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RIO-3 Investor Call – Final Determination Transcript

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Akshay Kaul 6:24

Akshay: OK. Good afternoon, everybody and a very warm welcome and thank you so much for joining us today. My name is Akshay Kaul and the director General for infrastructure at OFGEM. And I'm delighted to welcome you to the session on our RIO-3 Final Determinations.

The decisions that we've published this morning set the regulatory framework for the next price control period, which runs from April 2026 to March of 2031, and this covers the electricity transmission sector, the gas transmission sector, and the gas distribution sectors.

Today's call is an opportunity to walk you through the key elements of these Final Determinations to explain the strategic context and outline. What this means for investors, for consumers and the wider energy system.

After my introduction, we'll move into more detailed presentations on sector specific decisions on the totex - the total expenditure - and on the financial framework in the returns more specifically. And then we will conclude with our rationale for why we see this as a financeable and investable determination.

Akshay Kaul 7:48

If we move to the introductory slide, thank you.

We are at a pivotal moment for GB's energy system. The government's clean Power

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2030 ambition requires a rapid shift away from reliance on imported gas and towards secure, domestically produced low carbon energy. This means unprecedented investment in electricity transmission and infrastructure, while ensuring that the gas networks remain safe and resilient through this transition. The stakes are high.

Electricity demand is rising as we electrify transport, heating and industry, and the system must adapt to connect large volumes of renewable and nuclear capacity.

At the same time, gas remains critical for resilience and as a transition fuel, even as its longer term role evolves.

Our decisions today are about enabling this transformation while keeping a firm grip on costs and protecting consumers.

So, what does RIIO-3 deliver?

We're approving £28.1 billion of upfront funding across the ET, GT and GD sectors within a wider pipeline of up to £100 billion of spending over the period. For electricity transmission around £10.3 billion of baseline funding is confirmed now, with flexible mechanisms to release further funding as project as projects mature.

This will support delivery of up to £70 billion of spending to meet clean power targets.

For gas transmission, we are approving £3.2 billion focused on network resilience and security of supply, including cybersecurity. For Gas Distribution £14.6 billion of spending is confirmed now. Primarily for safety driven pipe replacement and for maintaining the reliability of that network.

All in all, our Final Determinations imply material increases in spending rates across all the sectors with the 6% increase for GD against the RIIO-3 actual spending, a 23% increase for GT against RIIO-3 actuals and the near quadrupling of spending.

For the electricity transmission sector.

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We have set a stable and predictable financial package with cost of equity allowance is 6.12% for gas and 5.70% for ET. These are at 60% and 55% gearing respectively, and a semi nominal whack or with average cost of capital ranging from 5.24% to 5.73%. This reflects the underlying increase in interest rates, and it ensures that the regime remains investable.

The stronger delivery incentives that we've put into the package will reward companies that deliver critical projects on time and efficiently while penalising underperformance. We have created the environment for companies to really have the opportunity to outperform on their returns as we are convinced that this will produce the greatest benefit for consumers.

We recognise that this level of investment comes at a time of cost pressures for households and businesses across the country.

We estimate that our Final Determinations will increase network charges in 2031 by £108 compared to charges in 2025/26.

But this is only part of the story. By reducing constraint costs and improving system efficiency, improving the penetration of renewables in the electricity system, RIIO-3 is forecast to deliver Bill savings of around £80 by 2031, alongside greater energy security and resilience. And therefore, we think the net impact on bills of this RIIO-3 package will be of the order of about £30 a year.

Acting now avoid higher costs later. It accelerates the shift to renewables. It reduces consumer exposure to volatile global gas prices. I don't need to remind you of the price

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shock that we sustained in 2021/22, and it supports economic growth through faster connections for new industrial projects.

In short, these Final Determinations mark a decisive step towards building a clean, secure and affordable energy system. They provide the clarity and confidence that is needed for investors, while ensuring the consumers are protected, and value for money is delivered.

We will now move into the detailed presentations and sector specific decisions and the financial framework. After that, we will open up the floor for your questions. Mics and cameras will be enabled at your end at that point, and you can raise your hand for questions, and I will bring you in.

Please also note that this call is being recorded and a transcript will be shared with all attendees afterwards. So, with that, let me hand over now to Steve McMahon to go through the RIIO-3 package in more detail. Steve, over to you.

Steven McMahon 13:22

Hi, good afternoon, everyone. So, my name is Steve McMahon. If you don't know me already, I'm OFGEM Director for Network Price Controls. I think Akshay has probably set the strategic context very well that you can see in terms of this slide here. Clearly, we've got different challenges and opportunities that we're responding to in the different sectors that we are covered by RIIO-3 and that we regulate. A key focus of all of that is how we do everything that we do at the moment. Keep the systems reliable, keep them safe, keep them resilient and improve that and strengthen that as we move forward. But clearly, there's different challenge. In the electricity side- how do we expand the capability and the capacity of the grid to reflect the new demands that are

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coming through and to tackle what is escalating constraint costs in the system. And on gas how - do we keep that safe and secure whilst we transition to alternatives?

It's a strongly incentivized package, is always especially in the Electricity Transmission side. We've tested all of these plans for efficiency, and I'll come back to that in terms of what that means on the individual sectors. And as Akshay said, this is a financeable and investable package. We said that a Draft Determinations, and we still see that as being the case today.

But what I'll do now is I'll in this first section I'll cover the totex positions in a little bit more detail for each sector. So that breakdown of the initial £28 billion baseline funding and the total investment pipeline, which is particularly relevant to the electricity transmission sector.

