RIIO-ED2 Network Price Control – Sector Specific Methodology

Division:	Networks	**Type of measure:**	Price control
Team	Network Price Controls	**Type of IA:**	Qualified under Section 5A UA 2000
Associated documents:	RIIO-ED2 Sector Specific Methodology Consultation	**Contact for enquiries:**	RIIO2@ofgem.gov.uk
Coverage:	Partial Coverage		

We published our draft Impact Assessment for the next network price controls for the electricity distribution sector (RIIO-ED2) in August 2020. It assessed the expected impact of our proposed methodologies for this this sector on companies and consumers. We said we would update the draft Impact Assessment at Sector Specific Methodology Decision stage.

Our Sector Specific Methodology Decisions were published in December 2020 and a separate Annex confirming our Finance Decisions was published on 11 March 2021. With all RIIO-ED2 Methodology Decisions now confirmed, this document updates our draft Impact Assessment. It provides updated estimates of the expected impacts, arising from changes to financial parameters, on companies and consumers.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU. Alternatively, please call Ofgem on 0207 901 7000.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

Contents

1. Introduction

Purpose

This Impact Assessment (IA) updates the draft Impact Assessment published in August2020[1] alongside our ED Sector Specific Methodology Consultation (SSMC).

The key focus of our August 2020 draft IA was to assess whether the regulatory options proposed for the next regulatory period for the electricity distribution sector would provide good value for consumers. The expected impact of those options on consumers and network companies were measured relative to the counterfactual (see page 6) and were based on a set of assumptions. In our Sector Specific Methodology Decision (SSMD) in December 2020,[2] we decided to adopt the package of proposals described as option 3[3] ('Targeted Changes') in the draft IA.

Changes from the Draft Impact Assessment

In this document we update the analysis presented in the draft IA in two areas:

1. Working assumptions for the allowed return on capital

2. The switch to Consumer Prices Index including owner occupiers' housing costs (CPIH).

The updated analysis reflects our recent decisions on the allowed return on capital that we will apply to the RIIO-ED2 price control, as described in our RIIO-ED2 Sector Specific Methodology Decision: Annex 3 Finance, published alongside this document.

We are not updating any other elements of Option 3, including the expected impacts from changes to operational incentives, informational incentives, changes to output delivery incentives and other impacts. This is because we consider that, based on the current information available, the analysis presented in the draft IA remains an accurate reflection of the expected impacts on network companies and consumers which will arise from our Sector Specific Methodology Decision.[4] Further detail on the underlying analysis

[1] Please see Ofgem (2020). RIIO-ED2 Network Price Control Draft Impact Assessment.
[2] Please see Ofgem (2020), RIIO-ED2 Sector Specific Methodology Decision.
[3] Please see page 6 of this document for a brief description of option 3. For further details, please see Ofgem (2020), RIIO-ED2 Network Price Control Draft Impact Assessment, pages 27-39 for a description of option 3.
[4] We note that in our SSMD our position on output delivery incentives has slightly changed compared to the SSMC as we have revised scope and design of three existing incentives: (Consumer Vulnerability, Connection

and evidence for these decisions can be found in the wider suite of our RIIO-ED2 Sector Specific Methodology Decisions and our previous draft Impact Assessment.

Similarly, we are not updating analysis regarding bills and distributional impacts of our Sector Specific Methodology Decision on different groups of consumers. As for other areas, we believe that the analysis presented in the draft IA remains accurate.

We note, as explained in Chapter 1, that our updated analysis on cost of capital and switch to CPIH results in a higher Net Present Value for consumers. That might result in a lower bill, but we believe it is unlikely to be material.

In line with Ofgem's Impact Assessment Guidance[5] and template we are reporting a summary of the options considered as well as the updated analysis described above in the rest of the document.

Stakeholder feedback

We did not receive any specific feedback from stakeholders on the draft IA for the electricity distribution sector. We note, however, that the Energy Networks Association and SGN and SHE-T provided comments in relation to the Draft Determinations Impact assessment for the transmission and gas distribution sectors, published in July 2020.

Given the similarities between the methodologies used in the electricity distribution sector and the other regulated sectors, we refer the reader to Final Determinations[6] for transmission and gas distribution, where we describe the feedback received and we set out our response.

Next Steps

We will review and, where necessary, update this IA at Draft Determinations stage in summer 2022.

