



Response to Ofgem's T3 & GD3 Draft Determination

KEY POINTS

- Ofgem's draft determinations take substantial steps towards ensuring longer-term financeability and investability.
- Its support for higher investment and the related bill impact - when combined with achievable incentives – promises decarbonisation, economic growth and long-term cost reductions.
- As a minimum, in the ED3 SSMC Ofgem must be explicit that ED3 will be grounded in the same principles it has established in the T3 financial methodology, and be clear that it will:
 - *Look ahead over at least three price controls* when making the financeability assessment;
 - *Adjust the speed of cashflows* to ensure that over that period (i) an efficient company would maintain two investment grade credit ratings and (ii) there is a fair balance of cost recovery from current and future customers; and
 - *Provide an indication of the range of possibilities and potential solutions* at the methodology stage, with a commitment to finalise all the relevant parameters of the price control and then properly assess financeability at the determination stage.
- It is already clear that, even after applying the T3 DD measures to improve financial resilience from the determinations, Ofgem will have to accelerate cashflows further for ED3.
 - It is a matter of fact that Ofgem has only three levers it can pull to accelerate cashflows: asset life length, the phasing of the depreciation schedule, and the capitalisation rate.
 - Under our analysis, the optimal solution for electricity distribution is likely to be to move to a 45-year sum of digits depreciation schedule.
 - This ensures an intergenerationally fair bill trajectory while delivering necessary cashflows to maintain two investment-grade credit ratings and safeguard against future shocks.
- The boost to the return on equity is a move in the right direction, but Ofgem's treatment of total market return embeds a downward skew in returns which needs to be remedied.
 - A balanced assessment of the evidence supports a higher value in the current interest rate environment – Ofgem should aim up in its overall range to encourage investment.
 - The need for such a ramp up in investment means that the transmission companies' risk profiles have changed. Ofgem should go further to reflect this in the cost of capital.
 - The same is true for electricity distribution – more so given the unclear signals from Government and Ofgem of a potential broadening of the scope for ED.
 - The need for a higher allowed equity return to support the required investment should be explicitly recognised, which, when combined with light-touch, effective incentives brings forward large amounts of investment and drives efficient delivery for customers.
- There is work to be done on the incentive package to ensure companies do not face undue downside risk, especially when tasked with a large expansion of the network.
 - It is unclear whether the outputs and targets for the myriad funding mechanisms are deliverable and incentives appropriately calibrated, creating unnecessary downside risk.
 - Placing incentives on companies to plan, optimise, learn, discover, innovate, and bear the risks and rewards of doing so will yield insights into efficiency and benefits for customers, but the targets must be achievable.
 - The weight given to subjective assessments within the information incentive dilutes the incentive on costs and weakens the strength of the package overall.
- The overreliance on reopeners and volume drivers creates supply-chain uncertainty and regulatory risk – for ED3, the T3 approach would not meet the NIC recommendations. Ofgem must remove this contingent funding model in ED3.

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1. Executive Summary

Ofgem's draft determinations take substantial steps towards ensuring longer-term financeability and investability.

1. The draft determinations for electricity transmission provides a solid basis for ensuring long-term financeability that we have long highlighted as a major gap in Ofgem's approach.
 - a. The immediate implementation of nominal debt funding is a major part of the approach to correcting the problem.
 - b. The electricity transmission approach rightly recognises that a higher equity return is reflective of the investment requirements, but there is more to do.
 - c. Ofgem's recognition of the merit of cash measures in fixing the financeability issue is also welcomed.
 - d. As is Ofgem's commitment to looking beyond the next price control when assessing financeability.
2. Whilst these approaches are welcomed, they have come much too late on the process. Sequencing matters - the higher the need for investment, the more important it is to establish the fundamentals of the investment framework early. Upfront, Ofgem must:
 - a. define (i) a sensible range of returns, (ii) a profile of cash-flows that sustains credit metrics, and (iii) a regime that ensures financial resilience; and
 - b. be clear on (i) the increase in capacity that is to be delivered, (ii) how that is to be funded, and (iii) how efficiency and innovation are to be incentivised.
3. No rational investor can give a strong, positive response to strategic investment if they are blind to critical elements of the frameworks and cashflow risks. While the draft determinations show Ofgem has now taken late steps towards a financial package that delivers financeability, refinement of this package is still necessary, while critical elements supporting investability overall – including how the incentive framework will encourage innovation and improvements in both customer and investor outcomes – appear to require substantial work ahead of final determinations.

Ofgem's support for higher investment and the related bill increase – if combined with effective, achievable incentives - promises economic growth and long-term cost reductions.

4. Enabling an increase in investment that keeps a greater array of pathways to net zero open and deliverable, promises lower energy bills for consumers in the longer term - especially when coupled with effective incentive regulation by Ofgem.
5. This promise of lower bills over the long term relies on Ofgem moving back to ex ante incentive-based regulation, where outputs and deliverables are achievable, and the framework allows efficiencies and innovation to thrive – and, crucially, the supply chain to respond to the increased certainty in the market signals.
6. This shift in focus towards investment can unlock a significant shift to more affordable, secure and sustainable energy. Investing now will unlock lower prices over the long term, enabling a more

affordable transition for all, and support job creation and investment in new skills that delivers economic growth via:

- a. The direct effect of more economic activity being undertaken by the industry relative to the counterfactual of “wait and see”.
- b. The relatively labour-intensive nature of DNO capital investment means the creation of a significant number of skilled jobs, which would be distributed across the UK by virtue of the regional nature of the DNO businesses.
- c. The higher investment in low-carbon technologies (LCTs) by customers as confidence grows that the network upgrades are being delivered.

As a minimum, in the ED3 SSMC Ofgem must be explicit that ED3 will be grounded in the same principles it has established in the T3 financial methodology.

7. Ofgem will publish its sector specific methodology consultation for electricity distribution (the “SSMC”) in September, and it is crucial that Ofgem takes this opportunity to confirm how it will apply this financeability framework to electricity distribution.
8. As a minimum, in the SSMC Ofgem must be explicit that ED3 will be grounded in the same principles it has established in the T3 financial methodology. Ofgem should be clear that it will:
 - a. look ahead over at least three price controls when making the financeability assessment;
 - b. adjust the speed of cashflows to ensure that over that period (i) an efficient company would maintain two investment grade credit ratings and (ii) there is a fair balance of cost recovery from current and future customers; and
 - c. provide an indication of the range of possibilities and potential solutions at the methodology stage, with a commitment to finalise all the relevant parameters of the price control and then properly assess financeability at the determination stage.
9. Ofgem should confirm that, if necessary, it will accelerate cashflows to ensure that an efficient company would maintain two investment grade credit ratings over that period and provide an intergenerationally fair bill trajectory.
10. Having confirmed this methodology, and without fettering its discretion in respect of the price control final determinations, Ofgem should also take the opportunity in the SSMC to set this issue in context and consult on solutions. This would both:
 - a. signal firmly to investors that – given the required increase in capital deployment – Ofgem is now taking seriously the need to make the sector investable over the long term; and
 - b. outline the boundaries for an informed debate about the optimal “path of prices” and how to best ensure intergenerational fairness and financial resilience.
11. It is already clear on the face of the analysis that Ofgem will have to accelerate cashflows at ED3. Ofgem should provide illustrative examples that show the options it will have to weigh-up as it addresses this issue.
12. The plainest way to do this would be to carry over the relevant aspects of the T3 draft determination, make sensible assumptions about the ranges for the other parameters for electricity distribution, run the financeability assessment, and then set out the potential solutions and their merits and disbenefits.

13. Even after applying the following measures to improve financial resilience from T3 draft determinations (i) the immediate implementation of the decision to move to nominal debt funding at the start of ED3 (with the sector average 20% of indexed linked debt); (ii) 55% equity gearing; and (iii) 5.5% cost of equity; analysis shows that Ofgem will have to go further in accelerating cashflows for a notional electricity distribution licensee.
14. Ofgem should take the opportunity in the SSMC to set this out clearly so that stakeholders can engage constructively on this complex topic.
15. The electricity transmission approach rightly recognises a top up is needed to the base provided by the debt and equity return, but this policy decision has come too late. Ofgem must give a sufficiently clear policy signal at ED3 SSMC that it will apply the principles of the T3 draft determination financial methodology.

Ofgem must commit to look ahead over at least three price controls when making the financeability assessment.

16. The notional electricity distribution licensee's FFO/net debt ratio must be at an investable level for the foreseeable future. Ofgem must adjust the speed of cashflows to ensure that over that period (i) an efficient company would maintain two investment grade credit ratings and (ii) there is a fair balance of cost recovery from current and future customers.
17. At a minimum, FFO/net debt must be above the floor set by Moody's 11% threshold to ensure that an efficient company would maintain two investment grade credit ratings. The SSMD and draft determinations require licensees to hold two investment-grade ratings, and because Fitch does not use the FFO/net debt metric, the 11% floor both aligns with Moody's target and aligns to the ringfence requirement. This reinforces the need for Ofgem to explore more robust options.
18. Current arrangements load an unfair proportion of the transition cost onto future customers, whilst the present generation enjoy an effective payment holiday. The flat cost recovery schedule at the upper bound of the economic life of an asset creates asset stranding risk as it is not intergenerationally fair, with future customers bearing the financial brunt.
19. Ofgem must bring forwards cashflows such that both of these requirements are met, so that the deal is acceptable to all stakeholders, both customers and investors. And in carrying out the financeability assessment, it must include the highest investment case to ensure that this criterion is met against the maximum level of funding Ofgem anticipates to release throughout the period.
20. Without these principles being met, Ofgem has failed against its duty to regard to the need for licence holders to be able to finance their licensable activities.

Ofgem must provide an indication of the range of possibilities and potential solutions at the methodology stage, with a commitment to finalise all the relevant parameters of the price control and then properly assess financeability at the determination stage.

21. Investors need certainty ahead of plan submission that Ofgem will ensure the determination leaves companies financially resilient and investable, with a clear policy signal of what the solutions considered will be.
22. Timing is important – this must come at the methodology consultation stage to get investor backing for the deployment of capital to support deliverability.

23. The reality is that this very positive step in the right direction for the transmission sector has come much later in the process than it should, and Ofgem must make these decisions earlier in the process in the ED3 price control review.

Under our analysis, the optimal solution for electricity distribution is likely to be to move to a 45-year sum of digits depreciation schedule.

24. Under any plausible range for total expenditure, Ofgem will have to accelerate cashflows. In fact, the nature of the problem means it is not actually very sensitive to this.
25. Even with a higher cost of equity of circa. 6.45%, the notional company's investment grading would drop off throughout ED3, before hovering on the sub-optimal investment grade over the next three price controls – not two investment grades above.
26. Ofgem then has three levers it can pull to accelerate cashflows: asset life length, the shape of the depreciation schedule, and the capitalisation rate. Each sectors investment path through the transition to net zero is different, impacting what is the appropriate solution. The shape of the gap in distribution is unlikely to render capitalisation rates a suitable option, with the solution relying on the depreciation policy, as:
- a. distribution is starting at a different place to transmission; and
 - b. distribution has a step up in investment going out to 2050, rather than a spike in the next price control.
27. If Ofgem wishes to pursue an asset life of 45 years, then straight line depreciation causes significant financeability and investability problems.^{1,2} However, transitioning to a 45-year sum of digits depreciation schedule could represent a viable solution for electricity distribution and should be considered in the SSMC. This approach stands up against the principles:
- a. *Financeability*: FFO/net debt is maintained above the thresholds for the next three price controls.
 - b. *Asset stranding*: the policy does not go beyond the expected economic life of the asset, ensuring it is fully paid for within its lifetime.
 - c. *Fairness and good value*: the schedule front ends the distribution of cost recovery to give lower net present value.
28. Highlighting 45-year sum of digits as an option for consideration and confirming that Ofgem is open to explore alternatives and seeking views from stakeholders, would be standard practice for Ofgem at a methodology consultation stage. It also maintains Ofgem's desire to keep the regulatory asset life similar to the economic life of the asset, albeit we do not agree with this policy preference as shorter depreciation timescales improve consumer welfare overall, taking current and future consumers together, on a green book NPV basis.
29. Focussing solely on the technical life of the assets is an error. This is only one factor, and it must be considered in the context of prior depreciation schedules and future investment profiles. The solution must ensure a smooth bill trajectory while delivering the necessary cashflow to maintain two investment-grade credit ratings and safeguard against future financial shocks.

¹ Frontier Economics, Review of Depreciation Policy for RIIO-ED3, January 2025.

² NERA, Depreciation Policy for RIIO-ED3, January 2025.

30. Transitioning to a 45-year sum of digits depreciation schedule is a credible option that provides a smooth path of prices, whilst only increasing bills by the amount required to maintain two investment grade credit ratings and a sensible degree of resilience to future financial shocks.
31. This is good for customers and investors and provides stability, alongside some (needed) headroom.

The boost to the return on equity is a move in the right direction, but Ofgem's treatment of total market return embeds a downward skew in returns which needs to be remedied.

32. Ofgem has made improvements to the cost of equity calculation, such as its calculation of historical ex ante total market return (TMR), but less weight should be placed on this and the top of Ofgem's TMR range is too low - it does not reflect prevailing rates.
33. Ofgem has failed to engage properly with "through the cycle" issues.³
34. Ofgem must not see the long run average historical TMR as a constraint on the top of the TMR range. Over time, Ofgem's policy would seem to give less than average historical TMR when gilts are low and average when rates are high – overall this provides investors with lower than historical average returns.⁴

A balanced assessment of the evidence supports a higher value in the current interest rate environment – Ofgem should aim up in its overall range to encourage investment.

35. Ofgem has not appropriately considered its decision as to where in its CAPM cost of equity range to select its cost of equity point estimate – a wide body of evidence supports selecting a cost of equity point estimate that is much higher than Ofgem's proposed point estimate.
36. Ofgem has failed to appropriately engage with cost of equity cross checks. In particular, Ofgem has applied an inconsistent quality standard to its own and ENA's proposed equity cross checks leading to it relying on a biased set of cross-checks.⁵ A balanced set of cross checks clearly demonstrates that Ofgem's proposed T3 cost of equity is too low.⁶
37. The T3 draft determination cost of equity fails to compete against alternative investments available to investors such as the 9-10% nominal returns available to investors in US markets or to provide a sufficient premium to equity investors relative to returns available to debt investors. This is compounded by the use of a 55% gearing assumption in ET3, which reduces the cost of equity actually being allowed while increasing the amount of equity that investors are required to provide – a combination which sends entirely the wrong signals.
38. The 3% dividends assumption should be 5% instead, which rightly has regulatory precedent. A 3% dividend yield is below the dividends made by a group of relevant peers; which reflects the fact that investors in networks are typically seeking income and not just capital growth. It is necessary that Ofgem makes its settlement appealing precisely to these investors in order to guarantee that it is investable. Ofgem cannot justify an assumption as low as its 3.0%; the overwhelming conclusion from the market evidence is that investors in network companies will reasonably expect a dividend yield in the region of 5%.

