

Citizens Advice response to ED3 Sector Specific Methodology Consultation



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Executive Summary

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Any investments need to represent long-term value for money and come under a robust efficiency challenge

Network funding must produce tangible benefits, including enabling people and businesses to play their part in the transition.

The quality of DNO customer service, including during interruptions and connections, must improve, and be as fair as possible.

Comparative data about DNO performance should transparently be available on the regulator's website, building on the RIIO ED1 approach.

Core document questions

Long-term integrated network development plans

Strengthening delivery accountability

Adapting for additional investment needs during the ED3 period

Conceptual models for ED3 delivery

Connections

Redefining connection types

Incentives for smaller connections

Broad Measure of Customer Service

Consumer vulnerability

Energy efficiency

Consumer voice/research

Enhanced stakeholder engagement (Independent Stakeholder Groups and guidance)

Accountability for consumer outcomes

Innovation

Distribution System Operator (DSO)

DSO network planning

Flexibility

Voltage Management

Losses

DSO incentive framework

[Resilient networks](#)

[Network Asset Risk Metric \(NARM\)](#)

[Climate resilience](#)

[Reliability](#)

[Resilience re-opener](#)

[Re-openers](#)

[Business Plan Incentive](#)

[Incentivising delivery](#)

[Cost assessment annex questions \(selected\)](#)

[Finance annex questions \(selected\)](#)



Executive Summary

Overview

People in Great Britain pay monopoly companies, via price controls, to run the infrastructure which brings power to their homes and businesses. During recent price controls, people have paid electricity distribution networks operators (DNOs) to do this at a time of relatively flat, even falling, electricity demand.

Now, the expected electrification of demand for transport and heating, as well as Clean Power 2030, is moving the dial. Homes and businesses are increasingly using electricity to power their vehicles and heat their homes, and turning to renewable power sources to help do so. Meanwhile businesses with high power demands (such as data centres), or government targets to achieve (such as new housing developments), are urgently wanting to connect to the grid.

So far, DNOs have been able to rely on improvements in appliance energy efficiency (for instance in lighting) and deindustrialisation to ensure there is sufficient headroom on their networks. This capacity may begin to disappear during the ED3 price period. To meet this increasing need for electricity, the energy regulator Ofgem is exploring a change in approach. In 2028-2033, the price control must ensure that DNOs build ahead of need, upgrading the network for future generations.

This marks a major shift in what price controls are trying to achieve at the distribution level. The size and significance of this shift should not be underestimated. Previous electricity distribution price controls have focused on improving the use of existing infrastructure as efficiently as possible. They have not been designed to build infrastructure which people will need in the future. Plus, those same price controls have allowed DNOs to achieve over £1 billion in windfall profits in the first three years of RII0-2, and are continuing to do so.¹

Ofgem therefore has a difficult task on its hands. Not only must it design a price control which avoids rewarding DNOs too generously, it must ensure DNOs do

¹ Citizens Advice, [Debt to Society](#), February 2025

much more than they've ever done, at a better-than-ever price for consumers. This may involve novel regulatory approaches beyond those used in previous price controls.

The importance of getting this balance right is fundamental to the validity of the current regulatory model. It is difficult for Ofgem and DNOs to justify increasing electricity bills for anticipatory investment after more than a decade of underspending their allowances. It is even harder for DNOs to justify an increase in bills in ED3 given the windfall that has fallen into the networks' laps during the current price control, as we have highlighted in our Debt to Society report.

This is why Citizens Advice is responding to this consultation and will engage with Ofgem and the DNOs over the next 2 years of the price control design. We can see a path where electrification of demand, done well, should lower bills in the medium term. It can also, as the government's Clean Power mission has made clear, boost economic growth. Yet it is critical that the road to electrification does not cost already-squeezed energy consumers more than it needs to. It should also be a road which is easy to walk; where customer service is high quality, and customer needs are met fairly.

As the statutory advocate for energy consumers, Citizens Advice has five priorities for the design of the electricity distribution price control (ED3):

1. The overall balance of risk and reward must **avoid being too generous** to DNOs, breaking the cycle of previous price controls.
2. Any investments need to represent long-term value for money and come under a robust efficiency challenge .
3. Network funding must produce **tangible benefits**, including enabling people and businesses to play their part in the transition.
4. The **quality of DNO customer service**, including during interruptions and connections, must improve, and be as fair as possible.
5. Comparative data about DNO performance should **transparently be available** on the regulator's website, building on the RIIO ED1 approach.

Whatever approach Ofgem adopts must provide enough certainty to DNOs to invest with least regrets while also ensuring there is flexibility to respond to developments in technology and changes in the wider economy.

The overall balance of risk and reward must avoid being too generous to DNOs, breaking the cycle of previous price controls.

It is our view that returns are likely to be over-weighted relative to risk under the SSMC proposals. In basing its approach on the UK Regulators Network (UKRN)'s guidance on the methodology for setting the cost of capital, Ofgem will set network returns at an unjustified level, benefiting company shareholders at the expense of consumers. This is due to UKRN's guidance bringing together existing methodologies and so consolidating the positions of regulated companies that have a commercial incentive to deliver high returns.

As we have argued previously, there is likely to be structural over-estimation within various elements of the cost of equity estimation due to approximations made while applying the Capital Asset Pricing Model (CAPM). For example, in line with CAPM theory, the Total Market Returns (TMR) should represent all assets in the economy, rather than UK equities. The CMA accepted this and noted that *"there is some evidence suggesting that total returns across all asset classes are lower than those on equities alone, and potentially materially lower"*², suggesting this leads to an over-estimation of the TMR. Other issues, for instance, how estimating equity betas by regression against UK equity market indices – rather than indices of all (global) assets - creates an upward bias in UK regulated company beta estimates, are explored in our responses in the finance annex.

The over-estimation of the cost of equity could be made worse if European comparators are considered in the equity beta estimation. Ofgem and the CMA have previously determined that little weight should be placed on European comparator betas since multiple types of risks can be expected to differ between the UK and European justifications, making comparison inherently difficult and meaning they do not improve the robustness of the estimation. Unless Ofgem can provide evidence on how the risks with comparability have been controlled

² CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), October 2021, Para 5.200

for, European betas should not be considered. A higher number of problematic comparators are not better than fewer higher-quality comparators. Further, since any perceived risks pertaining to the electricity distribution sector specifically must be, by definition, non-systematic i.e. diversifiable risks, they would not be captured in European equity betas anyway, so this further does not justify their inclusion. Changing the comparator set without providing compelling evidence for doing so would undermine regulatory predictability and stability.

Over-estimation of the cost of equity is also likely if sufficient consideration is not given to real-world evidence when setting the cost of equity point-estimate. There is clear and consistent evidence that network companies are able to make returns on investment that are too high. Real-world evidence of energy transactions over the last four years has shown purchase values reflecting a significant premium over the regulated asset value, indicating that the baseline cost of equity has historically been set too high. For instance the Market-to-Asset ratio of the 2024 ENWL transaction was 1.60. At RIIO-3 DD, Ofgem determined that:

*"It is difficult to accept that large MAR premiums can be justified by assumptions other than higher than required returns or lengthy and consistent expected outperformance."*³

The MAR values of energy transactions over the past few years are vital pieces of evidence which Ofgem must consider when setting the cost of equity. At ED2, we demonstrated that Ofgem failing to act on its own cross-checks resulted in £1.5 billion in excess returns going to companies.

Not only must Ofgem break the cycle of previous price controls, but must do so with an awareness that the proposed approach for ED3 will reduce risk to DNOs. In many cases it will also transfer that risk to consumers:

- "Plan and Deliver" aims to fund most investment ex ante, removing the uncertainty associated with re-openers or ex-post adaptability mechanisms. Ofgem also proposes that secondary network investment,

³ Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), August 2026, p.64

previously funded by volume drivers, is allocated in the baseline allowance. This would allow companies more control over delivery, reducing the risk associated with 'pay-per-unit' funding. There may be concerns that linking funding to delivery increases risk. This concern provides evidence that DNOs are currently receiving returns which are too high, because they are under-delivering, rather than that returns should be higher in ED3.

- Ofgem is exploring giving more responsibility for energy efficiency to DNOs. While this may be a new regulatory role for DNOs, we note that it allows better alignment with their other regulatory goals, e.g. around phasing investment in the low voltage grid, and has not been outside DNO risk appetite previously.
- Ofgem also proposes developing climate-resilience stress-testing, and better embedding risk from climate change into the way asset health is evaluated. This would support DNOs in managing future risk, giving them more of a case for further funding, and reducing the future cost of climate-change driven damage.

Ofgem must reflect the reduction in risk to DNOs when setting the cost of capital. Failure to do so would undermine legitimacy in the regulatory arrangements and mean that consumers are over-compensating shareholders.

We are also concerned that expecting DNOs to fund energy efficiency improvements by adding to the RAV could distort the price control process. Ofgem must take steps to ensure energy efficiency does not become a distraction. We do not think the cost of financing energy efficiency upgrades is likely to be different to the traditional investment of DNOs, with little additional uncertainty or risk. Ofgem will need to take steps to insulate any decisions on energy efficiency from the wider aspects of the price control.

Any investments need to represent long-term value for money and come under a robust efficiency challenge

Citizens Advice recognises that the next price control for DNOs is crucial to deliver the infrastructure necessary for decarbonisation. We expect that this will help make energy bills more affordable in the 2030s. We also recognise that

DNOs are competing for investment globally and that the Clean Power 2030 mission and 2050 target can deliver economic growth. However, in a time of high energy bills it is crucial to secure the right investment at the right price, so that today's consumers are not overly burdened with costs for a transition that benefits future generations. Consumer consent is essential for meeting system upgrades objectives, and it must not be undermined by price controls delivering outcomes that are generous to network companies at the expense of consumers.

- DNOs must not be funded to do what they were paid to do previously. The first year of ED2 has seen a 14% underspend against allowances, and it is unclear whether this underspend is driven by under-delivery or cost efficiencies.⁴ Although Ofgem reports an expected overspend in ED2, DNOs are safe from any clawback of savings from under-delivery, as long as their underspend doesn't exceed 20% of their non-variant allowances (£2.16 billion).⁵ We recommend that Ofgem enhances the ED3 close-out mechanism to reflect any shift towards anticipatory investment, the risk of under-delivery and the uncertainty mechanisms within the price control. We will pay close attention to how the ED2 close-out mechanism works.
- Incentives must not over-reward DNOs. Where incentives are being paid for DNOs to do something which consumers are already paying for, via baseline allowances or otherwise, Ofgem needs to justify this. If it is the case that Ofgem is trying to incentivise DNOs to do something exceptionally well, and better than previously, the incentives should reflect this. We strongly recommend that most incentives have relative targets, rewarding the best performing DNOs and penalising the worst, with a fixed minimum standard set as a backstop, and the incentive not being financed through consumer bills but from penalties incurred by worst performing DNOs.

⁴ Ofgem, [RIIO-2 Electricity Distribution Summary Annual Report: 2023-24](#), April 2025, p.19

⁵ Ofgem, [RIIO-ED2 Final Determinations Core Methodology Document](#), November 2022, para. 3.18

Network funding must produce tangible benefits, including enabling people and businesses to play their part in the transition.

We can see the benefit of the RESP and Ofgem's proposed "Plan and Deliver" approach, signalling that the energy system needs direction and accountability to decarbonise. That accountability must be maintained through ED3 and beyond.

- Although there are risks associated with "Plan and Deliver", it is a chance to ensure consumers avoid receiving nothing in return for funding, which, on balance, is a higher risk. Output metrics can be gamed, and without evidence that DNOs' underspending is actually driven by cost-savings, rather than gaming and 'reprioritisation', we support Ofgem's proposed approach.
- Business Plan Commitment reporting must mean something. The current approach is a step in the right direction in explaining DNO progress against their commitments. It needs to be easier to understand the trade-offs and consumer impact of DNOs activity funded by likely unprecedented amounts of consumer money.
- People and businesses will be able to financially benefit, and help lower overall system and network costs, by flexing their power usage. DNOs need to enable this to be done as easily as possible.
- The impact of spending on different consumers must be better captured, so that cost allocation and recovery is as fair as possible. This includes how the costs of unlooping and connections are spread.

Ofgem should look at novel approaches to keeping costs at a reasonable level. This may include more direction from Ofgem or bodies such as NESO on where investment is required, encouraging the deployment of flexible technologies such as batteries, as well as greater reliance on competition to drive down costs and increase innovation.

The quality of DNO customer service, including during interruptions and connections, must improve, and be as fair as possible.

Interactions between DNOs and customers are set to increase over the next few decades, as people install LCTs, DNOs upgrade consumer connections, planned interruptions will increase as networks upgrade their grid and unplanned interruptions may increase due to extreme weather events. Ofgem is making changes to ED3 to help address wider goals of the end-to-end review of connections. On both connections and interruptions, Ofgem must set out principles on what the price control aims to achieve: to improve performance over time, and reward best-performing DNOs. The way Ofgem designs incentives must reflect those principles.

- We support the development of a new incentive to improve customer service for both domestic and small business consumers connecting LCTs. We also support the adaption of the interruptions incentive, and recommend considering how incentives manage the occurrence of voltage fluctuations.
- The Broad Measure of Customer Satisfaction must be adapted to better reflect the nature of customer interactions, and the Customer Vulnerability Incentive needs to be separated into two separate incentives.
- Ofgem should establish a clear goal for reliability, such as a minimum standard for all energy consumers. This would ensure that all consumers receive the same minimum level of reliability regardless of where they live on the electricity network.
- Guaranteed Standards of Performance (GSoPs) must protect customers when things go wrong: including during power cuts and connections. The risk of consumer harm, and subsequent slowing of the transition, needs to be managed.

Comparative data about DNO performance should transparently be available on the regulator's website, building on the RIIO ED1 approach.

We anticipate increased public scrutiny of value for money and company performance as investment increases and due to greater levels of customer interaction with networks. Ofgem should ensure that the social licence between energy consumers and energy networks is strong and that consumers can have confidence in its legitimacy and in Ofgem's regulation.

- We want to see Ofgem better demonstrate how companies are performing against their targets and metrics, and in comparison to each other. The Network Performance Summary Report should be published promptly, and offer clear evaluation on whether the price controls are delivering as intended. While companies publish data themselves and huge quantities of data are submitted to Ofgem annually, there is little demonstrated accountability in RIIO-2 that shows whether Ofgem is satisfied or otherwise in the performance of network companies.
- We also want to see Ofgem publish key data and metrics in easy and accessible formats in the same way it publicises information in the retail market to give visibility to customers. This should take the form of league tables where it is appropriate to do so, as this provides additional incentive to companies over and above the financial incentives in place.
- We want Ofgem to commit to publishing performance monitoring as suggested above for reputational incentives. So far in RIIO-2 (covering Electricity Distribution, Gas Distribution, Electricity Transmission and Gas Transmission), Ofgem has not published any annual performance reports on any non-financial metrics: including, for ED2, the Annual Vulnerability Report, Annual Environmental Report and Major Connections Annual Report. This results in less effective stakeholder scrutiny, reducing the efficacy of reputational incentives, and minimising opportunities for lessons to be learned for future price controls. We would question the extent to which companies have reputational risk without this.

Core document questions

Long-term integrated network development plans

Q1.What are your views on our regulatory guiding principles that will inform the development of accountable investment planning and delivery?

Given both the potential scale and uncertainty of investment required over the next decade, we welcome Ofgem focusing on how to embed accountability into both planning and delivery. We agree with Ofgem that any upfront funding requires robust accountability. We therefore support the guiding principles, and agree that they reflect and account for the variety of goals which need to be achieved to invest cost-efficiently.

The 'consumer value' principle is critical, so we welcome its inclusion. We recommend that it is better defined to acknowledge that infrastructure 'funded through ED3 must be delivered in full and on time,' *and* at the best possible price. Consumers should receive the outcomes they are paying for, and not pay more than is necessary. We think it is better to incorporate this within the definition, even if efficiency is included as a separate principle, as consumer value ultimately cannot be measured without considering how much consumers are paying. Trade-offs between consumer outcomes and consumer cost will need to be carefully considered for ED3, including on investment and planning. This will be more pertinent as planned interruptions increase to facilitate upgrades, and as networks increasingly interact with consumers installing low carbon technologies.

Further, whilst we support that investment in electrification must aim to be as efficient as possible, we recognise that electrification may, in the short-term, provide greater benefits to certain households over others. For example, proactive investment in unlooping may lower overall costs of unlooping, but may provide additional capacity for certain consumers, e.g. those that invest in low-carbon technologies, over others.

It is therefore critical that investment planning and delivery keeps track of how benefits are being shared. Ofgem introduced a principle for NESO to 'be fair' in

delivering the RESP.⁶ Although this principle does not need to explicitly guide ED3 investment planning, information on ED3 investment spending will need to enable cost allocation, recovery, and incentives to be fairly set.

We therefore recommend redrafting the consumer value principle as follows: “Infrastructure funded through ED3 must be delivered in full and on time and at the best possible price, ensuring consumers receive the outcomes they are paying for, including on LCT connection, unlooping, and security of supply. The distribution of consumer value must be tracked. ”

A crucial part of ensuring accountability, including in relation to investment, is the accessibility of information and evidence that performance monitoring is effective. Without this, it is not possible for consumers to have confidence that there is legitimacy in the regulatory regime, and that the fairness that Ofgem aims to achieve is being delivered in practice.

As outlined elsewhere in this response, we are concerned by the lack of visible reporting on network performance, including investment planning and delivery. While companies publish data themselves and huge quantities of data are submitted to Ofgem annually, there is little demonstrated accountability in RIIO-2 that shows whether Ofgem is satisfied or otherwise in the performance of network companies and whether the price controls themselves are delivering what was intended.

We want to see Ofgem commit to publishing annual comparative performance monitoring, demonstrating how companies are performing financially, against their targets and metrics, and in comparison to each other. We also want to see Ofgem publish key data and metrics in easy and accessible formats in the same way it publicises information in the retail market to give visibility to customers.

Q2.Are the proposed objectives for the long-term integrated network development plans appropriate?

We broadly agree with the proposed objectives, and with the more general proposal to introduce long-term integrated network development plans. It is

⁶ Ofgem, [Decision on the Regional Energy Strategic Plan Policy Framework](#), April 2025, para. 1.11

important to bring together planning into one place. It would be counter-productive to propose different interventions meeting different goals without identifying their mutual benefits or the cumulative impact, including upon supply chains.

We recommend that the objectives include the role of flexibility, both at a system level and distribution level. For example, flexibility can be used to help 'realise efficient delivery' as well as to 'avoid disruptive ramp ups [in investment demand] that exceed supply chain capability'. Ofgem recognises a variety of use cases for flexibility in chapter 5 of the consultation, including for planning and investment. It would be consistent to ensure flexibility is reflected in the long-term integrated network plan objectives.

Another objective to include would be to identify the equity impacts. For example, plans should identify the impact of investments on consumers, including how consumer value is spread across the population. This would ensure transparency regarding the way consumer value is shared, enabling third-parties to evaluate the benefits and burdens of the price control targeting investment ahead of need. This could inform the way cost allocation and recovery, and incentive setting, is designed.

Q3.What are your views of the proposed structure and contents of the plan?

We generally welcome the structure and contents of the plan, especially the inclusion of 'delivery commitments and monitoring'.

We'd suggest one amendment under the 'outcomes for consumers'. The four long-term outcomes include one on enabling customer participation. We believe that 'customer service' should be added alongside this. This is because enabling customer participation is a way of ensuring customers receive a service they value and want. Enabling customer participation is important, but is less useful if that participation does not impact the service provided. We recommend that the plan also explicitly covers the role of flexibility, including enabling both system flexibility and consumer-led flexibility.