So, as Akshay set out an Electricity Transmission, we are setting a price control that enables a massive and frankly essential expansion of the grid. So, this is a huge investment programme, one that we probably haven't seen since the National Grid was formed in the 1960s. And we believe this investment is critical if you've seen our messaging today, we think the case for investing is far stronger for consumers than not investing, and that's something that we can we absolutely stand behind. So, as well as replacing aging assets to maintain those world class levels of reliability and making sure that the grid is resilient to climate change and cyber shocks, that that's what the investment is supporting. So, we're supporting this huge build-out of the programmes so that new renewable generation can be connected and all the new demands. So, whether it's from AI zones, data centres across the country that these things can connect quickly because that's what people are expecting from us. And in doing so as Akshay said, supporting this investment ultimately will help bring down bills.

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I think through in the medium term, investing in the Electricity Transmission grid is the key opportunity that will help to get bills down in the medium term.

So I'll come back to that a little bit later, but focusing on totex for now, you can see in the chart at the bottom right just how the expenditure that we are allowing now as a baseline allowance is dwarfed by that pipeline of expenditure that's coming through NPA. So, this is like a £70 billion plus programme overall.

In terms of the baseline allowances for the £10.3 billion that is, as you can see, £1.7 billion less than what companies had requested in the plans that they [*inaudible*] ... distilled due to where we feel costs are inefficient or wherever where we've applied an ongoing efficiency stretch to match the productivity that we think that the sector should achieve. There's been a relatively small number of activities where the costs have been disallowed, where we didn't feel that the need had been justified.

Now compared to where we were in the summer this is an increase in FDs of over a billion pounds on those Draft Determinations. At that time, when we had this call, I think we were quite clear that that where we did not feel that work was justified or the evidential bar had been met, we challenged the companies to come back with better evidence. So that position I think was made very clear just in terms of what we need to see in response from the companies, to meet that evidential challenge. And to the most part, that's something that they have done, provided stronger data and justification. And we'll set out on the slide what some of those main spend areas are. So, around project development, around asset health, around IT&T spent.

So, a key issue for us at Draft Determinations was also just how we model and benchmark indirects. So, these are the kind of the leading costs associated with the massive build out of the programme that we see over the next five years. And I think what became quite clear after Draft Determinations was that the three TOs have taken

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different interpretations in terms of how they define those costs, and I think that's something that we had to look to address, making sure the initial allocations were fair and reflective of the scale of project development that we were supporting. So, for Final Determinations, we've adapted to the cost methodology to reflect that, with more weighting on the company-specific forward-looking costs.

Now in terms of that that pipeline spend we've confirmed a range of mechanisms that we can use in-period to assess these projects as they mature, so that when we set allowances for them, we are confident that they need scope and cost are what the customers and what the system requires. And alongside that, there's various other things that we've done even before these Final Determinations just to de-risk the price control. So, for example, earlier this year we introduced the Advanced Procurement Mechanism. So that gives the sector the chance to avoid projects being delayed by supply chain constraints. So, getting ahead of that and understanding how they can place those contracts with the supply chain. So that was an important step and enabler for this overall programme. But that's the summary of the totex for Electricity Transmission.

Just moving on, I think next, we've got Gas Distribution. So, Gas Distribution is a more stable and steady state price control. We absolutely know that there will be a move away from natural gas over time. But I think the scale of that, the speed of that, still remains uncertain. So in in the meantime, we need to invest to make sure that these networks deliver the safe, secure supplies that customers and businesses depend on while we transition to those alternatives.

So as per the existing GD2 price control, a significant proportion of that overall investment relates to the repex programme. So that's out of the £14.6 billion that's £6.5 billion pounds which is effectively replacing the old [inaudible] means, which is

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obviously largely tied to delivering the remainder of the health and safety executive mandatory programme out to 2032. So again, the next five years are critical in terms of moving towards the finalisation of that phase of the programme. This is essential asset health investment for safety and resilience, as well as reducing leakage, which gives associated environmental and operational benefits. So, our key focus in assessing these costs has been to make sure that what we've allowed is delivered efficiently for consumers. So there has been a big change. So, baseline allowances for Gas Distribution are up £1.8 billion since our Draft Determinations, so that gap between us and the companies has reduced quite sharply. Some of that comes from modelling corrections. I think we always hold our hands up and where you are heavily relying on a modelled outcome then sometimes these things need to be recalibrated and that's what we've done since Draft Determinations. But a large chunk comes from further evidence support and needs case. Our needs case assessments for projects and the workloads and also updates to elements of our cost assessment methodology where we saw those modelling changes were justified.

Now, obviously policy direction is very important to the sector. I think particularly around the future of heat, and we continue to work closely with government to inform that process. In the meantime, we've reaffirmed our Draft Determinations position on accelerating the recovery of new spend and the GD3 control that allows us to better manage forward risks, ensures an orderly diversification and transition from gas, not just in GD3 but beyond, and ensures fairness and how charges are allocated between current and future consumers.

Steven McMahon 22.01

So just moving on to Gas Transmission. In totex terms it's the smallest of the three price controls, but no less important. And again, we're just reaffirming that importance both in terms of gas and electricity system reliability. Frankly, we're never [inaudible] £3.2 billion of upfront spare and funding now. So that's up from £2.5 billion at Draft Determinations s. Again, the big investment, the uplifting and investments here are

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around resilience. So, relating to asset health spend, but also cybersecurity and IT&T.

