

RIO-3 Draft Determinations

Citizens Advice response



**citizens
advice**

Energy Networks and Systems team
August 2025

Contents

Executive Summary	3
1. Overview Questions (selected)	12
Introduction	12
Cost of Service	12
2. ET Annex Questions (selected)	19
Outputs and incentives	19
Infrastructure fit for a low-cost transition to Net Zero	19
Secure and resilient supplies	24
Managing uncertainty	26
Infrastructure fit for a low-cost transition to Net Zero	26
Secure and resilient supplies	29
Cost of service	30
6. GD Annex Questions (selected)	32
Outputs and Incentives	32
Infrastructure fit for a low-cost transition to Net Zero	32
Secure and resilient supplies	34
High quality of service from regulated firms	36
Managing uncertainty	42
Infrastructure fit for a low-cost transition to Net Zero	42
Secure and resilient supplies	43
High quality of service from regulated firms	43
Totex Incentive Mechanism (TIM)	44
11. GT Annex Questions (selected)	45
Outputs and incentives	45
Infrastructure fit for a low-cost transition to Net Zero	45
Managing uncertainty	47
Infrastructure fit for a low-cost transition to Net Zero	47
Secure and Resilient Supplies	47
13. Finance Annex Questions (selected)	49
Allowed return on debt	49
Allowed return on equity	52
Debt Financeability	74
Regulatory Depreciation	74

<u>Indexation of Regulatory Asset Value</u>	<u>75</u>
<u>14. Impact Assessment Questions</u>	<u>76</u>

Executive Summary

RIIO-3, covering electricity transmission and the gas distribution and transmission sectors, will see a huge amount of system change. In the period we will hit 2030, by which time the Clean Power 2030 Action Plan aims to have delivered a clean energy system. This will require the biggest investment in the electricity transmission system since privatisation, potentially reaching over £80 billion. At the same time, the gas networks will need to maintain a safe and reliable service whilst anticipating a declining cost base and remaining flexible to potential changes in government policy, such as the decommissioning of large parts of the network.

The investments planned in RIIO-3 are important for consumers. They will pay back in both the reduction of constraint costs and the enabling of clean power, reducing the sensitivity of energy bills to global gas markets. This period is also likely to see more public scrutiny than ever. We have seen several failures in the water sector result in an all-time low in consumer trust¹ - this should serve as a cautionary tale for the energy sector. This investment needs to be delivered at value for money to maintain public confidence in regulatory arrangements. We believe the proposals are too generous to the network companies and so, by eroding consumer trust, put future investment at risk to the detriment of consumers.

There is clear and consistent evidence that network companies are able to make returns on investment that are too high. Real-world evidence of energy transactions over the last four years has shown significant premia being paid for network acquisitions, indicating the baseline cost of equity is too high. It is also too easy to outperform against regulatory expectations with all network companies currently outperforming under current settlements and all but one outperforming the last completed set of settlements. This includes windfall gains worth over £4 billion, without associated improvements in company performance or consumer outcomes.²

¹ National Audit Office, '[Regulators have failed to deliver a trusted and resilient water sector](#)', April 2025

² Citizens Advice, '[Debt to society: what the network companies should do with their windfall profits](#)', February 2025

RIO3 must, building on the progress Ofgem has already made, break this cycle and build consumer trust. We believe current proposals will again lead to excess returns and so put future investment at risk. Below we have outlined our main priorities, which represent the areas where changes are required:

- **Cost of equity.** The clear and consistent real-world evidence that the cost of equity is too high needs to be reflected and assumptions generous to the companies removed.
- **Incentives.** Some incentive schemes are designed to favour the companies. For example, companies will be rewarded for delivering transmission investment simply on time.
- **Direct impacts on consumers.** The range of possible bill impacts needs to be transparently communicated and fully taken into account in other areas, such as designing targeted bill support and the ongoing Cost Allocation Review.

Cost of equity

Delivering on the investment needed to meet Net Zero is crucial to provide consumers with a reliable energy supply. At the same time, meeting Net Zero requires continued consumer confidence, so must represent value for money for consumers. Throughout previous price controls there has been consistent evidence that the baseline cost of equity has been set too high. Failing to get returns right risks undermining public confidence. At this juncture of unprecedented investment, it is now more important than ever to break the cycle of network companies making too much money at the expense of consumers.

Real-world evidence

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

Energy transactions between 2021 and 2024

Transaction	MAR	Date
Western Power Distribution	1.61 ³	2021
SGN	1.35 ⁴	2021
National Grid Gas Transmission	1.30 ⁵	January 2023
SSE	1.70 ⁶	2022
National Grid Gas Transmission	1.25 ⁷	July 2024
ENWL	1.60 ⁸	2024

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

We are therefore disappointed that whilst Ofgem recognises this, it then does not take steps to include this real-world evidence in its determination of the baseline cost of equity. This risks undermining credibility and consumer confidence in being charged fairly for the massive investment required in RIIO-3. It is particularly notable that Ofgem has relied on transaction evidence previously⁹, but has not done so at such a crucial juncture. Maintaining regulatory predictability and stability is vital for long-term interests of both consumers and companies. Therefore, compelling evidence is required for Ofgem to move away from established positions, not least those that have been

³ National Grid, [Proposed acquisition of Western Power Distribution and Strategic Portfolio Repositioning](#), March 2021

⁴ Utility Week, [Analysts surprised at SGN premium](#), August 2021

⁵ Utility Week, [National Grid sells further 20% stake in National Gas](#), July 2023

⁶ EV for 25% stake: £1.47 bn. 100% implied EV: £5.88bn. RAV: £4.16 bn. From: Financial Times, [SALE OF 25% STAKE IN TRANSMISSION BUSINESS](#), November 2022

⁷ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, p.65.

⁸ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, p.65.

⁹ Ofgem, [ED2 Draft Determinations](#), December 2022, p.43.

accepted by the CMA.¹⁰ We want Ofgem to reconsider the weight of the consistent historical evidence that shows premia being paid for network companies, pointing to a baseline cost of equity that is too high.

Citizens Advice has applied Ofgem's MAR inference model to the recent transactions of NGT in July 2024 and ENWL in August 2024 to infer a real cost of equity. The real cost of equity range implied from these transactions is 2.82% to 5.09%, depending on the assumption for RAV growth. This suggests that Ofgem's proposed cost of equity of 6.04% and 5.64% for gas and ET respectively are far too high.

Structural over-estimation

It is not surprising that this real world evidence shows that Ofgem's proposed cost of equity is too high. This is to be expected due to the structural over-estimation issues we have previously outlined with approximations made while applying the Capital Asset Pricing Model (CAPM). For example, in line with CAPM theory, the Total Market Returns (TMR) should represent all assets in the economy, rather than UK equities. This argument was accepted by the CMA: *"we agree with Citizens Advice's argument that, theoretically, the TMR should reflect the return on all assets in the economy, and that there is some evidence suggesting that total returns across all asset classes are lower than those on equities alone, and potentially materially lower"*.¹¹ The CMA also acknowledges potential practical implementation issues, but says that regulators should give *"careful consideration"*¹². We see no evidence that any consideration has been given.

In practice, this situation has been made worse by changing position over the inclusion of European comparators. Ofgem and the CMA have previously determined that little weight should be placed on European comparator betas since multiple types of risks can be expected to differ between the UK and European justifications, making comparison inherently difficult and meaning they do not improve the robustness of the estimation. Despite all evidence suggesting European comparator betas are not reliable, Ofgem switches position from prior price controls to now include them. This undermines regulatory predictability and stability.

¹⁰ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), October 2021, p.226-227.

¹¹ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), October 2021, Para 5.200

¹² CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), October 2021, Para 5.201

In addition to having included European comparators without providing any evidence for doing so, Ofgem have applied further generosity by including European betas that are high and excluding those that are low, without significant justification for doing so, as explored in our response to FQ11. The upward pressure this puts on the estimation ultimately leads to an equity beta which sits within the range so high it is deemed inconsistent with econometric evidence according to experts in the field.¹³

Further generosity

Furthermore, despite the evidence that the cost equity is too high and the reasons why that is the case, Ofgem has also made a number of detailed decisions that are generous to the companies. These include:

Issue	Size of generosity	Detailed decision
Halo effect	7bps	Ofgem grants a +25bps adjustment to the cost of debt benchmark, despite the evidence pointing to only an +18bps gap. At RIIO-2, Ofgem made no downward adjustment despite there being a 7bps gap in the opposite direction.
Cost of carry	Up to 13bps	In previous price controls, Ofgem's cost of carry adjustment of 10 bps sat at the very top end of a plausible range from 1.5-11 bps. Drawing on the same methodology, Ofgem opt for cost of carry adjustments of 11bps and 13 bps.
Additional cost of borrowing	9bps - 15 bps	The CMA determined an additional cost of borrowing of 10bps at PR19 final determinations. Ofgem grants additional borrowing costs of 19bps for ET and 25 bps for gas.
Cost of raising new equity	Up to 5%	5% has been deemed to be a "high estimate of the cost of raising new

¹³ Wright, Burns, Mason, Pickford, [Estimating the cost of capital for implementation of price controls by UK Regulators](#), 2018, P.9

		equity". ¹⁴
Serial correlation	10 bps - 40 bps	In their ex ante TMR calculation, Ofgem removed a downward adjustment of -0.1% despite no conclusive evidence that serial correlation is not present. At PR19 the CMA suggested a downward adjustment of 40 bps to accommodate this.
Geometric-to-arithmetic conversion	6 bps	In their ex ante TMR calculation, Ofgem uses an uplift of 1.61% despite the CMA, DMA and Ofwat applying a 1.5% uplift.
CPIH basis risk	0.4%	Companies with exposure to CPI-linked instruments benefit from the 0.4% long-run wedge below CPIH indexation.

Given this context of wide-spread and consistent generosity in the price controls, Ofgem should be leaning on the side of caution when setting the cost of equity. Unfortunately, in RIIO-3 Ofgem has built-in further generosity with the inclusion of European beta comparators and by not taking into account transaction MAR evidence. Proposing a cost of equity at the mid-point of the CAPM implied range is therefore too generous and, in reality, represents 'aiming up'. We are calling on Ofgem to:

- Maintain regulatory predictability by not including European comparators
- Include transaction MAR evidence as part of the cross-checks
- Remove generosity from the detailed decisions outlined
- Select a cost of equity at the bottom of the estimated range

Incentives

RIIO1 and RIIO2 outperformance

Companies have been able to systematically outperform, due to allowances being too generous and performance targets being too easy to achieve, on a

¹⁴ Ofgem, [RIIO-ED2 Draft Determinations – Finance Annex](#), June 2022, P.120.

consistent basis. In 2019 our report [Monopoly Money](#)¹⁵ found that energy consumers in Great Britain had overpaid by billions between 2004 and 2019. This work updated and extended [Energy Consumers' Missing Billions](#)¹⁶, which was published in 2017.

Ofgem has been attempting to address this by both looking at the root causes of outperformance and introducing safeguards such as the Returns Adjustment Mechanism. However, using Ofgem's measure of financial performance known as Return of Regulatory Equity (RoRE), we have found that current performance is at a similar level to the previous set of price controls.

Number of network companies outperforming and underperforming

Number of companies	RIIO-1		RIIO-2	
	Outperforming	Underperforming	Outperforming	Underperforming
Electricity Distribution	6	0	6	0
Gas Distribution	4	0	4	0
Electricity Transmission	3	0	3	0
Gas Transmission	0	1	1	0
Total	13	1	14	0

Under incentive regulation, companies that perform better than others should be able to earn additional rewards. However, what we observe is systematic overall outperformance with *all* companies outperforming their allowed returns and earning additional rewards in RIIO-2. Again, we do not see these returns associated with improved outcomes for customers, but because of financing and tax benefits.

¹⁵ Citizens Advice, [Monopoly Money](#), 2019

¹⁶ Citizens Advice, [Energy Consumers' Missing Billions](#), 2017

R1103 package

We have scrutinised Ofgem's incentive package across all the sectors to ascertain whether they are likely to be effective in improving consumer outcomes and if they could end up generating excess company profits. While we are supportive overall, there are some incentives, such as the CSNP-F for Electricity Transmission, that appear to be weighted in favour of companies, asking consumers to bear more risk for under-performance. Additionally, in some cases (e.g. the Gas Distribution Complaints metric) we have suggested that Ofgem use dynamic targets to ensure that it is not too easy to either receive a reward or avoid a penalty.

Ofgem is also proposing several additional reputational incentives across the different sectors. ODI-Rs can be a useful part of the regulatory package, but Ofgem must commit to assessing their effectiveness in driving required behavioural changes and improving outcomes for customers. Ofgem should also ensure that ODI-Rs are set up to succeed by regularly publishing high quality information that places data within a narrative of improving or declining performance and including league tables to compare companies against each other and their own previous performance.

Direct consumer impacts

Vulnerability and Carbon Monoxide Allowance (VCMA)

Ofgem has increased the amount of the VCMA UIOLI funding pot from £74 million at the Sector Specific Methodology Consultation stage to £165 million at Draft Determinations. We are concerned that this money is not spent strategically and lacks the required level of regulatory scrutiny, which could result in duplications and gaps in provision for consumers in vulnerable circumstances. In our response, we outline ways for Ofgem to increase the value to consumers from the VCMA, including increasing the minimum ringfenced for collaborative spending.

Bill impacts

We believe delivering the plans outlined in R110-3 is in the interests of consumers. Investment, particularly in the crucial projects needed to enable Clean Power 2030, will reduce the payment of constraint costs and result in decarbonisation. Due to the heavy reliance on Uncertainty Mechanisms over

baseline allowances in ET3, the impact on bills may be hard to predict. Ofgem anticipates that the overall spend in ET could reach over £80 billion in the period, though the timing of when these costs will enter the system is yet to be determined. Ofgem will need to keep a transparent dialogue over bill impacts, as consumers have the right to know, and the regulatory arrangement will need to keep pace with other policy developments in the retail space and coming from the government. In particular, the ongoing Cost Allocation Review needs to be informed by a reliable range for future network charges. We have previously outlined that targeted bill support can mitigate against the risk for people who may lose out from changes needed to deliver clean power by 2030¹⁷. We believe that targeted bill support can mitigate the risk of people being worse off temporarily, before resulting benefits such as lower constraint costs are realised, as the level of support can be adjusted to reflect the impact on bills.

¹⁷ Citizens Advice, [Frozen in place](#), February 2025 (pg 22)

1. Overview Questions (selected)

Introduction

OVQ1. We would welcome any views on the enduring role of the ISGs during RIIO-3 and for future price controls.

We support the role of the ISGs as a critical friend to networks and as a way for customer needs to be represented throughout the RIIO period, particularly for those in underrepresented groups or in vulnerable circumstances.

We feel that there should be more consistency and transparency in ISGs. We noted that networks shared different levels of information in the ISG sections of their business plans, with some offering evidence of how ISG feedback was taken into account and others only giving more general statements. Ofgem should look to standardise how companies report on the role ISGs play in iterative business planning and accountability throughout the RIIO period.

