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Wales & West Utilities RIIO-3 Consultation Summary Response

We welcome the acknowledgments by Ofgem in the SSMC of the need to maintain the safety and reliability of the gas network, which is clearly in consumer interests.

Government agrees that there is a long term need for the gas distribution networks in the UK, however there is increasing uncertainty about the pathways involved towards 2050 and beyond. The need for decarbonised gas infrastructure is most certain to support industry, and we are confident our network will supply biomethane and hydrogen widely to support Net Zero, including for domestic customers. Even in a scenario with widespread electrification of heat for domestic use, there will still be a gas network in the 2040s, which needs to continue to be safe and reliable for consumers and the public. However, we do acknowledge there is uncertainty on the extent to which the network would eventually be used to this end and Ofgem is right to acknowledge the uncertainty on future demand for gas.

The focus on areas such as data & digitalisation, cyber & physical resilience and environment is positive and necessary to ensure we deliver the best outcomes for consumers and the wider UK PLC in RIIO-3 in terms of security, reliability, choice and affordability.

We note Ofgem is not minded to fund investment related to hydrogen until there is more certainty in policy. Even with more certainty, Ofgem does not foresee significant investment requirements in the RIIO-3 period 2026 - 2031. However, we need to act now to ensure the UK reaches the 2050 Net Zero target. This includes exploring the opportunities for hydrogen and the repurposing of the existing gas distribution networks in order to achieve the best long term legally enforceable government target of Net Zero by 2050. It also includes preparatory work to enable delivery beyond the RIIO-3 period, to ensure this can happen at the required pace under a range of different scenarios.

The use of agile re-openers is critical to enable the investment required in energy transition, to service industry and power generation and to support positive decisions on hydrogen for heat in the government 2026 heat policy. The reopeners should reflect the potential levels of investment required and an ease to make this happen. We expand on this in our question responses to **OVQ4**.

There are a number of key areas within the SSMC that need careful consideration and debate, including finance, use of the Future Energy Scenarios (FES), mains replacement, the Hydrogen Transport Business Model (HTBM). We respond in detail in the relevant SSMC questions and summarise our views below.

Finance

We welcome Ofgem's recognition of the different and evolving challenges facing electricity and gas and increased competition for capital in the UK and globally. Ofgem will be aware that the macro environment relating to long term investment and financing is very different to that prevailing in the lead up to RIIO-2, following the abrupt change to real and nominal interest rates after 2021. This has implications for cost of capital and investor's willingness to retain and provide new capital to our sector.

We also welcome the considerations given to asset stranding risk. We appreciate this is a significant matter for Ofgem. We and our sector peers look forward to engagement with Ofgem in these and other key areas.

There are some areas (e.g. inflation leveraging effect and tax clawback) where we request Ofgem to review its position and on which we have different views. Regarding financial resilience, it is very important to strike a fair and enduring balance between a robust regulatory ring fence and burden on investors. We look forward to engaging with Ofgem to discuss these matters further.

We trust that the significant evidence submitted both on a cross sector and Gas Distribution Network (GDN) sector specific basis will be useful to Ofgem in its policy development over 2024 and 2025. Further evidence will be forthcoming on specific areas in the coming weeks and months, as we have highlighted in our response.

Future Energy Scenarios (FES)

In our responses to questions around the use of FES we have provided feedback around two key areas. The first relates to the very low impact of FES scenarios on gas network investment in RIIO-3 and the second relates to our concerns around the recent changes to FES outputs and their implications on the use of FES more generally across industry.

The vast majority of investment in the gas networks is non-load related and required to meet legislative safety requirements and asset health intervention to maintain a safe and resilient network. In addition, growing security and cyber resilience demands require sustained levels of investment for years to come.

Our position is that there is no need to define a specific FES scenario for RIIO-3 planning and instead assumptions on the cost benefit assessment period for load related activity should be agreed along with a revenue driver on connection/disconnection assumptions that ensure optionality is maintained with low regrets of stranded investment.

Whilst the majority of our work is agnostic to any FES scenario as detailed above, we do have some concerns over recent changes to the framework and requirements for FES.

As recognised in the OFGEM Decision on the framework for the Future System Operator (FSO's) Centralised Strategic Network Plan (CSNP), FES is used across the industry for a range of purposes and in previous years has included information for a range of equally credible scenarios, covering all vectors.

The new requirements for FES are for outputs to include 3 pathways each meeting Carbon Budget and Net Zero targets with a central pathway being required for the shorter term. Our early engagement via the FES Network Forums suggests that these Pathways will be closely aligned to the previous scenarios which assume higher levels of electrification.

The Decision document mentioned above acknowledges that future work is required for long term evolution of supply and demand modelling and states that the pathways should allow the FSO (now National Energy System Operator (NESO)) to demonstrate in the FES publication if a policy target or ambition is not likely to be met.

Given the future role of Regional Energy Strategic Planners (RESP) and our experience of Local Area Energy Plans (LAEP) we are keen that this openness happens and that it is made clear in any single pathway that is engineered to meet targets what the risk is of it not being met. Without this clarity we are at risk of getting into a cycle of self-supporting unrealistic plans as they keep referencing each other. This threatens the hydrogen industry if investor confidence is impacted and gas network resilience and decarbonisation if required investment is not allowed on our networks. There is also a risk to electricity networks if they are expected to deliver reinforcement that they don't have the resources, funding, or time to deliver.

We will continue to support OFGEM and NESO working groups in this area and will respond to future consultations where relevant e.g. on the FES Methodology. However, we are aware that the majority of stakeholders responding to these consultations have interests in electrification and support the position that robust evidence is a requirement in addition to stakeholder views when any decisions are made.

Mains replacement

There are legitimate concerns that the traditional approach to cost assessment will not provide the allowances required to deliver efficient mains replacement in RIIO-3, as proven by the way allowances were calculated for RIIO Gas Distribution Period 2 (GD2), 2021 – 2026) and the associated significant underfunding that has been exposed in the RIIO-GD2 results to date and is expected over the remainder of the control across the GDNs.

There are many pressures influencing costs of delivering the mains replacement programme. As reported within our annual Regulatory Reporting commentary, pipe is now 70% more expensive to procure than even 18 months ago. Local Authorities (Councils) are applying lane rental costs and increasing the requirement for traffic management to work in the highway that have increased costs by circa £3m pa from previous years. In addition, labour costs are impacted by increased demand for investment in the UK water and electricity capital programmes, amongst others, with a finite workforce in the UK to deliver.

The nature of our work is also changing as we decommission the remaining pipes in the last years of the Iron Mains Replacement Programme (IMRP). The changes that the Health and Safety Executive (HSE) has made to its risk prioritisation policies since 2002, in order to maximise the safety benefit to the consumer, have resulted in many of the remaining pipes being short lengths with no ability to grow more efficient schemes for delivery around them. They are also more focussed in the rural and extremity areas of our region, increasing the challenge on resources, especially in Devon and Cornwall.

We are building costs bottom up, using a cost component model, derived using detailed data on specific pipe attributes, locations, and replacement techniques together with the costs we are incurring today. This approach will result in a much more representative efficient cost of delivering mains replacement in RIIO-3 compared to the use of historical costs. However, historical costs do demonstrate the increase in the underlying cost of delivering the programme year on year, and if used appropriately by Ofgem along with forecasts for RIIO Gas Distribution Period 3, 2026 – 2031 (RIIO-GD3), should lead to more appropriate allowances.

It should also be noted that the timing of an expected further HSE policy change on the iron mains replacement programme will be decided too late to influence our July submission. This could have a significant impact on the workload and costs which will need to be reflected in the December Business Plan.

Hydrogen Transport Business Model

We welcome the rollover of innovation funding and some Net Zero Uncertainty Mechanisms from RIIO-2 to RIIO-3. The financial caps need to be appropriate so they do not constrain the investment that could be required, and the scope of each mechanism needs to be designed to cover all the activities we would anticipate undertaking in RIIO-3, particularly in relation to hydrogen. This includes funding to respond to policy changes from UK government amongst others in this critical area.

Our key concern is the proposal for hydrogen assets to be funded only under the government's Hydrogen Transport Business Models (HTBM). Ofgem's current approach in the consultation process, is that even early-stage feasibility style activity for dedicated hydrogen networks would be excluded from RIIO-3 funding of any kind.

Each GDN needs to understand the potential development of new hydrogen infrastructure, as this will impact its own broader Business Plans and the development of plans for repurposing infrastructure. Understanding these interactions is also important to provide input to LAEP and is likely to be information which informs the RESP in future.

Since the SSMC document was published, we note that the government's Draft Strategy and Policy Statement for Energy Policy in Great Britain has been presented to Parliament. This states the expectation that "gas networks are prepared for transition to a low carbon future, with the feasibility and costs associated with different low carbon options or decommissioning assessed" (p. 17). It goes on to note that "funding allowed by Ofgem under the regulatory arrangements for networks has and will continue to be an important enabler of the necessary research and development for hydrogen" (p. 22).

Governments view therefore is that development expenditure for new hydrogen infrastructure, alongside repurposing of natural gas assets, should therefore be within the scope of RIIO-3.

For all points raised above, we expand further in the question responses found in the following responses:

- **FES** – OVQ 7-11
- **Mains Replacement** - GDQ 14-19
- **HTBM** – OVQ1

Due to the condensed timelines, which both Ofgem and the GDNs are working to, we expect to submit further expert reports and ask Ofgem to consider these through the process to arrive at the final SSMD.

Wales & West Utilities RIIO-3 Consultation Detailed Response

Overview Document

OVQ1 - Do you agree with our proposal for how RIIO-3 should interact with the Hydrogen Transport Business Model?

RIIO-3 clearly needs to interact with the Hydrogen Transport Business Model (HTBM), and we accept that under current policy the building and operation of new hydrogen infrastructure would fall within the HTBM in the RIIO-3 period. However, for the reasons set out below, we require that a reopener is designed to allow for the possibility of this changing, and for alternative approaches being preferable for certain projects.

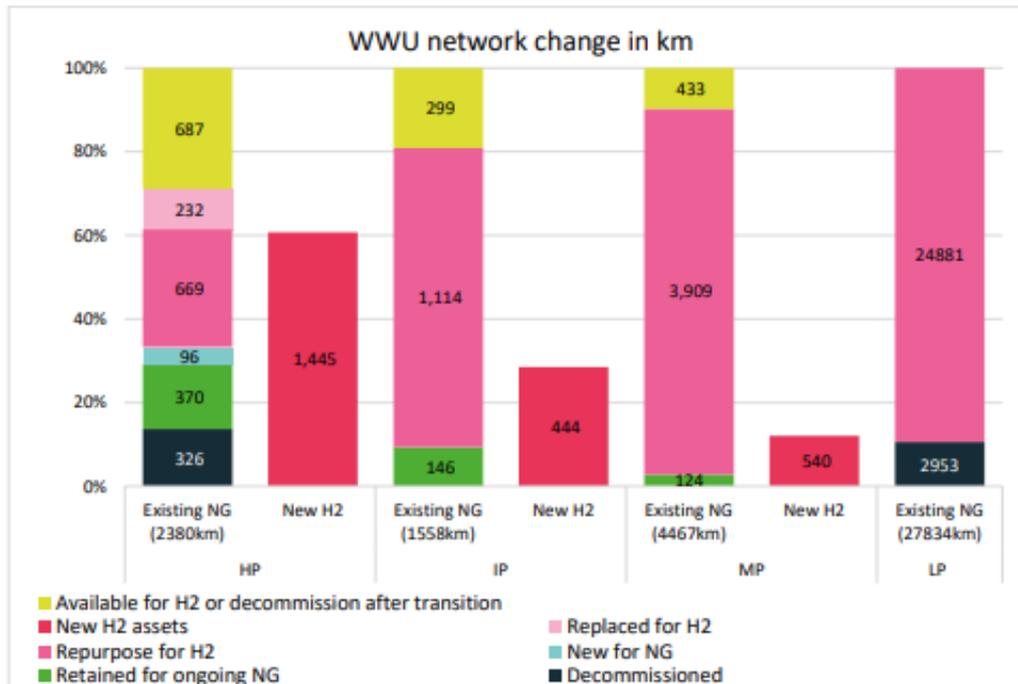
On this basis we particularly disagree with paragraph 4.8. In our view development expenditure for new hydrogen infrastructure should instead be in the scope of RIIO-3. Understanding the potential to repurpose existing natural gas network infrastructure for hydrogen, as set out in paragraph 4.9, involves at least consideration of new infrastructure: it is likely that a transition of an area of the existing gas network to hydrogen would be based on the development of some new infrastructure.

The government's Draft Strategy and Policy Statement for Energy Policy in Great Britain (SPS), presented to Parliament in February 2024, reinforces our view that development expenditure for hydrogen related activity should be within the scope of RIIO-3 mechanisms. The SPS sets government's expectation that "gas networks are prepared for transition to a low carbon future, with the feasibility and costs associated with different low carbon options or decommissioning assessed" (p. 17). It goes on to note that "funding allowed by Ofgem under the regulatory arrangements for networks has and will continue to be an important enabler of the necessary research and development" for hydrogen (p. 22).

The requirement for new infrastructure to support repurposing was set out in WWU's *Regional Decarbonisation Pathways* project report in 2022.¹ This project considered the role of gas network infrastructure under a range of scenarios and showed that repurposing is facilitated by dedicated hydrogen network development, not least to maintain security of supply during the transition.

¹ [regional-decarbonisation-pathways.pdf \(wwutilities.co.uk\)](#)

The following illustration (p. 62) sets out the conclusions for WWU’s network, illustrating the extent of both repurposing and development of new networks:



It is critical that potential development of new hydrogen infrastructure is understood by the existing gas network. This will be key evidence to derive investment in order to understand the potential for repurposing infrastructure. It is not simple to clearly separate these activities and could restrict the pace of Net Zero delivery and be incredibly inefficient in the long term if they are treated in isolation.

Understanding these interactions is also important to provide input to Local Area Energy Planning and is likely to be information which supports the Regional Energy System Planner in future. Development expenditure for new hydrogen infrastructure, alongside repurposing of natural gas assets, should therefore be within the scope of RIIO-3.

OVQ2 - Are there any additional activities relating to the development of hydrogen transport infrastructure, or repurposing of natural gas assets, that you think should be funded through RIIO-3, and if so, why do you think this is justified?

Development expenditure for new hydrogen infrastructure, alongside repurposing of natural gas assets, should be within the scope of RIIO-3, for the reasons set out in answer to **OVQ1**. The scope for Net Zero reopeners should also allow for policy changes, taking note of the government's Draft Strategy and Policy Statement for Energy Policy in Great Britain, which could bring new hydrogen infrastructure into the scope of RIIO-3 in future.