Agility and adaptability are also very important for gas transmission and that system I think particularly the role that the transmission system will play as the wider energy system evolves over the next decade and beyond. So, we've confirmed the arrangements for in-period funding through reopeners. [*Inaudible*]...around asset health and to respond to any requirements from changes in gas strategic planning.

So collectively I think this puts us in a position where we are making all of the critical resilience investments that are needed today with routes to additional funding and period at a fair cost to consumers. And again, we set out the evidential bar that we wanted a national gas to meet. So, we had lots of new data and information that came back and that's a big reason as to why the numbers have changed over that period. So, I think with that totex, I think I'm now handing over to Rohan to speak through returns.

Rohan Churm 23:45

Thanks Steve, and thanks everyone for joining today and for those I haven't met before, I'm Rohan Churm, I'm the Director of Financial Resilience and Controls at Ofgem.

I'm going to take you through the financial framework underpinning the RIIO-3 to explain how we've calibrated it to deliver stability, predictability and fairness, both for investors and for consumers. Let me start with the fundamentals. Our price control sets allowed revenues for network companies, including financing costs and the financial framework ensures those costs are efficient and fair.

There are three key principles behind this framework. Stability and predictability, which we see as essential to attract long term investment; balanced and competitive returns aligned with risk and market conditions; and consumer protection, the financial safeguards and spreading costs over time. And starting with the cost of equity, Ofgem

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has maintained a predictable methodology for RIIO-2, but the numbers have evolved to reflect the reality of today's market, which is higher interest rates and the inflation volatility since 2021.

We have applied the CAPM-based approach which will look very familiar to those who have studied RIIO-2, and the Final Determinations updated for current market conditions. Our key parameters are shown on this slide. We have reflected all the evidence received and what we are seeing in the market, and we are comfortable with the methodology and rationale set out at Draft Determination.

The beta includes the additional European comparators that we brought in for Final Determinations, which was a positive change for investors compared with RIIO-2. We have not aimed up on beta. We have increased the risk-free rate, which is based on 20-year index linked gilt yields adjusted to CPIH using OBR forecasts as those index-linked gilt yields have risen. We have not received any compelling new evidence to conclude that we should move away from the midpoint of the rate.

So that cost of equity, as Akshay said is 6.12% at 60% gearing and 5.70% at 55% gearing - the gearing assumption being the only difference between the sectors.

Turning to the cost of debt, this is an area where we've retained the core principles from RIIO-2, but the methodology has evolved somewhat more to reflect the external conditions. And the headline thing there is, as you may recall, if you're on the Draft Determinations call or I can update is that we are now having a bit of a different approach to the sectors, reflecting the significant growth in that we're expecting to see Electricity Transmission over the period. The fact that the cost of issuing debt in the market today is different to the cost of historical debt that is on the company's books given the change in interest rates. And also, we are adapting the control to semi-

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nominal approach reflecting the inflation that we we've seen.

The headline figures are that for Electricity Transmission, the cost of debt averages between 5.31% and 5.76% for Electricity Transmission companies, and the main difference there are the current debt levels against what we forecast on a notional basis those companies need to raise during RIIO-3. So, the higher numbers are for those companies whose RAV is growing fastest during the period essentially.

And gas is a slightly lower level there. That isn't because the marginal cost of issuing a unit of debt today for gas is lower. In fact, as I'll move on, our calibration says it is a bit higher. But it is that very stable broadly, overall that position through the price control, that means there isn't as much new debt being issued.

Since Draft Determinations, you can see that the electricity costs of debt have all fallen slightly. That is, that is mostly on these projections that slight fall in the total spend that's projected. Obviously, those actual numbers will evolve in our framework to reflect whatever the spend turns out to be. So, in that sense that isn't anything in our formula methodology changing, that's just something that's dynamically responding to those different forecasts. The gas numbers are a bit higher, reflecting the empirical data we've seen in the markets and some of the modest changes to the cost of borrowing allowances we've made. And also, some of that spend coming back in to create slightly more forward-looking debt.

In terms of the index, it will be the iBoxx sterling A and BBB non-financial 10 years maturity plus corporate indices, and we are using the 14-year trailing average to balance responsiveness with stability. And the calibration adjustments have shifted a little bit since Draft Determinations based on the data we've seen. They're shown on the slide there, a slightly bigger gap between electricity and gas and we've got some small

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increases to the additional cost of borrowing allowances reflecting feedback to the consultation that we have taken on board there.

So let me pull that together in the WACC, weighted average cost of capital.

I won't spend long on this slide as you have the figures, and they sort of mechanically add together what I've shown. But I sort of wanted to just re-highlight again that the revenues that companies receive will be on a semi-nominal basis. So that's the sort of middle row here of the bold rows. I think to compare to previous sort of price controls, it's probably better to use the real allowance to see how things are different to RIIO-2, and of course if you want to know what that might turn out to be in nominal terms after the indexation that companies will still receive on part of their debt cost and on the equity section of their RAV and that's the final row there. Those are all taking the OBRs CPIH forecast or assuming inflation thee.

The final thing to say is just that, as indicated at Draft Determinations, we've dropped the flat WACC approach that we had in RIIO-2 to avoid distortions and reflect the move to sector-specific yield and risk. So, I'll hand back to Steve now I think, to talk about the potential for companies to outperform baseline as the [*inaudible*] presume.

