submitted funding requests for £4.3bn in RIIO-3 for IT&T and data and digitalisation, a 65% increase on RIIO-2, where they expect to spend £2.6bn. Growth accounting analysis shows that the IT and communications sector has comparatively strong historical productivity growth rates compared to many other sectors. Therefore, the additional funding we have proposed for IT&T and data and digitalisation activities offers significant opportunity for network companies to drive efficiency improvements through their businesses.
- Companies' ability to benefit from efficiency gains resulting from historical customer-funded innovation funding provided in previous price controls. In RIIO-2, we made £563m of innovation funding available through the SIF and £262m (2023/24 prices) available through the NIA. While we are not currently able to prescribe a quantified value on the efficiencies we expect to be achieved from previous innovation funding, it is reasonable to expect productivity benefits from these historical investments to occur during RIIO-3. We also expect companies to benefit from investments in innovative new technologies (eg advanced leakage detection and data platform for leakage analytics in GD) which offer significant potential for productivity improvements in RIIO-3.
- The time period used in the EU KLEMS analysis, which includes the period of slower UK productivity growth since 2009. While productivity growth since 2009 has been comparatively weaker than that observed prior to the Global Financial Crisis, we think it reasonable to give consideration to longer time periods, to reflect productivity cycles. We also consider that regulated network companies are not fully impacted by wider productivity slowdowns, given the predictability that the price control frameworks provide over future revenues and returns compared to the companies operating in competitive markets.

- Recent UK regulatory precedent, including RIIO-2, RIIO-ED2, and Ofwat's PR24, which all used EU KLEMS-based growth accounting to set OE targets. There is also a notable alignment around OE targets at 1% per annum.
- Company submitted OE assumptions, which ranged from 0.1% per annum to 0.7% per annum. We consider all companies should at least be able to match the highest level of ambition (0.7%), as set out above.
- Independent forecasts of economy-wide productivity trends over the RIIO-3 period. While not regulated energy sector specific, they are informative about the direction of wider trends.

8.34 We have considered an OE target on totex across the plausible range:

- 0.7%: the bottom-end of our plausible range. This represents the highest OE target proposed by the companies, representing a relatively pessimistic view of the outlook for the OE improvements possible in RIIO-GD3. This approach places weight only on quantitative factors, with little consideration given to qualitative evidence.
- 1%: the mid-point of our plausible range. This represents a balanced view, which is grounded in quantitative analysis while giving appropriate weight to qualitative considerations on the potential for disembodied technical change and the use of VA. It also gives some weight to the expectation that companies should expect to see productivity benefits from their historical investments in RIIO-2 and planned investments in RIIO-3 in IT&T, data and digitalisation and innovation projects.
- 1.3%: the top-end of our plausible range. This represents an immediate return to the highest levels of average productivity growth observed historically. This target places significant weight on the delivery of strong productivity gains through: disembodied technical change; historical and planned IT&T; data and digitalisation; and innovation project investments. While not impossible, given the inherent uncertainty about the future of the economy, we do not consider it reasonable as an OE target for RIIO-3.

8.35 We propose a 1% OE target for RIIO-3. We think this represents a stretching but achievable challenge. It is supported by:

- sound and measured analytical assumptions within the growth accounting analysis;
- qualitative consideration of the methodological limitations to some elements of growth accounting approaches; and

- the potential for strong productivity gains resulting from record levels of IT&T and data and digitalisation investment in RIIO-3.

8.36 This also aligns with wider regulatory precedent, where it has been consistently judged to represent a challenging but achievable target for regulated companies.

Question

OVQ19. Do you agree with our proposed approach to ongoing efficiency?

9. A stable and predictable financial framework

Introduction

9.1 One of the crucial areas of focus in RIIO-3 is investment. Both the electricity and gas sectors are facing crossroad moments. There is a need for unprecedented levels of investment in ET; while the gas sectors must also play a vital role in maintaining energy security and safe supply.

9.2 In remunerating this investment, our role is to create a competitive environment that protects consumers while attracting the scale of capital investment required, with fair but not excessive returns for investors.

9.3 Our regulatory regime will need to evolve so that network companies continue to make financial decisions that benefit consumers both now and in the future. For example, we recognise the case for greater investment amidst a higher interest rate environment and have modified our allowances for companies to efficiently raise capital (debt and equity). Equally, we are evolving our approach from RIIO-2 and are putting measures in place to protect consumers from excessive risks, such as modifying our debt allowances to reduce consumers' exposure to inflation.

9.4 We are also taking proactive steps on financial resilience. Financial distress or failures can impact the confidence in an industry. That in turn can lead to higher costs for companies and the public. Consumers must have confidence in the energy sector; therefore we are introducing new resilience requirements for network companies. This includes a requirement that they maintain more than one investment grade credit rating and a lock-up on distributions if they go beyond a certain level of gearing.

9.5 Our financial framework broadly addresses three key themes:

- Setting cost of capital allowances that are efficient and attract the right levels of investment;
- Ensuring network companies are financeable - this protects consumers from risk associated with actual financing decisions that network companies and their shareholders have made; and
- Setting a balanced level of risk and reward across our overall RIIO framework and ensuring the sector is investable.

Cost of capital

9.6 Equity investors should be adequately compensated for the risks they take. Our proposed cost of equity allowance of 6.04% (assuming 60% gearing) and 5.64%

(55% gearing) reflects updated market conditions, including higher gilt yields and broader benchmarks.

9.7 The cost of debt allowance is indexed over the price control period to ensure it appropriately reflects market conditions. Foundationally, we use the same methodologies for setting allowances as RIIO-2. However we have introduced changes to fairly reflect market conditions and reduce unintended outperformance:

- Firstly, we are changing our benchmark index so that the allowed return on debt is less influenced by volatility in the water sector.
- Secondly, a nominal allowance for fixed-rate debt will reduce the exposure of consumers to inflation, recognising that because fixed rate debt investors assume inflation risk, it is not necessary for consumers to provide inflation protection for this source of capital.
- Using observable data, we are also taking a tailored approach to setting debt allowances across sectors. Bringing together our cost of equity and debt allowances, we are proposing a Weighted Average Cost of Capital (WACC) of 5.09% in gas and a range of 5.52% - 5.73% (sector average 5.62%) in ET (expressed in semi-nominal terms).