³ Frontier Economics, Assessing regulators' approach to setting the TMR - Implications for RIIO-3, August 2025.

⁴ Frontier Economics, Assessing regulators' approach to setting the TMR - Implications for RIIO-3, August 2025, executive summary, page 5.

⁵ Frontier Economics, Cross-check standards of evidence, August 2025.

⁶ Frontier Economics, Updated cost of equity cross-check evidence, August 2025.

The need for such a ramp up in investment means that the transmission company's risk profiles have changed – Ofgem should go further to reflect this in the cost of capital.

39. Investors have a choice over whether they invest their money – the electricity transmission sector needs to compete well and attract sufficient investment to expand the network.
40. Ofgem needs to reflect the forward-looking risk in its beta assumption fully reflects investors' expectations of asymmetric risk that they will face in T3. An upwards adjustment is required to reflect the heightened forward-looking risks faced by electricity transmission networks, through their substantially increased investment programme, compared to substantially backward-looking equity betas estimated from peers that will not be facing the same scale and complexity of investment programme in many cases.⁷
41. We agree with Ofgem that the beta range is asymmetrically skewed – fixing this should boost cost of equity – but we do not agree with Ofgem's assessment that its TMR and RFR ranges are most likely to be symmetrical – we think they're negatively skewed.⁸
42. The same is true for electricity distribution – arguably more so given the (unclear) signals from Government and Ofgem of a potential broadening of the scope for ED.

Headroom in the allowed cost of debt for electricity transmission provides some welcome support to the overall cost of capital – but Ofgem already needs to be clear how it will replicate this support when setting the cost of capital for electricity distribution.

43. The proposed headroom above the electricity transmission sector's actual cost of debt is implicitly the same as aiming up on the cost of equity, by almost 50 basis points. We support aiming up on the cost of equity, especially in sectors where there is a need to bring about a substantial uplift on existing investment levels.
44. Ofgem should anticipate a need to achieve a similar overall contribution to expected equity returns when it comes to ED3, given the need to provide comparable equity returns to the two closely linked-sectors. To achieve this at ED3 Ofgem will need to:
 - a. Set a cost of debt that at least funds the electricity distribution sector's expected cost of debt fully - which means not including ET companies as a cross check or for calibration.
 - b. Aim up on the electricity distribution sector's expected ED3 cost of debt by an equivalent amount to the aiming up implicit in the electricity transmission sector's allowances (or apply an additional aiming up adjustment to the ED3 cost of equity).

We also welcome Ofgem's willingness to flex downwards from the current notional proportion of index linked debt when setting its nominal debt return

45. We support Ofgem's proposed assumption for the notional indexed linked debt proportions, particularly the 10% assumed for ET3, and the logic that Ofgem has applied in arriving at it.
46. It is reasonable for Ofgem to start from the sector's current actual proportion of index linked debt and adjust away from it after taking into account factors including:
 - a. expected future trends in index linked debt issuance; and

⁷ Oxera, RIIO-3 draft determinations – CAPM parameters and debt-based cross-checks, August 2025, section 4.

⁸ Frontier Economics, Updated cost of equity cross-check evidence, 22 August 2025.

- b. the cashflow benefits of the change, which lead to lower future notional equity issuance requirements and the associated costs of these to energy consumers.

It is too early to transition electricity transmission away from the flat-WACC approach

47. Ofgem must recognise in its final determination the importance of the flat-WACC approach for any sectors that are being transitioned from a higher level of notional gearing to a lower one.
48. Reductions in gearing levels cannot be achieved overnight and, where a reduction in the assumed gearing level will lead to a lower WACC, it is appropriate for the WACC based on the initial gearing level to be adopted. Otherwise, the combined cost of equity and embedded debt will be underfunded.
49. The only remaining question is the period over which this transitional arrangement is applied. It is not clear to us that the transitional period should end after only one period for electricity transmission. Two periods would be more appropriate given the typically long tenor of debt issuance.

The need for a higher allowed equity return to support the required investment should be explicitly recognised, which when combined with light-touch, effective incentives brings forward large amounts of investment and drives efficient delivery for customers.

50. The most important thing to get right in “return on capital” is to secure a return to a suitable blend of a solid, competitive base return with light-touch, effective incentives that combine to bring forward large amounts of investment and drive efficient delivery for customers.
51. It’s in customer interest for the cost of equity to be high enough to support investment – otherwise there is a risk of under delivery.

There is work to be done on the incentive package to ensure companies do not face undue downside risk, especially whilst they are tasked with a large expansion of the network.

52. The incentives package needs to support companies as they face new challenges in expanding the network, even without external supply chain constraints. To deliver for customers, it is essential that incentives are not skewed towards downside risk, clearly defined up front and calibrated to be both achievable and challenging.
53. The incentives framework should not place a disproportionate weight of the deliverability risk on companies. It is not feasible for investors to deploy capital under a deal that is riddled with unclear clawback risk.
54. This needs to be fixed at the final determination to allow transmission companies to compete internationally for investment. As it currently calibrated, the cost of equity is not high enough to account for the risk that the transmission sector will find itself in a ‘doom loop’ where:
 - a. unachievable targets reduce funding available to make improvements, resulting in even worse performance;
 - b. clawback and downside risk makes investor returns significantly more volatile, harming the investability of the sector; and
 - c. wide-spread uncertainty of funding and returns discourages investment over the long-term.
55. This is not regulation that will provide a route to economic growth. Ofgem needs to take lessons from the Independent Water Commission’s recent report and reassess its approach.

It is unclear whether the outputs and targets for the myriad of funding mechanisms are deliverable and incentives are appropriately calibrated, creating downside risk.

56. In order for companies to be able to deliver outcomes for customers in a price control that is fair, balanced, and achievable, deliverables must be consistent with final allowances. Otherwise, companies are simply not funded to deliver against Ofgem and customer expectations. The scale of the haircuts Ofgem has imposed on companies in these draft determinations brings this into question, and presents a risk that companies are not funded to deliver the outputs that have been placed on them.
57. This issue becomes exacerbated once Ofgem imposes funding constraints which hinder the companies' ability to deliver the work required to achieve the outputs. Ofgem has opted for this approach here, making use of numerous funding mechanisms and tightly ringfenced allowances that create boundaries and associated distortions, remove incentives to find synergies, create regulatory risk, and involve a high regulatory burden on both Ofgem and the regulated companies.
58. On top of this excessive clawback risk, imbalanced incentive calibration is a concern. Some incentives included in this draft determination, for example the connections incentive and innovative delivery incentive, are largely incomplete in their scoping and have a negative skew. The draft determination is extremely late in the day for incentives to not be clearly scoped. This should have been done in the methodology decision.
59. The combination of (i) large cost allowance haircuts, (ii) numerous funding constraints, and (iii) imbalanced incentive calibration, together combine to risk creating a toxic incentive framework where the proposal is not attractive to investors. In general, the more vague, diluted or unrealistic a set of incentives, the more upward pressure this puts on base returns. This has not been accounted for in the electricity transmission package and harms the investability of the sector.

Placing incentives on companies to plan, optimise, learn, discover, innovate, and bear the risks and rewards of doing so will yield insights into efficiency and benefits for customers, but the targets must be achievable.

60. The incentives framework needs to encourage innovation to enable the transition at the lowest cost to customers through both transformative innovation and optimisation. The size of the prize over the 25-year period will be material – and especially important to seek out in electricity distribution where the transition requires a step-up in investment that is sustained throughout.
 - a. Higher investment in transformational innovation to enable the research, development and demonstration of initiatives prior to deployment will be key to unlocking lower costs.
 - b. Being able to optimise throughout the period encourages companies to seek out innovative solutions not known at the time of plan submission, reducing costs for customers.
61. However, the extreme amount of ringfencing and toxic incentive framework rids the deal of any incentive to innovate, and Ofgem's continuation of the RIIO-2 approach will fail to unlock the wealth of innovation and information that would drive both more efficient systems, and which could enable Ofgem to apply regulation more effectively in future price controls as the industry continues on its 25-year journey. This approach fundamentally locks the sector into an equilibrium that is high cost, and risks failure to deliver on the mission to decarbonise the economy.

The weight given to subjective assessments within the information incentive dilutes the incentive on costs and weakens the strength of the package overall.

62. Ofgem has made better use of the cost incentive element of the BPI, in Stage B, by using the full spectrum of the cost incentive via a quantitative assessment of cost efficiency.
63. However, Ofgem only places 55% weight on this cost incentive, with the remaining 45% of the BPI results being driven by subjective assessments which dilute the incentive to submit efficient plans.
 - a. Together the two components of Stage C, clarity and commitments assessment, account for 30% of the resultant rewards/penalties (16% for clarity and 14% for commitments). This is too large a weight given to subjective assessments, which dilute the strength of the incentive to deliver outcomes at the lowest cost.
 - b. Stage B's non-comparable cost assessment accounts for 15% of the BPI outcome across the industry. Ofgem could easily strengthen this element of the BPI by moving from its binary subjective assessment of 'justification' of unit costs, volumes and needs case, to a simple quantitative assessment that sets rewards and penalties that are proportionate to the efficiency of the costs.

The overreliance on reopeners and volume drivers creates supply-chain uncertainty and regulatory risk – for ED3, the T3 approach would not meet the NIC recommendations – Ofgem must remove this contingent funding model in ED3.

64. Only a minority of the deal has been settled upfront in this draft determination for electricity transmission's load-related work, with the vast majority funded via myriad of uncertainty mechanisms. This approach is not fit for purpose for what is needed over the next 25 years, and given the extent of ex post allowances, Ofgem has applied too low a bar for deeming costs to be 'uncertain' – even when the needs case is established. This level of uncertainty in the deal increases the regulatory risk, harms the supply chain and ultimately economic growth.
65. The proposed ex post funding arrangements are overly complex, with a myriad of uncertainty mechanisms being used to fund load. This ringfencing removes all incentive to find synergies with asset health expenditure, and distorts incentives within load with each mechanism limiting incentives to find the lowest overall cost in different ways.
66. A low baseline allowance, paired with the promise of frequent reopeners. creates a funding environment that is inherently unpredictable. This unpredictability undermines our credibility with suppliers, making it harder to recruit skilled contractors and negotiate long-term agreements. Faced with the risk of mid-project funding adjustments, suppliers demand higher risk premiums or simply step back from bidding. The result is either elevated costs or costly "boom-and-bust" cycles of ramp-ups and ramp-downs that stall capacity building and drive-up management overheads.
67. When this unstable funding framework combines with broader investability challenges, such as insufficient allowed returns and regulatory uncertainty, the entire system is jeopardised. Investors become wary of deploying the capital needed for large-scale network expansion, putting at risk the delivery of the additional capacity essential to decarbonise the economy.
68. Ofgem must not let the timeliness of policy decisions slip for ED3 as it has for T3. Companies need to understand the design of the incentives in detail, at the outset, for them to be effective – these should be sufficiently scoped by the SSMD.

2. Detailed responses to the questions

69. The rest of this consultation response sets out Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc's responses to Ofgem's detailed questions.
70. We have organised our response as per Ofgem's published documents and have responded to the detailed questions within the overview document, finance annex, impact assessment, and the three sector specific annex questions. We have not responded to the detailed questions within each company annex, as these are sector specific and it is the sectors in question that are best placed to respond.

Overview: Introduction

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

71. We support the continued role of Independent Stakeholder Groups (ISGs) as a core part of the price control process, both in RIIO-3 and beyond. In principle, we believe a well-supported ISG model contributes to a more transparent, responsive, and trusted regulatory framework, aligned with net zero, consumer value, and public accountability.
72. ISGs provide a valuable, independent lens on how network companies conduct good engagement and then subsequently reflect stakeholder priorities, demonstrate accountability, and drive continuous improvement.
73. We support Ofgem's intent to define the ISG's enduring role in delivery oversight, including potential inputs to annual reports, customer value metrics, or performance assurance.

Overview: Outputs and incentives

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

74. We support the increased focus on consistent and comparable annual environmental reporting.

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

75. Each sector is best placed to comment on whether the use of a Price Control Deliverable (PCD) is appropriate for their sector-specific projects, but in principle we support the use of PCDs where:
- a. The scope of the project can be determined upfront, and adaptability across solutions to optimise throughout the period, and find volume efficiencies to reduce costs for customers, is not a priority; and
 - b. Unit cost efficiencies can be found and should be incentivised.
76. There is an incremental cost difference between zero emission vehicles (ZEV) and internal combustion engines (ICE), so additional funding to ensure this output is deliverable is sensible, and the extent of progress towards fleet decarbonisation does depend on vehicle availability and suitability for operational use.

OVQ4. Do you agree with our proposed approach to measuring Baseline Network Risk Outputs and our application of the NARM mechanism?

77. We are supportive of the adoption of an equivalent to electricity distributions long-term monetised risk in other sectors.
78. The other sectors are best placed to comment on the detail, but the target must be aligned to allowances – the scale of the reductions Ofgem has made to company submitted costs puts this into question.

OVQ5. Do you agree with our proposed approaches to calculating the funding adjustments and to the application of penalties?

79. To increase the scope for synergies and efficiencies, the NARMs allowances should be fungible across all projects and the output should be assessed at the aggregate target level – not by individual projects.

OVQ6. Do you agree with our proposed approaches to improving the NARM framework?

80. The other sectors are best placed to comment on the detail of the mechanism, but we support the expansion of NARMs in a way that upholds the principles of the NARMs framework to allow for tradeability and adaptability as companies optimise throughout the period, and micromanagement should be avoided.

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

81. Each sector is best placed to comment on whether the use of a Price Control Deliverable (PCD) is appropriate for their sector-specific projects, but in principle we support the use of PCDs where:
- a. The scope of the project can be determined upfront, and adaptability across solutions to optimise throughout the period, and find volume efficiencies to reduce costs for customers, is not a priority; and
 - b. Unit cost efficiencies can be found and should be incentivised.