Steven McMahon 31:40

Thanks Rohan. Yeah, and any real price control incentives are always a big part of that. And that's no difference here. So, I talked you through a little bit earlier just in terms of the allowances that we were setting for each sector and what we thought the investment programme would look like overall. Alongside that for Electricity Transmission we are putting in place a strong, positively skewed incentive package that, along with maintaining high levels of reliability, should focus the company companies on delivering projects to time, if not earlier, to connect customers in line with their expectations and meet the needs of the system, to roll out innovation, things like dynamic line rating that was brought into the SO:TO incentives, that helps not just

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to think about in terms of building out new capacity, but also how do we make better use of what we've got already and reduce constraint costs of a new development for an established incentive. And then just how we minimise outages on the network again, so that the system-wide costs are reduced. So, retaining the core incentives from T2 is supplementing those with new incentives around major project delivery connections and innovation because these are the things that kind of drive value for consumers.

Now just in terms of the next slide, and this is probably the bit that that people find most interesting. So, what do we expect to get from them? So, I think what you see here is just in terms of the maximum and minimum opportunities for each of the TOs. Now, what we're not saying is that you would automatically be able to get the top end, but neither would it be likely that you would get to the I think the bottom as well. So ultimately, we think this is a strong positive skew, but what companies achieve will be based on their own performance. So, lots of new powerful incentives, I think intentionally about and upside asymmetry. We've got the SO:TO incentive. We've brought in that dynamic line rating, so that's uncapped. And we've got alongside this, the totex incentive mechanism obviously that protects against any major overspends increasing in focus on performing against those ODIs. So again, a key opportunity, if you look at the base returns that Rohan has talked you through for the high performing companies to really earn high returns that match their delivery of value for consumers.

Now just moving on to gas and again in gas, we're retaining a powerful TIM with output delivery incentives and focus around company activity, which directly impacts on consumers, and which consumers care about. In the Gas Distribution sector in particular and the things that matter for the system and network users and Gas Transmission. So, in Gas Distribution, a strong emphasis on reducing methane leakage through a new financial incentive that will encourage timely leak repairs, supported alongside that actually by innovative or funding for innovative technologies to accelerate leak detection and repair and flexible support for shrinkage management

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through the available uncertainty mechanisms. Again, incentive to maintain high quality service with the GDNs rewarded for achieving customer satisfaction scores that exceed thresholds set above 9 out of 10 and promoting collaboration between GDNs and other utilities on street work projects. This is something that attracts a lot of strong local support. So, we're expanding that beyond the existing London-specific incentive into a nationwide one.

And Gas Transmission, again there's a lot of commonality here with what we see in the current RIIO-2 price control. We'll get gas system operating incentives that will drive excellent performance by National Gas when delivering capacity constraint management, demand forecast and maintenance and residual balancing services to its customers. And alongside that driving good customer and user experience and environmental performance. Again, like some more contained incentive there but alongside the TIM still opportunities for the companies, the high performing companies, to earn higher rewards.

I think it's still with me, just get on to Return Adjustment Mechanisms. So just very briefly and that this was a RIIO-2 innovation and we've retained that for RIIO-3 under the same methodology. Again, it's another element of how we manage risks, so it provides a backstop protection for investors and consumers on the upside and the downside. So, we've set out our expectations here on how these mechanisms may operate. In fact, it's for each sector. But again, these are very much a backstop, and we would not be expecting them to be triggered. But again, it's just another part of the overall stability of the framework.

I think we'll move on next. This is just a slight update on revenue profile and so this is something that we've looked carefully at. You may have seen a lot of our narrative on bills this morning. So, we know what the costs are by 2031. We know what the benefits

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are from the investment that goes alongside that. But the other thing that we've looked carefully at is how we profile those costs over five years. So in response to our Draft Determinations, I think some suppliers, I think particularly those that have large non-domestic customer bases, they were concerned about the ramp up immediately in April 2026 that was implied by the Draft Determinations positions and just the consistency and alignment I think of those numbers and the how those were reflected in the forecast, the industry forecast that came being out there before Draft Determinations and then the updates that were made afterwards. So, there's something there about how we just work with the sector and look at how we improve the accuracy of that forecasting process. I think it's important for us just to make sure that we've got stable transparent forward looks just in terms of investment and how that will flow through into network charges. So, this is something that we've taken really seriously, something that we've leaned into. I think fundamentally we see a need to protect the stability of the retail market, especially when you've got large bases there that may be on fixed term contracts that might not have expected the ramp up and there were charges that were forecasting those for April 2026. And I think it's important that we maintain that stability through the RIIO-3 period. So, what was proposed today is a two-year period deferral of a proportion of revenue increases across each of the three sectors from RIIO-2 so dealing with that immediate step-up in April 2026 and also how you manage that transition into 2027 and the subsequent years. It's just to reassure you, it's fully paid. It's guaranteed within the price control costs aren't affected and the adjustments would be NPV neutral. So, we've set out our expectations and the Final Determinations today. We have been working closely with the companies over the last few weeks on this like given the way that the issues arose, I think over like the period since Draft Determinations and we're expecting to confirm the implementation through the licence change process that gives effect to These Final Determinations. But this is I think an important step for us to take here driven by protecting the underlying stability of the market.

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OK Rohan, I think I'm out handing back to you again.

Rohan Churm 39:14

Thanks, Steve. So yeah, just a couple more slides from me on financial parameters and the financeability assessment. So, if we could move on?

The first thing is just to confirm that our decisions on the financial parameters of the price control remain the same as the proposals in Draft Termination. This is literally a slide where all of the points are actually not changed at all. Importantly, we will include further financial resilience measures into the licence conditions to offer protections for creditors and consumers.