Ensuring network companies are financeable

9.8 We have a duty to have regard to the need for companies to finance activities which are the subject of obligations imposed by or under the relevant legislation. Most regulated utilities raise debt finance by issuing bonds in the capital markets. In addition, the companies have licence requirements to take all appropriate steps within their power to maintain an investment grade credit rating.

9.9 These ratings are issued by firms called rating agencies. An investment grade credit rating signals a strong likelihood that the company will be able to meet its liabilities and keeps the cost of debt low for networks. This keeps network charges low for consumers.

9.10 As set out in our SSMD, we assess financeability on an efficient notional company basis, using market datapoints to guide our assumptions about it.

9.11 We are proposing changes that bring forward the TOs' cashflows to support the financing of their operations. Specifically, for expenditure relating to re-openers and volume drivers, we propose reducing the capitalisation rate for ET from the natural rate (c.100%) to 85%. This means that some costs that would have

otherwise flowed through into bills after 2031 will instead be included in bills during the RIIO-3 period. However, this decision will in turn keep the costs of raising and investing capital into the ET system lower. We have carefully considered this decision to ensure that our adjustments are fair and not excessive.

9.12 We have also considered whether regulatory depreciation (a building block of the revenue that network companies are allowed) is appropriately set across different sectors. Our positions on depreciation in GD are set out further in Chapter 7, with some acceleration compared to RIIO-2. In both the GT and ET sectors we have decided to maintain our RIIO-2 approach to depreciate all assets over a 45-year life.

Ensuring the sector is investable with a balanced level of risk and reward

9.13 We introduced the concept of 'investability' to ensure we are actively testing whether the RIIO-3 financial framework supports the scale of equity investment required. We believe that by attracting the right investment, regulated networks can deliver the transmission and distribution systems needed to lower consumer costs and deliver cleaner and more flexible energy.

9.14 We have rigorously benchmarked our proposed equity return to ensure that is competitive and efficient. We have also carefully considered stakeholder feedback on how we can broaden our investability assessment.

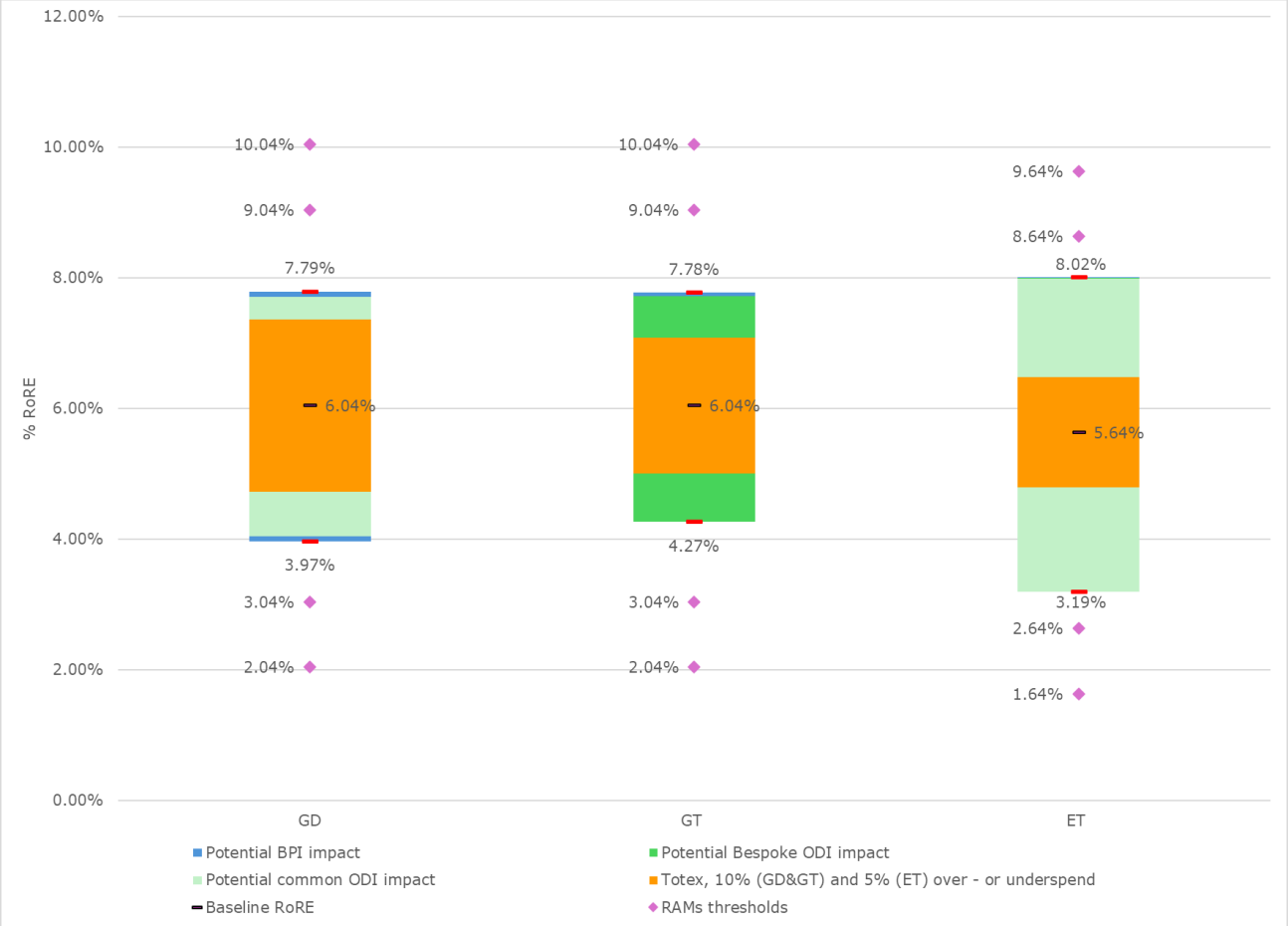
9.15 We are confident that our equity returns are attractive while being fair. They offer investors stability and predictability. In return for investment that delivers for consumers, investors will receive an inflation-protected return on their equity. There are further returns on offer to investors, however these are based on company performance against specific incentives. We also use our return adjustment mechanisms (RAMs) to safeguard consumers and investors alike from excessive returns or losses.

