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PRESENTED BY:

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JONATHAN BREARLEY: Welcome to the RIIO-2 final determinations investor call. I see from different videos flashing up many familiar faces, so I just want to say hello to all of you first of all, and thank you for taking the time to talk to us about the final determinations.

For those who don't know me, I'm Jonathan Brearley, Ofgem's CEO. I am joined by Akshay Kaul, Director of Networks, and Simon Wilde, Director for Analysis and Assurance. I should say congratulations, Simon has just started his job as Director of Analysis and Assurance.

Thank you to everyone for joining this call today. You have had some time to go through our final determination, so I would like to use this opportunity to talk in more detail about the decisions we have made and to answer some immediate questions you might have.

Now, I do want to say one thing upfront and I do want to reassure all of you. There's been a lot of debate in this process about the focus of Ofgem as a regulator on near term costs as well as on how we think about Net Zero, and what I want to say upfront is that, as well as thinking about customers today, we as a board and an organisation are passionate about getting the investment we need into the system to get to Net Zero and we are fully behind a green economic recovery in the UK. So, when we think about that final determination, we really have focused on what is the right balance between investors and customers, not only to deliver for today but also to get us on that path towards Net Zero.

Akshay will take you through the first part of the presentation and then Simon the second part, then we will open up to your questions. So, over to Akshay.

AKSHAY KAUL: Thanks, Jonathan, and good morning, everyone, or good afternoon or good evening, depending on where you are in the world. Many thanks for joining us today and for engaging with the RIIO-2 process to date.

For those on the phone as opposed to in the Teams meeting, you will need to open the slide pack yourself from our website, I think Aidan has sent the link to the slide pack in the invitation to this call, so I hope everybody has access to the slide pack.

For the questions that Jonathan mentioned at the end, for those in the Teams meeting itself, please use the 'raise hand' function, I will come to you for questions. For those that have dialled in on the phone, you will need to send Aidan an email to say that you want to ask a question and we will say your name to invite you to speak after the first tranche of questions from the Teams attendees have been dealt with.

Okay, so our final determinations, as Jonathan mentioned, are putting into practice the overall aims of RIIO-2, and that is to prepare the network companies to deliver Net Zero at the lowest cost to consumers while maintaining a system with world class reliability and customer service and making sure no one is left behind by protecting those consumers who find themselves in vulnerable situations.

The design of the price control enables both upfront funding and in-period funding to be provided as and when it is needed in whatever sector it is needed to achieve these outcomes. In so doing, we are also resetting investor returns to be in line with market evidence and stretching the companies to be more efficient and innovative in how they run themselves.

You might recall that three principal lines of debate emerged with the industry immediately following our final determinations in the summer. These were as follows. First, we had proposed cutting the company spending plans by about £8bn, and they complained that this would not provide sufficient funding for them to run a safe and reliable system. Second, we had proposed an adaptive price control with significant potential to inject additional funding through reopeners to respond to policy decisions on Net Zero. Although this was widely welcomed, industry worried that these reopener mechanisms would be too slow. Third, we had proposed allowed returns of just under 4% while companies were seeking returns between 5 to 6.5% in real terms.

In the next few slides I am going to provide an update on where we have come out at final determinations on these three lines of debate and then I will hand over to Simon who will take us through the detailed finance proposals which I know will be of particular interest to this audience.

I am on slide 6 now, which deals with the totex gap. As I mentioned, there was around an £8bn difference between us and the industry at draft determinations, and we have closed roughly half of that gap at final determinations. This closure of the gap has been caused by two things. Firstly, we have significantly improved engineering justifications that have been provided by the companies for capital expenditure, replacement expenditure and IT, and improvements made to the data and modelling. which compared one company with another. following the responses to draft determinations. This has been a really positive response from the industry to the challenge on evidence and justification that we had set out in the summer. The companies responded to our ask for greater quality of evidence and they have better justified significant areas of spending, particularly on asset health. Therefore, the volumes of work and, in consequence, the associated revenues, have shifted upwards between draft and final determinations.

We have also listened carefully to the evidence on the efficiency challenges for companies in draft determinations. These are slightly lower than those that we proposed in July, but still represent our view that the sector should increase its ambitions on efficiency from RIIO-1. There has been a slight reduction in the ongoing efficiency challenge, a 0.1% reduction from 1.3% to 1.2% in the gas distribution sector. We are still proposing the 85th percentile as the efficiency frontier, but we are proposing to adopt a glide path to that 85th percentile rather than applying it from day one of the new price controls.

Overall, however, the tougher efficiency challenge compared to RIIO-1 remains, which means that the relative reductions vary across the companies. For instance, there are relatively small gaps between us and NGN and Wales and West Utilities. There are moderate gaps for Scottish Power, for SSE, for Cadent and for SGN, and there are more material gaps for NGET and NGGT. So, that's the picture on the totex gap from draft to final determinations.

The second line of debate was the uncertainty mechanisms and the speed of these reopener mechanisms. As I said, they will play a much more significant role in RIIO-2 than they did in RIIO-1, and we took very seriously the industry's critique that we needed to improve the agility of these mechanisms. Indeed, we have worked very collaboratively with them and with other stakeholders across the summer and autumn period to improve the package of reopener mechanisms.

As a result, we have done four things that I wanted to highlight in my remarks. Firstly, we have put more Net Zero spend in the baseline itself, in the upfront baseline itself, that £30m package has more pre-construction funding for the big schemes like the Eastern HVDC link, and more project development allowances for companies to develop new ideas on Net Zero to put into the reopener process so they are not waiting around for the regulator's approval to do so.

Secondly, we have automated more of the mechanisms. We already had volume drivers for connections, but to that we have added an automatic mechanism for medium sized grid upgrades for National Grid Electricity Transmission.

Thirdly, for the administrative mechanisms which deal, for instance, with the large projects, we have constructed a streamlined approval process with a pipeline that will be formulated between us and the industry, a tiered and proportionate system of approval so that simpler schemes can get approval very quickly under a fast-track process and more complicated schemes take a bit more time, with an overall aim to get all the approvals on average done within nine months and to gate the approvals where necessary, particularly where you have long gestation projects that take three or four years to get through planning and consenting and construction. We want to provide staged release of the funding so companies can make the right decision in a timely way.

Fourthly, and very importantly, we are speeding up the cash flow from the time that we approve a reopener submission to the revenue reaching the companies. Currently, it takes more than two years for that to happen and we are going to change the process so that they get the revenue within the same year in which the reopener applications are approved.

It is worth re-emphasising the point here that at draft determinations we said that we expected – I think I used the phrase more likely than not – that outturn total expenditure in RIIO-2 would exceed outturn total expenditure in RIIO-1, and I think, if anything, we are more confident than we were at draft determinations that that will be the case. RIIO-2 essentially is a growth story from an expenditure and Net Zero perspective.

I am now on slide 8, and the third line of debate was on the cost of capital and rates of return. Simon will break down the three parameters in detail when he takes us through them, but I want to just address upfront the allowed return on equity.

We have assessed the cost of equity for energy networks to be 4.55% and set allowed returns at 4.30%. This is driven largely by revaluation of the notional equity beta which compares the relative riskiness of energy networks compared to the market. We have also retained the distinction between expected returns and allowed returns with a 25 basis wedge between the two, which is the same size as proposed at draft determinations, because we still expect the average company to outperform RIIO-2. However, we have materially strengthened this fail-safe protection that we introduced at DDs, so we are in effect now guaranteeing 0.25% income from incentives at a licensee-specific level. That means that investors can expect to earn 4.55% from network companies in RIIO-2 if they perform in line with expectations.