We made proposed adjustments to the capitalization rates for Electricity Transmission in Draft Determination reflecting the financeability assessment, and I'll talk about that assessment. But the headline is that we are proposing to keep those capitalization rates as proposed and we are maintaining the asset life assumptions for Gas Transmission [and] Electricity Transmission as well as the decision for Gas distribution to repay all new additions during the RIIO-3 targeting the government's net zero target date, which is currently 2050.

So, if we move on then to the financeability assessment. We do an in the round consideration of financeability, taking all of the other parameters as they are to ensure that an efficient operator, assuming the notional capital structure, can generate sufficient cash flows to meet its debt obligations by maintaining investor confidence. We are targeting credit quality on a notional efficient basis consistent with at least a Baa1/BBB+ rating.

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Under RIIO-3, the scale of investment in Electricity Transmission in particular is significant and that as we highlighted at Draft Determinations led us to make the change to the capitalization rate for ET as I highlighted on the previous slide.

We look at the package in the round testing allowed returns, totex, recovery, depreciation, revenue profiling, capitalization rates, and we test it based on credit metrics used by the three main rating agencies. We have notional gearing at 55% for ET, 60% for gas. Dividend yield assumed at 3%, consistent with RIIO-2 and equity issuance allowance at 5% of issuance costs. Our modelling analysis do show that when the package is taken as a whole, an efficient notional company achieves a simulated rating outcome consistent with Baa1 or BBB+ and it supports the financeability across the price control while maintaining affordability for consumers.

Relative to Draft Determinations this table looks pretty similar. It's actually just slightly better for the ET companies on average reflecting the slightly lower total projected spend I talked about earlier, but we didn't judge that those changes were sufficiently large or material for us to change the capitalization rate. We are even more confident in the financeability based on this assessment than we were at Draft Determinations. So, I'll hand over to Steve to conclude the presentation.

Steven McMahon 43:14

This is the last time it's been handed over to me, so we are, as Rohan said, we're confident on the financeability. We're equally as confident on the investability side. There's lots of that we've agreed on I think with the companies, with investors throughout the process that's taken us to here today. We've got our regulatory model, regulatory framework that's well established, that's transparent, it's stable. It's predictable. When we set out our positions, our Draft Determinations positions, I think we're quite clear in terms of what did we expect to change, especially on the totex side.

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I've described that today. More clarity on the incentives. When it came to the financial framework, we hadn't held anything back. This was us stepping up and understanding what the data and the market evidence was telling us and what we've done in the last six months is just adapt that to the current conditions. So, in the summer we thought this was strongly a financeable and investable framework. We see the same situation. There's been nothing the market data, the evidence like over the period in between that would lead us to a different conclusion around that. So, everything's benchmarked internationally. We've done a cross check of all our analysis and then we think the package supports the strong credit ratings and allows an efficient injection of the scale of capital that we need to see over the next five-year period and again we've adapted the framework where we've felt we've had to better manage risks. So, and just in terms of even the ASTI programme, the Advanced Procurement Mechanism that I mentioned earlier and also the totex, the step Totex Incentive Mechanism that will reduce or better balance that regulatory and delivery risk for the three transmission owners. We've got a strong incentive package as I talked through a little bit earlier that is skewed to the upside. But ultimately this is all about you. It has to be consumer centric; it is consumer centric. But at the same time a fair package to consumers and to investors. And we've got that adaptability as well as we move forward to reflect the evolving system needs and the new requirements and the new investment that we expect to see over the next five-year period. So, I think with that it brings us to an end of the presentation, and I'll be handing back to Akshay just for the Q&A.

Akshay Kaul 45:34

Thank you, Steve, and thank you, Rohan for those presentations. And I hope that those have given you a sense of the key decisions that have been published this morning in our Final Determinations. We are now into the Q&A. So, you should have the mics enabled at your end. So please do just put up your hand on the Teams chat and I will bring you in. We already have our first three questioners, so we'll start with Pavan Mahbubani over to you.

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Pavan Mahbubani 46:04

Hi, team. Good afternoon, Pavan Mahbubani from JP Morgan. And just wanted to extend congratulations to you and your colleagues on the publication of these Final Determinations.

My two questions centre around the point of affordability. And Akshay, you mentioned you know these pressures in your opening remarks. When we're looking at the forecasts when companies are applying for funding, it looks like the project costs are higher, certainly than forecast in 2022. So, the two questions I have are firstly, how are your conversations with the government when it comes to the programme, particularly in Electricity Transmission and do you still feel like there's an alignment between yourselves, the companies and the policy makers that this is the best, most cost-effective way forward? So that's my first question. And then secondly, if we continue to see costs rising for the transmission operators above what we see you know, for example in the financial models today, can you remind us what mechanisms are in place to protect investors from those you know, the rising costs, being able to continue to earn the returns as you've set them out? Thank you.

Akshay Kaul 47:10

Thanks, Pavan. And those are really good, very clear questions. So, I'll, I'll let Steve come in on your second question, which is about the totex protections, I think you're talking about when there's cost overruns in the spending. But on your first question, there is definitely very strong alignment between the government, us as a regulator and the industry, that this is the right way forward and I think as Steve said in his remarks, we can see from the mathematics that investing is cheaper for consumers than not investing. This is most obvious when you look at the Electricity Transmission sector. Its contribution to that roughly £110 increase in network charges is the order of about £60, but it creates about an £80 saving on the bill by bringing the constraint costs down

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that consumers are going to have to pay for otherwise and allowing more renewables to penetrate the market, which then has a dampening effect on wholesale power prices. So, we think Electricity Transmission, the spending in the sense more than pays for itself. And overall, when you look at the package across the £110 less the £80 saving the net impact of these RIIO-3 Final Determinations on bills at the end of the five-year period will be off the order of about £30 or about £2.50 a month.