Preparatory costs relating to the development of hydrogen infrastructure or the repurposing of natural gas assets could include:

- Low regrets physical work to prepare the network for repurposing, such as to allow for sectorisation, or upgrade additional pipes or assets alongside Repex work. It should be noted that some of this activity could also help prepare the network for decommissioning scenarios and is therefore required in either scenario.
- Network analysis and assessment, for example to consider network capacity under different scenarios.
- Recruiting and training staff to prepare for repurposing or decommissioning, recognising that delivery in RIIO-4 and beyond will require this preparatory activity in RIIO-3 given long lead times to achieve competency.
- Development of new systems, tools, equipment, and business processes to prepare for repurposing or decommissioning, recognising that delivery in RIIO-4 and beyond will require this preparatory activity in RIIO-3.
- Outline Planning, Feasibility/Pre-FEED, Detailed Design and Front End Engineering Design (FEED) activities related to hydrogen conversion, including new / repurposed networks and the interactions between them.
- Development of commercial arrangements for new hydrogen networks and any regulatory or legal work required to enable repurposing.
- Engagement with hydrogen and decarbonised gas producers, gas users and other relevant stakeholders such as local and regional authorities around the development of plans.
- Engagement with communities on long term changes to the gas networks, in preparation for future decisions and activities.

OVQ3 - Do you agree with the proposal that network costs relating to hydrogen blending at both distribution and transmission level should be included in RIIO-3 Net Zero related UMs? If so, which mechanism do you think is most appropriate for these costs and why?

Yes, network costs related to blending should be included in RIIO-3 Net Zero related Uncertainty Mechanisms (UM).

As the consultation recognises, commercial scale blending could commence around the start of the RIIO-3 period, so costs could be incurred early in the GD3 price control. This means that an UM for blending costs needs to be easy and quick to access, and uncertainty on the scale of network activity required means it should be flexible.

It is logical to include such costs within the scope of both the Net Zero and Reopener Development Fund (NZARD UIOLI) and the Net Zero Pre-construction Works and Small Net Zero Projects Reopener (NZASP). Reducing delays and unnecessary bureaucracy is essential to networks being able to respond to customer requests to inject hydrogen and policy changes.

OVQ4 - What are your views on the proposal of using the GD specific Heat Policy reopener, the RIIO-3 Net Zero related UMs, or a mixture of both to fund network costs incurred as a result of the government's 2026 decision on hydrogen for heating (where RIIO is deemed to be the most appropriate funding mechanism for these costs)?

We agree that it is likely that a mixture of both Heat Policy reopeners and Net Zero Uncertainty Mechanisms will be needed in this space given the range of potential outcomes of heat policy decisions, and uncertainty on what activities may be required for delivery within RIIO-3 or in preparation for activity beyond RIIO-3.

We also agree that it is likely that further evidence around repurposing or decommissioning will be required beyond the UK government's hydrogen heating policy decision expected in 2026. The combination of appropriately calibrated reopeners and Uncertainty Mechanisms will be required to fund this, subject to adequate allowances and appropriate governance.

We will be required to interact with NESO and RESPs during GD3, these requirements are being developed at the same time as we are finalising our Business Plan and therefore the costs we include in our base Totex allowances for this interaction and system development are subject to uncertainty. We suggest that extending the scope of the Heat Policy or Net Zero re-openers to include these costs would be sensible in case these costs are higher than expected at this early stage. These costs are likely to include additional staff, new systems, data sharing platforms, analytics, and engagement.

OVQ5 - What are your views on our proposal to not enable funding for further evidence relating to repurposing the existing network for hydrogen heating ahead of government's decision on hydrogen heating in 2026?

We strongly disagree with this proposal.

Further evidence gathering activity related to repurposing will be required in RIIO-3 irrespective of the nature or outcome of the government's hydrogen heating decision in 2026. This is recognised in the recent government Draft Strategy and Policy Statement for Energy Policy in Great Britain. Such evidence may be directly relevant to hydrogen in domestic heat but could also be used in relation to the decarbonisation of other gas users, such as industry and power generation. These are not in the scope of this decision but also use gas distribution networks. We also note this planned decision date is in strategy documents not legislation, so is subject to political change.

Evidence gathering and development of approaches is iterative: while safety evidence in general will be delivered to government and HSE in advance of the 2026 decision on hydrogen heating, it is likely that some evidence projects would fall between the start of RIIO-3 and the 2026 decision. For example, existing projects may identify the need for further evidence which is not currently anticipated; and more generally the industry will need to continue to refine and improve its approach just as it does with natural gas. However, this is likely to be of similar materiality to current evidence projects which are generally Network Innovation Allowance (NIA) funded, so this could be funded through innovation mechanisms as long as these are appropriately scoped to include hydrogen related evidence gathering.

OVQ6 - Should RIIO-3 help to manage future gas network decommissioning costs? If so, do you have views on what these costs could be and what mechanisms should be used, including for anticipatory funding?

Whilst we await decisions on the future of gas networks, it is essential we continue to deliver business as usual for the millions of customers, businesses and industries that rely on gas. It will not be appropriate for Ofgem to base key decisions on speculation about UK Government policy. The price controls were designed without an explicit assumption of asset stranding, so decommissioning is out of scope of the design and hence the question of funding decommissioning needs a government policy decision at the same time as the decision on Hydrogen for heat.

That said, exploratory costs related to understanding decommissioning and its delivery will require funding and some costs related to decommissioning will be consistent with repurposing for hydrogen, as noted in previous answers. A similar combination of uncertainty mechanisms and reopeners are required to fund such activity.

Activity relating to safely and efficiently delivering future decommissioning, and reducing its environmental impact, should also be in the scope of innovation mechanisms in order to develop technology and techniques which may be useful.

OVQ7 - Do you agree with the proposal to use the FES framework for selecting the RIIO-3 scenarios?

The vast majority of investment in the gas networks is non-load related and required to meet legislative safety requirements and asset health intervention to maintain a safe and resilient network. This investment is largely unrelated to supply/demand scenarios. The cost of maintaining the networks is largely fixed over a single price control regardless of the FES scenarios and numbers of users, varying more with weather, inflation and capital, and replacement activities (in particular for the remaining years of the Iron Mains Risk Reduction Programme). In addition, growing security and cyber resilience demands require sustained levels of investment for years to come.

Demand related investments are largely confined to the connection and associated reinforcement. We also need to disconnect homes due to customer requests or where the gas meter has been removed for more than 12 months. Completion of these workloads ensures compliance with the Gas Act, Gas Safety Management Regulations and our Licence Conditions. Further demand related optional investment is subject to cost benefit assumptions applied.

Given the reasons above WWU believe there is no need to define a specific FES scenario for general planning and instead assumptions on the cost benefit assessment period for load related activity could be agreed along with a revenue driver on connection/disconnection assumptions that ensure optionality is maintained with low regrets of stranded investments. This would avoid complexity that has no material benefit or purpose.

Whilst the majority of our work is agnostic to any FES scenario as detailed above, we do have some concerns over recent changes to the framework and requirements for FES.

As recognised in the OFGEM Decision on the framework for the FSO's CSNP, FES is used across the industry for a range of purposes and in previous years has included information for a range of equally credible scenarios, covering all vectors. This has enabled all users of the data to access a range of consistent and well understood scenarios for optioneering in planning processes.

The new requirements for FES are for outputs to include 3 pathways each meeting Carbon Budget and Net Zero targets with a central pathway being required for the shorter term. Our early engagement via the FES Network Forums suggests that these Pathways will be closely aligned to some previous scenarios which assume higher levels of electrification. The FES Methodology document, which will also be a requirement, has yet to be developed and consulted on. We understand that the Pathway outcomes have been engineered to meet carbon budgets even where these currently appear unlikely to be met and driven by a range of assumptions and stakeholder opinion which we have yet to see in detail.

The Decision document mentioned above acknowledges that future work is required for long term evolution of supply and demand modelling and states that the pathways should allow the FSO (now NESO) to demonstrate in the FES publication if a policy target or ambition is not likely to be met.

Given the future role of RESP and our experience of LAEP we are keen that this happens and that it is made clear in any single pathway that is engineered to meet targets what the risk is of it not being met. Without this clarity we are at risk of getting into a cycle of self-supporting unrealistic plans as they keep referencing each other. This threatens the hydrogen industry if investor confidence is impacted, and additionally threatens gas network resilience and decarbonisation if required investment is not allowed on our networks. There is also a risk to electricity networks down the line if they are expected to deliver reinforcement that they don't have the resources, funding, or time to deliver.

We will continue to support OFGEM and NESO working groups in this area and will respond to future consultations where relevant e.g. on the FES Methodology. However, we are aware that the majority of stakeholders responding to most consultations in this area have interests in electrification and would support that robust evidence be a requirement in addition to stakeholder views when any decisions are made.

OVQ8 - Do you agree with the proposal to use FES Leading the Way as the planning scenario for ET in RIIO-3?

We have concerns with this approach. There is no evidence that the UK is on a pathway to meet the FES Leading the Way scenario. This leads to significant risk of electricity consumers paying for major reinforcement on the energy network, for example, to enable electrification of heat whilst paying for their heat over the long term through natural gas, biomethane and eventually hydrogen.

We suggest a more conservative scenario should be used for RIIO-3.

OVQ9 - Do you agree with the proposal to use two FES planning pathways for the gas networks, i.e. Leading the Way and Falling Short as the additional common conservative scenario?

See **OVQ7**

OVQ10 - Is Falling Short the most appropriate common conservative planning scenario to be used for the gas networks? Or is a common gas network developed scenario more appropriate?

See **OVQ7**

OVQ11 - Is it feasible for all network companies to initially plan against FES 2023 before updating Business Plans in line with FES 2024, as proposed?

As stated in **OVQ7**, we do not see the need to use FES for setting the RIIO-3 Gas Distribution Price Control.

Whilst we do not believe there will be time to do all this and submit a well justified and robust Business Plan in December 2024 based on FES 2024, we note that the value of scenarios in gas is very low as much of the base plan is investment required for safety, reliability and environment, all largely required to comply with relevant legislation.

OVQ12 - Do you agree with our proposed approach on the role, scope and format of PCDs?

We understand and welcome the reason for putting a materiality limit on Price Control Deliverables (PCDs) as this will focus on those that are important.

We also welcome a review of PCDs to ensure they do not constrain delivery of the Iron Mains Replacement Programme. As an example, caps and collars on the Tier 1 services PCD require networks to deliver volumes within a band. As we enter the final six years of the mains replacement programme there will be no choice on the work we do as all tier 1 iron mains and attached services will need replacing. Due to this, we see no need for a PCD with caps and collars and therefore these should be removed. We expand on this in responses to **GDQ17 and GDQ18**.

It is not clear how Ofgem intends to deal with work that would have had a PCD in RIIO-2 but will not in RIIO-3. The implication is that spend on non-standard work that would have had a PCD in RIIO-2 now has to be fully justified in the Business Plan. We will work with Ofgem to understand the level of evidence required to move from PCDs to base allowances.

OVQ13 - Do you agree with our proposed framework for setting financial incentives? Are there any additional considerations that we should take into account?

The move to the RIIO arrangements was taken because it was accepted that RPI-x had served its purpose; however, the almost complete removal of incentives to outperform allowances in RIIO-3 means the mechanism whereby companies were incentivised to outperform with customers benefiting from the out-performance in the next price control period has gone; essentially leaving a mechanism where Revenue equals Outputs.

There is further work to do on improving customer satisfaction on Planned work, reducing lost gas, and developing collaborative streetworks between utilities where a lack of a financial reward will result in the current situation being maintained. A penalty only regime risks a different mindset of just doing enough to avoid any penalty rather than driving performance and promoting innovation.

We agree that incentives should be set on an absolute basis rather than a relative basis. Customers need to know what the standard of service is for a particular service; a relative standard seems likely to lead to confusion and will prevent the sharing of information between licensees. Setting incentives on a comparative basis risks unintended consequences and we note that in Water the relative incentive C-MeX is now being adjusted to have an absolute element. In line with the simplification approach to the RIIO 3 price controls we do not have the time to devise a comparative mechanism and to test it.

We have made the case for continued incentivisation of customer service in our response to **GDQ35**.

OVQ14 - Do you agree with our approach to setting reputational incentives? Are there any additional considerations that we should take into account?

We agree with the proposal to retain them in some cases. RIIO-1 had a closer balance between reputational and financial incentives. This worked well, driving outperformance in areas such as customer service, methane emissions and network balancing. Consideration should be given to a more balanced incentive package that truly incentivises innovation and focus on areas where outperformance is particularly challenging but encouraged by stakeholder evidence. We offer suggestions in the questions related to incentives through this document such as **GDQ2**, **OVQ21**, and **OVQ28**

OVQ15 - Do you agree with our proposals for bespoke outputs? Are there any additional considerations that we should take into account?

We believe there is a place for bespoke incentives where stakeholder support is clearly evidenced. In GD2, only 27% of proposals were adopted despite significant supporting stakeholder evidence. It would be useful if Ofgem could be clear on acceptable evidence levels to make the case for RIIO-3.

There is also a benefit in the bespoke streetworks co-ordination output being extended UK wide. The requirements for co-ordination are a focus for all Local Authorities and as such, shouldn't be limited to the London region.

OVQ16 - Do you agree with our proposal to retain the EAPs and AERs in RIIO-3? Please provide reasonings for your position.

We welcome the opportunity to re-write the Energy Action Plan (EAP), updating it and focusing action on near term, achievable SMART targets in emissions reductions, waste and biodiversity.

The Annual Environmental Report (AER) as it currently stands incurs a considerable cost to produce but some stakeholders have claimed in consultations with Ofgem that the AERs of the gas distribution companies are not widely read either within the industry or by the general public. If this is the case, it would make sense to resolve with Ofgem and the other GDNs how the same information can be delivered in a more cost-efficient and engaging way that stakeholders will find useful – see answer to **QVQ17**.

OVQ17 - What are your views on the new proposed AER format with Commentary and KPIs?

There is duplication of reporting in the current AER where it contains information from other reports such as the Innovation Report and our annual Sustainability Report. Some stakeholders suggest that the AERs are not read – perhaps because they are too dense and long.

A more succinct AER template common to all network operators would be welcome with the following cautionary caveat. Environmental Key Performance Indicators (KPIs) are the visible indicators of a complex system. The Environmental KPIs must be associated with a narrative explanation because positive action towards improved environmental conditions may not translate immediately into numerical KPIs that may be subject to lag or inertia.

We therefore advise against separating the KPI table from the commentary. If these were two separate documents in the public domain there is a major risk of KPIs being quoted without their explanatory context. A more user-friendly and engaging format where narrative and KPI quantitative data could be viewed together would be a welcome improvement, we will work with Ofgem to help achieve this simplification.

OVQ18 - Do you agree with our minded-to position of retaining the reputational incentive on TOs and GDNs for reducing their BCF?

Yes, in principle, but a temporary increase in business carbon footprint does not necessarily indicate that the company has become less efficient in managing its emissions. GDNs should not therefore be penalised where external constraints, outside of the direct control of the company, limit action on reducing emissions despite the company making every effort to reduce its emissions, or where increases in workload (which in the case of Repex reduce shrinkage) show an adverse trend in emissions.

Action on Scope 3 emissions would benefit from innovation funds where networks could collaborate to bring down emissions in supply chains where they share the same supplier or procure the same type of material such as personal protective equipment. This type of engagement would require the involvement of an expert third party such as the Ellen McArthur Foundation. The approach would benefit the wider economy and achieve emissions reductions across the whole utility sector. Innovation funding or re-opens therefore seem to be a more appropriate mechanism for enabling collaborative supply chain engagement to deliver Scope 3 emissions reductions.

OVQ19 - Are there any other suggestions you would like to make regarding reporting standards?