In between draft determinations in July and today, we have also seen the CMA's provisional findings for the PR19 appeals. Those provisional findings set a WACC allowance using an allowed equity return of 5.08%, which included 20 basis point uplift for the retail margin in the case of the water companies. The mid-point of the CMA's range for the water companies was roughly 4.55% for the water company as a whole, and if we subtract the retail margin, that gives a mid-point for the networks element of the water sector of about 4.35%. They then of course go on, as you probably are aware, to aim up by about 50 basis points to set the water networks number.

One important area where there is a difference between our final determinations and the CMA's provisional methodology is that we have considered their arguments and reasoning and concluded that we don't think it is necessary to aim up within the range for the cost of equity to attract the investment that is needed for RIIO-2. We have explained the reasons for this in detail in the final determination documentation, particularly in the finance annex, but I would be very happy to go into this aspect further on this call when we get to the Q&A.

There have also been some key incentive changes to final determinations. The sharing factor for transmission, for instance, where notably Scottish Power has had an uplift from 39% to 49%, a lower downside on the ODI range, so that the incentives in terms of maxima and minima are better balanced, and on the business plan incentive more companies are now earning rewards and fewer are earning a penalty due to the significant improvement in the evidence base between draft and final determinations.

Finally, investors often want to know how the best performing companies will fare in price controls. On this, our expectation is that the gas distribution companies that outperform their quality of service targets to the level of the cap and underspend by, say, 10% against the baseline totex allowances could expect to outperform the baseline allowed return by about 150 basis points. This is the same number that I communicated in draft determinations.

On the transmission side, the companies that outperformed the quality of service targets to the level of the cap and underspend by a similar 10 percentage points against baseline totex allowances could expect to outperform the baseline allowed return by about 120 basis points on average across the four licensees. This is a noticeable increase from the proposals at draft determinations where we had indicated 100 basis points was a reasonable expectation in this scenario.

So, overall, we think these determinations offer a better alignment of interests through RIIO-2 between the customers, companies and their investors. They ensure that we will have a fair settlement to deliver what is needed for Net Zero but at a fair price for consumers.

I hope that was a useful summary of the proposals, and I'm now going to hand over to Simon who will talk us through the key finance proposals in greater detail.

Over to you, Simon.

SIMON WILDE: Thank you, Akshay, and just to reiterate Jonathan and Akshay's welcome to everyone, and we look forward to having a good discussion on the topics which are listed here on page 9.

Let me go to page 10 and talk about the cost of equity, if I may. So, details are set out here on slide 10. As Akshay has mentioned, for companies with a notional gearing of 60%, we are now proposing an allowed return of 4.30% in CPIH real terms and, remember, we were proposing 3.95 at draft determination.

How do we get there? We are using the same three-step approach that we explained at the methodology stage and again at draft determination, but with updates for market data and a couple of the parameters having received evidence in the consultation stage.

In step one, we use CAPM to estimate notional companies' cost of equity with the three key parameters that we are all very familiar with, the first being the risk-free rate which has moved down 10 basis points from DDs to -1.58% now. After considering the various consultation responses we had and the discussion on this topic in the PR19 provisional findings, both of which suggested that the use of index-linked gilts – and we used the 20 year index linked gilt – there was a suggestion that this could lead to an underestimate of the risk-free rate. We have decided to maintain our draft determination position, for a few reasons. First, we used some cross-checks and in particular we look at nominal gilts and we look at SONIA swaps, both of which suggest that the index-linked gilt number is reasonable. Secondly, we have taken on board a lot of academic evidence, particularly updated reports by Professors Wright and Mason, which supports the use of index-linked gilts. Then, finally, by using index-linked gilts but by, as you remember, recalculating the cost of equity on an annual basis, we will capture the risk that the cost of equity gets out of line because of movements in the risk-free rate. So that's the risk-free rate.

The second parameter is total market return where our range remains 6.25% to 6.75% in CPIH terms. That's unchanged, and I would note it overlaps significantly with the range used by the CMA in their provisional findings, albeit we are slightly lower, but I would say really quite close.

For unlevered betas, and I am going to talk a lot about betas now so I need to be clear here. So, by "unlevered beta" we mean the effects of the equity beta alone, so in other words, it is calculating the overall beta for a company but making the assumption that the debt beta is zero. In contrast, and when we use the term "asset beta", which is higher than unlevered beta, an asset beta is a combination of the unlevered beta plus the effect of having a non-zero debt beta. So I will try and be precise as to which beta I am using at any one time.

For unlevered betas, we had a figure of 0.30 at draft determination, and that number already included a number of listed European utilities as requested by the companies. Since then, we have looked more deeply at the betas of National Grid and SSE and the water companies. Following the companies' submissions we received and updating our market evidence, we are now placing slightly more weight on National Grid's observed beta. We still place weight on the water company betas, we think that they are a useful measure of market valuation of regulated UK networks, but we do agree with the submissions we received that systematically National Grid plc's beta does tend to be higher than the water companies. As a result, we have slightly increased the unlevered beta to 0.31. That's unlevered beta.

The next beta to talk about is debt betas where we made a downward adjustment to our debt beta assumption and, remember, we use this in our de-gearing and re-gearing process. We have moved the debt beta from 0.125 to 0.075, and in doing this and in combination with the unlevered beta, this does result in a slight decrease in the asset beta, you will see in the table, from 0.36 to 0.34, but the overall effect of these two changes, the increase in the unlevered beta and the different debt beta actually increases the really important parameter which is the equity beta and, hence, increases the cost of equity.

Pulling that together, as before when we used a 60% notional gearing, we end up with a slightly higher mid-point of our equity beta range with an increase from 0.72 to 0.76. Combining these three parameters, we come up with a cost of equity range of 3.85% to 5.24%, and that's a mid-point of 4.55%, as Akshay has indicated. This is up 35 basis points from the 4.20% that we had at draft determinations.

We still use the step two cross-checks, and I'm sure we are going to have a discussion about this and it's important for our overall picture in determining that we think that the 4.55% is an adequate number. These cross-checks wherever possible use market observable data. As you know, we have regard to a range of benchmarks and I will particularly focus on three things. One is the implied equity returns from listed stocks by looking at their enterprise value to regulatory asset base ratios. The second is the continued low returns that we have seen bid for other energy assets, such as OFTOs, where we see weighted average cost of capitals materially below the range that we are suggesting today.

Thirdly, we do look at the Modigliani-Miller approach that the CMA used in their provisional findings in the NATS appeal where they go directly to the observed betas and they assume that WACC remains broadly flat as a result of gearing.

All three of these measures actually imply a cost of equity below the mid-point of our CAPM range. If you remember at draft determination, on that basis we actually slightly reduced the cost of equity in step two. However, we have decided not to adjust the step one mid-point in step two. We are forming an in-the-round judgement that the CAPM mid-point of 4.55% is appropriate. Had we applied the cross-checks, we could potentially have gone to a number around 15 basis points below 4.55.

Then moving on to step three, which I know continues to attract a great deal of interest, as Akshay said, we continue to have an outperformance expectation based on our analysis of RIIO-2. As a result, we deduct this 25 basis points from the cost of equity. This is Ofgem's assessment of the potential information asymmetry effect when we formulate RIIO-2 as a price control. You will remember that at the methodology stage we were at 50 basis points. We then looked in detail at the RIIO-2 calibration and concluded 25 basis points was appropriate, and we have not changed our view on this based on the evidence that we have received.