Incentive and Distribution System Operation); and introduced a new incentive (Short Interruptions Incentive). Given that the changes only affect three incentives, they are unlikely to be material. Further, it would be not possible to quantify the impact of these changes at this stage as targets for these incentives, rewards and penalties will only be set at Draft Determinations.

[5] Please see Ofgem (2020), Impact Assessment Guidance.
[6] Please see Ofgem (2020), RIIO-2 Final Determinations – Impact Assessment Annex, chapter 3.

Summary: Interventions and Options

What is the problem under consideration? Why is Ofgem intervention necessary?

The current RIIO-ED1 price control for electricity distribution companies was set for an eight-year period, which will end in March 2023. A new price control will need to be in place for the start of the next price control period on 1 April 2023 and Ofgem is required to determine the methodology that it will apply in setting it.

RIIO-ED1, and more generally the RIIO regulatory framework, was intended to be a high-powered regime, allowing companies which deliver high quality services at lower costs to earn attractive rates of return.

We reviewed evidence on the performance of network companies during RIIO-ED1 and, more broadly, the economic, technological and policy environment in which our next price control decision will apply. We identified a number of issues and changes that could be made to improve the RIIO framework for ED2 so that: (i) companies can earn returns that reflect their risk profile and performance improvements on their investment; (ii) customers can continue to benefit from high levels of service quality but at lower costs and (iii) companies deliver the investment required to facilitate the uptake of Low Carbon Technologies (LCTs) needed to meet the net zero targets.

What are the policy objectives and intended effects including the effect on Ofgem's Strategic Outcomes?

Ofgem's principal objective in carrying out its functions is to protect the interests of existing and future electricity and gas consumers.[7] In pursuit of this objective, we must have regard to a number of factors, including:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met
- the need to secure that all reasonable demands for electricity are met
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on the

[7] Please see s4AA Gas Act 1986 and s3A Electricity Act 1989.

- the need to contribute to the achievement of sustainable development

- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.

These duties are reflected in our objective for the next price control, which is to ensure that electricity distribution network companies deliver the value for money services that both existing and future consumers need. This involves the delivery by electricity distribution network companies of the following outcomes:

- improving the consumer and network user experience: network companies must deliver a high quality and reliable service to all network users and consumers, including those who are in vulnerable situations
- supporting the energy system transition: network companies must enable the transition to a low carbon, consumer-focused energy system
- improving the network and its operation: network companies must deliver a safe, sustainable and resilient network that is more responsive to change.

In the draft impact assessment, we set out a number of options to achieve these outcomes.

What are the policy options that have been considered, including any alternatives to regulation?

The draft IA considered four regulatory options for our Sector Specific Methodology Consultation for the electricity distribution sector:

- Option 1 - Do nothing counterfactual: Under this option, we would continue to apply the same tools and calibration as applied in RIIO-ED1, with some allowances and outputs reset to reflect most recent data
- Option 2 - Recalibrated RIIO-1 approach: Involves minimum changes to ED1 approach. We would retain similar mechanisms to RIIO-ED1 but revise certain areas of the regulatory package to reflect learning and evaluation
- **Option 3 - Targeted changes: Under this option, we would continue to use incentives to drive consumer benefits but would make more significant changes to certain areas, where we identify the potential for increased benefits**

- Option 4 - Alternative regulatory framework: Under this option we would move towards a regulatory framework which is closer to 'rate of return' regulation with limited upside incentive to match a low level of downside risk.

Option 3 reflects the methodology we have applied to the design of the price control for the electricity distribution sector as confirmed in the December 2020 Sector Specific Methodology Decision (SSMD). Accordingly, we have only updated analysis relating to this option and only in relation to the working assumptions on the cost of capital and the switch to CPIH. We consider that all other impacts remain consistent with the analysis presented in the draft IA.

Preferred option - Monetised Impacts (£m)

Business Impact Target Qualifying Provision	**Non Qualifying**
Business Impact Target (EANDCB)	Not Applicable
Net Benefit to GB Consumer Direct consumer Net Present Value (NPV) figures represent the direct impact on energy consumers compared to counterfactual (under option 3, central case) over the next price control period	Direct benefits excluding switch to CPIH: **£1,969 million** Direct benefits including switch to CPIH: **£686million**
Impact on network companies' revenues (under option 3, central case)	Direct benefits excluding switch to CPIH: **- £2,109 million** Direct benefits including switch to CPIH: **- £826 million**

Explain how the Net Benefit was monetised, NPV or other
NPV is calculated over the next regulatory period (5 years), from 2023/24 to 2027/28, using a discount rate of 3.5% (as per HM Treasury Green Book guidance). Costs and benefits are in 2023/24 financial year prices and have been inflated using CPIH indexation.