Taking both these points into account, we recommend redrafting “outcomes for consumers” section as follows:

Long-term outcomes DNOs aim to deliver over 25 years, including:

- Enhanced resilience and reliability
- Capacity to meet load growth
- Reduced environmental impact
- Enabling customer participation, including consumer-led flexibility
- World class customer service and value for money

Q4.Do you agree with the proposed use of tRESP outputs in DNOs' network impact assessments?

We welcome tRESP outputs being an input into DNO’s assessment of need for network interventions, including in their demand and supply projects and their optioneering assessments.

We also support that DNOs should ‘clearly document all the DFES building blocks used to construct its full demand pathway’ (page 28).

Q5.What are your views on the guidelines for proactive investment decision-making across all DNOs?

We understand that proactive investment could offer opportunities for medium-term cost savings, and ensure networks can meet future demand. However, there are also risks to front-loading investment. For example, it could exacerbate supply chain pressures, driving up costs to consumers. To manage these risks, we suggest the following.

The guidelines on optioneering of low-regret proactive investment should include reference to supply chain pressure as a factor to consider in cost-efficiency.

It would be useful to define certain words and phrases in the guidelines. For example it would help to clarify ‘future expected network needs’, ‘current’ or ‘near-term’. We note that it may be best for network companies not to ‘explore’ economies of scale but ‘develop’ them, recognising that much of network

infrastructure is 'expandable'. We also note one criterion for considering proactive investment to be low-regret is that 'upsizing for long-term need can be done at marginal additional cost'. Marginal additional cost is an economic term for the additional cost incurred from producing one extra unit of a good or service. We presume that the policy intent is that if investment is already being made, networks should upgrade that investment if the additional cost to meet long-term needs is low; they are, by definition, already marginal. Therefore, it may be better to choose a different phrase.

Ofgem should build evidence as to why a one month delay to connect LCTs could be a relevant indicator for low-regret proactive investment. We understand the rationale, and think it is important that delays to connection services are an indicator of need for investment. We would, however, caution against defining a time-frame without better understanding the trade-off between customer service and cost. We would not want to see a scenario where the month time-frame becomes a definitive indicator that investment is low-regret without clear rationale. For example, it may be more cost efficient to invest first in a different project instead of fixing a month-long delay for a few LCT connection requests. This trade-off is something we would expect the end-to-end review of connections to address.

Ofgem should look at novel approaches to keeping costs at a reasonable level. This may include more direction from Ofgem or bodies such as NESO on where investment is required, encouraging the deployment of flexible technologies such as batteries, as well as greater reliance on competition to drive down costs and increase innovation.

Q6. Do you agree that LV network reinforcement and unlooping of legacy service connections are suitable areas for a programmatic, area-based approach in ED3? Why or why not?

Citizens Advice recognises that LV network reinforcement and proactive unlooping of legacy service connections are likely to be necessary to meet long-term electrification demand. There is uncertainty about the capacity of the

LV network and the number of properties that will require unlooping during the ED3 price control period. Therefore, we would suggest that:

- Ofgem should clarify why ex-ante allowances would be more effective than volume-drivers to fund this work. We support a 'plan and deliver' approach, but would like to understand the potential benefits that outweigh the accountability benefit of using volume drivers.
- Any baseline funding for unlooping or LV reinforcement should only be available if DNOs have a complete and accurate picture of looped properties and LV network capacity/constraints. Otherwise, allowances risk being granted without sufficient information to hold DNOs accountable for delivery and costs.
- Allowances should only be available once DNOs have delivered LV network reinforcement funded via ex ante allowances in ED2 (roughly £58.5m million secondary reinforcement was unattached to PCDs/volume drivers in ED2)⁷. Ofgem should ensure consumers are not funding delivery of secondary reinforcement twice between ED2 and ED3.
- Ofgem should consider whether some financial responsibility lies with DNOs to upgrade fully depreciated assets such as looped connections. Network asset owners have been gaining benefits without investing further in looped service connections. Given some DNOs have launched pro-active unlooping programmes, funding this partially themselves, there is already an understanding that the responsibility does partially lie with networks to fund this activity.
- We recommend that Ofgem establish a clear goal for reliability, such as a minimum standard for all energy consumers. If Ofgem are looking to establish national consistency on unlooping and connections, it raises the question as to why such consistency is not needed for reliability.

⁷ Ofgem, [RIIO-ED2 Final Determinations Core Methodology Document](#), November 2022, p. 18.

Q7.What are your views on the need for national consistency in the delivery of proactive unlooping programmes?

It seems that 'national' in this case means that the programmatic approach would be governed by a framework and standards across DNOs. If the counterfactual is that the method of proactive unlooping would be up to DNOs, beyond that it should be area-based, then we would agree that the method should be national. Without this, there is a risk that DNOs are paid the same amount to do different things. It would therefore be helpful to understand what would be the funding mechanism for the programmes; for example an ex-ante allowance and/or governed by price control deliverables. We are supportive of a funding mechanism that is closely tied to delivery.

We do generally agree that national consistency is important to ensure consumers are not paying for services of different quality and standards. The proposals for customer service standards, a protocol for customer refusal, and monitoring, will all contribute towards better consumer outcomes. It is also important that DNO gives consumers options around unlooping, which can be disruptive both internally and externally. We want to work with Ofgem and the DNOs to ensure that any unlooping programme is as fair as possible to consumers.

We also welcome that the national framework for solutions deployed could enable both consistency and cost-efficiency. For example, 3-phase supply upgrade may not be needed in many homes, in the near or longer-term, and so having a framework which enables but does not prescribe such an upgrade is important.

We also support the policy intention that the benefits of proactive unlooping are delivered 'equitably and efficiently' across the country, recognising that there is often a tension between what is equitable and what is efficient. For example, proactive unlooping will benefit - and is already more targeted towards - households which are most able to adopt LCTs, or in more urban areas. It is also an activity which needs to be done less frequently for blocks of flats. Therefore, although pro-active unlooping in and of itself could lower total consumer costs,

the benefit will likely be most felt by those whose characteristics are often indicators of higher incomes and wealth. With this in mind, we would suggest that any cost recovery is carefully thought through. We recommend that Ofgem explains the interaction with other connection cost recovery measures, such as connection charges for heat networks and new housing developments, which may, ultimately, pass through to domestic consumers. We will look to ensure Ofgem is addressing this through the end-to-end review of connections, and recommend that Ofgem introduce a mechanism to track the distribution of consumer value.

Strengthening delivery accountability

Q8. What are your views on high-level delivery accountability options and their respective strengths and limitations?

Ofgem rightly acknowledges that the risk of consumer harm due to under-delivery will be even higher given the significant increase in investment. We therefore welcome Ofgem proposing more effective delivery accountability mechanisms for ED3. Linking funding to the specific project or type of work will reduce the risk of under-delivery. We therefore think that wherever possible/practicable, Price Control Deliverables are the best options to hold networks to account for delivery. For projects with quantity-based fixed costs, volume-based measures can limit the risk of wasted spending.

Meanwhile, we are concerned that output-based metrics do not link funding to the specific project or type of work that is needed. This could allow DNOs to receive more money than in previous price controls, with a broad metric as the primary mechanism holding the DNOs to account for how they spend that money. We are concerned that these metrics could be gamed to ensure maximum savings for the DNOs, at the cost of consumer spending. We have yet to see evidence that load-related expenditure is spent effectively by DNOs and so we do not recommend adopting output-based metrics. If Ofgem introduces any new blended metrics to measure network capacity, including at the low voltage level, the methodology behind these metrics must be transparent and robust. We want to avoid the sort of situation which exists with metrics such as

NARM today where the complexity of the metric makes it difficult to understand underlying network performance.

However, we are aware that the issues with network data, such as low voltage networks not yet being fully monitored, could limit the ability to apply price control deliverables. In these scenarios we would argue that the purpose of the ED2 LV network monitoring programme was to correct for this problem. There is a risk that DNOs time the achievement of network monitoring goals after any target setting for price control deliverables, so that they can ensure that as much of their funding is unlinked to price control deliverables. We would strongly urge Ofgem to manage this risk carefully, and not just through using volume drivers. In our view, DNOs should be able to have full monitoring of their LV network in place ahead of submitting their ED3 business plans.

Ofgem should also consider how price controls being more directive alters the risk profile for DNOs and may bring further benefits to consumers. We believe that more actions which move large amounts of discretion from network companies to Ofgem must further reduce the risk for these companies, but represent a transfer of risk to consumers. Ofgem cannot make changes which alter and move actual risk, and the perception of risk, for companies without then also reflecting this in the cost of capital. To do so would guarantee that returns do not reflect the changed nature of price controls.

Q9.Should delivery accountability mechanisms prioritise certainty over flexibility when funding low-regret, proactive investments aligned with strategic value decarbonisation and growth goals?

Yes, we agree that accountability mechanisms should prioritise certainty over flexibility when funding low-regret, proactive investments. We expect that some networks may already be putting in orders for ED3 assets, so it is likely that DNOs are operating in an environment where planning is more important than flexibility . This is especially true of funding low-regrets investments.

Q10. Are additional delivery incentives needed, or can a combination of accountability mechanisms and output-based incentives sufficiently ensure delivery performance?

When Ofgem was setting load-related expenditure in ED2, we made Ofgem aware of concerns that allowances were too high, and not reflecting the potentially reduced spending power of consumers, resulting in a slower uptake of LCTs. This would allow for windfall gains for the DNOs, if they underspent these allowances.⁸ Ofgem stated that the levels set were a 'reflection of the level of expenditure that will be required to facilitate the net zero transition, without leaving the networks with too much catching up to do in the future.'⁹ However, after the first year of ED2, Ofgem reported that underspend on load-related expenditure was partly driven by the 'take up of Low Carbon Technologies (LCTs) being lower than forecast'.¹⁰ We worry that a similar dynamic could occur in ED3. Ofgem's proposed approach to link allowances with delivery should reduce this risk in ED3 but it is an area we will want to continue to explore with Ofgem. This could include options such as more robustly challenging DNO delivery forecasts or removing the 20% tolerance on underspending at the close-out of ED3.

Adapting for additional investment needs during the ED3 period

Q11. What are your views on the assessment of the adaptability mechanisms, and should additional criteria be included?

The assessment of adaptability options makes sense, and we welcome the inclusion of the 'risks to consumers' criterion. We would welcome an evaluation of the potential for adjustments to include downwards adjustments to funding needs. Although the general expectation may be that the first RESP will recommend additional strategic investment needs, allowance should be made for RESPs identifying lower strategic investment needs. Ultimately, planning must be allowed to determine not just extra investment but also where investment may not be needed.

It may also be worth considering whether adaptability mechanisms will be needed to account for any energy efficiency programme which DNOs are

⁸ Citizens Advice, [Citizens Advice response to the Ofgem RIIO-ED2 Draft Determinations consultation](#), August 2022, p.3.

⁹ Ofgem, [RIIO-ED2 Final Determinations Core Methodology Document](#), November 2022, para. 3.17

¹⁰ Ofgem, [RIIO-2 Electricity Distribution Summary Annual Report: 2023-24](#), April 2025, p. 23.

required to deliver. Although we are not supportive of the price control funding such a programme, in the scenario that it is, we would need assurance that adaptability mechanisms could sufficiently limit consumer risk of under-delivery and perceptions of higher risk to DNOs.

Q13. How can adaptability mechanisms be designed to ensure DNOs respond quickly to new network needs while maintaining transparency, accountability and value for money?

On the design of re-openers, we recommend that Ofgem produces high, medium and low cost scenarios with proportionate scrutiny for the additional cost allowances that may result from re-openers. Re-openers should be symmetrical and equitable, meaning that DNOs and Ofgem can both trigger them and they should allow for both increased and decreased allowances as necessary.

We also recommend that Ofgem ensure adequate resources for scrutiny of re-openers, so that the process to adapt funding is as robust and efficient as possible.

We would expect Ofgem to consult on material re-openers to ensure transparency around any additional funding that the regulator approves.

Q14. What are your views on the proposed timing of the RESP reopener windows in years 2 and 4 of ED3?

We would like to better understand why Ofgem proposes this timing. Below we have mapped the proposed timings. There is a significant delay - over two years - between the RESP publication at the end of 2027 and the RESP re-opener window being in the first half of 2030. Although this is similar to the timeframe between tRESP and the proposed beginning of ED3, a re-opener to adjust allowances should require less resource than agreeing the full suite of funding. Meanwhile, it is unclear exactly how long the delay would be between the RESP update in 2030 and the second re-opener.

2026	2027	2028	2029	2030	2031	2032	2033
tRESP published Q1, SSMD and BPG published Q2	RESP and FDs published Q4			RESP update Q4			
DNOs submit business plans Q4		ED3 commences Q2		RESP re-open er submissions Q1 or 2		RESP re-open er submissions	

Conceptual models for ED3 delivery

Q16. In the context of ED3, do you consider that we should put more emphasis on Plan and Adapt or Plan and Deliver — to be more appropriate for achieving the guiding principles set out in Paragraph 3.5? Please explain your reasoning.

Based on the overall package set out in the SSMD, we believe that Ofgem should put more emphasis on Plan and Deliver. This is for four reasons:

1. We believe the Plan and Deliver model for network investment provides clarity on what is needed and the delivery timescales expected of network companies, enabling DNOs to focus on delivery.
2. We agree on balance that managing the risk of under-delivery is worth the trade-off that may result in in-period inefficiencies. This is particularly pertinent as Ofgem has stated that there will be a step-change in

investment,¹¹ and therefore there is greater potential for significant sums of money to be spent without anything to show for it.

3. tRESPs, RESPs and their updates, and long-term integrated development plans, are all designed to ensure accuracy in planning for business plan proposals. Prioritising flexibility over certainty could undermine the validity of these planning processes, signalling to stakeholders that whilst planning could give DNOs the business case for investment, it won't assure actual investment as per the plans. This could then reduce engagement with the planning processes, and result in plans being determined largely by DNOs.
4. As we said in response to question 8, we are concerned that output-based metrics which are not linked to specific interventions could be gamed to ensure maximum savings and de-prioritisation of more expensive projects.

If Ofgem introduces any new blended metrics to measure network capacity, including at the low voltage level, the methodology behind these metrics must be transparent and robust. We want to avoid the sort of situation which exists with metrics such as NARM today where the complexity of the metric makes it difficult to understand underlying network performance.

We would also note that Plan and Deliver will reduce risk for network companies in ED3, and in many cases will transfer that risk to consumers. While we think this may be the correct decision for consumers, it is important that Ofgem sets the cost of capital at a rate which recognises this change. Not doing so would undermine legitimacy in the regulatory arrangements and guarantee that networks will earn excess profits in ED3.

Whatever approach Ofgem adopts must provide enough certainty to DNOs to invest with least regrets while also ensuring there is flexibility to respond to developments in technology and changes in the wider economy.

¹¹ Ofgem, [ED3 Sector Specific Methodology Consultation](#), October 2025, p.15.

Q17. Are there additional mechanisms or combinations of mechanisms that should be considered to better support strategic, accountable, and adaptable delivery in ED3? If so, how might they complement or improve upon the models presented?

While we broadly support Plan and Deliver as a means of ensuring that network investments are efficient, it is important that the price control is able to adapt to technological and economic changes. The case for anticipatory investment is less strong if there are limited increases in electrical demand over the next few years or if the cost of flexible assets such as batteries falls significantly to the point where there is a meaningful reduction in peak demand. We encourage Ofgem to respond to these types of changes when approving both proactive investment and any reopeners.

It is also important to ensure that the cost of investment does not involve too heavy a burden on energy consumers who use electricity as an essential service. We recommend that Ofgem monitors the overall impact of network investment on electricity bills and builds in review points during 2028 - 2033 to determine whether consumers can afford the investment.

A crucial part of ensuring accountability is the accessibility of information and evidence that performance monitoring is effective. Without this, it is not possible for consumers to have confidence that there is legitimacy in the regulatory regime, and that the fairness that Ofgem aims to achieve is being delivered in practice. As outlined elsewhere in this response, we are concerned by the lack of visible reporting on network performance. While companies publish data themselves and huge quantities of data are submitted to Ofgem annually, there is little demonstrated accountability in RIIO-2 that shows whether Ofgem is satisfied or otherwise in the performance of network companies and whether the price controls themselves are delivering what was intended.

We want to see Ofgem commit to publishing annual comparative performance monitoring more promptly, demonstrating how companies are performing against their targets and metrics, and in comparison to each other. This should offer clear evaluation, as suggested in our response to question 50. We also

want to see Ofgem publish key data and metrics in easy and accessible formats in the same way it publicises information in the retail market to give visibility to customers. This should take the form of league tables where it is appropriate to do so as this provides additional incentive to companies over and above the financial incentives in place. For reputational incentives, this publicity of information is essential and we would question the extent to which companies have reputational risk without this.

Ofgem should look at novel approaches to keeping costs at a reasonable level. This may include more direction from Ofgem or bodies such as NESO on where investment is required, encouraging the deployment of flexible technologies such as batteries, as well as greater reliance on competition to drive down costs and increase innovation.

Connections

Redefining connection types

Q18. Do you agree that the connection types of 'minor' and 'major' should be redefined? If so, do you have thoughts on how they should be redefined, via voltage works required, customer type, a blend of the two, or a split not considered here?

Based on the information we currently possess, we cannot answer this question directly and are open to engaging with Ofgem further in 2026.

It would help if Ofgem could better clarify what the policy intent is behind defining connection types by customer. We're aware that the end-to-end review has yet to be published, but, without understanding Ofgem's policy intent, it is hard for us to come to a definitive view. Whilst the costs of redefinition are reasonably clear (e.g. the administrative difficulty on the DNO side, the risk of unfair incentives if DNOs interpret definitions differently), the benefits are less clear.

Ofgem acknowledges that they don't know the volume of connections demand, and customer journey of connections, by the type of customer. This is because the current satisfaction surveys and time to quote and connect incentives only

split out results by voltage, and provide a contact name and address. However, if there is no wider policy intent behind introducing underlying customer types in the incentives, arguably the data could be collected in a different format, but without a link to the incentives. This would reduce the risks arising from difficulties defining and interpreting categories of customer.

It is possible that Ofgem thinks that some customer types should have a different customer journey to others and the policy intent is to use incentives to change the experience of different customer types. We think this warrants further discussion during 2026 ahead of any methodology decision. It raises questions such as:

- whether a small business customer should have a better or different customer journey than an industrial and commercial customer or a domestic one?
- what are the customer types where more granularity by voltage might not reflect that the customer has different needs in relation to time to connect and time to quote?

Analysing the data from the major connections survey and connections portion of the customer satisfaction survey could help. Although customer type is not included in the survey, there are verbatim responses about what could have been done better. This could flag some issues which may vary depending on the customer type.¹²

There are examples where it could be important for customer type rather than voltage level to determine what connection service DNOs should provide. Connections with underlying domestic consumers (e.g heat network customers, new housing developments, new care homes) could currently be being de-prioritised in terms of time to connect, or customer service, in favour of connection requests from business customers (e.g data centres, offices). Some news stories are already coming out alleging this is the case.¹³

¹² For example, a response to question 33 of the customer satisfaction survey on connections suggested that a network's website is tailored for residential supplies and large commercial supplies. But the website could be made clearer for small commercial supplies.

¹³ The Londoner, [The data centres stopping new housing in London's poorest borough](#), July 2025

There could therefore be merit in setting better time to connect and quote targets, or satisfaction scores, for requests with underlying domestic customers compared to business customers. The regulatory regime must provide value to those living in the buildings for which they pay energy bills. The government, with its economic growth and housing build targets, would also need to consider this policy tension closely.

Incentives for smaller connections

Q20. Do you agree with our proposal for LCT connections and their associated enabling works to be brought into the connections scope and incentivised, with the potential to set varying working day targets for different connection activities? Why?

Yes, we are supportive of the proposal which will be a step towards ensuring a quicker, simpler and more consistent customer journey for those installing LCTs. We agree with the proposal to establish time to approve, quote and connect, plus the customer satisfaction survey.