That said, you will also remember that at draft determination we introduced an ex-post correction mechanism because we acknowledge we are estimating this information asymmetry effect with estimation error. At DDs, we proposed that this adjustment would be on a sector average basis. We have listened to feedback, particularly from companies and investors, and as a result any ex-post adjustment taking companies back up to their cost of equity will no longer be measured on a sector average basis, but will be specific to the licensee company. This gives even more protection, as Akshay has explained, and, again, as we pointed out at draft determination, remembering that this is a one-way potential adjustment that can only operate in the company's favour.

I should just say as a final comment on cost of equity that for the ESO we do have a higher asset beta, we have increased it from 0.45 to 0.55, reflecting its asset-light characteristics, and I am happy to talk more about the ESO in Q&A.

That was the busiest slide. We will speed up, so slide 11, here on slide 11 we cover a range of topics as you can see: cost of debt, depreciation, capitalisation and gearing. I will try to focus on the differences since the draft determination.

On cost of debt, we have increased the overall allowed cost of debt by eight basis points, so taking us to 1.82% in CPIH terms. This is as a result of us considering evidence for slightly higher debt issuance costs. We do, though, have a couple of differences between the companies. The first one is that we are inintroducing a small-company cost of debt premium. This recognises that our smaller networks are not able to issue benchmark sized bond issues every year in order to mirror our trailing average indexation, and we assess that as potentially costing them an additional six basis points, and this applies to our three smallest networks, so SGN Scotland to Northern Gas Networks and to Wales and West Utilities.

The second company-specific difference is that we are continuing to use a company-specific RAV weighted calculation for SHE Transmission, and that does solve for a slightly lower cost of debt allowance of around 1.6%, although I note that is still higher than their actual cost of debt.

The indexation mechanism remains as we proposed at draft determination, in other words these 1.82% costs will be recovered through a 10 to 14 year trading average, and the trading average we will use is the specific utilities iBoxx index. As we noted, this does remove debate about the so-called halo effect which we had to consider when we were using the more general corporate indices for A and BBB-rated bonds.

There was evidence submitted on this point that the average constituent rating within the utilities index has fallen over time. We are still content to use this index for RIIO-2, but we will monitor it to make sure it remains appropriate for RIIO-3.

When we combine the cost of equity and the cost of debt allowances, that gives a weighted return, a weighted allowed return on capital of 2.81%, so that's 18 basis points higher than the 2.63% we proposed at draft determination.

By way of context, a number of you very kindly participated in the process that was run by investor relations where we tried to understand what the analyst community's expectations were in advance of FDs. The average we had back from the survey on a cost of capital basis was 2.86%. So, that is slightly higher but it is within five basis points of the 2.81% that we're announcing today.

On depreciation, we have made no changes to the proposals at DDs, and just as a reminder, that means that there are no changes to the RIIO-1 position for electricity transmission or gas distribution, but for gas transmission we are bringing gas transmission in line with the position that we set out in RIIO-1 for gas distribution. So, the two gas sectors will be on a common basis, which is a 45 year sum of year digits, i.e. a slightly upfront weighted depreciation profile, and in both sectors we adjust totex levels going back to 2002.

Likewise, we have not made any major changes in our capitalisation approach, although, as Akshay has noted, the numbers do change as we have adjusted the mix of totex within the baseline allowances, and you can see the detail on table 17 in chapter 11 of the finance annex.

Finally, on gearing, as at draft determination we have determined a 60% notional gearing level for gas transmission and gas distribution. This is down slightly from the 62.5 to 65% in RIIO-1, and for electricity transmission, we have determined 55%, and this is obviously where two of the three ET companies are already. The reason for a slightly lower gearing level for the transmission sector is due to the potentially higher levels of investment from the reopeners that Akshay has just been describing.

Finally, as we did at draft determination, for those companies with a 55% gearing, we used the same overall weighted return on capital between the 60% geared companies and the 55% geared companies. We just adjust the mix of the cost of equity and the cost of debt so there is a flat WACC.

On slide 12, and again you have seen this before so I will be brief, you can see that the potential RoRE ranges from the overall package compared to RIIO-1 are lower on both the upside and the downside, and we continue to see the GD companies as having the potential to outperform by 150 basis points and, as Akshay has said, the average potential for outperformance in electricity transmission is probably slightly higher, probably around 120 basis points rather than 100 at DDs.

It is worth remembering that although the ODIs (the output incentives) do have slightly lower upsides than they have downsides, when we have calibrated them, we have set them in the expectation that companies have a fair chance of either outperforming or underperforming, so our intent is to set a fair bet, and history tells us that companies do outperform on average. As a result, and as we said earlier, we do expect companies to earn positive totex and ODI returns, and that's reflected in our cost of capital approach.

The final change, just to mention, and here there is a slight change, is that we still have a return adjustment mechanism. It is still symmetrical, so therefore protective on the downside as well as on the upside, and the original band for this kicking in at 3% outperformance still has the 50% sharing factor. However, we are introducing a new secondary threshold, plus or minus 4%. Outside of the plus or minus 4% bounds, a secondary adjustment of 90% rather than 50% will apply. The result of this will be to slow down any further over or underperformance, giving investors a greater degree of downside protection as well as slowing down upside performance beyond 4%.

The RAMs adjustmentwill be done at RIIO-2 close-out and therefore would be reflected in company revenues in RIIO-3.

On slide 13, my last substantive slide, on financeability, again there's relatively little change from our draft determination position. Whilst we don't target any one particular rating or one particular credit ratio, we do conduct this in-the-round assessment, and this suggests to us that the credit quality for the notional company remains consistent with being two notches above the minimum investment grade, in other words, broadly equivalent to BBB+/Baa1.

Our modelling work does assume that there is notional equity issuance for some companies, particularly in the higher RAV growth scenarios. But we think that is consistent with these scenarios and consistent with the role of equity in an environment where RAVs are growing relatively fast.

We have also included a whole series of various stress tests in the finance annex and, overall, we do view all notional companies as resilient. This table just sets out some of the key ratios, the adjusted interest cover ratio, FFO to net debt, and you will see that we test these ratios not just under our baseline investment levels, the levels consistent with the £30bn overall package, but we also look at what we call Net Zero 1, and then for the ET companies which could have to go even further for Net Zero 2, and our conclusion is that these ratios remain strong under all scenarios.

Then finally and wrapping up on slide 14, we have just set out a brief summary of some of the key financial changes between RIIO-1 and RIIO-2.

I will pause there and hand back to Jonathan, and we are happy to take questions.

JONATHAN BREARLEY: Great, thank you Simon and Akshay. We are now going to start the questions, so I am going to hand over to Akshay to co-ordinate this, thank you.

AKSHAY KAUL: Thanks, Jonathan. As you can see on the slide for this Q&A, given the format of this Teams meeting, we have two different approaches, as I said at the beginning, for asking questions. Let me just rehearse them again. If you are in the meeting itself, so you have video and you can see the slides live, please use the raise hand function in the Teams meeting and I will ask you individually to ask your question. If you are dialled in on the phone, to try and keep it orderly it is probably best to email Aidan at investor.relations@ofgem.gov.uk to say that you would like to ask a question and then Aidan will collate those, and I will call your name out and deal with the set of questions in one go after we have done a tranche of the ones from the Teams meeting. When I call your name out, you may well have been muted by the moderator, so you may need to press *6 to unmute on the platform and then ask your question, and you also may need to unmute yourself on your phone itself.