Some costs and benefits are hard to monetise and would arise beyond the next regulatory period. These are considered qualitatively.

We note that the switch from the Retail Price Index (RPI) to Consumer Price Inflation including Owner Occupiers' Housing Costs (CPIH) for indexation of the regulated asset value and allowed returns should be value-neutral to both investors and consumers in the long-run (consumers will be neither worse off nor better off). However, it does affect the timing of repayment of the Regulatory Asset Value (RAV), meaning that it reduces consumer benefits within the next regulatory period.

Our estimates of costs and benefits are indicative and subject to significant uncertainty in relation to how companies might respond to the incentives provided under our chosen option. We have undertaken scenario analysis to consider the impacts of different potential responses.

The figures provided above (Net Benefit to GB Consumers) have been revised to reflect our updated analysis on the allowed return on capital and switch to CPIH. Net Benefit to GB Consumers (excluding switch to CPIH) has marginally increased from £1,955 million in the draft IA to £1,969 million.

Net Benefit to GB Consumes (including CPIH) has decreased from £839 million to £686million.

As explained in Chapter 1, these revisions result from the updated analysis on the working assumptions for the allowed return on capital and revised inflation assumptions.

Preferred option - Hard to Monetise Impacts

We have performed a partial quantification for some of the components of our chosen option while others are considered qualitatively. In particular, we have not quantified in this IA impacts arising from changes to informational incentives, length of the price control, innovation, companies' responses to some of the tools introduced, administration costs and measures to introduce competition.

We consider that a large proportion of the monetised and non-monetised impacts we have identified would take place in the next regulatory period (RIIO-ED2, between 2023 and 2028).

However, there are also significant impacts that may go beyond the next regulatory period. These arise from decisions undertaken by companies that have long-term impacts. In particular:

- medium-term strategic impacts: these relate to asset resilience, competition, changes to the inflation rate and incentive rate
- long-term sustainability impacts: these relate to strategic investment to facilitate Net Zero, innovation and impact on the environment.

We identify that in some areas existing consumers would fund companies to deliver benefits that would be realised beyond the next regulatory period (for example, investment in innovation and strategic investment for Net Zero). At the same time, future consumers will contribute to some of these costs as capitalised expenditure, which will increase future RAV levels. In other areas, consumers in the next regulatory period might benefit if companies reduce spending by deferring investment which will result in higher costs for future consumers. We have proposed measures to tie totex allowances more closely to specific outputs to mitigate the risk of future consumers paying for lower levels of delivery than expected over the RIIO-ED2 period.

Key Assumptions/sensitivities/risks Several impacts associated with our chosen option are difficult to quantify given the stage of policy development and / or lack of appropriate data at this point. However, we have quantified the aspects that we think will have the largest impact on companies and consumers, to the best of our ability, using the information we have available to us at present. We have applied a number of "working assumptions" in order to assess impacts related to changes to incentives. Accordingly, any quantitative estimates are indicative at this stage. We intend to review our working assumptions at Draft and Final Determinations stages and might issue further impact assessments. Whilst some analysis can be completed using the information we currently have, there is uncertainty regarding how the network companies will respond in practice to the sector methodologies. Where appropriate, we have quantified a range of possible impacts and made use of sensitivity and 'breaking point' analysis. We have also identified implementation risk in those areas of option 3 where we are proposing significant change or the introduction of new methodologies. Overall, we consider that the potential for significant consumer benefit resulting from our chosen option outweighs the risk associated with it.

Will the policy be reviewed? Yes	If applicable, set review date: Draft Determinations Stage

Is this proposal in scope of the Public Sector Equality Duty?	No

Summary of impacts on consumers and network companies

The table below provides a high-level summary of the expected impacts of our chosen option, relative to the counterfactual. Further detail on the underlying analysis and evidence can be found in the draft IA published in August 2020 as well as in Chapter 1 of this document which updates analysis on cost of capital and switch to CPIH.

The monetised impacts presented below represent a partial quantification of some of the components of our chosen option. The NPV presented is an estimate of the impact on consumers over the next regulatory price control period (RIIO-ED2) compared against the RIIO-1 counterfactual. To assess how network companies might respond to some components of option 3, we present estimates under a range of scenarios ('Low', High', and 'Central').

