Minutes

RIIO-3 Investor Call - Draft Determinations

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Akshay Kaul 0:25
Good afternoon, everybody, and welcome to this investor call on RIIO-3 Draft Determinations. And a very good day to you wherever you are calling from, my name is Akshay Kaul. I'm the Director General for Infrastructure at Ofgem and I'm joined today by my colleagues from price control and regulatory finance teams who you will hear from very shortly. Today's call is an opportunity to walk you through the key proposals in our RIIO-3 Draft Determinations which we published this morning. These proposals cover the next price control period, which runs from April 2026 to March of 2031.

I'll begin with a very brief overview of the context for these price controls and some of the key messages, and then I'll hand over to Steve McMahon, my colleague, first who will talk through some of the sector specific detail on funding and incentives, and then to my colleague Rohan Churm, who'll talk through the financial framework. We will then finish with a Q&A session. Mics and cameras will be enabled at your end at that point, and we will explain how to submit your questions. Please also note that this call is being recorded and a transcript will be shared with all attendees afterwards.

Let me start by setting the scene. We are at a critical juncture for Great Britain's energy system. The government has recently approved the largest expansion of civil nuclear power in decades, alongside a major planned growth in renewables carbon capture and energy storage. All of this is aimed at delivering the flagship policy of this government, which is a clean power system by 2030. Now, given our current exposure to volatile and high international gas prices, it is clear to us that moving towards secure domestically produced energy is in the best interest of consumers. We never again want to see a repeat of the bill shock the consumers had to endure when gas prices spiked following the Russian invasion of Ukraine. Our Draft Determination set out the regulatory framework to support the transition to a cleaner power system. Through an upgrade to the electricity transmission network, we have already approved the case for some of the largest schemes through the ASTI programme, with sharp incentives to speed up delivery. All the remaining projects that were identified by the national energy system operator and their advice to government is necessary to meet the clean power goal are now approved to move forward to the next stage. If these projects are delivered successfully, this should significantly reduce the role of gas-fired power in meeting demand. If another gas price shock would hit in 2030, consumers will be significantly better protected. Alongside this major upgrade to electricity transmission, our Draft Determinations also set out the regulatory framework to maintain a safe, resilient and reliable gas supply to households and businesses. Gas will remain a vital transition fuel in the coming decades. The Draft Determinations build on the sector specific methodology decision we published in July of 2024. They apply that framework to propose specific funding, allowances, outputs and incentives for network companies. They reflect the extensive engagement that we've had with stakeholders and the business plans submitted by companies at the end of last year. The documents we published today are open for consultation until 26th August. Now, while each sector faces its own challenges and opportunities, there is a common thread running through all of this. It's very relevant to this call and that is the need to balance risk and reward. We believe that the regime that we're designing is investable. It offers fair returns that reflect the risks the companies take on while protecting consumers from excessive costs. Our financial framework is stable and predictable, which is essential for attracting continued investment into the sector and that investment is vital if we are to meet these clean power 2030 targets. We've also embedded performance-based incentives that companies that deliver will earn higher returns. Those that underperform will see lower returns and we've included safeguards to protect both consumers and investors from extreme outcomes.

Let me now touch very briefly on some of the sector-specific issues in electricity transmission. We expect capital investment to exceed £80 billion over the RIIO period. Some of that investment is being approved now with upfront funding to give companies the confidence to act early, securing supply chains and focusing on rapid delivery. The rest will be approved through in-period regulatory mechanisms once project costs are more certain. To gas distribution and transmission these networks, as I said, remain vital. But as we transition away from natural gas, we are working closely with the government in the future of the gas system, including how best to recover the costs of the gas infrastructure. From consumers in the future, we know that without action, the fixed cost of the gas network risk falling unfairly on a smaller group of future consumers. Pending the outcome of the government's work, which they announced this week, they announced a review of the future of gas this week, pending the outcome of that crucial piece of work we are proposing that all new gas distribution investment is paid back by 2050. This is a proportionate approach to a complex issue, and it aligns with similar actions being taken by regulators in Austria and the Netherlands and in Germany. Finally, our proposals include a set of adjustments to ensure the wider RIIO-3 package reflects the investment environment that companies are operating in while embedding crucial protections for consumers. These include an increase in the cost of capital to reflect higher interest rates, and the greater scale of capital needed and we've included measures to prevent excessive network company gains and shield consumers should substantial inflation increase return throughout this process, we remain focused on delivering value for consumers. We've applied a rigorous approach to test company plans, avoid unnecessary spending and set a strong efficiency challenge for the industry. Our regulatory approach continues to drive innovation to reward efficiency and hold companies to account for timely delivery and collectively, we believe that this will keep costs to the consumers as low as possible. Thank you once again for joining us today and for your continued engagement in this important process, which will run through the Final Determinations at the end of the year. I will now hand over to Steve McMahon, our Director for Price Controls will take you through more details on the overall Draft Determinations, including our key proposals on totex and incentives and Steve will then hand over to Rohan, our Director of Financial Resilience and Controls, who will go through the finance proposals. Over to you, Steve.

Steven McMahon 9:45
Good afternoon, everyone. And just to confirm, my name is Steve McMahon. I'm Director for Network Price Controls and I'm the SRO for the RIIO-3 programme. In his introduction Akshay has helpfully set out the strategic context I think, within which we are publishing these Draft Determinations today. I expect many of you that are on the call have been involved in a number of these price reviews over the years, including RIIO-2, ED-2, as well as some of the price reviews in different sectors. And as said within any of those, there's always a broader strategic context that generally shapes the approach that we take for RIIO-3. Some of those might be recurrent themes we need to or the need to invest more to meet new demands. How we drive a higher quality of service for consumers and how we retain efficiency whilst doing all those new things. In some cases there'll be unique challenges that are specific to the particular circumstances that we find ourselves. And today, what I would say is that going through the RIIO-3 process, there's lots that we agree on with the companies and with investors. As said, we've got a really clear plan on electricity transmission, building a clean power system by 2030. There's much more clarity on what's needed in terms of where we need to go on the scale of investment required. Then maybe if we can move on, please, just on to the next slide.

And we also know that we need to maintain high standards of asset health. That's absolutely critical for resilience now and the resilience of the system as demands grow over time. Again, as I said, look in gas, the plan is less clear in terms of a policy position, but we can start to see now how it's likely to emerge and that will clearly require a much more adaptive approach as we've shown on our position and on strand risk and accelerated depreciation, which I'll come back to a little bit later on and again, just to reinforce that point Akshay made across all of these sectors, we need much more agility in our regulation. We know that we need to adapt our approach moving faster where we can to remove barriers and create more certainty around delivery. And as noted the ASTI regime and the advanced procurement mechanism confirmed earlier this year are two important examples of that. I think overall today we feel that we are setting out an approach that builds the conditions to attract investment. I'll talk through that in a little bit more detail from a policy perspective and then Rohan will say a little bit more just in terms of the financial elements later. Another key element on our mindset is about how we can simplify the processes wherever possible. I think speeding up delivery taken that increasingly sector specific approach given the divergent challenges that we face. And I think that is driving a more distinct approach. A regulatory approach across the three sectors. In terms of next steps, I'll give you a quick overview of the three sectors beyond what I've said already. I'll get into some of the specifics around the incentive packages and then the totex revenues before handing over to Rohan to cover the regulatory finance side. If we move just next slide please.