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

82. No response.

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

83. Ofgem is right to focus on the need for strong workforce resilience and supply chain strategies to support the deliverability of the transmission to net zero, and the right regulatory framework is required to support the delivery of these strategies. This relies on upfront certainty without clawback risk and incentives to encourage the delivery of outcomes for customers, so that companies can bolster supply chains and workforce capabilities required to deliver the step up in investment.
84. We strongly support Ofgem's emphasis on Workforce Resilience as a strategic enabler of RIIO-3 objectives and broader net zero commitments. As a network operator, we agree with the recently published NIC report on the need to recognise that delivering the pace and scale of infrastructure required for the energy transition will depend on a skilled, inclusive, and resilient workforce.
85. We agree with Ofgem's overall position and welcome Ofgem's leadership in this area and look forward to further guidance and opportunities to collaborate with industry partners to build a

workforce capable of delivering a clean, secure, and resilient energy future. We welcome further clarity and action on the following.

- a. *Planning and Delivery:* To enable a sustained increase in our workforce to support the increase in investment, Ofgem must provide sufficient ex ante allowance for companies to invest in workforce expansion, and ensure additional funding is available if needed. As an industry, we also need:
 - i. balanced planning that acknowledges the role of the wider supply chain to meet delivery expectations to CP2030;
 - ii. workforce strategies that are grounded in transparent delivery plans and workforce capacity assessments;
 - iii. annual updates to Workforce Resilience Strategies and recommend integration with existing reporting cycles; and
 - iv. a cross-sector working group convened by Ofgem to facilitate collaboration and alignment with national initiatives.
- b. *Understanding our Workforce for the Future:* We endorse continued support for programmes that promote retention and wellbeing – especially for high-demand skill areas – and encourage deployment of retraining pathways like Skills Passports.

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

- 86. As per our response to OVQ9, “Ofgem is right to focus on the need for strong workforce resilience and supply chain strategies to support the deliverability of the transmission to net zero, and the right regulatory framework is required to support the delivery of these strategies. This relies on upfront certainty without clawback risk and incentives to encourage the delivery of outcomes for customers, so that companies can bolster supply chains and workforce capabilities required to deliver the step up in investment”.
- 87. We agree that the current supply environment, i.e. a lack of factory slots for equipment, and increased demand across key asset classes, is resulting in increases to prices that network companies face.
- 88. We agree that network companies should substantiate additional increases, to ensure that the price control’s methodology for escalating base prices (inflation and real price effects (RPEs) together) broadly match the changes to prices faced.
- 89. We believe that the RPE mechanism in all sectors should be funded via ex-ante allowances to allow companies to manage risk against the benchmark indices efficiently, supporting the delivery of all future pathways beyond RIIO-3. This will provide the much-needed investor certainty, which the RIIO-2 regime lacks.
- 90. On the Advanced Procurement Mechanism (APM) specifically, we agree that the APM will derisk the transmission operators in securing supply chain capacity in bulk, at a much earlier point in the project development cycle by accelerating a portion of future funding, increasing the pace of delivery.
- 91. Ofgem should give consideration as to whether a similar mechanism to accelerate a portion of future funding is required within electricity distribution and consult on this in the upcoming SSMC, to ensure continuity in supply during price control setting periods; in particular, for large discrete

strategic investment projects. This should also be considered for high value equipment such as transformers where we have experienced extended supply times.

92. Expansion of the APM across the industry would increase investor certainty across the industry as we ramp up to deliver the transition, allowing network companies to make earlier, firm commitments with our supply chain. And has the potential to reduce overall costs for customers, by allowing DNOs to lock in prices early, and commit to larger orders, thus benefitting from economies of scale.

Overview: Business Plan Incentive

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?

93. The best use of the Business Plan Incentive (BPI) is to encourage the submission of plans that deliver against specified outcomes and targets at the lowest cost to customers.
94. This requires a strong cost incentive that is proportionate to the efficiency of the submitted costs. Ofgem has made better use of this incentive in Stage B of the BPI, within the comparable cost element, by using the full spectrum of the cost incentive via a quantitative assessment of cost efficiency.
95. However, Ofgem only places 55% weight on this cost incentive, with the remaining 45% of the BPI results being driven by subjective assessments which dilute the incentive to submit efficient plans.
- a. Together the two components of Stage C, clarity and commitments assessment, account for 30% of the resultant rewards/penalties (16% for clarity and 14% for commitments). This is too large a weight given to subjective assessments, which dilute the strength of the incentive to deliver outcomes at the lowest cost.
 - i. Within the clarity assessment itself, we see no reason why any criteria should be given relatively more weight than other criteria.
 - ii. However the clarity assessment as a whole should be given less weight.
 - b. Stage B's non-comparable cost assessment accounts for 15% of the BPI outcome across the industry. Ofgem could easily strengthen this element of the BPI by moving from its binary subjective assessment of 'justification' of unit costs, volumes and needs case, to a simple quantitative assessment that sets rewards and penalties that are proportionate to the assessed efficiency of the costs.

OVQ12. Do you agree with the weightings applied per outcome for each sector for use in the Stage C - Business Plan commitments assessment?

96. Yes, we agree.
- a. Within the commitments assessment, we see no reason why any of the 'ratings' should be given relatively more weight than other 'ratings'.
 - b. On the 'outcomes' we agree that infrastructure fit for a low-cost transition to net zero should receive a greater weight in the electricity sector vs gas, given its relevance in electricity transmission.

Overview: Managing uncertainty

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

97. Yes. This helps to uphold a high bar for reopening the price control. There is precedent for 0.5% of annual average ex-ante base revenue, and we agree this should be applied consistently across companies.

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

98. We agree that it is sensible to remove the reopener windows for this mechanism, and the change to allow the Authority to trigger the reopener at any time, if advised so by NESO.

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

99. It is sensible to kick start projects that are transacted on at the back end to speed up the delivery, and the use-it-or-lose-it mechanism is more automated than a reopener would be. The electricity transmission, gas transmission and gas distribution companies are best placed to comment on the exact design and materiality of this mechanism.

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

100. Again, the electricity transmission, gas transmission and gas distribution companies are best placed to comment on the design of this mechanism.
101. In our view, it seems sensible to have a mechanism to ensure more material projects are funded throughout the period as the needs case arises.

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

102. The criteria of a resilience reopener needs to be clearly set out with a targeted scope and trigger, ideally triggered by legislative change, to ensure that the mechanism only allows for submissions regarding the additional cost to meet the required enhanced level – not general enhancement.
103. In combining areas of resilience into a broader resilience reopener, Ofgem should ensure that at a minimum, the uncertainty across the price control is held constant, and ideally reduced.
104. As per our response to Ofgem's RIIO-3 methodology consultation for electricity transmission, gas transmission and gas distribution (paragraphs 147-148, and 154):
- a. *"Ofgem's intention to reduce the number of reopeners at RIIO-3 is positive, but it must not to expect that simply reducing the number of reopeners, whilst maintaining the current scope for funding, will reduce the resource burden. This would also leave the same level of uncertainty in the price control – Ofgem must reduce this to restore investor confidence, be more decisive at the time of the price control settlement and stand behind its deal."*
 - b. *"Also, a blend of these reopeners with the current scope would blend means driven (e.g. the why) with delivery driven (e.g. the what). This would allow reopener submissions that muddy the line between truly additional costs associated with a change in the assumptions used to set baseline allowances and new projects companies would simply like to do."*
 - c. *"If Ofgem is to bundle various RIIO-2 reopeners into this broad reopener, it must keep the licence criteria very clear on the triggers for each element. Simply combining the current scopes will not resolve the resource issue. Ofgem should consider whether separate mechanisms would allow for greater transparency in submissions and hold itself accountable to only introduce scope for additional funding where there is a clear and*

justified trigger. Separate mechanisms also allows staggered submission and evaluation windows, which in turn can also help Ofgem to manage the resource burden."

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

105. No, we do not. The lack of change compared to the RIIO-2 mechanism does not address the volatility risk that the indexation methodology creates, and this proposal requires significant change for ED3.
106. Ofgem must return to fixed ex ante funding for RPEs to allow companies to manage the risk, as opposed to this risk being passed onto customers. Half of any expenditure variance that is driven by RPE volatility in period would then be passed on to customers (as per the sharing factor). Customers would experience much less cost volatility.
107. If RPE indexation is retained, the following principles for forecasting RPEs hold for all sectors and should be applied in Ofgem's final determinations (and also to ED3).
 - a. A broad set of indices should be used to reduce the risk of exposing network companies to an index and cost mismatch, with consideration given to new indices that do not necessarily have regulatory precedent but correlate with company costs. It is positive to see that Ofgem has broadened the scope of indices used in RIIO-3 vs RIIO-2.
 - b. Ofgem must fund real price effect allowances across the total cost base, where there is evidence of a real price effect, otherwise there is a real possibility of Ofgem not meeting its duty to ensure companies can finance the costs of their activities. If applying a materiality threshold, Ofgem should apply this to the combined effect of smaller categories taken together.
 - c. Where indices have long run growth rates that are systematically below the growth rate of company costs, even though they are correlated with those costs, Ofgem should use upwards mean adjustments to reduce the risk of systematically underfunding actual unit cost growth.
 - d. Ofgem must also ensure its methodology would fund the costs of the inputs companies use, not a basket of manufacturing inputs that omit the upwards pressure on final good prices that will result from growing electricity network component demand.
 - e. Ideally, Ofgem would make use of the efficient notional cost structure associated with the final allowances it gives in setting real price effects, as opposed to the submitted business plan structure.
108. The transmission and gas distribution companies are best placed to comment on whether the proposed indices in the draft determinations are a good proxy for the efficient input price growth in their sectors.

Overview: Cost of service

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

109. We support the application of an ongoing efficiency assumption that reflects the productivity gains companies should be able to achieve in the period - Ofgem must take into account all of the evidence it has available to ensure a fair determination, including the evidence that ongoing productivity gains will be lower than those seen in the past.

110. Instead, Ofgem has aimed up against the advice of its consultants, Grant Thornton, who determined 0.1% to 1.3% as a plausible range for the ongoing efficiency assumption based on quantitative growth accounting analysis using the well-established EQ KLEMS dataset, implying a mid-point estimate of 0.7%.
111. These findings are in line with the proposals from companies, and with our observations given in our ED3 framework response (paragraph 276), that:
- a. *“Over 30 years after privatisation, with strong cost incentives for much of this period, productivity improvements are more challenging now than ever in our business.*
 - b. *The labour-intensive nature of network investment can also be expected to constrain productivity growth (relative to the wider economy).*
 - c. *There has also been extensive evidence of slow productivity growth in the UK generally.”*
112. Ofgem has however set itself a range of 0.7% to 1.3% per annum, which is clearly a goal-seek to obtain 1.0% as the “mid-point”. Ofgem has attempted to justify this with un-evidenced “innovations”. These can create a substantial distraction from other pressing matters in price reviews and have been shown at appeal to be prone to regulatory error, in Ofgem’s attempts to make similarly justified uplifts to ongoing efficiency at RIIO-1 and RIIO-2.
113. If Ofgem were to take into account the tangible evidence here, it would set an assumption of 0.7% per annum.

Overview: Innovation

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

114. Innovation is key to unlocking productivity growth, quality outputs and lower customer bills. The recent Cunliffe report identifies that insufficient availability of funds for innovation projects has been a blocker to this in the water sector and draws on comparisons to the level of Research and Development investment in the telecoms sector of £1.2 billion.⁹
115. Without doing a comprehensive assessment of all plans, and then applying the regulatory formula, it is difficult to comment on whether the level of funding is appropriate. The other sectors are therefore better placed to respond to this.
116. We do, however, observe that there is a significant cost reduction of 35% across the company submissions. We believe there is a risk that this lack of funding could curtail innovation more broadly across the sector. We remain of the position that:
- a. Ofgem should increase the size of the upfront innovation funding and lower its aversion to flexing allowances upwards; and
 - b. the larger the upfront funding for innovation, the greater scope for gains through first-mover advantage and therefore boosting the incentive to innovate. The benefits of these innovations will ultimately bring about the lowest cost for customers in the long run and should be enabled.

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

117. This is sector specific, and gas network companies are best placed to respond.

⁹ [Independent Water Commission - Final Report, 21 July 2025](#), paragraphs 997-998 and 1003.

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?

118. Yes – we agree with the principle of the introduction of this fund. There is an opportunity to enhance coordination and ensure innovators, particularly SMEs, receive timely, consistent, relevant and targeted support.
119. We would challenge whether this advisory service needs to be a newly established service/body; the work carried out by the EIC for the past eight years has improved support and simplified access and therefore consideration should be given to augment the roles and responsibilities of the EIC.
120. In addition, we would recommend Ofgem reconsider the funding mechanism (i.e. collectively by network companies in proportion to their NIA award) or if not, look to award additional allowances to fund this given the significant reduction in NIA compared to submissions.

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

121. Yes – in principle this makes sense. Ofgem should exercise caution when implementing additional oversight and reporting to not increase the regulatory burden. As part of the implementation of these improvements, Ofgem should:
- a. set out clearly in the NIA governance document what the reporting aims are and define a common, fit-for-purpose format to produce ‘one source of the truth’ that can feed into the multiple reporting requirements to reduce administrative burden; then
 - b. scrutinise reporting against new requirements to ensure consistency across network companies; and
 - c. ensure reporting requirements are proportionate to the size of the funding pot.

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

122. We are supportive of the continuation of SIF funding as continued investment is needed to deliver high impact, transformative innovation. In terms of the value and beneficiaries, clarity is required on the amount of funding and the impacted sectors to determine whether this is, as a minimum, not a reduction in funding.
- a. *The amount of funding:* compared to RIIO-2, this must be at a minimum in line with inflation, but more fundamentally, should be an increase if the industry is to meet Ofgem’s innovation ambitions.
 - b. *The impacted sector(s):* We note the summary on page 106-7 sets out that the funding will be applied to gas distribution, gas transmission and electricity transmission. There is no clarity on whether electricity distribution will be brought into the same funding pot, or whether a separate pot be established. We welcome this clarity in the SSMC.

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

123. Applying a programmatic approach in principle is sensible. However, whilst we agree that the longer-term objectives and broader strategic questions are important, we feel that these are trying to resolve minor problems.

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

124. Yes – we agree with the principle of a deployment fund – this is a positive step and signals an appreciation of the challenges associated to the business-as-usual (BAU) rollout of innovation.

