OFGEM

STAKEHOLDER CALL

Record of Virtual Meeting

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PRESENTED BY:

Akshay Kaul	**Director of Networks, Ofgem**
Simon Wilde	**Senior Financial Adviser, Ofgem**

Transcribed by T A Reed (Wiltshire) Ltd
Tel No: 01793 764614

AKSHAY KAUL: Hello and welcome, everybody. A very good morning to you all from a somewhat foggy morning here in London. I am Akshay Kaul, I am the Director for Networks at Ofgem, and I am joined this morning by my colleague, Simon Wilde, our Senior Financial Adviser. Simon and I will talk you through the details of the final determinations for RIIO-2 that we have published on our website this morning.

This call is going to last for about 45 minutes and, if you have questions, there will be time at the end for those. You can ask a question on the Q&A sidebar in the panel on the side of your screen and we will try and cover as many of the questions this morning as we can.

In terms of the content that we are going to cover, I am going to start out by talking about how we reached our decisions, I will go through some of the key headlines in the package that we published this morning, I will give you a little tour of the documentation suite just to orientate readers as you make your way through it hopefully in the coming weeks, and then I will touch upon the next steps in the process. Then we will open up for Q&A and, as I say, you can ask your questions in the Q&A sidebar on the panel.

With that as an overview, let me begin by saying that we have published this morning the final determinations for the gas and electricity transmission companies, the gas distribution companies and for the electricity system operator. For the network companies, these are five-year spending plans and they span the period from 2021 to 2026, which is going to be quite a pivotal period in preparing the energy system for the challenge of Net Zero. This will involve a major investment programme into the UK's energy infrastructure to improve services for customers and for the environment, but to drive at the same time a fair price for consumers.

For the transmission and GD companies, as I said, the price control is going to span five years from 1 April 2021 to the end of March 2026. For the electricity system operator, it is an overall five-year control period but the business plan, the spending plan that is being approved, is only set for two years at a time, and the first business plan period is going to go from 1 April 2021 to the end of March 2023. The ESO will then submit a further business plan for the next two-year period. This has deliberately been designed to enable a high degree of adaptability that we expect from the ESO as it responds to a rapidly changing electricity system during this decade.

If we go on to the next slide, let me speak a little bit about how we have reached our decisions. If you look back, this has been a journey that began, of course, when we published our open letter back in July of 2017, and this is now coming to the conclusion of that process. We made our first decision back in July 2018 by setting the RIIO-2 framework. We then made a methodology decision last year in May, we received company spending plans in December, and we published draft determinations on those spending plans in July of this year. These final determinations are really the conclusion of that process and they have been informed by an extensive and remarkable variety of input from a very diverse set of stakeholders, probably the most diverse engagement that we have had with the price control process since we started this decades ago. That includes, of course, Ofgem's independent Consumer Challenge Group, the companies' Consumer Engagement Groups in gas distribution, the User Groups in the transmission sector, and the ESO's RIIO-2 Stakeholder Group, where many of these customer and consumer voices have been heavily engaged with us, particularly over the last 18 months. It includes a thorough review of the 20,000-plus pages of consultation responses that we received following our draft determinations in the summer, a series of webinars that we ran in the summer period and, of course, the open hearings, the open meetings that we organised in October, not to mention a range of bilateral and multilateral working groups and meetings that we have had with a range of stakeholders, including the network companies. This is the conclusion of that process of very extensive stakeholder engagement and let me now just take you through from the next slide onwards the key headline points in the package that we have published.

First of all, let me return to the objective of RIIO-2, which is to prepare the network companies and the ESO to deliver Net Zero at lowest cost to the consumer while maintaining world-class levels of system reliability and customer service and ensuring that no one is left behind.

To meet this objective, we have provided not just a chunk of upfront funding but added flexibility to the price control to fund what is justified now as well as what might be needed throughout the course of the five-year price control period. At the same time, we are challenging the companies to be as efficient as possible in how they run and finance themselves so that the cost for paying for all this additional investment to hit Net Zero is kept as low as possible to consumers. We are offering a reasonable allowed return that reflects current market rates and expectations of average outperformance across the industry, building on what we have observed from prior price controls. Finally, and very importantly, we are proposing a much larger package to protect vulnerable consumers in the aftermath of Covid-19. You can see on the right-hand side some of the key numbers but, from the next slide onwards, let me just talk you through each of those four main parts of the objective and how we have sought to meet that objective.