We note that most of the expected quantified impacts on consumers arise from assumed transfers[8] from companies to consumers, due to changes to the allowed return on capital compared to the counterfactual.

Compared to the estimates presented in the draft IA, we note that our updated analysis leads to higher benefits for consumers of approximately £14m (excluding the switch to CPIH). As explained in Chapter 1, this results from the updated analysis on the working assumptions for the allowed return on capital and revised inflation assumptions.

[8] The transfer should be intended as a proposed reduction in the allowed return on capital compared to the RIIO-1 counterfactual, which in part reflects a fall in financing costs.

Table 1: Impact on consumers of our Sector Specific Methodology Decision ('option 3') compared to counterfactual - quantified and non-quantified impacts, net present value over a five-year price control (£m 2023/24 (CPIH))[9]

<table>
<tr><th>Area of package</th><th>Mechanism</th><th>Low</th><th>Central</th><th>High</th></tr>
<tr><td rowspan="4">Changes to financial parameters</td><td rowspan="2">Return on capital</td><td colspan="3">1,792</td></tr>
<tr><td colspan="3">Network companies will receive lower returns on invested capital, via a lower return on equity investment and lower debt costs relative to RIIO-1</td></tr>
<tr><td rowspan="2">Switch to CPIH</td><td colspan="3">-1,283</td></tr>
<tr><td colspan="3">This change will be value-neutral to both investors and consumers in the long-run (i.e. consumers will be neither worse off nor better off) but does affect the timing of repayment of the RAV. This means the consumer benefit is negative within next regulatory period but will be positive in the future.</td></tr>
<tr><td rowspan="5">Changes to incentives</td><td>Totex Incentive Mechanism</td><td>21</td><td>61</td><td>64</td></tr>
<tr><td>Informational tools</td><td colspan="3">The impact from changes to informational tools is uncertain and some level of information asymmetry may persist over time. However, a combination of lower incentive rates and the introduction of our new information tools may increase the proportion of cost efficiencies relative to information rents, benefitting consumers further.</td></tr>
<tr><td rowspan="2">Output Delivery Incentives</td><td>19</td><td>99</td><td>154</td></tr>
<tr><td colspan="3">Consumers expected to benefit from improved service quality driven by more ambitious targets and minimum standards of performance.</td></tr>
<tr><td>Price control deliverables</td><td colspan="3">Consumers are expected to benefit from tying network company expenditure (totex allowances) more closely to delivery. However, consumer benefits may reduce if network companies will have less flexibility to deliver cost efficiencies.</td></tr>
<tr><td rowspan="4">Changes to other elements</td><td rowspan="2">Return adjustment mechanisms</td><td>63</td><td>17</td><td>0</td></tr>
<tr><td colspan="3">RAMs may be triggered under some scenarios considered. RAMs are expected to protect consumers and investors against ex post overall returns from network price controls deviating greatly from ex ante expectations.</td></tr>
<tr><td>Length of price control</td><td colspan="3">Consumers will benefit from lower risk of forecasting inaccuracies. However, there could be some negative impact on longer-term planning from companies.</td></tr>
<tr><td>Innovation funding</td><td colspan="3">Similar outcomes to RIIO-1 but more targeted to the energy system transition and addressing consumer vulnerability. We expect the starting value of innovation funding to be broadly in line with that observed in RIIO-1. Final design still to determined.</td></tr>
</table>

[9] Our estimates of impacts from the proposed change in the totex incentive rate, disregard the slow money component of totex, which is added to the Regulatory Asset Base of gas and electricity transmission, and gas distribution network companies, and as such they should be considered an overestimate of the impacts arising from changes to the methodologies for estimating these parameters.

	Competition	Where opportunities are identified to introduce competition into projects, consumers may benefit from additional cost and service efficiencies within the price control period. Future consumers also stand to benefit from better information revealed by prices that are set competitively.		
Administration costs		Potential for some additional resource and administration costs for Ofgem and network companies due to the introduction of new tools for RIIO-ED2 which increase flexibility and protect consumers.		
Total quantified impacts		**612**	**686**	**727**
Total, not including switch to CPIH		**1,895**	**1,969**	**2,010**

1. Impacts on companies and consumers from changes to financial parameters

In this chapter, we present our updated analysis of the expected impacts arising from our Sector Specific Methodology Decision on consumer and companies. The updated analysis reflects our recent decision on methodologies that would apply to financial parameters as set out in the Finance Annex.