9.16 This can be seen in our RoRE ranges. This metric shows the return on equity that an investor can expect plus a company's overall ability to out or underperform on their costs and output delivery incentives. For each price control period, we carefully calibrate these allowances to strike an appropriate balance between scope for outperformance for high-performing companies and the scope for underperformance for poorly performing companies.

9.17 We consider our RoRE ranges offer an appropriate level of reward with stretch targets for the risks borne by investors and networks.

9.18 We are also maintaining from RIIO-2 our RAMs to ensure that any excessive out or underperformance due to unforeseen factors is shared.

Figure 3: Illustrative RoRE ranges



10. Innovation

Introduction

10.1 Innovation is an essential part of how we expect energy networks to operate. To deliver a low-carbon energy system that is reliable, safe and efficient at a pace in line with our net zero targets, companies have to find new ways of developing and operating their networks.

10.2 Within RIIO-3, we encourage innovation in a number of ways, including through the TIM which encourages innovation within the core price control framework. This chapter sets our proposed refinements to our two dedicated regulatory funding mechanisms supporting innovation - the Network Innovation Allowance (NIA) and the Strategic Innovation Fund (SIF).

Network Innovation Allowance (NIA)

Purpose: Innovation funding to encourage early-stage Research & Development (R&D) by companies, and support innovators, as well as increase oversight of projects and reporting to improve demonstration of value for money.

Benefits: Networks deliver innovation that they would not otherwise undertake, with improvements leading to financial and environmental benefits for consumers.

Background

10.3 In our SSMD we decided to retain a flexible innovation fund in RIIO-3, the NIA, so companies can continue essential small-scale and early-stage R&D in an agile way. We also kept the NIA scope to "facilitate energy system transition and/or benefit to consumers in vulnerable situations" (referred as the "the NIA Eligibility Criteria").

10.4 We stated that we would base the amount of NIA funding given to networks on the quality of their Business Plans (BPs), ensuring that innovation projects provide value for money to consumers. Our RIIO-3 BPG, sets out the factors that we would consider in this assessment.[41]

10.5 We highlighted the need to explore increasing oversight of the NIA to ensure it delivers value for money to consumers.

[41] RIIO-3 Business Plan Guidance, paragraph 3.13.

10.6 Due to mixed feedback in SSMC responses on our proposal for an innovation accelerator to support early-stage innovators, we made no decision on whether to establish it.

Consultation position and rationale

Summary of consultation position

Funding mechanism: UIOLI allowance

Funding level: £217.6m across all the sectors.

Scope:

- Removing future of gas work from the scope of NIA funding.

- Utilising £2.5m of additional NIA funding to provide enhanced services to innovators.

Funding design:

- Increasing oversight of the NIA.

- Clarifying reporting requirements and addressing gaps.

Applied to: GD, GT and ET.

Funding level

Amounts awarded to each network

Table 15: Requested and proposed RIIO-3 NIA funding

Company	NIA funding requested	Proposed RIIO-3 NIA funding
Cadent	£21.5m	£18.0m
NGN	£15.5m	£9.7m
SGN	£30.7m	£6.2m
WWU	£37.9m	£11.8m
NGT	£40.0m	£11.2m
NGET	£135.0m	£117.5m
SHET	£25.5m	£20.0m
SPT	£22.5m	£20.7m
Total	£328.6m	£215.1m

Our Assessment Process

10.7 Given the evolving policy landscape, major investment in Electricity Transmission, and ongoing government decisions on the future of gas, we

decided that assessing Business Plans individually, rather than benchmarking against RIIO-2 innovation funding levels, would better ensure value for money to consumers.

10.8 Each network's final NIA award was calculated based on the following formula:
(Requested NIA – Deducted Workstreams) * BP Quality Assessment Score

Workstream deductions

10.9 The NIA is a flexible allowance, and we recognise that workstreams set out in the Business Plans may need to change to reflect emerging requirements. However, where we found workstreams that we concluded did not justify innovation funding, we reduced a network's NIA.

10.10 In assessing whether a workstream justified innovation funding, we considered whether the area of work:

- met our criteria of facilitating the energy transition or protecting vulnerable consumers;
- was duplicative of work that Ofgem, NESO, or another party was already doing;
- was already incentivised by other RIIO-3 incentives, and so did not require further stimulus funding;
- had been sufficiently funded in previous price controls, and thus did not require further stimulus funding;
- was sufficiently innovative;
- entailed a sufficient degree of risk to justify stimulus funding; and

related to outstanding government policy decisions that meant that its current need was uncertain.

10.11 When reducing a network's NIA for a specific workstream, the reduction reflected either

- the specific amount requested by the company, or
- our estimation of the workstream value, if no breakdown was provided.

10.12 Where a network's NIA was reduced due to a workstream not being funded, this is detailed in their company-specific Annex.

Business Plan Quality assessment

10.13 Each Business Plan Innovation Strategy was also assessed for overall quality using the factors set out in the BPG (including consideration of feedback

received through the Call for Evidence).[42] Based on this, we applied a further percent reduction to the requested NIA (as set out in Table 16).

Table 16: Business Quality Assessment - reduction to NIA awards

Company	**Adjustment to NIA award**
Cadent	-13%
NGN	-22%
SGN	-56%
WWU	-9%
NGT	-22%
NGET	-11%
SPT	-9%
SHET	-20%

Scope

Future of gas

10.14 In our SSMD, we noted the ongoing uncertainty regarding the future of the gas network - specifically how much (and which parts) might be retained, repurposed (e.g. for hydrogen) or decommissioned in the future. While hydrogen will play a significant role in the energy transition, its precise role remains uncertain. We also note there is the potential for overlaps with other funding mechanisms, including DESNZ's Hydrogen Transport Business Model (HTBM). As such, our SSMD decided that RIIO-3 should not fund further development of hydrogen transport infrastructure - since this can be supported through the HTBM - nor should it support further evidence gathering for hydrogen heating or blending until after government policy decisions are made in these areas. Should the government decide to proceed with hydrogen heating or blending, any associated costs deemed appropriate for RIIO-3 funding could be considered under the net zero UMs set out in Chapter 6, rather than through the NIA.