We are supportive of varying targets based on the circumstances of the customer, particularly if, for example, a customer is installing a heat pump because their boiler no longer works. This will help prevent consumer harm which could arise if consumers decide not to install a heat pump during winter because of delays on the DNO side. We also note that fairness is relevant to the circumstances of the consumer, such as whether they rely on consistent heat because they have young children or have a disability. We would welcome further discussions with Ofgem on how to determine the different scenarios.

We understand the rationale that it is fairer, and more cost-effective, to have varying targets by the complexity of the work carried out. It may be that a fuse upgrade can take place within a matter of days, while upgrading to a three-phase connection might take a matter of weeks. We would reinforce the importance of communication in this instance. Networks should ensure

information on their websites as well as via individual customer engagement is easy to understand.

We also can see a role for DNOs to improve the quality of their data during the remaining years of ED2. For instance, in relation to fuses, DNOs should have high-quality records of what fuse is currently installed at a property. Without this information at a household level, DNOs may unnecessarily ask consumers to wait for a site visit which simply confirms that the existing fuse is satisfactory.

We do not think it is appropriate to have 'standstill periods'. This may initially seem fairer, ensuring DNOs are not penalised for factors largely outside of their control. However, in a competitive market, companies which innovate in order to address factors largely outside of their control, are rewarded. A standstill period could therefore disincentivise innovation which would be in the interests of consumers. For example, DNOs may improve the way they communicate in order to limit the delays in consent from neighbours to access land, or may decide to collaborate with other third-parties (such as GDNs and other utilities companies) in order to increase the likelihood of local authority granting permits for roadworks, because this will reduce the overall number of permits being requested.

Q21. Do you agree the incentive should be reward and penalty (as per the RIIO-ED2 minor connections incentive)? Why?

We agree that the incentive should be reward and penalty, but strongly recommend that Ofgem define the aim of the incentive to ensure the design is cost-effective. For example, Ofgem could decide that the aim is to improve DNOs' connections service over time, and relative to each other. In this case, we strongly recommend that the incentive has relative targets, rewarding the best performing DNOs and penalising the worst, with a fixed minimum standard set as a backstop. The incentive should not be financed through consumer bills but from penalties incurred by worst performing DNOs. If consumers are paying to connect either directly, or indirectly via other price control funding (volume

drivers, ex-ante allowances), they should not have to pay again to incentivise a good service. This is already a condition of DNOs having their licence to act.¹⁴

Further, in a competitive market, customers pay for a service, and companies improve and innovate their service in order to attract more customers. This comes at the cost of other firms losing customers. One firm's benefit is at the cost of another firm's loss. The reward and penalty incentive should mirror the dynamic of a competitive market, where improvements in service offer zero sum rewards. Some firms may challenge that improvement and innovation in a competitive market can result in cost efficiencies, which do not cause a similar loss for other firms; they are positive-sum incentives. However, the Totex Incentive Mechanism (TIM) provides a positive-sum efficiency incentive. Adding another positive-sum incentive could reward DNOs simply because they are monopoly companies.

Q22. Do you think any LCT connection incentive should be for domestic, non-domestic, or both? Why?

We are supportive of the incentive including both domestic and non-domestic consumers. Given there are already incentives in current price controls to improve connection services for business customers with higher voltage works needed (and therefore more likely larger businesses), excluding the small business cohort could lead to unfair outcomes. We think it would be inconsistent to argue for an incentive that only applies to domestic customers, whilst also expressing support for an incentive split by voltage work. DNOs may argue for a split based on voltage work because it provides a clearer way for them to categorise their work. We would want to avoid a situation where the cost savings of not having to service non-domestic business customers to avoid a penalty makes the categorisation of customer type worth the apparent administrative costs.

¹⁴ Gas and Electricity Markets Authority, [ELECTRICITY ACT 1989 Standard conditions of the Electricity Distribution Licence](#), June 2025, Condition 10.AA

Broad Measure of Customer Service

Q30. Do you agree with removing the 'Connections Survey' and the LCT related elements from the 'General Enquiries Survey' from the CSS part of the BMCS and putting this into the new smaller connections incentive? Why?

In our view, the quality of DNO customer service, including in relation to interruptions and connections, must improve during the ED3 period, and be as fair as possible. It is possible that the BMCS has led to some improvements in customer service since its introduction in RIIO-ED1 but more can be done.

In response to the specific question, yes, we agree that separating the survey responses relevant to connections, both minor and 'micro' (i.e not new connections requests), and putting this into the new smaller connections incentive is a sensible proposal. This could enable better scrutiny and an incentive to improve the connection journey, and ensure appropriate focus is maintained on the experience of those domestic customers who are not looking to upgrade their connection. The success of this proposal will depend, however, on how the incentives are weighted. Ofgem will need to ensure no perverse prioritisation is inadvertently incentivised.

In our view, Ofgem should also regularly and transparently publish the comparative results of the new smaller connections incentive.

Q31. Do you agree that the remaining surveys under the BMCS CSS then be split between 'Planned Interruptions', 'Unplanned Interruptions' and 'General Enquiries'? Why?

Yes, we agree that this is the logical step to take when redesigning the BMCS incentive. In our view, Ofgem should promptly and transparently publish the comparative results of the BMCS, using easy-to-access data tables as well as the annual report on DNO performance.

Q32. Do you agree with the proposal to also report on and incentivise PSR vs Non-PSR survey results for each interruptions survey? Why?

Our analysis of consumer satisfaction data found that consumers on the PSR have a slightly higher average overall satisfaction level than those not on the PSR (9.10 vs 9.01) across all service types.

For planned interruptions the average overall satisfaction was 9.20 for those on the PSR, versus 9.03 for those not on the PSR. Similarly for unplanned interruptions, agent responses suggested those on the PSR had an overall satisfaction of 9.20, which is 0.17 higher than those not on the PSR. For unplanned interruptions message response, the average satisfaction was 0.09 for those on the PSR than those not on PSR.

This suggests that the requirements upon DNOs regarding the PSR, and DNO compliance with these requirements, improves the experience of consumers.¹⁵ It makes sense to require DNOs to report on the PSR versus non PSR survey results to ensure oversight but, if the incentive is financial, target setting would have to be calibrated to ensure DNOs aren't overly rewarded for something they are already doing or required to do.

Q33. Do you have a view on what weightings should be applied to the different surveys now proposed for the CSS part of the BMCS? Why?

If the different surveys are not weighted equally, it would make sense to weight them according to the proportion of customers who experience each service type. From our analysis of DNOs customer satisfaction data between 2020 and 2025 the breakdown for each service type is as follows (excluding connections):

- General enquiries - 20%
- Planned interruption - 26%
- Unplanned interruption - 54%

Unplanned interruptions also have the lowest average overall satisfaction, so increasing the weighting for this survey would ensure greater focus is given by DNOs to this area of (relatively) poorer performance. Unplanned interruptions

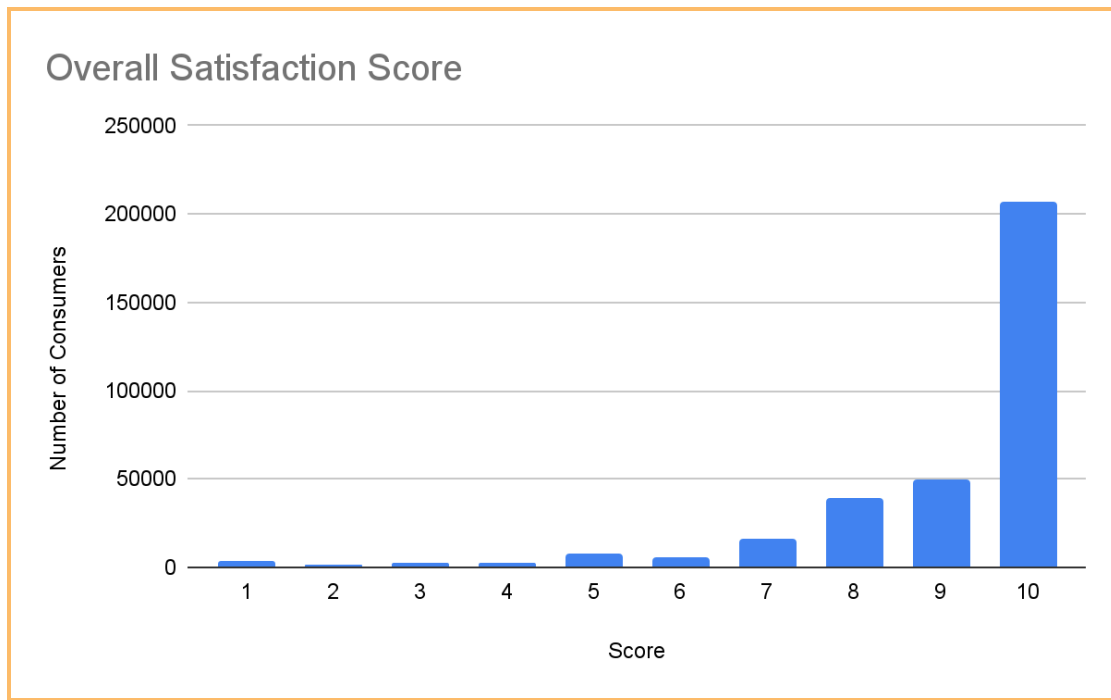
¹⁵Gas and Electricity Markets Authority, [ELECTRICITY ACT 1989 Standard conditions of the Electricity Distribution Licence](#), June 2025, Condition 10.AA

also have the potential to cause greater detrimental effects to consumers so it makes sense to have more focus on them.

Q34. Do you agree the CSS part of the BMCS should remain a penalty and reward incentive? Why?

Yes, we agree that the CSS part of the BMCS should remain a penalty and reward incentive, but that it should be a zero sum incentive. Our preferred option for an incentive would be to move to relative targets, rewarding the best performing DNOs and penalising the worst, with a fixed minimum standard set as a backstop, and the incentive not being financed through consumer bills but from penalties incurred by worst performing DNOs. This aligns with the Department for Business and Trade's intention in its Smarter Regulation proposals to introduce more relative performance targets for regulated industries. It also incentivises DNOs to both consolidate their improved performance and strive for exceptional performance without overpaying on an incentive at the expense of consumers.

We analysed the customer satisfaction data for these areas from financial years 2020 - 2025 across all electricity distribution networks. We found 62% of consumers scored their overall satisfaction at a 10, and that 93% of consumers scored their satisfaction at a 7 or higher. The average overall satisfaction score is 9.05. There is therefore a question about whether the benefit of levels exceeding 9/10 produces diminishing returns relative to the cost of doing so, which is why we propose relative targets.



Further, there is a 'long tail' of dissatisfaction (scoring lower than 7) with the service provided by DNOs. In general the correlations between overall satisfaction and the other questions were a lot lower for the dissatisfied group. For example, for the dissatisfied group within the planned interruptions category we found that the correlations between satisfaction with notice given, accuracy of start and finish times, and information provided and overall satisfaction were much weaker. For dissatisfied consumers the only factor that was weakly positively correlated with overall satisfaction (i.e. a correlation coefficient >0.2) was satisfaction with the notice provided. This implies that the reasons for their dissatisfaction are not being adequately captured in the survey. We would encourage Ofgem to investigate this, alongside asking DNOs to re-run the trial regarding survey channels. We are supportive of Ofgem moving to broaden survey channels, and would suggest considering the costs and benefits of including customers with more complex communication needs, i.e with English as an additional language, requiring British Sign Language, to ensure consumers of all types are represented.

Q35. Do you agree with our proposals to retain the complaints metric as a penalty-only incentive and to leave the weightings applied to each category unchanged? Why?

Yes, we agree with retaining a penalty-only incentive for complaints, especially given the improvements in results. Rewarding DNOs for handling complaints well would introduce perverse incentives. We support Ofgem updating the target score as they progress with the price control process.

Q36. Do you agree with our decision not to take forward the proposals set out in 'options considered but not proposed'? Why?

We agree that it is important not to discourage DNOs either from making it easy for a customer to complain, or from reporting on the full range of complaints they receive. We therefore support complaints volumes being excluded from the metric for now.

We would encourage Ofgem to agree to a broad definition which ensures DNOs are categorising complaints by time-frames consistently. Even excluding complaints volumes leaves inconsistency within the current complaints metric.

Consumer vulnerability

Q37. What is your view on the PSR Reach metric and whether this should form part of the AVR as a reputational incentive? If we were to continue this metric as a financial incentive, do you think it should continue as a reward/penalty or penalty only and should we change the weighting?

We believe the PSR metric should be retained in its current form in ED-3. However, as discussed in Q38, we believe it should be removed from the packaged CVI incentive.

Increasing the number of eligible households on the PSR is a significant part of a DNO's activities for its customers in vulnerable circumstances. We therefore feel that the incentive should remain as strong as possible, with both a reward and a penalty to encourage DNOs to increase their efforts in this area.

Over the next 12 months, DNOs have an important window ahead of the PSTN switch-off in January 2027. This switch-off may disproportionately impact customers living rurally without access to a mobile phone and reliant on medical equipment. DNOs should ensure that their PSR data is up-to-date and prioritise finding alternative ways to contact customers who may be hard to reach after the PSTN switch-off.

We would like to see more evidence from Ofgem and the networks around the assertion that PSR rates cannot be improved (or can only be marginally improved) in some licence areas. We feel that all companies should be striving for 100% coverage, due to the consumer benefits and detriments experienced by being included or not included on the PSR. Ofgem should also regularly and transparently publish comparative results showing the number of customers on the PSR by DNO. We also support the ongoing work to develop and improve PSR data-sharing between the water and energy sector, and are continuing to advocate for a government-led multi-sector PSR.

Q38. What are your views on the Social Value metric and the CSS elements of the CVI incentive. Are there any areas you think we should amend or adapt for ED3?

We are satisfied that the Social Value metric is a useful tool for assessing the value of DNO-led projects. Ofgem should look to assess how consistently it is being applied, however if feedback from all stakeholders is positive then Ofgem should not need to undertake a fundamental review of the methodology.

Although it is vital to capture customer satisfaction within the incentive, the CSS as it is can be seen as a blunt tool that relies on data collection from people in vulnerable circumstances, and it may not always be appropriate for partners to ask this of funding recipients. Additionally, it may not capture the full extent of consumer benefits. Ofgem should consider whether alternative methodologies, such as qualitative analysis, can be used.

We feel that the PSR metric should serve as a standalone incentive, with different treatment (a zero-sum design) applied to the other elements of the CVI.

Q39. Do you think the targets for the CVI metrics should be made common across DNOs? Why?

Assessing the performance of companies in ED-2, it is evident that there is a wide range of results for PSR reach in different licence areas. However, without evidence as to why these differences occur, it is difficult to form a view on whether individual targets should be retained for ED-3.

Regardless of whether Ofgem uses individual or a common target, we would like to see more stretching, dynamic targets used in ED-3, to reflect the importance of PSR reach. Ofgem should also consider how to facilitate knowledge sharing of best practice for increasing PSR reach in a competitive environment fostered by the financial incentive. Although this will be tricky, it is vital that customer outcomes are prioritised, and that best efforts are used to ensure that everyone entitled to extra support from their DNO actually receives it.

We also recommend that Ofgem change the CVI to be a zero-sum incentive, recognising that DNOs already receive allowances for vulnerability support. Rewarding them for using that money well is suggesting that customers need to pay a premium for good vulnerability support, which sends the wrong message. Ultimately, it is a licence condition for networks to treat vulnerable customers fairly, and consumers shouldn't need to pay extra to incentivise compliance. However, we feel that the PSR incentive should be exempt from this treatment, due to the importance of fostering knowledge sharing to improve standards across networks, which would be made more difficult in a competitive environment where one or more DNOs would always receive a penalty.

Q40. Do you think the AVR should be carried forward as an ODI-R to ED3, and why? If it is carried forward, are there any changes you think should be made to the structure and content?

Yes. This report offers an important opportunity for stakeholders to hold companies to account and to assess their vulnerability activities as a whole.

We would like to see the template amended to ensure comparability across companies. Our assessment of vulnerability strategies showed inconsistencies in format, style and terminology, as well as a lack of clarity around reported

statistics and missing links between services delivered and outcomes achieved.¹⁶ We would like to see greater standardisation to improve reporting, as well as the requirement for a standard one-page cover sheet at the start of each report, which would help to strengthen the reputational incentive.

Energy efficiency

Q41. Do you have any views on our proposal for DNOs to play a bigger role in the delivery of energy efficiency and low carbon measures?

Improving the energy efficiency of UK homes is important to improve lives, reduce bills and reduce peak demand from electric heating. We have highlighted consumer protection issues with the current model of delivering energy efficiency and ways to improve this in future¹⁷.

We strongly recommend that Ofgem ensures that any DNO involvement in energy efficiency, whether operationally or in terms of financing, does not distract the DNOs from their core activities. We expect that the next price control will involve both upgrading physical grid infrastructure and optimising use of the existing grid ahead of any increase in electricity demand later in the 2030s. DNOs will need to step up their level of activity to deliver efficiently and in the interests of consumers. Any involvement in energy efficiency should complement those objectives. There is also much more that DNOs could deliver during the current price control to facilitate energy efficiency upgrades, including much better visibility of their low voltage network.

We also recommend that Ofgem actively considers how to avoid letting energy efficiency alter the balance of the next price control too far in the favour of DNOs. Financing energy efficiency would likely be a small part of the overall package. While the benefits of warmer homes are very tangible to consumers, we would expect Ofgem to treat any new DNO activity in this space

¹⁶ Citizens Advice, [Watching the wires: Holding electricity networks accountable for spending on vulnerable customers](#), October 2025

¹⁷ Citizens Advice, [Stepping Up: Reforming protections in the retrofit market](#), October 2025

proportionally to the upgrades and optimisation required across the rest of their network.

The rest of this answer explores DNOs financing, coordinating and delivering energy efficiency.

DNOs financing energy efficiency

Funding is our primary concern with the proposal that DNOs play a bigger role in the delivery of energy efficiency and low carbon measures. Our preference is for the government to fund energy efficiency measures as this is the least regressive funding approach. Using private companies, whether DNOs or energy suppliers, to finance energy efficiency is typically more expensive and spreads the burden of payment unequally across consumer groups.

DNOs may argue that there is a higher risk around energy efficiency than their usual activity. This may be a combination of concerns from investors and lenders about DNOs taking on a new initiative which will need to be designed at pace ahead of the start of the new price control. We note that the revenue would be guaranteed through network charges and the activity would almost certainly be linked to network upgrades that help DNOs to optimise their grid. We also note that two DNOs have previously proposed carrying out energy efficiency installations using ED2 ex-ante allowances, seemingly without mentioning higher financial risk, which may undermine this claim.¹⁸ For these reasons, we would expect the cost of capital for funding energy efficiency to be similar to the rest of the price control.

DNOs coordinating energy efficiency

We can see a case for DNOs playing a bigger role in the way that energy efficiency and low carbon measures are co-ordinated. We can see opportunities for efficiencies which would ultimately, lower the costs and inconvenience for energy consumers. For example, DNOs could highlight areas of their network which have more headroom and where technologies such as heat pumps can be installed without reinforcement taking place first. DNOs could then direct

¹⁸ Ofgem, [RIIO-ED2 Final Determinations Core Methodology Document](#), November 2022, p.118.

load-related expenditure to other areas of the network, so that installations in those constrained areas can happen later but without delay. We therefore support DNOs finding mutual efficiencies between the roll-out of energy efficiency and the unlooping and LV reinforcement programmes.

Further, although we are aware that the focus on energy efficiency is primarily on heating measures, it is worth mentioning that DNOs could provide input on where the roll-out of fabric measures could most help address grid constraints, therefore reducing balancing costs, and the need for LV network reinforcement.