We agree that AER reporting standards should ensure that network companies report consistently on sustainable resource use and waste, supply chain management, embodied carbon, biodiversity, shrinkage, biomethane and other low gas connections.

However, we need a normalisation of metrics to accommodate different business models, network sizes and topographic challenges and allow a fairer comparison across companies. We also suggest establishing primary and secondary targets. The primary targets will be common to all GDNs and relate to activities that have the greatest environmental impact. Secondary targets would be bespoke ambitions material to the circumstances of the particular company.

OVQ20 - Do you agree with our minded-to position to withdraw the Environmental Scorecard and incentivise improvements in environmental impacts through the Annual Environmental Report (AER)? Please explain your reasoning.

Yes

OVQ21 - Do you consider that there are other areas which require financial incentives which cannot be captured by the AER? Please explain your reasoning.

An AER that includes shrinkage covers all the essential environmental impacts. We offer a suggested approach to Shrinkage incentivisation in **GDQ1** and **GDQ2**

However, it may be worth considering rewarding the social value delivered by pro-environmental actions that deliver multiple benefits through partnership with the public sector or community-level partners. This kind of work is analogous to the VCMA. An allowance of this type would enable us to find second life uses for redundant or remediated land that passes a safety threshold. It would fund physical and administrative/legal activity that would make the land useable by social enterprises and public bodies to deliver a measurable public good.

OVQ22 - Do you have any views on our proposals for the NARM framework?

We support the use of Network Asset Risk Metric (NARMs) to monitor asset risk and to provide a view of the benefit and appropriateness of asset investment decisions. The NARM methodology satisfies these requirements, and we agree, the RIIO-2 arrangements are appropriate and do not need revolutionary change.

We do not see the need to expand NARM to additional asset categories in Gas Distribution. NARM currently assesses 90-95% of asset investment, so expanding to other investment categories and asset groups has diminishing returns, with effort and administrative burden not justifying the outcome. Effort would be better focused on refining the assessment and reporting for assets in current scope.

NARM is incredibly data intensive and a view from Ofgem on usefulness of data provided would be welcomed to ensure our submissions provide the information and value required. Below, we highlight a number of areas we believe worthy of further debate.

Risk as a driver for investment decision-making

We need to ensure that we are able to broadly maintain risk not only at network and asset class-level, but also at individual site level, in the long term e.g. over 2-3 price controls.

NARM is very focused on risk at a high level. This can't come at the expense of the larger sites suffocating investment in smaller sites. We need to avoid a situation where we have sites that are outside of NARM's scrutiny because they have low risk compared to sites with more people in proximity and more downstream customers and therefore higher risk. There is a HSE expectation on minimum standards of asset health, as demonstrated by their inspector's approach when visiting our assets.

Effort to value

NARM is a relatively small proportion of Totex due to the exclusion of Tier 1 mains replacement, so the reporting requirements etc., both in terms of Business Plan submission and annual reporting, need to be proportionate.

Currently NARM Regulatory Reporting Pack (RRP) asks for a lot of data that we don't use in our asset management process and does not add value to our investment decision making. We would welcome a detailed review between Ofgem and Networks to refine RRP requirements to a level that provides Ofgem with information required to hold us to account and remove any data that gives no value.

One of the key gaps and challenges is alignment between NARM and Cost & Volumes. An option would be to make NARM categories the default level of aggregation (mains, services, risers, LTS pipelines, pressure control, filtering, preheating, odourisation & metering). This would link cost reporting and NARMs with a 1-1 relationship that provides clarity across the NARM and cost assessment processes.

Target-setting using Long Term Risk (LTR)

GDNs have developed a LTR methodology and will implement for RIIO-3. As LTR reporting is a new concept in gas distribution, careful consideration should be given to target setting. We believe the more simplified an approach, the better as we learn and develop the LTR assessment. For example, setting a fixed period for assessment for all assets and interventions would help balance simplicity and value. This can be debated through the NARM workgroups.

OVQ23 - Do you have any views on our proposed long-term approach to embedding climate resilience, including the principles for embedding climate resilience?

We support the suggested approach and principles.

The CS-Now Project funded by UK Government has already provided a catalyst for network collaboration on climate resilience, drawing attention to integrated and cascading risks that link all public utilities. In addition, companies need to assess their climate resilience, and report in 2024 to be compliant with Adaption Reporting Power (ARP4) so again this will move us along in anticipation for these GD3 proposals. We continue to invest in our climate resilience capacity and are collaborating with the other networks to bring consistency to impact assessments in this area.

OVQ24 – Are there any early learnings we should be aware of/incorporate to make progress on this in RIIO-3 or beyond?

The CS-Now project, funded by DESNZ, will provide a solid base of intelligence for both GDNs and DNOs to take further action.

OVQ25 – Do you agree with our suggested approach for embedding climate resilience into RIIO-3, namely: introducing resilience strategies; developing forward-looking resilience metrics; and introducing climate resilience working groups?

Yes, we agree. This proposal is consistent with the evolving requirements of mandatory financial/sustainability reporting.

OVQ26 – Do you agree with the proposals that we have set out around the resilience metric?

Yes, a metric would support our mandatory climate related financial disclosures obligations.

OVQ27 – Do you agree with our proposals on workforce resilience?

Yes, agree with the proposal. Collaboration currently takes place across the industry facilitated by our Sector Skills Council, EU Skills, consideration could be given to whether they could validate an industry approach and encourage outputs from that body to reported.

OVQ28 - Do you agree with our proposed key objectives for truth telling and efficiency incentives?

We agree that having an incentive to meet the minimum requirements should be maintained.

Regarding ambitious cost forecasts we share concerns that the current volatile cost environment means that cost forecasting is much more difficult than was thought when the GD2 cost forecasts were produced. This risk needs to be reflected in the efficiency mechanism and how Real Price Effects (RPEs) are calculated.

Incentivising / penalising forecasts relative to the benchmark essentially encourages companies to set their forecasts according to what they think the benchmark will be rather than what they think their costs will be. The aim should be to set the benchmark correctly and to do that realistic forecasts are required. The use of the term “truth telling” is emotive and obscures the fact that there are two stages required. First that the forecasts provided by a company are realistic and well evidenced and second a judgement as to whether they are efficient. A high forecast may be realistic based on companies’ assumptions and evidence but judged to be inefficient; equally a low forecast may be unrealistic but taken to be efficient. The test of whether forecasts are well justified must be clear, and not based on an assumption that lowest cost is most accurate. Actual costs will only be known after the event.

Any incentive needs to focus on robust and justified forecasts and not on whether they meet “the benchmark that we would otherwise have used..” (overview document 7.4 bullet 4). The fact that Ofgem has a benchmark in mind before they receive the forecasts suggests that Ofgem has a degree of information asymmetry that it benefits from and is not available to companies, unless Ofgem publishes its benchmarks.

OVQ29 - What are your thoughts on our proposals relating to minimum requirements under an evolved BPI approach?

We agree that a reduction in the number of requirements, focussing them on specific and material areas of the Business Plan and making clear how they are assessed should improve the Business Plan Incentive (BPI). It is vital that the assessment approach is adhered to, and that no informal subjectivity is introduced.

OVQ30 - What are your thoughts on an 'in the round' assessment of cost forecasts as opposed to a high/lower confidence breakdown and assessment?

The move to the RIIO arrangements was taken because it was accepted that the focus on RPI-x was not going to deliver what was required going forward; however, the almost complete removal of incentives to outperform allowances means the mechanism whereby companies were incentivised to outperform with customers benefiting from the out-performance in the next price control period has gone.

Any proposal to introduce a penalty or reward for cost forecasts that are too high relative to the benchmark seems to risk compromising the provision of accurate forecasts for ones that are based on expectations of where the benchmark will be set.

The Gas and Electricity Markets Authority (GEMA's) statutory principal duty is defined in Gas Act section 4AA. GEMA needs to ensure that the design of the price control process enables it to "protect the interests of existing and future consumers in relation to gas conveyed through pipes.." This section further states "Those interests of existing and future consumers are their interests taken as a whole, including...". GEMA needs to determine how to fulfil its duty in regard to cost forecasts.

We consider clarity in the process and resultant outcome of assessments to be important; any steps that can be taken to limit discretion from the process, thus providing all parties with clarity is welcomed. We are willing to work with Ofgem to achieve this, and ultimately reintroduce appropriate incentive mechanisms to the benefit of all stakeholders.

OVQ31 - What are your thoughts on an 'in the round' assessment of Business Plan ambition as opposed to requiring and assessing CVPs?

An 'in the round' assessment needs to be built on a clear objective criteria of how Business Plan ambition is to be assessed. For example, it could be assessed on ambitions to go beyond required levels of performance, or to how ambitious a cost challenge to well justified costs is proposed. Without a clear assessment framework an "in the round" assessment runs the risk of being seen as arbitrary.

OVQ32 - What are your thoughts on the size and strength of any truth telling incentive?

As noted in OVQ28, the use of the term “truth telling” is emotive and obscures the fact that there are two parts to this. First that the forecasts provided by a company are realistic and well evidenced and second a judgement as to whether they are efficient.

We agree that there should be a stage 1 assessment of compliance with minimum requirements and agree that Consumer Value Proposition (CVPs) have demonstrated little value compared to the effort required to produce the proposals. We do challenge the basis of comparing higher confidence costs to benchmarks.

Given Ofgem’s proposed position then this will mean that there is a Business Plan Penalty and no incentive. The stage 1 penalty needs to be appropriate and proportionate to drive the right behaviours.

OVQ33 - What are your thoughts on any alternative approaches that could be used instead of an evolved BPI?

Any alternative approach needs to address the issue that a low cost is not automatically judged to be high confidence and ambitious. The assessment of whether forecasts are “well justified”, “high confidence” and “ambitious” needs to be separated into three stages.

Well justified means that they are demonstrably based on robust evidence, for example, historical performance or from procurement events. High confidence means that there is high confidence that the outcome will be achieved, for example, a known unit price from a procurement event. A well justified forecast may or may not be high confidence as there may be factors outside the control of the network that affect the cost.

Ambition would be judged on the cost challenge each network sets itself.

The same cost could be produced by two different networks, one which had a well justified high cost with a high ambition; the other with a well justified low cost with a low ambition. In terms of the impact on the assessment of the efficient cost both would be the same although the level of ambition differed and hence the Business Plan Incentive should differ.

To implement this approach Ofgem would need two sets of numbers, first the forecasts and second the proposed cost allowances proposed by the network.

We would welcome the opportunity to work with Ofgem in the design of this incentive.

OVQ34 - What are your thoughts on the options for calculating the sharing factors and do you see strong reasons for changing the overall strength of the sharing factors relative to RIIO-2?

As can be demonstrated by the expected and actual costs in RIIO-GD2 compared with the allowances and Ofgem's view of rolling over the RIIO-GD2 control into RIIO-GD3, there's a significant risk that allowances will be insufficient to cover efficient costs.

This in a context of increasing mains replacement unit costs to conclude the 30 year IMRRP (an increasing level of underlying work is required to deliver the same linear length of replacement as previous controls), additional investment required to deliver the safety, resilience and security requirements clearly set out in the SSMC, the uncertainty in the direction of travel to net zero and the requirement for ongoing investment to maintain the existing network. The sharing factor for Totex Incentive Mechanism (TIM) should be set in this context, where it is likely that Consumers will benefit from a funding a minimum level of allowance in the base, but with a higher sharing factor to compensate for under/out performance.

This could be balanced by introducing a different sharing factor for higher risk/lower risk investment. For example, mains replacement where pipe cost has increased by 70% in the last year and the labour market has volatile and increasing pricing due to the level of investment in all UK infrastructure increasing demand on resource.

This could be linked to uncertainty levels on forecasted costs to be agreed between Ofgem and Networks. This would balance risk to consumers of high base allowances and also on companies being able to deliver within allowances.

OVQ35 - Do you agree with our proposal to retain the Net Zero Re-opener with its current scope and parameters for RIIO-3?

We agree with the proposal and consider it more likely that it would be triggered in RIIO-3 than it has been in RIIO-2, given the development of Net Zero delivery projects at earlier stages, which would be likely to be suitable for this mechanism in RIIO-3.

OVQ36 - What are your views on our proposal, in principle, to retain the Net Zero and Reopener Development Fund UIOLI for RIIO-3? What are your views on the types of projects it could fund and how it would interact with other sector specific price control mechanisms?

We agree with the retention of the Net Zero and Reopener Development Fund Use-It-Or-Lose-It (UIOLI) for RIIO-3.

Our experience in RIIO-2 has been that this fund has allowed us to take forward useful and impactful projects which would not otherwise have been funded, and that the UIOLI approach allows us to respond to emerging projects or circumstances quickly and effectively, whilst not disadvantaging consumers.

The NZARD UIOLI allowance should be widely scoped to consider the range of Net Zero related projects which may come forward in the RIIO-3 period, not all of which could be anticipated or specified at the outset of the price control as policy and technologies change.

As set out in our answers to **OVQ1**, **OVQ2** and elsewhere, we consider there to be a strong case for funding hydrogen related activity in RIIO-3 alongside the HTBM, as this work will be needed to consider the future role of gas distribution networks irrespective of (though clearly affected by) government decisions on hydrogen heating. This should be in the scope of the NZARD UIOLI allowance, alongside other Net Zero related investment and preparatory work, including work related to efficiency, emissions reduction, biomethane and decommissioning.

OVQ37 - Do you think we should retain the NZASP for GD and GT? What should its scope be and what kind of projects would you expect to be funded through this reopener in RIIO-3?

We support retention of a standalone Net Zero and Small Projects Reopener.

This can fund projects which are too large for the NZARD UIOLI Fund but would not be in scope for the Net Zero Reopener. Examples of projects that are likely to come forward in RIIO-3 include FEED for projects related to industrial clusters or delivery activity to support biomethane or transport related projects. In principle this style of reopener strikes a reasonable balance between the effort and scrutiny required on the part of both the networks and Ofgem, which may not be the case with either a broader UIOLI fund or a combined Net Zero reopener. As noted in our answers to **OVQ36** and elsewhere we consider that hydrogen projects should be within the scope of these mechanisms.

OVQ38 - Do you have any views on consolidating the Net Zero related re-openers and the UIOLI allowance?

We disagree with the Net Zero related re-openers and UIOLI allowance being consolidated.

Experience from RIIO-2 suggests that they serve different projects at different materiality and stages of evolution, so it is appropriate to have these as separate mechanisms. For example, feasibility stages for WWU's Hyline Cymru project have been funded through NZARD UIOLI, and the flexibility of this mechanism has allowed new supporting evidence to be generated as the project evolves. Moving forward into a FEED stage, we will be looking to make a reopener application and believe this is reasonable for the scale of activity and spending involved.

OVQ39 - Do you agree with our proposed position to retain the Coordinated Adjustment Mechanism for RIIO-3? If it were to be retained, what design and incentive considerations could we implement to enhance the utilisation and value of this mechanism?

We agree that in theory this mechanism provides a way of enhancing whole systems efficiency. In reality this has never been used, but a mechanism could be needed in the future. Our suggestion is to retain but with an opportunity to change the mechanism in the RIIO-3 period as NESO and the networks develop thinking in this space.