10.15 We have adjusted all networks' NIA requests accordingly. Where work has clear benefits to consumers, regardless of the outcome of government decisions, such as decommissioning or biomethane, this can still be carried out under the NIA.

[42] RIIO-3 Business Plan Guidance, paragraph 3.13.

10.16 The impact of this for each company's NIA award is in the company-specific Annexes.

Providing enhanced advisory services to innovators

10.17 Due to mixed feedback in SSMC responses on our proposal for an accelerator to support early-stage innovators, we continued stakeholder engagement on this matter. We found that innovators face a fragmented innovation support ecosystem, a lack of clarity on network company needs and challenges accessing past learning, making it difficult to engage network companies to access funding. Network companies noted that they often lack the expertise or resource to support early-stage innovators, and that misalignment between network company needs and innovator expectations can hinder project development at the ideation stage.

10.18 Therefore, we propose to use an initial £2.5m of additional NIA funding over the RIIO-3 period to create a central, 'one to many' advisory service to early-stage innovators. This service, offering advice, training and collaboration, would be freely accessible to all innovators. The aim is to enhance existing services, involve all networks, and improve awareness across the energy innovation ecosystem.

10.19 We propose that the initial £2.5m is funded collectively by each network company, in proportion to their NIA award. We will work with network companies and innovators to consider how this is used and gets allocated. We will have a role in the governance and oversight, and will work with networks to delegate activities to an expert delivery body. We will review its effectiveness two years into RIIO-3 and decide whether to maintain, stop or expand it.

Funding design

Improving NIA oversight

10.20 To address SSMD concerns around NIA outputs, including potential project duplication and 'Business-as-usual' (BAU) activities being undertaken within the NIA, we want to increase our scrutiny of how proposed projects meet the eligibility criteria. We intend to have direct engagement with larger budget projects and, where possible, create better links between project findings and Ofgem's policy work. We will also explore additional oversight tools, such as introducing an audit to ensure projects are demonstrating value for money. These changes will be reflected in the updated NIA Governance Document, to be consulted on at the end of the year.

Clarifying reporting requirements and gaps

10.21 Our post-SSMD engagement raised concerns about NIA project reports on the Smarter Networks Portal (SNP) not clearly showing value for money. In parallel, our internal reviews of NIA project reporting on the SNP, also identified significant gaps in companies' reporting. This raises concerns around: companies' meeting their licence obligations; a lack of financial transparency; how useful learning dissemination is; and undermines the ability to scrutinise delivery and outputs of projects.

10.22 To address this, we will explore options to update reporting processes and standards. We intend to provide additional guidance to companies including examples of good reporting and proactively raise poor reporting with companies. We will also consider making funding conditional on companies correcting gaps in reporting. We do not rule out a referral to enforcement to consider whether licence requirements have been complied with.

10.23 Following the SSMD, we reviewed companies' Innovation Measurement Framework (IMF) tables from 2022–2024, which track post-funding deployment. We found gaps in the tables, as well as identified a number of deployed projects missing from these. Such information gaps lead to an incomplete picture for Ofgem and consumers, as to how innovation funding is leading to value for money. To address this, we are feeding into the Energy Networks Association's (ENA) own review of the IMF. We will also require clear demonstration of the value of deployed projects through inclusion of case studies and lessons learned in networks' public Annual Innovation Summaries. We will also explore potential additional ways of ensuring the quality of post-funding reporting and its dissemination.

10.24 Changes to reporting will be reflected in the updated NIA Governance Document, to be consulted on at the end of the year.

Questions

OVQ20. Do you agree with our proposed NIA funding levels?

OVQ21. Do you agree with our approach to the future of gas-related workstreams?

OVQ22. Do you agree that £2.5m of additional NIA should be used to provide enhanced advisory services for innovators at the early stages of innovation development?

OVQ23. Do you agree with our approach to improving oversight and reporting of the NIA?

Strategic Innovation Fund (SIF)

Purpose: Innovation funding to support net zero projects and enable the rapid deployment of proven innovation.

Benefits: Networks and project partners deliver transformative innovation projects that are deployed at pace and at scale.

Background

10.25 In our SSMD[43], we decided to:

- Retain a competitive innovation fund in RIIO-3, the SIF, with similar funding to RIIO-2, to facilitate continued development of large-scale demonstrators, focusing on addressing net zero ambitions.
- Remove the 'Discovery' phase and fund this feasibility study work via the NIA, due to feedback that there was excessive SIF bureaucracy for early-stage projects.

10.26 In our SSMD we also set out our intention to:

- Make the SIF fund more strategic projects, by making SIF Challenges longer-term and evaluating how the Governance could be updated to best enable transformative innovation solving whole system problems.
- Consider potential solutions to deployment barriers, including the merits of a financial incentive for networks to deploy innovation.

Consultation position and rationale

Summary of consultation position

Funding mechanism: Competitive innovation fund.

Funding level: Approximately £500m in SIF funding.

Scope: Continued focus on transformative projects to enable net zero delivery with:

- Greater strategic direction setting through a Programmatic Approach.

- Clearer delineation of work between SIF and NIA.

- £50m of funding for rapid deployment of proven innovation.

Funding Design:

- Retaining the Discovery phase.

[43] RIIO-3 Sector Specific Methodology Decision – Overview Document, see Chapter 12 for our decisions on the SIF.

- Retaining well-functioning core aspects of the SIF from RIIO-2.
- More flexibility in project contribution rate.
- Establishing more agile SIF oversight.
- Updates to eligibility criteria.
- Pathway for transformative projects to receive Ofgem support.
- Increasing collaboration within the innovation ecosystem.
- Addressing gaps in reporting around deployment.

Applied to: GD, GT and ET.

Funding Level

The SIF will allocate £500m of funding

10.27 Based on the current rate of RIIO-2 SIF funding allocation, and the impact of inflation between 2021-26, we propose to allocate £500m of funding to SIF in RIIO-3.