There are also difficulties with interacting with ISGs due to their confidentiality arrangements with networks. While these may be necessary for commercially sensitive information, we would like to see more guidance from Ofgem on how ISGs fit into the wider picture of consumer advocacy.

Cost of Service

OVQ19. Do you agree with our proposed approach to ongoing efficiency?

We broadly agree with the proposed approach to ongoing efficiency. We believe the evidence supports a value above the mid-point of Ofgem's range and so the target should be at least 1%. In a competitive market, companies by default have to continually improve their productivity to stay competitive and profitable. It is fair that network companies have a sufficient productivity target to replicate this dynamic so that consumers are not funding inefficiencies. However, setting a productivity target by reference to non-regulated companies will not be sufficiently challenging. Firstly, it is important that consumer funded innovation allowances be taken into account. Secondly, every network company within a regulated sector can benefit from a single company's productivity initiative. This is due to mechanisms to share best practice that cannot exist in a competitive

market. For example, the Energy Networks Association says its mission is ‘to facilitate collaboration across our sector, share best practices...’

OVQ20. Do you agree with our proposed NIA funding levels?

Yes. In principle, we agree with Ofgem’s approach of not automatically awarding the full amount requested by network companies. This encourages more efficient use of funding. And Ofgem’s rationale for reducing the requested amounts is sound, reflecting the revised NIA scope - excluding hydrogen transport infrastructure and evidence gathering for hydrogen heating or blending - as well as identified gaps in network companies’ business plans.

OVQ21. Do you agree with our approach to the future of gas-related workstreams?

Yes, we support Ofgem’s proposal to halt funding for further hydrogen-related projects under RIIO-3. As hydrogen transport infrastructure is already supported through the Hydrogen Transport Business Model (HTBM), additional funding via RIIO-3 would risk duplication. Secondly, with policy decisions still pending on the use of hydrogen for heating and the potential for hydrogen blending at both distribution and transmission levels, it is sensible to pause further evidence gathering in these areas. Given that 90% of innovation funding comes from consumers’ energy bills, it is essential to avoid investing in areas of high uncertainty where major policy decisions are required and the benefits are not yet clear.

OVQ22. Do you agree that £2.5m of additional NIA should be used to provide enhanced advisory services for innovators at the early stages of innovation development?

We do not object in principle to the allocation of an additional £2.5 million of NIA funding to support enhanced advisory services for early-stage innovators. However, we are cautious about the potential for overlap with existing support structures, particularly those provided by Innovate UK and the Energy Systems Catapult.

To avoid duplication and ensure that any advisory services add value, a clear scope and delivery mechanism must be established. This initiative must complement, rather than duplicate, Innovate UK’s existing work to support innovators. To address these concerns, we recommend that Ofgem clearly

define the scope of the proposed advisory services in collaboration with stakeholders, and set out how these services will avoid duplicating support already offered by Innovate UK, the Energy Systems Catapult and other existing mechanisms.

OVQ23. Do you agree with our approach to improving oversight and reporting of the NIA?

Yes, we agree with Ofgem’s approach to improving oversight and reporting of the NIA.

Our report on innovation¹⁸ highlights persistent gaps in transparency that reinforce the need for stronger oversight of innovation projects funded by energy billpayers. We found that over 20% of reviewed NIA projects fail to clearly articulate their intended benefits, making it difficult to assess the value delivered. In addition, only 40% of projects include a breakdown of costs or funding sources, reducing financial transparency.

In addition, there is limited visibility on how many NIA-funded projects have moved beyond the research and development stage into full implementation. Without this information, it is difficult to assess whether NIA funding is delivering practical, real-world benefits for consumers.

These findings support Ofgem’s efforts to strengthen reporting requirements and improve the accountability of innovation spending, particularly given that energy billpayers provide the majority of funding for these innovation projects.

OVQ25. Do you agree with our proposals to introduce a ‘Programmatic Approach’ to the SIF?

Yes, we support the idea of a Programmatic Approach, but the current proposals lack clarity. There is limited detail on how Ofgem will measure the performance of networks or projects, and what will be considered a successful outcome. Implementation should be a core innovation target, with clear expectations for how many funded projects progress from trials to full deployment. It is also unclear what regulatory or financial consequences would apply if a network consistently fails to meet its innovation targets. We recommend that Ofgem

¹⁸ Citizens Advice, [Making Innovation Count: A Transparency Review of NIA and SIF Projects](#), August 2025

implements clear metrics and accountability mechanisms to ensure that the approach delivers the intended impact.

OVQ26. Do you agree with our proposal to introduce a £50m deployment fund, utilising £50m from the total £500m SIF allocation?

Yes, we support the £50 million deployment fund as a positive step toward scaling successful innovation. However, we are concerned that, without clear and transparent criteria for project selection, the funding could be directed toward projects that are simply easier to deploy or primarily benefit network companies. This risks overlooking projects that offer greater value to consumers or long-term benefits to the wider energy system. Clear guidance on how projects will be prioritised is essential to ensure the fund delivers meaningful impact.

In addition, projects supported through the fund should be required to maintain clear and detailed records of their implementation. This should include what was delivered, when it was delivered, key milestones achieved, and the consumer and system benefits realised. Comprehensive documentation would create a robust evidence base to assess whether deployment funding is delivering value, while also improving transparency and enabling lessons to be shared across the sector.

OVQ27. Do you agree that the deployment fund should also be open to innovation projects that haven't been funded through NIA, NIC or SIF?

Yes, we agree that the deployment fund should be open to innovation projects beyond those funded through NIA, NIC, or SIF. Restricting eligibility could exclude high-potential projects supported through other credible sources. Broadening access would encourage greater innovation diversity and enable Ofgem to support the most promising deployment-ready solutions, regardless of their original funding route. This approach would help maximise consumer value and accelerate system-wide impact.

OVQ29. Do you agree with our proposals to retain the core aspects of the SIF for RIIO-3?

Yes, we agree with the proposal to retain the core aspects of the SIF for RIIO-3. However, we have concerns about oversight and reporting. Our report highlights inconsistencies in the level of information provided across SIF projects, making it

difficult to assess progress and impact. We also found that several SIF projects are still marked as “live” despite their end dates having passed. Strengthening oversight and ensuring timely, consistent reporting will be essential to maintaining the credibility and effectiveness of the SIF in RIIO-3. We will share our innovation report with Ofgem and the networks, and would encourage Ofgem to consider the findings when designing the SIF for RIIO-3.

OVQ30. Do you agree with our proposals for a more flexible approach to contribution rates to fund SIF projects?

Yes, we support the proposal to introduce greater flexibility in SIF contribution rates. Removing the 10% contribution requirement for high-risk, high-impact projects could enable innovations with significant consumer or system benefits that might otherwise struggle to attract funding.

However, we believe it is important that network companies have some level of financial commitment to all innovation projects to ensure shared risk and accountability. For example, Ofgem could consider setting a minimum contribution rate — such as 5% for higher-risk projects and perhaps 20% for lower-risk, commercially attractive projects.

Requiring higher contributions from lower-risk projects ensures public funding is focused where it is most needed, while maintaining a diverse innovation pipeline and making efficient use of consumer funds.

OVQ31. Do you agree with updating the SIF eligibility criteria and assessment process?

Yes, we agree with the proposal to revise the SIF eligibility criteria and assessment processes, placing a greater focus on project outcomes. Moving from a binary yes/no assessment to a scaled approach will enable Ofgem to identify projects that offer the most significant benefits to consumers more effectively. However, we are concerned that, without clearly defined metrics, a scaled assessment could introduce subjectivity and inconsistency in decision-making. To ensure fairness and transparency, it will be crucial for Ofgem to develop a robust and well-defined scoring framework to guide the new process.

OVQ32. Do you agree with our proposal to establish a direct pathway for transformative projects to seek Ofgem's support for funding?

Yes, we agree with the proposal to create a direct route for innovators to engage with Ofgem. This approach helps address a key structural issue where network companies may deprioritise projects that do not offer them direct commercial benefits, even if those projects could deliver significant value to consumers or the wider system. However, we are concerned that without a requirement for networks to take projects forward, some high-potential proposals may still fail to progress. Even with Ofgem's support, network involvement is still essential to getting projects off the ground.

OVQ33. Do you agree on the need to clarify roles and responsibilities within the innovation ecosystem, and the factors that we should consider?

Yes, we agree with the proposal to clarify roles and responsibilities and strengthen collaboration across the innovation ecosystem. Clearly defining the role of each party will help reduce duplication, improve coordination, and streamline decision-making. Greater clarity will also support a more efficient and transparent system—ensuring that resources are used effectively. This is particularly important given that consumers fund the majority of innovation activity.

OVQ34. Do you agree with our approach to improving reporting of deployed SIF projects and lessons learned post-funding?

Yes, we agree with the proposed approach to improving reporting for deployed SIF projects and lessons learned post-funding.

At present, there is very limited visibility on how many SIF-funded projects progress beyond trials to full-scale implementation. Without this information, it is impossible to judge whether consumer-funded innovation is delivering real-world benefits or simply remaining as pilots. Tracking and reporting on implementation outcomes is essential to understanding the actual impact of SIF funding.

In addition, only projects in the Alpha and Beta phases are currently required to report lessons learned. This requirement should be extended to Discovery phase projects to capture insights from the entire innovation cycle. Extending the lessons learned requirement to all phases would ensure a more complete picture of the innovation process and maximise the value of consumer-funded research.

Our report on innovation transparency also highlights that the quality and depth of lessons learned documentation vary significantly between projects. To ensure meaningful learning and sector-wide improvement, all projects should be required to provide sufficient context and detail when reporting on lessons learned.

2. ET Annex Questions (selected)

Outputs and incentives

Infrastructure fit for a low-cost transition to Net Zero

ETQ1. Do you have any views on our proposed approach to which projects will be in scope of the CSNP-F ODI-F, especially projects submitted through the Load Re-opener?

We agree with Ofgem's new position in the Draft Determinations that all CSNP-F outputs should be in scope. This will streamline regulatory approach, and aligns ET3 with NESO's robust analysis on where consumer benefits can be best realised.

Considering the non-CSNP projects for the ODI-F through a consultation process should enable Ofgem to gain a balance of views between different commercial and consumer representatives. Ofgem should however be mindful of how this could delay project delivery dates for essential build, and calculate consultation timelines to line up with NESO's ODDs.

ETQ2. Do you agree with our proposed approaches to determining a TDD for CSNP-F Outputs and non-CSNP-F Outputs?

We agree that using NESO's ODD makes sense, as it aligns with existing work calculated into the consumer value of new investment, along with deliverability and wider system needs. The TDD for non-CSNP-F projects, e.g. those coming through the Load Re-opener, being determined by TOs makes sense in theory, as TOs will be closer than Ofgem to the logistics and practical considerations surrounding delivery. Ofgem should attempt to strike a balance between making a thorough assessment of a TOs proposed TDD (ensuring in particular that TOs are not allowing unnecessary lee-way) without duplicating the work that TOs have already done, therefore delaying the process.

ETQ3. Do you agree with our proposed inclusion of a minimum availability standard in the CSNP-F ODI-F?

Yes, we agree that the principle of a minimum availability standard will ensure that assets are fully operational and can contribute to the reduction of

constraint costs borne by consumers. Excluding factors outside of TOs' control would be a fair approach (provided that TOs can prove that they couldn't have foreseen and mitigated against the event).

It is unclear how and why Ofgem has reached the figure of 93% circuit availability for projects. It would be useful to see the rationale to assess whether or not this is appropriate.

ETQ4. Do you agree with our proposed approach to Delay Events in the CSNP-F ODI-F?

We recognise that there may be significant delays to projects that could not have been foreseen by the TOs, and they should not be penalised when these occur. We agree in principle with the inclusions and exclusions, including that supply chain issues should not be considered as TOs are expected to use other mechanisms, such as the APM, to mitigate against this. We do feel though that the inclusion of a 1 in 10 weather event is generous, and it could be argued that these could be mitigated against as part of effective contingency planning. Ofgem should consider lowering this to 1 in 20.

However, as outlined in our response to ETQ5, under the proposed structure of the CSNP-F ODI-F incentive, the TOs will benefit from a 12 month deadband following the TDD. In practice, this would work as an additional protection for TOs for delay events both in and out of their control, ensuring that they do not incur penalties for late delivery of up to one year. With the double protection of Delay Events (adding another year on top of the deadband) and the deadband for TOs, consumers are bearing a disproportionate level of risk, as even small delays put us further from unlocking the cost savings of reduced constraints and cheaper renewable power.

ETQ5. Do you agree with our proposed shape and size of the CSNP-F ODI-F incentive?

Ofgem's proposal for the size and shape of this incentive is similar to how ASTI worked under RIIO-2. We outlined our concerns with ASTI in our Sector Specific Methodology response¹⁹, specifically that its asymmetric design is detrimental to consumers, resulting in a bias towards rewards for companies when projects are

¹⁹ Citizens Advice, [Response to RIIO-3 Sector Specific Methodology for the Gas Distribution, Gas Transmission and Electricity Transmission Sectors](#), March 2024

delivered early or on time, and penalties only incurring past the deadband date - leaving consumers bearing most of the risk for late delivery. We have similar concerns for this incentive, which is again calibrated to minimise risks for TOs at the expense of consumers. The current proposal provides a reward for simply delivering on time and a series of protections against penalties for late delivery. This is significantly skewed in the favour of the TOs. We offer some suggestions on how the incentive could be recalibrated below. If this is not done, then this asymmetry should be taken into account when considering the cost of equity.

Ofgem justifies a 12 month deadband due to the degree of unavoidable uncertainty around the TDD, but that only appears to be relevant in late delivery, as TOs receive a reward for delivering on the date. The consultation argues that TDDs are uncertain, it does not seek to argue they are ambitious and points out that TOs will be involved in the process to set ODDs.

We would expect the target delivery date to be seen as neutral, receiving neither a reward or penalty, given that the date should have been chosen to accurately reflect the most realistic picture of when we can expect TOs to deliver a project. TOs should be incentivised to deliver on time but should not be rewarded for doing so. A lump sum to incentivise delivering on time is only required because of the deadband. Removing the deadband, alongside removing the lump-sum reward, ensures the TOs have an incentive to deliver as early as possible but do not get rewarded for delivering on time.

We support the daily reward increasing in line with NESO's forecast constraint cost saving for projects where this exists, as it clearly aligns rewards with consumer benefit and ensures that any payment to companies is outweighed by general system savings. However, we do not believe it makes sense to have different incentive rates for rewards and penalties. The consumer benefits are the same for rewards and penalties and so the incentive rates should be the same. Additionally, different rates could provide the wrong incentive at a portfolio level. TOs will have an incentive to prioritise delivering projects early over minimising delays to late projects, even when the consumer benefits for delivering the late projects are up to double the benefits of delivering early projects.