With those opening instructions, let's see if we have any questions. We have 235 attendees, so I am going to gradually make my way down the very long list of hands that has cropped up. Let's begin straight at the top with Alex Leng from UBS. Alex, please go ahead.

ALEX LENG: Hi, good afternoon, everyone. I hope you can hear me. Thanks for the presentation and the Q&A today. I had a couple of questions. First, I wanted to ask how you expect the uncertainty mechanism for Net Zero reopeners to play out in terms of potential additions and timeline for review. You have the Net Zero totex scenarios on slide 19. Some of the additional spend is quite large, nearly double the baseline in some cases, so it would be good actually to know what assumptions you have used behind that, so how you expect the process for that within the five-year control to play out. Could that basically mean revisiting some of the prospects not included today relatively quickly or is it likely to be heavily weighted towards the end of the control, and operationally how do you perceive the risk of bottlenecks or any delays?

Then a second question on the totex gap, and this is mainly a specific question related to National Grid as it has the largest. I believe a fair part of this appears to still relate to asset health spend, and I wanted to ask is debate around the justification settled here now? I think back in July you mentioned, if there was still evidence to debate or discuss, this could be brought up after final determinations in reopeners or what not. So, I wonder, from your perspective, does the determination today represent closing the book on the debate or whether it is based on insufficient evidence at this point but more could still be seen? Thank you.

AKSHAY KAUL: Thank you, Alex. Let me respond directly on the two questions. I think your first question was on the timing and scale of the reopeners and how that additional expenditure would flow through the controls. I think the short answer to this question is we don't know because the whole point of these uncertainty mechanisms is that the timing of the policy decisions that will unlock the need for this investment is currently unknown, but we expect that it will come through at some point in the RIIO-2 period. Of course, we wait in anticipation of the energy White Paper which will be the first salvo, but leading up to COP26 there will be a range of strategies and proposals coming out from government that in due course will require investment responses from the companies.

So, we think the exact timing is difficult to settle, but probably towards the early to the mid-part of RIIO-2 there will be a need to fund a lot more project development and early construction activity beyond what we already put into the baseline, and then towards the back end of RIIO-2 those projects will start to fructify into actual construction and operations.

There is also some of the very large anticipatory investment schemes that might come through the Net Zero reopeners, and I just wanted to again paint a picture, highlight a couple that will be significant but again where the timing is impossible to settle right now. The first is the East Coast upgrade where we are working together with BEIS and the industry to see if we can come up with an integrated onshore/offshore design for the expansion of the grid to support 40 gigawatts of offshore wind in the North Sea. There's a lot of work to do on that front. When exactly we are in a position to have submissions from the companies and input the funding, we don't know at the moment, but we will know hopefully not too far into the future.

The other one I wanted to mention was EV charging. There is a very big initiative to provide high-speed charging across the motorway service stations, and again we expect that there will be a transmission and distribution component to that. ED2 of course is two years later, but for the transmission element we fully expect to use the Net Zero reopeners to fund that sort of intervention.

Alex, your second question was about the totex gap and in particular on National Grid, and you were asking whether that still reflects a non-closure of the book on asset health. I think the first thing to say is that the response from the industry as a whole and National Grid in particular from the engineering perspective has been really, really strong and really, really positive, and their teams have put forward a huge amount of additional compelling evidence, and there is largely an engineering alignment now between Ofgem, the regulator, our engineering team and the engineering team at National Grid on what work is needed in the next five years to keep the system safe and reliable. I think that is a really, really positive outcome for consumers.

To the extent that there remains a gap, some of it is because the projects are uncertain and some of it is because even in the original spending plans, National Grid had put forward proposals for projects that span but go into RIIO-3 that are not necessarily needed in the RIIO-2 period. But, by and large, there is engineering alignment and therefore I am optimistic therefore that part of the book has been closed.

Let's go on to the next question then from Deepa Venkateswaran. Deepa, please go ahead.

DEEPA VENKATESWARAN: Thanks, Akshay. My two questions, firstly on the 4.55 versus the 4.3, and you explained it quite nicely that you are in effect giving someone 25 basis points of outperformance, but equally you are also not incentivising someone to push the boundaries, say, if they were on the borderline. I was just wondering, isn't it simpler to give an allowed cost of equity of 4.55 headline rather than this rather long-winded way, particularly if investors are comparing allowed returns in the UK versus other countries? That was the first question.

The second one to Simon is I just noted that the capitalisation ratios have changed for some of the entities, particularly the National Grid entities in gas transmission. So I was just wondering what is behind that, is that just a function of the cost of equity now going up and therefore you needing less capitalisation adjustments, or was there something else behind that? Thank you.

AKSHAY KAUL: Thank you, Deepa. I think, Simon, you could probably take both of those.

SIMON WILDE: Yes, certainly, why don't I do that. So, you raise a really good question, Deepa, on the 25 basis points when there is this company-specific adjustment. It does technically mean that the company's marginal incentive to outperform if they are between zero and plus 25 basis points, that is blunted, and we discussed this trade-off at our draft determination phase and we discussed it in the finance annex.

The reason we have made the change is that the companies tell us on balance that they would rather have the certainty than the incentive effects, but I think, more importantly than that, I think most companies are going to set themselves ambitious outperformance targets that will go beyond 25 basis points and, therefore, so long as they can see the potential on totex and ODIs to go beyond 25, they are still fully incentivised to do the first 25 in order to get there.

The reason that we haven't just gone straight to the cost of equity, I think it is an important philosophical point. We believe we are setting the price control with information asymmetry and, therefore, we believe that a certain amount of the outperformance arises not from innovation and from effort, but as a result of information asymmetry, and as a result we think it is fair that that element is not rewarded, whereas if we did what you recommended, Deepa, then they would get the 4.55 and then they would also get on top of that 4.55 all of that outperformance, whereas what we are saying is, actually, we think the first 25 basis points is unearned, it is as a result of information asymmetry. This is in line with our point about wanting, in the long run, there to be a pull on the cost of capital and not to be baking structural outperformance. So, it is more complicated, I agree, but it is still there for a very specific reason, albeit with this protection.

Then on the capitalisation rates, I think that's a shorter answer, which is that because we have pulled some additional investment, and particularly capital investment projects from the uncertainty mechanisms into the baseline, we continue with exactly the same approach, which is that we set a natural capitalisation ratio for the baseline that reflects the genuine underlying mix of opex and capex, and so there has been absolutely no adjustment to those capitalisation ratios for the baseline for financeability, and in fact, if you look at the ratios, I would argue that both the grid companies have got a bit of a buffer and so we don't think we need that.

DEEPA VENKATESWARAN: Thank you.

AKSHAY KAUL: Thank you, Deepa. Could I just ask participants, after you have asked your question and you don't have a further question, do take down your hand because with 235 attendees it is going to be become very confusing to keep track of who still wants to ask a question and who still has an old hand up, if you follow my meaning, that would be great, thank you.

Let's move on then to Mark Freshney from LRYB, which I don't think is the firm name. Anyway, Mark, go ahead.

MARK FRESHNEY: Good afternoon, Mark Freshney from Credit Suisse. Thank you for taking my call. Three questions, if I may.

Firstly, on aiming up, which is something you evidently disagree with but there is a lot of uncertainty on future investment in this sector, and particularly, I guess, the distribution companies will likely see higher spends if we get to Net Zero, and of course the Prime Minister's announcement of the 68% target for 2030 just reinforces that, so why would Ofgem not look to aim up?