10.28 The final amount will be determined by projects awarded funding and we propose to retain the ability to increase this amount within RIIO-3 to respond to system needs.

Scope

Greater strategic direction setting through a Programmatic Approach

10.29 We propose introducing a 'Programmatic Approach' to innovation that combines the long-term SIF Challenges we committed to in the SSMD with more collaborative delivery, enabling greater collective accountability for outcomes.

10.30 While the SIF has improved sector collaboration, projects remain fragmented and slow to scale, with limited accountability for delivery against SIF Challenges. To address this, the Programmatic Approach will:

- Set long-term Challenges and core innovation targets for RIIO-3, by mid-2026, based on recommendations from a Taskforce that we will establish in the coming months. These targets can be refined during RIIO-3 as impacts of innovation projects are understood and lessons are learned, but will remain largely consistent. In the case of major shifts in policy or markets, we may add or remove SIF Challenges during the price control.
- Establish a lean and centralised function - which will meet at least quarterly - to oversee and coordinate delivery of innovation to meet the targets set by

the Taskforce at the pace and scale needed for the GB's energy transition ambitions.

- Have membership and participation from senior decision makers from networks, sector experts and key market stakeholders who can drive delivery of these set targets.
- Have its outputs presented for evaluation by Ofgem leadership on an annual basis.

10.31 The expectation is that the Programmatic Approach will lead to greater accountability from networks and their partners in ensuring SIF Challenges are met. The design of the oversight and coordination function will be developed in coming months through market engagement.

10.32 To set the long-term direction the sector requested, we will set up a Taskforce before the start of RIIO-3. Its objective will be to report recommendations on innovation Challenges and targets, as well as identify key network licensees or industries needed to unlock barriers or deploy proven innovations during RIIO-3, by mid-2026. The Taskforce Chair will be appointed by Ofgem.

Clearer direction on uses of NIA and SIF to avoid duplication of work

10.33 Stakeholder feedback highlighted that there can be a lack of clarity between the NIA and SIF. We think the Programmatic Approach proposed above will help provide networks and the industry with clearer direction of what projects should be carried out within each fund. Increased direction will also be reinforced within the improved oversight and support for each fund.

Utilising up to £50m of SIF funding for rapid deployment of proven innovation

10.34 In our SSMD, we set out our intention to consider a financial incentive for networks to deploy innovation that delivers benefits to consumers and other network users.

10.35 One key issue we identified was that projects that finished during a price control period could face barriers to deployment, particularly when they did not deliver sufficient efficiency savings to a network to be incentivised through the TIM. This could then lead to delays in deployment until the next price control period, and thus delay benefits to consumers.

10.36 We initially considered either a re-opener or a 'Use it or Lose it' Allowance (UIOLI) to incentivise deployment, but our analysis and engagement with stakeholders identified that neither provided the desired balance of agility and accountability.

10.37 Creating a deployment fund under the SIF framework was identified as a route that ensures both agility and accountability. The fund will be administered by a delivery partner, with similar eligibility criteria to SIF and the use of expert assessors. We propose to allocate an initial £50m to this deployment fund, retaining the option to increase this amount through consultation within the RIIO-3 price control period. The £50m will come from the £500m SIF total allocation.

10.38 To ensure that this deployment fund maintains flexibility and has the most impact, we propose that it will not be limited to SIF projects or tied to current SIF Challenges. Any proven innovation that can demonstrate it has no viable timely alternative pathway to deployment, whether originating from SIF, NIA or NIC, will be eligible. Additionally, we propose allowing other innovations which can show that they are at deployment stage, but were developed through alternative sources of funding, to be eligible. The fund will remain competitive, with projects delivering the most consumer benefit being prioritised.

10.39 We are also proposing to introduce an ODI-F for the ET sector to incentivise innovative delivery of large projects. This could include further deployment of proven innovation. Please refer to Chapter 3 of the ET Annex for further detail.

Funding Design

10.40 The funding design details below pertain to design around Discovery, Alpha and Beta phases only, and are not relevant to the Deployment phase.

Retention of the Discovery phase

10.41 We made the decision in the SSMD to remove the Discovery phase on the basis that there was excessive bureaucracy in applications and oversight for early-stage projects. Our expectation was that this early-stage work would be delivered within the NIA. Since the SSMD, we have introduced improvements to the SIF process to address these concerns within the RIIO-2 SIF, including moving to more frequent application 'Cycles', with more flexible timings on starting and finishing projects.[44] We are also planning on introducing clearer direction on what work should be funded within SIF and NIA respectively within the Programmatic Approach. Based on the above changes and positive market feedback on these RIIO-2 changes, and our planned clearer direction on work within each fund, we now propose to retain the Discovery phase (reversing our SSMD decision).

[44] SIF Governance Document v2 (update of 10 April 2025), paragraph 1.20.

Retaining core aspects of the SIF from RIIO-2

10.42 We have reviewed the SIF's core RIIO-2 regulatory design and engaged industry on it. We propose to retain most of it as we think it is working well. This includes:

- The operating model – the SIF will retain the 'Discovery', 'Alpha' (see previous section), and 'Beta' phases.
- Required industry collaboration and third-party involvement.
- Scope of eligible projects - albeit changes are proposed to how we set the strategic direction and determine the frequency of Challenges (see section on Programmatic Approach).
- Funding via the use of system charges.
- Multiple application windows, currently termed 'Cycles', per year.
- The continued use of independent expert panels to evaluate projects.
- Delivery and coordination of the SIF from an appointed third-party. All decision-making power to remain with Ofgem.
- Continued SIF oversight to ensure value for money and delivery of impact (but with some proposed changes to improve ongoing project oversight, discussed in the next paragraph).

10.43 Our industry engagement highlighted the need for a more agile ongoing project oversight process to reflect changing circumstances. We also identified the need for clearer rules around stopping poorly performing projects. Therefore, we propose to update the governance process to ensure ongoing projects can adapt quickly to change as they are being progressed. We will also look at governance changes to enable us to quickly stop projects that are not meeting their objectives. We will engage with industry in coming months, and make any necessary updates to the SIF Governance Document.