125. In addition, we would like to understand more detail pertaining to the rationale behind the figure of £50m – specifically whether this is a carve out of the SIF funding pot, or a proportion of totex.

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?

126. Yes. This is a sensible approach as part of the new deployment fund, which presents an opportunity to deploy and scale up existing innovation that sits outside these funding mechanisms.

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

127. Yes. This is a foundational stage to innovation projects and having access to funding for this ensures that companies are encouraged to take on more challenges and not wait solely for something that seems certain to work.

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

128. Yes – we agree with the retention of the core aspects of the SIF for RIIO-3.

129. In line with paragraph 10.43 of the consultation, the introduction of a more agile centric approach and oversight defends against changing circumstances. We welcome the agile approach, however feel it is important to consider augmenting this determination to explore opportunities with better performing projects as well as mitigating risks related to poor performance projects.

- a. The current draft determination only covers where projects are stopped due to poor performance – this is a positive step to mitigate the risk of lost time on a project or hypothesis.
- b. We would encourage Ofgem to make the guidance objective in its nature to ensure a clear and consistent bar is set and monitored.

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

130. We agree in principle of a more flexible approach to SIF contribution rates. However, more work needs to be done on the detail of the proposal in order that we can comment in full.

131. We support the reduction of the 10% contribution rate for higher risk and impact initiatives as this will encourage a more experimentation centric approach and more transformational innovation. In addition, this will have a positive impact, greater participation and flexibility from new and existing partners.

132. In terms of the increase above the 10% contribution rate for “less risky projects”, we are concerned that this will be difficult to define and has the potential to encourage lower impact, incremental innovation. Furthermore, this could be a barrier for SMEs and academia, as these partners may struggle to co-fund at higher levels.

133. Ofgem should consider further consultation, engagement and clarity in the guidance before implementing this. One area that could be explored could be to introduce a tiered approach, that also considers the stage of the project, in addition to the level of risk and impact. In addition, the introduction of % contribution rate cap and collar values.

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

134. Yes. We support the idea of higher quality and more outcome-focused projects. We encourage Ofgem to ensure that when implementing additional criteria (i.e. Scaled assessments, deployment, dissemination and impact, as per paragraph 10.45) it is clear how the subjective and objective assessments will play out in terms of approval of new/advancing existing projects.

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

135. Yes – in principle, this appears to be sensible. At this stage, we cannot comment further until there is more clarity on the detail and design of this process.

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

136. Yes. Executed appropriately, this would encourage better collaboration, engagement, consistency and overall efficiency.

OVQ34. Do you agree on the need to clarify roles and responsibilities within the innovation ecosystem, and the factors that we should consider?

137. No. As per our response to OVQ23, Ofgem must exercise caution when implementing additional oversight and reporting so as not to increase the regulatory burden.
138. There is an opportunity as part of the ENA work on the Innovation Measurement Framework and existing obligations to define a common fit-for-purpose format to produce 'one source of the truth' that can feed into the multiple reporting requirements to reduce administrative burden.

Overview: Cyber Resilience

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

139. We agree with the decision to retain the mid period reopener, and it is positive that the authority has retained the ability to trigger reopeners in response to changes in threat levels or government policy or guidance.

Overview: Data and Digitalisation

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

140. Yes. We're aligned with the continuation of the licence obligation to publish routine updates to the Digitalisation strategy and action plan update. This is a positive mechanism to provide updates for stakeholders.

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

141. Yes. We're supportive of the introduction of the Data Sharing Infrastructure (DSI) licence condition and the headline principles of its application. The DSI, if implemented effectively, could bring about transparency, consistency and alignment across companies and should ultimately promote better interoperability.
142. We note that the DSI is not likely to be fully operational (see paragraph 12.13 of the consultation), and as such, we would encourage Ofgem to iterate the guidance within the decision between draft and final determination with more detail and clarification to ensure this licence condition can be

implemented, managed and followed appropriately. If clarity cannot be provided, then the licence condition should be removed until such time when it can be.

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

143. Yes. We're aligned with rolling forward the same RIIO-2 Digitalisation re-opener mechanism into RIIO-3, provided the scope and trigger remains clear and targeted to limit uncertainties.

Finance Annex: Allowed return on debt

FQ1. Do you agree with our approach to estimating efficient debt costs and calibrating the index?

144. We support Ofgem's decision to move immediately to a fully nominal allowance for the notional company's nominal portion of its debt book.
145. We also continue to support Ofgem's established approach to index calibration on a sector specific basis, based on a forecast of the sector's expected actual cost of debt – but we have the following observations on the ET3 calibration.
146. The proposed headroom above the ET sector's actual cost of debt is implicitly the same to aiming up on the cost of equity, by almost 50 basis points. We support aiming up on the cost of equity, especially in sectors where there is a need to bring about a substantial uplift on existing investment levels.
147. Ofgem should anticipate a need to achieve a similar overall contribution to expected equity returns when it comes to ED3, given the need to provide comparable equity returns to the two closely linked-sectors. To achieve this at ED3 Ofgem will need to:
- a. Set a cost of debt that at least funds the ED sector's expected cost of debt fully - which means not including ET companies as a cross check or for calibration.
 - b. Aim up on the ED sector's expected ED3 cost of debt by an equivalent amount to the aiming up implicit in the ET sector's allowances (or apply an additional aiming up adjustment to the ED3 cost of equity).

FQ2. Do you agree with our proposal to use a combination of iBoxx GBP A and BBB 10+ non-financial indices rather than the iBoxx GBP Utilities 10+?

148. Ofgem appears to be proposing to switch back to the index it used in RIIO-1, away from the one it adopted for RIIO-2.
149. We do not see any need to switch indices, especially as:
- a. There are advantages and disadvantages of different indices. None will fare perfectly in all circumstances.
 - b. Those factors that caused Ofgem to switch to the utilities index, instead of the non-financial indices used at RIIO-1, may apply again in future.
 - c. The cost of water sector debt can be expected to normalise over time (including Thames Water's cost of debt, once it has restructured its finances or entered temporary nationalisation).
 - i. In any case, provided the cost of debt is calibrated correctly, the impact of the choice of index is limited to how that cost of debt allowance is adjusted over the

5-year price control. Water yields should not overly distort that movement with a long-term trailing average.

- ii. Further, water company bonds would only remain in the index while they remain investment grade, and if they are investment grade, it remains appropriate to retain them in the calibration.
 - d. The choice of index will in any case “come out in the wash” in respect of the cost of embedded debt, through the calibration process.
150. Whilst both sets of indices have regulatory precedent, we recommend Ofgem does not change away from the utilities index as it remains the most relevant benchmark. Either way, the most important point from an investor perspective is that Ofgem commits to a reasonable external benchmark and calibrates the trailing average to match the relevant sector’s expected cost of debt.
151. We also note that the decision taken for ET3 and G3 would not preclude a switch back to the utilities index for future price reviews.

FQ3. Do you consider our proposed notional ILD assumption to be appropriate?

152. Yes, we support Ofgem’s proposed assumption for the notional ILD proportions, particularly the 10% assumed for ET3, and the logic that Ofgem has applied in arriving at it.
153. It is reasonable for Ofgem to start from the sector’s current actual proportion of index linked debt and adjust away from it after taking into account factors including:
- a. expected future trends in index linked debt issuance; and
 - b. the cash flow benefits of the change, which lead to lower future notional equity issuance requirements and the associated costs of these to energy consumers.

FQ4. Do you agree with our approach to setting the additional cost of borrowing allowances?

154. NERA, in a report prepared for ENA¹⁰, has identified that Ofgem’s backwards looking approach to estimating the additional cost of borrowing does not fully reflect the RIIO-3 borrowing costs from:
- a. A higher cost of carry, including thanks to higher forwards looking:
 - i. spreads between debt costs and the cash deposit rate, which warrant a 12 basis points increase in the additional borrowing cost allowance; and
 - ii. requirements for cash, relative to debt, due to the substantially higher RAV growth and debt issuance over the RIIO-3 period, which warrants a further 13 basis point increase (when taken together with the point above); and
 - b. liquidity costs, where Ofgem includes commitments fees for a revolving credit facility (RCF) but does not include drawdown costs, warranting a 3 basis point increase.

FQ5. Do you agree with our proposed treatment of inflation with respect to the allowed return of debt?

155. We support Ofgem’s approach of adopting a 2.0% assumption for CPIH inflation, based on the Bank of England’s 2.0% CPI inflation target.

¹⁰ NERA, Liquidity Cost & Cost of Carry Allowance at RIIO-ET3, August 2025, slide 6.

156. The 2.0% inflation assumption is widely recognised by investors. There is too much uncertainty regarding any long-term difference between CPI and CPIH inflation to justify a different approach, particularly since changes in government policy could alter this relationship.
157. We also note that the inflation assumption in deflating the cost of debt index is now less financially material a parameter than it was in the past, given the move to debt allowances that are largely nominal.

FQ6. Do you agree with the removal of the infrequent issuer allowance?

158. We do not agree with the removal of the infrequent issuer allowance - the ED2 approach was appropriate.
159. Even if Ofgem considers some change to be necessary, it should consider a tapered allowance, or a different threshold, rather than complete removal.

Finance Annex: Allowed return on equity

FQ7. Do you agree with our methodology for calculating the RFR?

160. We continue to hold the view that Ofgem's methodology fails to recognise the convenience premium implicit in the quoted prices of gilts.
161. The underlying risk-free rate, and the appropriate starting point for CAPM calculations, is a rate that does not reflect this convenience premium. Ofgem's risk free rate should be adjusted upwards to recognise this.
162. There is a broad base of evidence that supports the existence of a convenience yield in government bonds, including evidence from the Bank of England relating to UK government gilts. Ofgem has dismissed all of this evidence in pages 48 to 51 of its finance annex on the basis that Ofgem considers that it does not robustly demonstrate the existence of a convenience yield in UK gilts **at the specific 20-year horizon that Ofgem has used**. The standard of evidence Ofgem is applying is virtually impossible to meet, since it appears Ofgem would only accept evidence that directly relates to 20-year UK gilts. This is inappropriate in the context of a broad base of evidence that triangulates on a different conclusion.

FQ8. Do you agree with our methodology for calculating the inflation wedge?

163. We do not agree that Ofgem can assume a February 2030 "bright line" for convergence between RPI and CPIH in its inflation wedge calculations.
164. There is a 3-month lag structure in UK index linked gilts issued after 2005, and an 8-month lag structure in UK government index linked bonds issued before then.¹¹ This will mean that RPI inflation will continue to affect the overall yield earned on UK government index linked debt for longer than would otherwise be the case. Put another way, RPI inflation for the purposes of index linked debt is lagged.
165. Ofgem should reflect this lag in its final determination calculations by making allowance for an additional 1-2 quarters of the RPI – CPIH wedge. Any effect will of course be relatively small in the context of what (at SSMD) was an 11 basis point adjustment to the real risk-free rate.

¹¹ <https://www.dmo.gov.uk/media/jgtoofwc/indexlinked3m.pdf>. We understand that the last pre-2005 UK government index linked bonds will be redeemed in July 2030, therefore the effect of 8 month lagged bonds could not extend the impact of RPI inflation on index linked bond real yields beyond July 2030.

FQ9. Do you agree with our methodology change in calculating the ex-ante TMR?

166. Ofgem has made improvements to the cost of equity calculation, such as its calculation of historical ex ante total market return (TMR), but less weight should be placed on this and the top of Ofgem's TMR range is too low - it does not reflect prevailing rates.
167. Ofgem has failed to engage properly with "through the cycle" issues.¹²
168. Ofgem must not see the long run average historical TMR as a constraint on the top of the TMR range. Over time, Ofgem's policy would seem to give less than average historical TMR when gilts are low and average when rates are high – overall this provides investors with lower than historical average returns.¹³
- a. Successive regulatory decisions have reduced this parameter in the context of a protracted period of ultra-low risk-free rates – suggesting a practical regulatory policy of reducing this parameter when interest rates are low.
 - b. Given this, there should be an expectation of a stronger "bounce back" in the parameter in an environment of much higher risk free rates, otherwise investors will not be adequately funded for the cost of equity across the whole economic cycle.
 - c. If the TMR is now constrained to be no higher than the long run average in the current environment, then its longer term track record (which includes a lower TMR when interest rates were lower) will fail to allow the long run average TMR across the whole of the cycle.
 - d. Extensive cross checks undertaken by Frontier Economics on behalf of ENA also demonstrate that the assumed TMR should be increased.¹⁴
169. Although Ofgem proposes an increase in this parameter from the low points seen in RIIO-2, this increase is not sufficient to restore the TMR to a high enough level.

FQ10. Do you agree with our methodology for estimating beta?

170. Ofgem's methodology represents a substantial improvement on the RIIO-2 approach.
171. However, Ofgem also needs to incorporate an upwards adjustment at ET3 to reflect the heightened forward-looking risks faced by electricity transmission networks, through their substantially increased investment programme, compared to substantially backward-looking equity betas estimated from peers that will not be facing the same scale and complexity of investment programme in many cases.
172. Oxera's report on behalf of the ENA, which also includes extensive consideration of the "low beta" anomaly, concludes that Ofgem needs to select an asset beta in the upper half of the range to adequately reflect these issues.¹⁵

FQ11. Do you agree with our proposed set of comparators which also incorporates selected European utility stocks?

¹² Frontier Economics, Assessing regulators' approach to setting the TMR - Implications for RIIO-3, August 2025.

¹³ Frontier Economics, Assessing regulators' approach to setting the TMR - Implications for RIIO-3, August 2025, executive summary, page 5.

¹⁴ Frontier Economics, Updated cost of equity cross-check evidence, 22 August 2025.

¹⁵ Oxera, RIIO-3 draft determinations – CAPM parameters and debt-based cross-checks, August 2025, section 4.

173. Yes, we support the proposed set of comparators – including Pennon and European comparators – as this gives a broader base of evidence than the RIIO-2 approach in an area where this was necessary.

FQ12. Do you agree with the conclusions we have drawn from our chosen crosschecks?