Secondly, on the RAMs, putting a cap at around about just above 7 with 50% sharing and then a very aggressive 90% sharing, 100 bps above that, it seems to me as if most companies, if they are going to run their businesses efficiently, they may as well just sit at just below the RAMs. If you get that, surely that is almost a disincentive for the industry to be more efficient and elicit more information that would ultimately get costs for consumers down.

My third question is just on Net Zero 1 and 2. Can you go through those scenarios, just broadly what they entail?

AKSHAY KAUL: Okay, thank you, Mark. Let me start by actually bringing in Jonathan on the question of the return adjustment mechanisms and then I will come in on the aiming up and then turn to

Simon for your Net Zero 1 and 2 question, Mark. Jonathan, do you want to come in on the return adjustment mechanisms.

JONATHAN BREARLEY: Sure. I think we are trying to achieve a balance here and we are very cognisant that last time price controls had been set, they have not always turned out as the regulator and indeed investors expected at the start of the process. Part of our experience, Mark, has been that work sometimes is not avoided but delayed into a further period, and therefore you create this slightly odd dynamic for companies between different time periods for the price control. So, the philosophy behind this is to make sure we get a balanced package, we make sure we get the investment in place, but that doesn't go outside of the early expectations of where we are, and it is borne out of the experience we have had over the last few years. You will remember, when we talked to companies about voluntary returns, one thing they asked us for was a clear account of the rules upfront so it was clear what we would do in circumstances where things didn't turn out the way we expected, and that is what we have put in place here.

Coming back to your question, what you often find is when there are marginal choices, there are good things you can do with funding to maintain asset health and make sure the system is resilient in the future.

AKSHAY KAUL: That's great, thank you, Jonathan. Mark, your second question was on aiming up, which I agree is a very important aspect that has come up since the CMA's provisional findings in the water sector, and I did make a mention of this in my opening remarks. I think the question that we asked ourselves after we read the CMA's provisional findings is: is there a need to aim up on the cost of equity in order to secure the investment that we think is necessary, particularly from a Net Zero perspective in RIIO-2? Let me just walk you through the three or four reasons why we thought that it is not necessary.

First of all, one reason to aim up could be that we are estimating underlying risk-free rates, interest rates with error, and you want to allow for some changes in that underlying risk-free rate environment, changes in financial market circumstances as you go through the next five years. We don't think it is necessary for RIIO-2 because we are indexing the RIIO-2 cost of equity to risk-free rates, and the cost of equity number will just move in line with changes in financial circumstances.

The second reason you might worry about aiming up is if you think that there will be other changes to wages or the prices of construction materials, etc, and therefore companies might get underfunded for that reason. Again, we don't think there's a need to aim up in that respect because we are indexing the prices of wages and construction through the so-called real price effect allowance.

The third reason you might aim up is because you are worried that you set a price control and then you forget about it for five years, and then what happens if companies need to put in a lot more money to respond to policy shifts, will investors be incentivised to do that? Again, we don't think we need to aim up to secure that investment precisely because we are putting in this architecture, very significant architecture of reopeners to inject the additional funding when and where it is needed at whatever time it is needed.

The fourth reason that you might want to aim up is because you might worry that the cost incentives are too strong and they might cause companies to underspend and therefore degrade the quality of service to customers. Again, we don't think there is a need to aim up in RIIO-2 because we set the quality of service targets and licence obligations that protect consumers from any such wasteful or harmful underinvestment.

So, those are the four reasons, but let me turn also to Simon, if you want to come in and add anything to that list of four.

SIMON WILDE: All of those are right, I think, and therefore we are in a very different space to some of the theoretical models about aiming up. What I would say is that the greater our ability to benchmark returns and cross-check the admittedly theoretical CAPM result, the greater the confidence that we should have in that number, and that's why I spent some time talking about our "real world" cross-checks which I think gives Ofgem greater confidence in believing that 4.55% is adequate and arguably is in excess of the average benchmarks, a number of which are materially below the 4.55.

Then if I can just turn to the Net Zero 1 and Net Zero 2 question. So, you will see, Mark, from slide 19 in the appendix that Net Zero 1 is essentially an extra £5bn and Net Zero 2 is an extra £10bn. The Net Zero 1 is very close to the illustrative case that we had at draft determinations, and these were projects which were reasonably well identified but where the needs and the cost was not yet fully certain. The illustrative case in DDs was a slightly higher number, but we have moved some of those costs into baseline, so Net Zero 1 is very similar to the approach that we were taking at draft determination.

We did get observations from both companies and investors that the electricity transmission companies may need to go a lot further, for example, with additional network reinforcement for renewables or a real acceleration on the EV side, and that's why we looked at this case where there could be an extra £5bn on those ET companies.

MARK FRESHNEY: Thank you very much, thank you.

AKSHAY KAUL: Thank you, Mark. Our next question comes from Maria Fassakhova. Maria, please go ahead.

MARIA Fassakhova: Hi. Good morning, everyone. I just wanted to ask for a clarification on the 25 basis points extra return on equity. How will this be made in practice if the company, let's say, outperforms on part of the price control and underperforms on the other part? So, do you take into account totex, ODIs, financing, tax? Do you take into account whether this is controllable or uncontrollable, you know, whether the severe weather events are included in this? Yes, if you could, thank you.

AKSHAY KAUL: Simon, do you want to come in on that?

SIMON WILDE: Yes, certainly, Maria, thanks for that question. So, it's designed to cover outperformance or underperformance specifically around the totex incentive mechanism and the output delivery incentive, so TIM and ODIs. It is not designed to cover financing and it is not designed to cover the BPI, and the reason for that is that the two operational measures are much more associated with the notional company, whereas the other two measures on financing and BPI are much more actual-related. Our approach on BPI is that the notional efficient company could have had an expectation of zero on the BPI, so it's just those two measures, Maria.

MARIA Fassakhova: Could I ask for a follow-up here. Let's say if a company outperforms on ODIs but underperforms on totex and just achieves a baseline RoRE, would it still be adjusted upwards?

SIMON WILDE: We will look at the net position. So, let's just take an example. If a company was up 20 basis points on TIM and -10 on ODIs, then it would be up 10 on a net basis, but that's less than the 25 and so would then receive a 15 basis point adjustment in RIIO-2 close-out to take it to the full 25.

MARIA FASACOLA: Okay, thank you.

AKSHAY KAUL: Thank you, Maria. Our next question comes from Elchin Mammadov. I hope I have pronounced your name correctly. Elchin, please go ahead.

ELCHIN MAMMADOV: Thank you for taking my question. Elchin Mammadov from Bloomberg Intelligence. I have two quick ones. The first one is the appeals process. If a company appeals, what sort of timelines are we talking about? Obviously, we know it might happen after February, but what are the cut-off periods and stuff like that, if you can talk a little bit more about that.

The second one is how is the preparation for RIIO ED2 coming along? I think the business plans are due next year. Are we expected to see such a high range of uncertainty on totex, or we will have greater certainty because we will have the White Paper and what not, so if you can talk a little bit more about that, that will be great, thank you.

AKSHAY KAUL: Thank you, Elchin. Those are really, really good questions. On your first question about the appeals process, we will start consulting on the licence amendments to implement these final determinations probably next week, and then direct the changes to the licences in the early part of February, and then the companies have until early March to decide whether or not they want to appeal any aspects of the licence modifications to the CMA. As you mentioned, within that window, currently the CMA is expected to come up with the final decisions by the middle part of February, so the companies will know by the time the appeals has been done and where the CMA has come out on the water sector appeals.