We are unable to assess the level and symmetry of risk for TOs following all the measures to reduce risk, such as the Delay Events and APM, but note that Ofgem view the caps on penalties as ‘appropriate to limit the amount of risk’.

ETQ6. Which of the two proposals for the Connections Capacity ODI-F target setting methodology do you think is most appropriate and why?

We agree with Ofgem that the first proposal should be the preferred option. Aligning with NESO’s Gate 2 update of the connections queue will help to incentivise TOs to prioritise connections that are most strategically aligned to meeting Clean Power 2030 targets, which is in consumers’ best interest for reducing overall system costs.

Ofgem’s proposed asymmetric design with a higher level of reward than penalty is justified as outperformance ‘would be challenging to accomplish’. Ofgem should monitor performance against this incentive to ensure that its hypothesis is correct, and that more broadly the incentive is calibrated correctly to ensure that TOs are meeting targets without gaining rewards too easily. It should be reviewed after a set period of two years.

ETQ7. Do you have any further considerations on our chosen direction for a RIIO-ET3 Connections Capacity ODI-F, including detail on how the targets could be built up?

We agree with Ofgem that the Quality of Connections Survey may work best as an ODI-R instead of an ODI-F as seen in ET2.

ETQ8. Do you agree with our proposed design of the Community Benefit Funding pass-through mechanism?

We agree with the use of a pass-through mechanism for TOs to deliver community benefits in line with new voluntary government guidance. However, we do not believe the proposal to only review administration costs related to project delivery if above 10% of the community funds meets government guidance. This guidance states: *Ofgem will scrutinise the delivery costs of Transmission Owners and developers, who will need to demonstrate to Ofgem that delivery costs have been built up from first principles, with resourcing costs itemised rather than based on fixed rates or percentages of overall project cost, and are efficient and economic in order for the costs to be recoverable.*

ETQ9. What are your views on our consultation positions for the TOs' EAP commitments in RIIO-ET3?

In using ODI-Rs instead of ODI-Fs, Ofgem will need to commit to the timely publication of data, including league tables, and conduct annual reviews to ensure that the reputational incentives are working as intended to improve performance across the sector.

ETQ12. What are your views on our consultation position for the IIG ODI-F target methodology in RIIO-ET3, in particular the bespoke treatment of SHET?

We are broadly in support of Ofgem's consultation position, and recognise that IIG initiatives offer direct consumer benefits through the reduction in greenhouse gas emissions. Proactive investment now could prevent more costly interventions or future carbon penalties that would ultimately be passed to consumers. However, Ofgem must commit to an appropriate level of regulatory scrutiny, including in-period reviews of performance, to ensure that TOs are not being awarded large amounts of money to enable them to gain rewards on this incentive - all of which would be paid for by consumers.

ETQ13. Do you consider that we should use the IIG Exceptional Event mechanism to manage potential issues with historical IIG inventory data? If so, why?

Yes. We feel that all measures should be taken to manage issues with historical IIG inventory data. Without this, consumers could end up paying for reductions that are not fully verified, undermining accountability within the RIIO-3 framework.

ETQ14. What are your views on our consultation position for the SF6 Asset Intervention PCD in RIIO-ET3?

We feel that extending the PCD to all TOs would provide an additional layer of consumer protection. Interaction between the ODI-F and PCDs should be scrutinised to ensure that rewards and penalties are working above and beyond the baseline expectations of TOs to drive the appropriate behaviours.

Secure and resilient supplies

ETQ15. What are your views on our proposals for the RIIO-ET3 ENS ODI-F, including the two different target setting methodologies we have shared?

Our preference would be for a penalty-only incentive for Energy Not Supplied, as TOs have embedded improved performance and are therefore continuing to receive rewards for performance that can no longer be seen as outstanding. Of the methodologies Ofgem has shared, we feel that Option 1 would be more appropriate as it considers more recent (and therefore relevant) data.

ETQ16. What are your views on our consultation position for the SO:TO incentive approach to BAU enhanced services in ET3?

Though we do recognise the value in an incentive that directly influences the reduction of constraint costs in the network, as we shared in our response to the Sector Specific Methodology Consultation, we have concerns that this incentive as it stands may not represent good value for money. In year 2 of the current scheme, for example, the TOs were able to earn over £8 million in incentive rewards compared to costs of £1 million.²⁰ We welcome the introduction of eligibility criteria to ensure only actions requiring incentivisation are rewarded but are unable to assess whether this fully addresses our concerns about value for money. We suggest Ofgem tests this by seeing what difference the criteria would have made had they been in place for RIIO2. If rewards would still be significantly higher than costs, our preference remains for Ofgem to move to a 95:5 sharing factor to reduce the rate of return.

ETQ17. Do you agree with our proposal to introduce a clawback mechanism in the SO:TO ODI-F for enhanced services requested that are unfulfilled?

Yes. It is essential that consumers do not pay for requests that don't materialise, and that the TOs are disincentivised to decline requests where the enhanced services are within their remit.

ETQ19. Do you agree with the need to introduce an Innovative Delivery Incentive to drive the five behaviours that we've identified and do you consider that there are any behaviours that are missing?

²⁰ Table 1 RIIO-2 System Operator: Transmission Owner Optimisation output delivery incentive

We broadly agree with the five behaviours identified as they would all deliver tangible consumer benefits. The behaviour that may be hardest to quantify is 'innovations in design/engineering', and its results (e.g. new design choices) could be captured within the other four benefits, particularly in speeding up delivery and savings in the supply chain.

ETQ20. What are your views on our proposed design of the Innovative Delivery Incentive?

On paper a reward-only incentive is hard to justify, as it assumes that poor performance against the objectives is neutral, even though it may have negative impacts on consumers. If Ofgem is to proceed with this incentive design, it should take care to calibrate the rewards sufficiently so that they are simultaneously difficult to achieve and worth the TOs stretching themselves to receive the reward. It should commit to reviewing its proposal of 50-100bps of RoRE in period to ensure that this balance has been struck effectively.

Of the options outlined for measuring performance, we agree that the Ofgem-led panel would be the best option, as it would take into account both quantitative and qualitative performance indicators. As well as industry input, the panel should look for consumer interest bodies to give a balanced overview of TO performance.

ETQ21. What are your views on how TOs could demonstrate 'consumer value' to justify rewards under the Innovative Delivery Incentive?

TOs should stick tightly to the criteria outlined by Ofgem in its proposed behaviours. TOs' performance should also be benchmarked against both previous years and each other, to ensure that only the best performance is rewarded under this incentive.

ETQ22. Do you agree with our proposal to introduce the CSNP Co-ordination LO?

Yes. Given that the CSNP will be one of the greatest influences on the ET3 period, and a key driver to ensure that CP2030 targets are met, an LO is the best mechanism for ensuring TOs focus their behaviour on the most important factors and outline Ofgem's basic expectations of companies in the next five years.

ETQ23. What are your views on our consultation position for the LEI UIOLI in RIIO-ET3?

We feel that the UIOLI mechanism is most appropriate for visual amenity works, and we appreciate Ofgem's proposals for additional data requirements that should provide greater transparency on how money is being spent.

ETQ24. What are your views on the proposed New Infrastructure Stakeholder Engagement Survey ODI-R, including areas of engagement measured, the proposed survey design, the stakeholders targeted, and the proposed reporting format?

Ofgem's proposal to include league tables and annual reporting requirements on this ODI-R should help to make the reputational incentive a strong driver to improve performance in stakeholder engagement. We would welcome a common template to make this reporting more comparable between TOs.

Ofgem should consider how it will monitor performance to ensure that improvements are made throughout ET3, especially given that this has been identified as an area of concern for stakeholders.

Managing uncertainty

Infrastructure fit for a low-cost transition to Net Zero

ETQ25. Do you agree with our proposal to retain the APM for RIIO-ET3 in its current form?

Yes. We are supportive of the APM being retained for ET3, and for the APM Cap to roll over between price control periods.

As the Draft Determinations for ET3 regulation are weighted towards timely delivery, there is less protection for consumers from cost overruns. In this context, the APM is a crucial tool for allowing cost savings to be made, allowing TOs to use their commercial insights to cut costs in the supply chain. Ofgem should therefore commit to an in-period review of the APM, making sure that TOs are maximising its benefits, and committing more funding to be made available if necessary.

ETQ26. Do you agree with our intended approach to PCF in RIIO-ET3?

Yes. As outlined in our response to Ofgem's Sector Specific Methodology Consultation, we are supportive of PCF being set at 2.5% of each TOs current forecast total project costs, and that all load-related expenditure should be in scope. We agree with Ofgem's Draft Determinations position that all PCD outputs should be reviewed on a case-by-case basis, due to the lack of certainty regarding spend in ET3.

ETQ27. Do you agree with our updated definition of EEW?

Yes, we welcome Ofgem's clarity on an exact definition of what constitutes Early Enabling Works.

ETQ29. Do you agree with our proposed scope, re-opener windows and materiality threshold for the Load Re-opener?

As outlined in our response to the Business Plans Call for Evidence²¹, we feel that more spending in ET3 will go through UMs rather than baseline allowances than is optimal. This could result in less oversight from Ofgem, leading to projects offering less value for money, and increases in bills that are harder to predict.

However, given that TOs have put the case forward for there being more uncertainty in ET3, we do feel that the proposed Load Re-opener offers a good compromise. We are particularly in support of a LO for the delivery of outputs.

While we agree in theory with the £25 million materiality threshold, Ofgem will need to ensure that numerous smaller projects are not cumulatively adding costs without the same level of scrutiny that larger projects are subject to.

ETQ30. Is it clear how the different Load Re-opener tracks operate, and do you agree with the rationale for introducing them?

Yes, we feel that Ofgem's proposals strike the right balance between applying necessary regulatory scrutiny to ensure that projects offer value for money, and avoiding unnecessary delays to build.

ETQ31. Do you agree with the scope and materiality threshold for the Load UIOLI?

Yes. This seems a sensible option for projects below the threshold for the Load Re-opener. The UIOLI mechanism will ensure that unspent funds are returned to

²¹ Citizens Advice, [Response to the Ofgem Call for Evidence on the ET, GT and GD Business Plans for RIIO-3](#), February 2025

consumers, and the Governance Document will help ensure that TOs stay within the scope of the mechanism. Ofgem should ensure that it undertakes periodic compliance reviews and commits to updating the governance should it prove to be unclear.

ETQ32. Do you agree with our proposed design of the generation and demand connections volume driver mechanisms?

We are broadly in agreement. This mechanism should ensure that TOs can swiftly adapt to the growth in renewable generation, which is ultimately in consumers' interests as it reduces constraint costs and enables cheaper renewable energy to come onto the grid.

However, we are concerned that in using a volume driver mechanism, additional costs could be passed through, which reduces the impetus on a TO to deliver efficiently. Ofgem will need robust oversight in this area to prevent overspending.

ETQ37. Do you agree with the proposed scope of the CSNP-F Re-opener?

Yes, we agree that a Re-opener is the best mechanism for costs associated with CSNP projects, given that there is uncertainty around its exact scope before its delivery in 2027. We concur that the scope should be projects included by NESO in the CSNP, as this removes the need for a needs case to be assessed.

ETQ38. Do you have any views on our proposed design of the CSNP-F Re-opener?

We support the inclusion of a LO for delivery on the date of NESO's prescribed ODD, as well as Ofgem's decision not to proceed with a materiality threshold due to the high potential for interlinkages between projects in the CSNP.

ETQ39. Do you agree with our proposed approach to T2/T3 crossover projects?

There is a lack of detail in Ofgem's proposals due to the need for further engagement with the TOs, therefore it is hard to comment on the proposed approach. However, we agree with Ofgem's position that no justified investment should be left unfunded, and that usual close-out mechanisms, or specific ET3 UMs, may be the best way for funding to be allocated.

ETQ40. Do you have any views with our proposed approach to ITA project eligibility?

We are supportive of Ofgem's outline for projects that will be eligible for the Independent Technical Advisor review, including the need for the scope to be malleable to the changing policy environment. The key characteristics outlined (materiality, complexity and strategic importance) align with key consumer priorities.

ETQ43. Do you have any views on our proposal to reject these two environmental UMs?

We are in favour of Ofgem's proposal due to the high costs and lack of associated detail in the TOs' business plans. We agree that it would be preferable to consider the use of low-carbon materials within the Project Assessment stage of the Re-openers. This will allow the regulator greater scrutiny, and consider low-carbon materials alongside other priorities, such as delivering projects quickly or for greater value.

Secure and resilient supplies

ETQ44. Do you agree with our proposal to introduce a Non-Load Re-opener to address funding gaps in shared-driver projects where the load-related need no longer exists, but an asset health requirement remains?

Yes, we agree with the rationale that a Non-Load Re-opener will prevent projects that could fall through the cracks of new priorities. Ofgem's preferred option should offer additional scrutiny through a needs case assessment and would link funding requests directly to consumer value. It is vital that certain uncertainties are managed by TOs through baseline allowances to ensure that consumers are not expected to bear all of the risk.

ETQ45. Do you agree with our proposed design of the Non-Load Re-opener?

It makes sense to use the default materiality threshold of 0.5% of the average annual ex ante base review to ensure that unplanned low materiality interventions are managed elsewhere.

Cost of service

ETQ70. Do you agree that the TIM in RIIO-ET3 should have a primary focus on risk management and a secondary focus on cost efficiency, and that doing so would be in the interests of consumers?

We believe it should be possible to maintain a focus on cost efficiency whilst also changing the balance of risk. We have previously outlined that we had not seen any evidence that there is a strong relationship between the share of under/overspends retained by companies and the size of those under/overspends²² i.e. the effectiveness of efficiency incentives does not, in practice, appear to be especially sensitive to the sharing factors. Although our call for lower sharing factors was to protect consumers from the systemic underspending against allowances that has been typical of energy network price controls, it also applies to protecting companies against overspends.

It is worth emphasising that adjusting the TIM does not manage the risk. It simply moves exposure to the risk from the companies to consumers. Indeed, as it is moving risk from parties with some ability to manage the risk to consumers, who have no ability to manage the risk, it is detrimental to risk management. Nevertheless, derisking the companies is an acceptable approach given the importance of the investment to consumers. Consumers, however, require compensating for this increased exposure through a lower cost of equity, reflecting both the specific changes Ofgem are proposing to reduce company risk and its general willingness to intervene on behalf of companies (for example, with the repeated interventions to make the retail price cap more generous²³).

We also feel that cost efficiency should not be abandoned entirely. It is vital that consumers see value for money from their (significant) investments. Some regulatory tool to address efficiency should be maintained at all times.

ETQ71. Do you agree with our proposed 'stepped' design of the RIIO-ET3 TIM, including the values that we have used to set each 'step'?