First of all, preparing the networks to meet Net Zero, we are proposing a funding package, an upfront funding package, of up to £30 billion to maintain our networks and support companies in the transition to Net Zero. We are then supplementing this with a flexible package of uncertainty mechanisms which will enable £10 billion or more of additional funding to allow companies to bring forward strategic network investments during the price control period to help meet Net Zero targets. For instance, this could encompass the anticipated coordinated expansion of the onshore and offshore grids to meet the ambition to put 40 GW of offshore wind in the North Sea.

We are also proposing a package of innovation funding to do more research and development into green energy. A minimum of £450 million is being set aside under the strategic innovation fund and another £209 million under the company-specific network innovation allowances.

We are also proposing a brand new funding approach for the electricity system operator which enables it to spend approximately half a billion pounds over its first two-year business plan period to progress the changes necessary to operate the electricity system carbon free by 2025, to maximise competition across the energy system, and to facilitate a whole-system approach to network operation and planning.

If we move on to the next slide, I said preparing the system for Net Zero, but at lowest cost to consumers is the second part of that objective. We are proposing greater efficiency targets and lower returns, which are the key ways in which we will keep the cost of meeting Net Zero to consumers as low as possible. So there is a 16 per cent overall downward adjustment on average to the levels of spending that the companies have proposed in their business plans, reflecting mainly our overall efficiency challenge to them to do more for less.

A greater proportion of the costs that are saved by network companies under RIIO-2 will be returned to consumers, so somewhere between 50 to 65 per cent will be returned to consumers as opposed to the 35 to 50 per cent that was returned in RIIO-1.

There will be greater accountability for what companies are asked to deliver. This will ensure that network companies are only paid for what they deliver and consumers are refunded for work not carried out.

We are also proposing an ongoing efficiency challenge of 1.2 per cent per year across most of the gas distribution and transmission cost base, compared to an average efficiency challenge of 0.8 per cent in RIIO-1. That is a 50 per cent increase in the ongoing efficiency challenge on the industry.

As far as returns are concerned, the overall cost of equity is being reduced from approximately 7 to 8 per cent in RIIO-1 in real CPIH terms to 4.55 per cent in RIIO-2, at the 60 per cent level of gearing, and this 4.55 per cent cost of equity will be made available to network companies through a base allowed return that is set at 4.3 per cent and a guaranteed income from incentives of 0.25 per cent which reflects the outperformance that we expect on average across the industry.

If we go on to the next slide, the third part of the objective statement was that we will get to Net Zero at lowest cost to consumers while maintaining world-class levels of customer service and system reliability. In that space, we are proposing a package of incentives to improve further the quality of service for consumers. These include incentives to reduce the network companies' own impact on the environment, including fleet emissions, greenhouse gas emissions and resource use and waste. We are also proposing approximately £13 billion of funding for companies to maintain, replace and repair ageing network assets and further funding for network resilience. We are strengthening gas distribution service standards, including doubling consumer compensation payments if companies fail to meet minimum standards and, as you would expect, right across the industry we are keeping very high levels of targets for system reliability and minimising customer interruptions.

If we go on to the next slide, this is the last – but not least in any way – part of the objective statement, which is to do all of that but make sure that no one is left behind, particularly that the consumers who find themselves in vulnerable situations are properly taken care of by network companies. To achieve this, we have throughout the process introduced a very strong representation of consumer voices at the heart of developing the RIIO-2 price controls through the enhanced engagement process that we have run in the last 18 months. We have strengthened the quality of service targets, particularly in key customer priority areas such as quicker connections, higher system reliability, and minimising environmental impact. We are also focusing our innovation stimulus on improving services for consumers in vulnerable situations.