DNOs delivering energy efficiency

As to the potential for DNOs directly commissioning or carrying out low carbon and energy efficiency measures, we recommend that Ofgem considers how to ensure that the new role does not detract DNOs from their core role, including unlooping and enabling LCT installs. In ED2 Ofgem would not provide ante allowances for the repair and replacement of gas boilers, or the installation of energy efficiency measures, to support DNO delivery of their vulnerability strategies. They decided that such activity went beyond DNOs' role and were 'concerned that allowing DNOs to operate in this space may impact a competitive market and consumer's choice in deciding a preferred third party company to install energy efficiency measures.'¹⁹ These are challenges that Ofgem must respond to in the next phase of the design of the price control.

Consumer voice/research

Q47. Do you have any comments on the proposed guidance on consumer research set out in Appendix 3?

We are generally supportive of the proposed guidance on consumer research. We welcome that Ofgem has developed this through conversations with wider stakeholders. We have two comments:

- under 'Triangulation' or 'Analysis Plan', we would suggest adding that variable analysis could improve the quality of the research. For instance, this could explore whether there is a relationship between variables that

¹⁹ Ofgem, [RIIO-ED2 Final Determinations Core Methodology Document](#), November 2022, p.119

may skew the results or whether particular demographics or consumer types report different results. This is particularly important given our recommendation that the distribution of consumer value is tracked.

- under 'Research Questions', it may be worth mentioning that asking a customer how satisfied they are is influenced by a variety of factors, including demographic and energy characteristics, and the high-level score should not be understood as independent from those. On its own, customer satisfaction cannot be used to point towards policy solutions because it reflects not only DNO performance, but other factors. Research needs to take this into account, which links to the previous variable analysis point.

We welcome that Ofgem and DNOs have identified a set of drivers for collaborative research, but recommend identifying a set of drivers for individual research. We believe adopting a research approach of 'collaborative unless otherwise proven necessary' would ensure research is cost-effective and not duplicative. DNOs must have a strong justification as to why this kind of research - if funded by energy consumers - must be carried out by them individually, rather than collaboratively.

Enhanced stakeholder engagement (Independent Stakeholder Groups and guidance)

Q48. Do you have any comments on the proposed ISG guidance as set out in Appendix 4?

We support the role of the Independent Stakeholder Groups (ISGs) as a critical friend to networks and as a way to represent customer needs throughout the ED3 period, particularly for those in underrepresented groups or in vulnerable circumstances. However, ISGs should not be the only source of scrutiny and should not seek to replicate the effective monitoring and scrutiny role that we believe is central to Ofgem's duty, as the regulator, on behalf of consumers. Indeed, as we set out elsewhere in this response, we think Ofgem needs to improve the level of transparency around the outcomes delivered by DNOs during the ED3 period.

We feel that there should be more consistency and transparency in ISGs. Ofgem should look to standardise how companies report on the role that ISGs play in iterative business planning and accountability throughout the RIIO period. This could be via ISG reporting. For instance, an expected output of the ISG would be, alongside 'a log of recommendations to the network company', a statement as to whether the recommendations were implemented, and how.

We are encouraged that the companies will be responsible for ensuring the ISG has information to enable it to provide meaningful input and challenge, and effective scrutiny in the interests of consumers and stakeholders. Ofgem will need to scrutinise the information provided to overcome any potential information asymmetry between the companies and the ISGs. There is also a wider question about how much of the information the company will be responsible for providing should be available in the public domain. We are concerned that ISGs could act as inadvertent gatekeepers for information of public interest. We would want to avoid a situation where ISGs are the only groups with the necessary information to effectively assess value for money.

However, as it stands, we think the following regarding paragraph A4.3 of the proposed guidance.

- We would suggest that information be provided to the ISG about progress against delivery of the business plan, and the corresponding bill impact data for that spending. This reflects that the ISG's purpose is to provide scrutiny not just in development but during delivery of its business plan.
- We support placing responsibility, via the guidance, on the company to ensure that the ISG has information about value for money for customers of specific areas of funding. This should include, for example, the value of baseline funding sought to address consumer vulnerability, which is not currently publicly available, as we highlighted in a recent blog.²⁰

²⁰ Citizens Advice, [Watching the wires: Holding electricity networks accountable for spending on vulnerable customers](#), October 2025

In terms of ensuring the consumer voice is heard, there can be limitations in how organisations outside the ISG can interact with ISGs due to their confidentiality arrangements with networks. While these may be necessary for sharing commercially sensitive information, we would like to see more guidance from Ofgem on how ISGs can support organisations such as Citizens Advice in advocating for consumers.

Alongside the use of ISGs, we encourage Ofgem to consider using the model of independent national performance panels that are currently deployed to advise Ofgem on NESO and DSO performance. Such a panel could be established in advance of ED3 and contribute to the regulatory framework decisions. The principles of open hearings used in RII0-2 to hold companies to account on business plans could also be deployed much more widely to ensure that scrutiny is applied in a visible way and companies are answerable to questions.

Accountability for consumer outcomes

Q49. Do you agree with our proposal to retain and adapt SLC50 Business Plan Commitment Reporting? Do you have suggestions for how the reporting should evolve?

We are supportive of retaining the SLC50 Business Plan Commitment reporting. It would help to understand why Ofgem wants to adapt the guidance. In particular, what transparency and accountability do Ofgem think is currently lacking?

In terms of the guidance, we recommend incorporating spending and bill impact data alongside the commitments. This would help to evaluate consumer outcomes more effectively. It would be easier to track value for money, and delivery, by setting out:

- How much has been spent against each of the business plan commitments
- What was forecast to be spent in the business plan
- How the current spending will likely feed through into an average bill

Ultimately, alongside DNOs reporting on delivery against their Business Plan Commitments, we think it is essential that Ofgem publishes information to bring these reports together into a simple publicly available comparison. DNO reporting currently suffers from a lack of transparency which Ofgem should seek to address in ED3. We also recommend that Ofgem should transparently evaluate what is working well and what isn't going well for consumer interests.

Q50. Do you agree that we should proceed with the development of a Consumer Value Framework for ED3 and if so, do you agree with the principles set out above as the basis for developing a CVF?

We agree with the purpose for the Consumer Value Framework, 'to enable Ofgem and DNOs to provide a consistent and transparent approach to communicating the value created by DNOs' business plans in a way that is understandable to consumers and wider stakeholders.' However, we think that rather than spending time and resources developing this framework, Ofgem should consider using that resource to communicate more frequently, transparently and incisively on the currently reported data.

For example, the Ofgem annual report for electricity distribution from 2023-2024 was published on 7 April 2025²¹, when DNOs had to submit the vast majority of regulatory reporting by 31st July of the previous year²². Given that Ofgem publishes a wide variety of data quarterly for the retail market, it is clearly possible for Ofgem to publish regulatory data more frequently, and with less delay.²³ These delays make it harder to advocate for the interests of consumers in a timely fashion.

Further, the annual report itself could be an opportunity for Ofgem to clearly explain how DNOs are or are not providing value for consumer money, and their view on that. For example, Ofgem acknowledged that DNOs underperformed against their ED2 targets to minimise interruptions to consumers' power supply.

²¹ Ofgem, [RIIO-2 Electricity Distribution Summary Annual Report: 2023-24](#), April 2025

²² Ofgem, [RIIO-ED2 – Overview of the Regulatory Instructions and Guidance](#), February 2025, p.8-9.

²³ Ofgem, [Retail market indicators](#), October 2025

Encouragingly, Ofgem explained what spending to address that performance consisted of, and the amount. Ofgem could have also explained:

- 1) The reason for underperformance - how much was completely out of DNO control (storms, incidents etc), and how much because DNOs were not doing enough?
- 2) What the financial impact is - what will be the likely impact on an average consumer bill? How much money was spent on vulnerability support in response to interruptions - and is that therefore counterbalanced by the money recouped from the penalty?
- 3) Whether customer satisfaction recorded via the BMCS correlates with length of the interruption or frequency of the interruptions?
- 4) Whether they have any indicators of wellbeing and economic impacts of those interruptions?

These questions are examples of the way the regulator can communicate consumer value without relying on a new framework, created by DNOs, to do so. These kinds of questions can apply to other metrics, for example, the BMCS, and total expenditure. For instance, why do some DNOs perform so highly in customer satisfaction and which areas of satisfaction do they think could be improved?

We welcome the attempt to explain the key drivers of underspend, but we recommend translating this into simpler, more straightforward to follow terms. For instance, does a “mobilisation delay” just mean the DNO decided to do it later? What is Ofgem’s view on that? Does “cost re-engineering post Final Determinations” suggest that a cost assessment was overly high, and will consumers therefore end up paying for roughly half of the difference between what a DNO said it would cost, versus what it actually costs, for no reason?

Ultimately, Ofgem needs to more clearly communicate how it protects the interest of energy consumers, and a new framework of communication for DNOs will not necessarily achieve that alone. Instead, Ofgem should prioritise more comparison of DNO-reported information, more frequent publications,

translating complex terminology into plain language, and explaining the impacts on people, including their bills, their power supply, and the customer service they receive.

Digitalisation and data

Q51. Do you agree with our proposed approach on all five themes? Why?

We are supportive of Ofgem strengthening its focus on efficient and transparent DNO use of data and digitalisation. Work under the proposed five themes could improve value for money for consumers, whether via avoiding unnecessary consultancy charges, ensuring data can be shared without costly processing, and supporting system planning and flexibility markets with accurate asset data.

We recommend that Ofgem sets expectations on DNOs around the use of AI in their processes, including in relation to customer service. For instance, while the use of AI may reduce costs for routine, non-urgent questions, we would expect DNOs to make available real people to answer urgent inbound calls or emails during an unplanned interruption.

We urge Ofgem to consider the approach to visibility of secondary network/low-voltage network data. This includes ensuring that DNOs provide full visibility of their network as soon as possible and no later than 2027. Enabling third-parties to access these data could help system planning and third-party innovation in flexibility offerings, energy-efficiency installation.

Innovation

Q54. Do you agree that we should maintain the current NIA Eligibility Criteria? Why?

While we can see a case for networks receiving innovation funding, we are currently investigating whether funding mechanisms such as the NIA have delivered tangible change for consumers. We think that Ofgem should make public their value for money assessments of innovation spend as a whole to improve wider scrutiny of innovation funding.

We believe that the current Network Innovation Allowance (NIA) eligibility criteria could be strengthened by introducing an explicit requirement for consumer engagement in the design and development of innovation projects. Embedding such a requirement would ensure that projects are shaped with consumers in mind from the outset, with engagement beginning early in the innovation process. This would enhance the relevance of innovation to consumer needs and increase the likelihood that outcomes deliver tangible consumer benefits.

We recognise that not all innovation projects will be suitable for direct consumer engagement. This may include early-stage research or system-level initiatives that do not directly involve end users. In these instances, projects should still be required to demonstrate a clear and credible link to future consumer benefits and to set out, in clear and accessible terms, how their outcomes are expected to improve consumer experience, affordability, or system reliability. Incorporating this requirement would reinforce the consumer focus of innovation funding, strengthen transparency, and align with Ofgem's objective of improving the visibility and accountability of innovation spending.

We also acknowledge that introducing additional eligibility criteria for electricity distribution companies under RIIO-ED3 may diverge from the arrangements in place for other network operators under RIIO-3. Such divergence could create inconsistency and complexity within the innovation landscape, potentially making oversight and comparison more challenging. To avoid this, any update to the NIA eligibility criteria for electricity distribution should be accompanied by corresponding adjustments to the RIIO-3 framework to maintain alignment and consistency across sectors. We can see no issue with Ofgem improving governance around innovation funding during the RIIO3 price control, particularly when this involves millions of pounds.

Q55. Do you agree with our suggested approach for assessing and setting NIA? Why?

We support Ofgem's proposal to introduce clearer, more consistent requirements for the information that electricity networks must provide, along with guidance on the format and level of detail expected. Linking the quality and

completeness of this information to the Innovation Minimum Requirement under the BPI, Stage A, represents a proportionate and effective approach.

Evidence from the business plans submitted by the Gas Transmission, Gas Distribution, and Electricity Transmission companies highlights significant variation in both the depth and quality of innovation-related information. In several cases, submissions lacked sufficient clarity and supporting evidence.²⁴ Transparency has also been a persistent issue across innovation funding mechanisms, including the NIA, as identified in our 'Making Innovation Count' report.²⁵ Strengthening disclosure requirements for DNOs ahead of the submission of their ED3 business plans will therefore improve transparency, enhance comparability between network plans, and raise the overall quality of innovation proposals submitted for regulatory assessment.

We agree with Ofgem's proposal to use Stage C of the BPI to maintain incentives for networks to deliver high-quality innovation strategies. This link between innovation performance and the BPI will encourage more comprehensive, evidence-based submissions, while proportionate penalties for weaker plans will reinforce accountability and help embed innovation governance within core business planning.

Ofgem should consider the extent to which network companies have successfully implemented and embedded the outcomes of previous innovation projects when assessing and determining the level of NIA funding. Our *Making Innovation Count* report highlighted that Ofgem's current approach does not adequately track the deployment of innovation projects, despite deployment being a key indicator of whether NIA-funded activity delivers tangible consumer benefits.²⁶ Incorporating past delivery performance into funding assessments would help ensure that innovation funding leads to practical application and

²⁴ Citizens Advice, [Citizens Advice response to the Ofgem Call for Evidence on the Electricity Transmission, Gas Transmission and Gas Distribution Business Plans for RIIO-3](#), February 2025, p.47.

²⁵ Citizens Advice, [Making Innovation Count - A Transparency Review of NIA and SIF Projects](#), August 2025

²⁶ Citizens Advice, [Making Innovation Count - A Transparency Review of NIA and SIF Projects](#), August 2025, p.17

measurable improvement, rather than remaining at the pilot or proof-of-concept stage. This approach would promote better value for money, accelerate system-wide learning, and maximise the benefits delivered to consumers.

Q56. Do you have examples of projects that weren't able to deploy in RIIO-ED2 due to the lack of funding, or that you anticipate wouldn't be able to deploy in ED3 without the extension of the Deployment Fund to cover DNOs in ED3?

We are unable to provide specific examples due to the limited availability of public data on whether innovation projects have been deployed, or on the reasons why deployment has not occurred, even where technologies appear mature and ready for implementation. The ENA's *Energy Networks Annual Innovation Report* highlights only a selection of projects, which does not provide a comprehensive view of overall deployment activity. Greater transparency is therefore needed for ED3.

We recommend that Ofgem or Innovate UK take a more active role in collecting and publishing data on the deployment status of innovation projects. We strongly recommend that Ofgem requires network companies to report clearly on the outcomes of each project, including whether and how it has been adopted, or the reasons for non-deployment.

This enhanced transparency should not be limited to innovation projects led by DNOs but extended across all energy sectors, including Gas Distribution, Gas Transmission and Electricity Transmission, and NESO. Consistent reporting across sectors would enable more effective oversight and support better value for consumers from innovation funding.

Q57. Do you perceive a lack of coordination and direction as an issue for the deployment of innovation in the ED sector, and do you think a similar intervention to the TID is needed to resolve this?

It is difficult for us to answer this question with confidence because neither Ofgem nor the networks currently publish information about the deployment of

innovation projects. For that reason, we consider the primary barrier to the timely deployment of innovation projects in the electricity distribution sector to be the lack of comprehensive, accessible data on deployment outcomes. This challenge is not unique to electricity distribution but is evident across all energy sectors. We think Ofgem, Innovate UK and the networks could do better.

As outlined in our 'Making Innovation Count' report, deployment is not consistently tracked. The information available through the Smarter Networks Portal is limited, and Ofgem does not currently collect sufficient data on post-funding deployment. This reflects a lack of regulatory focus on deployment within the existing framework.²⁷ The lack of reliable information makes it difficult to determine how many innovation projects have been successfully implemented or to identify why others have not progressed beyond the trial stage. Without this visibility, Ofgem cannot effectively assess the impact or value of innovation funding.

Improved availability and quality of deployment data is essential to enable Ofgem to set realistic, evidence-based targets for the adoption of innovation projects. Although a substantial number of projects receive funding under the current framework, there is often no clear expectation for when or how these solutions should transition into business-as-usual. Enhanced transparency on deployment outcomes would therefore support the development of more effective performance measures and ensure that innovation projects deliver meaningful and measurable benefits across the sector.

Q58. Do you agree that further incentivisation is needed within the price control for innovation that doesn't primarily benefit networks? Do you have evidence to support this?

We recognise that there may be a need for additional incentives—whether financial or reputational—to support innovation that delivers broader consumer or societal benefits, rather than direct value to network companies. However,

²⁷ Citizens Advice, [Making Innovation Count - A Transparency Review of NIA and SIF Projects](#), August 2025, p.17

Ofgem will need to present a clear needs case, demonstrating that the consumer benefit will outweigh the further financial outlay of a new incentive.

New (or existing, restructured) incentives could help to prioritise projects with significant public value, rather than leaving networks to manage their own prioritisation, which could result in operational benefits taking precedence.

However, the introduction of new financial incentives raises essential questions about the impact on consumer bills. There is also a risk that applying such incentives only within the electricity distribution sector could create sectoral divergence, adding complexity to the innovation landscape and making it more challenging to compare performance or monitor progress consistently.

A more effective approach would be for Ofgem to set clear expectations within the price control framework to ensure that innovation activity delivers measurable consumer and societal benefits, rather than focusing predominantly on network operational efficiency. For instance, Ofgem could require that a defined proportion—expressed as either a specific number or percentage—of innovation projects demonstrably benefit consumers or align with the wider public objectives set out in the SIF and NIA Governance Documents.²⁸

For such targets to be realistic and achievable, improved availability and quality of deployment data will be essential. Better visibility of innovation outcomes would enable Ofgem to set evidence-based targets and translate innovation projects into tangible benefits for consumers and the whole system.

Q59. Do you have any feedback on what kind of mechanism would best provide this incentive, while ensuring that networks are only rewarded for actual delivery of consumer or system benefit?

If Ofgem decides to introduce a new financial incentive to support the implementation and widespread rollout of consumer-focused innovation, any

²⁸Ofgem, [SIF Governance Document](#), April 2025, p.13. and Ofgem, [RIIO-2 NIA Governance Document: Version 3](#), February 2023, p.17

such mechanism should be explicitly designed to enable the transition from successful trials to full implementation. Rewards should be provided only where there is clear evidence that projects deliver benefits to consumers or the wider energy system, rather than improving network efficiency.

A benefits-based approach could link incentive payments to measurable outcomes, such as verified consumer benefits, cost savings, and service improvements. This would ensure that the reward is directed toward projects that generate tangible, lasting public value.

For such an incentive to operate credibly, improved visibility of innovation outcomes is essential. Enhanced transparency and more comprehensive data on deployment status and realised benefits would allow Ofgem to assess whether projects have been adopted and to link payments to meaningful delivery. Without this visibility, it would be challenging to design or administer an outcome-based incentive with confidence.

Alongside any incentive, Ofgem should also consider introducing proportionate penalties for networks that fail to deploy or deliver funded innovation without a reasonable justification. This would help create a more balanced and accountable framework, ensuring that public funds are used effectively and that consumer-funded innovation leads to real-world benefits.

Distribution System Operator (DSO)

DSO network planning

Q60. Do you agree with our proposed scope for the DSO's role in network planning for ED3, including leading long-term integrated development planning and enhancing forecasting? How should DSOs ensure that future iterations of these plans align with emerging strategic inputs such as the Regional Energy Strategic Plan (RESP) and Strategic Spatial Energy Plan (SSEP) when they become available?

Ultimately, network planning should be a way of ensuring consumer needs are met in a timely and cost-efficient way. To do so, it is critical that networks

consider the full range of tools available. Physical reinforcement is only one of those tools. If planning in the function of a Distribution System Operator (DSO) will ensure that the full range of tools is available, we are supportive of Ofgem giving DSOs some kind of planning responsibility.