In terms of electricity transmission, this is where we see the most material increase in scale when you look at that five-year period in totality. Now there's two reasons why we're investing in the sector. The first is still getting the basics investing to make sure that the system is operated and maintained to high standards, ensure it remains one of the most resilient in the world as it is just now. And then that second part and that key driver of growth is the investment that will allow the country to transition to a system that better protects consumers through clean domestic power, and in so doing we help achieve the government's clean power plan. That's the key thing about moving away from the volatile markets and getting a bit more stability in the system. The system operator, NESO has how we get there and the projects that are needed and RIIO-3 for us is not about relitigating that and standing in the way the way of the scale and pace of investment needed to maintain those resilient standards and to meet that clean power mission. But the key point is all of this still needs to work for consumers. We still have to carefully manage costs. And we need to drive efficiency. We need to make sure that the companies can keep their promises around delivery, maintaining that those high standards asset health I talked through and also ensuring long term value from all the investments that are made. We're not just investing here for

2030. This is part of our trajectory on to the next decade and through to 2050. I think we still have a job to do and where there are still gaps then we've been very clear with the transmission owners in that sector, what the issue are, and what's needed to resolve it. And I'll come back to that a little bit later. And just turning to the gas sectors on the next slide please.

Firstly, around gas distribution, we continue to rely on these networks as a source of heat. We know that there's going to be a move away from natural gas over time and any net zero pathway, but the scale and speed of that still remains uncertain. In the meantime, we have to invest in the networks to make sure they deliver safe and secure supplies of gas for as long, frankly, as people need them. And I would say there's much more stability and our regulation of this sector, the design of the price control and how we expect investment and revenues to track over the next five years, around half the proposed allowances relate to the repex programme, the replacement programme, which is obviously linked closely to delivering the remainder of the health and safety executive mandate, mandatory programme out to 2032. Again, the next five years are critical in terms of moving towards finalisation of that phase of the programme. That's essentially safety driven asset health investment and our focus therefore is ensuring that this is delivered efficiently for consumers. And as said, that is introduction. The other big policy question is around the handling of strand and risk. That's something we've engaged extensively on since publishing our method decision last summer. We've had direct engagement with investors and today what we are setting out is something we consider to be a balanced but proactive decision on the approach that we'll take, which we think is consistent with both the feedback that we've received and the options that we set out in the method decision last year. Accelerated depreciation is one part of a much bigger policy question around a controlled transition away from gas. And as we look forward to working with government as part of their ongoing policy development and as I said yesterday, ministers published their update to the market and that includes a call for evidence on network investment and cost recovery. And late 2025, we would consider the implications that process very carefully and reflect on our regulatory approach as necessary. But in the meantime, we've acted sensibly to address the issue of strand and risk in this evolving policy context. Next slide please.

And gas transmission is in a slightly different place to gas distribution, I think recognising the key role it plays from a security of supply perspective and increasingly as a back-up source of power and the clean power system using the gas fired power stations as backup for low end, low solar rays, the national gas plan included a significant increase in resilience related spending. Largely asset health investment to manage risk and substantial investment of cyber and IT systems. And we also recognise the natural gas transmission system is a adaptive to accommodate growing LNG flows, which move the system design away from the traditional North South flows to more east to west. Again, there's a lot we agree on with national gas, a key issue there is mainly down to how mature some of the optional and whether the scale of spending proposed is deliverable in practice. Again, some challenge that we're pushed back on that we work through the consultation process. Just moving on to incentives.

Next slide, in ET electricity transmission. The scale of what we're doing and accepts the context for how we are balancing risk and reward through the incentive package, we are supplementing the existing incentives that have worked over which the main one is focused around the reliability of the network. And then there's new and strong incentives on delivering new capacity projects to clean power on time and connect a new generation to the network. Specifically, the design of the CSNP-F delivery incentive has drawn heavily from the ASTI arrangements, similar to that, companies will face penalties for late delivery of schemes, but we are allowing a one year grace period before penalties kick in, and we're also counter balancing the risk of penalty with an immediate reward for on time and even earlier delivery could see TOs earning a maximum reward that is twice the size of any corresponding penalty. We're also seeking views on a new innovative delivery incentive to encourage TOs to really stretch themselves and the early design stage of a project to reduce its overall cost and delivery programme. We think this needs to be sufficiently strong to drive the innovation required, and we are setting out today that could be up to 100 basis points of rewards only. That's something that we're consulting on with a view to confirming that Final Determinations. But we see that as an important part of the overall incentive pack. Very closely linked to the things are some of the more material challenges that we see on the system around new technologies dynamic line weightings and smart wires. How we better approach outages, how we deal with strategic demand connection, some of the key challenges that are facing the system and that's something that we welcome further engagement on. I would say in gas there's more consistency in the package. Again, from RIIO-3, focusing on and incentivizing the things that matter most to consumers and network users and retreat, retaining strong incentives on efficiency through the totex incentive mechanism. And I think just to confirm on the totex mechanism, we are proposing an adapted approach for electricity transmission just to reflect that overall scale of investment that we are seeing and to look at that balance, I think around delivery and how we maintain robust controls on cost. That's something that we are consulting on. But back to GD, with the key ones are customer service, safety interruptions, collaborations on street works to minimise disruptions and then a new incentive on the percentage of repairs that they do for non-emergency gas escapes within seven and twenty-eight days, which also helps with the environmental side. And finally on GT, we've got a range of measures that are focused around system operation, environmental performance and service standards which again are broadly consistent with RIIO-2. Now just going back to revenues. Next slide please.

What we're saying today is that the total investment in the RIIO-3 periods, all sectors covered by the RIIO-3 programme, could be £100 billion, but you see that we're only settling around 1/4 of that now. In terms of headline numbers, after exclusions, the total company submitted cost for all sectors was £32.7 billion. We're currently comfortable to settle £24.2 billion of that, a reduction of eight and a half billion or 26%. Now just to be really clear, that doesn't mean to all of these revenues disappear. I think in the documentation we've clearly set out the drivers which broadly fit into three buckets. The first is efficiency - our scrutiny through benchmarking and technical assessments of unit costs and applying an efficiency challenge, the scale of that will vary across each sector - and gas, for example, there may be more instances where we disagree on the need to deliver a project. The second is where we need to do something or where the need to do something is accepted, but we might not yet be comfortable on the scope or deliverability. If I take electricity transmission in particular, this is a key example of when we need to make sure we're investing or make sure that investing in the short term for clean power delivers long term enduring value for consumers. These are not costs that are being disallowed more than additional clarification is sought on areas where we're not yet comfortable and those have been clearly signposted, as Jamie said, in this material today to you all we would class this as an evidential rather than efficiency component, and that clearly is subject to the information coming back. Then there can be movement in that. We've said what we think the problems are and those relevant parts and what information we need to solve it. Last but not least, there's a more conventional reason where we think funding may need to come later once there's more certainty in the scope and cost of a project. There's a lot of emphasis on the need for us to simplify price controls and settle more upfront. We understand that there's been various reports and recommendations to that effect, and in a RIIO-3 context most of what you see coming in period is driven by the companies themselves, specifically on that pipeline and electricity transmission. The argument from the companies is that we need to see more maturity in the scope of those projects and more certainty on the costs before we start to settle on the price that's factored into the price control. That's really a quick summary, I guess just in terms of wrapping up before handover to Rohan in terms of what to expect now between Draft Determinations and Final Determinations, we engage obviously constructively in the consultation process and will continue to be driven by the data, the evidence and the information that comes back, as well as wider changes in the market. Now obviously I've spoken in areas like totex where there is that evidential challenge that we've put down and as I said, look, if we get the information there, then we feel that they can, we can set all these revenues by Final Determinations. We've also set out where we think the overall incentive package can evolve, particularly for that delivery incentive in ET and building on some of the original proposals that the companies had set out in their business plans, in other areas we haven't held anything back. I'll now hand over to Rohan who will cover the financial framework proposal.