We have proposed stronger licence conditions for network companies to treat all consumers fairly and, as I mentioned at the start, there is a step change in the funding and protection available for consumers in vulnerable situations. Together with the scheme that we run to extend the gas network to fuel poor households across the country, we are doubling the allowance that we provide to the gas distribution companies to help consumers in vulnerable situations and to raise awareness about carbon monoxide poisoning from £30 million at draft determinations to £60 million at final determinations. This will also encourage the industry to work with local partners and charities to maximise the benefits from the support that is being offered.

Those are the key messages from this morning's publication. It is quite a voluminous set of documents and there is a lot of detail. Just to help stakeholders navigate that detail, I thought it would be useful to provide you with a rough overview of the publication suite itself. When you go to our website, what you are going to see is essentially at the top a core document which is highlighted there in orange on the slide. The core document will give you an overall summary, from a technical perspective, of the entire cross-sectoral final determinations package and it also sets out and justifies the cross-sectoral decisions that we have made which are common across the network sectors for both gas distribution as well as transmission. It will set out and explain the reasoning behind those cross-sectoral decisions. Then you can go into a series of sectoral annexes. There is a separate sectoral annex for gas distribution, a separate annex for transmission and a separate annex for the system operator and for finance. These sector annexes will provide you with much greater detail on the decisions that have been made on a sectoral basis for each of those component parts and they will set out a much greater detail in terms of justifying those sectoral decisions, what stakeholders said, and how we have responded to that feedback.

In addition, you can also go down to the level of the individual licensee, so there is a series of annexes that are specific to each of the licensee companies, and you can see in one document all the final determination proposals that affect a particular licensee in the company-specific annex. Finally, there are some technical annexes for those that are so inclined – if you want to go into much greater detail, for instance, on our cost assessment methodology or you want to find out everything there is to know about the network asset risk metric where we hold companies to account for their spending on asset health. You can go into those technical annexes and get the detail there.

Hopefully, that is a helpful overview of the publication suite itself and will help stakeholders navigate that set of documents in the next few weeks.

If you just go on to the next slide, the next steps from this point onwards, the final determinations are not the end of the process. We are going to issue shortly, probably next week, a statutory consultation on the licence modifications that will implement these final determinations into the licences of the individual network companies. That statutory consultation will run until the early part of February, where we will direct the licence modifications into licences and also set out the regulatory instructions and guidance to use for the operating period of RIIO-2.

In the lead-up to the start of RIIO-2, from 1 April, we also plan to consult on and to publish a set of associated guidance documents that will help us and the industry and stakeholders more generally engage with a number of the processes during the operating part of the control. Then, from 1 April 2021, the RIIO-2 price controls for gas and electricity companies, for the gas distribution companies and the electricity system operator will commence.

Of course, companies will continue to be held accountable for their performance. Each year, we will assess that performance to drive forward improvements, to maintain a world-class energy system that delivers more of what customers and consumers want.

With that, I am going to pause now. As I said, my colleague, Simon Wilde, our Senior Financial Adviser, joins me to take any questions from the audience at this stage. As I said, you can ask your question in the Q&A panel on the sidebar and we would be happy to answer any of them.

Our first question comes in the space of the Net Zero reopener. The question is:

> "Where can we find the details regarding the Net Zero reopeners?"

All the details on this should be set out in the final determinations core document. This is the first document that is published right at the top of the website page announcing final determinations. Go to the core document and you will find a section in there. I think it is Chapter 11, from memory, but don't hold me to that. It is called the Net Zero and Innovation chapter in the core document and you will find all the details of the Net Zero system reopener.

The second question is:

> "Many thanks for the overview. In your view, do you think the final determinations strike the right balance between uncertainty mechanisms and the delivery of Net Zero?"

That is a really good question and, of course, if you remember, this was one of the three iconic lines of debate following our draft determinations in the summer. The adaptability of these price controls to changes in policy for Net Zero is widely welcomed but many stakeholders expressed worries about whether the mechanisms themselves would be agile and quick enough to respond.

I just want to highlight, I think, four things that you should look out for that we have done between draft and final determinations that help to strike a better balance, as you say, between uncertainty mechanisms and speedy delivery of Net Zero targets. The first is that we have put more funding for Net Zero projects into the baseline itself, particularly in terms of pre-construction funding for some of the large schemes like the Eastern HVDC Link and providing project development allowances for network companies so that they can develop proposals for reopeners without waiting for approval from Ofgem.