One way Ofgem proposes to do this is to involve DSOs in long-term integrated network development planning. It is unclear whether DSOs would be leading this, as proposed by the consultation question, or supporting this, as proposed by the consultation text (paragraph 5.71). We would welcome clarity on this point.

In theory, however, we support networks, as part of their DSO function, inputting into the RESP and SSEP as part of their identification of future system needs and spatial demand growth, as well as feeding back their own data to ensure wider strategic inputs are as accurate as possible.

Q61. How should DSOs best coordinate with other parties (eg NESO, local authorities, iDNOs, gas networks) to deliver whole-system outcomes through network planning? Are there specific governance or data-sharing arrangements that should be strengthened?

We are supportive of networks collaborating across the energy system, which is already within the scope of their role, and provides benefits to them as well as the wider energy system. For this reason we are supportive of the development of, and mandated participation in, the Data Sharing Infrastructure.

In the next phase of ED3, we recommend that Ofgem sets out how they envisage coordination occurring between DSOs, DNOs, iDNOs, gas networks, local authorities, NESO and the NESO teams working on RESPs.

Q62. What additional data, digital tools, or visibility improvements are needed to enable DSOs to deliver proactive, spatially targeted network planning in ED3? Please provide examples of gaps or best practices.

We support networks enhancing their forecasting capabilities, and planning for emerging localised constraint patterns. Not doing so risks unnecessary delays to connections, damage to network equipment, and preventable outages. We

would expect that networks are doing this anyway, as part of their role to meet consumer needs in a cost-effective and timely way.

We support networks making it easy to access data about capacity, constraints, and progress against plans. This will enable third parties to align with network planning. For example, flexibility providers could target offerings to areas where there may be particular constraints and demands on the network, while businesses, including data centres, could time investment in line with when network headroom will become available. This would also enable wider feed through into RESP planning.

As we highlight elsewhere in this response, one gap in data visibility relates to the low voltage network. We urge Ofgem to ensure that DNOs make this data publicly accessible before the end of the ED2 price control. DNOs should already have complete visibility over their low voltage network and be providing this to help homeowners, businesses, housebuilders, data centres and others to plan and invest accordingly.

Q63. How should DSOs incorporate flexibility services and connection process improvements into their network planning approach to ensure timely, efficient, and predictable connections? Should this be incentivised, and if so, how?

We would encourage the role of planning to meet consumer demand, using the full suite of tools, such as flexibility services, in supporting faster and more predictable connection times. We want to re-emphasise that this should also be balanced against cost-efficiency. We expect that the updated connections incentive, if designed and calibrated correctly, should increasingly drive this.

Flexibility

Q65. How can we best ensure that flexible connections aren't deployed at the expense of network reinforcement?

We agree with Ofgem that the ED3 methodology must strike the right balance between flexible connections and network reinforcement. Ofgem is trying to

encourage electricity networks to continue to offer flexible connections, while also proceeding with low-regrets anticipatory investments for reinforcement. To answer this question, we think Ofgem needs a full picture of DNO capacity, including down to the low voltage network. We strongly recommend that Ofgem ensures that DNOs have a complete understanding and publish this for the likes of housebuilders, data centres and homeowners.

Q66. How can we best ensure that DER/CER are not prevented from accessing wider flexibility markets due to the use of ANM or lack of NESO-DSO coordination?

We believe that an essential way to ensure that DER/CER can access wider flexibility markets is to ensure that demand for flexing energy usage/storage in a certain place, whether from NESO or DSO, has a value reflecting that demand. We recommend that a mechanism is developed for better price signals regarding the place of need for flexibility. This should take into account demand driven by a wide variety of factors, rather than different factors driving separate price signals for different activity, and creating needlessly fragmented markets. As energy markets are currently fragmented, the triage cost of trading on these markets is likely to be outbalanced by potential benefits to those supplying services on the market i.e generators. Whereas, as those providing services on the market become not just large energy generators but DER/CER providers, the triage cost may provide a barrier to entry which prevents market participation. We would expect load controllers to help manage this, but ensuring the design of the system doesn't bake in triage costs is essential.

A price signal for demand should take into account locational demand for factors such as:

- system-wide balancing
- voltage management at both system and distribution level
- capacity management at both system and distribution level
- loss optimisation

This would allow for prioritisation between where flexibility is needed within a distribution network and within transmission networks. Ultimately, without

price reflecting locational need for generation or demand adjustments, DER/CER will have little incentive to access wider flexibility markets. DER/CER will also lack the ability to make informed, cost-effective trade offs on whether to meet flexibility demanded at transmission/national level versus flexibility demanded at the distribution level.

The use of Active Network Management (ANM) schemes make it difficult for accurate cost signals to be applied to users of those schemes as the DSO has an option to curtail users at limited or no cost. This may lead to lower costs for the DSO but higher overall system costs. This needs to be taken into account when assessing the suitability of ANM schemes.

Q67. Are further incentives required to incentivise and encourage the use of flexibility in line with our approach for ED3?

The consultation sets out a variety of use cases where flexibility has value, but is not deployed at the expense of network reinforcement. Ofgem then asserts that these ‘will be incentivised by the outcomes we are seeking to achieve, rather than incentives on the use of flexibility itself.’ We agree that outcomes-based incentives are the best way of encouraging networks to plan for and adopt flexibility. We have mapped those incentives to each use case:

Flexibility use case	Incentive	Efficacy
Manage outages and faults during planned and unplanned interruptions	Interruptions Incentive	Ofgem has indicated that this is the use case 80% of the time
Rapid connections times	Proposed connections incentive, TIM	As yet untested-encourage zero-sum incentive
Smooth a programme of network reinforcement	Volume drivers, TIM linked to PCD for reinforcement	Need more evidence on how volume drivers have/haven’t incentivised flexibility smoothing

		reinforcement.
Reduce curtailment	Regularly Reported Evidence as part of DSO incentive	One metric in incentive only
Flexibility as cost-efficient enduring solution	TIM- but with greater link to delivery to avoid under-delivery driving underspend	

The greatest area where there is no direct incentive is in curtailment. We consider that the best solution is one that mimics zonal pricing as proposed in our answer to question 66, but welcome discussions as to what else could incentivise using flexibility to reduce curtailment.

Voltage Management

Q68. Do you agree with the proposed voltage management responsibilities for DSOs? Are there any aspects you disagree with, or any additional responsibilities we should consider?

We broadly agree with the proposed voltage management responsibilities, although we cannot yet form a full judgement on the proposal to allow NESO to request DSO flexibility to help manage voltage.

We would welcome a simpler explanation of the consumer impact of DSOs meeting this service (temporarily reducing voltage as needed by NESO at primary substations). It is unclear whether reducing voltage would result in an impact for end consumers, or whether the impact will only be noticed on the primary distribution network, rather than the secondary distribution network.

If reducing voltage will impact the secondary distribution network, it would be helpful to understand how DNOs would manage this, for example through flexibility markets, to reduce the risk of under-voltage and therefore consumers being unable to access the power they need. In this scenario, the incentive

should be carefully calibrated so that the benefit to the system (and therefore for consumers) of balancing via voltage reduction at primary substations is quantified against the cost of the voltage reduction to consumers. Nonetheless, we are broadly supportive of a proposal that aims to make the best use of networks' assets in the interests of balancing the electricity system.

We also believe that Ofgem should hold DNOs responsible for voltage variations which result in consumers being unable to access the power they need, or result in damage to consumer equipment, where typical protections (e.g. voltage stabiliser) have not been able to prevent damage. This is even more important in a scenario where primary substation voltage reduction creates more voltage variations for consumers. This issue will also impact those in more remote areas, given that the magnitude of voltage rise and drop increases with the distance from the circuit substation. Voltage management is therefore critical to ensure the rural/urban imbalance seen in reliability is not further entrenched.

People have been seeking support from Citizens Advice following voltage issues, encountering damage to their appliances, including heat pump inverters failing, an inability to charge their electric vehicles (EVs) overnight, and being unable to heat their home or use hot water. We analysed a sample of cases over the past five years, where people have come to Citizens Advice seeking help when their network supply has been unreliable. We found that roughly 1 in 11 had issues due to under or over voltage, with half of those cases relating to EV charging.²⁹ We expect this will only increase as more people adopt LCTs.

We recommend that the GSoPs are updated so that consumers are compensated for damage and for lack of supply when voltage is not managed within permitted limits. This is particularly in the case of over-voltage, which can permanently damage appliances. Although there are GSoPs which require that DNOs explain the cause of the voltage being outside the limits of permitted variations, there is no requirement to provide compensation to the affected consumer, as long as the DNO explains why the variation happened. Further, it

²⁹ Of a sample of 168 cases, 15 were about people seeking help with voltage management issues.

seems that over or under voltage which results in consumers unable to supply their home as needed are not treated as 'interruptions' under the GSoPs.

Further, we understand that voltage management is regulated via legislation,³⁰ as well as the distribution code,³¹ and that the ENA is currently considering changes to the permitted limits. We would welcome discussion on whether this is sufficient to ensure voltage is kept within permitted limits, or whether an incentive should be established specifically applying penalties where voltage is not kept within the permitted limits, or treating voltage drops and spikes outside of the permitted limits as an interruption.

Q73. Do you have any comments on the proposal for the creation of a new incentive for the provision of flexibility through demand reduction?

Any incentive should be carefully calibrated so that the benefit to the system (and for consumers) of balancing via voltage reduction at primary substations is quantified against the cost of the voltage reduction to consumers. We would need clear evidence that consumers would not be paying twice for services to manage voltage at transmission level. There is a risk that NESO's outsourcing of voltage management to DSOs is paid for twice, once via this direct incentive, and once via NESO's price control.

Q74. Do you support the requirement for a published voltage management strategy from each DSO, with an annual reporting requirement?

We welcome transparency regarding voltage management, and would support this information being as standardised and straightforward to understand as possible. Generally for reporting, and in the case for this proposed reporting requirement, we believe reports should set out:

- what the company's business plan forecast or committed to,
- progress against those forecasts or commitments

³⁰The National Archives, [The Electricity Safety, Quality and Continuity Regulations 2002](#)

³¹ Distribution Code, [The Distribution Code of Licensed Distribution Network Operators of Great Britain](#), March 2025, DCO6.

- spending against the forecast
- estimated feed through onto average customer bills
- any trade-offs made
- impacts upon consumers (positive and negative)

We would also recommend that Ofgem considers whether it will have capacity to scrutinise and compare those annual reports in order to sufficiently incentivise good behaviour.

Losses

Q76. Do you support Ofgem's focus on loss optimisation over loss reduction in ED3? Why?

We agree that loss optimisation is a better focus than loss reduction, as it recognises the trade-offs involved between reducing losses and limiting other costs or achieving other objectives. We would welcome clarity on whether this would result in a change to Standard Licence Condition 49, or whether the change will be reflected in business plan guidance only.

Q79. Do you believe there is a case for introducing financial or discretionary incentives to encourage active loss optimisation by DSOs? If so, what form should these incentives take (eg direct financial, reputational, discretionary rewards), and what risks or complexities should be considered?

We understand that there are barriers to encouraging active loss optimisation via the price control, given the difficulties in measuring loss reduction, let alone loss optimisation. This means that a financial incentive cannot be linked to a consistent, comparable target.

However, we recommend including loss optimisation in the DSO incentive framework. This would help ensure that DSOs are scrutinised for the way in which planning and operational efficiency decision-making has optimised losses. This would encourage DSOs to embed this approach. Although data collection is tricky, DSOs can still model and be tested on how they are making decisions where loss optimisation is a factor in that decision-making. They can also be

challenged on the way in which they are improving monitoring and metering, and developing a standardised modelling approach for measuring losses. Failing to develop a standardised measurement and monitoring regime (including across LV network) for losses could be financially penalised at the end of the ED3 period.

DSO incentive framework

Q81. Do you agree that the proposed aims for the DSO incentive framework appropriately reflect the core functional areas for ED3 (flexibility services, network planning, voltage and loss management)? Are there any additional priority areas that should be included, and how should these be measured?

We agree that the proposed aims for the DSO incentive framework. We would suggest that the overall aim of the ED3 DSO Incentive Framework should be 'cost-efficient reliability', recognising that equity plays a role within that. We particularly welcome the aim to 'support the maturation of flexibility markets, ensuring accessibility...and transparency.' We also agree that aiming for outcome-based performance is important.

Q82. How should the incentive framework evolve to reflect the DSO's more proactive role in network planning, operational use of flexibility, flexibility market development, and whole-system coordination?

We agree that some of the current metrics will need to be adapted, including potentially removing the reporting area of flexibility deferral. Meanwhile, secondary network visibility and curtailment will be important reporting areas to maintain. As we noted in our response to question 79, including losses optimisation within the DSO incentive will be a way of ensuring losses are a factor in DSO decision-making. As for voltage management, we are open to this being either a stand alone incentive or within the DSO incentive. The former may be a way of directly avoiding scenarios as we flagged above in response to question 68. However, we are aware that voltage management is an issue which

should be addressed within the round against supporting flexibility markets, long-term planning etc. Practically speaking, the quality of data on voltage management will likely inform whether it can be implemented as a direct ODI-F or included within the DSO incentive.

Q83. Are the current parameters (Stakeholder Satisfaction Survey and Performance Panel) an effective way of measuring DSO performance? How do you view the role of Regularly Reported Evidence (RRE) in complementing these assessments?

The Performance Panel is a useful tool in measuring DSO performance. Progress made in standardising how DSOs report on performance, including to the Performance Panel, regarding terminology and assessing consumer benefits, needs to continue.

Q84. How can the DSO Incentive be designed to complement, and not duplicate, other mechanisms such as the Connections Incentive, BMCS and the Interruptions Incentive Scheme?

We welcome Ofgem aiming to avoid duplication when designing the DSO incentive. Ofgem should consider carrying out a mapping exercise as we did in response to question 67.

Ultimately, the DSO incentive was designed as many of the outcomes could not be measured or incentivised directly. We would therefore encourage Ofgem to consider which DSO aims can be measured directly, or incentivised directly, and which require qualitative analysis (the survey and performance panel). Where qualitative analysis is needed, this should inform the inclusion of complementary incentives within the DSO Incentive.

Resilient networks

Q85. Are there additional risks, dependencies or policy areas that we should consider strengthening network resilience in ED3 beyond those set out in this chapter?(chapter 6)

Ofgem must ensure that the 'coordinated package of measures designed to protect consumers' does not over-reward DNOs, nor over-complicate the regulatory regime. The design of the package should account for:

- 1) The risk that consumers pay multiple times for network resilience, by defining the goal of each incentive and ensuring the incentive design reflects that goal. We can see merit in changing incentives to be zero-sum to avoid over-rewarding DNOs.
- 2) The fact that stress testing and improving climate resilience will lower overall risk to DNOs, by supporting them to manage asset health and the future cost of climate change driven-damage.
- 3) The lack of accessible reporting and performance management conducted by Ofgem on resilience, including Worst-Served Customers.
- 4) The interplay of the resilience proposals with long-term network development plans and business commitments.
- 5) The need to reduce regulatory asymmetry, by simplifying the regime governing resilience, and building up capabilities to better understand network resilience in a more extreme climate.
- 6) The need for an overarching goal or minimum standards for reliability. This could be met by a variety of measures, including those outside of ED3, such as:
 - updating the GSoPs, including to protect vulnerable customers during power cuts
 - co-ordinating with RESP teams and GB Energy on community energy projects
 - investigating the potential of a 'hybrid' grid, with cross-subsidised back-up from DER including batteries for those in areas more vulnerable to repeated or long interruptions.

We expect that increased monitoring of the low voltage network during ED2 will highlight additional assets that require maintenance or replacement during ED3. This monitoring may uncover weaknesses that should have already been apparent to DNOs. It is important that Ofgem bears down on costs where asset health has unjustifiably been allowed to deteriorate.

Network Asset Risk Metric (NARM)

Q86. What are your views on setting outputs on additional asset classes not currently reported in NARM?

We understand that Ofgem cannot check the health of all DNO assets and that the NARM is designed to give Ofgem some insight into overall asset health. The NARM is a particularly complex metric that is difficult to interrogate. We think that DNOs have been funded sufficiently over recent price controls to ensure that their assets in general are healthy. While occasional issues will inevitably arise, e.g. when parts fail, this should not be because of a lack of maintenance.

We are supportive of setting outputs on additional asset classes not currently reported in NARM. This is especially important given the assets include LV services, and programmatic funding is being proposed for LV reinforcement. Without having a framework which holds DNOs to account for the current health of their LV network, we would be wary of consumers paying to reinforce the LV network. Applying a framework focussed on asset health to LV services would help effectively prioritise LV spending, whether load or non-load related.

Further, Ofgem recognises that the challenges associated with adopting non-NARM assets remain significant, and include insufficient asset-level or population-level data. Given that consumers are funding 'DSOs...gaining enhanced capabilities through LV monitoring and forecasting' (paragraph 5.108) in the current price control, we would not expect insufficient data to be an issue for adopting LV services into a NARM- adjacent framework.

Ultimately, it is our view that as much asset replacement and refurbishment expenditure should be captured by NARM as possible, to ensure asset health is monitored and maintained efficiently.

Q87. What are your views on our proposed approach to increasing our reporting on non-NARM assets to improve our understanding of asset health?

We agree with the proposed approach, and welcome standardised health reporting on assets. Even if it is never feasible for these assets to be subject to risk modelling, ensuring DNOs and Ofgem have oversight over the health of their assets is beneficial to ensuring cost-efficient security of supply.

Q88. What are your views on our approach to enhancing data assurance on the data input into the NARM? Are there alternative ways we could enhance our data assurances processes?

We are supportive of enhancing data assurance. However, to form a judgement on the value of spending consumer money on independent audit, we need to understand the rationale better. It would be helpful to know whether the need for independent audit is particular to NARM data, or whether it is a rationale that also applies more broadly to network reporting.

Q89. What are your views on introducing subsidiary targets in NARM to hold DNOs accountable to their Business Plans? Are there other ways we could hold DNOs accountable?

We are generally supportive of the “plan and deliver” model, and as such encourage Ofgem to apply the model to the NARM as well, by introducing subsidiary targets. Although we cannot offer insight into how that would work in practice, it makes logical sense to link business plan commitments and proposals to the health of the assets in question. This could offer another avenue by which to hold DNOs accountable to their business plans.

Q90. Do you agree with our approach to enabling the future effects of climate change on asset deterioration to be modelled in NARM?

We believe that Ofgem could do more to enable the future effects of climate change on asset deterioration to be modelled in NARM. We encourage Ofgem to develop its own ability to model and understand climate change impacts. Otherwise there is a risk of information asymmetry, with the regulator entirely dependent upon network evidence regarding what climate resilience standards should be set and therefore the level of investment networks receive.

We welcome the fact that DNOs have developed a capability to specify a rate of deterioration within the CNAIM models, which would reflect climate change's potential impact on assets. We understand that using this within the CNAIM model relies upon identifying an evidence-based deterioration rate. We also understand that geography impacts the deterioration rate, and that this will need to be factored into modelling the future effects of climate change on asset deterioration.³²

An absence of a deterioration rate should not be a reason for Ofgem deciding whether or not assessing the impact of climate change upon asset deterioration is required. We believe, as the NIC report made clear, that it is required. The question is more whether Ofgem will prioritise developing the evidence to establish a geographically-sensitive deterioration rate. Having in-house capabilities to model and understand climate change impacts ensures Ofgem can hold networks to account for future asset health, and challenge investment spending to ensure the appropriate balance between cost and security of supply. This will become increasingly important in future price controls, and is critical to Ofgem delivering on its objective to protect the interests of current and future consumers.

Climate resilience

Q91. What are your thoughts on our phased approach to stress testing which seeks to provide greater clarity on investment costs and rationale whilst building up capabilities to support government in setting national resilience standards/goals?