Obviously, any increase in bills is difficult for many households. Energy debt is already £4.5 billion pounds and rising. So, I do want to knowledge, I think that the government has done a very big thing in the budget recently, providing relief to households and taking a chunk of the policy costs from energy bills into general taxation. But we very much remain completely aligned on both fronts. You know, it's very important to get this investment in because this isn't the most cost-effective way forward for consumers, but that doesn't mean that we should take our eye off the fact that there is still stress in the retail market and there's still more work to do to bring energy debt levels down. Steve I'll hand over to you now just to talk about the second question. I think Pavan was asking is what protections are there for investors in case there are significant cost overruns on particularly ET I think was mentioned.

Steven McMahon 49:24

Yeah and I think you've got a combination of those two things. There's one is all the existing protections that we're rolling forward. So, if you think about, we get RPEs, we've got the RAM's mechanism. There's always the ability to top up funding in particular areas as the needs changes and as costs move over time. I think fundamentally if you look at the Electricity Transmission sector, we're not taking a bet just now on what the cost of these projects are going to be. So, the vast majority of all of the major project delivery sits in period. So that will come through the reopener mechanisms, and we would expect that to come forward into these mechanisms once the cost is more certain. So again, I think that in itself is a huge protection I think for the investor sides

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that we have a good understanding of what the cost of these projects is going to be. And then you've got the other mechanisms that I think kick into place.

The other big one is just around the step totex incentive mechanism. I mentioned that just in the presentation. We have adapted that I think it is a big change compared to what we had. It's the flat TIM in RIIO-2. And again, it's very much designed to try and better manage that risk. Now there is a slight change just in terms of the position relative to Draft Determinations. I think we had quite strong feedback just on that about did it potentially just do too much to try and manage that risk. So, we've kept having strong cost incentive properties but looked at the like the ranges at the end so that you've not got a full pass through. But again, the step TIM should give a lot of protection I think to the companies but sharpen up maybe some of those incentives for efficiency. So, when you take all of these things in the round, we think there is adequate protection there against the sort of risks that you set out.

Thanks very much, Pavan, for those two questions, let's go next to Jenny Ping. Jenny, please go ahead.

Jenny Ping 51:21

Hi. Thanks very much for the presentation. Jenny Ping from Citi, a couple of questions from me please. Firstly, just on the totex, the total totex, can you just outline especially in the pipeline segment of it what's really caused the £10 billion reduction?

Reduction, i.e. the £78 to the £70 billion decline from DD into FD, it seems that the vast majority comes from National Grid and Scottish Power, so just quite keen to hear what projects those are relating to and if it's just the cancellation of those or delay into ET4.

Secondly, a little bit along the same vein as Pavan's question around changes of policies, but the other way. Obviously, some of the retailers are calling for no more gold

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plating of networks and potentially pushing some of the investments into future regulatory periods. If we were to see that the totex coming through the uncertainty mechanisms to materially reduce due to policy decisions in the future, does this change any of the components in financeability that's effectively implied in a big CAPEX to go through. Does that some of that get clawed back? Sorry, that's the second question.

And then just thirdly on the reprofiling of revenues. When do we get some of the visibility in terms of the split by companies to understand what the implications are for companies' earnings targets? Thank you.

Akshay Kaul 53:14

Thanks, Jenny. So, I think maybe the first and third question Steve, do you want to take in terms of what's caused the reduction in the pipeline in ET and when will companies know about the reprofiling? And then maybe I'll come back to Rohan on the second question.

Steven McMahon 53:23

Yeah. So, the just in terms of the reduction and again, when it comes to the pipeline, the number is always going to be a forecast. So, we had a forecast in the summer. We have a forecast now. It's not related to the cancellation of any projects. It's basically a combination of just reprofiled spend. So totex expend and some model corrections that we're unpacking from Draft Determinations. So, this is our best view. Obviously as you move forward, you use the most up-to-date data that you have available and that's simply what we've done. But it will always be reflective of the cost going forward and that's why we've got the agility. But in terms of publishing today, that's our best view and the number happens to be lower.

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In terms of the reprofiling we've worked quite closely. We've been working quite closely with the companies. I think we've set those out and in aggregate today. I think that was the right step. We're going to put our process now that we've confirmed the revenue position. So, the companies will be able to see the financial model. And over the next week, I think we'll be working with the companies just to confirm those values and how we've assessed the financeability checks and then the idea with those would be locked down. But the numbers are known, I think to the companies individually at the moment. And then there's a process between now locking down the PCFM and confirming going through the licence consultation with those will be clear and those will be reflected in the charging statements that then are published by the companies going into the New Year.

Akshay Kaul 54:54

Thanks, Steve and Rohan. The second question was that if the totex levels in the pipeline materially change with changes in policy what does that do to financeability and are we likely to claw back any of these financeability adjustments that we've made?