Rohan Churm 25:33
Thanks, Steve, and thanks everyone for joining today. For those who I haven't met before, Rohan Churm to financial residence controls and I'll take you through the financial framework underpinning the RIIO-3 draft determination. As Akshay outlined, we're at a very pivotal moment for the energy sector, delivering the scale of investment needed requires regulatory framework that is both stable and predictable, and our financial framework is designed to be that in order to attract the capital the sector needs, while ensuring consumers are protected and value is delivered. I'll start with the key headlines of our financial framework and how we've thought about this application in RIIO-3.

So we do focus on giving investors stability and predictability. You will have seen our proposals at earlier stages in the sector specific methodology consultation in 2023, the sector specific methodology decision in 2024. Today's proposals build on those earlier publications, in turn, we believe that stability helps give consumers the confidence in the sector and the decisions that companies and investors take. We have carefully calibrated our financial parameters and this framework represents an attractive investment proposition, we have set out balanced and competitive cost of capital allowances. These are higher than the RIIO-2. Investors are fairly compensated for inflation impacts and there are performance incentives that can be earned. We also ensure that our framework encourages investment that genuinely delivers for consumers. We're progressing proposals around debt allowance modifications and financial resilience measures that are intended to protect consumers from unnecessary risk.

If we move on to the cost of equity - here we are using our three-step approach which will be familiar to many of you. We've updated our cost of capital assumptions to reflect current market conditions, particularly the higher interest rate environment and our proposed real cost of equity is 6.04% at 60% gearing and 5.64% at 55% gearing. These figures reflect the same asset betas and so are equivalent on a like for like basis. Allowed equity return is very close to your average expectation based on the 55% gearing assumption you used, that is obviously testament to the very impressive analytical capabilities of those of you that took part, but I would also argue highlights the predictability and transparency of our approach.

Our starting point is to use the CAPM approach for setting allowed return. The risk-free rate - we have used a 20-year index link gilt rate which as of March 2025 gives a rate of 2.01% which includes an inflation wedge of 0.1%. For reference, because that will be a parameter we update as the market evolves before Final Determinations, that same approach yesterday gave 2.06%. Our total market return rate of 6.9% has been set using ex-ante and ex-post data in line with UK regulators network guidance. As signalled in our SSMD, we are including additional comparable European companies in estimating the beta, which leads to a higher asset beta -0.375 compared to 0.349 for RIIO-2.

Overall, this leads to a competitive allowed return from step one in our approach. We will note that the only driver of the difference between gas distribution and transmission networks and electricity transmission is the gearing assumption - the asset betas are identical. So, step two in our approach involves cross-checking our return to other sources and assessing whether companies are investable. We set out in our SSMD last year that we would formally introduce the concept of 'investability' to test whether returns are sufficient to attract and retain capital. Whether any further adjustments to equity returns are needed beyond step one - reconsider that after updating for high risk for interest rates and increasing the asset beta in step one are allowed to derive from step one is attractive and sufficient investors will receive a competitive equity allowance, additional regulatory asset value indexation for inflation, plus further incentive returns if companies perform well. Likewise, we see no evidence to warrant further adjustments at this point in step three. If we turn on to the cost of debt, next slide.

Many things are the same as RIIO-2, but there are some key and important areas where we are proposing to update our approach. Previously our allowance was fixed fully in real terms, while in RIIO-3 we will be setting a semi-nominal allowance. The motivation for this is to avoid consumers provided an allowance link to inflation. By the associated costs firms faced not inflation linked because of the widespread use of fixed rate debt. We believe this provides better alignment of the allowance to fair costs when inflation deviates from a long run assumption. This also results in more company revenue upfront, but it removes a proportion of the regulatory asset value indexation, so reduces consumer costs over the long run in absolute terms. Given the very significant RAV growth in electricity transmission and the typically higher interest rates for new debt issuance now that global interest rates have risen, we are also waiting the trailing averages against RAVs on a company specific basis to better reflect in each case the scale of additional debt issuance needed. RAV waiting also provides stronger assurance that the allowance remains aligned to efficient costs of market-based change. For the gas sectors based on observed data, we are also assuming a 25 basis points increase above the benchmark of the costs of raising new debt. All of these changes do make it a bit harder to interpret the headline WACC allowances, which are now semi-nominal, and I'll go through those on the next slide.

The proposed allowances here for debt are 4.45% for gas distribution and transmission, and a bit more than 1% higher as an average for the electricity transmission sector. Behind this is an index link debt assumption of 30% for the gas sectors and 10% for electricity transmission. This means for gas the debt allowance is 30% real and 70% nominal. For electricity transmission, 10% is real, 90% is nominal. We are also proposing a change in the benchmark interest to an average of the iBOXX A and BBB,10 plus maturity with a 14-year trailing average as we think this benchmark is likely to result in closer alignment of the allowance to efficient costs due to changes in market rates. We've applied a fixed calibration adjustment of 60 basis points for gas and 45 basis points for electricity transmission to the benchmark. So, the expected allowance broadly aligns with forecast average efficient debt costs. The overall main allowance incorporates the impact of the 25 basis point premium for new gas debt I mentioned above. Our additional cost of borrowing allowances are 25 basis points for gas and 19 basis points for electricity transmission. Compared to RIIO-2 this means the allowance unchanged for gas while it's reduced by 6 basis points for electricity transmission.

So bringing together debt and equity on the next slide alongside a notional gearing assumption gives us a weighted average cost of capital. The notional gearing assumptions are unchanged from the RIIO-2 as trailed in SSMD. Given other changes made, we do not think it is appropriate to continue with the Flat WACC adjustment made in RIIO-2. This slide shows semi-nominal allowances alongside real and nominal allowances, assuming 2% inflation. For a like for like comparison to RIIO-2, I would probably encourage you to look at the real WACC allowance, but I would then make three points: first these returns are high, this broadly reflects higher global interest rates and the higher asset beta, including European comparators. Second, the WACC allowances for electricity are higher than the gas, this reflects the higher cost of new debt to historic debt and the much greater issuance of new debt in electricity transmission owing to the size of the capital programme, as opposed to a higher marginal return on a unit of debt in electricity. Third, the difference in WACC allowances increases significantly once you move to semi-nominal space driven by the lower index link debt assumption for electricity transmission, but because the gas companies will receive inflation indexation or the greater share of the regulatory asset value, that does not show up in either the fully real or fully nominal estimates. So, while the semi-nominal allowance is the in-year cost of capital, part of the return that companies will receive, I would encourage you to also consider the other metrics when comparing relative returns across sectors or companies. I mentioned earlier that performance incentives will provide scope for companies to earn additional returns through strong performance for consumers, while penalising underperformance, and our financial framework aims to balance risk and reward, which can be seen in our published return on regulated equity ranges which reflect this balance. They will continue to provide scope for high-performing companies to earn additional returns while ensuring that underperformance, should it occur, is appropriately penalised.

But also maintaining our return adjustment mechanisms from RIIO-2 - these help to share the impact of unforeseen events, protecting both consumers and investors from excessive gains or losses completely risking control. You can see the thresholds in the chart as the dark diamonds. There is a ± 300 basis points primary threshold, providing a 50% primary adjustment rate and a 400 basis point secondary threshold providing a 90% secondary adjustment mode. Just as a reminder, we exclude financial performance when calculating the return adjustment mechanisms. We believe this framework offers a good balance - it supports the scale of investment needed, rewards efficiency and delivery, and protects consumers from unnecessary costs. Maintaining an investment-grade credit rating is essential to keeping borrowing costs low and ultimately reducing the cost to consumers of the investment we need. Similar to RIIO-2, we have taken an ‘in the round’ consideration of debt finance ability. Taking into account the impact of the price control overall, including totex allowances, allowed return, notional gearing, RAV depreciation and capitalization rates, we have chosen for RIIO-3 to target credit quality on a notional efficient basis, consistent with at least the Baa1 or BBB+ rating.