It seems that the stress testing proposed by Ofgem aims to build greater evidence to establish an immediate (ready for ED3) climate resilience goal, and an ability to assess whether and how networks can meet a future (as yet unestablished) climate resilience standard. We support the importance of doing

³² National Infrastructure Commission, [Electricity distribution networks: Creating capacity for the future](#), February 2025, p.36.

this work to ensure networks are fit for the future. The Climate Change Committee this year judged that the energy sector's ability to deliver and implement reduced vulnerability of energy assets to extreme weather is limited, with no improvement since 2023.³³ It is clear that stress-testing could help improve this ability.

We would also, as recommended in our response to question 90, encourage Ofgem to develop its own ability to model and understand climate change impacts. Otherwise there is a risk of information asymmetry, with the regulator entirely dependent upon network evidence regarding what climate resilience standards should be set and therefore the level of investment networks receive. Ofgem recognises that there is a trade off between customer service levels and the costs of building resilience to High Impact Low Probability (HILP) events. Judging that trade off requires independent evidence and an ability to interrogate that evidence.

Q92. What are your reflections on the stress testing methodological framework for the first phase (see Climate resilience stress testing methodological framework annex)? Does it align with your expectations of the responsibilities of a DNO and current capabilities? Can you foresee any support or changes that might improve its effectiveness? Do you have any views on priorities for future phases of work?

We highly support that interdependencies and criticalities should be priorities for future phases of work. This is especially important given that the Climate Change Committee this year judged that the energy sector's policies and plans to identify and manage interdependencies in preparing for climate change are insufficient.³⁴ We recommend that the interdependence between energy supply

³³ Climate Change Committee, [Progress in adapting to climate change: 2025 report to Parliament](#), April 2025

³⁴ Climate Change Committee, [Progress in adapting to climate change: 2025 report to Parliament](#), April 2025

and other sectors should be taken into account in future climate resilience stress testing. For example, the switch off of the PSTN phone lines in January 2027 shows an interdependency between energy services and telecommunication and requires DNOs to take proactive action to ensure they can continue to engage with all of their PSR customers during and after an interruption.

Q93. Do you agree with our proposed granular approach to categorising climate resilience investment to hold DNOs to account? What are your views on the suggested categories (ie direct, incremental, load, non-load, operational, reactive, incremental and transformational)? How can we ensure that this works effectively alongside other approaches in ED3, notably LRE and asset health proposals? What are the risks and challenges?

We agree that it is important to be able to understand the value of investments to improve network climate reliance, and then track their delivery.

However, we would encourage Ofgem to investigate whether adding to and consolidating existing frameworks could enable this, rather than creating a new framework.

Q94. Do you agree that strengthening the rationale for investments is required to allow for differences in local contexts between networks and that our proposed approach to improve guidance for climate resilience strategies and business plans is the best way to do this? Do you agree that we need a clear link between CRS and LINDPs and what are your thoughts on how we can do this?

We agree that it will be important to improve coherence between a long-term climate resilience goal, Climate Resilience Strategies, and Long-Term Integrated Network Development Plans. We support the long-term development of a quantitative method to value the significance of investments in providing climate resilience.

Q96. Do you agree with our approach to introduce Climate Resilience Metrics and Indicators (CRMI) at the start of ED3 and use the learnings to shape future decisions (either for future price controls or via a re-opener)?

We support introducing a quantitative method of ranking assets' resilience to climate change, both current and future. We support that in future price control periods this should be used as a method to value investments. We would like to better understand how the CRMI would interact with NARMs and any other frameworks used to value investments.

Ultimately, we would encourage the use of a singular language and framework to apply to both asset replacement and refurbishment, building new assets, and operations. We are not necessarily recommending that the NARMs methodology is applied universally. Rather, we are recommending that methods to quantify the importance of investment for now and the future are as simple and universal as possible. This will ensure that those who are evaluating investments and delivery on those investments can do so more easily, and limit the extent of regulatory asymmetry.

Reliability

We welcome the review of interruptions incentives. Ofgem recognises the importance of reliability, which will become more critical with increasing reliance on electricity, but trickier to achieve as events driving interruptions (storms, network upgrades) increase . Ultimately, it would be helpful to set out what the aim of the incentives are. The proposals suggest a variety of aims:

1. To improve network reliability (generally)- driving reductions over time in the overall frequency, and length of, interruptions
2. To reward DNOs which are more reliable than other networks and more reliable than previous price controls due to their activity (rather than due to external factors)
3. To improve the balance of network unreliability, lessening the degree to which it disproportionately occurs for some individuals more than others
4. To know the occurrences of interruptions by length, time, frequency and place

We are supportive of achieving all four of those aims, with the difficulty lying more in designing incentives which do so without creating perverse outcomes.

For example, such a design could create significantly higher costs to consumers, or discourage DNOs from improving reliability. We also support Ofgem considering how this incentive interacts with others, including the GSoPs. We would also encourage Ofgem to consider how investment in network upgrades will help achieve the first aim. Subsequent performance improvements in future price controls, cannot be double counted and rewarded as has been seen in the gas distribution sector under the shrinkage incentive in RII0-1.

We would also recommend adding a fifth aim:

5. Establishing a minimum standard of reliability which customers can expect, regardless of location. This minimum standard could be met not only through reinforcement but facilitating DER such as grants/collaboration with GB Energy to help community energy projects.

There may be trade-offs between incentives and funding for:

1. Preventing interruptions
2. Restoring interruptions quickly
3. Managing the potential impact of interruptions, including via off-grid solutions
4. Managing the actual impact of interruptions, including storm responses

We would encourage Ofgem to consider how low-carbon tech and battery storage may enable those trade-offs to be managed in a cost-efficient and equitable way. This is especially important as some areas with poorer reliability - particularly remote and rural areas- will also be areas where low-carbon power generation is situated. It may be felt by residents that there is an extractive relationship, where the benefits of the transition are not being fairly shared.³⁵

To maintain consumer trust in the energy system as it transitions, we encourage Ofgem to map the profile and geography of those who are experiencing, or likely to experience, prolonged or repeated interruptions. This should include

³⁵Naumann and Rudolph, [From the "Right to Energy" to the "Right to the Countryside" and Back Again: Contextualizing Rural Energy Transitions](#), November 2025, and Countryside and Community Research Institute, [The Challenges for Rural Electrification](#), August 2025

worst-served customers, and identify and cost the options for those consumers to achieve the four goals highlighted above.

See below for some views on the particular proposals.

Q98. What is the impact of short interruptions on consumers and are certain regions or customer groups more affected? Do you expect the severity of these impacts to change over the ED3 period? If so, in what way and why?

We have some cases of consumers coming to Citizens Advice seeking help after experiencing short interruptions, particularly frequent short interruptions. This has impacts for those with medical equipment that is reliant on a stable supply, and for those who may struggle to reset their power supply when the interruption triggers surge protection to trip.

For example, a client had repeatedly contacted a DNO about mains 'flicker' - momentary dropouts / voltage drops and spikes on their supply- which had been affecting them for nearly a year. The flickers trigger their Residual Current Device to trip, which shuts power off in most of the house. This causes issues with working from home, as they lose connection in calls and have to reset the RCD frequently. If the client goes away, they empty the freezer to avoid losing all their food, and the burglar alarm will set off after the back-up battery runs out. The DNO did not want to take any action to remedy this.

Another case shows a client struggling as they experience multiple interruptions- including short interruptions. In the past year they'd experienced twenty interruptions, some of which were only minutes long. However, the client has a medical device that is linked to the hospital, and the interruptions are interfering with the equipment.

Another example is a case involving a disabled pensioner who, along with her partner, experienced six power cuts within one hour. Each interruption caused their surge protection to trip, shutting off the entire electricity supply.

Resetting the power requires reaching a fuse box mounted high on the wall, which the customer cannot access due to her disability. If she is alone when

this happens, she is unable to restore power at all. An engineer advised that a monitoring device was needed but warned it could take months to install. This case shows how frequent short interruptions can disproportionately harm vulnerable consumers, particularly older or disabled people who cannot reset their supply and rely on stable electricity for safety and daily living.

It would be helpful to understand whether voltage drops and spikes are treated as interruptions of less than three minutes or not. If so, as mentioned in our response to question 68, we have evidence that the impact of these can be detrimental, especially to households with EV charging. Given that EV charging will become more commonplace, we recommend that the incentives aim to address this problem.

We would also recommend Ofgem consider the findings of the recent value of lost load study, which suggests that customers experience a fixed cost associated with any interruption to their electricity supply. Although the study did not look at interruptions of less than three minutes, this finding still has implications.

Q100. Do you agree that a formal mechanism should be introduced to recognise and address the experiences of customers significantly impacted by short interruptions? If so, what form should this mechanism take (eg enhanced reporting, adjustments to existing incentives, or alternative mitigation approaches)?

We agree that a formal mechanism should be introduced to address this. Short interruptions do impact medical equipment, including kidney dialysis machines. We would recommend Ofgem adjust existing incentives to minimise short interruptions. We also recommend another backstop, so that those who are financially vulnerable, and rely on medical equipment, have uninterrupted power supplies. The GSoPs should be updated accordingly.

Q101. Are long-duration outages becoming a more significant concern, and could a targeted IIS incentive or penalty for 12+ hour events effectively

address this? How could such a mechanism work and are there system or data barriers to implementing it?

Long-duration outages are becoming a more significant concern as an increasing proportion of customers will rely on electricity for heating and eating. Over the past 5 years, people have come to Citizens Advice for help with power cuts, over 1,400 times.³⁶ We analysed a sample of these cases and identified examples where long-duration outages are causing harm, especially for vulnerable customers.

One example is a case involving an older couple, both managing health issues, who were left without electricity for 108 hours during Storm Darragh. The outage cut off all heating, lighting, and the ability to cook food, as well as telephone communication because the local mast also failed. With no way to stay warm or prepare meals, the couple had to leave their home every day to find warmth, eat hot food, and stay in touch with their family. This case illustrates how people, particularly older or vulnerable households, increasingly depend on electricity for essential daily needs such as heating and preparing food. When outages are prolonged, the consequences can quickly become unsafe and unmanageable.

Another example involves a disabled parent caring for three children—two also disabled—who faced an unplanned power cut lasting a significant period of time. The outage stopped all electricity and the boiler, leaving the home freezing. With no heating and due to her own health issues and her children's needs, the parent had no option but to buy a gas heater and gas bottle to keep the family warm. This highlights how unplanned outages can create immediate risks for disabled households, who depend on electricity for basic safety, warmth, and wellbeing.

³⁶ 1 April 2020-31 March 2025, 1416 unique cases of domestic and small business consumers with a network supply issue seeking help from the Consumer Service.

As the energy system moves away from gas, more households—especially vulnerable ones—will rely almost entirely on electricity for heating, cooking, communication, mobility, and medical needs. Unlike the gas sector, which has GS3 requiring networks to provide temporary heating and cooking facilities during outages, there is currently no equivalent GSoP protection in electricity.

To close this gap, a new electricity GSoP should be considered that requires network companies to provide temporary alternative power solutions—such as mobile generators, battery packs, or portable charging equipment—to households most in need during prolonged outages. This would offer timely and practical support to vulnerable consumers and ensure protections keep pace with the transition to a fully electrified energy system. This would also act as an incentive to reduce long-duration outages.

We also suggest that Ofgem considers re-weighting the BMCS to reflect the occurrence of unplanned interruptions, as recommended in response to question 33, so that customer support is better incentivised.

We support exploring how the interruptions incentive might better protect those liable to extended power cuts, working alongside updated GSoPs. We would welcome more analysis regarding the profile and geography of consumers who are more likely to experience long duration outages, and the costs of options for better supply and support. Introducing a minimum standard for reliability could inform a specific incentive for longer duration outages.

Q102. How should multiple unplanned interruptions be defined (qualifying criteria similar to WSC?) and monitored over time, and could targeted incentives or reputational tools help improve outcomes for customers who are persistently affected?

As evidenced by the list of cases in response to question 98, we have found that multiple interruptions can cause detriment to consumers. We are supportive of protecting individuals, especially vulnerable individuals, from experiencing more heightened detriment. It seems unfair that although the incentive does drive an overall reduction in interruption length, and frequency, it does not target how that reduction is shared across consumers. We would therefore welcome more

analysis regarding the profile and geography of consumers who are more likely to experience multiple interruptions, and the costs of options for better supply and support. The cost of targeting multiple interruptions needs to be outweighed by the benefit.

Either way, we would suggest that Ofgem include multiple planned, as well as unplanned, interruptions within any definition. Ultimately, a consumer who is experiencing frequent interruptions comes to expect them, so the nature of whether they are unplanned or planned does not necessarily prevent much harm. For example, one client came seeking our help because although they had been warned of multiple planned interruptions, they were concerned about the impact on their living standards.

Q103. Do you agree we should review the extreme weather event thresholds for IIS to determine whether they are still appropriate in light of the changing climate? If so, do you have a view on the possible approaches we have set out, and why.

Yes, we agree that Ofgem should review the extreme weather event thresholds. Ensuring electricity networks are working towards reliability in the environment we inhabit, rather than one where all things are equal between DNOs, is critical. Climate change is driving more frequent or more severe storms, and the current incentive design is not driving DNOs to prevent interruptions caused by such external factors.

However, we recognise that the design will need to prevent disincentives- where DNOs find that factors outside of their control hold more weight in their financial affairs, and therefore aiming to improve reliability is not worth the cost to them. We would therefore suggest that Ofgem consider how the climate resilience work, including the NARMs and climate stress testing, would interact with updating the incentive. It may be that the increased scrutiny upon the climate resilience of current and future assets complements new targets for reliability in more extreme weather.

Q105. Should the IIS be amended to reflect the expected increase in planned interruptions from the increase in network investment in ED3? If

so, how, and how can this be done whilst ensuring that customer impacts are effectively mitigated?

We understand that planned interruptions will need to increase to facilitate network upgrades. As we noted in response to question 67, and as Ofgem also notes in the consultation, minimising planned interruptions is incentivised by the interruptions incentive. We are therefore not supportive of removing the incentive. For planned interruptions, Ofgem should investigate the merits of a zero-sum design which rewards the best performing DNOs proportionate to the penalties for worst-performing DNOs. This would manage the risk that networks choose not to upgrade the grid due to potential financial incentives. This is because they would be incentivised to perform well compared to their peers, rather than an expectation which may prove a deterrent to network upgrades. We are aware that this may depend on the extent to which the volume of planned interruptions required differs by DNO.

Further, given funding of upgrades will be more linked to delivery, there will be greater incentive linked to those upgrades, and this will therefore help outweigh the risk that upgrades are discouraged by the interruptions incentive.

Q106. Beyond the UIOLI mechanism, what additional regulatory or operational measures could be introduced to ensure sustained and equitable improvements for WSCs?

In our response to ED2 Draft Determinations, we recommended that Ofgem should develop a minimum national standard for reliability to replace the current WSC scheme and that the minimum standard should apply to both HV and LV levels.³⁷ We warned that a Use it or Lose it (UIOLI) allowance does not offer the protections of a minimum standard as companies could not deliver their proposed schemes. A minimum level of reliability would ensure that all customers receive the same service standard, especially in a more electrified world. We expected that the increased monitoring at LV level during ED2 should

³⁷ Citizens Advice, [Citizens Advice response to the Ofgem RIIO-ED2 Draft Determinations consultation](#), August 2022

help enable the identification of those receiving a markedly worse service at lower voltages. This remains our view.

We know that worst served customers in terms of electricity reliability seem to typically have a base level expectation of interruptions, often due to living rurally. ED3 presents a new opportunity to ensure the needs and experiences of worst served customers are properly understood. We therefore support Ofgem increasing transparency via the proposed changes.

However, the WSC reporting requirements already require an annual report on WSC projects, and a publication of the methodology for identifying worst-served customers.³⁸ What is missing is analysis and easy-to-access summary of DNO's WSC performance. We recommend that Ofgem, as a minimum, commits to publish this each year to make the reputational incentive somewhat more effective. Doing this analysis would also help Ofgem understand what measures would ensure more sustained and equitable improvements for WSCs.

Moreover, as mentioned earlier, we recommend that Ofgem map the profile and geography of those who are experiencing, or likely to experience, prolonged or repeated interruptions. This should include worst-served customers, and identify and cost the options for those consumers to achieve the four goals of prevention, restoration, proactive and reactive recovery support. That research should gather together DNO research that already exists, incorporate any findings from tRESP and RESP processes which have sought stakeholder engagement, and the VoLL study. Community energy groups and remote communities will have feedback on what could help ensure that the energy system meets their needs at a fair price.

Q107. Is the current threshold for defining WSCs still appropriate? If not, what principles should guide any revision to ensure it remains fit for purpose?

³⁸ Ofgem, WSC Governance Document, [WSC Governance Document](#), February 2023

Given the concerns regarding interruptions unfairly affecting some consumers, it could be argued that broadening the definition of WSCs could help address this problem. However, we are concerned that:

- 1) Broadening the definition makes it harder to assess WSC funding proposals and compare how WSC funds are spent
- 2) Ofgem is already concerned about limited visibility regarding WSC interventions.
- 3) There is a risk that an incentive which targets prolonged or repeated interruptions rewards outputs from investment already paid for by consumers under the UIOLI mechanism. Broadening WSC would therefore increase the risk of over-rewarding DNOs.

Nonetheless, we suggest that the research we recommend above, on less reliably served customers, considers the role of the WSC funding, and its threshold, in addressing the four reliability goals.

Resilience re-opener

Q109. Do you agree with our proposed approach to introduce a resilience re-opener? Why?

Yes, we are supportive of consolidating the ED2 resilience re-openers into one resilience re-opener. We welcome engagement on the design of the re-opener, noting our previous response to the question on re-openers in the ED3 framework consultation:

'We recommend that Ofgem produces high, medium and low [cost] scenarios [with proportionate scrutiny] for the additional cost allowances that may result from re-openers. Re-openers should be symmetrical and equitable, meaning that DNOs and Ofgem can both trigger them and they should allow for both increased and decreased allowances as necessary.'³⁹

If Ofgem decides to adopt the 'plan and deliver' model, we would caution against erring from this model unless absolutely necessary. The NIC report recommends

³⁹Citizens Advice, [Response to ED3 Framework Consultation](#), January 2025, p.17.

that price controls use 're-opener mechanisms only where there is genuine long term uncertainty'⁴⁰. Ofgem has set out a plethora of triggers for the resilience re-opener.

Some of these triggers may be better treated as input informing investment for ED4, and we would urge Ofgem to consider influencing the development of the security of supply standards and the climate resilience standards to align with adoption for ED4, rather than necessitating in-period investment changes. After all, the government has already signalled that the former will unlikely be developed by 2028,⁴¹ and has committed to developing the latter by 2030. If government deadlines are already flexible, we cannot see why input into ED4 rather than immediately in ED3 would be a problem. Further, given stress-testing capability is due to be developed by the end of this year, this should allow results to inform investment proposals for ED3 baseline, rather than later in the ED3 period via a re-opener.

Re-openers

Q119. Do you agree with our proposals for pass-through costs? Why?

Yes, we agree with the proposal to move specific pass-through costs, namely business rates, into the baseline. It is important to incentivise DNOs to minimise these costs via the TIM, as the water sector has done in their PR24 price control, especially given the business rate costs are forecast to be £1.8 billion for ED3.

We understand the rationale behind a miscellaneous pass-through, but would highlight the risk that this discourages what the previous proposal aims to do: encourage DNO cost efficiencies.

On transmission connection charges, we support action to ensure consistency in the way DNOs are recovering these costs, and minimising perverse incentives.

⁴⁰ National Infrastructure Commission, [Electricity distribution networks: Creating capacity for the future](#), February 2025, p.10.

⁴¹ Department for Energy Security and Net Zero, [Electricity Distribution Networks Study: government response](#)

Q121. Do you agree with our proposals for volume drivers? Why?