The appeals process then takes over from April. It usually is about six months, and so in the normal course of events you would normally expect to get a decision from the CMA by, say, September, the end of September or October. I know that this year, when we went through the Ofwat process, because of Covid-19 the regulator allowed for another six months, so in fact a whole year was allowed to get through the appeals because of Covid-19, and the requirement for us all to get better at remote working. Now that we have all learnt from that test, one would be optimistic that one can go back to a six-month turnaround for the appeals.

Your other question was about ED2, which is actually something we will probably not spend a lot of time on today because there is going to be an announcement on ED2 on the methodology decision for ED2 later this month. I think the two main things I will say is, first of all, that, yes, Elchin, you are right that if we do get the White Paper and a lot of the underlying strategies in terms of heat strategy, building strategies, hydrogen strategies and so on coming out of government in time for the ED2 business planning that concludes at the back end of next year, then, absolutely, you're right, a great part of that process will be much better informed by policy certainty on those fronts.

I think it is also worth saying that we have definitely all learned some lessons as we have been through the gas and transmission controls and, again, I think ED2 will benefit from having been through this exercise once, and so one would expect that there would be a sharper engagement all round when we get to ED2.

JONATHAN BREARLEY: Can I just chip in, Akshay, on that question. It is really a philosophical point I want to make, Elchin, which is, look, the energy economy is changing fast and so we are signalling with this settlement that price controls are going to need to adapt in a way that they haven't had to before. Even if we do get a clear signal from the White Paper, even if we do get a clearer sense, for example, of how both heat and transport will evolve, it is unlikely to stop there, and so, if you plan out the timetable to 2028, then all sorts of things will happen and what we have to do is design price controls that can change as the economy around them changes.

AKSHAY KAUL: That's really helpful. Thank you, Jonathan. Our next question comes from Jenny Ping. Jenny, please go ahead.

JENNY PING: Hello, hi. A couple of questions, please. Just following on from Elchin's question in terms of the appeal process, can I just check, I know water's process is very different in the sense there is a whole package versus components, but can corporates, energy companies, actually select very specific, down to, for example, the performance wedge or down to a very nitty-gritty, can they go into that level or is it just challenge in general on WACC and anything related WACC? That is the first question.

Secondly, I note that you have updated part of the competition section in your document which, apologies, I haven't had the time to read in its entirety. Can you just outline whether there are any major changes in terms of how you perceive competition and obviously in the context of the uncertainty mechanisms and the big capex that is coming up. Thank you.

AKSHAY KAUL: Great, thank you, Jenny. On your first question about the nature of the appeals process, you are right, it is different. In the water sector it is a redetermination, so the CMA has to put itself in the position of the water regulator and redetermine the entirety of the price control for the appellant company. In the energy sector, it is a merit-based appeal system, so companies can take any particular issue, any particular decision in the price control package, and as long as it is material, I think materiality is one of the thresholds, and as long as they can show that the regulator was wrong in reaching the decision that they did, they can take that particular issue to the CMA, so there is that very distinct difference between the two regimes.

Before I go on to your competition question, does that answer the question you asked, Jenny, or is there any follow-up to that?

JENNY PING: Can you just say what the materiality is, is that normally 10% of turnover?

AKSHAY KAUL: You know, I don't think it is set quantitatively. I think it is just something that the CMA considers when they give permission to appeal, but let me check that with our legal team and I will get back to you on whether there is a quantitative threshold. That's a really good point.

Then on your question about competition proposals, I don't think there are any major changes in the final determination package. We are still anticipating, hopefully with the Energy White Paper and then an Energy Bill, getting powers to roll out onshore competition and to implement into the onshore sector the competitively-appointed transmission operation regime and the CATO regime. I guess the one thing that we have flagged is that we aren't implementing the competition proxy model into the licences at this particular point in time. So it is there on the table in case we think that it is better value for money for consumers to use it, then at the time we will direct the licence modifications to implement something of that nature, but it is not going through the licence modification process at this particular point in time. Other than that, there aren't any major changes to the competition proposals.

JENNY PING: Thanks.

AKSHAY KAUL: Our next question comes from Martin Young. Martin, please go ahead.

MARTIN YOUNG: Yes, good afternoon to everybody. A couple of questions, although the first one has two parts, and that's on the outperformance wedge. Simon has talked about asymmetry of information, but if I look at a company that has a TIM of 50% or near to 50%, you're basically saying that all of it is high confidence costs, and you yourselves define high confidence costs as being those that you are able to set independently of the network company themselves, and actually there is limited value in company cost forecast as a benchmark. So, in that instance, surely that is tantamount to you saying there isn't any asymmetry of information and that takes you on to the conclusion that actually – this is gas distribution that we are generally talking about here – that the idea of an outperformance assumption on gas distribution is somewhat flawed. I just wondered if you had some comments around that.

Then the second part of the outperformance wedge question is about the way that it ends up being calculated. You gave an answer to a previous question about it applying to TIM and applying to ODIs.

If we just look at TIM alone, if for example you had a TIM of 33%, does that mean that a company has to outperform on totex by 75 basis points before they get themselves into positive territory versus the ex-post adjustment that they would get if they did nothing?

The second question is around the CMA process. I would suggest that it probably serves nobody's interests, at least consumers' interests, to go to the CMA given that the CMA, even if they move from the 5.08% determination, provisional determination for PR19 in water, there is a fair chance that they are going to land above your 4.3%. I would say that energy is a more risky business than water and, therefore, if the CMA lands at 4.3 or above, then surely you are going to find a company going to the CMA because you, in energy, have the single item appeal process. How do you feel about the probability and the risk of somebody going to the CMA?

AKSHAY KAUL: Really good questions. I think there were three questions there, Martin, rather than two, but anyway, three questions. Simon, do you want to come in on those?

SIMON WILDE: Yes, certainly, I am sure that Akshay and/or Jonathan might want to add as well.

So, question one (a) was how can we assert the information asymmetry when we have got companies where there is a relatively high proportion of what we describe as high confidence totex, and I think that is a good question, but high confidence is not complete confidence, Martin, and the process that we follow had certain elements in common with the process that we followed in RIIO GD1, and I would just observe some of the TIM outperformance that we saw I think across all four of the GD ownership groups. I think the two are not completely inconsistent and we believe there is information asymmetry when we set cost and incentive targets across all of our sectors.

On your second point, you are right that if there is a sharing factor of 33%, then the adjustment of 25 basis points means you would need 75 basis points of RoRE outperformance, gross RoRE outperformance, in order to get down to 25%. I wasn't too sure whether you meant 75 basis points on totex levels. Obviously, the key factors in assessing this are going to be the relationship between totex and RAV, the notional gearing level and then the sharing factor. It is an arithmetic combination of those three numbers.

Then on the CMA point, all that I would say is we have very much taken the CMA's provisional findings seriously. We did a very, very detailed review which is public. That process still has time to play out, and I really don't want to speculate as to where the CMA will land. I would also observe I think there are multiple differences between the energy and the water sector.

You referenced, I think, perhaps the biggest potential range of difference, Martin, of a 5.1% figure that includes a 20 basis point uplift for retail activities, so that is 4.9, and you referenced the 4.3, and I think we genuinely hope that companies and investors will take comfort from the conversation we just had about the 25 basis points and the company-specific adjustment. If so, one is then talking about 4.55 versus 4.9, which is not immaterial, but I do think there is a risk of overstating the differences here.