Rohan Churm 55:10

Yeah, I think it's a good question. I think the word claw back has a risk of being pejorative and I guess I distinguish between some effect that will naturally in a dynamically adjust that's built into the framework complements that's published today, that everyone can see versus sort of a future decision being taken that will be a change. And I think we're talking about the former not the latter, but essentially there would be two mechanisms I think where the revenues would be essentially you know, change if that money was not spent. Other than obviously the pure totex effect, one is that obviously we change the capitalization rate or Bucket 2 in particular. So implicitly companies are getting more fast money for each pound they're spending their spending

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in that Bucket 2 than for other elements of investment they're doing. And so, if that Bucket 2 reduces, then as a share of the investment spending the companies are doing, the capitalization might will increase and so you know that slightly change the effect of that adjustment we're doing.

The second thing is, as I also touched on earlier, that the cost of debt we've got is dynamic. It will evolve - and the index - both to rates and through the RIIO-3 period what's happening on market rates but also to that spend. So, as I was highlighting earlier and one of the reason those electricity transmission companies have those higher cost of debts is because we're projecting more debt needs to be issued on a notional basis, as the RAB is increasing. If they are spending less, the RAB isn't increasing as much. The cost of debt will be declining, but that that will be eminently fair and financeable because they won't be needing to issue that. So, I don't think there's any financeability challenge if the spending is less, and I don't think that you should expect any unexpected changes in the parameters, but some of the way that we've designed the parameters, I think quite smartly, means things will naturally adjust.

Akshay Kaul 57:44

And Rohan, would you go as far as saying that we've taken a totally conservative view on financeability. So, if the totex spending ends up being lower, it'll only improve the financeability?

Rohan Churm 57:54

Yes, in a sense we tested the financeability against those full spends and I know that you know some of you on this call in your analyst reports were sceptical of whether those full spends would end up happening. It's not for me to say today where they'll be obviously the totals move down a bit since Draft Determinations, but we wanted to do that financeability assessment you know on that very [*inaudible*].

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Akshay Raul 58:20

I think that was a sense of Jenny's question that you could get delays in the projects and the spending moves out, but I think we're saying that that would only improve the financeability situation.

Thank you, Jenny. Hopefully that answers your three really good questions. Next up is James Brand. James, please go ahead.

James Brand 58:38

Hi. Thank you for taking my question and congratulations on getting it done and in plenty of time for Christmas as well this time so you can spend your time searching out Christmas presents for your [*inaudible*].

Two questions both on the incentives. Firstly, you say that the incentives are kind of weighted to the upside or skewed to the upside. Would you say that the P50 is also weighted to the upside? I'm not sure whether you've calculated a P50, but if you have is it weighted to the upside?

And then on the delivery incentives getting things done on time, the companies after the Draft pushed back quite strongly on having such a big ramp up in CAPEX in year one of the period and you've obviously kind of reduced the profile there a little bit. But I think if we compare what you have in year one and maybe even year two to what the companies have in their kind of business plans that are published it implies a much quicker ramp up in CAPEX than the companies have. And I was just wondering whether you could give us a bit more colour on that. Has that been a big debating point as you've been going through this process that the companies have been trying to push back

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deliveries of projects based on it taking longer to kind of ramp? And if that has been a big area, I guess you haven't been fully convinced. But I'm just very interested in any kind of context you can give us on that dialogue. And if the if the kind of company's position is ends up being the right one, then it just takes a bit longer to ramp up projects and get things going. Does that mean that they're going to be in a worse position when it comes to these delivery incentives? I'm aware that there's allowances around things like planning, if that's what drives the hold up, maybe it doesn't affect the projects, but I'd just be very interested in the kind of context around the incentives and specifically that dynamic. Thank you.

Akshay Raul 1:00:44

Sure, thank you, James. And again, on your second question first. So I think we worked very closely with the companies in looking at the realistic rates of totex spending in particular for the first year to make sure that those are credible and sensible.

And the profiling of the charges that Steve described in the slide, you know it reflects that agreed position between us and the industry and what is a realistic ramping up of the spending. But I'll let Steve come in and say a bit about that and also Steve, on the first question, I think is about do we expect the average company to outperform on the incentive.

Steven McMahon 1:01:16

Yeah. So just on that on the point about the profile. And so, I think a Draft Determinations, it was a fairly kind of even profile over the five years, but that reflected I think the company views on their spend profiles that were submitted alongside their business plan. What we've done since Draft Determinations is work companies to update those spend profiles, so they've changed their view, which is what we've reflected I think and the analysis that we've set out today. So that was done before we even talked about revenue profile. And so we've just naturally updated together a better reflection where they may be on planning and consenting that has pushed some of the

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stuff a little bit further back. Now obviously all of this is still pipeline related. So, it will come through, it will come through just in terms of as and when the projects are ready to be delivered. So again, that gives us confidence just in terms of the deliverability and it's important that we don't have consumers overpaying like on those uncertainty mechanisms upfront. So that's something that we have looked to minimise. In terms of the incentives, all of this has to be customer centric. So, we have to look at what is it that we're trying to achieve, but we will use P50 to set the incentives. We believe that that will be robust and accurate. It's something that the TOs themselves will be involved in. So yes, we do think there's a positive skew, we don't think it's an unrealistic position just to calibrate those incentives around. And as I've already said and Akshay said, they are on balance that we expect that there is an upside opportunity that comes through these incentives individually and as a whole overall.

Akshay Raul 1:03:01

Thank you, Steve, and thank you, James, for that question. Next up is Charlotte Brunning. Charlotte, please go ahead.

James Brand 1:03:04

Thanks.

Charlotte Brunning 1:03:07

Thank you. Thanks Akshay and thanks, Steve. Been a good presentation. I know it's been a long journey for you and the companies and just want to echo the comments of, I appreciate that it does give people sufficient time to digest.