The second thing we have done is we have made more of the uncertainty mechanisms automatic, rather than administrative, so they will not require Ofgem approval. The companies can flex their allowances automatically as demands change on the system. These automatic mechanisms, for instance, in the case of electricity transmission, will cover both the connection requests that network companies get from generators and suppliers to connect to the grid, as well as the cost of the grid upgrades that are required to handle the changing power flows for all the projects between zero to £100 million. All of these allowances will flex automatically but what will still be retained is administrative allowances for other larger projects which cannot be automated.

Even for those larger projects, the third thing I was going to point out is that we are proposing a streamlined process for approving those schemes where we have a fast-track approval process for relatively uncomplicated schemes where the evidence base is very clear, and a slower track or significant scrutiny process for those where the case is more complex. We will, of course, publish a pipeline of these schemes and develop the underlying guidance that is necessary to help make the submissions and get them approved in collaboration with the industry.

The fourth and final thing I wanted to mention in this space is that currently it takes about two years for the network companies to receive the revenues after we have approved projects for reopeners. We are going to try and speed up this process so that they get the revenues within the same year in which the reopener applications are approved, which will have the consequence that it will significantly ease any strain on company cashflows as spending for Net Zero increases as we go through the course of the decade.

So these four changes, I think, are all quite significant and they move the package, we think, a long way towards striking a much better balance between handling uncertainty through uncertainty mechanisms and speedy delivery of Net Zero.

The next question is:

> "How does the final determination differ from the draft determination and what were the reasons for the changes?"

I think the three main areas I would highlight – one I have already talked about – is how we have sought to make the uncertainty mechanisms more agile to respond to the demands of Net Zero. This was one of the three main lines of debate following draft determinations. Let me quickly cover the other two and then I will bring in Simon to talk a bit more about the cost of capital changes, in particular, which I know will be of quite a lot of interest to stakeholders.

The two other areas, first of all, we had cut, if you remember, the company spending plans by about £8 billion at draft determinations and there was concern expressed by the industry that that was not giving them sufficient funding for keeping a safe and reliable system. We have received an incredible amount of evidence back from the companies following our challenge to them in draft determinations and, because of this evidence, we have sought to reduce essentially that £8 billion gap by half, reflecting justified increases in the volume of work that we agree is needed on the system, so we are providing much greater revenue for a higher volume of work needed on the system, while maintaining still a relatively tough efficiency challenge which accounts for that still remaining £4 billion or so of gap between us and the industry. So that £8 billion gap that existed at draft determinations has closed by half, largely because much better evidence has been provided on the volume of work, but we have retained a strong efficiency challenge to push the companies to do more for less.

On the third line of debate, which is on the cost of capital, you remember the companies were looking for a return on equity between 5 to 6.5 per cent. We had published allowed returns that were just under 4 per cent at draft determinations. The picture at final determinations is as follows. We have concluded that the cost of equity for energy network companies at 60 per cent gearing is around 4.55 per cent, based on the evidence largely driven by a reassessment of the evidence that we received on asset betas or the riskiness of energy network companies. That 4.55 per cent is provided to the industry in two parts. We are setting the allowed returns at 4.3 per cent and then we are guaranteeing income from incentives which reflect our expectations of outperformance of 0.25 per cent. So the 4.3 plus 0.25 per cent gets you to 4.55 per cent which is the return that investors should expect to make from energy companies in RIIO-2.

Simon, do you want to come in a little bit more and explain some of the reasoning behind the changes on the cost of capital front, in particular, and then we will carry on with the other questions?

SIMON WILDE: Yes, thank you, Akshay. Akshay has provided the key detail that the assessed cost of equity has increased slightly by 0.35 per cent from 4.2 to 4.55 per cent. That is largely due to stakeholder feedback, particularly from companies, that we received as a result of our consultation and we have applied slightly greater weight to the market evidence that relates to National Grid. We still placed some weight on other listed UK regulatory networks like water but we have slightly increased the weight to National Grid. We have also made a slight, and this is very technical, adjustment to something called the debt beta, and those two effects increase the cost of equity allowance.