174. No – a balanced assessment of cross checks supports a higher cost of equity than the one Ofgem has chosen, for example through choice of a point estimate from the top half of the range.
175. Frontier Economics has assessed Ofgem’s approach and found it has not applied a consistent quality standard across the cross checks, resulting in an overall cross check assessment that is too low.¹⁶
- a. The debt based cross checks developed on behalf of ENA, by Frontier Economics using hybrid bonds¹⁷ and Oxera using its debt premia methodology (now updated to use Ofgem’s chosen debt indices)¹⁸, demonstrably meet the standard of evidence that Ofgem has applied to other cross checks. Ofgem should revisit this decision and incorporate the results of these cross checks as evaluated by Frontier and Oxera.
 - b. Ofgem has been inconsistent in using DGM-based evidence through its MAR analysis while not adopting the DGM analysis in other guises, such as Frontier Economics assessment of the evidence on the TMR¹⁹.

FQ13. Do you agree with our treatment of risks to the ET and Gas sectors as non-systematic?

176. We do not agree that non-systematic risks should not be reflected in the cost of capital.
177. Non-systematic risks are only irrelevant to the cost of capital under a set of highly restrictive capital asset pricing assumptions. These assumptions will not be met in the real world since they assume the bankruptcy process is costless, which it is not.
178. One of the most substantial risks that faces network sectors is regulatory and political risk; while these can be regarded as non-systematic, their presence undoubtedly increases the cost of capital that investors require, compared to a risk free environment. Ofgem must set a cost of equity that recognises these risks, particularly where it expects substantial additional equity investment in sectors where it has reduced the regulatory gearing assumption (since the additional equity is just as exposed to, and potentially heightens, these same risks).

FQ14. Do you agree with our proposed dividend allowance policies for the notional gas and electricity companies?

179. No, we do not agree with Ofgem’s dividend allowance policies. The 3% dividend assumption should be 5%, which rightly has regulatory precedent.²⁰
180. A 3% dividend yield is below the dividends seen on the group of relevant peers that Ofgem has used to estimate equity beta, which we set out in the table below. This reflects the fact that investors in networks are typically seeking income and not just capital growth. It is necessary that Ofgem makes its settlement appealing precisely to these investors in order to guarantee that it is

¹⁶ Frontier Economics, Cross-check standards of evidence, August 2025.

¹⁷ Frontier Economics, Updated cost of equity cross-check evidence, August 2025.

¹⁸ Oxera, RIIO-3 draft determinations – CAPM parameters and debt-based cross-checks, August 2025, section 6.4.

¹⁹ Frontier Economics, Updated cost of equity cross-check evidence, 22 August 2025.

²⁰ Ofgem’s dividend assumption for DPCR5 and RIIO-ED1 was 5%, for example.

investable. Ofgem cannot justify an assumption as low as its 3.0%; the overwhelming conclusion from the market evidence is that investors in network companies will reasonably expect a dividend yield in the region of 5%.

Table 1. Dividend yield comparators

Company	Dividend yield ²¹
National Grid	4.42%
United Utilities	4.46%
Severn Trent	4.63%
Penon	6.32%
Terna	4.55%
Redeia	4.81%
Enagas	4.48%
SNAM	5.52%
Average	4.90%

FQ15. Do you agree with our proposal not to apply the flat WACC approach?

181. We do not agree with this proposal.
182. Ofgem must recognise in its final determination the importance of the flat-WACC approach for any sectors that are being transitioned from a higher level of notional gearing to a lower one.
183. Reductions in gearing levels cannot be achieved overnight and, where a reduction in the assumed gearing level will lead to a lower WACC, it is appropriate for the WACC based on the initial gearing level to be adopted. Otherwise, the combined cost of equity and embedded debt will be underfunded.
184. The only remaining question is the period over which this transitional arrangement is applied. It is not clear to us that the transitional period should end after only one period for ET. Two periods would be more appropriate given the typically long tenor of debt issuance.

FQ16. Do you agree that our proposed package for gas and electricity companies is investable?

185. The proposed package represents a substantial improvement on the RIIO-2 methodology and has addressed some of the critical challenges to investability, but further changes will be necessary to ensure investability.
186. Ofgem has not appropriately considered its decision as to where in its CAPM cost of equity range to select its cost of equity point estimate – a wide body of evidence supports selecting a cost of equity point estimate that is much higher than Ofgem’s proposed point estimate.
187. Ofgem has failed to appropriately engage with cost of equity cross checks. In particular, Ofgem has applied an inconsistent quality standard to its own and ENA’s proposed equity cross checks

²¹ Source: Hargreaves Lansdown, except Terna which we calculated directly, as of 21 August 2025.

leading to it relying on a biased set of cross-checks.²² A balanced set of cross checks clearly demonstrates that Ofgem's proposed T3 cost of equity is too low.²³

188. The T3 draft determination cost of equity fails to compete against alternative investments available to investors such as the 9-10% nominal returns available to investors in US markets or to provide a sufficient premium to equity investors relative to returns available to debt investors. This is compounded by the use of a 55% gearing assumption in ET3, which reduces the cost of equity actually being allowed while increasing the amount of equity that investors are required to provide – a combination which sends entirely the wrong signals.
189. The 3% dividends assumption should be 5% instead, as set out in our response to FQ14 above.
190. Investability also needs to consider the 'return of' capital as well as the 'return on' capital. Whilst some 'speed of money' changes have been made for ET3, Ofgem has not adjusted its regulatory depreciation approach which remains a severe investability concern. See our response to FQ26.

FQ17. Do you agree with our working assumption that there is risk symmetry within the aggregate balance of the whole price control?

191. The combination of substantial increases in investment in ET, combined with Ofgem's proposed haircuts to allowances and an uncertain and potentially punitive incentive package, suggest to us substantial levels of asymmetric downside risk.

Finance Annex: Debt financeability

FQ18. Do you agree with our approach to assessing financeability?

192. In this response, we first set out our views on Ofgem's overall approach to ensuring financeability, in the settlement before answering the more specific question around how Ofgem has assessed financeability.

Ofgem's approach to ensuring financeability

193. The draft determinations for electricity transmission provides a solid basis for ensuring long-term financeability that we have long highlighted as a major gap in Ofgem's approach.
- a. The immediate implementation of nominal debt funding is a major part of the approach to correcting the problem.
 - b. The electricity transmission approach rightly recognises that a higher equity return is reflective of the investment requirements, but there is more to do.
 - c. Ofgem's recognition of the merit of cash measures in fixing the financeability issue is also welcomed.
 - d. As is Ofgem's commitment to looking beyond the next price control when assessing financeability.
194. Whilst these approaches are welcomed, they have come much too late on the process. Sequencing matters - the higher the need for investment, the more important it is to establish the fundamentals of the investment framework early. Upfront, Ofgem must:

²² Frontier Economics, Cross-check standards of evidence, August 2025.

²³ Frontier Economics, Updated cost of equity cross-check evidence, August 2025.

- a. define (i) a sensible range of returns, (ii) a profile of cash-flows that sustains credit metrics, (iii) regime that ensures financial resilience; and
 - b. be clear on (i) the increase in capacity that is to be delivered, (ii) how that is to be funded, and (iii) how efficiency and innovation is to be incentive.
- 195. No rational investor can give a strong, positive response to strategic investment if they are blind to critical elements of the frameworks and cashflow risks. While the draft determinations show Ofgem has now taken late steps towards a financial package that delivers financeability, refinement of this package is still necessary, while critical elements supporting investability overall – including how the incentive framework will encourage innovation and improvements in both customer and investor outcomes – appear to require substantial work ahead of final determinations.
- Ofgem's approach to assessing financeability**
- 196. We have mixed views on Ofgem's approach to assessing debt financeability.
- 197. Ofgem has taken a significant step forward in its recognition of the need to assess debt financeability across at least three price control periods. An assessment solely on the basis of the single price control period would carry a significant risk of storing up problems for the future, and leaving them to a stage where solving them would present serious affordability issues. A more measured, long term, approach can mitigate this risk.
- 198. We also support use of financial ratios as assessed by multiple rating agencies, particularly in light of the new licence requirement to maintain more than one investment grade credit rating.
- 199. However, there are shortcoming in Ofgem's approach that should be addressed for the final determinations.
 - a. Ofgem needs to change its mindset, away from allowing the long-term metrics to fall all the way to the investment grade thresholds, and towards a mindset of maintaining at least some headroom in the longer term, even if it is a reduced level (bearing in mind the points Ofgem mentions in paragraph 5.70).
 - b. At a minimum, FFO/net debt must be above the floor set by Moody's 11% threshold to ensure that an efficient company would maintain two investment grade credit ratings. It is rational that Ofgem's financeability testing is consistent with its own licence requirement. The Moody's FFO/net debt Baa lower bound (11%) therefore needs to be used in the assessment of this ratio, in Figure 86 of Ofgem's finance annex. This bound will be breached at RIIO-5 under Ofgem's proposed financial profile and implies further cash support is needed.
 - c. The financeability assessment must include the highest investment case to ensure that this criterion is met against the maximum level of funding Ofgem anticipates to release throughout the period.
 - d. Ofgem should also incorporate the debt to EBITDA ratio, as used by S&P. The same factors that cause FFO/net debt to fall also lead to an increase in debt to EBITDA; but the additional metric does need to be assessed to test whether it remains under a 6x threshold and understand whether the transmission sector in fact maintains a set of investment grade S&P financial metrics.

FQ19. Do you agree with our proposal to adjust bucket 2 capitalisation rates from natural rates to 85% for all ET licensees to support financeability? Are there alternative measures that stakeholders consider more appropriate?

200. We support Ofgem's proposal to not adopt a higher capitalisation rate than the RIIO-2 status quo of 85% for this bucket.
201. Moreover, we are not clear that this reflects any reduction relative to the accounting capitalisation rate, if this is what Ofgem means by "natural" rate, since any major increase in capital expenditure will also require a scaling up of business support expenditure that is not capitalised (or would not be capitalised in the accounts of the entity undertaking the physical work).
202. A lower capitalisation rate for this bucket could therefore be considered to further support financeability, as a step down from the status quo.

FQ20. Do stakeholders have views or evidence on long-term financeability considerations, including the appropriateness of the proposed asset lives?

203. Ofgem is entirely right to take into account long-term financeability considerations in decisions it takes in the current price control review.
204. We comment on regulatory depreciation (i.e. asset lives) in our response to question FQ26 below.

Finance Annex: Financial resilience

FQ21. Do you agree with our proposal to implement the Financial Resilience measures as laid out in our SSMD and the proposed methodologies set out above?

205. We provided our views on these three measures in response to Ofgem's methodology consultation for RIIO-T3 and GD3. We still hold these views, and do not reproduce them here to avoid duplication.
206. Turning to financial resilience as one of the pillars of investability, Ofgem should recognise that the sector must be financially resilient in the eyes of all stakeholders, including investors. The recent consultation on a potential higher level of ringfence requirements, or a further detailed review, sends the opposite message:
- a. Ofgem has only just examined the ringfence and decided that it has what it needs. What are investors supposed to make of it having second thoughts?
 - b. Some of Ofgem's proposals show a tendency towards restricting capital return to investors – how should investors (including those considering capital injections) interpret this?
207. We provided a separate response to Ofgem's consultation on a ringfence review and do not reproduce it here.

Finance Annex: Corporation tax

FQ22. Do you agree with the proposed position that by including robust protections within the Price Control Financial Handbook, a tax forecasting penalty is not required?

208. We agree a tax forecasting penalty is not required; however,
- a. Ofgem must be clear as to what is meant by "robust protections" and how these would be implemented.

- b. Ofgem should provide clarity on the concept of ‘a notional efficient company’ in this regard.

209. With reference to paragraph 7.82, this could be dealt with by review of the tax reconciliation variances rather than by adopting the concept of ‘a notional efficient company’, which appears to be unnecessarily complicated.

FQ23. Do you agree definitions for ANDt and TDNI should be updated to reflect the principles outlined in paragraph 7.41?

210. We agree with Ofgem's proposal on the basis of the principles outlined.

Finance Annex: Regulatory depreciation

FQ24. What are your views on our proposal to accelerate depreciation for new assets only in GD and is there any further evidence you would like us to consider before we reach a final decision?

211. The adjustments Ofgem is making - for new assets only - may be insufficient in light of the potential decommissioning of the gas distribution networks. Ofgem may need to consider further changes or alternatively develop and implement a backstop mechanism that will allow for future recovery of any stranded assets.

FQ25. Do you agree with our proposal to maintain the existing depreciation policy for gas transmission assets?

212. We have no specific views on this but note that the gas transmission sector would also benefit from the backstop RAV recovery arrangements that we suggest in response to FQ24 above.

FQ26. Do you agree with our proposal to maintain the existing depreciation policy for electricity transmission assets?

213. Under no scenario should Ofgem consider focussing on the expected technical life of the assets and it should never set the regulatory depreciation lifetime of new asset additions to be longer than the expected life of those assets, as it appears to propose for electricity transmission.

214. We are not aware that Ofgem has published the CEPA analysis that it states it relied on²⁴ and so we have been unable to review it.

215. Ofgem's brief description refers only to the “weighted technical life” of assets. We understand Ofgem's pre-existing policy to be to use the expected economic life of the asset which will, by definition, be shorter than the technical life of the asset. We also do not agree that the calculations set out at paragraph 8.56 support 45-year regulatory depreciation. The technical life of historically installed assets cannot be used to support a regulatory depreciation period for new asset additions in excess of the expected technical life of those new asset additions.

216. Moreover, a much broader range of factors than Ofgem currently appears to be taking into account should be considered in setting this parameter, given its long term effects. A narrow debate over the expected economic life of the asset misses that facts that:

- a. Current annual depreciation is suppressed for electricity networks by the transition to longer depreciation lifetimes implemented in the RIIO price controls; and it is not

²⁴ Ofgem, 2025, ET3 and G3 draft determinations, finance annex, paragraph 8.53

generationally fair to confer the benefits of a further depreciation holiday on current customers (to the detriment of future customers).

- b. There is a social welfare NPV positive effect from faster regulatory depreciation, through the lower long term interest and equity return costs paid by consumers, since the cost of capital on these regulated investments exceeds HMT's green book's long term discount rate.
- c. Faster regulatory depreciation can carry further overall cost benefits to energy consumers, when cashflows are relatively strained, such as reduced requirements for equity injections and the associated costs, and potentially a lower cost of debt if credit metrics are enhanced (a benefit which would be passed on to consumers over successive price control processes, through Ofgem's debt index calibration process).

Finance Annex: Return Adjustment Mechanisms

FQ27. Do you agree with our proposals for the RAM thresholds and adjustment rates?

217. We do not think RAMs should be used and therefore do not agree with Ofgem's proposal. We reproduce part of our ET3 and G3 methodology consultation response on RAMs below.