I just had a sort of very specific question just on the revenue profiling. So, we had understood that there was going to be shifts in the allowances to sort of shift the allowances back towards the end of the allowance period, which does seem to have

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happened, you know, in the context of sort of about £400 million, the Gas Distribution and around £400 million for electricity. There was a comment in the presentation that this will be done in an NPV neutral way, but I just wanted to confirm that and sort of just the concept that the network companies will be kept whole from any sort of reprofiling in the in the allowances.

Akshay Raul 1:03:59

That was a great question. Steve?

Steven McMahon 1:03:59

Yeah, absolutely. That's a key point and a key message we want to get across. We're not trying to constrain costs here. So, the costs will be kept whole. So, in that sense, it is NPV neutral. So, when we talk about the £108, that's the headline that we went on today that reflects the increase in network charges on bills based on the five years. What we suggested, for the reasons that I'd set out, that there's a market stability consideration here. And if you look at just how we move from effectively RIIO-2 was set in a very low-interest rate environment. So yes, you've got additional investment, but you're moving alongside that in terms of just through a higher interest rate environment. So, the costs that go alongside that, whether it be in the WACC, whether it be around some of the broader mechanisms in place. So, we just think that the good case for doing that, we've tried to be measured, I think in that respect, we're working collaboratively with the companies on doing it, but it would be NPV neutral. So absolutely those Costs are guaranteed for the price control. and as we've set out in the Finance Annex that the companies themselves will have a say just in terms of how that profiling works at the backend and how quickly those costs are recovered. The key principle for us is stability and transparency and making sure that these can be accurately reflected, in good time into the tariff setting processes.

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Charlotte Brunning 1:05:20

OK. Thank you.

Akshay Raul 1:05:22

Thanks, Charlotte.

And Steve, we're just saying for clarity that the profiling just means that the revenues might be slightly lag relative to the cost, but they will come with the cost of capital adjustment applied to the [*inaudible*].

Steven McMahon 1:05:34

Yeah, we may call the relevant adjustments on that. So, it should not undermine the investment that needs to happen.

Akshay Raul 1:05:42

Next up is Deepa Venkateswaran. Deepa, please go ahead.

Deepa Venkateswaran 1:05:47

Thank you so much for taking my question. Akshay, I think on the cost of capital, I think it's been more technical adjustments or mark to market, but it seems like the biggest change you have made is moving on the incentive package. Could you maybe highlight what you think has been the biggest change? And I'm focusing only on Electricity Transmission here and you know, in your view, has that taken the investability of the package forward. Thank you.

Akshay Raul 1:06:15

Yeah, that's a really good observation Deepa. And you're right. I think the biggest

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change is between DDs and FTDs on the incentives, because we've been working hard with the industry to get the incentive package to reflect the value that is at stake here for consumers, and as Steve put up in that slide, you know we've retained the core RIIO-2 incentives on reliability, customer satisfaction and on cost, but we've added these three new incentives on connections, innovative delivery and major project delivery. And I think that just reflects how much value Electricity Transmission companies can create here for consumers if they run their businesses a lot more efficiently. The managed outages more efficiently, they create more capacity on the grid through things like dynamic line ratings. And of course, very importantly, if they deliver these major network upgrades to time and budget. So, there's definitely a big skew, quite deliberately in terms of the development of the incentive package. And Steve, do you want to come in on the numbers in terms of how we think that's shaping up to *[inaudible]*?

Steven McMahon 1:07:25

Well, yeah, it's not even specifically on the numbers. I think it's a little bit like we were really open at Draft Determinations. What were the things at that point that we thought would change? The first was around totex. We'd set a challenge and the companies responded to that and each sector, the second bit was around the ET incentives. Like the intent was clear. Yeah, I think we knew the sort of things, that the behaviours, that we wanted to incentivize at Draft Determinations, but by our own admission there needed to be more shape I think in definition just in terms of what that would mean in practise. So how we set the targets that offer a fair bet to the companies and consumers, how we are clearer in terms of what's been incentivised and to what extent. I think as well, it shouldn't be understated. But even on like the SO:TO incentive, the inclusion as Akshay said the dynamic line ratings, again, we're not just focused on new network builds, but also how can we make *[inaudible]* processes and technologies are well developed. But we see the potential there just to really drive it forward over the T3 periods. Again putting a sharp incentive I think around that. So, all of the values and

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again I go back to that positive skew, each of them has a positive skew and totality and assuming strong performance against each of them and what is a fair bet, then high performing companies should be able to earn those higher returns.

Akshay Raul 1:08:47

Yeah. And Steve is also saying that this is one of the areas where we heard loud and clear from investors, right, that they wanted to see this really clear incentivization and a clear route to the upside. And we have responded to that in the Final Determinations very emphatically.

Deepa Venkateswaran 1:09:04

Yeah. Thank you so much and congratulations once again.

Akshay Raul 1:09:08

Thank you so much. I don't see any further hands in the queue, but as always, we'll just leave a couple minutes for the audience to just gather their thoughts and wait to see if there are any further questions.

And if not, then I think that's a good sign that we can bring the call to a close. So may I just say a very big thank you once again to everybody on the call for making the time to join us today, for all your engagement and help and support through this long price review process. We're not quite at the end yet, so this is the Final Determinations, but there's still the licence consultation to follow and RIIO-3 will then go live from the 1st of April 2026. So, if I don't see you again until the new year, may I just wish you a very happy Christmas and New Year and see you in 2026. Thank you very much everybody.

RIIO-3 Investor Call – Final Determination Transcript