OVQ40 - Do you agree with our proposal to allow physical security costs to be submitted through a broader resilience re-opener?

We agree with the proposal but trigger levels should be kept to current levels. Triggers set at a level that assumes all elements of the re-opener would have to occur would not be appropriate. The mechanism should allow a reasonable submission if any element of uncertainty within the scope is realised.

OVQ41 - Do you agree with our proposed approach to introduce a resilience re-opener?

We agree that a resilience re-opener is required; however, two items need to be added:

- 1) Adaptations required to meet climate change impacts to assets where this work was not included in the RIIO-GD2 Business Plan, for example flooding, soil erosion, impact of excessive heat, storms and so forth. This would include both work done as result of these impacts, and also work needed to address risks before they materialise. For example, a diversion of a main where it is threatened by river erosion but not yet compromised. This would include the environmental elements included in the RIIO-GD2 Diversions and loss of development claims re-opener but would be much wider in scope and include moving or adapting above ground assets.
- 2) As a company which owns, maintains, and operates Critical National Infrastructure (CNI), we consistently experience changes in risks and threats. These may arise from shared knowledge from UK government on physical threats, physical security breaches, vulnerabilities in equipment that are no longer deemed suitable to align with risks such as insider threats and external security breaches. Incidents of this nature can significantly impact Business as Usual (BAU) for us. Allocating a separate allowance for physical security, independent of the allowance for our CNI sites, enables us to respond to such incidents and be proactive in reducing risks before they occur. This can include physical security upgrades, staff training, and ensuring all security equipment can be maintained appropriately.

Establishing a national security allowance would facilitate achieving this goal. This would also allow for both reactive and proactive security upgrades across our depot sites and operational non-CNI sites, safeguarding our physical infrastructure, corporate network, operational technology, our people and assets.

OVQ42 - Do you have any views on whether the Opex escalator should be retained and if so, how we could evolve the Opex escalator for RIIO-3?

No response

OVQ43 - Do you have any views on how we should effectively monitor the delivery of UMs?

It is logical to have PCDs for the material outputs from re-openers or other UMs. Outputs from re-openers or other UMs that are not material should be treated in the same way as small projects in the Totex Base allowances. That is, they are not individually monitored as much of this work is required to meet other obligations on us for example maintaining our assets, meeting cyber and physical security obligations, or meeting obligations to provide connections and reinforce our network to meet our obligations to meet demand experience one day in every 20 years.

With regard to cost, through the RIIO-GD2 submitted re-openers GDNs worked with the Ofgem teams to define and then refine the quality and level of cost information (actuals or forecast) to be included in re-opener submissions. This working relationship should continue with Ofgem standardising across all re-openers where applicable.

Annual RRP returns and associated commentary includes specific requirements to report on the progress of UM cost and delivery and this should continue; those submissions already adhere to Data Assurance Guidance (DAG) assurances and representations. More frequent updates are likely to create a burden on both Ofgem and GDN teams with little benefit.

For business activities that are covered by the scope of a re-opener Ofgem could require that networks provide detail of the material cost assumptions in Business Plans. This would allow a line by line comparison of the costs requested in a re-opener application with those in the Business Plan; however, this approach would only be valid where Ofgem provided Totex allowances for all the costs requested in the Business Plan.

OVQ44 - Do you have any views on whether to evolve the RIIO-2 methodologies for RPEs and ongoing efficiency for RIIO-3, and if so, how?**Real Price Effects (RPEs)**

While we agree with the general framework for RPEs, the RPEs as currently applied does not fully capture the cost increases faced by the industry, for instance due to increased pressures from competing infrastructure projects driving up prices or labour shortages in the gas sector amidst the uncertainty over the future of gas. We therefore recommend that Ofgem carefully examines the relationship between costs and RPE indices and works together with GDNs in calibrating RPE indices (selection and weighting). This might include carrying out more detailed RPE analysis, for instance on real wage growth associated with the skills needed from WWU's operational staff.

We also note that there may be a link between RPEs and risk/financeability. Ofgem has previously argued that the indexation of RPEs as an uncertainty mechanism reduces risks, therefore supporting the assumption of a low cost of capital.

Ongoing Efficiency (OE)

OE is intended to capture the potential for frontier shift movements from implementing new technologies and working practices. To assess OE in GD2, Ofgem used historical performance of the GDNs and total factor productivity (TFP) growth in the UK. We consider that both of these approaches need to evolve for GD3.

UK productivity growth, as measured by TFP, has continued to stagnate since 2008 and this productivity slowdown is widespread across industries. To consider that GDNs can continue to surpass productivity growth in the rest of the economy and can continue to improve productivity at the same rate as has been historically achieved is not sustainable given the headwinds faced in GD3.

The historical performance of the GDNs needs to be carefully considered alongside their planned performance over GD3. The drivers for any reduction in forecast performance need to be examined and understood such that recent historical performance is not simply used to overwrite what the GDNs consider is feasible. Moreover, there is a risk of double counting OE, for example, when our suppliers bid for work they implicitly incorporate their own estimates of OE within their pricing. Similarly, careful consideration needs to be given to ensure no double counting occurs with respect to any OE embedded within Consumer Price Index (CPIH).

The methodology for constructing OE from TFP values needs to be more transparent and appropriate for GD3. Moreover, OE most naturally applies to business as usual costs but is more problematic for areas such as Repex. Repex is not an ongoing cost area, and thus OE is less applicable here. The past Repex programme focused on customer safety and risk i.e. lower diameter tier 1 pipes, close to houses, and consisting of material most at risk of leak (cast/spun iron). These were simple projects, readily repeatable in nature such that there was significant scope for learning by doing and improving best practice over a number of future price controls. GD3, in contrast, is a fixed programme impacted by the policy decisions of the past, a greater proportion of Ductile Iron, a greater proportion of 8" diameter mains, smaller and more complex projects.

With the IMRRP coming to a close in 2032, additional investment in innovation above that already embedded by GDNs, that will improve an operational team's ability to increase their efficiency, is far less likely given the payback of investment required by third parties. Therefore, applying an additional OE challenge (above that already embedded) to a programme at the end of its delivery is not appropriate.

This is also true for other operational activities; we do not expect innovation on business-as-usual operational activities to be wide ranging and yield material productivity improvements within GD3.

Additional third party reports have been commissioned which assess both Ongoing Efficiency and Real Price Effects, but due to the condensed timeframe of this SSMC they are not available in final for this submission. Both reports are on track for completion within the month of March 2024 and will be submitted to Ofgem as soon as possible. We therefore request that Ofgem review and consider the findings in this report once submitted to them.

OVQ45 - Do you have any views on the potential application of RPEs and ongoing efficiency to re-opener applications?

We understand that in theory RPE and OE methodology could apply to re-opener applications. However, we consider OE as not materially relevant to reopeners, as with RIIO-GD2, and therefore this methodology should not change. For RPEs, we do not see a reason for pre-determining this at the start of the price control given it could differ dependant on each re-opener application submission. The decision on whether RPE methodology applies should be built into the re-opener application based on the evidence and certainty (i.e. fixed nature) of the submission. We set out this reasoning below.

The biggest factor in whether an RPE and/or OE adjustment is material is the time period between submission and expenditure. A longer time period increases the likelihood of RPE and/or OE creating a material variation. In practice though this risk is somewhat confined; re-opener application windows are mid-way through price controls and there are often multiple application windows, thus limiting the exposure to an extensive time-period that would lead to a material variation.

In addition, costs included in submissions are typically fixed and therefore not suitable for RPEs and/or OE to be applied, either because GDNs are claiming actual costs already incurred or because forecast costs have been derived through fixed tenders. During the re-opener assessment process Ofgem determine whether a GDNs reopener submission represents efficient spend which is typically supported by substantial evidence (both internal and third party). Thus, we consider applying a further OE challenge to these submissions is not logical nor likely material.

Given these points on practical application, and the immaterial nature of these adjustments in GD2, we think the resultant adjustment to allowances would not be material across a price control and this should set the starting point for GD3. In particular, we think an OE adjustment would not be material, and for RPEs we think that Ofgem could keep flexibility by keeping this as a decision determined as part of the re-opener application assessment. GDNs would propose what proportion, if any, of the submission would benefit from applying RPEs based on the evidence and certainty (i.e. fixed nature) of the submission.

OVQ46 - Do you agree with our proposed approach to cyber resilience in RIIO-3?

We agree with the proposed approach to cyber resilience in RIIO-3. We believe it gives a better balance by shifting the focus to baseline allowances (providing they are sufficient and assessed on a GDN by GDN basis given these costs are not scalable or comparable across GDNs) rather than UIOLI, but still retaining PCDs, which we believe should be minimised to reduce administrative overhead whilst still ensuring full Cyber assessment Framework (CAF) alignment.

Retaining a regular re-opener mechanism for IT, cyber and physical security to address changes occurring within the cyber threat landscape during RIIO-3 also provides a level of flexibility that will continue to be required. This is likely to be indefinitely, given the everchanging and increasing threat landscape we, as a Critical National Infrastructure (CNI) owner, operate within. A similar approach will be required for physical security as well, as this also continues to develop to safeguard these same CNI assets, providing increased resilience in the supply of gas to consumers.

OVQ47 - Do you have any views on our proposal to retain a flexible allowance, providing evidence for why you think that it should, or should not be, retained?

We strongly support retention of a flexible innovation allowance. This encourages continuity in innovation and ensures a consistent innovation framework within a common strategic approach. This benefits network customers by helping innovation permeate throughout the networks and allowing learnings to be more easily shared between licensees leading on different projects, for the benefit of consumers across the UK.

Similarly, this consistency and flexibility helps third parties to work with us. A flexible allowance supports the time and space required for innovation within businesses and this in turn allows us to support and engage with third parties. This is particularly important for smaller innovators and new entrants, who may need support to engage with networks and understand the innovation process.

We have evidence from the Innovation Culture project managed and published by PA consulting on behalf of UKRI '[Innovation culture: There's no stopping you | PA Consulting](#)', that an exemplar network innovation culture requires "individuals and teams that have space to think creatively, time to support development and roll-out of innovation, and time to collaborate and explore new ideas".

This was corroborated by feedback from key stakeholders and 3rd parties who were surveyed as part of the bi-annual Innovation Strategy refresh that is currently being undertaken by LCP Delta through the Energy Networks Association (ENA) on behalf of networks. A funded innovation team of subject matter experts from the relevant strategic areas across the organisation to deliver the innovation portfolio, is key to developing a realistic roadmap to facilitate Net Zero 2050.

Ofgem and the networks need to continue working closely together, and flexible regulatory innovation funding is key to that, especially a funding mechanism that is enduring across price controls, ensuring networks can focus on game changing innovation for future of the energy transition.

In RIIO-2, flexible funding allowance facilitates collaboration; with around 50% of our network led innovation projects being collaborative with other networks. This is further evidenced in the ENA Annual Innovation Report ([fy23-ena-annual-innovation-summary-report-final-version.pdf \(energynetworks.org\)](#)), where, of the projects registered in FY23, 60 projects across all networks, included more than one network operator (46% of all projects initiated). This ensures value for consumers, avoids unnecessary duplication and facilitates learning between networks, providing best value for consumers and removing competitive barriers.

Flexible funding also allows networks to be agile and respond quickly to market changes. In a recent report from the House of Commons Committee of Public Accounts '[Support for innovation to deliver Net Zero \(parliament.uk\)](#)', creating the right environment for research and innovation to succeed is vital if the UK is to achieve Net Zero by 2050.

One of the elements that allows flexible funding to work is the governance surrounding it. All flexibly funded projects follow the strict guidelines outlined in the licence condition, working in tandem with internal governance processes and external peer review processes with other networks through ENA groups. As the gas networks exit from most activity with ENA, alternative appropriate governance will be developed to continue to meet these requirements and expectations. This avoids unnecessary duplication and supports the sharing of learning from in progress and completed projects across licensees, and with third parties.

Each project has a single page outline shared between the networks to check for duplication and log collaboration opportunities. Each project is published on the ENA Smarter Networks Portal <https://smarter.energynetworks.org/> with project information publicly available. This includes pre project initiation where key information like scope, cost, technical readiness level at start/end, outline business benefits and other important data is recorded. Each project also has a closure report published on the portal (and an interim report if a project is in progress through an annual regulatory report cycle). All projects can be assessed at any point and can be audited to ensure compliance to funding guidelines with allowances removed for non-compliant projects. We'd like to see this flexibility maintained in RIIO-3, within appropriate governance, to build on progress from RIIO-2.

OVQ48 - Do you have any views on our proposal to retain a competitive network innovation funding pot, that continues to focus on key challenges facing the energy sector, with phases to de-risk the pot?

We would like to see a competitive funding mechanism retained but with a reduction in volume of administrative burden and an increased window of opportunity each year for innovators and networks to access.

We would like to see at least two windows of competitive funding per year to de-risk having a single funding window. This will ensure game changing innovation doesn't have to wait 12 months to access the next window, allowing more time for innovators to develop their ideas and reduce bottleneck mentality which is seen with the current single annual entry process. We'd also like to see the annual SIF challenges become more consistent to support long term future portfolio planning.

We would also like to see Discovery rounds removed as they have the highest administrative burden relative to the value of that stage of the process. A flexible NIA style funding route could instead provide the entry mechanism. The Alpha/Beta scope and funding levels from RIIO-2 SIF could then form the 'competitive' innovation funding pot, with direct entry to 'Alpha' or 'Beta' to encourage diversity of projects and approaches. Our "*2023 SIF Consultation Letter 1678187457518*" response to Ofgem outlined our early thinking in this space which was to support using flexible funding before moving direct to Alpha/Beta phases.

The resource required to support a competitive process also needs to be considered. Funding only starts once a project is initiated but a significant amount of time is spent to engage with the market, review pitching, filter ideas, and work with innovators (particularly those new to networks or early start-ups) to develop the application, which is key to success of the portfolio. The cumulative impact on resource of multiple rounds per price control and the resource intensity required to shape larger Beta projects (especially as not all will have a direct network benefit), needs to be factored into any retention of competitive funding: it would be appropriate to consider core resource for innovation governance and wider subject matter experts within the business as part of base allowances.

OVQ49 - Do you have any views on how the structure of the price control innovation funding could be adapted to better focus on whole systems problems, and ensure strategic alignment with other public sector initiatives?

Flexible NIA style funding in RIIO-2 has enabled networks to manage and respond to a rapidly evolving landscape, supporting consumers where and when they need it most. This level of flexibility supports the wider supply chain of innovators and should be retained.

Accessing non-competitive framework and funding like innovation funding, is agile as it allows network to respond to market and technology changes quickly and pivot as ideas and learning is developed. It also requires networks to share learnings and encourages networks to work together to learn from each other across whole energy systems and deliver better outcomes in an open and collaborative way. This approach also avoids duplication by providing a forum for open discussion and challenge on innovation projects and allows networks to address common issues and facilitate collaboration. This enables trials of innovative but untested solutions to achieve key goals, which is a critical step in the development of new technologies and approaches to reach Net Zero 2050 targets.