"We do not think Return Adjustment Mechanisms (RAMs) should be used. If Ofgem takes good decisions on the appropriate design and calibration of each element of the price control, then the overall package should make sense and RAMs should not be needed. They are a blunt mechanism placed on top of what should be carefully made decisions, that might have the effect of switching off carefully designed incentive mechanisms.

However, if RAMs are to be used, the calibration must give companies clear financial incentives to improve performance. Companies that do not hit fair performance targets should face penalties, while companies that perform well and deliver benefits to consumer must be permitted to benefit through the calibration of incentives giving sufficient headroom over the allowed return on equity.

*If performance bands are too narrow, one effect would be to curtail the important incentive provided for the leading firms (those outperforming the most) to keep driving performance forward in customers' interests. This may prevent best practice from being discovered, at a potentially significant cost to all consumers."*²⁵

218. However, we do support Ofgem's continued exclusion of company-specific financial performance.

*"Financial performance should not be included. This would amount to a sharing factor on the cost of debt through the back door and a five-year price control period does not provide an adequate timeframe for measurement of financial performance."*²⁶

FQ28. Do you agree with our proposal to include programmes such as ASTI within RAMs?

219. We do not think it would be logical to implement a RAM while excluding operational and cost performance on a substantial part of the price control settlement, therefore we support this element of the proposal in light of the overall approach.

²⁵ Northern Powergrid, March 2024 ET3 and G3 methodology consultation response, paragraphs 339-341.

²⁶ Northern Powergrid, March 2024 ET3 and G3 methodology consultation response, paragraph 343.

Finance Annex: Indexation of Regulatory Asset Value

FQ29. Do you agree with our proposals for RAV Indexation?

220. We support Ofgem's decision to move immediately to a fully nominal allowance for the notional nominal share of debt costs; and hence we support Ofgem's decision to not index the portion of RAV accounted for by notional fixed rate debt.
221. We also agree that Ofgem needs to uplift the entire RAV by the CPIH inflation that occurs up to the end of March 2026 (including inflation that occurs during the whole of the month) before switching to the partial indexation approach from April 1 onwards.

Finance Annex: Other finance issues

FQ30. Is there any additional evidence we should consider to improve our setting of regulatory capitalisation rates?

222. We can offer no additional evidence specific to the relevant sectors.
223. We think a more specific definition of the "natural" capitalisation rate would help improve transparency for stakeholders – including full definitions of capital expenditure (capex) and operating expenditure (opex) that it appears to hinge on.
224. When setting the regulatory capitalisation rate, Ofgem should not only consider the "natural" rate but also needs to consider the capitalisation rate in the wider context of cash flows and financeability.

FQ31. Do you agree with the approach to maintain the RIIO-2 treatment for disposal of assets?

225. We support the proposal to retain the RIIO-2 approach, of netting asset disposal proceeds against totex.
226. We note that the alternative proposal, 100% fast money treatment of disposal proceeds for fully depreciated assets, would be NPV negative (on a green book analysis using a societal discount rate), rather than NPV neutral as Ofgem states at paragraph 11.45 of its finance annex. This is because failing to pay back an element of RAV with the proceeds would lead to higher long term interest charges being paid for by consumers.
227. We also consider that it is not clear cut that it would be intergenerationally fair for current customers to receive 100% of the proceeds from the disposal of fully depreciated assets – a discount is already factored into the charges of current customers thanks to previous disposals of assets that were netted off totex, rather than being treated as 100% fast money. Given this, maintaining the status quo would be more intergenerationally fair than a change to the policy.

FQ32. Do you agree with the proposal for the ex-ante base revenue definition we will use to calculate the re-opener materiality thresholds?

228. The absolute materiality threshold itself is more relevant than the exact methodology used to derive it, and the appropriate level will depend on the risks and issues faced by the sector in question. We have no evidence on the suitability (or otherwise) of the thresholds that Ofgem has calculated for the electricity transmission and gas networks sectors.

FQ33. Do you agree with the proposal for how we will set ODI caps and collars at final determinations that are fixed for the duration of RIIO-3?

229. In general we support using caps and collars for ODIs that are fixed (in real terms) for the duration of the price control period, particularly where the value of the deliverable to consumers is expected to be broadly constant. We cannot however rule out scenarios where an alternative approach might be appropriate, for example if an output was expected to become substantially more important to consumers during the course of the price control period.

FQ34. Do you agree with the proposal to move to using nominal WACC as the single uniform TVOM?

230. Yes, we support the approach taken in RIIO-ED2 of using a single uniform TVOM. As Ofgem notes, it is simpler and removes the potential for licensees to gain (or lose) depending on the exact cause of an under-recovery.

FQ35. Do you agree with the proposed base revenue forecasting penalty mechanism?

231. We agreed with Ofgem's proposal for a forecasting penalty mechanism in our own ED2 draft determinations; and also agree with Ofgem that a generally consistent approach across the sectors is sensible, where this is reasonable.

FQ36. Do you agree that the thresholds have been set appropriately?

232. The methodology Ofgem uses to establish the threshold on a common basis for the different sectors and companies covered by this determination is simple and transparent; we also agree that it makes sense to recognise differences in the proportion of revenue accounted for fast money and pass through costs. That said, Ofgem should reconsider the inclusion of passthrough cost in the forecasting penalty methodology and remove any uncertainty from variations in these costs, as they are non-controllable.
233. However, if there are differences between companies in the length of time ahead they have to forecast and set tariffs, and/or the volatility of their fast money and pass through allowances, the methodology may not yet have fully achieved Ofgem's policy ambition of putting the companies and sectors on a level footing.

Impact Assessment

IAQ1. Do you agree with our approach to assessing the economic impacts of RIIO-3?

234. It is welcome that Ofgem has acknowledged that a bill increase is required in the short term to release investment and reduce costs over the long term. Ofgem should go further in its economic impact assessment and focus on the positive impact to economic growth from the step up in investment. At present the economic impact assessment:
- a. compares RIIO-3 uncertainty mechanism allowances, constraint cost savings, financial parameters and revenues to RIIO-2 levels from a bill impact perspective, not an economic perspective; and
 - b. acknowledges there will be job creation due to the step-up in investment, which should lead to growth, but only refers to the job growth figures quoted in business plans. It does not take into account the cost reductions it has imposed, which will reduce the number of jobs created, or acknowledged the impact of its overreliance on ex post funding mechanisms, which will likely dampen supply chain confidence and the pace of growth due to the uncertainty of the deal.

235. Enabling an increase in investment that keeps a greater array of pathways to net zero open and deliverable promises lower energy bills for consumers in the longer term - especially when coupled with effective incentive regulation by Ofgem.
236. This promise of lower bills over the long term relies on Ofgem moving back to ex ante incentive-based regulation, where outputs and deliverables are achievable, and the framework allows efficiencies and innovation to thrive – and, crucially, the supply chain to respond to the increased certainty in the market signals.
237. This shift in focus towards investment can unlock a significant shift to more affordable, secure and sustainable energy. Investing now will unlock lower prices over the long term, enabling a more affordable transition for all, and support job creation and investment in new skills that delivers economic growth via:
- a. The direct effect of more economic activity being undertaken by the industry relative to the counterfactual of “wait and see”.
 - b. The relatively labour-intensive nature of DNO capital investment means the creation of a significant number of skilled jobs, which would be distributed across the UK by virtue of the regional nature of the DNO businesses.
 - c. The higher investment in low-carbon technologies (LCTs) by customers as confidence grows that the network upgrades are being delivered.

IAQ2. What are your views on the appropriate approach to evaluation of the economic impacts of RIIO-3?

238. Ofgem should consider the impact of final allowances and use of uncertainty mechanisms on job creation, supply chain and economic growth.

IAQ3. Do you agree with our approach to modelling the bill impacts of RIIO-3? Please provide any additional effects or alternative measures that you think would be appropriate?

239. We have no views to add to our responses to IAQ1 and IAQ2.

ET Annex: Outputs and incentives

240. We have given principle-based feedback on outputs and incentives in our executive summary and in response to the Outputs and Incentives section of the overview document.

241. The design and scope of the sector specific incentives is best explored by Ofgem and electricity transmission network companies in most cases, but we do offer responses to the following.

ETQ1. Do you have any views on our proposed approach to which projects will be in scope of the CNSP-F ODI-F, especially projects submitted through the Load Re-opener?

242. The approach is sensible to include all outputs from the CNSP-F and use a principles-based approach to include other non-CNSP-F output projects.

ETQ2. Do you agree with our proposed approaches to determining a TDD for CNSP-F Outputs and non-CNSP-F Outputs?

243. Yes, the methodology is reasonable to base the target on the Optimal Delivery Date (ODD) as set by the NESO in the majority of cases.

244. It is important that there are appeal or dispute mechanisms in the method by which the NESO sets the ODD using inputs from and consults with the transmission owner.

ETQ3. Do you agree with our proposed inclusion of a minimum availability standard in the CSNP-F ODI-F?

245. Yes, defining explicit criteria for delivery of a project being achieved is useful.

ETQ4. Do you agree with our proposed approach to Delay Events in the CSNP-F ODI-F?

246. Yes, it is an additional measure in addition to the deadband to recognise and adjust for the real-world events that result in delivery not being fully controlled by the transmission owner.

ETQ5. Do you agree with our proposed shape and size of the CSNP-F ODI-F incentive?

247. Yes, both shape and size appear appropriate albeit the size of the incentive needs consideration in light of the whole T3 package of incentives to check overall calibration and reward/risk properties.

248. Ofgem includes good justification for the penalty, deadband and reward. Having a one-year deadband is appropriate to manage the uncertainties inherent in the setting of targets.

249. Linking the early delivery reward to the NESO's forecast constraint cost is an appropriate method to recognize the impact on consumers in the value of the incentive.

ETQ6. Which of the two proposals for the Connections Capacity ODI-F target setting methodology do you think is most appropriate and why?

250. There is work to be done on the incentive package to ensure companies do not face undue downside risk, especially whilst they are tasked with a large expansion of the network.

- a. The incentives package needs to support companies as they face new challenges in expanding the network, even without external supply chain constraints. To deliver for customers, it is essential that incentives are not skewed towards downside risk, clearly defined up front and calibrated to be both achievable and challenging.
- b. The incentives framework should not place a disproportionate weight of the deliverability risk on companies. It is not feasible for investors to deploy capital under a deal that is riddled with unclear clawback risk.

251. This needs to be fixed at the final determination to allow transmission companies to compete internationally for investment. As it currently calibrated, the cost of equity is not high enough to account for the risk that the transmission sector will find itself in a 'doom loop' where:

- a. unachievable targets reduce funding available to make improvements, resulting in even worse performance;
- b. clawback and downside risk make investor returns significantly more volatile, harming the investability of the sector; and
- c. wide-spread uncertainty of funding and returns discourages investment over the long term.

252. This is not regulation that will provide a route to economic growth. Ofgem needs to take lessons from the Independent Water Commission's recent report and reassess its approach.

253. On the two methodology proposals, both solutions have merit:

- a. They incentivise companies to deliver additional network capacity in a timely manner;
 - b. Targets for required outputs can be set based on the work programmes agreed following connections reform or after setting of the T3 price control; and
 - c. The proposed reward/penalty is relatively low-powered with a smaller downside to reflect the factors outside of companies' control.

254. Ofgem's lead preference of connecting the generation projects by target dates established by the newly reformed connections queue is the most appropriate.

 - a. This lead options provides a very clear relationship with the connections programme and the clear GB imperative of the need to build a cleaner grid by 2030.

255. The alternative option to reward the delivery of additional system capacity would need to be scoped such that there is no overlap or conflict with other connections incentives, and ensure synergistic benefits are taken into account. In our sector, the latter is best achieved via the use of fungible ex ante allowances.

 - a. There is potential overlap with the CSNP-F proposed incentive for delivery of certain infrastructure projects.
 - b. A more subtle issue is that an integrated strategic plan is seeking delivery of investment with synergistic benefits where say an investment delivers additional capacity and improved asset health. If this option for incentivising the additional capacity is chosen, then any perverse impact on incentivising these synergistic benefits needs considering.

ETQ7. Do you have any further considerations on our chosen direction for a RIIOET3 Connections Capacity ODI-F, including detail on how the targets could be built up?

256. No.

ETQ20. What are your views on our proposed design of the Innovative Delivery Incentive?

257. The design and scope of the incentive is best explored by Ofgem and electricity transmission network companies – but the lack of clarity on the scope for a draft determinations stage is unacceptable and creates regulatory risk.

258. In order for companies to be able to deliver outcomes for customers in a price control that is fair, balanced, and achievable, deliverables must be consistent with final allowances. Otherwise, companies are simply not funded to deliver against Ofgem and customer expectations. The scale of the haircuts Ofgem has imposed on companies in these draft determinations brings this into question, and presents a risk that companies are not funded to deliver the outputs that have been placed on them.

259. This issue becomes exacerbated once Ofgem imposes funding constraints which hinder the companies' ability to deliver the work required to achieve the outputs. Ofgem has opted for this approach here, making use of numerous funding mechanisms and tightly ringfenced allowances that create boundaries and associated distortions, remove incentives to find synergies, create regulatory risk, and involve a high regulatory burden on both Ofgem and the regulated companies.

260. On top of this excessive clawback risk, imbalanced incentive calibration is a concern. Some incentives included in this draft determination, for example the connections incentive and innovative delivery incentive, are largely incomplete in their scoping and have a negative skew.

The draft determination is extremely late in the day for incentives to not be clearly scoped. This should have been done in the methodology decision.

261. The combination of (i) large cost allowance haircuts, (ii) numerous funding constraints, and (iii) imbalanced incentive calibration, together combine to risk creating a toxic incentive framework where the proposal is not attractive to investors. In general, the more vague, diluted or unrealistic a set of incentives, the more upward pressure this puts on base returns. This has not been accounted for in the electricity transmission package and harms the investability of the sector.
262. The incentives framework needs to encourage innovation to enable the transition at the lowest cost to customers through both transformative innovation and optimisation. The size of the prize over the 25-year period will be material – and especially important to seek out in electricity distribution where the transition requires a step-up in investment that is sustained throughout.
 - a. Higher investment in transformational innovation to enable the research, development and demonstration of initiatives prior to deployment will be key to unlocking lower costs.
 - b. Being able to optimise throughout the period encourage companies to seek out innovative solutions not known at the time of plan submission, reducing costs for customers.
263. However, the extreme amount of ringfencing and toxic incentive framework rids the deal of any incentive to innovate, and Ofgem's continuation of the RIIO-2 approach will fail to unlock the wealth of innovation and information that would drive both more efficient systems, and which could enable Ofgem to apply regulation more effectively in future price controls as the industry continues on its 25-year journey. This approach fundamentally locks the sector into an equilibrium that is high cost, and risks failure to deliver on the mission to decarbonise the economy.