The other thing I would just emphasise is that by adjusting the ex post mechanism for outperformance assumption, this really does make sure it is the fail-safe mechanism that we had indicated, so we are highly confident that companies will earn at least their cost of equity which we assess at 4.55 per cent.

The last thing I will say is we have made a slight adjustment to the cost of debt allowance based on evidence that we received about the true costs of issuing debt and, as a result, our overall expectation on return on capital, so debt and equity, is 2.81 per cent. So this is up about 20 basis points of 0.2 per cent on draft determinations, so 2.81 per cent. We did a survey of market expectations, or equity analyst expectations, ahead of final determination and the average of that was 2.86 per cent, so 2.81 versus 2.86, so it feels as though, when you look at the overall return on capital, we are broadly in line with current market expectations. Akshay?

AKSHAY KAUL: Thank you, Simon. Let us actually segue very neatly from that into the question of what is going to be the overall impact on charges as a result of our determinations. I think the key change from draft determinations, at draft determinations we had said that the combined effect of all our proposals was that network charges on bills for household customers would fall by about £20 per year and then this £20 per year initial saving would gradually get used up as spending and investment increases to meet Net Zero as we go through the course of the decade. I think that picture is still largely as it was. However, because we are increasing the levels of the baseline spending for network companies, and we are slightly increasing the cost of capital, that initial saving we are now predicting will come down from £20 to £10 per year, and it will still be adequate to pay for quite a large amount of the £10 billion of additional Net Zero funding that we think will come through the course of the price control period. We expect overall, by the time we get to the end of the price control period, network charges on bills will be roughly flat, and we will have allowed a significant increase in investment needed for Net Zero.

Simon, do you want to add anything on that bill impact picture?

SIMON WILDE: No. I think you have described it perfectly, Akshay. Thank you.

AKSHAY KAUL: Thank you. The next question is about the uncertainty mechanisms. Alistair Wilcox asks that:

> "There were some concerns raised following the publication of the draft determinations about the lack of flexibility in some of the reopeners, the LOTI, for example, which is the reopener for large transmission projects, and the risks that this placed on the delivery of the Net Zero challenge. What can you tell us this morning about the outcome of the discussions that have taken place over the last five months on this?"

That is, again, a really good question. There is quite a long answer to this question because it is a complex space. Let me give you the simple details in summary. As I say, the picture for uncertainty mechanisms, if you take the transmission system, is as follows. For connections, there is an automatic mechanism, so it is very quick to respond. For grid upgrades that are between zero to £100 million, particularly on the National Grid system, we are again making that automatic so that will respond as capacity is added or subtracted on the transmission system. That leaves, as you say, the large connection projects above £100 million and the large transmission grid upgrade projects which will go through some of these bespoke reopeners, such as the large onshore transmission investment reopener.

What we have done with this is a few things. First of all, we are going to construct a common pipeline with the industry of these large projects so that there is greater visibility of what projects are being developed as they come through and we will provide pre-construction funding to allow project development to proceed in a quick and agile way.

Secondly, we are going to co-create the guidance for these large projects with the industry so that our approval gates essentially match the investment decision gates for companies as they go through the development of these large schemes. These schemes, inevitably, take a few years to get through the planning and consenting system, get through procurement, and then get through the construction and commissioning period. So at each of these phases we will work with the industry to carry out first of all a needs case assessment, so it gives confidence to both the regulator and the industry that the needs case is well made, that will happen around the time of the planning and consenting of the schemes, and then we will provide them with an assessment of costs and therefore the revenue allowances in time for companies to make their final investment decisions before they construct and build out the schemes.

Finally, as I said, what we are trying to do, particularly for these larger schemes, but this is a general point that applies across the reopeners, is speed up the time that it takes for network companies to receive revenues after we have given final approval for revenue for a particular project from the current two years plus to making sure that we can get them the revenues within the same year. This is slightly technical, but we are doing this essentially by forecasting, together with the industry based on that pipeline I mentioned, the revenues from uncertainty mechanisms in advance so that the cash is already in the system and then, as we go along, we can true it up to make sure that the revenues match the projects that have been approved.