NIA funded projects often feed into a variety of follow up projects either within network or cross network, which are often funded and matched through other mechanisms or funding sources. We have shown clear examples of this in our annual innovation report, on pages 19 and 20 '[network-innovation-allowance-annual-summary-2022-23.pdf](#) (www.utilities.co.uk)' where we show how our portfolio of projects build on each other for each strategic area and how the different funding is used in a complimentary fashion to progress the innovation strategy and build on prior project learning. They also build iteratively through price control periods as ideas are built over time.

This inherent flexibility allows NIA funded projects to support high risk, low technical readiness level (TRL) solutions that can build into larger demonstrator or product style projects. The flexibility also applies to smaller projects where incremental development and the ability to fail fast sits alongside larger scale innovation projects, allowing rapid dissemination of ideas and enabling quick and iterative development of solutions. This incremental approach means that although related projects may appear similar, they build on previous work and enhance shared network understanding as evidenced in the previous paragraph.

As mentioned in the previous questions, resource is required not just for flexible allowance but also to develop competitive allowance applications, retain skills and experience and support an innovation culture through the networks. In the current price control flexible allowance is calculated on an internal vs external expenditure where resource can be levelled across the price control period to the total spend in GD2, allowing governance, supporting functions, technical experts and project leads to work on the innovation portfolio. We think this is critical to successful innovation and would like to see sufficient discussion on how this can be achieved before the Sector Specific Methodology Decision (SSMD).

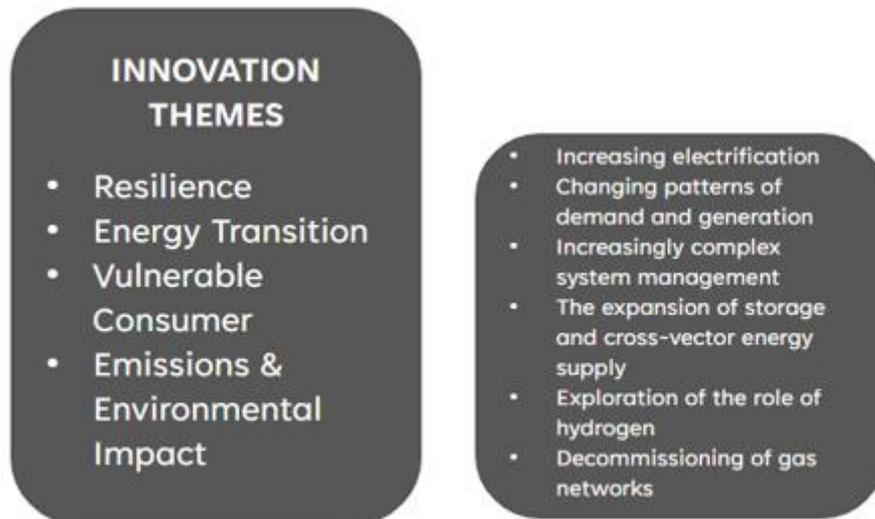
As a group of energy networks, we've worked together to design a new mechanism as seen in Fig 1. below. Today we're funded for future of energy and vulnerable customer related innovation, and we'd like to see this continue, however, we would also like to see innovation funding criteria expanded to include new themes and strategic areas as seen in Fig 2. below.

An enhanced funding criteria would see us remaining focused on future of energy and vulnerable customer themes, of which data and digitisation innovation remains a key part but would also focus on areas we can impact today e.g. emissions reduction, network resilience, environment and sustainability, biodiversity net gain, safety, health and wellbeing of colleagues. We will be making the case for hydrogen to be in scope of innovation and uncertainty mechanisms as we do not expect evidence development on hydrogen to stop in 2026 even if there is a firm heat policy decision, and much of that has been funded by NIA flexible funding to date.

Fig 1. Joint GDN funding model proposal (inc. Technical Readiness Levels (TRL))

Network Innovation Incentive (NII)	Research & Development	Baseline Innovation Fund for each network (90% funded) Projects <£1.5m	NIA	Budget for the RIIO-3 period to be managed by the network to develop projects, stakeholder collaboration	TRL 1-6
	Innovator Accelerator	Innovation Fund for Innovators supported by networks (TBC%)	*new	Ability for innovator led activities to be funded, supported by networks but not led	TRL 4-7
	Demonstration	Innovation Fund for Projects >£1.5m, requiring approval and peer review. (up to 90% Funding). Assessment made by 3 rd party to ensure consistent approach and meets energy system needs.	SIF	Request for funding window open every 6 months Submission must include evidence of past (NIA) work proving demonstration capability and all key elements as seen today in SIF process. Could be managed through UKRI or other system. Option to start with short Alpha phase or move straight to Beta	TRL 4-8
	Future Regulator Sandbox	Funded through NIA/SIF or Reopener activity	*new	Ability for networks to trial innovative approaches to the energy system in live trials led by Ofgem. Sits alongside the current regulatory sandbox.	TRL 7-9
	Scale Up & Hand Over	Baseline Innovation Fund for each network (up to 90% funded) Projects <£1.5m	*new	Budget for the RIIO-3 period to be managed by the network to disseminate projects, deliver benefits across energy system and implement	TRL 7-9
	UM Development	UIOLI Fund for each network to enable development of Net Zero Projects <£2m (100% funded)	UIOLI	Budget for the RIIO-3 period to be managed by the network to develop Net Zero Solutions for reopener application	TRL 7-9
	NZ UM	Opportunity for networks to attain additional funding for hydrogen and net zero projects CAPEX (100% funded)	UM	Budget for the RIIO-3 period to be managed by the network to deliver Net Zero Solutions into the network	TRL 7-9
	Implementation	Business Funded deployment activities (0% funding)	BAU	Business to self fund implementation past the first deployment and ensure driven into relevant investment programmes	TRL 9

Fig 2. Joint GDN innovation themes proposal



Although Ofgem’s position of Operational Excellence innovation in the SSMC is not currently minded to be funded in RIIO-3, we believe that this will lead to missed opportunities for customer benefits which would not be delivered on a commercial basis alone. Looking beyond RIIO-3, significant operational delivery work will be required for Net Zero, whether that involves hydrogen conversion, decommissioning or a combination of the two. During RIIO-3 it would therefore be appropriate to develop innovative techniques which could deliver long term efficiency. Flexible funding that was given in RIIO-1 facilitated collaboration and shared learning between networks. The impact of this is that in RIIO-2, each network develops their own competitive innovation strategy so the ability to share learning and collaborate is lost.

One example of this is from RIIO-1, was a project to design and develop a 'Ductile Iron Window Cutter' tool [Ductile Iron Window Cutter Tool | ENA Innovation Portal \(energynetworks.org\)](https://www.ena.gov.uk/innovation-portal/ductile-iron-window-cutter-tool). The project cost £87k, once implemented the new cutting tool was assessed to generate £55k of anticipated benefits per annum across our network. The design after testing was deemed successful and the tool implemented. Benefits are tracked per annum to realise savings which were higher than anticipated as highlighted in RIIO-1 Ofgem Innovation Funds Information Request REF: OFG1161. The tool was also implemented by other networks which greatly increased the realised benefits per annum for the project.

In summary, we would like to see a flexible and agile funding mechanism that supports iterative development seamlessly between price controls, supports collaborative working across a wide range of qualification criteria and TRL’s, and that is resourced sufficiently to allow networks to strategically work across the whole energy system.

OVQ50 - Do you agree with our proposal to continue with a similar level of innovation funding, and if not, could you provide evidence for why a different amount is required, including consumer research you are aware of into their willingness to pay for network innovation?

We support the UK government target to spend 2.4% of GDP on research and development, which is mentioned in the SSMC. This would continue the trend from the circa 0.7% of overall revenue for innovation funding that was awarded in RIIO-1, and an estimated 1.5% funding levels that have been allowed in RIIO-2.

A recent report from the House of Commons Committee of Public Accounts '[Support for innovation to deliver Net Zero \(parliament.uk\)](#)', said that in terms of the private sector, the Government estimates a significant increase in external investment to deliver Net Zero. The Government expects that overall low-carbon investment will need to increase in total from an estimated £23 billion in 2022 to between two to three times that level per year through the late 2020s and into the 2030s, with most, but not all, of this increase coming from the private sector. RIIO-2 innovation allowances have been pivotal to exploring how innovation can play a role in developing the new technologies required, increasing the efficiency of delivery and ultimately in reducing the cost of this transition for consumers. In terms of the private sector, the Government estimates a significant increase in external investment to deliver Net Zero and we would see the role of network innovation increasing alongside it.

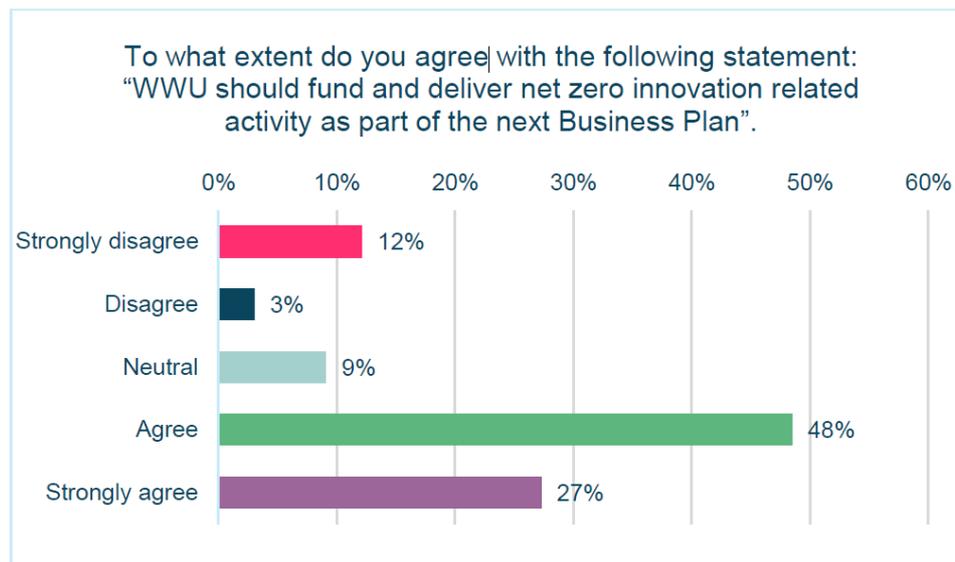
Since the SSMC was released, the Government has laid a draft Strategy and Policy Statement before Parliament: [draft-strategy-policy-statement-energy.pdf](#) the following quote highlights how "funding allowed by Ofgem under the regulatory arrangements for networks has and will continue to be an important enabler of the necessary research and development for hydrogen" (p. 22). This has been a core element of innovation funding for gas networks in RIIO-2, where projects have been evidencing the role of hydrogen in Net Zero and developing the safety case in line with the HSE amongst other key areas such as consumer vulnerability, data and digitization, biomethane and other green gases, and more whole system challenges.

We have also completed some initial stakeholder feedback on innovation through a Regional Workshop with a total of 63 stakeholders in attendance, representing 49 organisations. When asked to indicate which topics were most important to them in the next Business Plan, 'vulnerable customers' and 'Net Zero' were the most popular which is highlighted in Fig.3. below. The importance of these topics was further highlighted by these same stakeholders, such as "vulnerability", "fuel poor" and "Net Zero by 2030". Reflecting the themes of previous discussions, "collaboration" also emerged as a key focus for WWU among attendees. However, splits emerged during the discussions as to the differences to the approach taken and the areas of focus.

During discussions, there was a broad consensus across stakeholders on the need for innovation and the potential benefits of funding it. However, differences emerged around which projects should be prioritised, and concerns were raised about the financial implications of providing funding for these kinds of projects.

An overarching theme across all discussions by attendees was the broad endorsement of pursuing innovation projects, particularly in the context of reducing energy consumption and making advances towards Net Zero goals. A local authority elected member emphasised the importance of innovation in reducing energy use and enhancing smart energy practices. Representatives from vulnerability groups and charities also supported this approach if it directly benefited customers and did not adversely affect them financially.

Fig 3. Regional Workshop Slide Vote



OVQ51 - Do you agree there is a need to expand the scope of innovation funding to be more inclusive of third parties?

No, we see this area to be one of continual improvement, not radical change, which recognises that flexible funding with a broad scope is critical for third party innovators. We already make significant efforts to engage third parties and flexible funding allows time and space to foster relationships with third parties, who can bring ideas across a wide range of topics at times that fit the evolution of their products and services, rather than fitting into competition windows.

WWU, in collaboration with other networks, have a range of tools and approaches to engage third parties. These include the annual Energy Innovation Summit where we had 1,137 attendees from 340 organisations, and our annual innovation report which we publish and disseminate widely. We also engage and present to different types of partners at a regional and national level through different events throughout the year.

We foster direct engagement with partners and have a detailed communication plan to support project dissemination both internally and externally across different media channels. We also have a direct mailing list with over 400 registered third parties to whom we communicate with monthly on our tenders, events and project dissemination.

We issue our innovation problem statements widely through the Bravo platform and via Find-a-Tender. We also engage with the Strategic Innovation Fund (SIF) process via UK Research and Innovation (UKRI) to meet new innovators and third parties. We have introduced the new Basecamp Event in RIIO-2 organised by the ENA where networks generated 53 problem statements and received 273 proposals from innovators, and we expect to build on the success of that format through the remainder of RIIO-2.

We attend key events like Innovation Zero/Infrastructure Zero, Utility Week and also work with consortia such as South Wales Industrial Cluster, Hydrogen South West and the newly funded Great Western Supercluster of Hydrogen Impact for Future Technologies (GW-SHIFT) programme. We are also involved in projects such as the Milford Haven Energy Kingdom and Ambition North Wales.

OVQ52 - What are your views on us establishing an accelerator to support early-stage innovators?

Although we support this initiative in principle and have included it in our suggested funding mechanism design in **OVQ49** Fig 1. above, we have concerns on the value that early-stage innovator support would be for consumers and the time and resource constraints on networks to administer. Consideration needs to be given to quality of pitching and understanding the importance that consumers might place on this as ultimately the bill payer would be taking the risk funding this type of activity.

Other organisations offer this service today, so we need to be careful not to duplicate what's already in the marketplace e.g. NG partners have a venture capital organisation. Key is to understand how networks would resource, filter, and prioritise ideas to capture the real value add game changers and how this would be managed alongside adherence to procurement rules.

OVQ53 - What are your views on our proposal for this to be a smaller part of a future challenge fund and to be sponsored by networks?

If there is a genuine gap in the market, value for consumers identified, and networks are resourced and funded appropriately, we would be supportive.

OVQ54 - Do you have evidence of potential innovation projects that have not been implemented or sought funding due to the five-year structure of the price control? How could this issue be addressed?

We would like to see carryover funding for projects that span price control periods to remove the current ramp down, ramp up approach that uncertainty on innovation funding brings to progress of the portfolio.

To bridge into RIIO-2, 12 months of carryover NIA (CNIA) was allowed, of which we had 18 projects to the value of ~£1m (where all spend needed to complete within that 12-month period). This was well received amongst networks as it helped bridge some of the risk on committing to projects in later years of the current price control.

It didn't, however, eradicate the ramp down and ramp back up approach entirely. The uncertainty on resource and continuation of innovation funding between price controls is still a major challenge, with risk mitigation enforcing this ramp down/up approach. To evidence this, Table 1 below illustrates our investment in the final two years of RIIO-1 followed by the first three years of RIIO-2.