More flexibility in project contribution rates

10.44 We propose to allow more flexibility in the level of the SIF compulsory contribution rate. Currently it is set to a level of at least 10% for all SIF projects. However, we think there is scope to change this to encourage more transformational projects and help SIF funding go further on behalf of consumers. Therefore, we propose to:

- Remove the compulsory 10% contribution rate for the most risky and high-impact projects that benefit consumers exclusively or where the benefits are realised beyond networks. This will be at the discretion of Ofgem and is

intended to remove any financial barrier that could otherwise impede these types of projects.

- Increase contributions for less risky projects and those with significant grid-edge activities. For example, where innovation uses established, low-risk technologies in order to create or expand a commercial market, this should only require limited SIF funding to reflect the benefit to consumers. This will be for projects where either or both networks and third parties stand to benefit significantly, and will be set at the discretion of Ofgem.

Updates to eligibility criteria and assessment process

10.45 We are proposing changes to SIF eligibility criteria and assessment processes to ensure higher-quality, more outcome-focused projects. SIF projects are currently assessed against eight yes / no criteria. While this provides a clear, consistent set of criteria for decision-making, we think we could make improvements to assessment of which projects will deliver greater benefit to consumers. We therefore propose revising the SIF criteria and decision-making processes to allow for more scaled assessments, and to better capture deployment, dissemination and impact.

Pathway for transformative proposals to gain Ofgem support

10.46 At SSMC, innovators and sector bodies reported that network companies can act as gatekeepers to transformative projects that do not benefit them directly.

10.47 To address these concerns, we propose establishing a process for innovators to gain our support in seeking funding. This will involve us:

- Identifying key areas within the Programmatic Approach where innovation is needed to deliver consumer benefit, but this innovation is unlikely to benefit networks directly.
- Establishing a process for third parties to submit project proposals to Ofgem targeting these innovation areas.
- Facilitating engagement between networks and the project proposals viewed as beneficial to the GB energy system.
- Collaboratively exploring funding pathways for these project proposals with network companies, although there will be no obligation to take forward any project.

10.48 The expectation is that this support will bring together networks and innovators to deliver transformative projects and highlight potential funding gaps.

10.49 We will engage the market on the design of this process in coming months, with the process to be set out in the updated SIF Governance Document.

Increasing collaboration within the innovation ecosystem

10.50 Alongside the Programmatic Approach, we wish to explore options for clarifying roles and responsibilities and increasing collaboration amongst parties active in the innovation ecosystem. This would involve better alignment on events, Challenge setting, data gathering and dissemination of learning. The aim of this is to address stakeholder feedback that the innovation ecosystem is unnecessarily complex and fragmented. It will aim to make the most efficient use of consumer money and stakeholder time to deliver consumer benefits at pace.

Addressing gaps in reporting around deployment

10.51 The concerns around reporting of deployed projects post-funding set out in paragraphs 10.21 to 10.24 of this Chapter (on improving reporting within the NIA) are also valid for SIF-funded projects. Companies report on the deployment of projects post-SIF funding using Innovation Measurement Framework (IMF) tables, which are being reviewed by the ENA, and we are feeding in. We also aim for companies to improve their reporting on deployed projects through inclusion of case studies and lessons learned in their Annual Innovation Summaries. We will explore additional ways of ensuring the quality of post-funding reporting and its dissemination.

Questions

OVQ24. Do you agree with our proposals to allocate £500m for SIF funding?

OVQ25. Do you agree with our proposals to introduce a 'Programmatic Approach' to the SIF?

OVQ26. Do you agree with our proposal to introduce a £50m deployment fund, utilising £50m from the total £500m SIF allocation?

OVQ27. Do you agree that the deployment fund should also be open to innovation projects that haven't been funded through NIA, NIC or SIF?

OVQ28. Do you agree with our proposal to reverse the SSMD position of removing the Discovery phase from SIF?

OVQ29. Do you agree with our proposals to retain the core aspects of the SIF for RIIO-3?

OVQ30. Do you agree with our proposals for a more flexible approach to contribution rates to fund SIF projects?

OVQ31. Do you agree with updating the SIF eligibility criteria and assessment process?

OVQ32. Do you agree with our proposal to establish a direct pathway for transformative projects to seek Ofgem's support for funding?

OVQ33. Do you agree on the need to clarify roles and responsibilities within the innovation ecosystem, and the factors that we should consider?

OVQ34. Do you agree with our approach to improving reporting of deployed SIF projects and lessons learned post-funding?

11. Cyber Resilience

Background

11.1 As networks become smarter and more automated, network companies will increasingly rely on interconnected technologies and systems to deliver services to customers. There is a necessity for ongoing investment to ensure network companies' networks and information systems, are adequately protected to detect and prevent cyber-attacks. All network companies are also required to be complaint with the Network and Information Systems Regulations 2018 (NIS Regulations).[45]

11.2 In our SSMD, we decided that all network companies must submit a unified Cyber Resilience Business Plan (CRBP) covering both Information Technology and Operational Technology. We also decided that each network company's totex requests should be funded mainly through baseline allowances.[46]

11.3 To evaluate the network companies' CRBPs, we conducted a bottom-up assessment focusing on the merits of the needs case, deliverability, and costs of each project proposed by the companies.

11.4 Due to national security concerns, we cannot provide further details regarding our assessment of the projects. Our rationale for the proposed Cyber Resilience expenditure (including the balance between baseline funding and the UIOLI allowances) is detailed in confidential annexes that have been shared directly with the network companies for private consultation.

11.5 Cyber Resilience will be supported by the following regulatory mechanisms:

- Cyber Resilience UIOLI allowance - providing flexible funding capped at up to 20% of totex.
- Cyber Resilience PCDs - that align with the Cyber Assessment Framework (CAF), to track delivery of projects that contribute towards CAF outcomes.
- A Cyber Resilience re-opener - enabling potential changes to cyber funding during the price control period.

[46] Subject to Totex Incentive Mechanism.

Cyber Resilience UIOLI allowance

Purpose: Flexible funding for network companies to improve cyber resilience.