²² Citizens Advice, [Response to Sector Specific Methodology Consultation](#), March 2024, OVQ34

²³ Citizens Advice, [Response to the Ofgem statutory consultation on amending the methodology for setting the allowance for supplier profit margin in the retail price cap](#), July 2023

We are broadly supportive of the 'stepped' design of the TIM. However, we are concerned that at 15% of over-spend, there is full cost pass through. This means that there is no efficiency incentive on companies, and could result in consumers bearing the risk of poor planning from TOs, or procurement not fully realising value for money. Although cost efficiency is a secondary priority for Ofgem, it should be wary of abandoning it entirely. We believe maintaining a 5% sharing factor, in conjunction with the protection offered by the Returns Adjustment Mechanism, could still provide sufficient protection to the consumers. Alternatively, Ofgem could retain the ability to intervene on clearly inefficient spend, similar to arrangements that have been in place for the System Operator²⁴, who also operates on a pass-through basis.

An area that is not covered in the consultation, but is important to properly incentivise delivery, is compatibility with the delivery incentive (CSNP-F ODI-F). This delivery ODI-F gives TOs a share of the consumer benefits of delivering infrastructure reflected by avoided constraint costs. This share will generally be different to the share of under/overspend meaning the overall incentive to the TO will not reflect the overall consumer benefit. Ofgem should review this.

ETQ72. Do you agree with our proposal to include ASTI within this TIM approach?

Yes, we agree it is sensible to avoid differing TIM treatments in different parts of the price control.

²⁴ Approach to 'Demonstrably inefficient or wasteful expenditure'

6. GD Annex Questions (selected)

Outputs and Incentives

Infrastructure fit for a low-cost transition to Net Zero

GDQ2. Do you have any views on our proposed funding for the DPLA and ALD?

Advanced Leak Detection

We agree with Ofgem's proposal to fund the roll out of ALD through baseline allowances, and to allow requests for additional funding through the NZARD UIOLI allowance. This aligns with HSE's expectation that ALD should be rolled out for monitoring of leaks by all GDNs from 2026 onwards.

However, there is a wide variation in the costs requested for ALD in networks business plans. Cost proposals range from £4.9 million for NGN to £27.4 million for Cadent. It is unclear what is driving these differences. It is also unclear which technologies the gas networks intend to use and how often they plan to proactively survey their network to monitor leakage. Due to this uncertainty, it is hard to evaluate if the networks' proposals offer value for money for consumers. Ofgem should ensure it scrutinises GDNs proposals in this area and ensure that there is sufficient justification for the differences between them. Ofgem should also set clearer expectations on how networks should use ALD to ensure there is not significant variation in consumer outcomes across different areas of the country.

Digital Platform for Leakage Analytics

We agree with Ofgem's position to fund the DPLA through baseline allowances for Cadent, and through the NZASP Re-opener for NGN, SGN and WWU. This reflects the fact that Cadent has led the DPLA innovation project, and so it has greater certainty of costs and timelines for implementing the DPLA in GD3 than other networks. It appears that the uncertainty around costs for other networks will not be clarified before Final Determinations, meaning that funding through the NZSAP is most appropriate.

However, if different networks roll out DPLA at different times it could create a lot of variation across the country and fail to deliver sufficient benefit for consumers. A delayed roll out may also undermine attempts to collect data for a potential shrinkage incentive in GD4. Ofgem should consider if it is possible for the most important parts of this programme, for example the shrinkage model, to be rolled out as soon as possible.

The implementation of the DPLA does also raise wider questions about how the findings from innovation projects are shared and subsequently implemented. Our recent report reviewing innovation projects found that some projects lack clear next steps around how the findings should be implemented and do not explain how the findings are disseminated.²⁵ We believe Ofgem needs to introduce clear reporting guidance for innovation projects to ensure they produce insights that are specific, actionable, and transferable.

GDQ3. Do you agree with our proposed design of the 7 and 28 Day Repair Standards ODI-F, including the proposed performance targets and incentive rate?

We agree with Ofgem's proposal to introduce a repair standards incentive requiring that GDNs complete 75% of outstanding repairs in 7 days and 90% in 28 days. Data collected through the RRP's show networks' performance in this area has declined. This new incentive is a useful backstop to prevent any further deterioration in performance. Introducing this new standard also aligns with Ofgem's new legal duty to prioritise the UK's 2050 Net Zero target.

We agree that a penalty only incentive is warranted, as repair standards is an area in which consumers would expect a minimum standard of performance. We believe that the incentive rate of a penalty cap of 0.17% of RoRE is appropriate, as it is in line with similar penalty only incentives such as the complaints metric and unplanned interruptions incentive.

We do not believe that introducing this standard will cause networks to prioritise short term and reactive work to leakage. Networks should be able to manage their work load to address both proactive long term leak management and short term fixes. We believe that the differing 7 day and 28 day targets account for any difference in complexity of the repairs required. We also note that the proposed

²⁵ Citizens Advice, [Making Innovation Count](#), August 2025

targets are less stretching than those originally proposed by NGN, that networks should fix 89% of outstanding repairs within 7 days and 98% of outstanding repairs within 28 days.

GDQ4. Do you agree with our proposal to enable the GDNs to submit RESP coordination and engagement activities through NZARD and NZASP?

We agree, on a technical basis, with Ofgem's proposal to enable GDNs to submit any proposals for RESP co-ordination and engagement activities through the NZARD and NZSAP. However, we do not believe GDNs should need to do so in practice. The role of NESO in developing the RESPs is to provide strategic oversight and co-ordinate stakeholder engagement activities, so coordination funding should not be required. Meanwhile, we do not believe engagement activities are outside business as usual activity, as is the case for engagement with price control development. Ofgem asserted that a reasonable and prudent GDN acting in its own interests would participate in RESP engagement, regardless of the new requirement to do so²⁶. It is therefore not appropriate for bill-payers to fund GDNs to carry out new engagement workstreams. If funding for this type of work does become required, we recommend that the GDNs make use of their ~£1bn windfall returns²⁷ and if not, then the NZARD and NZASP are the most appropriate ways to fund this.

Secure and resilient supplies

GDQ5. Do you have any feedback on our approach to assessing non-mandatory repex workloads?

We agree with Ofgem's approach. We feel the objectives of ensuring the GDNs maintain a safe network and that investment is justified and efficient in the context of declining usage of gas are the right ones to use to assess non-mandatory repex. We believe that the timing of further investment in the gas network, against a background of declining gas usage, needs to be very carefully considered to ensure consumers do not pay for assets and activity which could fail to deliver benefits in time. We also support the proposal to reduce the payback cut-off period from 16 years to 11 years.

²⁶ Ofgem, [RESP - Policy consultation on licence modifications](#), July 2025, Paragraph 3.15

²⁷ Citizens Advice, [Debt to society](#), February 2025

GDQ6. Do you have any comments on the proposed design of the Tier 1 Mains Decommissioned PCD, including the position to retain the 3% cap on the upwards Allowance Adjustment Mechanism?

We agree with Ofgem's decision to retain this PCD. We particularly welcome Ofgem's proposal to retain the 3% cap on the upwards Allowance Adjustment Mechanism, with any overspend beyond this captured by the Totex Incentive Mechanism. This cap is needed to protect consumers from inefficient overspend.

GDQ7. Do you have any comments on the proposed design of the Tier 1 Services PCD, including the position to retain the 10% cap on the upwards Allowance Adjustment Mechanism?

We agree with Ofgem's decision to retain this PCD. We particularly welcome Ofgem's proposal to retain the 10% cap on the upwards Allowance Adjustment Mechanism, with any overspend beyond this captured by the Totex Incentive Mechanism. This cap is needed to protect consumers from inefficient overspend.

GDQ8. Do you agree with the proposed design of the Tier 1 Iron Stubs PCD?

We agree with Ofgem's proposal to introduce this new PCD to fund Tier 1 iron stubs work. We support the automatic clawback mechanism included in the design for any under delivery, which will ensure that consumers are not paying for work which is not undertaken.

GDQ9. Do you agree with our proposal to update the Emergency Response Time LO to prevent the downward reclassification of gas escapes?

We agree with Ofgem's proposal to update the Emergency Response Time LO to prevent the downward reclassification of gas escapes from uncontrolled to controlled after the initial classification by the National Gas Emergency Service. We agree with Ofgem's reasoning that, during a remote risk assessment carried out over the phone, some consumers may not be able to assess the situation appropriately and that the original classification of the gas escape should still stand.

GDQ10. Do you agree with our proposed design of the ERTLO ODI-R?

We agree with the proposed design on this incentive. A reputational incentive in this area could motivate companies and ensure that attention is paid to this area by senior management in GDNs. We welcome the proposal to mandate the GDNs to publicly report data in cases where they fail to meet their obligations under the ERTLO. We believe that requiring the GDNs to provide a breakdown of the number of failures in each month and the length of time of the failure ensures Ofgem has oversight in how consistently networks are meeting the licence obligation. Collecting this data also means that it could be used to form the basis of targets in the future, if the ERTLO target is changed from annual to seasonal or monthly.

It would be useful for Ofgem to publish a collated, consistent and comparable view of the data collected for this reputational incentive. For all reputational incentives we believe that wider and clearer scrutiny of this data would increase the level of attention given to it by networks. It would also maximise the value of the incentives and the value for money for consumers, by ensuring companies are striving to deliver the best they can with the funding provided by customers.

High quality of service from regulated firms

GDQ11. Do you agree with our proposed design of the VCMA UIOLI mechanism?

Given the proposed increase in funding, and significance this gives VCMA funding as part of the overall suite of vulnerability initiatives, we believe there needs to be a step-change in VCMA governance. We agree with Ofgem's aim to *"encourage increased stakeholder input into project design, promote collaboration beyond the 25% ringfenced minimum, and enhance the reporting of project and partner learnings"*. We also note that Ofgem *"expect the GDNs to deliver on their commitments to seek further opportunities for collaboration with other GDNs, sectors, and funding sources"*. However, given the scale of the proposed funding, it is no longer sufficient to rely on *expecting* and *encouraging*, it should now be *required* that GDNs deliver on commitments.

In order to do so, Ofgem should:

- Raise the 25% ringfenced for collaborative spending. This would leverage economies of scale, reduce the proportion of the funding spent on admin costs, and create the possibility of more engagement with the broader network, including government departments. Recognising the value of

stability, changes could be applied only to the additional funding proposed compared to the Sector Specific Methodology decision. As this is new money yet to be decided upon, GDNs cannot have committed spending and so it remains open how it is spent. To reduce the burden on GDNs (who we appreciate have already delivered their vulnerability strategies) they could first look for opportunities to scale up their most successful individual projects into collaborative ventures.

- Create a role for an independent, expert group or party within the VCMA governance. There are a range of roles that this could perform, but should include ensuring there is a cohesive strategy towards addressing vulnerability, including fuel poverty. This should be developed as part of updating the VCMA governance guidance ahead of Final Determinations.

Additionally, although we support several activities moving into baseline funding, it is hard to see how GDNs will spend the additional money apportioned to them with the exclusion of some of their existing work, and given that in some years of GD2 (with a lower funding pot) the money wasn't fully spent²⁸. Ofgem will need to ensure that BAU activities receive a high level of regulatory scrutiny to ensure that projects are funded through the correct channels and that double funding is avoided.

We welcome Ofgem's review of the VCMA governance document before Final Determinations and the increased reporting metrics around BAU funding, as a way to increase scrutiny in this area which we believe has been lacking. As a comparator, the much smaller allowances of approximately £70 million in the ED2 period have been subject to significant oversight from both Ofgem and wider stakeholders, and will be underpinned by an independent assurance process²⁹. It is unclear if Ofgem regularly reviews PEA submissions to check that they have sufficient data and are of an acceptable quality, and while the requirement exists for a project to have a 'positive' SROI, they do not appear to be assessed for value for money.

We believe that Ofgem should commit to a review of the common SROI tool and, if necessary, direct the GDNs (potentially in partnership with the DNOs) to re-work the tool. It is one of the only measures for ensuring accountability, comparability and sufficient analysis of VCMA projects, however we have

²⁸ Gas Distribution Networks, [VCMA Annual Collaborative Report](#), 2021/22

²⁹ Ofgem, [ED2 Final Determinations](#), December 2022

concerns over how well it is working in practice and how widespread its adoption is. With a new standard of £150 million + VCMA funding each period, a workable common SROI is essential.

GDQ12. Do you agree with our proposed design of the Customer Satisfaction ODI-F?

Our preferred option for a customer service incentive would be to move to relative targets, rewarding the best performing GDNs and penalising the worst, with a fixed minimum standard set as a backstop. This aligns with the Department for Business and Trade's intention in its Smarter Regulation proposals to introduce more relative performance targets for regulated industries. It also creates incentives for GDNs to both consolidate their improved performance and strive for exceptional performance without overpaying on an incentive at the expense of consumers.

However, based on the design of the CSAT ODI-F in Draft Determinations, we support the targets Ofgem has proposed to set. In previous price control periods we have been concerned that CSAT targets were not stretching enough. We believe that GD2 targets were too generous and consistently rewarded GDNs for their performance. We welcome the fact that Ofgem no longer considers using data from GD1 for target setting is in consumers' best interests. The higher reward bands Ofgem has proposed for GD3 will avoid the outperformance seen in GD1 and the first years of GD2, and ensure that only performance which is exceptional relative to GD2 performance is rewarded. We also believe that the increase in the penalty bands will consolidate GDNs' performance and discourage deterioration.

Connections Survey

We agree with Ofgem's proposal that there should be a minimum threshold of survey responses for the connections survey score to count as part of the CSAT incentive, and that if the threshold is not met the score becomes ODI-R for that individual network. There is a high degree of uncertainty around how many connections there will be in GD3, particularly once the Future Homes Standard is introduced, and it is not in the interest of consumers or networks for GDNs to be rewarded or penalised on statistically unreliable survey data.

We agree with the proposal that the maximum incentive exposure available for each of the three survey areas should be fixed at an absolute weighting of 33.33% of the overall CSAT ODI-F. This fixed-weighting approach means that consumers are not potentially over-rewarding networks for their performance in other categories.

We note the concern from GDNs that the removal of Domestic Connection Load Allowance (DCLA) could impact connections survey scores. We don't think that this is the case, as it is likely that many consumers would not know the price of a connection before the DCLA removal. As the impact of the DCLA removal is still unknown, we do not think it would be in consumers' best interest to reduce the connections survey target at this time.

GDQ13. Do you agree with our proposed design of the Disconnections Customer Satisfaction ODI-R?

We agree with the proposed design of this incentive. Disconnections will become an increasingly high proportion of GDNs' workload in the future and it is necessary to collect data in this area to form the basis of potential ODI-F in GD4 and beyond. We also agree with the proposal that there should be two different surveys for consumer-led, paid for disconnections and for HSE-required, socialised disconnections. The consumer journeys for these two types of disconnection are very different and that may impact level of satisfaction. It is also important that both Ofgem and GDNs have oversight of the consumer experience for both of these types of disconnection.

GDQ14. Do you agree with our proposed design of the PSR Customer Satisfaction ODI-R?