There are some questions about links to the final determinations which I see colleagues have helpfully set out in the chat. Thank you very much for that. The next question is from Una. It says:

> "Thanks for the overview. It's great to hear about the increase in vulnerability funding given the overall levelling up agenda. What will be the decision-making process for projects and funding for the £60 million for vulnerable consumers and carbon monoxide awareness?"

Una, thanks for that question. That's a really good question. We will be providing guidance to the industry but it will largely be for the companies – we are giving a large amount of flexibility, that is the main point. We are giving funding and support but a lot of flexibility to the companies to design their programmes with local charities and stakeholders so that they maximise the impact of that funding on vulnerable consumers in their area. We are going to ask companies to report on their programmes and share learning on how they are utilising the funding to maximise impact through an annual industry and stakeholder event so we can diffuse best practice in this kind of levelling up right across the entire industry.

The next question is:

> "How long would a reopener realistically take to be re-approved? What is the process? Any timeframes would give the network companies some confidence".

Again, a very good question. Let me just quickly refer back to my answer a while ago on the increase in automation for much of the uncertainty mechanisms to improve the agility and responsiveness. Even for the ones that remain administrative, particularly for these large projects that I was talking about, we are going to aim to get reopener applications approved within a nine-month timeframe, but we are not setting a fixed deadline for them precisely because we think there will be a diversity in these cases. In some cases, you might have simple and uncomplicated schemes which can be approved much faster than that nine-month timeframe and we would like to have the ability to fast-track those submissions. Similarly, there may be some submissions which are much more complicated, either from a stakeholder or policy perspective, that take a little while longer, and we would like to apply that longer time scale to make sure that good decisions are made in respect of those schemes. So the key word here really is proportionality in the scrutiny and in the timeframes that reflect the underlying complexity and evidence base that is submitted to us for these reopener projects.

There is another really good question.

> "There was some criticism at draft determinations that you had not taken sufficient account of the input from customer and stakeholder groups. Have you taken more account of this in the final determinations?"

The first thing I want to say is absolutely. We recognise that there was that critique because the draft determinations did not really contain any assays on how we had taken account of the input from customer and stakeholder groups. I want to emphasise once again that at draft determinations we absolutely relied heavily on what we had heard from our very diverse set of engagements with stakeholders prior to draft determinations, but we accept that we did not really have a document or a section explaining precisely how we had taken that input into account. We have addressed this critique by doing exactly that at final determinations. Chapter 3 in the core document sets out, I think very clearly and systematically, how the feedback that we have received from customer and stakeholder groups has influenced the decisions at final determinations. Then, if you go through the core document and each of the annexes where the decisions themselves are set out, in each of the cases we have made reference to the particular responses that we had in that area from stakeholders, including the User and Customer Engagement Groups, and how our decisions respond to that feedback.

The next question is that:

> "At draft determinations you said that the use of reopeners and other uncertainty mechanisms might take the ratio of FD investment allowances to ongoing allowances to 50:50 or 60:40. What is the ratio now?"

To answer this question, if you just focus on totex and what we call baseline totex in the core document, when we published draft determinations, you will remember that that baseline totex number for the network companies was just over £16 billion and then we said there would be potentially another £10 billion or so that comes through the reopeners. So that 16 to 26 ratio would have been probably around 60:40 at draft determinations. That 16 number has now increased to about 20 and the £10 billion number for reopeners is unchanged. So we are really looking at say 20 out of 30 which is probably something more like 65:35 or 66:34 as the ratio in final determinations.

The next question comes from Mark Tiernan(?).

> "Although the two-year windows enable agility in the electricity system operator sector, will the absence of a five-year foundation of funding create uncertainty in investing in both projects and the market?"

I presume again for the ESO. Simon, do you want to take that question about two years versus five years for the ESO?

SIMON WILDE: Yes, certainly. Thank you, Akshay. For the ESO, we are setting some parameters on a five-year basis, so many of the financial parameters, to give that certainty on returns. Secondly, because the ESO is responding to a rapidly evolving landscape, we felt it was important to let them come back to us on a two-yearly basis to tell us how much money they need. What I would say is if you look at the request for that first two years, we have delivered almost all of the totex that they required to really give them that certainty and, secondly, they are not exposed to the same totex underspend and overspend incentive mechanism because we are not looking for a penny-pinching ESO. We want them to have the resources to invest.