Benefits: UIOLI allowances enables companies to undertake small projects where there is a clear needs case, but where the options and costs are unclear at the time of setting RIIO-3.

11.6 We decided in the SSMD that the network companies could request UIOLI allowances for the first three years of RIIO-3. We also implemented a cap of 20% on the UIOLI allowances proportion of the total Cyber Resilience expenditure.

11.7 Collectively, the network companies requested 9% of their allowances as UIOLI. This is reassuring and underscores that investment in Cyber Resilience is transitioning from new and novel projects in RIIO-2 towards routine operations in RIIO-3.

11.8 As with the other allowances, the UIOLI allowances are detailed in confidential annexes that have been shared directly with the network companies for private consultation.

Cyber resilience PCDs

Purpose: We have assigned PCDs to all the Cyber Resilience allowances proposed in the Draft Determinations.

Benefits: PCDs will help us to track delivery of projects that are critical to protecting the energy network and reduce funding if projects are not delivered.

11.9 All allowances have been placed under PCDs. These are redacted from the public as they cover specific outputs related to critical national infrastructure.

11.10 We do not have PCDs for UIOLI allowances as the outputs are uncertain. However, we propose to align reporting requirements for UIOLI allowances with those for Cyber Resilience PCDs.

NIS-R Cyber Resilience re-opener

Purpose: To adjust allowances in the event of a significant change to the cyber threat landscape, significant change in government policy or guidance, or the

emergence of new technology capable of significantly improving cyber resilience.

Benefits: Helps ensure new projects can be funded to enable compliance with the NIS Regulations by improving cyber resilience.

Consultation position and rationale

Summary of consultation position

11.11 In our SSMD we decided to have a NIS-R Cyber Resilience re-opener. We are now consulting on its design characteristics.

UM Type: Re-opener.

Scope: Cyber Resilience activities that support NIS-R compliance.

Number re-opener windows: One mid-period.

Date of re-opener window: 2 April 2029 - 13 April 2029.

Ability for Authority to trigger the re-opener: Yes.

Materiality threshold: None.

Applied to: GD, GT and ET.

11.12 All network companies recognised the need for the Cyber Resilience re-opener we decided to implement in SSMD.

11.13 The proposed re-opener window aligns with the conclusion of the three-year UIOLI allowances funding period. This would then enable network companies with matured UIOLI projects to consider requesting additional allowances for a specific investment project resulting from it. We expect all allowances awarded under the re-opener to fall under PCDs, with no additional UIOLI funding during RIIO-3.

11.14 As set out in the SSMD, we will retain the authority trigger to open new application windows if we decide that there has been a significant change in the threat or regulatory landscape during RIIO-3.

Questions

OVQ35. Do you agree with our proposals for the Cyber Resilience re-opener?

12. Data and Digitalisation

Introduction

12.1 In our BPG,[47] we stated that companies should include a specific section in their business plans related to digitalisation investment and we provided guidance about how investment proposals could be justified.

12.2 We show the total requested expenditure against our Draft Determination position for data and digitalisation in Table 17 below. This excludes miscategorised funding that was requested.

Table 17: Requested and proposed RIIO-3 data and digitalisation funding

Company	Funding requested	Proposed RIIO-3 funding
Cadent	£30.9m	£18.4m
NGN	£9.6m	£9.4m
SGN	£26.8m	£26.8m
WWU	£20.3m	£19.3m
NGT	£260.5m	£197.4m
NGET	£322.5m	£315.0m
SPT	£88.5m	£80.8m
SHET	£222.2m	£175.0m
Total	£958.3m	£854.5m

12.3 The reasons for our decisions on funding for each company is provided in the network company Annexes, and in the GT document for NGT.

12.4 Data and Digitalisation will be supported by the following mechanisms:

- A Digitalisation licence condition, which requires companies to have and update a Digitalisation Strategy and a Digitalisation Action Plan, comply with DSAP Guidance, and to take account of DBP Guidance.
- A new proposed Data Sharing Infrastructure (DSI) licence condition that will require companies to participate in a DSI, once operational.
- A Digitalisation re-opener.

[47] RIIO-3 Business Plan Guidance, https://www.ofgem.gov.uk/sites/default/files/2024-07/RIIO-3_Business_Plan_Guidance.pdf paragraph 6.22-3

Digitalisation licence condition

Purpose: To enable further digitalisation of the energy sector.

Benefits: Companies have increasing levels of digital and data maturity, publish Digitalisation Strategy and Action Plans (DSAPs) that show what progress has been made and what needs to be made, and demonstrate compliance with Data Best Practice (DBP).

Background

12.5 This is based on an existing licence condition that was set up in RIIO-2 and ED2 to increase and enable continuous digitalisation of the energy sector. It sets out licence obligations to have and update a Digitalisation Strategy and a Digitalisation Action Plan, comply with DSAP Guidance, and to take account of DBP Guidance.

12.6 In the SSMD we noted our commitment to further digitalisation of the energy sector and unlocking the value of both consumer data and energy system data.

Consultation position and rationale

12.7 Since its introduction, the Digitalisation licence condition has enabled Ofgem greater understanding, oversight, and engagement with licensees on their digitalisation journeys. This has been done transparently – with information publicly available about licensees' intentions and plans, and how they relate to stakeholder needs. Compliance with DBP Guidance has helped maximise the benefits of data for users whilst complying with the needs of security, privacy, commercial concerns, and serving the public good.

<u>Summary of consultation position</u>

12.8 We consider that network companies must make changes and continuously improve their business practices to achieve the benefits that can be delivered to consumers from digitalisation and better use of data. We propose to retain the approach in RIIO-ET2 with a licence condition that will require licensees to have a DSAP and to act in accordance with DBP when using relevant data. These requirements will help ensure that network companies take specific and transparent actions to continuously improve their use of data and deliver digitalisation benefits to consumers.

Questions

OVQ36. Do you agree with our position of not changing the Digitalisation licence condition?

DSI Licence condition

Purpose: We want network companies to connect to a future Data Sharing Infrastructure (DSI).

Benefits: This will facilitate greater digitalisation and better sharing/use of data, delivering efficiencies and savings to the sector.