Our primary focus is to ensure that consumers get value for money out of the price control. We generally think volume drivers are a more efficient way of ensuring that consumers only pay for what's delivered. However, if Ofgem decides to adopt a "plan and deliver" approach, which funds unlooping / LV reinforcement via baseline, there must be clear accountability measures to make this happen.

We agree with the proposal to remove the volume driver relating to disposal of transformers contaminated with PCB, which sets the expectation that DNOs should have fulfilled this legal requirement by 2028.

Q122. Do you agree with our proposals to consolidate reopeners relating to resilience and cyber? Why?

Yes, we support consolidating reopeners relating to resilience and cyber. Ultimately, we are supportive of limiting the need for re-openers, where funding may be subject to less oversight from Ofgem, leading to projects offering less value for money. Further, re-openers create increases in bills that are harder to predict. See our response to question 109 for our position on the resilience re-opener.

Business Plan Incentive

Q125. Do you agree with our proposals to retain Stage A of the BPI as per RIIO-3 BPI? Why?

Yes, we agree that having a minimum requirement for information, and quality of information (which would be a change from the RIIO-3 BPI) in a business plan, should be necessary to avoid a penalty. We recommend that Ofgem recalls that poor information provided by transmission operators in their RIIO3 business plans led to much of their baseline allowances being disallowed. It is critical for the success of a 'plan and deliver' model that this does not happen for ED3.

Q126. Do you consider that an asymmetric incentive for Stage B, weighted towards rewards, would deliver the greatest benefit for consumers, as per RIIO-3 and if not, do you consider that BPI Stage B should be removed?

Consumers should pay the best possible price for DNO activity. We therefore support the policy intent, and the intended outcome, that DNOs make accurate, ambitious cost forecasts. Nonetheless, it does not reflect well that an incentive is needed to discourage DNOs from over-inflating or under-justifying the costs they forecast in their business plans. We would welcome evidence from Ofgem that rewarding DNOs for being ambitious with cost-assessments leads to cost savings for consumers. We would urge Ofgem to consider how this proposal interacts with the cost assessment proposal, to avoid consumers rewarding DNOs unnecessarily. We would recommend that a penalty is maintained rather than the incentive being reward-only.

Incentivising delivery

Q129. Do you agree with our proposed approach to setting TIM sharing factors? Why?

We remain unconvinced that sharing factors in the TIM, as currently set, have evidential merit or represent value for money for consumers.⁴² While we understand the rationale behind not using a stepped TIM as seen in ET-3, Ofgem should look to retain its primary benefit (in that it pushes networks more towards over-spend, which actually results in delivery for consumers) in the model it chooses.

We therefore support lowering the sharing factor, and applying a consistent sharing factor across the sector. We also support that the primary TIM conditionality tool should be PCDs. The benefit of sharing the savings from underspends, or the costs from overspends, should be contingent on the output being actually delivered. Given this position, we would also urge Ofgem to recognise that doing so would lower the risk to DNOs, who would ultimately be

⁴² Citizens Advice, [Response to Sector Specific Methodology Consultation](#), March 2024, OVQ34

passing more risk (of over-spend) to consumers. This should be reflected in the cost of capital, as investors will be taking on lower risk themselves.

Q130. Do you agree with our proposals regarding the application of PCDs? Why?

We support that PCDs should cover the majority of the investment plan, and that non-load spending should have an increased link to PCDs. Taking the first year of ED2, all DNO groups reported costs to be below allowances across the first reporting year, with forecast underspends ranging between 6% and 22%.⁴³ Based on past experience, we are also unconvinced by DNO forecasting an overspend by the end of the ED2 period.

It is therefore essential that, as Ofgem plans a step-up in investment, as much as possible of that investment is delivered, rather than consumers paying for nothing. We support Ofgem finding ways to link non-load spending to PCDs, recognising the need to prioritise areas with the most material financial risk.

Q131. Do you think that additional delivery incentives might be needed in ED3 and if so in which areas?

We would agree with Ofgem's hypothesis that material underspends, particularly in the early years of the price control, are more likely an indicator of under delivery or poor planning, than of genuine efficiency.

We would therefore support a close-out mechanism being used to claw back allowances where sharing factors are not linked to price control deliverables.

We would also encourage Ofgem to understand more about the potential for incentives to be duplicative; i.e PCDs and ODI-Fs and TIM. It is our view that the TIM targets efficiency of spend, whilst other incentives target the quality of the spend's outcome. In a competitive market, competition rewards those who produce higher- quality services/goods with zero-sum rewards (i.e more customers, at the cost of another firm losing customers), and do so efficiently

⁴³ Ofgem, [RIIO-2 Electricity Distribution Summary Annual Report: 2023-24](#), April 2025, p.21.

with net positive rewards (i.e better profit margins, which does not detract from the profit margins of other firms). For that reason, one essential way of avoiding duplicative incentives is to ensure incentives regarding the quality of the output (ODI-Fs) are zero sum and relative.

Cost assessment annex questions (selected)

CAQ39. Do you agree with the growth accounting approach and the choices used when setting ED3 OE targets? If not, what alternatives should we consider?

We broadly agree with the proposed approach to ongoing efficiency. In a competitive market, companies by default have to continually improve their productivity to stay competitive and profitable. It is fair that network companies have a sufficient productivity target to replicate this dynamic so that consumers are not funding inefficiencies. However, setting a productivity target by reference to non-regulated companies will not be sufficiently challenging. Firstly, it is important that consumer funded innovation allowances be taken into account. Secondly, every network company within a regulated sector can benefit from a single company's productivity initiative. This is due to mechanisms to share best practice that cannot exist in a competitive market. For example, the Energy Networks Association says its mission is 'to facilitate collaboration across our sector, share best practices...'. It is therefore reasonable for the ongoing efficiency challenge to be set at the upper range of the available evidence.

Finance annex questions (selected)

Allowed return on debt

FQ3. Do stakeholders consider it reasonable to adjust our long-term CPIH inflation forecast to the latest OBR assumption?

Yes, we support adjusting the long-term CPIH inflation forecast to the latest OBR assumption.

As noted by Ofgem, the 2% long-run CPIH assumption used to deflate the cost of debt allowance at ED2 likely under-stated long-term CPIH expectations by around 0.4%. Because the real debt yield is calculated by deflating the nominal yield using this inflation assumption, using a figure that was too low likely resulted in an overstated real cost of debt allowance. This has effectively given network companies a windfall gain. Updating the long-term CPIH assumption to align with the OBR's explicit CPI-CPIH wedge would therefore improve the accuracy of the real cost of debt calculation and better align the allowance with long-term macroeconomic expectations.

FQ4. Do stakeholders have any objections to our proposed approach to apply Inflation Option 1 (as defined in 2.19)?

No, we have no objections. We support the proposed approach to apply inflation Option 1.

Our previous research has shown that network companies received a financial windfall of £3.9 billion between 2021 and 2024 due to the mismatch between the allowance for debt costs and actual debt costs. Networks are continuing to receive a windfall since out-turn inflation sits above the long-run inflation assumption. Setting a nominal allowance for fixed rate debt and applying this in proportion to the notional capital structure fixed rate debt assumption helps mitigate this.

We note, however, that there is still a chance for a windfall to be gained on the ILD assumed portion. Firstly, the 2% CPIH inflation assumption used to deflate nominal yields may understate long-term CPIH expectations, which would make the allowed return on debt too high. As outlined in our response to FQ3, correcting this would prevent an overstated allowed real return on debt. Secondly, given the long-run wedge between CPIH and CPI being 0.4%, companies that hold CPI-linked debt stand to gain a windfall because the RAV is indexed to CPIH. We believe Ofgem should take further steps to address this particular potential windfall.

We also note that the indexation of debt provides a high degree of risk protection to UK network companies that is not always granted in comparable regulated energy sectors, such as in the US. This materially lower business risk profile for UK networks must be fully reflected in the determination of the overall cost of capital.

FQ5. Do stakeholders have new evidence for us to consider in our review of the additional cost of borrowing allowances or infrequent issuer premium?

In its PR19 redetermination, the CMA decided that 10 bps was appropriate for additional cost of borrowing. We suggest Ofgem follows this approach to maintain regulatory consistency and stability.

We support the RIIO-3 DD proposal to remove the infrequent issuer allowance. The infrequent issuer allowance has generated an unjustified premium in previous price controls.⁴⁴ The ability for a company to decide on an efficient structure should, where possible, be left to companies. It is then up to companies how to structure their financing within acceptable parameters. Low issuance in a segment of large corporate structures means that additional costs of low issuance can be well-mitigated. It is not credible that network companies cannot mitigate this periodic fluctuation of investment where relevant. In any case, at RIIO-3, Ofgem has determined that were companies to face an

⁴⁴ Citizens Advice, [Response to the Ofgem RIIO-ED2 Draft Determinations Consultation - Finance Questions](#). August 2022, P.6.

infrequent issuance premium, this is already reflected in the main allowance and that “providing an additional allowance would present a material risk of overcompensation of companies.”⁴⁵ It is therefore only justified that the infrequent issuer allowance be removed.

FQ6. Do stakeholders agree with our proposed RAV-weighted approach for calibrating the index for ED networks?

Yes, we support Ofgem’s introduction of RAV-weighting for calibrating the index for ED networks. This approach better aligns the allowed cost of debt with the capital actually deployed in the network, ensuring that consumers pay a more proportionate cost for financing.

Allowed return on equity

FQ8. Do stakeholders agree with our interpretation and proposed application of UKRN Recommendations 2 to 7?

We don’t agree that Ofgem’s approach should be solely based upon the UKRN guidance on the methodology for setting the cost of capital.

In our view the current UKRN guidance on the methodology for setting the cost of capital will likely mean a potentially substantial upward bias in the allowed cost of capital. This will be to the benefit of company shareholders and at the cost of consumers.

In response⁴⁶ to UKRN’s consultation we were clear that we didn’t believe that the outputs of the UKRN guidance were compatible with the government’s call for the UKRN Cost of capital taskforce to ensure that the setting of the periodic cost of capital must ensure value for money and provide a fair deal for all consumers, and accordingly, to ensure the general affordability of consumers’ essential bills.

Given the significant capital expenditure required to meet Clean Power 2030, it has become more important than ever that the approach to cost of capital

⁴⁵ Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), P.34.

⁴⁶ Citizens Advice, [Citizens Advice response to UK Regulators Network \(UKRN\) guidance for regulators on the methodology for setting the cost of capital](#), 2022.

provides a fair deal for consumers and seeks every opportunity to ensure consumers' bills are affordable. However, we don't believe the UKRN exercise has determined a methodology which finds the right cost of capital - i.e. one that is likely to provide returns which are neither too big nor too small. Indeed, the UKRN has not attempted to do so, rather stating that the guidance *"brings together and consolidates existing methodologies used for setting the allowed return in regulated sectors"*⁴⁷

The guidance therefore accepts the established positions of the regulators, which are strongly influenced by the regulated companies. It doesn't acknowledge or reflect that there are also alternative positions from consumer bodies - i.e. Citizens Advice - that deserve meaningful scrutiny and attention. This is particularly disappointing as there is a clear asymmetry. While companies and their shareholders have an unambiguous commercial incentive to ensure returns are as high as possible, our views are aligned with public interest and the government that returns should be neither too high nor too low.

We believe that the currently proposed methodology will likely lead to returns which are too high. In response to Ofgem's final determinations for ED2 we stated that the methodology resulted in at least £1.5 billion in excess returns going to companies using Ofgem's own cross-checks.⁴⁸

The government's consultation regarding economic regulation also identified these issues citing the NAO's 2020 report on Electricity Networks, which highlights that, based on available data, energy network companies forecast 9.2% returns on average, in comparison with average FTSE returns of 5.25-5.75%.⁴⁹

Simply hard-coding the approaches that have led to this generosity, through the UKRN guidance, isn't in the interests of consumers. We have previously recommended that UKRN should commission an update to their 2018 cost of

⁴⁷UKRN, [Guidance for regulators on the methodology for setting the cost of capital](#), 2023.

⁴⁸ Citizens Advice, [Citizens Advice response to the Ofgem RIIO-ED2 Draft Determinations Consultation - Finance Questions](#), 2022.

⁴⁹ National Audit Office, [Electricity Networks](#), 2020.

capital study under a new process. The 2023 cost of capital guidance⁵⁰ does not address the inherent and structural asymmetries. A new process should be followed that enables a diversity of perspectives to be independently considered, in particular taking into account the views of those who represent consumer and public interest.

In the meantime, for this price control, Ofgem shouldn't be relying solely upon the UKRN guidance.

FQ9. Do stakeholders agree with the methodology for calculating the CAPM parameters: RFR, TMR and beta?

Citizens Advice partially agrees with the methodology for calculating the CAPM parameters. However, we continue to believe there is structural generosity baked-in to the CAPM cost of equity calculation which has not been addressed.

TMR

We support Ofgem's proposition to continue to estimate the TMR rather than the ERP. As noted by Ofgem, regulators have historically adopted a stable TMR approach, and maintaining regulatory predictability and stability is vital for long-term interests of both consumers and companies. This approach has historically supported high returns on the basis that a through-the-cycle approach would be maintained.

However, it is likely that the TMR is over-estimated in general. This is because TMR estimates should not be based on the average returns on UK equities, but on the average returns on a wider and more diversified portfolio of investments, namely, including bonds, property, infrastructure, private equity, and other such assets that are all readily available to the typical investors in UK energy and water network companies. Such a portfolio is necessarily more diversified than UK listed equities alone, therefore a much better fit for the CAPM's requirement that the 'market portfolio' should represent the most diversified (and readily available) portfolio of investments to relevant investors. Such a portfolio is also

⁵⁰ UKRN, [UKRN guidance for regulators on the methodology for setting the cost of capital](#), March 2023.

likely to exhibit lower average returns than equities alone, owing to the inherently geared nature, on average, of equities.

This position was previously accepted by the CMA⁵¹ and recognised by Ofgem, yet Ofgem have continued to use equities only on the basis of practicality grounds. This puts upward pressure on the cost of equity estimate. If the TMR cannot be estimated on the basis of all assets, then a downwards adjustment should be made to the cost of equity point estimate to offset this.

Further, whilst Ofgem is proposing to give weight to both historical ex post and ex ante TMR estimates, these both use long-run historical returns data. The use of historical data is likely to over-estimate the TMR. This was acknowledged by the CMA in PR19 redeterminations, noting that many academic studies conclude that the ex post approach is likely to over-estimate required returns. This upward bias should be considered when Ofgem set their point estimate for the cost of equity.

Equity beta

Citizens Advice supports Ofgem's proposal to consider a range of timeframes and frequencies when analysing equity beta data, and to confirm the exact calibration of our calculations on the basis of the evidence considered. Our view is that the evidence supports the use of longer-term betas, since short-term betas suffer from upward bias. This is because short-term movement in equity and bond prices is strongly correlated with overall market indices, such as the FTSE All Share Index. The covariance of index-constituent equity and bond prices (and returns) with market indices is independent of the underlying systematic risk applicable to individual index constituents. In comparison, it is typically only when individual equities or bonds enter or exit an index that there is a greater divergence in prices and associated returns from the index. This equity and bond market trading behaviour therefore results in a strong bias of short-term beta estimates towards "1" for all firms in a given index compared to the underlying long-term systematic risk and beta.

This is recognised by academics. For instance:

⁵¹ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), 2021, P.71.

“[One] driver of co-movement of returns is commonality in trading activity [...] simply by virtue of being part of the stock index [...] exhibit excessive covariation in their returns [...especially] in the short run [...] whereas] at long horizons, returns [...] revert to reflect fundamentals.”⁵²

The UKRN 2018 cost of capital report includes an appendix by Stephen Wright and Donald Robertson on estimation of beta at longer horizons. They argue that: “if [UK utility regulators] are concerned to assess the nature of systematic risk at long horizons, [they] should ensure that our estimation techniques are consistent with that horizon [whereas, in contrast...] what is now standard practice in beta estimation: the use of relatively short (2- 5 year) samples of, usually daily data [...] reflects the relatively short-term objectives of most users of estimated betas in the finance industry”.⁵³

Accordingly, the report recommends a “fairly long horizon, for example, 10 years” 10 on grounds that this is “more relevant to the long horizons used by regulators”

Additionally, there are reasons to suggest the current methodology for estimating beta may lead to an over-estimate. The effect of estimating equity betas by regression against UK equity market indices – rather than indices of all (global) assets is itself likely to create an upward bias in UK regulated company beta estimates. This reflects that movements in UK regulated company share prices will be far more correlated with UK share prices generally than with movements in all global asset prices. This matters because equity betas are intended to reflect the correlation between an individual equity’s systematic risk and the systematic risk of all assets, not just a small subset of such assets. This is also especially relevant given that the investors in UK regulated companies are themselves among the world’s largest diversified investors, investing in all asset classes across all geographies, of which UK equities comprise only a small component. The use of local, rather than world, betas therefore puts upward

⁵² Robin M. Greenwood and Nathan Sosner, [Trading Patterns and Excess Comovement of Stock Returns](#), Financial Analysts Journal., 2007, Vol. 63, No. 5.

⁵³ Donald Robertson and Stephen Wright, [UKRN report - Appendix G: Beta Estimation for CAPM-WACC at Long Horizons](#), 2018. P.139.

pressure on the estimation. Ofgem should consider this inherent upward bias in the equity beta when setting the point estimate for the cost of equity.

Further, there is some evidence to suggest that the use of OLS for estimating the equity beta may face limitations. Specifically, an Ofgem-commissioned report by Donald Robertson⁵⁴ noted that if beta is time-varying, then an OLS regression assuming a constant coefficient is mis-specified and the model subject to heteroscedasticity. Robertson found “overwhelming evidence”⁵⁵ that beta *is* time-varying and argued that GARCH estimation may be more suitable as it “provides a good estimate of the long run parameter and also models the short run dynamics of beta”.⁵⁶ Robertson further found that using lower frequency data over longer data samples for OLS estimates eliminated a lot of the heteroscedasticity and estimates were more in line with the long-run estimates from GARCH models. We ask Ofgem to consider the use of a GARCH model and/or use of lower frequency and longer-sample data if OLS is used.

FQ10. Do stakeholders agree with us using our proposed RIIO-3 beta comparators for ED3?

We agree that for any additional comparators to be considered, there must be sufficient evidence that their inclusion allows Ofgem to calculate a more accurate estimate of the beta that is appropriate for energy networks.

However, at RIIO-3 SSMD and Draft Determination, European comparators were included without Ofgem providing any evidence that this allowed them to calculate a more accurate estimate of the beta. The inclusion of European comparators in RIIO-3 is in direct opposition to Ofgem’s position at RIIO-2, and no evidence has been provided that the prior concerns with including European comparators have been resolved.

At RIIO-2 draft determinations, Ofgem commissioned CEPA to assess the evidence on asset betas, including European comparators, which led to their

⁵⁴ Donald Robertson, [Estimating beta](#), April 2018.

⁵⁵ *Ibid*, p.39

⁵⁶ *Ibid*, p.23.

decision to not include European betas at RIIO-2. In their response to the RIIO-2 CMA appeals, GEMA had argued that little weight should be placed on the observed equity betas of publicly traded European companies because:

*"multiple types of risk might be expected to differ between the UK and European jurisdictions (political risk, regulatory risk, macroeconomic risk etc.) and multiple adjustments to the European data may therefore be required to provide a suitable proxy for the systematic risk of a UK "pure play" energy company. Each such adjustment carries its own margin for error, the cumulative effect of which risks distorting the overall outcome so as to deprive it of all probative value"*⁵⁷

GEMA further stated that:

*"Given the inherent difficulties in making beta comparisons across jurisdictions, GEMA was entirely justified in relying on UK beta observations rather than making a speculative adjudication on the relative merits of different European samples and how these would translate into the UK context."*⁵⁸

The CMA recognised that European comparator equity betas may be subject to "noise" from: non-regulated activities within comparator firms, issues with the quality of the data due to volatility in betas over time or illiquid share trading, and differences in the regulatory environment. The CMA determined that:

*"there is complexity and a requirement for a large number of judgements to be made in performing European comparator analysis" and were "not persuaded that inclusion of such data would have improved the robustness of GEMA's beta estimation."*⁵⁹

The CMA concluded that GEMA was not wrong to exclude European comparator data in RIIO-2.