Table 1: 5-year RRP profile between price controls (2018/19 prices)

Actuals	Actuals	Actuals	Actuals	Forecast
2019/20	2020/21	2021/22	2022/23	2023/24
1.52	1.16	0.83	1.16	3.82

To improve on the position between RIIO-1 and RIIO-2 where projects are expected to run beyond a price control period, we would like to see all projects initiated within a price control, continue with agreed funding until project completion as long as they do not exceed the overall price control allowances. For example, if a licensee has £1m worth of projects underway at the end of RIIO-2, and together with completed projects they remain within their overall NIA allowance for that control, they should be allowed to complete to their natural timeline and still be considered part of the RIIO-2 allowance.

Ofgem has already adopted this approach for SIF, NZASP and Network Innovation Competition (NIC) projects, so we would like to see this consistency for flexible funding in RIIO-3.

Early indication of the mechanisms in RIIO-3 (or at least core elements of them) would also help to prevent similar issues at the end of RIIO-2.

For roll out across price control periods, we don't have any specific project examples, but we'd like to see a sensible approach that allows efficient implementation no matter where in the price control a project lands e.g. latter year price control projects implementation might not incentivise as much network benefit as an early year implementation due to efficiency claw backs between price controls.

A fair assessment of benefit realisation that delivers for consumers but doesn't penalise networks for implementing projects late in the price control where they may not realise any benefit themselves, would be key to this as it would ensure a fair and balanced benefit realisation between consumers and networks for any efficiencies derived from implementation.

OVQ55 – Do you agree with our proposal to run FRS trials with an explicit focus on informing changes to the rules governing energy network activities – incentivised through SIF or other price control mechanisms?

Yes, we are supportive of Future Regulation Sandbox (FRS) and have included it in our draft funding mechanism shown in **OVQ49** Fig 1. The ability to include FRS trials in projects funded via Ofgem innovation allowances is critical to enabling FRS, as is a strong process and accompanying governance.

Where flexible or competitive funding is used, it should be at network request, forming part of the project scope, and the innovation criteria needs to reflect that FRS projects can be funded via innovation funding allowances. Where there are key whole system opportunities or other larger scale changes, a separate centralised fund/allowance that can be accessed outside of flexible or competitive funding could also be considered to reduce the impact on individual network innovation project portfolios.

OVQ56 - What topics could FRS trials usefully focus on and why?

Some example areas from us that we've reiterated from our response to Ofgem's Call for input "Proposal to introduce the Future Regulation Sandbox" and remain relevant in this context are:

- Biomethane injection, which has been happening for about 10 years, challenges the way the energy value of gas (CV) is calculated as an average over a Local Distribution Zone (LDZ) under the Gas (calculation of thermal energy) Regulations. Biomethane producers have to add propane to the gas they inject to raise the CV, this adds cost.
- Hydrogen injection for blending will shine further light on the constraints imposed by these regulations in furthering the energy transition. Hydrogen injection will also increase the volume of gas from distributed sources, which is likely to have other implications for the operation of the system.

OVQ57 - Do you have any feedback on the view that not enough network innovation funded projects have been rolled out, and can you share any evidence you have to support your position?

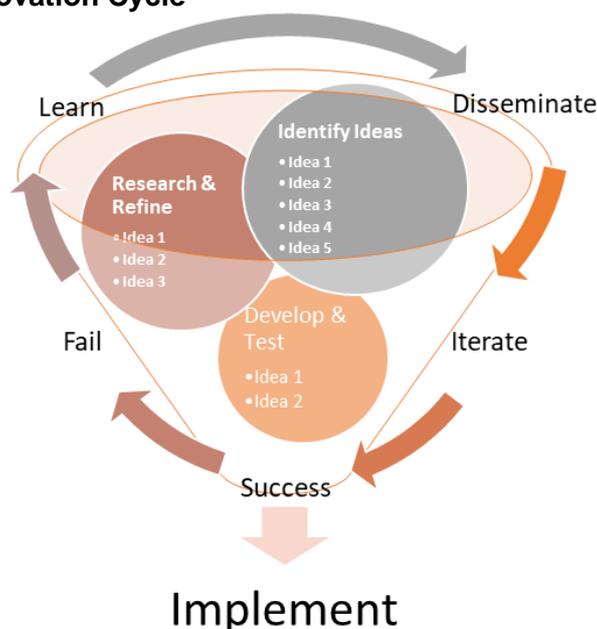
Our view is that innovation success should not be measured only in terms of roll out, and where roll out is considered a success, that implementation benefit is derived not only by financial benefit but on wider strategic return on investment criteria e.g. supporting vulnerable consumers.

To evidence the above point that not all projects need to be rolled-out, we have projects in RIIO-2 that are purely for research and learning generation. This allows us to fail fast and encourages iterative development to ensure the right ideas are refined and only those are taken forward and the knowledge gained is disseminated and used to support follow on innovation.

It's also vital that we're part of developing early-stage innovation, e.g. working in partnership with universities and start-up organisations. We have strong relationships with numerous universities and start-up organisations through various channels e.g. UKRI, KTN, Welsh Government Innovator Support teams, and through direct approach via events and dissemination opportunities, where we encourage and support early innovation to develop either with early TRL research, or via knowledge building on how to work effectively with energy networks and how we can fund and support their ideas.

Figure 4. below shows how ideas are nurtured through the innovation funnel with key to success being the arrows surrounding the funnel focussing on not just success, but how iteration, dissemination, failure, and learning are key criteria in the innovation cycle.

Fig 4. The Innovation Cycle



Large scale change such as that required to support the energy transition also requires time to develop, so a price control period is not necessarily a reflective length of time in which to assess implementation as evidenced in "Innovation timelines from invention to maturity" - a paper from the UK Energy Research Centre.

<https://ukerc.ac.uk/project/innovation-timelines/>

To give some context, in RIIO-2, we have led on twenty-six flexibility funded projects. Twenty of these moved from Technical Readiness Level (TRL) 2 to 3, and three projects moved from TRL 3 to 4. These projects are a good example of how early TRL level projects developing research and evidence gathering are required to support the energy transition e.g. the UK government Hydrogen Heating Programme (HHP), where funding for 57% of contributing projects in the programme has so far used £10m of flexible funding to assess feasibility, safety, and costs of 100% hydrogen for heating, to help inform the 2026 heating policy decision. These projects are clear evidence of roll out of an innovation not being considered as success, as they focus purely on the wider learning and knowledge gathering that will form the core basis of any future transition of the network. We will continue to make the case for hydrogen to be in scope of innovation and uncertainty mechanisms in RIIO-3, as we do not expect evidence development on hydrogen to stop in 2026, even if there is a firm heat policy decision.

NIA flexible funding has also been used collaboratively to support a number of gas network led programmes that are managed through the ENA e.g. End User Safety Group (EUSE), which has been looking at the hydrogen safety case with DESNZ and the HSE.

Requirements for funding changed from RIIO-1 to RIIO-2 and existing measures such as the Innovation Measurement Framework, only pick up cost savings rather than wider Strategic Return on Investment (SRoI) benefits which we think should be a key part of assessing innovation implementation success. In RIIO-1 we implemented projects that generated both cost and emission savings and these are referenced in RIIO-1 Ofgem Innovation Funds Information Request REF: OFG1161. Of the two projects we have implemented in RIIO-2, both projects had no monetary benefit, however wider benefits have been seen for both vulnerable customers and local authorities. These particular projects are evidenced below and didn't require wider funding for roll out, but other projects that have no incentive for network implementation would benefit from additional funding to increase roll out success.

The first was NIA_WWU_2_04 - Tools of Engagement Phase 2, to improve local authorities' knowledge of the energy networks and the impact of different types of energy projects and interventions, particularly in relation to the balance of supply and demand and whole system cost with an engagement pack. This project helped engage local authorities in local area planning and is a good example of how research and learning can build on each other as this was a further development on NIA_WWU_055 - Pathfinder Plus, which was to understand financial implications of the Pathfinder tool engineering solution to allow scenarios to be optimised based on financial metrics. This project was also complimentary to learning gained in NIA_WWU_051 - Green City Vision.

The latest iteration is NIA WWU_02_44 - Pathfinder Development project, which will further develop this tool to add segmentation by individual home or street level for help to support local authorities further with the planning process.

The second was NIA_WWU_2_06 – Consumer Vulnerability Impact Assessment Tool, where a tool was developed for each network to assess every flexibly funded innovation project in RIIO-2, to ensure that all customers are included in the journey to Net Zero from the start, by including the most vulnerable in these assessments and how each innovation project may impact these consumers, with accompanying mitigation suggestions.

OVQ58 - What are your views on the design of potential new mechanisms to address this?

The mechanisms should continue to focus on all TRL levels of innovation as outlined in the proposed funding mechanism in question **OVQ49**, Fig 1. This will enable the research and development to continue iteratively and, where a project success is deemed as implementation, facilitate implementation via a mechanism, particularly for projects that do not drive a direct benefit to the implementing network e.g. benefit consumers. We don't have a direct example of this type of project ourselves, but we have seen another network apply for funding for the Smart Street project as it had a significant benefit for consumers, but the cost of implementation was not available in the price control incentives. This is an example of where we would see a new funding mechanism being very beneficial.

As networks we've worked together to suggest a new funding style mechanism that brings together flexible and competitive funding, covers all TRL levels, and includes how we can align the funding to strategic direction and support whole system thinking and provide a single structure that can be communicated with public sector initiatives, innovators and 3rd parties. The new funding design can be seen in Fig 1. in **OVQ49**.

How implementation is funded needs to consider the networks position as private business and impacts to cashflow, slow/fast return models, benefits to consumers and appetite of shareholders running a private business. Some implementations can be put into Business Plans, but for those still with inherent risk and/or with benefits that don't necessarily directly benefit a network e.g. huge consumer benefit realisation that would cost the network to implement with no opportunity for returns, there should be funding to assist with implementation.

We'd like to see any implementation mechanism retain the flexibility of NIA style funding, where speed of roll out is the key consideration and any review process is fast and efficient to support an effective rollout. The potential for a stage gate approach or a simple mechanism to expand allowances would be beneficial; a UIOLI or some kind of re-opener or application process with a fast and efficient review process could also work.

We'd also really like to see Ofgem (and any sub-contracted funding management e.g. UKRI for SIF) promoting all innovation for networks regardless of funding mechanism. We have a variety of anecdotal feedback from the market, innovators, and the Catapult networks, that the current bias towards SIF sends very conflicting messages on network innovation. A lot of organisations we speak to think that innovation funding is limited to a once yearly SIF mechanism via the annual challenges and is the only way to secure funding for their idea, despite the continued messaging from networks to the contrary.

OVQ59 - Do you have any views on the timelines for modernising regulatory reporting?

We agree with the ambition stated in the consultation. It may be sensible to move forward with a limited number of data sets to test processes and gain learning, understanding the need to move this forward at pace. Progressing a few test cases in RIIO-2 would provide this learning and help development of a roadmap. We suggest Repex would be an ideal first use-case given its maturity and high value.

Due to the necessary time needed to deliver this with value we suggest a RIIO-3 re-opener is necessary as spend required in RIIO-3 may not be determined with certainty prior to Business Plan submission.

We do have some concerns in using the BPDTs as the starting point for review. There needs to be a thorough review of what data is valuable and used by Ofgem. Starting with BPDTs could be constraining. The review should also consider data formats; for example, could mains replacement and asset data be shared in mapping files as opposed to tables.

OVQ60 - Do you have any initial views on opportunities for improving efficiency in providing the data that Ofgem receives as part of regulatory instructions and guidance?

We would support a review of the tables submitted to Ofgem and only uploading cost assessment data. This should be in the format required for modelling as this would save networks and Ofgem the time required to reformat the data to run the statistical analysis.

OVQ61 - Are there areas of regulatory reporting that would be most beneficial to start with in the modernising project?

Mains replacement as a big spend area, and with a significant amount of non-monetary asset data, would seem sensible area to test. It also enables exploration of the use of spatial data, not just tables.

Wales & West Utilities RIIO-3 Consultation Detailed Response

GD Annex

GDQ1 - What are your views on our proposal to remove the shrinkage ODI-R as a separate output?

Shrinkage (methane emissions) is of high importance to stakeholders and would benefit from an appropriate incentive in RIIO-3. There is no evidence of the current Reputational Output Delivery Incentive (ODI-R) driving behaviours across the GDNs, in contrast to the RIIO-1 incentive package which evidently drove outperformance in this area.

We believe this is best served in RIIO-3 by removal of the current reputational incentive and a revision of the current financial incentive and the use of a single and improved financial incentive in their place.

GDQ2 - What are your thoughts on the options we have set out for the shrinkage ODI-F and on the design of this incentive?

Methane emission reductions should be appropriately incentivised to drive innovation and deliver benefits above and beyond the mains replacement programme benefits.

We understand Ofgem's concerns with mains replacement and being funded through base Totex and then rewarded again under a shrinkage incentive. In our view, this could be managed simply with a target that is based on the allowed Repex workload, so any reward would sit above the base reductions delivered by mains replacement.

We support a single financial incentive that covers total emissions as opposed to the current financial incentive that focusses on only a proportion of methane emissions from the networks.

Consideration needs to be given to the Digital Platform for Leakage Analytics (DPLA), SIF project which completes in RIIO-3. This could revolutionise methane detection and targeting of investment. Due to timing of the project, it is unlikely there will be 100% certainty of costs by Business Plan submission and there will need to be a re-opener or UIOLI mechanism to enable implementation of the findings and deliver the benefits on emission reductions.

GDQ3 - If we provide baseline funding or a UIOLI allowance for shrinkage, can you provide examples of initiatives that could be funded, indicative cost, and why these activities would not go ahead without specific price control funding?

We support the UIOLI in this area.

The DPLA SIF project will conclude in the RIIO-3 period and could result in significant evolution in methane detection and targeting.

This will require investment to implement. It is too early at this stage to forecast accurate costs, but we are working as a collective of networks to develop thinking and will provide our best view in the December Business Plan. Investment in this area could require significant funding and in turn, is expected to deliver significant benefits in targeting methane emissions. Any investment would be subject to Cost Benefit Analysis (CBA). Due to the return being primarily societal benefits it would be unreasonable to expect networks to fund without sufficient allowances for the work.

GDQ4 - If the Digital Platform for Leakage Analytics is rolled out to all GDNs in RIIO-GD3, what would be the indicative cost and timescales for this?

Current view from the project in the UK wide cost of the preferred option is £70.77m in 2020/21 prices. An assumption at this stage would be £7.1m for WWU in the RIIO-3 period. It should be noted that these costs will be refined throughout RIIO-2, but final forecasts will not be available until end 2025.

There is potential to implement the supporting systems by end RIIO-2, but the deployment of methane detection innovations (Cars, drones & satellites) would begin in RIIO-3. This is the bulk of the spend.

Proposals relating to the Shrinkage and Leakage Model and the future regulatory mechanisms will be provided in our December Business Plan.

GDQ5 - If up to 20% hydrogen is blended into the distribution network, what would be the impact on operational practices and shrinkage?

Networks are working collaboratively to design an implementation plan that considers all activities required for the GDNs, markets and regulatory frameworks to be blend ready, as early as possible.