Background

12.9 In paragraph 6.13 of the RIIO-3 Framework Decision,[48] we require licensees to participate in data sharing infrastructure, once operational, to enable wider system benefits.

12.10 A Data Sharing Infrastructure (DSI) is a digital infrastructure that comprises the technologies and common data standards to facilitate seamless and secure data sharing between multiple entities. This in turn enables greater collaboration and innovation across the energy sector. In our recent governance decision, we outlined the context behind, and constituent components of a DSI.[49]

Consultation position and rationale

Summary of consultation position

12.11 Connecting to a future DSI involves a variety of technical requirements, that will vary based on the specific licensee and change as the DSI Delivery Body (expected to be NESO) develops the DSI. Given this, we propose a new licence condition that will focus on two outcomes:

- Network companies' deploying a Data Preparation Node, compatible with DSI, by a clear delivery date.
- Adhering to the Trust Framework that will be set out by the DSI Delivery Body.

12.12 The definitions that we propose to use within the licence condition to support the delivery of these outcomes are:

- A Data Preparation Node is a node on an organisation's own infrastructure that prepares data into a minimum operable data standard (specific to each data type and use case), and presents it through standard computer connections, access and security controls.

[48] Future Systems and Network Regulation: Framework Decision Overview,
[49] Governance of the Data Sharing Infrastructure Decision, https://www.ofgem.gov.uk/sites/default/files/2025-03/Governance_of_the_Data_Sharing_Infrastructure_Decision.pdf

- A Trust Framework is a pre-agreed framework which provides participants with accurate risk management profiles, common user attributes, identity management, and pre-negotiated agreements based on use cases. This is intended to establish the user's confidence, right, and legality to share data between parties.
- The DSI Delivery Body is the organisation appointed by DESNZ to develop and/or procure components for the pilot and minimum viable product (MVP) of the DSI.

12.13 The DSI itself is currently under development and may not be fully operational when RIIO-3 licences come into force. We are considering our approach on how this can be best handled.

Questions

OVQ37. Do you agree with our proposed approach to the DSI licence condition?

Digitalisation re-opener

Purpose: A re-opener to allow for the consideration of any further investment in digitalisation infrastructure.

Benefits: To support the further digitalisation of the energy sector that is essential for achieving net zero and delivering more efficient management of the system.

Background

12.14 Data and digitalisation are key to enabling products, new services and interfaces for consumers and industry participants, but there is some uncertainty about the timing and full scope of developments required in this area. This re-opener will ensure that the network companies are able to respond when there is more information about the required developments in their roles and responsibilities.

12.15 In the SSMD we decided to replace the RIIO-2 Non-operational IT Capex Re-opener with a common digitalisation re-opener.

Consultation position and rationale

Summary of consultation position

12.16 We propose that the re-opener will have the following design characteristics.

UM Type: Re-opener

Scope: Investments relating to technological or policy changes and developments that contribute to further digitalisation of the energy sector.

Number of re-opener windows: One.

Date of re-opener window: July 2028.

Ability for Authority to trigger the re-opener: Yes.

Materiality Threshold: Yes (see paragraph 8.45 of the SSMD Overview Document).

Applied to: GD, GT and ET.

12.17 These design characteristics are comparable to the re-opener that we recently introduced in RIIO-ED2. We think the ability for network companies to come forward with an application once during the price control period in 2028 is sufficient because we want to ensure that network companies' applications in this area are timed together for greater efficiency in our assessment.

Questions

OVQ38. Do you agree with our proposed design of the Digitalisation re-opener?

13. Your response, data and confidentiality

13.1 All proposals published as part of these documents are draft proposals, subject to consultation. We will publish our decisions on the RIIO-3 price controls in our Final Determinations later this year. We will implement our Final Determinations by modifications to the companies' licence conditions, after further consultation on licence drafting.

Consultation stages

13.2 Table 18 below sets out the key stages for this consultation and how we will progress from Draft Determinations to Final Determinations

Table 18: Consultation stages

Stage	Date
Consultation Open	01/07/2025
Consultation closes (awaiting decision). Deadline for responses	26/08/2025
Final Determinations (including publication of consultation responses)	Winter 2025

How to respond

13.3 We want to hear from anyone interested in this consultation. Please send your response to RIIO3@ofgem.gov.uk.

13.4 We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

13.5 We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, your data and confidentiality

13.6 You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

13.7 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with

you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

13.8 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

13.9 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

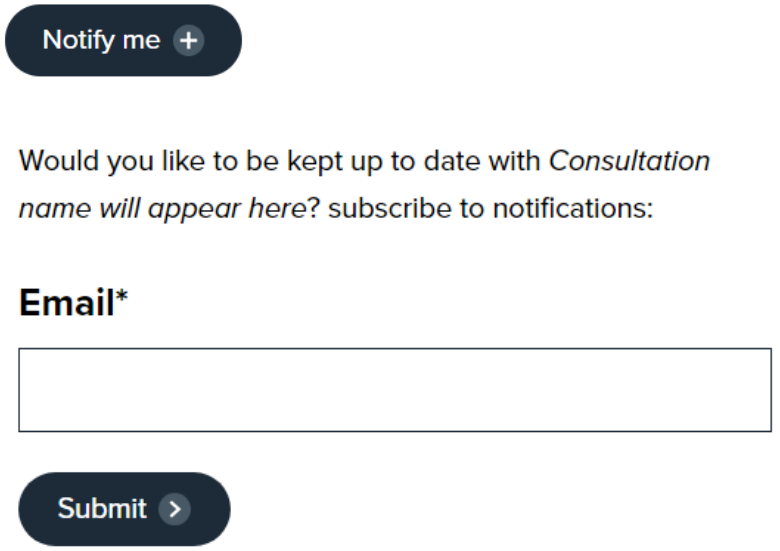
13.10 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Choose the notify me button and enter your email address into the pop-up window and submit. ofgem.gov.uk/consultations



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

Appendices

Appendix 1 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name, address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. **Why we are collecting your personal data**

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest, ie a consultation.

4. With whom we will be sharing your personal data

We will not share your personal data with any other person or organisation.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for 12 months after the project is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete

- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, click on the link to our "ofgem privacy promise".