We welcome the introduction of a separate PSR Customer Satisfaction ODI-R to require the GDNs to publicly report a breakdown of their PSR-only satisfaction scores. This will ensure that customers on the PSR, who may both have more frequent interactions than other customers with their GDN and be more at risk of detriment from unsuccessful interactions, can expect improvements to their level of customer service due to GDNs being held to account. If Ofgem intends to proceed with a reputational incentive, then the data should not only be published in annual vulnerability reports but also available in a league table format on Ofgem's website. This would allow for easy comparisons to be made by interested consumers, stakeholders (including consumer groups) and

industry. Ofgem should ensure standardisation in reporting for the best data to be available.

We would like to see these metrics incorporated into the customer satisfaction ODI-F, given that PSR customer satisfaction is a key driver of GDNs' commitments and obligations to their customers in vulnerable circumstances.

GDQ15. Do you agree with our proposed design of the Complaints Metric ODI-F?

We support the proposal to retain the penalty-only complaints incentive in GD3. Our preference would be for the complaints metric to use dynamic targets rather than static targets. This would best avoid issues of outperformance and better reflect an overall industry standard throughout the GD3 period. However, if a static target is retained, we agree with tightening the penalty score and reducing it from 5 to 3.5. This better reflects current GDN performance and will encourage GDNs to consolidate their improvements in complaints handling.

We also support the strengthening of this incentive by applying the maximum financial penalty for scores of 5 and above, compared to 10 and above in GD2. This means financial penalties will increase more sharply than in GD2 which will further encourage networks to ensure they are performing well in this area.

GDQ16. Do you agree with our proposed design of the PSR Customer Complaints ODIR?

As stated in GDQ14, we are supportive of the design of the new ODI-R, although we feel that there is a strong case for including PSR complaints data as a new metric within the Complaints penalty-only incentive. As with the PSR Customer satisfaction ODI-R, Ofgem should ensure that the data is also published in a league table format on its website to allow interested consumers, stakeholders and industry to scrutinise the information provided.

GDQ17. Do you have any views on the proposed approach to setting unplanned interruption targets for both non-MOBs and MOB through the Unplanned Interruptions ODI-F?

Non Multiple Occupancy Building Target Setting

We support Ofgem's proposal to set a common target for non-MOBs for all GDNs. Setting a common target for unplanned interruptions is an essential way

to ensure customers receive good levels of reliability across GB and that all GDNs have suitable plans, procedures and resources in place to deal with unplanned interruptions when they do occur.

However, while setting the minimum performance level (MPL) and excessive deterioration level (EDL) by using the highest annual average duration recorded by the GDNs is reflective of the actual service delivered, it does not consider whether this is an acceptable level of performance. Ofgem states that this ODI-F 'incentivises the GDNs to ensure their performance in getting customers back on gas following an unplanned interruption does not deteriorate'. However, Ofgem should consider whether it's reasonable to expect GDNs to make marginal performance improvements where they can and to embed this performance in future years.

Multiple Occupancy Building Target Setting

There is a careful balance to strike in setting targets for MOBs in order to recognise that geographical factors can mean performance varies widely, but also that setting different targets can create a 'postcode lottery' where the service delivered to consumers is significantly different across the country. Ofgem should more explicitly consider the acceptability of performance levels and the extent to which it's appropriate for them to differ to this extent across GB.

We support the proposal for WWU and NGN to have the same MOB's MPL and EDL as for SGN Southern. We agree that due to the low number of MOB's in these networks there could be large swings in their performance due to a single large incident. Using the same target as for SGN Southern will ensure that there is more similarity in the level of service consumers receive across the country.

GDQ18. Do you have any views on the proposed expansion of the Collaborative Streetworks ODI-F across GB?

We are concerned that the expansion of this incentive across GB will result in overrewarding networks for work that, in some cases, is already part of their business-as-usual operation. There is value for consumers in utilities liaising with local authorities and collaborating on streetworks. However, many networks already collaborate with other utilities in this way without a financial incentive.

As such we believe that expanding this incentive is not warranted, and that it will not deliver value for money for consumers.

GDQ19. Do you have any views on the proposed minimum threshold, the methodology used to set it, and the incentive reward rate for the Collaborative Streetworks ODI-F?

We support the lowering of the value of this incentive, and the setting of 2 different incentive rates with projects that meet a minimum criteria receiving £75k, and £125k for projects identified to be of strategic importance by the central coordinator. We believe that these incentive rates better reflect the costs of collaboration than the rate in GD2, and will offer better value for money for consumers than offering a flat incentive rate for all projects undertaken.

We also support the minimum annual threshold of 5 projects that need to be completed before rewards can be received. Introducing a minimum annual threshold for collaborative streetworks projects is appropriate to ensure that collaboration with other utilities is embedded into all GDNs' BAU way of working. It also ensures that networks are providing sufficient value to consumers before being rewarded.

Managing uncertainty

Infrastructure fit for a low-cost transition to Net Zero

GDQ20. Do you agree with the introduction of the proposed Biomethane Connections UIOLI, including with the proposed scope and funding caps?

We support Ofgem's proposal to introduce a £15m UIOLI fund per GDN in GD3, and the proposal for there to be an individual funding cap of £1m per biomethane connection. Biomethane may have an important role to play in decarbonisation and therefore it is important that there is progress in this area. The UIOLI funding & individual funding cap encourages biomethane connections to be made where they are viable, without overburdening consumers or making consumers pay for projects that are not delivered.

GDQ21. Do you have any views on our proposed design of the Heat Policy Re-opener?

We agree with Ofgem's decision to retain this re-opener, in light of the considerable uncertainty and the future of gas and government heat policy. We also agree that this re-opener should be authority-triggered.

Secure and resilient supplies

GDQ22. Do you agree with our proposed scope of the HSE Policy Re-opener?

We agree with the proposed scope of this re-opener. The trigger being any material changes to GDNs' repex costs that occur as a result of changes to repex related HSE policy or legislation seems sufficiently broad for GDNs to be able to fund any repair or maintenance costs. We also welcome that the reopener allows for both downward adjustments as well as upward adjustments. This means that consumers will be able to benefit from any changes that could result in costs reducing.

GDQ23. Do you agree with our proposed design of the Tier 2A Volume Driver?

We agree with the proposed design of this volume driver. We would note however the differences in how networks determine their risk action threshold for this work, and thus the differences in their workload. Without a single consistent risk-action threshold across GDNs it is hard to understand if this work is offering the same value for money and the same level of safety for consumers across the country. Ofgem should continue engaging with GDNs and HSE to establish if it is possible to use a single risk action threshold in this area.

High quality of service from regulated firms

GDQ25. Do you agree with our proposed design and unit rates for the Safety Disconnections Volume Driver?

We agree with the proposed design of the volume driver. We agree that it will enable management of the uncertainty around the number of disconnections that will be carried out in GD3, and ensure that consumers only pay for safety-related disconnections work that is delivered. We concur with the proposals to fund the labour and materials costs associated with disconnections through this volume driver, and overheads through baseline allowances, unless GDNs can demonstrate that their back office work for safety-disconnections is ringfenced and distinct from their customer-led disconnections work.

We agree with the proposal to set network specific rates as there is a wide range in potential costs and these may be dependent on network and geographical area. As Ofgem is reviewing the disconnections policy framework there is also uncertainty around what the disconnections process will look like at the end of GD3. It will be important that this volume driver is flexible enough to adjust cost allowances if there are changes to the number of safety disconnections that are carried out, or changes in how much these disconnections cost.

Totex Incentive Mechanism (TIM)

GDQ46. Do you agree with our proposed TIM sharing factor?

We have previously stated in our response to the Sector Specific Methodology consultation that we believe sharing factors should be set on a consistent basis across sectors and at a lower level than in previous price controls.

For Gas Distribution, we believe the main risk to consumers with regards to TIM is that allowances are set too high and consumers fund well in excess of actual expenditure (although this is often presented as a 'saving' for consumers). This is based on a consistent pattern of underspending against allowances across different sectors and across different price controls. We also do not believe that there is clear evidence that higher sharing factors result in an increased focus on efficiency³⁰. So, we believe that the TIM sharing factors should be reduced, potentially to a similar level as for ET (although there is no need for a stepped approach for GD).

³⁰ Citizens Advice, [Response to Sector Specific Methodology Consultation](#), March 2024, OVQ34

11. GT Annex Questions (selected)

Outputs and incentives

Infrastructure fit for a low-cost transition to Net Zero

GTQ1. Do you agree with the proposed licence obligation for National Gas to collaborate with NESO and to seek stakeholder feedback in the area of gas strategic planning?

Yes. This LO would align GT with the proposals in ET3 for collaboration with NESO and ensure that holistic network planning is integrated across the transmission system.

GTQ2. Do you have any views on the proposed design of this incentive?

We are supportive of Ofgem updating emissions targets to embed historic performance. As outlined in our SSMC response, rewards were earned in GT2 despite NGT experiencing *“increased volatility of the network and changing flow patterns over the past two years... [which has] increased the need to run compressors”*.

GTQ3. Is the yearly reduction in the target tonnes of carbon preferable to a target which remains constant throughout the price control?

Yes. Setting yearly reductions would ensure that the targets are up for review and offer a significant level of ambition for NG.

GTQ4. Do you have any views on the proposed design of this incentive?

The new Greenhouse Gas Emissions pipeline ODI-F aligns with the customer priority for NG to reduce its emissions. We are supportive of the use of an independent auditor to analyse National Gas’s baseline performance in the first year of the price control. A symmetrical incentive design is appropriate as it recognises the detriment and benefit to consumers, however Ofgem will need to ensure that its year-on-year targets are sufficiently challenging as to not over-reward NG.

GTQ5. Do you think the limited life of this incentive is appropriate?

Yes, provided that performance reaches a level that Ofgem and the independent advisor deem acceptable and beneficial to consumers at the end of the period.

GTQ6. Would you support a penalty only incentive in succeeding price controls?

We would. Once performance improvements are embedded, rewards would be too easy to receive, and instead NG should be incentivised to embed its improved performance.

GTQ7. Do you have any views on the proposed design of this incentive?

As LOs already exist for NG to identify and repair fugitive emissions, the proposed ODI-R could work to improve performance above and beyond the baseline expectations. Ofgem should consider publishing the annual metrics more widely than just in NGs' Annual Environmental Report, so that it is open to greater scrutiny from stakeholders and interested consumers.

GTQ8. Do you consider it appropriate that the incentive is reputational rather than financial?

Yes, however as with all new ODI-Rs, Ofgem should assess in period whether the ODI-R is working as intended to drive improved performance. If not, it should consider whether a PCD or ODI-F would be more appropriate.

GTQ9. Do you have views on potentially introducing this incentive as a financial incentive in RIIO-GT4 should National Gas show consistently good performance in RIIO-3?

We feel that the best rationale for introducing an ODI-F in GT4 would be if performance turns out to be below par. Good performance would demonstrate the success of the ODI-R in changing company behaviour. An ODI-F would be needed however to add an additional carrot and stick incentive should NG need to improve its performance.

GTQ10. Do you agree with the proposed NTS Shrinkage package, including the design of the NTS Shrinkage procurement ODI-F and the proposal for a new licence obligation on National Gas to have a proportionate and appropriate NTS Shrinkage Procurement Strategy in place?

We feel that it is difficult to ascertain the best design of the ODI-F until the results of the shrinkage review are available. Should meter error be revealed to be a major driver of unidentified gas, then an ODI-R may be more appropriate.

Our position remains that the best way to set targets in the volatile energy market is to relate them to a particular gas price (x% above or below a set price point).

GTQ11. Do you agree with the proposed scope of the NTS Shrinkage Review?

We are pleased that Ofgem is proceeding with its Shrinkage Review. The proposed scope outlined in the Draft Determinations is vague, however we are supportive of the factors outlined.

GTQ12. What are your views on the scope or design of the mechanism, as well as on the proposed allowances in this section?

We are wary that the introduction of the Redundant Assets PCD would set a precedent for decommissioning of the gas grid to be placed on gas bill payers. While depreciation is a risk that can be pre-empted and managed by gas networks, decommissioning poses no benefit to current or future consumers therefore issues of intergenerational fairness do not come into play. We feel that the best way for decommissioning costs to be paid is through general taxation, though in lieu of any policy decision being made Ofgem should not introduce mechanisms in RIIO-3.

Managing uncertainty

Infrastructure fit for a low-cost transition to Net Zero

GTQ28. Do you agree with the proposed expanded scope of the Authority-triggered Gas Strategic Planning Re-opener?

Yes. This mechanism will help to enable holistic network planning needed for the RIIO-3 period.

Secure and Resilient Supplies

GTQ32. Do you have any views on the proposed Asset Health re-opener?

We concur with the need for a UM for asset health related costs rejected from baseline allowances due to a lack of clarity. Ofgem should however apply rigorous scrutiny and needs assessment for any costs coming through this UM, particularly for the number of projects over and above their suggested four. This is due to the unpredictability of cost rises that could occur for consumers when funding is delivered in this way.

GTQ33. Do you have any views on the proposed re-opener application windows?

Having two defined re-opener application windows within the period would help to reduce the regulatory burden and give a clear directive to NG to prepare for its cost assessment. It also makes sense for the Authority to trigger additional windows should scope costs look to exceed the materiality threshold.

GTQ55. Do you agree with our proposed TIM sharing factor? Business Plan Incentive (BPI)

We have previously stated in our response to the Sector Specific Methodology consultation that we believe sharing factors should be set on a consistent basis across sectors and at a lower level than in previous price controls.

We believe the main risk to consumers with regards to TIM is that allowances are set too high and consumers fund well in excess of actual expenditure (although this is often presented as a 'saving' for consumers). This is based on a consistent pattern of underspending against allowances across different sectors and across different price controls. We also do not believe that there is clear evidence that higher sharing factors result in an increased focus on efficiency³¹. So, we believe that the TIM sharing factors should be reduced, potentially to a similar level as for ET (although there is no need for a stepped approach for GT).

³¹ Citizens Advice, [Response to Sector Specific Methodology Consultation](#), March 2024, OVQ34

13. Finance Annex Questions (selected)

Allowed return on debt

FQ1. Do you agree with our approach to estimating efficient debt costs and calibrating the index?

We think the adjustment to the benchmark has been applied inconsistently compared to RIIO-2 and is greater than the evidence suggests, to the detriment of customers. Ofgem analysis of 14 issuances from five issuers across the GD and GT sectors during the 2023–2024 period, shows a YtM at issuance that exceeded the benchmark by +18 basis points on a simple average basis, when weighted by issuance size.³² Ofgem however grants GD and GT a benchmark adjustment of +25 basis points to offset this negative halo effect. This is a +7 bps increase with no justification.