So I actually think the combination of five years and two years is a really good combination and we have every expectation that when they come to us to discuss what is needed from year 3 onwards, that we will have a similarly productive conversation.

AKSHAY KAUL: Thank you. We next have a question on business plan penalties and rewards.

> "The business plan penalties and rewards are quite significantly different at final determinations compared to draft determinations. What are these changes and why has there been such a big change?"

That is correct, there has been a significant change in the business plan penalties and rewards, and that largely reflects the additional evidence that has been provided between draft and final determinations, particularly on the underlying justification for some of the bespoke outputs and consumer value propositions that the companies had sought rewards for, and also for the underlying work that is needed on the system where some companies had faced penalties because that work had been disallowed for the lack of adequate justification and then they did provide adequate justification in the response to draft determinations.

So those are the reasons why the penalties and rewards have shifted so what you will see in the final determination package is that more companies are earning business plan rewards and that is driven by a greater acceptance of the consumer value propositions and bespoke outputs where the evidence case has been made out and a reduction in the disallowance of work volumes that was there at draft determinations which has reduced the size of the penalties.

In the case of the reward incentives in particular, I think there is probably a slight bias towards rewards in the gas distribution sector and, in the transmission sector, the picture is a little bit mixed. I think SSE and Scottish Power are neutral or positive in terms of overall rewards whereas National Grid remains negative in terms of an overall penalty reflecting the stage one failure to meet minimum requirements which remains unchanged between draft and final determinations.

Julie Cox asks:

> "With respect to revenues being provided to network companies in the same year as work approved, will this lead to short notice changes to network charges?"

Simon, this was a question, I think, that suppliers had asked us to look into as well, which is about the volatility of network charging and how we manage that. I think our assessment, but you will correct me, is that the changes we are proposing should help both get cashflow quicker to companies but also reduce the sort of year-on-year volatility as far as customers are concerned. Is that correct?

SIMON WILDE: That's right. What we are allowing is, in the annual financial model, we are allowing companies to forecast for future years the level of investment they think they will make under uncertainty mechanisms. That will have a true-up mechanism so if they over or underestimate, for example, what they will invest in year 3, once we get to year 3, we can correct for that, but what it means is that you shouldn't see these very, very lumpy charges going through after the event. So without this forecasting, tariffs would start a bit lower but then could really escalate and be quite volatile later on in the period, whereas this mechanism has actually said as well as allowing companies to match their costs and their expenditure on an annual basis, should also avoid that really peaky profile that might otherwise emerge.

AKSHAY KAUL: There are still lots of questions but I am afraid we only have time for one final one. Simon, let that be the one on the CMA provisional findings.

> "What, if any, implications for the allowed cost of capital has there been from the CMA provisional findings on the water price review?"

SIMON WILDE: Thanks, Akshay. What I should say is a couple of things. One is that the current PR-19 water review process is at the provisional finding stage and that the CMA is consulting on the document that it put out a month or so ago.

Secondly, we take the CMA seriously and as evidential, but there are a number of areas that we do not quite agree with them on and we did respond to them on 29 October, and that letter is public on the CMA website.

Taking a step back, the midpoint of the CMA's range for water networks is very close to the number that we published today. It is actually below the number that we have published today by about 0.2 per cent. So some of the issues we have are more technical issues about should you aim up, should you not aim up, and how exactly do you look at a notional company's cost of debt? So I think we have taken it on board but we have had to apply our own judgement.

AKSHAY KAUL: That's great. I think I am going to draw it to a close there. Thank you, Simon, and thank you to everybody who has taken the time to come in early this morning and engage with us. I hope you enjoy reading the final determinations documentation suite. If we haven't answered any of your questions on this call and you still have those, please do get in touch either with me or Simon or anybody in the RIIO-2 team, and we will be happy to take questions over the coming weeks and months.

With that, let me close the event. Thank you, everybody, for joining this morning.

SIMON WILDE: Thanks, all.