From our assessment, gas distribution and transmission networks are considered financeable on a notional efficient basis at 60% gearing. Electricity transmission - given the large capital programmes that need to be delivered in RIIO3, we have decided to adjust the bucket two capitalisation rates from the natural rates close to 100% to 85% to support financeability. Bucket 2 contains all non baseline spend such as those covered by uncertainty mechanisms, which includes the allowances for major new multi-billion pound network upgrades such as those funded under ASTI. We consider that the electricity transmission networks are financeable on a notion efficient basis 55% gearing following this adjustment and to note that a qualitatively similar adjustment was made in RIIO-2 but this impact is much larger in RIIO-2 given the scale of the spend in bucket 2.

Last but not least, protect consumers and indeed, investors, from the risk of financial distress we're proceeding with our financial resilience proposals as set out in SSMD. Just to remind you of those, companies must maintain more than one investment grade rating, making it harder to rating shop, we're introducing a distribution lock up if gearing is at 75% or above, and we require an extended version of the existing certificate of resources which will show the licensee have sufficient resources to cover the entire price control period or a minimum of three years ahead. These measures are designed to protect the sector and consumers from moving towards a place that it isn't currently in. In fact, we would expect these measures to have zero impact in the central case in most scenarios, but it is important to protect against the scenarios that we would not want to be in. That means we see them as very low cost and prudent way to protect consumers from those tariffs. And finally capitalization rates and asset lives, we are not aiming off the natural capitalisation rates for gas distribution and transmission. The natural capitalisation rates for electricity transmission bucket one spend are also natural with 85% of bucket two which I mentioned on the previous slide. We have an unchanged 45-year asset life assumption for electricity and gas and we have an assumed asset life to 2050 for all new gas distribution in period investment.

To conclude, our financial framework is stable, predictable and fair. It will support the equity and debt raising needed to deliver a cleaner, secure and affordable energy system, while ensuring that consumers are protected. I'll hand back now and I'm happy to answer your questions during the Q&A.

Akshay Kaul
Thank you, Rowan. Thank you, Steve for that overview. We'll go into Q&A now. And if you can just raise your hand on the Teams call. And then in order I will draw each questioner in. We already have some early hands up and we'll start the Q&A with Pavan Mahbubani. Pavan, please go ahead.

Pavan Mahbubani (JP Morgan) 41:01
Thank you, Akshay, and thank you team for the presentation. This is Pavan Mahbubani from JP Morgan. I have two questions please. Firstly, on totex allowances for T3, I appreciate that there's a lot of focus on baseline and that there's a significant proportion of projects funded under ASTI

being agreed outside of this price control process. But you know, for example, looking at the chart in your slide taking SSE and as an example, the totex is showing £32.3 billion. It actually looks, unless I'm mistaken, higher than what they asked for last December. And those are the numbers I'm seeing reflected in the financial models, so I guess I'd like to know, will we get a bit more granularity or clarity by December on how much is likely to be funded? Are there any projects that look unlikely to be delivered by 2031 or does that depend on the companies, that's my first question? And then my second but related question is looking at items linked to totex and linked to RAV growth, two things come to mind. Firstly, your financeability assessment - is it your intention to ensure that the companies are financeable all in? Again, with the SSE example, are they financeable in your assessment? Using that £32 billion? And then on the RAV weighted cost of debt, does that vary based on the out turn RAV growth or is that set ex ante? Those are my questions. Thank you.

Akshay Kaul 42:22
Great questions, Pavan. So I think let's start, Steve, with you on the totex and I'll bring Rowan in on the finance questions.

Steven McMahon 42:25
Thanks, Pavan. Just on totex, I think if you look at electricity transmission, I mean the numbers that we are publishing today are consistent with the business plan asked. Clearly, we have to go through a process of normalisation just to make sure that we are assessing from the right starting point and that the assessments are applied consistently across all of the companies. There was a slight difference in terms of how each of the companies have approached that I think in the business plan. Now in terms of the balance that you've got between baseline and the combination of pipeline and uncertainty mechanisms, that's not really driven by us. The pipeline investment across the 3 TOs reflects the fact that there was very little capital investment load programmes I think in their baseline ask, that's not going to change between now and Final Determinations in December. So you're still going to be in a world where we'll settle an amount up front, but you're still going to have a reliance on the in period mechanisms for the majority of those load projects that are not picked up. So any change in the baseline totex allowances between now and December go more towards obviously if there was any change in our efficiency, the companies have all of our data and will be interrogating each other's data to make sure that we've benchmarked those costs where we can benchmark appropriately, but also more importantly, the evidential challenge for some of the companies in particular. Now I'm conscious that that does not apply across all of the TOs, but having the clarity and information on those and spending areas will

allow us to make a more robust decision at final determination, so that's going to be the totex picture I think for ET getting into final determinations.

Rohan Churm 44:20
And there's a really simple headline answer to your financeability question, which is 'yes', and the base case testing that we're doing is assuming the full spend. So, it's a clear 'yes', but I'll just let Stefan add a bit of colour to that.

It's an excellent question. so as Rohan just articulated, the base case includes the full pipeline. Everything that you saw on that slide and actually in a change from ED, our higher case now is for ET 5% on top of that. So, it's in a way, it's even more severe and for gas, it's 10% on top of that sort of base case that's already there.

Thank you, Stefan and Ron, and thanks, Pavan, for that question. Let's go next to Mark Freshney.

Mark Freshney (UBS) 45:13
Hello. Thank you for taking my questions. Just some further clarity, if I may, on the financeability testing, just to be clear, the BBB+ includes the £22 billion-odd equity that you are forecasting going into the bit, or allowing to go into the business should I say? And also what kind of dividend yields or dividend assumptions are you making in that financeability testing? And then secondly, just a theoretical question. You're assuming more cash flows, right? The semi-nominal versus the real return adds about 100 bips to what companies actually get, which is 1% of RAB, which has a material positive impact on earnings because it all drops through the income statements. And I was just wondering if you even if it wasn't in the document in the finance annex, whether you had actually considered what adding 100 bips to returns might do to the required cost of capital. Thank you.

Rohan Churm 46:34
Thanks. So, I think, you know, to take to take a step back. We run a lot of the processes like step one and step two of the CAPM process, and we get natural capitalization rates and asset lives and then we've run the financeability assessment, and we consider what aim offs or things might be needed. You're absolutely right that when we do that modelling, we do assume equity raising and dividend pay in line with our published model and we've maintained the dividend yield assumption at 3%. We recognise that there was an argument that, with the very significant compound asset growth being seen that dividends could be lower with the returns coming in

future but actually we've recognised that this is a sector where there's a lot of investors who do value that income and they value that consistency of dividends. So, we've maintained that dividend yield assumption at 3% despite that quite changed growth outlook. So that I think answers that bit of the question. On the sort of fixed rate debt assumption, that wasn't a change we made because we did the financeability assessment. We made it for the reasons that we've sort of consulted on previously and I set out in the introduction. Consumers were sort of fully indexing and ensuring that the price control for all investors in terms of inflation. The revealed preference of companies, and a number of investors, would not to need that and protection with the amount of extra debt issued, the cost of providing that protection was obviously painful for consumers during the period when inflation rose.