By contrast, at ED2, despite there being evidence of a positive halo effect of 7bps using a weighted average, Ofgem did not make any downward adjustment. At ED2, Ofgem stated that “The calibration of the index implicitly captures “on the day” performance for embedded debt”³³ and they “cannot be certain that a positive halo effect will continue for new debt and its likely impact would in any case be small.”³⁴ The same argument should now be applied to the negative halo effect - if Ofgem again cannot be certain that this will continue they should not have made an adjustment for this. It is inconsistent for Ofgem to have made an upward adjustment when there appears to be a negative halo effect, but not have made one when there was a positive halo effect.

FQ2 - FQ3.

No answer provided.

³² Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), August 2025

³³ Ofgem, [ED2 Draft Determinations - Finance Annex](#), June 2022, P.12.

³⁴ *Ibid.* p.12

FQ4. Do you agree with our approach to setting the additional cost of borrowing allowances?

Cost of carry

Ofgem's estimate of the combined cost of carry and liquidity/RCF cost has been derived broadly in line with the methodology adopted for RIO-2 and ED2. At RIIO-2 draft determinations, a cost of carry range was proposed at 1.5 – 11bps with Ofgem adopting 10bps at final determinations, sitting at the high end. At ED2, final determinations Ofgem states *"we have decided, as proposed at DDs, to adopt a point estimate from the upper bound of our plausible range (2-10bps)."*³⁵ Considering that cost of carry allowances of 10bps and 11bps were considered at the upper-bound in RIIO-2, this suggests the proposed cost of carry allowance components of 13bps and 11 bps for GD/GT and ET respectively are also over-generous.

We do not think that Ofgem took a proportionate position on setting the cost of carry at the top of a plausible range in previous price controls, especially given the recognised and structural generosity of the overall CAPM approach as described in our responses to FQ9 and FQ10, which they have now exceeded in this price control.

It also reduces the incentive to manage liquidity actively throughout the year. Instead, firms are effectively rewarded for holding large year-round cash balances, even if that is not the most efficient approach.

We think that choosing the very top end of the range over-rewards some companies and does not encourage this cost impact of company structure to be passed on to the companies. This is suboptimal from a consumer perspective. We therefore think the cost of carry allowance should be set at the mid-lower end of a plausible estimate.

Additional cost of borrowing

Ofgem granted a total 25bps additional cost of borrowing allowance at ED2 draft determinations, which was equivalent to the allowance provided in RIIO-GD&T2 Final Determinations. At ED2, Ofgem stated: "We note this is higher than the 10bps included in the Competition and Market Authority's (CMA) PR19 Final

³⁵ Ofgem, [RIIO-ED2 Final Determinations Finance Annex](#), November 2022, P.15.

Decision on its redetermination for four water companies.”³⁶ At RIIO-3, Ofgem has continued to set the additional cost of borrowing far above the CMA’s determination of 10bps, at 19bps for ET and 25 bps for gas. We do not see a good reason for setting the additional cost of borrowing so far above the CMA’s water PR19 redetermination. Given the use of water as a close comparator on other metrics, this appears inconsistent.

We question the reliance on self reported transaction and liquidity cost reporting to set this allowance and do not have clarity that the elements of the adjustment are independent and so whether each factor is justified. Any claim that the PR19 approach was different in the round on the attribution of cost clearly implies a degree of overlap in these funding grounds.

Derivatives

We agree that derivatives are not a necessary feature for the notionally efficient operator.

FQ5. Do you agree with our proposed treatment of inflation with respect to the allowed return of debt?

Yes, we support the proposed treatment of inflation with respect to the allowed return of debt. Our previous research has shown that network companies received a financial windfall of £3.9 billion largely due to the mismatch between the allowance for debt costs and actual debt costs.³⁷ Setting a nominal allowance for fixed rate debt and applying this in proportion to the notional capital structure fixed rate debt assumption helps mitigate this.

We note, however, that there is still a chance for a windfall to be gained on the ILD assumed portion. Firstly, the 2% CPIH inflation assumption used to deflate nominal yields may under-state long-term CPIH expectations, which would make the allowed return on debt too high. Secondly, given the long-run wedge between CPIH and CPI being 0.4%, companies with exposure to CPI-linked instruments stand to benefit from the discrepancy with CPIH indexation. We believe Ofgem should take steps to address any potential windfalls.

³⁶Ofgem, [ED2 Draft Determinations - Finance Annex](#), June 2022, P.13.

³⁷ Citizens Advice, [Debt to society: what the network companies should do with their windfall profits](#), February 2025

We also note that the indexation of debt providers further protections to UK network companies that is not always granted elsewhere, for example in the US regulated energy sector. This further serves to lower risk for UK network companies, which should be reflected in the overall cost of capital.

FQ6. Do you agree with the removal of the infrequent issuer allowance?

Yes, we agree with the removal of the infrequent issuer allowance. The infrequent issuer allowance has generated an unjustified premium in previous price controls.³⁸ The ability for a company to decide on an efficient structure should, where possible, be left to companies. It is then up to companies how to structure their financing within acceptable parameters. Low issuance in a segment of large corporate structures means that additional costs of low issuance can be well-mitigated. It is not credible that network companies cannot mitigate this periodic fluctuation of investment where relevant. In any case, in RIIO-3, Ofgem has determined that were companies to face an infrequent issuance premium, this is already reflected in the main allowance and that *“providing an additional allowance would present a material risk of overcompensation of companies.”*³⁹ It is therefore only justified that the infrequent issuer allowance be removed.

Allowed return on equity

FQ9. Do you agree with our methodology change in calculating the ex ante TMR?

We disagree with some elements of the methodology change in calculating the ex ante TMR.

Serial correlation

We do not support the removal of the serial correlation adjustment. Ofgem state that there are *“conflicting views around the presence of serial correlation in the data and note the difficulties of proving or disproving this with a statistically significant level of accuracy”*⁴⁰. In the RIIO-2 appeals, the CMA supported arguments that whilst statistical significance was difficult to find in this area,

³⁸ Citizens Advice, [Response to the Ofgem RIIO-ED2 Draft Determinations Consultation - Finance Questions](#). August 2022, P.6,

³⁹ Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), P.34.

⁴⁰ Ibid, P.52.

*“there were other good reasons to believe that serial correlation was reasonably likely to be present in returns in some form.”*⁴¹ Analysis carried out by the CMA during the PR19 redetermination suggested a negative adjustment for serial correlation of up to 40 basis points.⁴² This could be applicable to the ex ante DMS approach due to the use of historical returns data.

At RIIO-3 SSMD, Ofgem took the decision on balance to *include* an adjustment of -0.1% for serial correlation. At draft determinations, Ofgem have back-tracked on this and removed the adjustment. Maintaining regulatory predictability and stability is vital for long-term interests of both consumers and companies. Therefore, compelling evidence is required for Ofgem to move away from established positions. This has not been provided. Ofgem should therefore re-instate the serial correlation adjustment in line with the CMA view.

Geometric-to-arithmetic conversion

Additionally, for their geometric-to-arithmetic conversion, Ofgem uses an uplift of 1.65% at SSMD, and 1.61% at draft determinations. However, as Ofgem notes at SSMD: *“the CMA, DMS and Ofwat apply a 1.5% uplift.”*⁴³ Ofgem state this is to maintain consistency with their ex post methodology, but do not explain why 1.65% was used there. This means there is generosity baked in to both the ex post and ex ante estimates. Ofgem should adjust the conversion to 1.55% in line with best practice elsewhere.

Structural generosity

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

⁴¹ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), 2021, P.89.

⁴² *Ibid.* p.89.

⁴³ Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), P.77.

diversified (and readily available) portfolio of investments to relevant investors. Such a portfolio is also likely to exhibit lower average returns than equities alone, owing to the inherently geared nature on average of equities.

This position was accepted by the CMA:

“theoretically, the TMR should reflect the return on all assets in the economy, and that there is some evidence suggesting that total returns across all asset classes are lower than those on equities alone, and potentially materially lower”.

Ofgem also recognised this at RIIO-3 SSMD:

“We note Citizens Advice's concerns, and agree that some of the CAPM methodologies used by regulators have been calibrated to function in line with available data rather than the purest interpretations of CAPM theory.”

Yet also noted that:

“we think that the practicality issues identified by Citizens Advice are likely to be structural and unavoidable when estimating the cost of equity for a price control.”

It is not defensible to allow structural over-estimation on practicality grounds. If the issue cannot be addressed at source, then it should be taken into account where judgement is required, with downward adjustments made to compensate for this.

Further, whilst Ofgem includes both ex post and ex ante TMR estimates, these both use long-run historical returns data. At SSMD, Ofgem notes that: *“some regulators have also considered forward-looking evidence in their most recent decisions”*⁴⁴, but opt against this due to the UKRN guidance. The use of historical data is likely to over-estimate the TMR. For instance, in the PR19 redeterminations the CMA noted that many academic studies conclude that the ex post approach is likely to over-estimate required returns. The CMA cites Mehra and Prescott's (1985) observation that:

“the high historical returns provided by equities relative to government bonds are inexplicable in the context of standard economics models that describe risk”, and

Blanchard, Shiller and Siegel's (1993) conclusion that:

⁴⁴ Ofgem, [RIIO-3 SSMD](#), July 2024, P.78.

“the ex post ERP appears far in excess of what is justified by standard asset-pricing models with reasonable levels of risk aversion”.

Additionally, the UKRN guidance cites Dimson, Marsh and Staunton’s argument that *“the forward looking equity risk premium is liable to be much lower than historical estimates using long run averages”*. It is notable that the DMS data is used for the ex post and ex ante estimations.

With this in mind, it is possible that the ex ante estimate suffers similar issues from the use of historical data since, when rounded, the ex post and ex ante estimates sit only 10 basis points apart.

FQ10. Do you agree with our methodology for estimating beta?

Citizens Advice disagrees with some elements of the methodology for estimating beta. We support the use of the longer-term 10 year asset betas. However, there are reasons to suggest the equity beta estimation is too high. Estimating beta is challenging, with significant debate across the literature, as shown by the diverging views in the UKRN report.⁴⁵ It is the one component of cost of equity where Ofgem must use its judgement and discretion, and it is therefore important that Ofgem scrutinises their approach. It is our view that Ofgem and Ofwat have materially over-estimated the level of systematic risk facing the UK regulated energy and water companies, and therefore the corresponding equity betas.

This view is supported by Mason, Pickford and Wright within the UKRN report, who believe that the high values of equity beta of 0.8 and 0.9 assumed in prior price controls by Ofgem and Ofwat respectively, were *“inconsistent with econometric evidence”*.⁴⁶ The equity beta of 0.83 at 60% notional gearing therefore sits within the range deemed inconsistent with econometric evidence.

Long-term data and lower frequencies

Wright and Robertson argue for estimation of beta based on “longer-term data and at lower frequencies”⁴⁷, on grounds that this is “more relevant to the long

⁴⁵ Wright, Burns, Mason, Pickford, [Estimating the cost of capital for implementation of price controls by UK Regulators](#), 2018.

⁴⁶ Ibid, P.9

⁴⁷ Wright at al., [UKRN report: Estimating the cost of capital for implementation of price controls by UK Regulators](#), 2018, P.9.

horizons used by regulators”⁴⁸. We therefore support the use of the 10-year asset betas, but note that the use of higher frequency daily observations may not be suitable. Wright and Robertson argue that the use of longer-term data at lower frequencies “results in distinctly lower equity beta estimates”⁴⁹, namely, of raw equity beta estimates in the range 0.3-0.5 – and towards 0.3 at lower estimation frequencies – on the basis of United Utilities and Severn Trent Water, the same two listed water companies on which Ofwat and Ofgem rely on for their beta estimates.⁵⁰

Global indices

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

OLS limitations

A further potential limitation is the use of an OLS model to estimate equity beta. A report previously commissioned by Ofgem by Donald Robertson highlighted the “time-varying” nature of beta and therefore the considerable challenges of estimating forward-looking betas, especially when based on historical data.⁵¹ He noted that if beta is time-varying, then an OLS regression assuming a constant

⁴⁸ Wright at al., [UKRN report: Estimating the cost of capital for implementation of price controls by UK Regulators](#), 2018, P.9.

⁴⁹ Ibid, P.9.

⁵⁰ Ibid, P.9.

⁵¹ Donald Robertson, [Estimating beta](#), April 2018.

coefficient is mis-specified and the model subject to heteroscedasticity. He argued that GARCH estimation may be more suitable as it “provides a good estimate of the long run parameter and also models the short run dynamics of beta”.⁵²

Robertson further finds that:

*“OLS estimates at lower frequencies are in much closer agreement with the long run estimates of beta obtained from the multivariate GARCH approach. As we move to lower frequencies we generally see a decline in the estimated betas”.*⁵³

Robertson concludes that:

*“there is overwhelming evidence that beta is time varying and these variations can be quite persistent”*⁵⁴, and

*“using lower frequencies eliminates a lot of the heteroscedasticity and gives estimates closer to the long run betas. But this requires a much longer sample of data for estimation.”.*⁵⁵

This supports the use of the 10-year asset betas for the equity beta estimation. However, the use of daily observations may put upward pressure on the estimate due to the presence of heteroscedasticity. Further, if it is thought that beta is indeed time-varying then OLS may not be the most suitable approach and we support the use of a GARCH model as a cross-check for equity beta at the very least.

RIO-3 protections lower systematic risk

Finally, it is not credible that mechanisms such as the Return Adjustment Mechanism (RAM), volume drivers, re-openers, pass-through mechanisms and indexations do not reduce systematic or non-diversifiable risk to which a company is exposed. However, the impact on the price control risk is not currently reflected when setting the equity beta. The UKRN report notes that past research by Ofgem has specifically made the case that on the basis of a priori reasoning – i.e. from first principles – that the risk profile of cashflows for regulated businesses is almost entirely ‘idiosyncratic’ (i.e. non-systematic risk,

⁵² Donald Robertson, [Estimating beta](#), April 2018, P.23

⁵³ Ibid, p.35.

⁵⁴ Ibid, p.39.

⁵⁵ Ibid, p.39.

also known as ‘diversifiable’ risk)⁵⁶, namely, that such companies face almost no systematic risk, and therefore should be expected to have betas close to zero. We agree that the regulated network sector facing limited systematic risk and equity beta should be much closer to zero.

All the above evidence suggests that Ofgem’s proposed equity betas of 0.83 and 0.74 are too high. Combined with the generosity in detailed decisions highlighted elsewhere in this response, Ofgem should opt for a cost of equity that is at the least within the lower end of their range, if not below it.

FQ11. Do you agree with our proposed set of comparators which also incorporates selected European utility stocks?

No, we do not support the inclusion of the European utility stocks.

Previous evidence against inclusion of European comparators

At RIIO-2 draft determinations, Ofgem commissioned CEPA to assess the evidence on asset betas, including European comparators. Ofgem chose not to explicitly include European comparators.

In their response to the RIIO-2 CMA appeals, GEMA had argued that little weight should be placed on the observed equity betas of publicly traded European companies because:

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

GEMA further stated that:

“Given the inherent difficulties in making beta comparisons across jurisdictions, GEMA was entirely justified in relying on UK beta observations rather than making a

⁵⁶ Wright at al., [UKRN report: Estimating the cost of capital for implementation of price controls by UK Regulators](#), 2018. P.54.