1.1 In this chapter we present updated estimates of the impacts arising from changes to financial parameters, relative to the counterfactual. Specifically, we have updated our analysis to take into account:

- methodology decisions (working assumptions) regarding the allowed return on capital;
- revised RPI, CPIH inflation assumptions, including the long term RPI/CPIH wedge.

1.2 We are not updating any other elements of Option 3, including the expected impacts from changes to operational incentives, informational incentives, changes to output delivery incentives and other impacts. This is because we consider that, based on the current information available, the analysis presented in the draft IA remains an accurate reflection of the expected impacts on network companies and consumers which will arise from our Sector Specific Methodology Decision. Further detail on the underlying analysis and evidence for these decisions can be found in the wider suite of our RIIO-ED2 Sector Specific Methodology Decisions and our previous draft Impact Assessment.

Summary of impacts

Summary of impacts on consumers

1.3 We find that consumers would benefit by approximately £1.9 billion (excluding switch to CPIH) under our central case within Option 3, compared to the counterfactual. We note that most of the expected quantified impacts on consumers arise from transfers from companies to consumers (see Table 1).

1.4 Compared to the estimates presented in the draft IA, we note that our updated analysis leads to higher benefits for consumers of approximately £14m (excluding the switch to CPIH). As explained below, this results from the updated analysis on the working assumptions for the allowed return on capital and inflation.

Summary of impacts on companies

1.5 We find that company revenues would decrease by approximately £ 2.1 billion (excluding switch to CPIH) under Option 3 (central case) compared to the counterfactual, over a five-year period (see Table 2 below).

Table 2: Impact on network companies' revenues of our Sector Specific Methodology Decision compared to counterfactual - quantified and non-quantified impacts, net present value over a five-year price control (£m 2023/24 (CPIH))[10]

<table>
<tr><th>Area of package</th><th>Mechanism</th><th>Low</th><th>Central</th><th>High</th></tr>
<tr><td rowspan="4">Changes to financial parameters</td><td rowspan="2">Return on capital</td><td colspan="3">-1,792</td></tr>
<tr><td colspan="3">Network companies will receive lower returns on invested capital, via a lower return on equity investment and lower debt costs relative to RIIO-1</td></tr>
<tr><td rowspan="2">Switch to CPIH</td><td colspan="3">1,283</td></tr>
<tr><td colspan="3">This change will be value-neutral to both investors and consumers in the long-run (i.e. consumers will be neither worse off nor better off) but does affect the timing of repayment of the RAV. This means the consumer benefit is negative within next regulatory period but will be positive after about twenty years.</td></tr>
<tr><td rowspan="5">Changes to incentives</td><td>Totex Incentive Mechanism</td><td>-52</td><td>-201</td><td>-312</td></tr>
<tr><td>Informational tools</td><td colspan="3">In addition to quantified impacts, new totex incentive rate setting mechanism and new information tools may increase the proportion of cost efficiencies relative to information rents.</td></tr>
<tr><td rowspan="2">Output Delivery Incentives</td><td>-19</td><td>-99</td><td>-154</td></tr>
<tr><td colspan="3">In addition to removal of some incentives, re-calibration may change risk/reward balance potentially reducing delivery of outputs in some areas.</td></tr>
<tr><td>Price control deliverables</td><td colspan="3">Tying totex allowances more closely to delivery may reduce some scope for company underspends relative to the counterfactual.</td></tr>
<tr><td rowspan="4">Changes to other elements</td><td rowspan="2">Return adjustment mechanisms</td><td>-63</td><td>-17</td><td>0</td></tr>
<tr><td colspan="3">RAMs may be triggered under some scenarios considered. RAMs are expected to protect consumers and investors against ex post overall returns from network price controls deviating greatly from ex ante expectations.</td></tr>
<tr><td>Length of price control</td><td colspan="3">Five-year price control length may reduce exposure of companies to risk but also reduces the extent to which they can benefit from delivery of efficiency gains</td></tr>
<tr><td>Innovation funding</td><td colspan="3">Might be small reduction in potential revenues as a result of removal of the innovation roll-out mechanism. Do not anticipate significant difference in revenues from company perspective, however final design still to be determined.</td></tr>
</table>

[10] Figures for Totex Incentive Mechanism are expenditures not revenues. In the long run the net present value of these measures, should be the same. However, in the 5 year RIIO-2 period they may have different impacts depending upon whether they are fast money or slow money (capitalised into the RAV). We have not modelled this factor in this Impact Assessment. Therefore, our estimates in the table, should be considered an overestimate of the impact on companies' revenues.