JONATHAN BREARLEY: If I could just perhaps jump in on both questions at a fairly high level, Martin. I think part of what we tried to do here with the whole package is be realistic about what a regulator can know, and there is no such thing as perfect information and therefore the thinking around the RAMs but also the outperformance wedge is just being realistic about what we can and can't do, and the way we have designed the outperformance wedge now, if we're wrong, then companies get 4.55 anyway.

All I would say on the CMA process in terms of how we feel about it, we have had a very, very clear steer from our board who have asked us to get the organisation and the decision to the right point and the right balance between customers and shareholders, and that's what we have focused on here. It really is matter for the companies as to what they do after that. As we have said publicly this morning, we do genuinely believe this gets us to Net Zero, it gets the investment we need in place and it does it in a way that gives a fair price to customers, and that's our job. Of course, we will work constructively with companies through the CMA process if they choose to go down it.

One last thing I would say, and I just want to emphasise that last point, we have talked to the CEOs about different scenarios and we are all really clear that it is in everyone's interest to behave sensibly and constructively over the next months to make sure we get the investment we need in place and, ultimately, if it goes to the umpire, sensibly play on under any circumstances.

AKSHAY KAUL: Thank you, Jonathan. Our next question comes from Ashley Thomas. Ashley, please go ahead.

ASHLEY THOMAS: Yes, hi there, thank you. Sorry, just returning to the issue of the CMA appeals process, obviously it is not a redetermine issue, but I guess there is the issue with interlinkages that you sort of sought to get more clarity from the CMA last year. So, apart from the basic sort of CAPM to inform your views, are there any elements of the determination that you have highlighted today that you would like to highlight that you believe are interlinked?

AKSHAY KAUL: Yes, that's a really good question, Ashley. I think I would say at a high level we see the control as something that works in the round. You know, it is made up of component parts but ultimately the regulator has to stand back from the component parts and ask itself, just as Jonathan was describing a moment ago, have we struck the right balance between getting a fair price for consumers and ensuring that there is an attractive investment regime to get the investment that we need, including for Net Zero. That balance is inherently something that has to be done in the round looking at the totex package as a whole, we ask ourselves is that sufficient to allow network licensees to do what we want them to do, looking at the cost of capital and asking if that is sufficient, and looking at the incentives. It is the interplay between the three, and of course in the case of RIIO-2 also the reopeners, that will flex the control as we go along. It is the interplay between these four things that determines the effectiveness of the package as a whole.

What we wanted to simply point out in the debate we had over the last year on interlinkages is that it can be unwise in circumstances to take particular components of it out and determine them separately without thinking about what effect they have on the balance of the price control in the round. That's something the CMA of course has always said that they are willing to consider. They only have been asking that the regulators, when they do make those sorts of arguments, are clear about what sorts of interlinkages we are talking about, and there is a whole chapter dedicated to this in the core document that was published this morning which looks at exactly this issue of the in-the-round balance and the tests that we have applied to ensure that we strike it right.

ASHLEY THOMAS: It sounds like you want an in-the-round approach, but there is nothing sort of specific you want to identify in terms of the interlinkages.

AKSHAY KAUL: Well, I think I would just direct you to the chapter that sets them out. What we haven't sought to do, Ashley, is do a catalogue of every single interlinkage between every component of the control and another because it would become a very encyclopaedic exercise because there are so many interacting parts that have these interlinkages with one another. What we have sought to do in the chapter in the core document is set out at a high level for somebody else looking at this process how we have sought to achieve balance in the round, and we think that that will serve the system well when it comes around to looking at this question at a later date.

ASHLEY THOMAS: Thank you.

AKSHAY KAUL: I am conscious of time. There are a number of people on the phone wanting to come in, so let me invite Dominic Nash. Dom, are you on the line? Do you want to ask your question now?

DOMINIC NASH: Hi there, yes. Can you hear me?

AKSHAY KAUL: Yes, we can hear you, go ahead.

DOMINIC NASH: A couple of questions from me, please. Firstly, coming back to the CMA appeal process, what would happen if the CMA delayed their final findings beyond the cut-off point for the licence appeal, would you be pragmatic and give more grace to the companies to have a look at what they are going to say before they have the right to appeal?

A point on that, by the way, I remember listening to Ofwat, it must be seven years ago, when they were adamant that that 20 bps of retail margin should be included in the overall infrastructure costs, so I am intrigued why you think that should be taken out.

Finally, on the competition question and the Net Zero, you have those two scenarios on page 19 where you add £5bn and £10bn to the final determinations. What proportion of those do you think would be open to competition as we currently look at it, please?

AKSHAY KAUL: Great, thank you, Dominic. Simon, do you want to come in first on the question on the retail margin in the water sector and how that relates to the CMA findings and then I will come in on the question on the CMA appeals and competition.

SIMON WILDE: Yes, certainly. Again, I can only speak from an energy perspective, not from the water regulator's perspective. As I understand it, that margin, that uplift is specifically to do with retail activities and, as far as I'm aware, the energy network companies don't have an equivalent business, and therefore if you want to look at networks on a like-for-like basis, it is appropriate to adjust. So, that is how we are reading, if you like, both the PR19 final determination where it was a smaller gap, it was a difference between 4.19% and 4.09%, and then the CMA has widened that gap to 20 basis points. But in both cases we think the best like-for-like comparison is network to network.

AKSHAY KAUL: Thank you, Simon. On the question, Dominic, you asked about the CMA appeal process. There is a statutory timeline of 56 days standstill period that has to follow the licence direction in early February for the control to begin on 1 April, and the legislation doesn't give us a whole lot of flexibility with that, so we do need to do that. As things stand, I think the CMA is fairly confident about their mid-February timeline for making their final decision, and that should give ample time for companies to take that into account before their appeals window closes at the early part of March. So, we aren't anticipating any need for any greater flexibility than that, but obviously we will keep that situation under watch.

On your question about competition and what proportion of the Net Zero spend could be competed, I think that is actually hard to give a precise answer to because we know what the criteria are for competition once we have the legislation and the powers on the books, and that is new, high value and separable projects above £100m. Certainly, a lot of the kinds of things that we are talking about in the reopener part are definitely new and high value. Whether they will also be separable I think will depend upon the nature of the projects once they are scoped up, so we are talking really here, say, about the East Coast upgrade or about the motorway charging scheme, and, indeed, if they meet the criteria, then absolutely, we will reserve the right to apply competition to them, but I am afraid I can't give you a precise number at this stage because I don't know yet the scope of those projects.

DOMINIC NASH: Thank you.

AKSHAY KAUL: The next question comes from Fraser McLaren. Fraser, please go ahead.

FRASER McLAREN: Hello and good afternoon. Just a couple of questions from me, please. Just curious as to whether anyone at Ofgem has had any dialogue or any feedback from the CMA about the areas where you seem to have varying views, especially the outperformance wedge and the need to attract investment in the sector.

Secondly, you mentioned that the narrower ODI ranges reflect your expectation about performance, but when combined with the outperformance wedge, is that not double-counting? Thanks.

AKSHAY KAUL: Jonathan, do you want to come in on the dialogue with the CMA and then Simon on the ODI ranges and the wedge.

JONATHAN BREARLEY: Sure. Look, you know that we have responded to the CMA consultation and I will let Simon actually expand on the details of that. Equally, the process is such that we can't have pre-conversations, we have no sense of where a panel might go with some of the decisions that are there. All I would say is, particularly on the determination they are making on water, they have had some very constructive and very detailed conversations with us.

AKSHAY KAUL: Thank you. Simon, do you want to come in on the question of the ODI ranges and the wedge?