So essentially, you know, in a symmetric way we've reduced that so the consumers would not be on the hook or make a gain should inflation go below next time so that that change was not made as part of the financeability assessment, but of course you're right that it has had indirect effect that going into the financeability assessment of, all else equal, improving the conditions and that is a material effect. And so something that is taken into account in the financeability assessment. Stefan would you like to add something?

Stefan Blanchard 49.17
I just wanted to because I think that the essence of the question is obviously there's a stimulative effect on the credit ratios. But we've run the testing as if that never happened as well and they're still financeable with the package we propose. So, if rating agencies, for example, refresh their guidance in response to that policy change, there is a bit of a chicken and egg dynamic going on, we still think that the package is financeable even in that sort of most conservative case. I guess on the equity raise assumption, we consider this to be very reasonable and again that the package we've done the assessment, and we think it's investable. It's worth noting that the companies get this 5% equity issuance allowance for the assumed equity issuance and that's been conducted. So, giving them the cost coverage to go out and raise that equity, and then when you put it on top of this package, we think it's a reasonable expectation that these companies will be able to raise the required equity that's as modelled in the financeability assessment.

Mark Freshney 50:21
Thank you very much.

Akshay Kaul 50:21
Thank you. Thank you, Mark, for that question. Let's go next to Dominic Nash.

Dominic Nash (Barclays) 50:28
Hi there. I hope you can hear me all right and thanks for your presentation. Can I ask three questions please?
The first one - I was intrigued in your document where you're basically saying that the bill impact for electricity transmission is plus 52 pounds. Sort of primary impact, but you then basically say that there are two areas that the bill impact will actually go negative 25 pounds for wholesale costs, but also 55 pounds for the average bill on constraint cost reduction. Can you just give us a flavour as to what proportion of total constraint costs you think this extra transmission will remove and does that mean that zonal power pricing is or isn't in your assumptions for the constraint cost removal? And the second question - I think you always get asked this, as does Ofwat all the time, which is comparing you against the water numbers. I think the key thing that comes out here is your asset betas are significantly higher than in the water sector, which basically means that you're thinking that they are higher risk than the waters, yet you've also dropped waters from the iboxx indexes, which implies that waters are probably higher risk than the power names. The second question is then do you think that power networks are indeed higher risk than water? Or do you think there should also be a super national sort of consistency, maybe in setting cost of capital? And the third question - just a simple one here. SSE came up with a response this morning, which was quite interesting, saying why does the cost of capital fall as gearing goes down, which is a very good point. Anything I can see here that I think the debt beta is probably calculated incorrectly and it implies 40 bips of pickup in from risk free when you probably need 130 to 140 bips. So, I just wanted to know why you think WACC should be falling as gearing goes down? Thank you.

Akshay Kaul 52:30
Three really good questions. I'll just cover off your point about zonal pricing first and then I'll hand over to Steve for the breakdown. In terms of the bill impacts, we haven't made any assumptions here about REMA zonal pricing bringing down constraints. What we're doing is simply modelling the effect of increasing the grid capacity primarily between Scotland and England on the reduction in the constraint costs that are currently being endured by consumers and will grow as we go through this decade as more and more renewables connect up in Scotland and there isn't sufficient grid capacity to send their power down to England. So the big chunk that you pointed out of the saving in constraint cost is actually avoiding an increase in the constraint costs as we go

through the decade, but we haven't made any assumptions about where the government goes on market reform or zonal pricing. But Steve, do you want to come in on the bill breakdowns and then I'll bring in Rowan again on the finance.

Steven McMahon 53:28
I think it's a good point, Dominic, and we've tried to be really, really, I think honest on the course. So, we know this is the increase in network charges from the investment decisions that we're taking through RIIO-3 but through the impact assessment, we've also looked at the likely benefits within a range. But what is a reasonable spot estimate within that as you pick up, if you look at even the total electricity component, is like 74 pounds of 104 but there is a chunk of that that we would be doing in any circumstances. So, what we are looking at is 52 pounds based on the acceleration of the delivery that the major projects for clean power. Now if you look at the benefits, we are guided by the NESO's numbers on that. So, at the start of June, they published the latest update on annual balancing costs. I think the numbers at the moment, so it's about £2.7 billion in system balancing costs. So the top highest risk number is it if you had no network investment, so you had the network that we've got at the moment, then no system balancing costs go over £13 billion. So that's obviously a significant increase from where we are now. If you take the 80 projects identified by the NESO, those are expected to reduce them down to around about £8 billion. But if you get some acceleration in those projects, so i.e., we assume that all of those projects are delivered by 2030 there's a further £4 billion benefit. And so we have worked our impact assessment off of those numbers. So it's directly based on the NESO's numbers and then that scenario where we deliver all of these projects, the total system balancing cost would be £4 billion as opposed to the over £13 billion. I think that's the simplest summary. But you can refer back to the publication from early June if it if it helps.

Rohan Churm 55:26
Thanks Steve. So, I'll do an introduction to your second question. I'll pass to Stefan to say a bit more and then I might ask you to just repeat the third question plus Dominic, to make sure we answer it.

I mean at a headline level. I think one of the points we're making in the finance annex, is that where the costs of equity and debt are determined at different times and they don't necessarily appear consistent in the whole structural way as they would be if it was determined simultaneously, and I guess without any judgement at all on the water equity betas it it's very clear that some of the idiosyncratic factors, in some water companies, debt costs are having an outsized effect on the index that we were using. And so it's that that has necessitated the shift. But of course, we have adjusted the calibrations around the new index to sort of make up for that. But I'll turn to Stefan.

Stefan Blanchard 56.33
I's a really great question Dominic. I'd say, as Rohan's mentioned, we sort of switched the index to make the index in a way more representative, of how energy on energy networks that costs might change throughout the price control period and because utilities is more affected by the ongoing sort of individual issues of water, it means that it might move in a way that's not reflective of our energy network. So it's to do with more that alignment, I guess if you were to compare the debt assumptions, which is an interesting premise, so the way Ofwat I understand do it is that they've got a new debt assumption which is again based on this average of the same as what we've moved to the A and BBB non-financials, but they've assumed that water companies are issuing 30 basis points. I think if I recall correctly again. Forgive if I'm wrong about Ofwat's determinations. 30 basis points for the benchmark, whereas we've assumed that ET companies are issuing in line with our benchmark. So I guess that's 30 basis points lower and then for the gas companies, it's 25 basis points. So, it's not really related to the switch of the index is not really related to sort of that that risk dynamic that you pointed to. Don't you have a third question?

Dominic Nash 57:56
A simple one. How does WACC, why does your WACC fall when you move from 60% down to 55% because your debt beta is either wrong or your fair value debt adjustment for the embedded debt isn't being accounted for in the lower levered company. I think it's what you're probably doing, all things being equal, I would have thought the WACC would have remained the same. So, I think SSE might have a point there.

Rohan Churm 58:29
I think we might want to get back to you and pick this up bilaterally. Clearly one of the things we have done this time is created these different weights on different forward-looking and backward-looking debt assumptions in companies' specific allowances and clearly given the big differences between the forward-looking costs and back-looking costs and how different they are to the cost of equity that then results in, you know, some differences on the WACC that are necessarily reflecting the underlying sort of risk judgments that are going into marginal unit. But perhaps we can pick this up and bilaterally just understand the exact example that we're going to get back.

Dominic Nash 59:22
No worries. Thank you very much.

Akshay Kaul 59:25
Thanks, John. I think let's go next to Deepa Venkateswaran. Deepa, please go ahead.