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

*speculative adjudication on the relative merits of different European samples and how these would translate into the UK context. "*⁵⁸

The CMA recognised that European comparator equity betas may be subject to "noise" from: non-regulated activities within comparator firms, issues with the quality of the data due to volatility in betas over time or illiquid share trading, and differences in the regulatory environment. The CMA determined that *"there is complexity and a requirement for a large number of judgements to be made in performing European comparator analysis"* and were *"not persuaded that inclusion of such data would have improved the robustness of GEMA's beta estimation."*⁵⁹ The CMA concluded that GEMA was not wrong to exclude European comparator data in RIIO-2.

Ofgem recognises that including European comparators differs from RIIO-2 and states this is to take into account changes in risk for RIIO-3 relative to RIIO-2. Ofgem does not provide any evidence that there has been any increase in risk. But crucially, making an a priori assumption that there is an increase in risk is not a defensible rationale for including European comparators. To warrant inclusion, Ofgem must explain why European comparators are now reliable when all previous evidence suggests they are not. Ofgem have failed to provide this rationale and all reasons for why European comparators were not included at RIIO-2 still apply. It is therefore not reasonable to include European comparators which Ofgem themselves stated possess "inherent difficulties" and which the CMA stated did not improve robustness. For Ofgem to change position without compelling evidence damages regulatory predictability and stability and so is not in the long-term interests of consumers or companies.

Were European comparators credible and robust, they should have been consistently used throughout price controls to *inform* risk assessment, not included now *because* Ofgem thinks there is an increase in risk. Citizens Advice does not agree that RIIO-3 contains more risk than RIIO-2. But by Ofgem's own logic, if RIIO-3 did possess greater risk, and this was picked up in European betas, then RIIO-2 by definition was lower risk and would have been picked up in European betas. Ofgem chose to not include European comparators at RIIO-2

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

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

which Ofgem stated would have lowered the equity beta. If European comparators are now included, this means that customers were over-charged throughout RIIO-2. The decision to include European comparators when they increase the equity beta, despite there being no change in evidence to support their inclusion, whilst not having included them when it would have resulted in a lower equity beta, is not consistent or fair. Fundamentally, the switch in position without any evidence undermines regulatory predictability.

RIIO-3 European comparator issues

Ofgem have not provided evidence on how differences in regulatory environments, macroeconomic and political risks across the European comparators and the UK have been accounted for. The 10-year asset betas for Italy of 0.43 and 0.44 for ET and GT are only 0.01 apart, but sit significantly higher than all UK comparators and the Spanish comparator betas. This suggests the high betas are a function of the Italian regime itself and are not useful comparators. This is supported by an Oxera report that found a risk premium for the total equity market in Italy that was not immaterial and was potentially in excess of 1.5%.⁶⁰ At the same time, Portuguese company REN has a 10-year asset beta of 0.20, with the Spanish comparators sitting in the middle. The vast divergence between the Italian and Portuguese betas suggests that country or firm specific factors, not sector-specific factors, are driving the betas and serve to highlight their unsuitability as comparators to the UK.

Such factors may include but are not limited to:

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

If Ofgem is to meaningfully include European comparators, it must provide analysis on how these factors have been considered. Ofgem have not for

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

instance, provided any analysis on how the Belgium and German regulatory environments are materially different to warrant exclusion. We are not convinced that in the round, looking at regulatory environment, macroeconomic and political factors, German and Belgium network companies are materially more different to those in the UK compared to Italy and Spain. Whilst there may be some elements of the Italian and Spanish regulatory environments that are more in common with the UK, other risks may be more dissimilar compared to Germany and Belgium, for instance. As noted above, whilst the Italian and Spanish regimes may be most similar to the UK, it is clearly not a comparable regulatory environment that is driving their betas, since Italy's are significantly higher.

Ofgem excludes REN from the comparator set on the basis that it possesses a low beta which they cannot explain. But equally, Ofgem has not explained why the Italian betas are significantly higher than the other comparators. Ofgem state that they "have avoided including beta comparators which seem anomalously low or high"⁶¹ but this isn't reflective of their practice. No beta has been excluded for being too high, only lower betas have been excluded. If the Italian betas are kept in despite being inexplicably high, then it is consistent to include the Portuguese beta despite being inexplicably low.

Non-systematic risk should not be reflected in betas

Including European betas to address perceived increased risk is also not valid by Ofgem's own logic. Ofgem states they endeavour to "*carefully consider the type of risk being faced*".⁶² When considering network arguments on additional risks to their sectors, specifically higher capital expenditure in ET and asset stranding in GD and GT, Ofgem concludes these are non-systematic, diversifiable risks.⁶³ Citizens Advice agrees that such risks are non-systematic and are therefore excluded from the CAPM. Yet, Ofgem cites these exact risks as the rationale for including the European comparators to estimate the equity beta, a core component of the CAPM. Since the additional perceived risks suggested by the networks are non-systematic, they by definition would not be captured in the equity betas of European comparators. This means there is no justification for

⁶¹ Ofgem, [RIIO-3 draft determinations finance annex](#), p.58

⁶² Ibid, P.61.

⁶³ Ibid, P.57. §3.62 - 3.63.

including European comparators as they do not capture what Ofgem state justify their inclusion.

In line with perceived additional risks being non-systematic, Ofgem state that they consider it most appropriate to address these changes of risk ‘at source’ i.e. not in the cost of equity but elsewhere in the regulatory package, for instance through Totex Incentive Mechanism (TIM) rates, load-related re-opener mechanisms and the advanced procurement mechanism. Yet in opposition to this position go on to *also* address perceived changes in risk within the cost of equity, through the incorporation of European comparators.⁶⁴ At best this position is inconsistent and leads to over-compensation of perceived risk, and at worst this position is unsound since equity betas do not capture non-systematic risk.

Citizens Advice does not believe sufficient evidence has been provided to justify the inclusion of European betas. As noted, we believe the only valid reason for now including European comparators is that the difficulties in extrapolating sector-specific, systematic risk from country-specific risk has been addressed. As can be seen by the divergence between the Italian, Spanish and Portuguese betas, there are clearly country or firm specific factors that are driving the divergence which make them unsuitable for estimating an equity beta for UK network companies. European betas may be useful to provide insight on whether the betas of gas or electricity networks differ materially, but using them for this separate purpose does not justify their inclusion in the equity beta estimation for UK networks.

Citizens Advice proposal

We believe it is most appropriate to remove the European comparators. If evidence is provided on why European comparators now improve the robustness of the equity beta estimation, then it would be appropriate to include the low beta for REN in line with the inclusion of the high Italian betas, or to remove the Italian betas and maintain REN’s exclusion.

Ofgem proposes to set the asset beta at 0.375, the approximate mid-point of the 10-year beta comparators. Maintaining the UK-only beta comparators or

⁶⁴ Ofgem, [R10-3 draft determinations finance annex](#), P.61.

removing the anomalously high and low betas of Italy and Portugal would produce a mid-point of 0.355. This would generate an equity beta of 0.78. Maintaining the Italian betas and including REN in the European comparator group would produce a mid-point of 0.32. This would generate an equity beta of 0.69.

Asset Beta at 0.075 debt beta ⁶⁵

Network companies	10-year	Midpoint ⁶⁶	Midpoint ⁶⁷	Midpoint ⁶⁸
UU	0.32	0.355	0.375	0.32
SVT	0.33			
Pennon	0.39			
National Grid	0.36			
Engagas	0.36			
Snam	0.44			
Red Elec	0.33			
Terna	0.43			
REN	0.20			

Comparators	Asset beta ⁶⁹	Equity beta ⁷⁰
UK-only/ European exc. IT, PT.	0.355	0.78

⁶⁵ Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), P. 56.

⁶⁶ UK only comparators: UU, SVT, Pennon, National Grid.

⁶⁷ Ofgem proposed comparators: UU, SVT, Pennon, National Grid, Engagas, Snam, Red Elec, Terna.

⁶⁸ Ofgem proposed comparators + REN: UU, SVT, Pennon, National Grid, Engagas, Snam, Red Elec, Terna, REN.

⁶⁹ Mid-point of 10-year comparator asset betas

⁷⁰ Equity beta with 0.075 debt beta and 60% notional gearing.

Ofgem proposed	0.375	0.83
Ofgem proposed + REN	0.32	0.69

FQ12. Do you agree with the conclusions we have drawn from our chosen crosschecks?

We support the use of the cross-checks but believe there are limitations to the cross-checks deployed, and therefore the conclusions Ofgem has drawn.

Transaction MAR precedent

At RIIO-2 draft determinations, Ofgem utilised market-to-asset ratio (MAR) cross-checks looking at changes in the share price of three listed water companies post PR19, which the CMA determined was not wrong. The conclusion drawn from this evidence was that the cost of equity was not too low, however, it would have been fair and consistent to use such cross-checks to also determine whether the cost of equity is too high. At RIIO-2 draft determinations the MAR-implied cost of equity sat between 3.2% and 4.1%, a range well below the 4.2% cost of equity proposed at draft determinations, suggesting that the cost of equity was indeed too high.

At the RIIO-2 appeals, Ofgem refers to additional MAR evidence from National Grid's acquisition of Western Power Distribution. National Grid's own analysis confirmed the purchase reflected a 61% premium over the regulated asset value. In their appeal response, GEMA states that:

- "Whatever uncertainties exist in MAR data, they undoubtedly support GEMA's view that there is strong evidence showing that assets of utility companies are sold at a premium, and that the premium is significant."⁷¹.
- "The CMA is able to, and should, take the WPD Purchase into account in this appeal".⁷²
- "GEMA was plainly entitled to have regard to MAR data, and would have been entitled to have regard to data from the WPD Purchase had it taken place."⁷³

⁷¹ GEMA, [RIIO-2 PRICE CONTROL: RESPONSE TO APPEALS ON FINANCE ISSUES AND TNUOS](#), April 2021. p.56 .

⁷² Ibid, p.57 .

⁷³ Ibid, p.57 .

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

At ED2 draft determinations, Ofgem indeed included additional MAR estimates using the WPD transaction and three other recent transactions:

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

Source: *ED2 draft determinations notable MAR transactions since December 2020.* ⁷⁴

Using an inference model, Ofgem analysis showed the transaction MARs implied a cost of equity of the range 3.2% to 3.9%. Ofgem's proposed cost of equity of 4.75% would have required an out-performance assumption of 4.3%, which as Ofgem recognised is "implausibly high". Based on the inference model and the transactions, Ofgem concluded that "the cost of equity is, in all likelihood, lower than 4.75%.". Yet, Ofgem did not make any downward adjustment to their cost of equity on this basis.

RIIO-3 transaction MAR evidence

At RIIO-3 draft determinations, Ofgem includes a MAR cross-check using Ofwat's MAR analysis of the UK listed water sector, post PR24 final determinations. The analysis showed that the September 2024 average MAR premium was 9%. This inferred a cost of equity range of 4.2%-6.2% (CPIH-real) showing that Ofgem's proposed cost of equity figures of 5.65% and 6.04% at 55% and 60% gearing respectively sit at the top end of this range. This suggests Ofgem's proposed cost of equity values are likely too high.

In addition to the traded water sector MARs, Ofgem refer to several major transactions having been announced in 2024 showing transactions being completed at premia to regulated asset bases:

⁷⁴ Ofgem, [RIIO-ED2 draft determinations finance annex](#), June 2022, p. 43.

Transaction	Premium
January 2024 Pennon acquisition of Sutton and East Surrey (SES) Water	c.6%
July 2024 Macquarie Asset Management acquisition of the remaining 20 per cent equity interest in NGT held by National Grid	25%
August 2024 Iberdrola acquisition of 88% of Electricity North West (ENWL)	60%

Whilst Ofgem refers to these transactions in the draft determinations, they do not infer a transaction MAR-implied cost of equity range from these transactions or use them explicitly as a cross-check. This is despite the fact that, as shown above, Ofgem stated transaction MARs should be taken into account by the CMA during RIIO-2 appeals, stated they would have themselves been entitled to utilise transaction data had it been available during RIIO-2 draft determinations, and used transaction MARs for ED2. It is therefore inconsistent to not use transaction MARs to generate an implied cost of equity and for these values to be used explicitly as a cross-check in RIIO-3.

It is particularly important that the energy transactions are used to infer a MAR-implied cost of equity cross-check since, in this instance, the energy company transactions were under-taken at premia which far exceeds that of the water transaction and the listed water sector traded MARs.

Below, Citizens Advice has applied Ofgem's MAR inference model to the recent transactions of NGT in July 2024 and ENWL in August 2024.

Ofgem's Market to Asset Ratio inference model and NGT/ ENWL transactions

Component	ENWL	ENWL	ENWL	NGT	NGT	NGT	Formula
Baseline allowed ROE	6.04% ⁷⁵	6.04%	6.04%	6.04%	6.04%	6.04%	A

⁷⁵ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, CAPM-implied cost of equity at 60% notional gearing

Expected Outperformance	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	B
Real ROE	7.04%	7.04%	7.04%	7.04%	7.04%	7.04%	C = A + B
CPIH	2.00% ⁷⁶	2.00%	2.00%	2.00% ⁷⁷	2.00%	2.00%	D
Nominal ROE	9.04%	9.04%	9.04%	9.04%	9.04%	9.04%	E = C+D
RAV Growth (Real)	0.00%	1.00%	2.00%	0.00%	1.00%	2.00%	F
RAV Growth (Nominal)	2.00%	3.00%	4.00%	2.00%	3.00%	4.00%	G = D + F
Dividend pay-out ratio	100%	85.80%	71.59%	100%	85.80%	71.59%	H = 1 - F/C
Dividends paid	7.04%	6.04%	5.04%	7.04%	6.04%	5.04%	I = H * C
Market to Asset Ratio (MAR)	1.60 ⁷⁸	1.60	1.60	1.25 ⁷⁹	1.25	1.25	J
Notional Gearing	60% ⁸⁰	60%	60%	60%	60%	60%	K
Equity Multiple	2.50	2.50	2.50	1.63	1.63	1.63	L = (J-K)/(1-K)
Real Cost of Equity	2.82%	3.42%	4.02 %	4.32%	4.71%	5.09%	M = I/L + C-I

The NGT and ENWL transactions based on Ofgem's model suggests a potential real cost of equity between 2.82% and 5.09%, at 60% gearing, depending on real RAV growth. This suggests that Ofgem's proposed cost of equity of 6.04% at 60% gearing is too high.

Whilst Ofgem notes that *"transaction MARs can nonetheless convey important information on cost of equity"*⁸¹, in contrast to their previous positions as demonstrated above, Ofgem state *"we believe the MAR model is more suited to traded MAR ratios rather than transaction MARs because of the difficulty in*

⁷⁶ Ofgem, [RIIO-3 SSMD Finance Annex](#), July 2024

⁷⁷ Ibid

⁷⁸ UBS analysis shows the acquisition value equated to premia of approximately 60% to the regulated asset base. Ofgem, [RIIO-3 Draft Determinations](#), P. 65.