	Competition	Introduction of competition may drive down company allowed revenues, though extent of effect will depend on the number of projects that are found suitable for competition models		
Administration costs		Some additional costs for companies to manage new and revised tools introduced. However, materiality is expected to be of a lower order of magnitude than many of the other impacts considered in this IA.		
Total quantified impacts		**-643**	**-826**	**-975**
Total, not including switch to CPIH		**-1,926**	**-2,109**	**-2,258**

Impacts from changes to financial parameters

1.6 To estimate the impact of changing the allowed return on capital and the impact of the switch from RPI to CPIH, we needed an ED2 RAV estimate.

1.7 The SSMC draft IA used end of RIIO-1 RAV values from the 2018/19 regulatory financial performance reporting, and a simple growth assumption (1.4% a year, based on the historical trend), and a conversion factor to 2023/24 prices to derive the ED2 RAV estimate[11].

1.8 We have maintained these assumptions, and only revised the inflation and return on capital assumptions, as shown in the table below.

Table 3: Assumptions used for quantifying impacts from changes to the allowed return on capital and switch to CPIH in SSMD and SSMC

1.9 These changes have the following effects:

Assumptions	**SSMC**	**SSMD**
RIIO-1 final year RAV (£m 12/13 prices)	23,285	23,285
Growth from RIIO-1 end to midpoint of RIIO-2	1.036	1.036
RIIO-2 midpoint RAV (£m 12/13 prices)	24,122	24,122
Inflation from 12/13 prices to 23/24 prices (RPI)	1.329	1.275
RIIO-2 RAV assumption (£m 23/24 prices, RPI)	32,063	30,762
RIIO-2 allowed return on capital assumption (real RPI)	2.08%	2.02%
Counterfactual allowed return on capital assumption (real RPI)	3.34%	3.34%
Long term RPI/CPIH wedge assumption	0.81%	0.97%

[11] Please see paragraph 4.7 of the SSMC draft IA.

- The lower inflation factor, and thus lower RIIO-2 RAV assumption, decreases the magnitude of all the financial impacts
- The lower RIIO-2 allowed return assumption increases the return on capital impact, though note that measured in *real CPIH* terms, the allowed return is higher than the SSMC assumption (which is captured in the next point)
- The change in RPI/CPIH long term wedge increases the negative impact of the switch, as there is a higher uplift from RPI to CPIH allowed return.

1.10 The final values are converted into CPIH based prices, and future benefits discounted at 3.5%. The changes between the SSMC IA and this update are summarized in the table below.

Table 4: Changes in quantified benefits for consumers between SSMC and SSMD (£m, 2023/24 (CPIH))

Quantified value	SSMC	SSMD	Change
Return on capital	1,778	1,792	14
Switch to CPIH	-1,115	-1,283	-167
Financial parameters total	662	509	-153

Allowed return on capital

1.11 We have followed the approach taken in the SSMD draft IA, where we made assumptions for all sectors, including the ED sector, in order to assess the impact of changes to the allowed return on capital.[12] Accordingly, we multiply the RAV estimate for the ED2 period by the difference in the WACC allowance, as described in the SSMD draft IA.[13]

1.12 We have updated the allowed return on capital for RIIO-ED2 in line with the SSMD working assumptions, and a long-term inflation wedge of 0.97% to measure it in real RPI terms.

[12] For further information see page 41: https://www.ofgem.gov.uk/system/files/docs/2019/08/ssmd_ia_updated_version_31_july_2019.pdf#page=41
[13] See paragraph 4.15: https://www.ofgem.gov.uk/system/files/docs/2019/08/ssmd_ia_updated_version_31_july_2019.pdf#page=43

Switch from RPI to CPIH

1.13 We expect the change from RPI to CPIH to be NPV neutral.[14] However, in isolation, over the next regulatory period, this change will result in an increase in revenues for network companies and a corresponding increase in charges for consumers.

[14] See paragraphs 6.19 to 6.25 here: https://www.ofgem.gov.uk/system/files/docs/2019/05/riio-2_sector_specific_methodology_decision_-_finance.pdf#page=108