ETQ24. What are your views on the proposed New Infrastructure Stakeholder Engagement Survey ODI-R, including areas of engagement measured, the proposed survey design, the stakeholders targeted, and the proposed reporting format?

264. We welcome Ofgem's continued emphasis on meaningful and measurable stakeholder engagement through mechanisms such as the proposed New Infrastructure Stakeholder Engagement Survey ODI-R.
265. From an electricity distribution perspective, we support the underlying principles of transparency, consistency, and stakeholder voice embedded in this proposal. In particular, the focus on core engagement qualities – promptness, frequency, methods, quality, and responsiveness to feedback – aligns well with the values of good engagement and service delivery.
266. However, we would note that electricity distribution companies already operate under a mature and embedded stakeholder engagement framework, developed and tested through successive price control periods.
267. As such, we believe the need for a parallel ODI-R in electricity distribution is less pressing, given the breadth and depth of current engagement practice already subject to annual scrutiny and scoring under existing ODIs, reputational incentives and the oversight of our Independent Stakeholder Group (ISG).
268. We welcome continued dialogue on the appropriate tools to support high-quality stakeholder engagement in RIIO-ED3 and would be happy to contribute learnings from the distribution sector to inform transmission-focused proposals such as these.

ET Annex: Managing Uncertainty

269. We have given principle-based feedback on uncertainty mechanisms in our executive summary and in response to the Managing Uncertainty section of the overview document.

270. Several uncertainty mechanisms are sector-specific and so Ofgem and the electricity transmission companies are best placed to design and scope of the funding mechanisms. We therefore do not provide a specific response to questions ETQ26 to ETQ28, and ETQ40 to ETQ43. We do respond to the remainder of the questions in this section with principle-based views that hold across all sectors, below.

ETQ25. Do you agree with our proposal to retain the APM for RIIO-ET3 in its current form?

271. We agree this should be retained and consideration given to a similar mechanism for electricity distribution, as per our response to OVQ10 in relation to the APM.

ETQ29. Do you agree with our proposed scope, re-opener windows and materiality threshold for the Load Re-opener?

272. Only a minority of the deal has been settled upfront in this draft determination for electricity transmission's load-related work, with the vast majority funded via myriad of uncertainty mechanisms. This approach is not fit for purpose for what is needed over the next 25 years, and given the extent of ex post allowances, Ofgem has applied too low a bar for deeming costs to be 'uncertain' – even when the needs case is established. This level of uncertainty in the deal increases the regulatory risk, harms the supply chain and ultimately economic growth.

273. The proposed ex post funding arrangements are overly complex, with a myriad of uncertainty mechanisms being used to fund load. This ringfencing removes all incentive to find synergies with asset health expenditure, and distorts incentives within load with each mechanism limiting incentives to find the lowest overall cost in different ways.

- a. Only 0.2% of load-related allowances have been set ex ante with no risk of clawback. The scope to find synergies and efficiencies within this funding pot and across asset health works will be limited, due to its immateriality.
- b. A use-it-or-lose-it mechanism is wrapped around 1.9% of load-related allowances, which allows for tradeability across solutions, there is no incentive to find efficiencies or optimise – as the company receives no benefit for this.
- c. Several volume drivers cover 9.3% of load-related allowances, but as these allowances are only notional, there is no incentive to find volume efficiencies or synergies. Companies are only incentivised to find unit cost efficiencies, within this work type.
- d. Load reopener funding then covers the remainder of the load-related allowances (56.1% is associated with the CSNP-F reopener, 32.5% with the load reopener). There is only the incentive to find efficiencies within each reopener ringfence, which will be limited as companies now have the ability to influence the cost assessment after delivery, and where Price Control Deliverables are attached to projects, there will be no incentive to find synergies or optimise across solutions.

274. A low baseline allowance, paired with the promise of frequent reopeners. creates a funding environment that is inherently unpredictable. This unpredictability undermines our credibility with suppliers, making it harder to recruit skilled contractors and negotiate long-term agreements. Faced with the risk of mid-project funding adjustments, suppliers demand higher risk premiums

or simply step back from bidding. The result is either elevated costs or costly “boom-and-bust” cycles of ramp-ups and ramp-downs that stall capacity building and drive-up management overheads.

275. When this unstable funding framework combines with broader investability challenges, such as insufficient allowed returns and regulatory uncertainty, the entire system is jeopardised. Investors become wary of deploying the capital needed for large-scale network expansion, putting at risk the delivery of the additional capacity essential to decarbonise the economy.
276. If it is Ofgem’s intention to continue the RIIO-2 approach at RIIO-3, with funding provided via lower ex-ante allowances that are then supplemented with additional increases throughout the period, Ofgem should carry out the financeability assessments on the maximum level of funding it anticipates to release throughout the period – and accept that it has chosen an approach that will hold back growth of the supply chain.
277. The full design and detail of appropriate funding mechanisms differs by sector and it is important to assess this properly at each review, due to the nature of the work being so different (large and lumpy in transmission, compared to little and often in distribution). The approach to funding load in ET3 will not be appropriate for ED3; this extent of ringfencing would stifle innovation, reduce opportunities to find synergies and efficiencies, and limit our ability to adapt throughout the period to respond to customer needs.
278. In its ED3 methodology decision, Ofgem must set a methodology that is in line with the NIC recommendations, and commit to the use of ex-ante funding for load-related projects in a fungible pot to incentivise network companies to carry out investment at the lowest cost to customers. Aligning the funding mechanism to the pathway in a way that incentivises capacity released will be crucial to drive the right outcomes and avoid significant consistency problems in electricity distribution. In the electricity distribution sector, our Timely Anticipatory Network Capacity Indicator (TANCI) proposal is the key to this, assuring the delivery of capacity and via the use of fungible ex ante allowances allowing flexibility across solutions, promoting efficiency and encouraging synergies. Reopeners should then be used sparingly and only applied where there is a clear trigger, otherwise too broad a description risks inefficient delivery of investment.

ETQ30. Do you agree with the scope and materiality threshold for the Load UIOLI?

279. The use of use-it-or-lose-it allowances does allow flexibility across solutions, however:
- a. only within this ring-fence, reducing the scope for companies to find synergies or optimise to reduce costs overall for customers; and
 - b. it doesn't incentivise companies to find efficiencies, as all underspend is stripped away.
280. This approach should not be carried across to ED3. For our sector, our new proposal for load funding, TANCI, will allow for flexibility across solutions, promote efficiency, and encourage synergies.
281. UIOLI is supposed to be used where finding efficiencies aren’t a priority – this will not drive the lowest cost of the transition and is not in customers’ interest.

ETQ31. Do you agree with our proposed design of the generation and demand connections volume driver mechanisms?

282. Any volume driver should be upwards only, to ensure baseline allowances are given with certainty. The draft determination indicates that the load volume driver mechanisms flex both upwards and downwards, creating regulatory risk and investor uncertainty.

283. Without certain and upfront funding, volume drivers give no incentive to find volume efficiencies – only unit cost efficiencies. These will therefore not be a route to the transition to net zero at the lowest cost, and similar to the use-it-or-lose-it allowance, limit incentives to find synergies.

ETQ32. Is it clear how the different Load Re-opener tracks operate, and do you agree with the rationale for introducing them?

284. The tracks are unclear, and the overuse of uncertainty mechanisms results in an overcomplicated price control with distorted incentives. Ofgem should look to adapt a simpler approach in ED3.

285. The distinction appears to be clear (CSNP-F driven vs non CSNP-F driven) – but each licence condition criteria must be clear and targeted.

ETQ33. Do you agree with our proposal to apply the 'stepped TIM' to volume drivers as part of general totex?

286. We agree with the proposal to include volume drivers alongside general totex for efficiency incentive purposes.

287. However, it does not seem necessary to apply a stepped TIM to this category of expenditure, as it does not meet the criteria we think should be applied for identifying where this approach is appropriate.

a. The stepped-TIM approach may make sense in order to avoid that area of cost dominating the whole efficiency incentive where:

- i. risk, uncertainty and costs of particular area are sufficiently high; and
- ii. the costs in that area can be completely ringfenced from other expenditure, and synergies ruled out.

b. Where any of these criteria are not met, for example if risk is lower, a stronger efficiency incentive can be applied, and Ofgem should make use of this to reduce costs for customers – relying instead on the effectively stepped totex incentive mechanism that the return adjustment mechanism already achieves.

288. *ETQ34. Do you agree with our proposed methodology for excluding atypical connection projects from the regression model?*

289. Electricity transmission companies are best placed to answer this, as it depends on the data.

ETQ35. Do you agree with our proposal to use the Load Re-opener (above £25m) and Load UIOLI (below £25m) to fund projects that fall outside ± 1.5 standard deviations from the regression mode?

290. Electricity transmission companies are best placed to answer this, but in principle the funding mechanism should be consistent with the cost benchmarking approach.

ETQ36. Do you agree with our treatment of RIIO-ET3 Volume Driver crossover projects and our approach to allowance profiling?

291. It seems sensible to ensure projects that span price control periods are sufficiently funded and can be completed. There may be more simplistic approaches to avoid projects running out of funds, for example using simple percentages.

292. Allowing a portion of load-related funding for future price controls to be determined via existing arrangements would help bridge the gap between price controls, but would only boost supply chain capacity and investor confidence if it is not clawed back at a later date through retrospective regulation.
293. If it is Ofgem's intention to continue the RIIO-2 approach at RIIO-3, with funding provided via lower ex-ante allowances that are then supplemented with additional increases throughout the period, Ofgem should carry out the financeability assessments on the maximum level of funding it anticipates to release throughout the period.

ETQ37. Do you agree with the proposed scope of the CSNP-F Re-opener?

294. We agree that CSNP projects will require a funding mechanism throughout the period and new need cases arise. Electricity transmission companies are best placed to comment the scope of this reopener.

ETQ38. Do you have any views on our proposed design of the CSNP-F Re-opener?

295. In cases where projects are extremely material, the costs are truly uncertain and the risk profile is high, the materiality threshold for COAE of 10% of the project cost allowance will protect both customers and companies, by ensuring the costs required to deliver the project are made available.

ETQ39. Do you agree with our proposed approach to T2/T3 crossover projects?

296. Project delays are often outside of company control, and a close-out mechanism to ensure large projects can be delivered throughout the following price control period if needed is sensible.

ETQ44. Do you agree with our proposal to introduce a Non-Load Reopener to address funding gaps in shared-driver projects where the load-related need no longer exists, but an asset health requirement remains?

297. The extensive number of re-opener mechanisms will no doubt cause confusion, and disincentivise companies to find synergies across load and non-load.
298. If the projects were funded with ex ante allowances and subject to deliverables like NARMs and TANCI, this wouldn't be an issue. Ofgem should encourage companies to embed the synergies give the certainty of allowances regardless of the driver.

ETQ45. Do you agree with our proposed design of the Non-Load Re-opener?

299. Electricity transmission companies are best placed to comment on the design of the reopener. See our response to ETQ44 on our views on the need of this reopener.
300. The distinction between load vs non-load reopeners will not incentivise companies to find synergies and may cause complexities in assessing submissions consistently within each standalone reopener.
301. This is overuse of uncertainty mechanisms – not good for investor or supply chain certainty.

ET Annex: Cost of service

302. Ofgem and electricity transmission companies are best placed to design the detail of the cost assessment. We therefore do not provide a specific response to questions ETQ46 to ETQ57, ETQ60 to ETQ61, ETQ63, ETQ66 to ETQ67. We do however respond to the remaining questions in this section, with principle-based views on cost assessment methods that hold for all sectors.

ETQ58. Do you agree with the CAI UIOLI allowance to support TOs growth ahead of CP2030? What are your views on the scope and chosen level of CAI UIOLI funding?

303. It is important to fund indirect expenditure to support capital expenditure – but it is not clear why it needs to be UIOLI. Ofgem should fund indirects to the greatest extent that it can via ex ante allowances.

ETQ59. Do you agree with our proposal to remove the opex escalator for RIIO-ET3?

304. As our response clearly shows, we are strong supporters of ex-ante allowances that incentivise companies to find synergies and efficiencies and give investors certainty. As per our response to question ETQ29, “the full design and detail of appropriate funding mechanisms differs by sector and it is important to assess this properly at each review, due to the nature of the work being so different (large and lumpy in transmission, compared to little and often in distribution). The approach to funding load in ET3 will not be appropriate for ED3; this extent of ringfencing would stifle innovation, reduce opportunities to find synergies and efficiencies, and limit our ability to adapt throughout the period to respond to customer needs”.
305. However, Ofgem has retained its load-related volume drivers for electricity transmission to fund the capital investment, and provision of additional funding the associated indirect costs is essential. Therefore it only makes sense to remove the opex escalator if the indirect costs associated with the volume drivers is funded elsewhere.
306. Provided that the CAI UIOLI includes indirects funding associated with the volume drivers, yes.

ETQ62. Do you agree with our approach to MEAV? What do you think we could do to improve its robustness?

307. Ofgem and electricity transmission companies are best placed to design the detail of their Modern Equivalent Asset Value (MEAV), making the relevant exclusions (on both the cost and driver side) where data is inconsistent.
308. Ofgem should look to control for differences in costs due to factors other than MEAV through the use of additional exogenous cost drivers, as opposed to trying to adjust MEAV in the first instance.
309. Electricity transmission companies are best placed to design the detail of their MEAV, making the relevant exclusions (on both the cost and driver side) where data is inconsistent.

ETQ64. Do you agree with our approach on insurance? What methodological improvements can we make?

310. We have no comments on the TO approach to insurance benchmarking; however, we note that the onshore and offshore split referenced as rationale for use of network length ratio benchmarking in ET will not be relevant for ED. As such separate consideration should be given to the appropriate basis for assessment of insurance costs at ED3.

ETQ65. Do you agree with our approach to pension scheme admin and PPF levy? What else should be considered within this approach?

311. We are comfortable with Ofgem's proposal.

ETQ68. Do you agree with our approach to maintaining future optionality through ensuring licensees use extendible design?