SIMON WILDE: Yes, so the ODI ranges have narrowed, as you said, Fraser. We have made some changes, some relatively modest changes from DDs to FDs, and those do actually slightly increase the top end of the range for some of the companies, as Akshay outlined in his presentation. The averages are now 120 basis points on RoRE for transmission and 150 basis points for gas distribution. So, in both cases, those are multiples of the 25 basis points of the distinction between expected and allowed return. So, we are hopeful that companies will see plenty to go for and therefore be incentivised to aim for those 1.2% to 1.5% and that they can accept that a small minority of that flows from information asymmetry, i.e. the initial 25 basis points. We do see them as compatible, in terms of a short answer, Fraser.

JONATHAN BREARLEY: Just very quickly, if I could say one last thing, just on investment in general, I just want to emphasise the point that I opened with, which is you do have a board of a regulator that is very cognisant of our duty, and we see our duty as getting the necessary investment to keep the system secure but also to get to Net Zero. So, what we have set out here is our view of what we think the right balance is, and that is what forms our final determination.

AKSHAY KAUL: Thank you, Jonathan and Simon. Our next question comes from Chris Laybutt. Chris, please go ahead.

CHRIS LAYBUTT: Good afternoon. Thank you very much for taking my questions. I just have one or maybe two. Looking ahead to ED2 and RIIO-3, if we see a successful appeal next year on a particular element, and I guess we are talking about the cost of capital, how would that decision impact future review processes, do you think?

AKSHAY KAUL: Thanks, Chris. I think, if I understood your question correctly, you are saying if there is an appeal to a RIIO-2 decision which then gets settled at the back end of next year, how will that affect future price controls including ED2 and RIIO-3. Is that correct?

CHRIS LEYBERT: Yes, that would be terrific, thank you.

AKSHAY KAUL: Okay, great. If there is a CMA decision that provides new evidence or new reasoning on a part of the price control that is relevant to ED2 and RIIO-3, for instance on the cost of capital, then we absolutely would take that into account. I think the way that we design these price control processes, there are multiple opportunities to do that. So, for instance, in ED2, of course, we are going to set out the finance parameters a little bit later than December, I think we will probably set them maybe February or March time of next year in terms of working assumptions, and then we will actually consult on a firm proposal for something like the cost of capital, say, or the totex values for ED2 in the summer of 2022, and that will be adequate, ample time to take into account any experience from this current round of price controls, including of course any potential CMA appeals.

Our next question comes from James Brand. James, please go ahead.

JAMES BRAND: Hello, can you hear me?

AKSHAY KAUL: Yes, we can hear you, James, go ahead.

JAMES BRAND: Great, thanks. Just two questions, hopefully relatively quick ones from me. The first is on National Grid Electricity Transmission where you obviously had the biggest gap on totex and have closed a substantial amount of that gap. You have also cut the totex retention rate to very low levels, and I think in the document explained that due to your lack of confidence or less confidence in the spending plans that National Grid set out. I was just wondering whether you could provide some comments on why you have so much less conviction still in National Grid's investment plans, what specific areas have you allowed funding for that you are doubtful that the money might need to be spent or potentially that you have allocated too much money and it might cost less to deliver those outcomes. That is the first question.

The second one is just on this 150 basis points of outperformance you are talking about for gas distribution and 120 for electricity transmission. Just to be clear, are you saying you think that's a likely outcome for what a good performing company can deliver in outperformance and, if so, what is that based on? Is it based on totex savings in prior periods or is there some kind of other methodology? Thanks.

AKSHAY KAUL: Thanks, James. Those are both really good questions. Let me take the second one first. Your question was what is that outperformance indication for I think I called a good performing company based on. I think I mentioned that it is based on some specific assumptions, and I will talk about how we come to them, and that's based on outperforming on the ODIs, the output delivery incentives, up to the level of the cap that has been set for them in the price control, and outperforming on totex at the same time by about 10%. This is not unprecedented given what we have seen in previous price controls, including in RIIO-1. But I wouldn't say it is a likely outcome in the sense that this is not an average expectation for the industry. The average expectation, as I said, for the industry is about 25 basis points of outperformance, but the 100 to 120 is if you get to the cap of performance on the quality of service and you underspend by about 10% on totex, which is stretching but do-able, then that is what you can expect to earn. I hope that that is clear.

JAMES BRAND: Yes.

AKSHAY KAUL: Thank you. The second question you asked was about National Grid ET and why, in spite of the fact that there has been a closure of the gap on totex with them, their incentive rate has actually come down, I think you said to 33%, which is correct, it has come down from 39% in draft determinations to 33%. The principal reason for this is that as we have increased the volumes, James, both in terms of the deliverability of a lot of the expenditure as well as the underlying pricing and the cost of it, a lot of the asset health programme that National Grid does for instance is based on very large portfolios of assets, and it isn't really feasible for us to go down to a granular asset level and check that for every asset there is definitely a good case and the price is exactly right. We have tried to do the best that we can using relatively imperfect, relatively blunt tools, for instance, for what are called the lead assets, which are overhead lines and transformers in the transmission system. We don't set asset-specific targets to say you must replace this many transformers, you must replace this many overhead lines, etc. What we do is set an overall risk reduction metric and then we give a lot of flexibility to the companies to trade in and trade out of that risk reduction metric.

Essentially, what happens as you increase the volume of investment in something like asset health is you get more certainty from a consumer perspective that there will be more than sufficient funding there to protect consumers' interest from a safety and reliability perspective, but there is also less confidence in whether that exact level of spending is definitely going to be needed. The combination of those two effects is what has diluted the National Grid incentive rate down from 39 to 33% in terms of overall costs.

JONATHAN BREARLEY: Just one thing to amplify what Akshay has already mentioned but just to be clear, we obviously had concerns at draft determination stage about the evidence that we received, and National Grid have worked incredibly impressively with us and collaboratively with us to take us through the evidence to get us where we are today, so I just want to reinforce, we have had a very good working relationship across the board, but particularly with National Grid.

JAMES BRAND: Thank you.

AKSHAY KAUL: Our next question comes from Verity Mitchell. Verity, please go ahead. Verity, are you still on the line? Please go ahead. I think we may have lost Verity there. I see there's one more hand on the Teams, so Mark , please go ahead and ask your question. Mark, please go ahead and ask your question. *(Pause)* I am misreading the name, it is actually Bartek. Bartek, please go ahead and ask your question. I apologise for misreading your name. *(Pause)* That doesn't work either. Okay, very good.

Look, I think we are getting to the end of what has been a really interesting discussion, so I think we will draw it to a close there. Obviously, the conversation doesn't need to stop. If you guys have further questions in the coming days and weeks, please get in touch with our investor relations team. You can see their details up there on the slide. It just remains for me to say a big thank you to everybody for engaging with the process thus far. We have really, really valued your engagement. I am just going to hand back to Jonathan to make any closing remarks before we end.

JONATHAN BREARLEY: Thank you, Akshay, and just to say thank you to all of you for taking the time today to talk through the details of our final determination. I'm sure you're going to have many questions in the coming weeks, so we all stand ready to make sure we can answer those in as much detail as possible.

Just one final reflection from me, there is an ongoing conversation we need to have as an organisation with yourselves around how the investment is going to evolve over time, not just in the network sector but across the energy sector as a whole. I personally and I'm sure the whole of the team look forward to continuing to work with you in a constructive way to make sure we all deliver on the things that we want, which is looking after customers today but, equally, getting ourselves to Net Zero. Thank you.