At 20% by volume some updates will be required to our operational practices to meet the requirements of a revised safety case which would need to be accepted by the HSE. This may include the need to use new equipment e.g. chromatographs which can be used with a hydrogen blend.

New methodologies would be needed for connections and capacity processes and in some locations new settlement arrangements would be needed to manage higher percentage blends.

Commercial frameworks are being reviewed by industry through [UNC Review Group 0849](#)

KPMG has been commissioned by the networks for a detailed study on all requirements for blending. This will give a view on the investment needed and the legislative, safety and commercial changes required. We will be in a position to provide the investment needs case in our RIIO-3 December Business Plan.

GDQ6 - What are your views on the options we have laid out for the heat policy re-opener, including whether this should be combined with other RIIO-3 Net Zero mechanisms?

We agree that uncertainties related to heat policy remain and therefore that it is appropriate to maintain a re-opener in this area.

On balance we are supportive of retaining a separate reopener on heat policy to the wider Net Zero reopener, and the proposed triggers set out in paragraph 2.24, subject to:

- Ensuring that the trigger related to “Connection charging arrangements for distributed entry connections” can include any low carbon gas, not just biomethane supplies, we would also like to see a specific mechanism agreed for entry reinforcement for GD3 and expect to expand on this in due course.
- A broad definition of policy and regulatory changes related to heat decarbonisation policy, to capture the range of potential outcomes in this area (this should include changes to the settlement system and DN systems or the Gas (Calculation of thermal energy) Regulations to address the issue of CV capping for distributed gas injection and hydrogen blending).
- Sufficient, likely annual, windows to trigger the reopener through the RIIO-3 period, or preferably the ability to bring forward applications under this reopener at any point in the RIIO-3 period, reflecting uncertainty in the timing of policy and regulatory decisions that may impact the areas in scope.

The GDNs collectively are working towards a change in connection charging arrangements for distributed entry connections that will broadly mirror the arrangements for electricity distribution entry. This is expected to entail using the Heat Policy re-opener in GD2; however, if this change is not implemented in GD2 it will need to be part of the GD3 settlement.

GDQ7 - What are your views on our proposed approach for managing uncertain costs relating to regional energy strategic planning?

Including costs relating to the implications of Regional Energy Strategic Planning (RESP) recommendations in the Net Zero re-opener is a logical approach, subject to a number of points:

- There will be activity and costs for the GD sector related to the RESP prior to any recommendation being made, which are certain to fall within the RIIO-3 period. For example, these could relate to engagement with the RESP, or Local Area Energy Planning activities more generally which ultimately inform the RESP. These should be funded through base allowances or, if sufficiently uncertain, the proposed Net Zero Use It or Lose It Allowance.
- Implications of RESP recommendations during RIIO-3 are inherently uncertain but may require relatively fast response and have implications across the GDN sector as well as in specific regions. The Net Zero reopener therefore needs a broad scope (including for dedicated hydrogen related activity), with mechanisms and resource to respond quickly, to be able to meet such recommendations. If separately retained, the Heat Policy reopener should also have scope for response to RESP recommendations, for example around distributed entry connections and gas composition.

GDQ8 - What are your views on our proposal to remove the Commercial fleet electric vehicle PCD in RIIO-GD3?

We have not found a use case for Electric Vehicles in our fleet. This is after a number of trials. Hydrogen vehicles are too early in development, production and fuelling network and currently too expensive.

As there is still huge uncertainty in this area, we look to keep this re-opener mechanism in case:

1. new batteries become available
2. hydrogen becomes justifiable by CBA

GDQ9 - What are your views on our proposal to remove SGN's bespoke Biomethane improved access rollout PCD in RIIO-GD3?

We agree that SGN's bespoke Biomethane improved access rollout PCD can be removed.

We have progressed the same technologies in RIIO-GD2 using other funding mechanisms such as Use It or Lose It and NIA. We would anticipate using similar mechanisms in RIIO-GD3 and suggest this would be common across the GDNs.

GDQ10 - What are your views on our proposal to remove SGN's bespoke remote pressure management PCD in RIIO-GD3?

The decision should be made based on the level of stakeholder support for continuation.

GDQ11 - What are your views on our proposal to remove SGN's bespoke Gas escape reduction PCD in RIIO-GD3?

The decision should be made based on the level of stakeholder support for continuation.

GDQ12 - What are your views on our proposal to remove SGN's bespoke Intermediate pressure reconfigurations PCD in RIIO-GD3?

The decision should be made based on the level of stakeholder support for continuation.

GDQ13 - What are your views on our proposal to remove Cadent's bespoke HyNet Front End Engineering Design PCD in RIIO-GD3?

The decision should be made based on the level of stakeholder support for continuation.

GDQ14 - What are your views on the benefits of Repex that we have identified, how well the Repex programme is currently working, and what evidence we should consider as part of the joint Repex review?

We agree with the benefits stated.

We would add the benefit to the public of less unplanned repairs and a single, well planned Repex project that would result in us rarely, if ever, returning to the area to work on the gas network.

We will submit independent analysis from DNV and Baringa on safety, environmental and economic benefits of the mains replacement programmes. These two documents are appended to this consultation response.

The benefits case for Mains replacement is compelling. The challenge is ensuring appropriate funding as we conclude the Iron Mains Replacement Programme in RIIO-3 and first year of RIIO-4. We expand on this in detail in our responses to cost assessment questions.

GDQ15 - Do you consider there to be alternative approaches that could deliver mandatory Repex at least cost to the consumer whilst maintaining the legislative safety standards?

As gas networks, we have completed a number of innovation projects to manage iron and steel mains risk without replacing the assets. We are now entering the last quarter of the IMRP; innovative techniques are already adopted and embedded where possible and suitable to our network. Given the time it takes to validate innovative technologies as safe for use and operationally roll-out, we do not think there will be any substantial innovation in GD3 on BAU. This will certainly be the case for third parties who have an investment payback period limited by the end of the IMRP.

The Cast Iron Joint Sealing Robot (CISBOT) is the exception, but it is designed for large diameter mains of particular categories. We have a very small population of qualifying pipes in our region. We have had quotes to use CISBOT on our network that were more expensive than the cost of our more traditional replacement techniques. For this reason, we have discounted CISBOT but will keep under review if the technology develops.

GDQ16 - What are your views on our proposal to keep the HSE policy re-opener, but to reduce its use to a single trigger?

We agree that a HSE policy re-opener is needed. However, its scope needs to consider HSE's changing legislation across price controls changes of view on existing legislation - e.g. mains in gardens, where HSE approach and demands have changed with no formal policy changes. This is also the case in HSE changed approach to enforcing fatigue requirements.

Our expectation is funding for fatigue and other HSE policy changes in RIIO-2 will be allowed in base for RIIO-3.

HSE policy changes are not frequent but are also not visible on a timeline. Our preferred approach would be an open window through the RIIO-3 period to cater for this.

GDQ17 - What are your views on the design of the Tier 1 mains decommissioned PCD?

Length: we think that the cap of a 3% upward adjustment is not required. The work required to deliver the close out of the IMRRP is largely fixed with the exception of dynamic growth pipes. We are bound by legislation to complete all of those pipes by 2032. The certainty over the remaining population of pipes changes the need to have any caps and collars in place.

Diameter: We accept that the PCD provides protection to consumers by adjusting allowances for the diameter mix delivered and this should continue. On the basis the work will be what it will be to deliver compliance with PSR13a.

We suggest removal of cap and collars. With this removal, the PCD will work for consumers and networks alike by protecting consumers from excessive allowances but enabling networks to deliver the work required by legislation.

GDQ18 - What are your views on the proposed design of the Tier 1 services PCD?

The work required to deliver the close out of the IMRRP is known with the exception of dynamic growth pipes. We are bound by legislation to complete by 2032. This leaves us no option but to select schemes from a large pot as the whole pot needs to be completed. This changes the scope of the PCD and means caps and collars are not appropriate as we will have to deliver what is remaining to do.

We accept that a PCD provides protection to consumers for service volume. On the basis the work will be what it will be to deliver compliance with PSR13a, we suggest the removal of cap and collars. With this removal the PCD will work for consumers and networks alike, by protecting consumers from excessive allowances but enabling networks to deliver the work required by legislation.

GDQ19 - What are your views on the design of the Tier 2A mains and services replacement volume driver?

We support continuation of the current mechanism.

GDQ20 - What are your views on the design of the London medium pressure PCD (Cadent North London only)?

No Response

GDQ21 - What are your views on our proposal to retain the diversions and loss of development claims re-opener in RIIO-GD3, and whether all the cost areas are still uncertain in RIIO-GD3?

We agree with its retention. Diversion and loss of development claims are by their nature unpredictable and therefore retaining this re-opener is necessary.

We support the environmental claims part of this re-opener being expanded to include work done to address need ahead of damage being done as currently the re-opener is restricted to work done as a result of soil erosion. The scope needs to be wider and include work to address a potential problem (including diversions and other works to protect assets) before it arises and also cover a wide range of climate adaptation work.

As an alternative we also support this element being moved to a wider ranging resilience re-opener.

GDQ22 - What are your thoughts on our proposal to continue the emergency response time LO and whether the target should be set monthly, quarterly or annually?

The current regime delivers, as evidenced by our very low incident levels and high customer satisfaction scores. We have met our Licence Condition every year since our formation back to 2005.

Gas escapes increase significantly in the winter period which poses challenges in response. In times of severe weather e.g. snow, the roads can become gridlocked due to drivers being unable to move, limiting the ability for us to reach jobs at speed, even with the best winter preparedness plans.

We suggest the Licence Condition should remain as-is but a move to monthly reporting and supporting commentary would give an increased visibility and enable more scrutiny as appropriate if networks fail within any month.

GDQ23 - What are your views on our proposal to remove the Tier 1 iron stubs reopener in RIIO-GD3 and our approach for the costs to be included in the baseline allowances?

We agree that tier 1 stub-ends should be included in baseline allowances. As per **GDQ55** we think that GDNs should provide cost and workload estimates and these should be separately assessed, network by network.

This is important as some GDNs had this funded in GD2 and therefore will all be at different places by GD3 making comparisons across networks challenging.

GDQ24 - What are your views on our proposal to remove the Capital projects PCD in RIIO-GD3?

In RIIO-GD2 we are delivering one large pipeline replacement which individually is material; we are currently undertaking feasibility studies on a number of pipelines that have been identified as requiring replacement within the RIIO-GD3 period, each of which would also be individually material and required to maintain safety and reliability.

As such, we would recommend continuing with this PCD.

GDQ25 - What are your views on our proposal to remove the Gas holder demolitions PCD in RIIO-GD3?

This will not impact WWU as our final gas holders were demolished in RIIO-2.

GDQ26 - What are your views on our proposal to remove the Multiple Occupancy Buildings safety re-opener in RIIO-GD3?

The RIIO-GD2 re-opener for safety programmes on Multi Occupancy Buildings (MOBs) was too limited by being specific to buildings of 3-5 storeys. The outcomes of the Hackitt inquiry have been primarily focused on higher risk buildings and changes in Legislation. The resultant need for building safety cases has been focused on those of a height of 18m and above in England.

We were therefore restricted in any opportunity to trigger this re-opener in RIIO-GD2.

We expect to include costs relating to MOBs in our baseline costs, however there is still a lot of uncertainty in this area. As the safety case requirements are still being embedded, engagement with building owners or responsible persons for the high-risk buildings is still in its very early stages, and therefore we do not yet have a good understanding of their expectations or requests upon us to support the safety of the building and any remedial actions that may be required.

There is also uncertainty in the area of commercial MOBs, known as Complex Distribution Systems (CDS). This is an asset group that all GDN's have been working to identify in RIIO-GD2 and although work on these assets will form part of our baseline RIIO-GD3 proposals, there may still be ongoing work to identify the assets and associated interventions, therefore uncertainty will remain.

In summary, while the current RIIO-GD2 re-opener may not be applicable for RIIO-GD3, another form of re-opener for MOBs is expected to be needed.

GDQ27 - What are your views on our proposal to remove NGN's bespoke job completion lead-time including re-instatement ODI-R in RIIO-GD3?

The decision should be made following review of stakeholder support.

GDQ28 - What are your views on our proposed position on the role of GDNs in relation to vulnerability, and how can they support a just transition to Net Zero?

We will continue to support vulnerable customers and comply with our licence conditions. We continually look to refine and evolve the services and equipment we provide.

Our stakeholders agree we have a part to play in supporting customers through the Net Zero transition with our GD3 role being to develop our people and to provide unbiased advice and signposting to customers directly and through our partnerships. In order for us to do this, we propose that it is funded as a part of the Vulnerability and Carbon Monoxide Allowance for GD3 and should apply to all customers in the same way that CO awareness is in the current VCMA governance.

GDQ29 - What are your views on our proposal for GDNs to develop individual and joint-GDN vulnerability strategies?

We agree to the development and publishing of a vulnerability strategy. This would cover our strategy for identifying and supporting customers during our core activities as well as our VCMA funded work and wider support for communities. This allows us to reflect different approach to work in England and Wales such as alignment to the Wales Future Generations Act and the Welsh Government Warm Homes programme.

Within the strategy we would include a section on GDN collaboration. This would reflect our common licence conditions, Guaranteed Standards of Performance (GSoPs), KPIs and intention to work collaboratively to evolve services, drive best practice, and collaborate on projects with national partners. This approach ensures stakeholders have one document to reference rather than multiple publications.

GDQ30 - Do you agree with our proposal to retain the RIIO-GD2 vulnerability minimum standards is sufficient to ensure customers in vulnerable situations are protected and treated fairly?

We agree that the current standards remain sufficient.

We will continue to seek external testing assurance of our services through the relevant standards such as our ISO22458 Inclusive Service Provision accreditation and associated Kitemark.

GDQ31 - What are your views on our proposal to retain the use of the VCMA UIOLI allowance, on the alternative option to incentivise vulnerability through an ODI-F, and on which activities to support vulnerability could be funded through baseline allowances?

We agree to retaining the VCMA UIOLI allowance that has been used in GD2.

The UIOLI allowance allows flexibility to use the funds effectively throughout GD3. Stakeholders see the alternative ODI-F used in RIIO ED2 to be very mechanistic and driven by financial gain or avoiding a penalty whereas the VCMA has led to true partnerships with mutual benefits for the GDNs, third parties and customers.

Our Independent Stakeholder Group (ISG) and stakeholders support the UIOLI model and also would like to see this continue in GD3.

Where the GDNs have developed additional services delivered through our engineers such as additional CO investigations or repairs to pipework/appliances whilst on site, this could be embedded into our licence and funded through baseline allowances, with appropriate safeguards included. However, CO safety campaigns will be captured within the VCMA allowances.

GDQ32 - At what level should VCMA funding be set to ensure its effectiveness and sustainability, and what percentage should be ringfenced for collaborative projects?

At a time when it is likely that the consumers will still be recovering from the current cost of living crisis, the impact of world conflicts and high interest rates are expected to continue, it is logical to continue the VMCA allowances at their current levels to best help those in most need.

We therefore propose £17.5m which equates to £3.5m each year which would allow us to continue with the majority of our regional and collaborative partnerships currently in place. We know that the partnerships are well received by our stakeholders and their feedback is that we should continue in RIIO-GD3.