To warrant inclusion at ED3, Ofgem must explain how European comparators would now allow them to calculate a more accurate estimate of the beta, when

⁵⁷ GEMA, [RIIO-2 PRICE CONTROL: RESPONSE TO APPEALS ON FINANCE ISSUES AND TNUOS](#), April 2021, p.43 .

⁵⁸ GEMA, [RIIO-2 PRICE CONTROL: RESPONSE TO APPEALS ON FINANCE ISSUES AND TNUOS](#), April 2021, p.43 .

⁵⁹ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), 2021, P.130.

previously Ofgem stated doing so involved “inherent difficulties” and the CMA stated this did not improve robustness. For Ofgem to change its approach without compelling evidence damages regulatory predictability and stability and so is not in the long-term interests of consumers or companies.

Evidence from RIIO-3 DD shows that European and UK betas differ significantly:

Asset betas

Network company	Country	Sector	10-year beta
UU	UK	Water	0.32
SVT	UK	Water	0.33
Pennon	UK	Water	0.39
National Grid	UK	Electricity	0.36
Engagas	Spain	Gas	0.36
Snam	Italian	Gas	0.44
Red Electrica	Spain	Electricity	0.33
Terna	Italy	Electricity	0.43
REN	REN	Electricity	0.20

The 10-year asset betas for Italy of 0.43 and 0.44 for Electricity Transmission and Gas Transmission are only 0.01 apart, but sit significantly higher than all other comparator betas. This suggests the high betas are a function of the Italian regime itself and are not useful comparators for UK networks. This is supported by an Oxera report that found a risk premium for the total equity market in Italy that was not immaterial and was potentially in excess of 1.5%.⁶⁰ At the same time, Portuguese company REN has a 10-year asset beta of 0.20, with the Spanish comparators sitting in the middle. The vast divergence between the

⁶⁰ Oxera, [Estimating the cost of capital for Italian electricity and gas networks](#), June 2015.

Italian and Portuguese betas suggests that country or firm specific factors, not sector-specific factors, are driving the betas and serve to highlight their unsuitability as comparators to the UK.

Such factors may include but are not limited to:

- larger proportions of unregulated business, for instance, within Italgas and Enagas.
- EU gas companies such as Snam being exposed to higher cost and volume risks from capacity bookings on interconnectors, compared to the UK.
- Red Electrica having been impacted by the Iberian blackout.
- Higher political and regulation risks compared to the UK. For example, lower regulatory stability or predictability, a lack of appeal/ redetermination processes, particularly in Italy.

If Ofgem are to include European comparators it must provide evidence on how these factors have been considered and, in line with its own position at the CMA appeals, how differences in regulatory environments, macroeconomic and political risks across the European comparators and the UK have been accounted for. Additionally in line with Ofgem's own position at CMA appeals, it is likely that multiple adjustments to the European data may be required to provide a suitable proxy for the systematic risk of a UK "pure play" energy company, and evidence of these adjustments must be provided. If, as was the case at RIIO-2, this is too difficult, then European comparators should not be included.

We also question the rationale for considering European comparators at this time. In ED3 SSMD, Ofgem proposes including European comparators on the basis that there is a lack of pure-play listed UK comparators. However, the lack of UK comparators does not itself justify European comparators if they are not robust or comparable. A higher number of comparators does not improve the methodology if there are issues with the quality of those comparators.

At RIIO-3 SSMD and DD, Ofgem justified the inclusion of European comparators due to perceived increased risk from higher capital expenditure in electricity

transmission T and asset stranding in gas. However, as acknowledged by Ofgem, these risks are non-systematic/ diversifiable risks, meaning they should not form part of the beta estimation. Ofgem confirms this in ED3 SSMC:

“The CAPM that we use to estimate the cost of equity assumes that risks that are specific to an investment, or set of investments, can be diversified away - meaning that investors do not require compensation for exposure to these 'specific' or 'non-systematic' risks ... Beta is the measure of an assets exposure to undiversifiable systematic risk, relative to the average exposure of assets in the market.”⁶¹

This means any perceived increased risks in the electricity sector would not be captured in European comparator betas, as betas do not account for non-systematic risk.

Ofgem should clarify that it is indeed their view that perceived risks specifically pertaining to the electricity sector are non-systematic, and that these perceived risks should therefore not appear in the CAPM estimation, in line with CAPM theory.

FQ11. Do stakeholders agree with our proposed set of cross checks in Step 2?

We support the use of the proposed cross-checks but believe there are important considerations in how they are implemented.

Market-to-Asset Ratio (MAR)

It is our view that real-world evidence should be used to inform the cost of equity. We therefore support the use of Market-to-Asset ratios (MAR) as a cross-check. However, this approach should be applied consistently, using the most recent real-world energy transactions to ensure relevance.

At RIIO-2 appeals, Ofgem did indeed utilise MAR evidence from National Grid's acquisition of Western Power Distribution. National Grid's own analysis

⁶¹ Ofgem, [ED3 Sector Specific Methodology Consultation – Finance Annex](#), December 2025, p.24-25.

confirmed the purchase reflected a 61% premium over the regulated asset value. In their appeal response, GEMA states that:

- “Whatever uncertainties exist in MAR data, they undoubtedly support GEMA’s view that there is strong evidence showing that assets of utility companies are sold at a premium, and that the premium is significant.”⁶²
- “The CMA is able to, and should, take the WPD Purchase into account in this appeal”.⁶³
- “GEMA was plainly entitled to have regard to MAR data, and would have been entitled to have regard to data from the WPD Purchase had it taken place.”⁶⁴

This shows that Ofgem were strongly in support of including transaction MAR analysis at RIIO-2, and would have considered transaction data from energy company acquisitions in their determinations, had recent transactions been under-taken.

At ED2 draft determinations, Ofgem indeed included additional MAR estimates using the WPD transaction:

Transaction	MAR estimate	Source	Date reference
Western Power Distribution	1.61	National Grid	Mar 2021
Bristol Water	1.44	Pennon	Jun 2021
SGN	1.35	JP Morgan	Aug 2021
National Grid Gas Transmission	c.1.30	Investec	Feb 2022

Source: *ED2 draft determinations notable MAR transactions since December 2020*.⁶⁵

Using an inference model, Ofgem analysis showed the transaction MARs implied a cost of equity of the range 3.2% to 3.9%, significantly below the CAPM implied cost of equity of 4.75%.

⁶² GEMA, [RIIO-2 PRICE CONTROL: RESPONSE TO APPEALS ON FINANCE ISSUES AND TNUOS](#), April 2021. p.56 .

⁶³ Ibid, p.57

⁶⁴ Ibid, p.57

⁶⁵ Ofgem, [RIIO-ED2 draft determinations finance annex](#), June 2022, p. 43.

At RIIO-3 DD, Ofgem refers to several energy transactions, however does not infer a MAR-implied cost of equity range from these transactions or use them explicitly as a cross-check. Instead, Ofgem's MAR cross-check uses Ofwat's MAR analysis of the UK listed water sector, post-PR24 final determinations. This is a departure from Ofgem's support of energy transaction MARs at ED2 and the CMA appeal response, and is a missed opportunity to use current, real-world evidence in the energy sector to test the CAPM implied cost of equity.

Real-world evidence of energy transactions over the last four years has shown significant premia being paid for network acquisitions. The below Market-to-Asset ratios show premia of between 25% to 70% consistently being paid across at least six transactions:

Energy transactions between 2021 and 2024

Transaction	MAR	Date
Western Power Distribution	1.61 ⁶⁶	2021
SGN	1.35 ⁶⁷	2021
National Grid Gas Transmission	1.30 ⁶⁸	January 2023
SSE	1.70 ⁶⁹	2022
National Grid Gas Transmission	1.25 ⁷⁰	July 2024
ENWL	1.60 ⁷¹	2024

⁶⁶ National Grid, [Proposed acquisition of Western Power Distribution and Strategic Portfolio Repositioning](#), March 2021

⁶⁷ Utility Week, [Analysts surprised at SGN premium](#), August 2021

⁶⁸ Utility Week, [National Grid sells further 20% stake in National Gas](#), July 2023

⁶⁹ EV for 25% stake: £1.47 bn. 100% implied EV: £5.88bn. RAV: £4.16 bn. From: Financial Times, [SALE OF 25% STAKE IN TRANSMISSION BUSINESS](#), November 2022

⁷⁰ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, p.65.

⁷¹ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, p.65

We agree with Ofgem's assessment within the RIIO-3 draft determinations that: *"it is difficult to accept that large MAR premiums can be justified by assumptions other than higher than required returns or lengthy and consistent expected outperformance."*⁷²

It would be irresponsible of Ofgem to not explicitly take these transactions into account and use them to generate a MAR-implied cost of equity as a cross-check at ED3.

We would also like to highlight a potential issue with Ofgem's ED2 MAR implied cost of equity model.⁷³ The model includes an "expected outperformance" assumption of 1 - 2%. However, MARs are already driven by expectations of future regulatory returns, so assuming additional outperformance embeds higher implied returns. We suggest that this outperformance assumption is removed from the inference model.

OFTO

Whilst the returns required by investors in new OFTO projects provides a useful measure of current investor requirements, the IRRs set by equity investors do not provide a directly comparable benchmark for regulated energy companies, not least because of the differences in gearing and beta assumptions. Ofgem recognised and acted on this at ED2:

*"we have conducted further analysis of OFTO IRRs to make them more comparable with a cost of equity at 60% notional gearing."*⁷⁴

At ED2 the unadjusted OFTO implied equity IRR was 4.4%, but the adjusted OFTO implied cost of equity, which is more directly comparable, sat lower at 3.1%. However, at RIIO-3 DD Ofgem went against this approach and did not include an adjusted, more comparable, OFTO cost of equity estimate. This undermines the principle of regulatory predictability and stability. We recommend that Ofgem

⁷² Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), July 2025, p.64.

⁷³ Ofgem, [RIIO-ED2 Draft Determinations – Finance Annex](#), August 2022, p.44

⁷⁴ Ofgem, [ED2 Draft Determinations](#), June 2022, P.46.

includes an adjusted OFTO cost of equity estimate that is comparable to network gearing levels in ED3.

Investment manager TMR forecasts

At RIIO-2, in addition to the unadjusted Investment managers' TMR cost of equity, Ofgem calculated an adjusted Investment managers' TMR cost of equity with 0.9 equity beta. Albeit with an implausibly high equity beta which was inconsistent with the beta assumption of 0.72 used for the CAPM cost of equity derived from historical TMR data. Similarly, at ED2, Ofgem included an adjusted investment managers' TMR cost of equity. However, at RIIO-3 DD, Ofgem departed from this precedent and did not include an adjusted Investment managers' TMR cost of equity. This again undermines the principle of regulatory predictability and stability. We recommend that Ofgem include an adjusted Investment managers' TMR cost of equity, using a plausible equity beta, i.e. significantly lower than 0.9, for ED3.

infrastructure fund implied equity IRRs

We have previously commissioned research which has shown that, in general, the required returns from regulated utilities are amongst the lowest of all infrastructure sectors – which would imply a lower than average beta.⁷⁵ At RIIO-2, Ofgem acknowledged that “*we have not attempted to present IRRs on a risk-adjusted basis, and hence acknowledge asset or financial risk could impair comparability among funds and/or direct applicability for RIIO-2.*”⁷⁶ Ofgem should take this into consideration when interpreting infrastructure fund implied equity IRRs at ED3.

FQ12. Do stakeholders agree that our proposed allowed return on equity ensures the investability of the sector?

We are unsure as to what “proposed allowed return on equity” this is referring to.

⁷⁵ Citizens Advice, [Ofgem consultation on RIIO-2 Draft Determinations Finance Section](#), 2020, P.37.

⁷⁶ Ofgem, [RIIO-2 Draft Determinations – Finance Annex](#), 2020, paragraph 3.96.

We do not support the introduction of the term ‘investability’ in addition to ‘financeability’. If companies are able to finance their activities in part through raising equity, then they have been deemed investable. There is a risk that the introduction of the term ‘investability’ risks being a construct designed to justify additional returns for companies. We believe this could significantly undermine public trust in regulated networks and the regulator.

It is our view that the sector is highly financeable (and by extension “investable”). The real-world MAR evidence demonstrates a premium relative to the regulated asset value being paid in energy transactions. Regulated, monopoly energy networks are low-risk investments that offer stable, inflation-linked returns compared to regular equities, making them attractive to long-term investors. Investor appetite has always been strong for regulated utilities, and growth of the electricity sector is an opportunity for investors due to the expanding RAV base. Although we have seen no evidence of this, even if rates of returns are not attractive to current investors, it’s highly likely there will be investors for whom they are attractive. This means raising new equity is a risk to companies’ share prices and not to consumers. We have seen no evidence that there is any material risk of failing to attract sufficient investment, and any claim about insufficient investability should only be made with compelling evidence. No decisions should be made on the basis of ‘investability’ concerns if the risk is only hypothetical, not material.

It should also be noted that the discretion network companies have over whether to invest is limited. The price control sets clear deliverables and the licence sets clear obligations. If, in an extreme situation, companies are genuinely unable to raise capital, Ofgem has already been clear that it has the tools to manage this scenario.⁷⁷ Providing extra funding to manage a theoretical risk that doesn’t appear to exist in the real world, and for which the ultimate consequences are limited, isn’t in consumers’ interests.

⁷⁷ Ofgem, [GEMA response on Finance Issues and TNUoS](#), Para 257.5

Debt Financeability

FQ17. What evidence, if any, should Ofgem consider in relation to expanding its assessment of financeability?

We note that the financeability position of a number of the network companies has been substantially improved through the RAV additions realised through the inflation-related windfall during RII02. Also, Ofgem made minimum expectations around how this windfall should be distributed explicitly clear.⁷⁸ Ofgem should now demonstrate the impact on financeability of the windfall and confirm whether any changes to distribution policies have been made that affect this financeability assessment.

Depreciation

FQ20. Do stakeholders have views on our application of asset lives for ED3?

We note that DNOs have highlighted that the transition from 20-year to 45-year asset lives could cause a drop in annual cash flows in future price control periods, due to declining revenues from the shorter-lived asset base while revenues for the longer-lived assets gradually increase.

As noted in our response to FQ17, the financeability position of a number of the network companies has been substantially improved through the RAV additions realised through the inflation-related windfall during RII02. Ofgem should confirm how the windfall has improved financeability and whether this offsets any potential issues from the 20 - 45 year depreciation transition.

FQ21. Do stakeholders have views on depreciation methodologies that could be adopted for ED3?

We support Ofgem's principle of ensuring intergenerational fairness when setting the rate of depreciation. We agree that different generations and types of

⁷⁸ Ofgem, [Call For Input - Impact of high inflation on the network price control operation – Conclusion and Next Steps](#), August 2023, Para 3.6

consumers should pay network charges broadly in proportion to the value of the services they receive.

To maintain regulatory predictability and stability, compelling evidence should be required to move away from established positions, for instance, the use of straight-line depreciation. If Ogem is considering other methodologies, evidence on the case for change should be provided, and the impact on consumers and any implications for intergenerational fairness should be made clear.

FQ23. Do stakeholders have views on technical asset lives and depreciation periods?

We do not agree that depreciation policies should be considered against other measures that could adjust network cash flows such as the proposed implementation of Inflation Option 1 as set out in Chapter 2. Inflation Option 1 is designed to correct a distortion in the price control, namely, companies earning a windfall gain from the mis-match between debt allowances and debt costs under periods of high inflation. It is therefore not conceptually correct for networks to treat that windfall as part of their baseline cash flows necessary to sustain the business. If a network company has become reliant on the windfall for liquidity, it is evidence that the windfall distorted expectations, not that depreciation policy needs to be changed.

Depreciation is a cost-recovery schedule intended to reflect economic asset lives and intergenerational fairness, not a liquidity tool. Networks have means to manage cash flow, including financial structure, working capital management, short-term liquidity tools and dividend policy. These mechanisms should operate independently of windfall corrections. If the removal of a windfall creates pressure on cash flows, this indicates an over-reliance on temporary gains rather than an issue with depreciation design.

Return Adjustment Mechanisms (RAMs)

FQ26. Do stakeholders have views or evidence as to why RAMs should or should not continue?

Protection, for both consumers and companies, against materially different sector performance than expected is important and should be continued.

Ofgem should consider whether introducing an Outturns Adjustments Mechanism⁷⁹ (OAM), as included by Ofwat in the water sector, is a better mechanism than RAMs. An OAM has clear advantages over a RAM as it can ensure returns are consistent with expectations and so maintain public confidence.

Nevertheless, we recognise RAMs limit the exposure of both consumers and companies to a poorly calibrated price control. Both of these effects should be of benefit to consumers. However, as the RAM changes the risk structure of the companies for shareholders it can be expected to, at some level at least, reduce the equity beta of the companies.

This needs to be either taken into account explicitly in determining beta or as further support for adopting value towards the bottom of ranges when assessing cost of equity.

FQ27. Do stakeholders have views or evidence as to whether the RAMs methodology should be amended, such as recalibrating the threshold or rates or including financial performance?

We note Ofgem's position at RIIO-3 SSMD that it would not be in consumer interests to include financial performance when calculating RAMs.⁸⁰ Ofgem argued that whilst unexpectedly high returns can occur due to information asymmetry between themselves and the networks companies when setting totex levels and incentives, since the cost of debt is set with reference to external, outturn indices there is not the same level of asymmetry in relation to financial performance. Ofgem further argued that using a notional structure to set allowed returns on capital, means the risks and rewards of financing decisions sits with companies, not consumers. It was Ofgem's position that were

⁷⁹ [Ofwat PR24](#)

⁸⁰ Ofgem, [RIIO-3 Sector Specific Methodology Decision – Finance Annex](#), July 2024, p.194

financial performance included in the RAM, consumers may share in the benefits of financing outperformance, but also the risks of financial underperformance.

However, the £3.9 billion financial performance windfall that networks received did not arise from companies taking on risk in their financing decisions, but was a systematic uplift due to the regulatory design of setting debt allowances. Further, whilst Ofgem argues that a notional WACC insulates consumers from company-specific financing decisions, it does not protect consumers from systematic mis-specification of the debt allowance. For example, whilst the introduction of RAV-weighting improves alignment with deployed capital, it does not completely eliminate the potential for the notional allowance to over or under-estimate actual market debt costs. Further, the notional allowance can still over-estimate market debt costs for prolonged periods due to factors such as index selection, timeline or lag structures, or the treatment of historical, new and inflation-linked debt.

Whilst Inflation Option 1 addresses one source of windfall for networks, other areas remain unaddressed. For example, companies may still benefit from CPI-indexed debt because the RAV is indexed to CPIH, which has historically run around 0.4% higher than CPI. This mismatch means the notional allowance for debt is slightly overstated relative to actual debt costs, creating a windfall gain for networks.

We agree that consumers should not have to bear any risk associated with company financing decisions, however, a RAM could be designed to specifically include regulatory-induced financial performance, or systematic out-performance rather than individual deviations. One such approach could be to replicate Ofwat's introduction of an Outturn Adjustment Mechanism (OAM) at PR24.⁸¹ The OAM adjusts equity returns for systematic over/underperformance. Specifically, if the median company's realised RoRE falls outside a ± 50 bps deadband around the baseline allowed return on equity, Ofwat applies an adjustment to all companies equal to the difference between the median

⁸¹ Ofwat, [PR24 final determinations - Aligning risk and return appendix, December 2024](#), pp.15-18.

company RoRE and the ± 50 bps threshold. We would be interested in Ofgem considering such an approach for ED3.

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