⁷⁹ UBS analysis shows the acquisition value equated to premia of approximately 25% to the regulated asset base. Ofgem, [RIIO-3 Draft Determinations](#), P. 65.

⁸⁰ Ofgem, [RIIO-3 SSMD](#), July 2024, Allowed Return on Equity Early View Summary Calculations

⁸¹ Ofgem, [RIIO-3 Draft Determinations Finance Annex](#), July 2025, P.68.

*estimating the acquisition synergies arising from a transaction MAR*⁸². The CMA determined, however, that “the assumed synergies and ‘other’ benefits within each of these recent transactions would have needed to be unrealistically high to outweigh cost of equity allowances that were materially too low.”⁸³. In line with the CMA, we do not agree that the large premia can be accounted for by ‘synergy’ effects alone. We would expect Ofgem to seek to capture any efficiencies for the next relevant price control period (ED3) and so synergy effects are further limited.

Ofgem utilised transaction MAR evidence at ED2 and drew upon it in their RIIO-2 appeal defence. Maintaining regulatory predictability and stability is vital for long-term interests of both consumers and companies. Therefore, compelling evidence is required for Ofgem to move away from established positions. This has not been provided so Ofgem should continue to utilise transaction MAR evidence at RIIO-3.

OFTO

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

*“we have conducted further analysis of OFTO IRRs to make them more comparable with a cost of equity at 60% notional gearing.”*⁸⁴

At ED2 the unadjusted OFTO implied equity IRR was 4.4%, but the adjusted OFTO implied cost of equity, which is more directly comparable, sat lower at 3.1%.

In RIIO-3, Ofgem goes against this approach and does not include an adjusted, more comparable, OFTO cost of equity estimate. This again undermines the principle of regulatory predictability and stability. We recommend that Ofgem includes an adjusted OFTO cost of equity estimate that is comparable to network gearing levels.

Unadjusted investment managers' TMR cost of equity

⁸² Ibid, P.68.

⁸³ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), 2021. p.238.

⁸⁴ Ofgem, [ED2 Draft Determinations](#), June 2022, P.46.

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

Infrastructure Funds IRR

We have previously commissioned research which has shown that, in general, the required returns from regulated utilities are amongst the lowest of all infrastructure sectors – which would imply a lower than average beta.⁸⁵ At RIIO-2, Ofgem acknowledged that *“we have not attempted to present IRRs on a risk-adjusted basis, and hence acknowledge asset or financial risk could impair comparability among funds and/or direct applicability for RIIO-2.”*⁸⁶ Since RIIO-3 Infrastructure Funds IRR draws on the same methodology, the same issue applies. We recommended that the cross-check from infrastructure funds is calculated from the lower end of the range of funds' IRR reviewed by Ofgem and not the average.

Additional metrics

Finally, we do not support the additional metrics suggested by the network companies. Our view is that the price control is attractive to investors and there is no risk of the networks not being “investable”. In any case, since Ofgem chose to not act on its own cross-checks that showed the cost of equity it was setting was too high at ED2, it would not be fair or consistent to act on any additional cross-checks which suggested the cost of equity was too low.

FQ13. Do you agree with our treatment of risks to the ET and Gas sectors as nonsystematic?

⁸⁵ Citizens Advice, [Ofgem consultation on RIIO-2 Draft Determinations Finance Section](#), 2020, P.37.

⁸⁶ Ofgem, [RIIO-2 Draft Determinations – Finance Annex](#), 2020, paragraph 3.96.

Yes, we agree that the risks to the ET and Gas sectors is nonsystematic. It would be very hard to argue that expansion in electricity capacity and perceived stranded asset risks are systematic since they are not economy-wide factors. The perceived additional risks facing ET and gas are diversifiable and are therefore nonsystematic by definition.

However, we do not agree that Ofgem is treating these risks as nonsystematic. Ofgem refers to these exact risks to justify the inclusion of European comparators in the equity beta estimation, which according to CAPM theory is only meant to capture systematic risks. Ofgem has provided no other rationale for the inclusion of the European comparators, other than referring to the perceived changes in risk in RIIO-3:

"We recognise that including European energy network companies in estimating beta differs from our previous approach in RIIO-2. However, when taking into account the changes in risk for RIIO-3 relative to RIIO-2, we consider that including EU network companies better addresses these changes."⁸⁷

Ofgem later confirm that they *do not* see additional risks for ET and gas as being systematic:

"we did not think any additional risks identified were systematic, non-diversifiable, and therefore something that consumers should compensate investors in energy networks for."

The perceived changes in risk cannot both be systematic and nonsystematic. As noted above, it is impossible to argue that electricity and gas specific risks are systematic as they are not economy-wide risks. Ofgem should therefore remove the European comparators if it sees perceived changes in risk as nonsystematic.

FQ15. Do you agree with our proposal not to apply the flat WACC approach?

Yes, we support the proposal to not apply the flat WACC. In previous price controls, if a company's actual gearing was lower than notional gearing, they benefited from a cost of equity that was higher than its financial risk. By removing the flat WACC approach in RIIO-3, this distortion is eliminated, allowing companies' allowed returns to more closely reflect their actual capital structure and enabling them to choose an efficient gearing strategy without being penalized or overcompensated.

⁸⁷ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, P.56.

FQ16. Do you agree that our proposed package for gas and electricity companies is investable?

We agree the package is investable, as no evidence has been provided that it is not investable. However, we do not support the introduction of the term 'investability' in addition to 'financiability'. If companies are able to finance their activities in part through raising equity, then they have been deemed investable. Ofgem have not explained how 'investability' differs from 'financiability' and states that:

' "equity financeability is considered in Chapter 3, which is also termed "Investability" ' ⁸⁸

suggesting they are interchangeable terms. The introduction of the investability concept therefore risks being a construct designed to justify additional returns for companies. We do not believe any additional tests of investability are required.

Real-world evidence as shown by the MAR values indicates that the sector is highly attractive to investors. Citizens Advice does not agree that RIIO-3 poses additional risks relative to RIIO-2 nor that there is a risk of failure to attract equity. Within electricity transmission, the growth required in the sector is an opportunity for investors, who will receive returns from a much higher RAV base. Within gas, Citizens Advice does not believe there is a risk of stranded assets, as all costs will be recovered, and the risk of perceived stranded assets has been addressed through accelerated depreciation. We believe that the regulated energy networks sector is uniquely *low risk* relative to other equities due to guaranteed, stable demand and protected revenue and returns.

This contrasts with the standard "your capital is at risk" risk warning disclosed to equity investors in general. Regulatory economist Professor Dieter Helm has noted that:

*"The overwhelming financial value in most utilities is in the accounting number—the [regulatory capital value]. This is guaranteed by the financing duty on the regulator, so that equity risk lies with customers, not shareholders."*⁸⁹

⁸⁸ Ofgem, [RIIO-3 Draft Determinations](#), July 2025, p. 81.

⁸⁹ Dieter Helm, Commentary: Special administration, financing functions and utility regulation, 2008

Within ET, we consider that even though there is a significant increase in capex required to deliver Clean Power 2030 and Net Zero 2050 decarbonisation targets, we believe the multiple new protections in place for companies make the investment low-risk. The cost of equity being offered is generous relative to the true level of risk faced by investors, making it attractive.

Although we have seen no evidence that rates of returns are not attractive to current investors, it's highly likely there will be investors for whom they are attractive. This means raising new equity is a risk to companies' share prices and not to consumers. In extremis, if companies are genuinely unable to raise capital, Ofgem has already been clear that it has the tools to manage this scenario.⁹⁰ Providing extra funding to manage a theoretical risk that doesn't appear to exist in the real world, and for which the ultimate consequences are limited, isn't in consumers' interests.

At RIIO-2 appeals, the CMA support this view, stating:

*"we are not convinced that investors require an uplift to the CAPM implied cost of equity as a result of Net Zero. As set out in our assessment above, we do not think that under-investment is likely during the RIIO-2 price control based on the MARs evidence and other mechanisms that GEMA has put in place"*⁹¹

We also believe that the 5% cost of raising new equity has been set too high. Ofgem states that:

*"given a relative lack of historical data specific to equity issuance costs at the companies subject to RIIO-3, it is difficult to set an appropriate allowance ex ante that will provide sufficient compensation for efficient equity issuance costs in most scenarios whilst preventing consumers from over-compensating companies for costs that were ultimately not incurred."*⁹²

However, rather than try to strike a balance between what is fair for both sides, Ofgem have continued to choose a 5% cost of raising new equity despite noting previously that *"there is evidence that this allowance level is more generous than allowance provided in a very similar regulatory regime (Water)"*.⁹³ Ofgem further stated at RIIO-2 GD&T Final Determinations and reiterated at ED2 draft

⁹⁰ Ofgem, [GEMA response on Finance Issues and TNUoS](#), Para 257.5

⁹¹ CMA, [Final determination Volume 2A: Joined Grounds: Cost of equity](#), 2021, P.308

⁹² Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), August 2025, P.72

⁹³ *Ibid.* P.122

determinations that a 5% cost of raising new equity “was likely to be a high estimate of the cost of raising new equity”.⁹⁴

Ofgem floats a new option to create a mechanism for assessing the equity issuance costs actually incurred by companies to help ensure that only costs efficiently incurred were compensated by consumers, but disappointingly does not develop this into a proposal or take this forward. Ofgem notes that *“we will continue to work with stakeholders and assess any evidence that a clawback or ex post cost assessment process would be in the consumer interest and would support more accurate compensation of efficient equity issuance costs.”*⁹⁵ Given the asymmetry in resources between networks and consumers/ consumer bodies, it is the responsibility of Ofgem to develop evidence on the merits of this approach on behalf of consumers. Citizens Advice would like to see further analysis on this proposal.

FQ17. Do you agree with our working assumption that there is risk symmetry within the aggregate balance of the whole price control?

We believe that the balance of risk is asymmetric in favour of the network companies. This is based on the evidence of consistent and systematic outperformance in previous price controls⁹⁶, the changes made to move risk from companies to consumers and overall confidence that Ofgem will intervene should an unexpected event occur to the detriment of companies⁹⁷.

Debt Financeability

FQ18. Do you agree with our approach to assessing financeability?

We note that the financeability position of a number of the network companies has been substantially improved through the RAV additions realised through the inflation-related windfall during RIIO2. Also, Ofgem made minimum expectations around how this windfall should be distributed explicitly clear⁹⁸. Ofgem should now demonstrate the impact on financeability of the windfall and confirm

⁹⁴ Ofgem, [RIIO-ED2 Draft Determinations – Finance Annex](#), June 2022, P.120.

⁹⁵ Ofgem, [RIIO-3 Draft Determinations - Finance Annex](#), August 2025, P.123.

⁹⁶ As outlined in the Executive Summary

⁹⁷ See response to ETQ70

⁹⁸ Ofgem, [Call For Input - Impact of high inflation on the network price control operation – Conclusion and Next Steps](#), August 2023, Para 3.6

whether any changes to distribution policies have been made that affect this financeability assessment.

Regulatory Depreciation

FQ24. What are your views on our proposal to accelerate depreciation for new assets only in GD and is there any further evidence you would like us to consider before we reach a final decision?

We agree with Ofgem's proposal to accelerate depreciation for new assets only in the gas distribution sector. This approach aligns with Ofgem's duties to ensure intergenerational fairness and the Government's decarbonisation aims, while also recognising that decisions about investment recovery in GD cannot be made in isolation from wider decisions about the future of gas and the transition.

We note that DESNZ plans to publish a call for evidence on network investment and affordability in autumn 2025 to seek views on potential investment recovery options. We welcome the opportunity to engage in this discussion.

FQ25. Do you agree with our proposal to maintain the existing depreciation policy for gas transmission assets?

We agree with the proposal to maintain the existing depreciation schedule for gas transmission assets. We agree that there is low risk in waiting until the next price control period to change the depreciation schedule, as GT depreciation makes up very little of consumers' bills. It is also more likely that parts of the transmission network may still be required post-2050, as they may be repurposed for transporting hydrogen or biomethane. We believe that it is prudent to wait for a clearer policy directive from the government on these issues before changing depreciation in GT.

Indexation of Regulatory Asset Value

FQ29. Do you agree with our proposals for RAV Indexation?

Yes, we agree with the proposals for RAV indexation. As noted in our response to FQ5, we support a nominal allowance for fixed-rate debt in line with the notional capital structure. Our previous research has shown that network companies

received a financial windfall of £3.9 billion largely due to the mismatch between the allowance for debt costs and actual debt costs.⁹⁹ Setting a nominal allowance for fixed rate debt and applying this in proportion to the notional capital structure fixed rate debt assumption helps mitigate this.

As noted in Q5, there may be other potential areas for windfalls to be generated due to indexation which Ofgem should explore. Additionally, RAV indexation in general offers strong protections to UK network companies, which lowers risk and should be reflected in the cost of capital.

⁹⁹ Citizens Advice, [Debt to society: what the network companies should do with their windfall profits](#), February 2025.

14. Impact Assessment Questions

IAQ1. Do you agree with our approach to assessing the economic impacts of RIIO-3?

Ofgem should look to increase the general understanding of the potential impact on bills, in order to inform wider policy discussions around affordability.

We believe delivering the plans outlined in RIIO-3 is in the interests of consumers. Investment, particularly in the crucial projects needed to enable Clean Power 2030, will reduce the payment of constraint costs and result in decarbonisation. Due to the heavy reliance on Uncertainty Mechanisms over baseline allowances in ET3, the impact on bills may be hard to predict. Ofgem anticipates that the overall spend in ET could reach over £80 billion in the period, though the timing of when these costs will enter the system is yet to be determined.

Ofgem will need to keep a transparent dialogue over bill impacts, as consumers have the right to know, and the regulatory arrangement will need to keep pace with other policy developments in the retail space and coming from the government. In particular, the ongoing Cost Allocation Review needs to be informed by a reliable range for future network charges. We have previously outlined that targeted bill support can mitigate against the risk for people who may lose out from changes needed to deliver clean power by 2030¹⁰⁰. We believe that targeted bill support can mitigate the risk of people being worse off temporarily, before resulting benefits such as lower constraint costs are realised, as the level of support can be adjusted to reflect the impact on bills.

¹⁰⁰ Citizens Advice, [Frozen in place](#), February 2025 (pg 22)

Citizens Advice helps people find a way forward.

We provide free, confidential and independent advice to help people overcome their problems. We are a voice for our clients and consumers on the issues that matter to them.

We value diversity, champion equality, and challenge discrimination and harassment.

We're here for everyone.

citizensadvice.org.uk



Published August 2025.

Citizens Advice is an operating name of The National Association of Citizens Advice Bureaux.

Registered charity number 279057.