Deepa Venkateswaran (Bernstein) 59:32
I have two questions. The first one, and all the questions are focused on ET. So, on the fast money ratio, in your consultation, you basically say that in order to improve financeability, you're allowing 85% capitalization for anything beyond the baseline and the baseline number capitalization is again very significantly different. So what ends up happening is if you have a company with a lot of baseline, very little growth CapEx, it has a higher fast money than a company the other way around and the more CapEx you add on uncertainty, the lower the fast money ratio is, which is the purpose of what you're trying to do. And so, I wanted to understand what was your thinking and how come the baseline fast money issues have moved so much? I mean since RIIO T1 started, we've been looking at roughly 85% for those items and you know, last time it was 80% or even slightly below 80. So, I was just wondering how numbers have moved around. It's kind of creating a perverse incentive, so I wanted to know your thoughts and would you consider restructuring it in a way that it actually delivers what you wanted to do, which is help those companies. And I also note that many companies didn't even want such high fast money ratios in their business plans. Some of the slower growth companies didn't want that high. So that's the first question. Secondly, on slide 17, I guess one observation and one question. So, for an investor who has the option to look at ET GD GT all three, what this simple chart will say look in gas distribution and transmission, there's lower risk from anything going wrong with high investments. You get a pretty decent allowed return of 6% and the RoRE ranges you know, with totex being fairly easy in that sector, gets you [inaudible]. On the other hand, with ET you start with a much lower allowed cost of equity and then there is this pretty uncertain ODI potential common impact which could give you the top end. But it only then gets you to 8%. So what is the incentive really for investors to put £4 billion, I mean £80 billion overall totex if you add up all the numbers into that sector, whereas they could, you know, just very easily get similar returns with much lower risk, so I'm not entirely sure that the risk reward balance for ET is actually factoring in that higher level of spend.

Akshay Kaul 1:01:59
Thanks, Deepa. I think those are really, really good two questions, Steve, do you want to start with the capitalization rates?

Steven McMahon 1:02:05
And I think it's a really good question, Deepa, but we haven't adapted that in any way it is the natural rate. I think what you're seeing, it goes back to that point between is the nature of the business plans that we had submitted where you have quite a lot of uncertainty around the capital programme. So, the reality or the implications of that is that in the baseline spend, there's not a lot of load, they are certainly relative to previous price controls. So that will drag down, I think, the natural rate and that split between opex and capex because most of that has been put into pipeline spam, so we haven't adapted that in any way. It just mimics exactly what the companies have submitted.

Deepa Venkateswaran 1:02:46
And will there be any opportunity for the companies to reallocate. I don't know what is the best way but just to make this work as it was intended and probably helps consumers as well if they're slightly less fast money for some companies because they didn't even want that.

Steven McMahon 1:03:03
Well, I don't. Yes, we're not expecting any resubmissions of the plans. I mean, the companies will see our numbers. We did go through a process early in the year to see if they wanted to adapt that based on if any of their investment plan had been more mature. So, just in the early spring compared to where they were in December, what we get is very little in response to that. So, I wouldn't expect that to adapt between now and Final Determinations. As I say, it just reflects the spending profile that's been submitted by the companies where we've made the adjustments as to obviously bucket two and where again in the circumstances are that you've got a much broader range and similar to RIIO-2, all we've done is to say, look, there's a bit of uncertainty around the opex, capex mix on that. So, we went to the lower end of the range. But yes, but it's driven by the data from the companies rather than ourselves. On that first bucket.

Rohan Churm 1:03:58
Just to come in on the second question, I mean. Of course, the cost of equity is applied to a higher share for ET. So that does affect the WACC. But clearly and we're taking an empirical approach to the betas and the assessment of the equity risk. And I think what's interesting when you look at

those companies is that there isn't any clear ranking difference between the betas we're seeing on gas versus electricity. There's a mix and clearly,
I mean, I think you've highlighted there are some, you know challenges for electricity transmission in terms of the build. But of course there's a significant amount of de-risking elements in other parts of the package than the finance angle, including because the advanced procure mechanism, ASTI, the RAMs etc and of course it's also an opportunity with the compound asset growth and what that's going to mean for how revenues in years are going to be growing, you know, quite rapidly through the price control. So, we're weighing those things up and we could have gone higher electricity, we could have gone higher gas, and when we left those sort of betas equal and that was the judgement we made for that. Clearly we'll be assessing that evidence for the full considerations.

Akshay Kaul 1:05:34
Do you want to add to either question there?

Stefan Blanchard 1:05:34
And, just on the capitalisation rates, we made a similar adjustment, albeit the scale was different in RIIO-2. So we did lower that bucket two capitalization rate at the same time. And I think it was interesting that you said it wasn't working as intended, but if if we wanted to target increasing cash flow to the firms to help with the financing challenge that they might face throughout the price control period due to the capital programme, if you'd applied it to bucket one, it would have a much, much smaller impacts than on bucket 2 just because of the relative scale of spend going through both. Additionally, the bigger the bucket 2 implies, the bigger the capital programme because of the sort of spend that's going through that bucket. So, if you were going to target to the companies that for example, had that bigger capital programme, it probably makes sense to target that component as well.

Akshay Kaul 1:06:33
The only other thing I'd add in terms of risk reward overall, you know, when you look at the total return including incentives, like you can see from the chart that Steve and Rohan had put out that, the incentivization is much stronger in ET because we think the value at stake there for consumers is much, much higher, so companies that do deliver these projects to time, you know to time and budget, we'll see considerable increases in their return to reflect the challenge that we are putting on the industry, and similarly there's a range of things that the transmission companies can do to help with reducing constraints by optimising outages. I think that's going to be a big issue. There's

an incentive around that and speeding up connections. And again, there's an incentive around that. It's a very different proposition if I look back to RIIO-2, the incentivisations were not that dissimilar across the sectors and so you could take a look at the baseline return allowance and do a comparison. But I think in this round you really have to look at, as Steve was saying, the sectors quite differently. ET has more, much bigger delivery challenge in it, but there's also much, much more heavily incentivized gas is more stable and much more conventional in the treatment that we're getting to that sector.

Deepa Venkateswaran 1:07:55
How did you calibrate the RoRE ranges for ET? Because these are very new incentives. Obviously, we've not had time to look at the details, but because the common ODI impact, I mean they do stand out in that chart as being substantial. So just wondering how you calibrated your range saying that's the sort of upside or downside?

Akshay Kaul 1:08:12
Yes. Steve, do you want to come in on the calibration of the incentives?

Steven McMahon 1:08:24
I think it reflects just what the genuine potential is there. Now, I understand that there's probably quite a bit of risk that's attached to that in terms of how you realise the full upside potential, particularly around these delivery incentives. But I think it's unquestionable from our point of view that if the companies are delivering like those high standards of performance, delivering these projects on time, then that's the scale of the reward that's there. It is much more powerful as Akshay says compared to RIIO-2, and the other thing that we've tried to do is de-risk this as much as we possibly can at source. There's lots of things that the companies would greatly be worried about, external factors, but the likes of our advanced procurement mechanism that allows them to go in, place those orders and book those manufacturing slots with key supply chain and providers at the moment. So again, all of these things we are trying to design like the overall risk and reward framework to make sure that it is genuinely that is the upside potential there for the companies with moderated like currently as we've set out the TIM estimates just to try and again drive that delivery with maybe a slightly less focus on cost efficiency or at least protect and not insulate the companies from that, that's something we'll continue to explore. It reflects all of those factors, Deepa, once you take them into consideration.

Akshay Kaul 1:09:50

Thank you. Deepa. Let's go back to the next question to Mark.