312. This seems sensible in principle, if land is available and costs are not excessive, but the cost assessment must take Ofgem's preference on this into account.

ETQ69. Do you agree with our drive to reduce the use of F-Gases as far as possible and do you agree with our intent to fast track selected AIS solutions to minimise the use of F-Gases now and in the future?

313. It is important to note that the design and manufacturing of SF6 alternative switchgear is in a different position for distribution voltages, and alternative F-gas free assets at lower voltages are not yet available. This limits our ability to reduce SF6 use.

314. Ofgem suggestion that when SF6 assets are used companies should give visibility of a path to removal in the future lacks clarity on the timeframe, albeit there is a lack of decision-making from DEFRA on this legislation.

ETQ70. Do you agree that the TIM in RIIO-ET3 should have a primary focus on risk management and a secondary focus on cost efficiency, and that doing so would be in the interests of consumers?

315. See our response to ETQ33.

ETQ71. Do you agree with our proposed 'stepped' design of the RIIO-ET3 TIM, including the values that we have used to set each 'step'?

316. See our response to ETQ33.

ETQ72. Do you agree with our proposal to include ASTI within this TIM approach?

317. The ET3 TIM rates are low enough to address the risk associated with ASTI projects that consistent rates across projects make sense.

GD Annex: Outputs and incentives

318. We have given principle-based feedback on outputs and incentives in our executive summary and in response to the Outputs and Incentives section of the overview document.

319. The specific choice and design of the sector specific mechanisms is best explored by Ofgem and gas distribution network companies with a sector specific understanding – but we have provided our perspectives as an electricity distributor network below, where we think they may be relevant. We do not respond to GDQ1 to GDQ11, and GDQ17 to GDQ19.

GDQ12. Do you agree with our proposed design of the Customer Satisfaction ODI-F?

320. We recognise that the way in which targets have been calculated for the CSAT ODI-F aims to reduce the postcode lottery effect by using averaged scores across the GDNs' GD2 performance and standard deviation to calculate the cap and collar.

- a. The electricity networks are operating very different networks due to geographical, demographic and network design feasibility factors. This leads to a range of challenges, some of which are more pronounced for certain networks. For ED3, this disparity should be taken into account to ensure that targets strike a balance between providing an equal and fair service across the country and allowing all companies to compete fairly for the incentive outcomes.
- b. The narrowing of the margins between cap and collar will make targets more challenging to achieve.

321. There has been no strong evidence that gas customers' expectations will increase in GD3, meaning that the focus is on continued quality rather than significant growth. This is likely to be the same for electricity customers, although noting that demand for electricity connections will increase significantly.

322. We support the decision that eligibility for the CSAT ODI-F will be determined by a minimum number of completed surveys. This will ensure a fair application of the ODI. While gas demand is difficult to forecast, leading to a relatively low minimum survey requirement of 1000, the minimum requirement for electricity companies may well be higher.

GDQ13. Do you agree with our proposed design of the Disconnections Customer Satisfaction ODI-R?

323. Due to the lack of robust data with which to forecast expected gas disconnections during GD3, we agree with the decision to make the incentive reputational.
324. We also agree that the surveys should be split between consumer-led disconnections and safety-driven disconnections.
325. We would encourage GDNs to commit to working alongside DNOs developing LCT connection journeys to ensure a smooth customer experience between gas disconnection and electricity connection.

GDQ14. Do you agree with our proposed design of the PSR Customer Satisfaction ODI-R?

326. While comparing the experience of PSR and non-PSR customers is important to indicate commitment to and service delivered for vulnerable customers, it should be remembered that:
- a. PSR customer experience is already captured within the CSAT ODI-F.
 - b. PSR reach and data quality factors mean that some vulnerable customers will not be registered as such and therefore not captured within this survey, and conversely some customers registered as PSR will not actually be eligible and will be incorrectly included in this survey.
 - c. PSR customers are more likely to experience additional communication needs, social anxiety and/or disabilities which make it harder for them to take part in a survey. This will impact the quality of the survey data.

GDQ15. Do you agree with our proposed design of the Complaints Metric ODI-F?

327. Lowering the target for the Complaints Metric ODI-F is a reasonable measure to encourage continued high performance on managing complaints.
328. The electricity networks are operating very different networks due to geographical, demographic and network design feasibility factors. This leads to a range of challenges, some of which are more pronounced for certain networks. For ED3, this disparity should be taken into account to ensure that targets strike a balance between providing an equal and fair service across the country and allowing all companies to compete fairly for the incentive outcomes.

GDQ16. Do you agree with our proposed design of the PSR Customer Complaints ODI-R?

329. We agree that targets for PSR customers should be equal to the wider population. However, it should be remembered that:
- a. PSR complaints are already captured within the Complaints Metric ODI-F.
 - b. PSR reach and data quality factors mean that some vulnerable customers will not be registered as such and therefore not captured within this survey, and conversely some customers registered as PSR will not actually be eligible and will be incorrectly included in this survey.

- c. PSR customers are more likely to experience additional communication needs, social anxiety and/or disabilities which make it harder for them to take part in a survey. This will impact the quality of the survey data.

GD Annex: Managing Uncertainty

- 330. We have given principle-based feedback on uncertainty mechanisms in our executive summary and in response to the Managing Uncertainty section of the overview document.
- 331. The specific choice and design of the sector specific mechanisms is best explored by Ofgem and gas distribution network companies with a sector specific understanding – but we have provided our perspectives as an electricity distributor network below to GDQ24, where we think they may be relevant. We do not respond to GDQ20 to GDQ23 and GDQ25 to GDQ31.

GDQ24. Do you agree with the scope of our Diversions Re-opener?

- 332. The scope and trigger must be targeted to ensure no overlap with other cost categories.

GD Annex: Cost of service

- 333. The specific choice and design of the cost assessment is best explored by Ofgem and gas distribution network companies with a sector specific understanding – but we have provided our perspectives as an electricity distributor network below, where we think they may be relevant. We do not respond to GDQ33 to GDQ35 and GDQ40 to GDQ41, as the appropriate exclusions, workload adjustments and non-regression analysis methods are sector specific and depend on the data.

GDQ32. Do you agree with our proposed use of a 'top-down' regression model?

- 334. We support the use of totex benchmarking – we believe this, with the provision of ex ante allowances, provides companies with the strongest incentives on total cost efficiency.
- 335. Totex benchmarking has the ability to measure overall value for money, capture trade-offs across cost categories, and deliver strong incentives for DNOs to pursue synergies and achieve efficiency improvements.
- 336. The growing importance of synergies and focus on long-term integrated planning strengthens the case for totex benchmarking and fungible, ex ante allowances. It is positive that Ofgem has made use of a cost benchmarking approach that minimises cost boundaries, but it is not clear whether the nature of funding mechanisms has been recognised in benchmarking, given the retention of volume drivers.

GDQ36. Do you agree with our proposed approach to pre-modelling normalisations and adjustments?

- 337. It is preferable to control for variations across companies within the regression model with a cost driver, to allow the model to unpick the efficient cost associated with each cost driver.
- 338. But it isn't always possible to find a cost driver that lends itself to this, and it is plausible that a company that operates in a sparser area faces a higher cost to serve each customer. These companies shouldn't be penalised for this in a model that doesn't control for this variation across companies, and using a pre-modelling adjustment to control for differences in density is sensible.
- 339. Account for density via a driver within the modelling is preferable, but a pre-modelling adjustment to ensure companies with a higher cost to serve the more urban or sparsely populated areas is good

GDQ37. Do you agree with our proposed approach to totex benchmarking?

340. The gas distribution networks are best placed to comment on the exact specification, but the simplicity of this cost assessment is good practice as it increases transparency and does not dilute the determination with inferior cost models.
341. Where there are several potential totex models with strong and intuitive statistical results, all based upon strong economic and engineering rationale, there is merit in using multiple models to give multiple views of efficient costs. But it is good practice not to use additional models where there is a clearly superior model for the sake of using an average.

GDQ38. Do you agree with the proposed level of aggregation, estimation technique and time period for our econometric modelling?

342. The gas distribution networks are best placed to comment on the detail with regards to the estimation technique and time period, as this depends on the data. However we support the use of pooled OLS regression analysis in the cost assessment, and models based on historical and forecast data.
343. On the level of aggregation, we support the use of totex level econometric modelling as all cost trade-offs are captured, and its use incentivises companies to submit plans at the lowest cost and find synergies in future price controls. See our response to GDQ32.

GDQ39. Do you agree with our proposed cost drivers and approach to weighting drivers in the totex CSV?

344. There is little weight, if any, given to exogenous cost drivers. They all appear to be volumetric and therefore endogenous to some degree. Ofgem should look to give weight to more exogenous cost driver, as these ensure the model incentivises companies to reduce costs in an efficient way, as opposed to the use of endogenous drivers that reward those who submit higher volume forecasts, and gives the strongest possible cost incentives.
345. Ofgem should use pre-regressions to determine the weights within the Composite Scale Variable (CSV). It is bad practice to impose weights on each driver, as this does not let the data speak through the regression. The use of company submitted cost proportions also introduces further endogeneity into the model.

GDQ42. What are your views on our proposed approach to applying the catch-up efficiency challenge?

346. We agree in principle with the use of the catch-up efficiency challenge. All sectors should be challenged to keep up with the frontier companies and find efficiencies.

GDQ43. Do you consider that the efficiency frontier should be based on historical performance?

347. The efficiency frontier should be based on forecasts to ensure any step up in investment is accommodated, without historical unit costs dragging the frontier down. This will be critical in ED3 to ensure that investment ahead of need is accommodated.
348. Both historical and forecast data to set the regression if structural breaks between price controls can – then the calculation of the efficiency frontier should be based on the forecast data

GDQ44. Do you agree with our assessment of technically assessed costs and bespoke outputs?

349. The specific choice and design of the cost assessment of technically assessed and bespoke costs is best explored by Ofgem and gas distribution network companies with a sector specific understanding.

GDQ45. What are your thoughts on our approach to disaggregating cost allowances?

350. We do not support Ofgem's methodology to disaggregated cost allowances here, and this approach must not be replicated in ED3.
351. The disaggregation of allowances should take into account the cost assessment and funding mechanisms. The use of submitted cost shares to disaggregate allowances is not consistent with the cost assessment and was found to be wrong in law in the RIIO-2 Appeals.
352. Ofgem should ensure that any disaggregation of allowances takes into account the cost assessment and associated funding mechanisms.

GDQ46. Do you agree with our proposed TIM sharing factors?

353. Yes. The sharing factor of 50% will encourage gas distribution networks to find efficiencies and deploy innovative solutions throughout the period.

GT Annex: Outputs and incentives

354. We have given principle-based feedback on outputs and incentives in our executive summary and in response to the Outputs and Incentives section of the overview document.
355. The specific choice and design of the sector specific mechanisms is best explored by Ofgem and gas transmission network company with a sector specific understanding – we therefore do not respond to the questions in this section (GTQ1 to GTQ27).

GT Annex: Managing Uncertainty

356. We have given principle-based feedback on uncertainty mechanisms in our executive summary and in response to the Managing Uncertainty section of the overview document.
357. The specific choice and design of the sector specific mechanisms is best explored by Ofgem and gas transmission network company with a sector specific understanding – but we have provided our perspectives as an electricity distributor network below, where we think they may be relevant. We do not respond to GTQ28 to GTQ30, GTQ32 to GTQ37, and GTQ39 to GTQ40.

GTQ31. Do you have any thoughts on the materiality threshold proposed?

358. We agree that a materiality threshold of 0.5% of totex is sensible.
359. As per our response to question OVQ13, "Yes. This helps to uphold a high bar for reopening the price control. There is precedent for 0.5% of annual average ex ante base revenue, and we agree this should be applied consistently across companies."

GTQ38. Do you agree with Ofgem's proposal to fund the proposed IT enhancements through Data and Digitalisation re-opener?

360. Any application of reopeners should be targeted in their scope and trigger. We consider Ofgem's proposal to apply the re-opener mechanism to investments that are speculative or subject to significant uncertainty whether in terms of cost or technological maturity to be a reasonable and proportionate approach. The proposal appropriately distinguishes between baseline-funded initiatives and those that are either net new or intended to build upon existing capabilities. We

support this position, as it ensures that funding is targeted at genuinely incremental developments while maintaining flexibility to respond to evolving technological and market conditions.

361. We note that National Gas Transmission's request includes further investment in, or potential through multiple upgrades during RII0-2. Considering this, Ofgem's position that any future replacement proposal must be supported by a clear needs case and robust justification is both appropriate and proportionate. Given the scale of prior investment, we agree that any further funding should be contingent on demonstrating a compelling rationale and clear benefits beyond what has already been delivered.
362. We recognise that subjecting proposals with a high degree of uncertainty to a re-opener mechanism is a pragmatic and appropriate approach. This not only ensures regulatory oversight but also mitigates risk for the operator. Accurately estimating costs for technology projects is inherently challenging when the scope or maturity of the technology is not yet fully defined. Furthermore, emerging or cutting-edge technologies often carry a premium due to limited market availability and evolving standards. However, the rapid pace of technological advancement can lead to significant shifts in both cost and capability over relatively short periods, potentially unlocking new opportunities and efficiencies that were not initially foreseeable.
363. While we agree that it is appropriate to manage investments with inherent uncertainty through a re-opener mechanism that has a targeted scope and trigger, we believe there is merit in considering a modest allocation of baseline funding to support early-stage activities such as proof-of-concept development and initial design work. This would enable more robust and informed re-opener submissions at the appropriate time, with greater clarity around the proposed solution, scope, and expected benefits. Such an approach could improve the quality of future funding requests and reduce delivery risk by ensuring that foundational work is already underway.

GT Annex: Cost of service

364. The specific choice and design of the cost assessment is best explored by Ofgem and the gas transmission network company with a sector specific understanding – but we have provided our perspectives as an electricity distributor network below, where we think they may be relevant. We do not respond to GTQ41 to GTQ48, GTQ50 to GTQ54 and GTQ56 to GTQ58.

GTQ49. Do you agree with our proposal to remove the opex escalator?

365. See our response to ETQ59.

GTQ55. Do you agree with our proposed TIM sharing factor?

366. The sharing factor of 39% will encourage gas transmission companies to find efficiencies and deploy innovative solutions throughout the period. It is weaker than the incentive for gas distribution networks to do this, but the transmission operator is best placed to comment on the risk profile of their projects.