Mark Freshney 1:09:57
Thanks, Akshay. Two further questions. Firstly, the CMA process on Ofwat. I mean occasionally the CMA mean, I know that your WACC process is very well developed and very well established, but I know that the appeals body have influenced what you do in the past. My question is, is there time for you to take into account what the CMA may say on water and to incorporate that into the final or is it likely to come too late for you? And secondly, and excuse me for being direct, but you have a great line of sight into the companies and a lot of things pass your desks that give you a strong impression of what goes on within those companies. There's a lot of capex, or totex should I say, £80 billion more than these companies have ever done in the past, and they've yet to fully ramp up and I know companies have fallen short, internally, in your personal view is this £80 billion deliverable?

Akshay Kaul 1:11:22
I'll take the second question first, Mark. I think that it is a considerable challenge to scale up to this level, there's no question about that. That's why Steve was saying we are going out of our way to support the industry, to work with their supply chain and make sure that they can put early orders in, book manufacturing slots, just put in place all the apparatus that allows essentially a quadrupling of the rate of capital expenditure in that sector. Now, whether it will actually go all the way up to £80 billion by the end of 2031, I think that remains to be seen. And there are many other things that I think also have to click in for all of the money to be spent at that sort of furious rate. That includes, for instance, the reforms to the planning system, how quickly these projects progress through their consenting cycles and so on, which I know the government very much has in their sights. But I think for this purpose we've assumed that we will make the push to clean power 2030, get all these projects done and try to work out what the effect of that would be on bills and on the companies and their finance ability. You could say in that sense that it is quite an ambitious approach to the capital expenditure. But we thought that is the right place to be rather than start with something that is much more pessimistic and then find that the companies are not prepared for the full round, Mark, if that makes sense. And I think on your first question, I'm fairly sure that we will find out the CMA outcome on water ahead of Final Determinations. But Steve, you might want to come in on that?

Steven McMahon 1:12:54
I do believe that the CMA asked for an extension. I think they can ask for a six-month extension of

that. I think if you went by Ofwat's timelines, we are due decisions no later than March 2026 but sooner if possible, so I'd need to check that, but I do think they asked for an extension, so clearly it's something that we would monitor quite carefully along, but whether we have all the information available for Final Determinations, that's still uncertain.

Akshay Kaul 1:13:31
Thanks, Mark. Let's go next to Harry Wyburd, who's online. Harry, please go ahead.

Harry Wyburd (Exane) 1:13:38
Hi, thanks for taking my question. It's quite a simple one - where do you think you're most open to making changes on this by the final determination? Listening to everything we've just been through on baseline totex you indicated the evidential challenge, and it looks like essentially, you see some room for movement there, so that one seems likely that you would be open to some change. On returns, I sense some valid challenge from the industry, probably per Dom's earlier question. On financeability I think you mentioned that the plans would still be financeable even if you removed the nominal debt allowance. It looks like you feel like you've got quite a lot of headroom there, or at least that's the impression that I got throughout this call. So, would that be a fair ranking of where you're most likely or you think you're most likely to countenance change in in this plan by December, or would you rank it differently? Or are there any other areas where you feel like there's more room for further discussion with the industry?

Akshay Kaul 1:14:45
Thanks, Harry. I think my summary would be - you're right on the evidential challenge. We're definitely open on totex to looking at that and getting more evidence from the companies. I think on the returns and the financeability we have tried to set out what we think is a considered full position, not necessarily expecting to change that for Final Determinations, but I'll let Rohan come in on that. Steve, do you want to say anything more on totex and incentives?

Steven McMahon 1:15:09
I think that's the obvious one. As I say we know that totex, there was likely to be more movement in that. We've tried to work constructively, even just giving the companies a sense of the things that we would push out and where would need that data and information. And clearly if we can be satisfied it's in consumers' interest then we would look to set all those allowances I think by Final Determinations. I think that's one area that will evolve. The other one that I picked up in my presentation is also around the incentive framework we've sketched out in ET. But we looked at

some of the proposals that have been submitted by the TOs around additional incentives that they weren't quite there yet. I don't think there was added value to the extent that we'd like to see. We have developed them a bit further and we'll look to consult, I think, and engage on that with the companies, in particular between now and the final determination. So that would be the obvious one. The other one is as Akshay says, and I'll let Rohan cover from a finance perspective, but we haven't held back. I think that's usually like the perception of a regulator, that draft determination that they do hold things back knowing that we will go up. Now clearly the consultation process is a consultation process. We will engage in that constructively after data and information that we think hasn't been properly considered that comes to light, of course that will be reflected in our thinking. But as Akshay said, what you see today is our best view in some of these parameters, but I'll let Rohan speak to that.

Rohan Churm 1:16:41
Just entirely consistently with that, we're cognizant that this is a sector where a lot is happening and some people have already been raising finance prior to these determinations and things are ongoing so we didn't want to go out with some sort of artificially low numbers and create a bit of a shock and then bump them up. We've tried to look at the data, look at the judgements and shoot for what we think is right from the evidence we're seeing, and clearly there are areas of our finance package where we predictably and transparently update as market data moves. And so, you should clearly expect us to follow and respond to that. Clearly, we are open to the sort of robust consultation process of evidence. But I guess what I would encourage you all not to do is assume that we will sort of bump up numbers just because we always have without there being some logical reason. If we do move, it will be for a logical and compelling reason. Otherwise, you should expect the judgement to stay the same.

Harry Wyburd 1:18:01
OK.

Akshay Kaul 1:18:01
So in short Harry this reflects the state of the evidence as we see it today, and if the evidence doesn't change, then this is where we will be in Final Determinations.

Mark, is that an old hand or a new hand? I'll just come back to you quickly.

Mark Freshney 1:18:16
It's an old hand. I can't lower my old hand, but it's an old one.

Akshay Kaul 1:18:17
OK. All right, we go next then to Dom again. Dom, please go ahead.

Dominic Nash 1:18:26
Hi there. I know the feeling about old hands. Do you actually have a date for the final determination? That's all, or at least a week, or I think you're still saying it's in the winter. Is that right? And secondly, the nominal depth proportion that you've got for ET at 90%. Can it give us a bit of colour on what the rationale for the 90% is and from where I'm standing, and maybe some analysts may or may not agree with me here, but it does seem that you've gone virtually to 100%. You've got a nice dose of complexity just to throw it in to keep us all busy. So why didn't you just go straight to 100% nominal debt? Thank you.

Akshay Kaul 1:19:11
Alright. Thanks, Dom. On the date for final disseminations.

Steven McMahon 1:19:15
We haven't nailed down a specific date, but what I would say is that there's a very high probability of being very early December. So that kind of first week or so in December.

Dominic Nash 1:19:28
OK. Thank you.

Rohan Churm 1:19:29
Broadly what we've tried to do, Dom, while reflecting the actual companies can and will vary from the notional structures in their financing decisions, and that encourages them to be efficient and then the risk for them. What we've done broadly is just try to match the allowances roughly to what the companies data set are actually doing. It's roughly 90% because the amount of debt on average across the three of the money is roughly 90%. If we've got 100 and we wouldn't have been taking account of that, roughly 10 that is indexed.

Dominic Nash (Research) 1:20:13
OK. Thank you.

Akshay Kaul 1:20:14
Peter, please go ahead.

Peter Bisztyga (BoA) 1:20:24
Thanks for taking my question. Just one on the overall level of the allowed RoEs. So, your kind of 5.6% I think sort of in nominal terms is 7.8%. If I if I think about what you've been saying about investability and the fact that these companies have to compete for capital globally, one of the biggest markets obviously is the US, where probably your average utility there is being granted 9 1/2% nominal. We've moved to a world where US treasuries used to trade at a premium to UK treasuries. They're now traded at a discount, albeit a marginal one. I'm just wondering, how do you justify what is over a roughly 200 basis point gap, you know between UK and US nominal returns? That's my main question then, just a clarification on the chart that you had on slide 17 showing your RoRE and RAMs. The orange totex thing looks kind of evenly distributed around 5.6% RoRE, and I'm just wondering why that is, if the totex is skewed in favour of delivering on time and ahead of schedule.

Rohan Churm 1:22:16
You've raised the comparison to the US, which as you'd imagine was something that we looked at. But of course, we looked at the comparison to lots of different regulatory regimes and it's important that the UK is attractive in that, but if we're either at the top or the bottom and we probably wouldn't be doing our job. Investability is of course not just about the cost of equity, it's about the overall balance of risk and reward and that includes the policy design, the beta estimation, the indexation, the de-risking. You will make judgements on whether companies have tended to achieve the regulatory rates of return set out in the past or not, which should also be factored into comparisons of forward-looking rates. On that basis we do think that the UK, for the reasons you highlighted is likely to have the ability with inflation, with incentives, to get into those type of line or a bit higher nominal numbers. Equally, I'd add that comes with some of the de-risking elements, the inflation protection etc. We feel that overall, we're in quite a good place. We think it's an attractive proposition and it is something that we've looked at, of course we'll continue to look at comparative regimes of regulators that we can.

Akshay Kaul 1:24:06

To your question on the totex calibration, I think unless the team will correct me, it's simply a mathematical reflection of a symmetrical overrun or underrun relative to the baseline. Do you want to just come back Peter and re-ask that question?

Peter Bisztyga 1:24:20
So maybe I just haven't understood how it works, but because you can sort of overspend, sorry, just completely ignore me. I was thinking about something else. Ignore that question. Apologies.

Akshay Kaul 1:24:33
Alright. Thank you, Peter. Let's go next to Farman Ahmed, Farman, please go ahead.

Ahmed Farman (Jefferies) 1:24:44
Thank you for the presentation. This is Ahmed from Jeffrey's. I just have a very quick clarification question on the totex. As I listened to the call, my understanding is that a lot of the work that you've done, as would be expected, is on the base totex and that's where the efficiency challenge and the evidence challenges come from. But for the other components, the UMs and project the pipeline capex, it's all reference to the business plans and it hasn't gone through, let's say, an Ofgem review of what's entailed and gone through your assessments. My question is your understanding, and secondly, my question is are we likely to get a view from Ofgem by let's say FD's on practically, how much of that £80 billion is deliverable over the price control. Or is there a process that will just have to wait through? It'll be an in-period process and it actually will driven more on a project-by-project basis by the company. I'm effectively asking about UMs and pipeline as to what is exactly the addressable market for this price control process. Thank you.

Akshay Kaul 1:26:12
Thank you. Just on the second question, I think we will try because of the nature of this controlling ET every year when we publish the annual reporting to update the forecasts of expenditure looking forward, so that there is a transparency about what the expectations are. I'm sure as you say that they will evolve through time, but at this stage, I think our best guess is over the period of RIIO-3 it is likely to be at the top end, about £80 billion in all. Steve, do you want to come back on the first question?

Steven McMahon 1:26:40
And I think a very basic level, so we can only offer a detailed view on the data and information that has been submitted. So clearly and that reflects the baseline assessments that we've

undertaken at the moment. You've got this huge pipeline of investment that will be forthcoming, I think, during the investment period, and we'll only really be able to offer or take a detailed view on cost once we see those projects coming through and that will be naturally through the end period mechanism. So, as well as the agility of the processes and the price control it actually says that we'll need to look at how we then can reflect those assessments back, transparently, and just track progress alongside it. So that gets to the core of just the end period operation of the price control, but in in terms of the general deliverability, I mean the whole basis of what we're doing here is that we've got a plan that the NESO has set out. The companies are then setting out business plans that will allow them to meet that plan. So irrespective of whether things have been submitted to us, that work is ongoing in the background and all of the enabling arrangements that we are putting in place is very much geared towards that delivery. So, when we talk about the supply chain engagement, we talk about the calibration of risk. I think the price control, how we set the financial parameters, it's assuming that we deliver this in full. So that should give you some comfort, but actually opining on the specifics. I say from the needs case for the investment, but specific costs and the detailed option here and that's still to come.

Akshay Kaul 1:28:18
I think we're coming up to the last three minutes. So, if there are no further questions. OK, we've got a final question from Andrew Moulder. Andrew, please go ahead.

Andrew Moulder (CreditSights) 1:28:51
Can you hear me now? I'm just following up on an Ahmed's question earlier.

Akshay Kaul 1:28:53
That's much better, yes.

Andrew Moulder 1:28:59
Obviously this £80 billion is a big number and I just wonder how much work have you actually done on that? As in how long is it going to take to get this additional £70 billion or £80 billion approved once the companies want to put these projects into motion? I mean, if you're talking about a clean power by 2030 then presumably the last of these projects needs to be fully approved by 2028 or something, or it's not going to be delivered by 2030. I just want to get a feel for the timeline to actually deliver this £80 billion from when the companies say, 'we're ready to move on this project', how long will it take you to approve that spending?

Akshay Kaul 1:29:44
You're absolutely right, Andrew. And I think as the NESO themselves noted in the advice you know, because it takes a certain amount of time to physically build network infrastructure, the vast majority of those 80 projects, and probably all of them, need to have their consenting and procurement complete by the end of 2026. So that is why this is quite a considerable challenge. But Steve, do you want to come in on in terms of the numbers, you know, how they will come up in particular in terms of how we approve the cost things?

Steven McMahon 1:30:12
I think to that very point, we've designed the arrangements that apply from 1st April next year to give us that ability to adapt and adapt quickly to any of these schemes that are coming forward. It might be the case that we hit the first day of the price control and we've got reopeners that just reflects the reality of where we are. We would have been keen to see more of that and put forward for baseline approval. You'll see that reflected in our assessments through the BPI. But the reality is the companies want to take a little bit more time to follow the development scope. And the cost of those projects, now two key things. One is that we're not re litigating the need for the investment that's been established by the NESO. I think secondly, it has to still be subject to our cost assessment processes, but if you've got prices back from the market for projects that are well scoped, then hopefully that would allow us to go through these in a way that doesn't create unnecessary delays. So, all of the machinery has been designed to make sure that we can do the regulatory approvals as fast as we possibly can.

Andrew Moulder 1:31:17
Can I just follow up on that. How quickly would it come into the revenues that the companies actually earn in terms of the bills that the customers are paid? Are we talking about the sort of two-year period or again, would that come in the same year they start incurring the expense?

Steven McMahon 1:31:32
So that'll just go through the normal established processes. We have an annual iteration process that we go through, and we adapt the price control because the reality is that a lot more to the spend is uncertain and comes in period. So, we have established mechanisms that account for that.

Andrew Moulder 1:31:48
OK. Thank you.

Akshay Kaul 1:31:50
Right. Fantastic. Well, thank you once again everybody for joining us this afternoon. I hope that was a helpful call. The conversation certainly shouldn't end here. I think this is the start of the conversation, start of the consultation period. As I said, we are open to consultation up to 26th August, so please do engage with that consultation and if there are any other questions that occur to you after that you would like answers to, then please do get in touch with us and we'll be happy to follow up as needed. Look forward to engaging with everybody as we head towards final determination by early December. Thanks everyone.