We are engaging with our partners to gain further insight into customer's needs, but also the impact to their programmes of work and employment if the funding is scaled back.

We agree that there should be collaborative projects and to keep this at a minimum of 25% of totals allowances. This allows us to properly support our customers and address the regional differences that we see between Wales and England such as age of housing stock, Wales wide coordination of health and care & Repair Services, and different measures of fuel poverty and government support schemes.

GDQ33 - How should VCMA funding be allocated to ensure maximum impact for consumers in vulnerable situations?

We would propose maintaining the current process to allocate the VCMA funding across the GDN's based upon customer numbers. Through engagement with our ISG, we believe this to be the fairest and most appropriate approach. Other potential allocation bases such as fuel poor statistics or health metrics, are measured differently across England and devolved governments, and could lead to inappropriate allocations being made.

Whichever measure is used, allowances need to be set once based upon one year's statistics, and not be subject to annual review which would lead to certainty of funding when establishing contractual partnerships for the RIIO-GD3 period.

GDQ34 - How can learnings from VCMA projects better inform the GDNs' organisational approaches to consumer vulnerability?

We believe that the current VCMA annual showcase event provides an opportunity for good general feedback; however, it should be noted that it is just one event in a programme of ongoing stakeholder engagement. We believe that by running more in depth events focused on topics such as CO or fuel poverty with informed stakeholders and relevant GDN partners will provide more challenge and opportunities to identify learnings for future projects and support. In Wales, we are linking up our key delivery partnerships and bringing them together on a quarterly basis to ensure we coordinate the identification and support of the people in Wales.

Our relationship with Disability Charity SCOPE has helped in our rebranding and review of our website to ensure it is fully accessible, and to provide training to our customer facing staff on how to better support people with disabilities. The National Society for the Prevention of Cruelty to Children (NSPCC) have helped us to review and update our safeguarding strategy ensuring we have the confidence to report concerns to the right authorities to ensure children are protected.

The current VCMA governance encourages this learning and sharing through annual reports and events and is fit for purpose as evidenced by the GDNs development and actions in RIIO-GD2 to date.

GDQ35 - What are your views on the options we've set out to incentivise customer satisfaction during RIIO-GD2?

We propose to maintain the existing reward and penalty mechanism. Our Planned work will continue to impact around 40,000 customers per year for RIIO-GD3. we invest the reward in continued investment to minimise the impact of the disruption to customers, and continual innovation will be required to meet changing and increasing customer expectations such as digital services, supporting an aging and increasingly diverse population, driving down timescales etc. A penalty only mechanism will therefore reduce investment and innovation.

We do not agree with the option of a relative incentive with only the upper quartile GDNs getting a reward. The GDNs work well together now driving consistency in the survey process, regular best practice forums and sharing of innovation which would not happen if the reward was relative. Such an approach could stop this and may lead to failing GDNs reducing their efforts in these important areas. We note that OFWAT is moving away from using relative incentivisation in PR24.

All GDN's have improved customer service levels and the gap between the top and bottom performing network is much smaller. There are barriers across the GDN's that will challenge closing the gap further. These include different demographics, regional factors and delivery models, which all effect scores.

A relative mechanism where only the top two GDN's to receive a reward would create silos and competition leading to de-convergence between GDN's. The GDNs have built up trust and sharing of best practice through customer and priority customer forums that would be lost if networks were being pitched against each other financially. It is worth noting OFWAT are moving away from this approach to an absolute measure similar to the energy networks for PR24.

We have concerns around Connections surveys volumes. A declining workload will result in fewer customer survey returns; potentially dropping to levels that are statistically unreliable. The GDNs will submit joint evidence to Ofgem to demonstrate this risk. GDN's are also working with Explain Market Research to quantify the impact. Explain Market Research are reviewing the existing questions and what changes could be made to help customers provide the best feedback and score for the service they received.

GDQ36 - What are your views on how the complaints metric can ensure customers' complaints are resolved quickly and effectively?

We propose to maintain the current complaints metrics. We believe the current metric is appropriate and focusses us to resolve complaints with customers quickly and effectively. We believe the current D1 and D31 measures are appropriate and the threshold of 5 remains appropriate.

We don't believe that including complaint volumes in the metric would be advantageous. We believe that this would drive the wrong behaviours creating a risk that not all expressions of dissatisfaction would be recorded. In addition, there are factors that could increase complaints in GD3, such as customers having to have their gas supplies disconnected to support low carbon solutions, and the removal of the Domestic Load Connect Allowance (DLCA) for first time gas connections which increase the cost of a typical domestic house cost from approximately £1,000 to £2,500, and the stop on gas connections to new homes. However, we support publishing the volumes of complaints we receive.

We would support reporting a separate line for Priority Service Register (PSR) customers, similarly as we do for Customer Satisfaction performance.

GDQ37 - What changes, if any, are required to the GSOPs?

A thorough review of the GSOPs was undertaken during the Business Planning process for RIIO-GD2 between GDNs, stakeholders and Ofgem. That resulted in the Statutory Instrument (SI) being amended in April 2021 providing more protection to priority customers, making all payments automatic and index linked to CPIH.

Through our stakeholder engagement we have not identified any further changes that are required to the current GSOPs. We therefore support the continuation of the current SI and indexing of payments in RIIO-GD3 to ensure customers received suitable compensation for any inconvenience experienced.

However, the statutory instrument can be open to interpretation, and we would welcome the opportunity to complete the guidance document that was drafted by Ofgem ahead of RIIO-GD2 but never finalised.

GDQ38 - What are your views on our proposed options for the unplanned interruption ODI-F?

The Output keeps a focus on minimising the duration of unplanned interruptions but to some extent duplicates the focus that GSoP 1 brings to networks.

We have a relatively small population of medium and high-rise MOBs compared to other networks. If the output is split by MOB and non-MOB for all networks, we would expect that the target time for non-MOBs would be common for all GDNs.

GDQ39 - What are your views on the options we have set out for the Collaborative Streetworks ODI-F?

All Local Authorities and other stakeholders require more streetworks co-ordination between utilities and the societal benefits (reduced road congestion, reduced lost productivity, reduced impact on householders and businesses), as evidenced by the Greater London Authority (GLA) collaborative streetworks ODI-F for SGN and Cadent, are significant.

We support the use of a single fixed amount for the incentive and the ODI-F being extended to all networks and all areas.

With the incentive, we would be able to lead on coordination of works amongst our regional utilities and be in a position to proactively take project proposals to our 50 Highway Authorities. However, based upon the current incentive of £0.3m per collaborative project and the 0.5% of base allowances cap, that would only mean 7 collaborative projects for us across our whole network per annum so a higher cap would drive more collaboration across our network.

GDQ40 - What are your views on whether the new, large load connections reopener is still needed in RIIO-GD3?

This continues to be needed due to ongoing uncertainty with the number, size and complexity of these connections.

We continue to see applications from customers for large gas demands associated with gas fired power generation, Combined heat and power, back up to district heat networks, gas for transport and large commercial loads. Many of these projects will need their gas connection in the GD3 period and would be hard to predict in a Business Plan submission required in 2024. A number will require specific reinforcement and the large load connections reopener provides assurance to GDNs over funding for this uncertain workload / cost. This also provides protection for consumers against the risk of funding investment in base allowances and the need for this investment not materialising.

For example, we currently have a customer bidding for Carbon Capture and Storage as part of a new gas connection. 7km of IP reinforcement required at a cost of £7m with £2m funded by WWU.

GDQ41 - What are your views on whether the specified streetworks costs reopener is still needed in RIIO-GD3?

This re-opener remains a requirement as there is still huge uncertainty for us on streetworks costs in RIIO-GD3.

Whilst the South West Highway Authorities have moved to permit schemes, Wales has for now retained the noticing regimes under the New Roads and Street Works Act (NRSWA). However, a pan-Wales move to permits would create a large additional cost for us. We are also starting to see Highway Authorities consulting on lane rental (Oxfordshire) which would add large costs to our planned and emergency repair costs in GD3 should they proceed.

The Department for Business and Trade are recommending that all Highway Authorities in England move to a lane rental system.

GDQ42 - What are your views on our proposal to remove the Fuel Poor Network Extension Scheme in RIIO-GD3?

We agree.

With current volumes being so low and no financial incentives for first time gas heating systems we agree with the proposal to end the Fuel Poor Network Extension Scheme (FPNES), however there should be recognition that gas may still be the best / only solution for some homes and businesses in RIIO-GD3 and we would like to have some discretionary funding under the VCMA or existing housing connections to fund gas connections to a small number of homes in desperate need for a solution.

GDQ43 - What are your views on our proposal to remove the consumer vulnerability ODI-R in RIIO-GD3?

We agree this can be removed as it is captured within licence obligations and other reporting including the Vulnerability and Carbon Monoxide Allowance, Customer Satisfaction scores for customers on the PSR, and Guaranteed Standards of Performance.

GDQ44 - How can the annual VCMA event be improved?

We believe there could be an annual vulnerability event that could showcase GDNs identification and support of priority customers including the VCMA and innovation for customers.

However, our core obligations don't change significantly year on year and VCMA projects are likely to roll over from GD2 to GD3 so there is a risk that the annual requirements risk the event becoming repetitive so every two years may be more appropriate.

GDQ45 - What are your views on our proposal to remove the DLCA, and do you see any challenges that might arise if it were to be removed?

Around 50% of existing homes receive the Domestic Load Connection Allowance (DLCA). Its removal will see the cost of a gas connection increase 2-3 fold. In some cases, a heat pump is not an option due to lack of space for the pump / water tanks / grid capacity and the high cost of a connection combined with no safety net (such as the FPNES) risks customers staying in a cold home or seeking a solution through oil, LPG or coke / log burners, which may not be the most effective or efficient solution.

The removal of the DLCA will require a change to S10 of the Gas Act and our Licence SSC4B.

We support the Net Zero transition and support customers making the best option for their homes and businesses. We are concerned that customers will continue to seek quotations from us to compare with low carbon heating options.

However, acceptance rates will probably be much lower than now. We therefore propose a different funding model with our connections team funded through base allowances for meeting our statutory obligations to quote, and customers who progress to a connection only paying the fair costs associated with their connection.

GDQ46 - What are your views on our proposal to remove the domestic connections volume driver? If you think it should be retained, what changes do you recommend for its design?

We recognise that if there is no DLCA, then there will be no net cost and therefore no requirement for a domestic service volume driver.

However, consideration needs to be given to the impact of low carbon solutions, in particular heat pumps, replacing gas in existing homes and businesses.

This will result in a significant increase in disconnection volumes through the Gas Safety Installation and Use Regulations (GSUIR) process (the obligation to isolate the service when the gas meter was removed 12 months previous). With government targets of 600,000 new heat pumps being installed each year and allowing for the majority of new housing to have heat pumps, volumes for us could be as high as 160,000 across GD3, however there is uncertainty with the volumes so a new volume driver would be required with unit rates for domestic services and pipe diameters' / pressure tiers for non-domestic services.

If disconnections from the gas network as a result of heat pump installations are predominantly done as GSIUR cut-offs funded by the generality of customers through a volume driver or allowances, then those disconnecting are being subsidised by remaining gas customers. A principle of networks' connection policy is that existing customers should not subsidise new connections driven by Gas Act section 9 (1), if this approach is applied to disconnections, then it is clear that there is an issue to address. Therefore, while a volume driver is a short-term solution for GD3, given the expected increase in disconnections from current extremely low levels, further thought needs to be given to this issue for future price controls.

GDQ47 - What are your views on our proposal to remove the smart metering rollout costs re-opener in RIIO-GD3?

We disagree with the proposal to remove the smart metering rollout cost re-opener in RIIO-GD3. Although we have not submitted a claim under this re-opener, the rollout still has a considerable way to go and it is likely that Suppliers have left the less easy installations until the end so there is the possibility of GDNs seeing further costs in addition to those that we have seen and reported to date. As the rollout is ongoing and driven by Suppliers, we propose that in this case the RIIO-GD3 re-opener should allow for costs incurred on or after 1st April 2021, that is the RIIO-GD3 re-opener should include costs incurred in RIIO-GD2.

GDQ48 - Should personalising welfare services continue to be supported under RIIO-3 and, if so, how should it be funded?

This was for Cadent only, but we do not see any need to continue.

GDQ49 - What are your views on our proposal to remove Cadent's bespoke Highrise building plans ODI-R from RIIO-GD3?

No comment on this question.

GDQ50 - What are your views on the potential advantages of using multiple Totex regression models in RIIO-GD3?

We agree with the points made in GD Annex 5.01 to 5.17. In theory, utilising multiple models will make the cost assessment outcome more robust; consistencies and inconsistencies between models can be investigated and understood.

This is particularly important given the different operating models GDNs employ and the potential inconsistencies in treatment of costs (i.e. capitalisation rates), among others. Conversations within the Cost Assessment Working Group have identified capitalisation and cost allocation methodology changes by GDNs over the last few years; this leads to inconsistent cost allocation across activities, both within a single GDNs year on year numbers but also when comparing across GDNs. Additionally, GDNs employ different operating models (insourced or outsourced functions), utilising their industrial teams across different work activities all of which creates cost allocation issues and therefore the potential for differences in detailed reporting of costs to Ofgem.

As such, we see benefit in continuing the focus on improving the top-down Totex modelling suite, in the first instance, which we consider to be more reliable. Complementary bottom and middle-up models need to be considered as part of this process (if only for cost driver validation) but should only be adopted for allowance determinations where a model is deemed equally (or more) robust and provides additional insight, above that provided by top-down modelling. Triangulating across additional models only results in a more robust outcome if those additional models are also robust. It is noted that higher correlation coefficients don't of themselves necessarily mean more robust models.

Thus, careful consideration needs to be given to the robustness of any additional or alternative models to not reduce the overall robustness of the outcome. That is, the potential for alternative/multiple Totex models is contingent on whether Ofgem will be able to create similarly robust models with alternative cost driver specifications and/or periods of data considered. For example,

- Asset values, as represented in the MEAV (Modern Equivalent Asset Value) metrics (maintenance and overarching) and the Repex synthetic cost drivers are currently the largest cost drivers by weight. While company MEAVs are arguably the best proxy to capture network scale and complexity (at least among cost drivers for which data is available, i.e. compared to network length, customer numbers or throughput), the specific construction and weighting of this metric should be carefully considered. We also detail below why the current construction of Repex synthetic cost driver does not adequately capture the drivers of these legislated costs. Similarly, the current Totex models may not be adequately accounting for activity drivers of costs or asset health, which are important drivers of various operational costs and investment needs, respectively.

We thus consider it important that Ofgem collects additional data on potential cost drivers across the board (and for Repex in particular), to test alternative model specifications **(these are set out in GDQ51)**.

- Similarly, given that GDNs are experiencing (and continue to expect a future) step-change in costs, Ofgem should consider how best to address this issue. Potential solutions/modelling considerations in this regard include: (i) testing for structural breaks, (ii) using similar top-down models over alternative time periods (for example, GD2 and GD3 only, the GD3 period only, etc) or placing greater weight on more recent and/or forward-looking costs, if appropriate, (iii) testing alternative time dummies and trends, (iv) examining potential differences in time profiles across GDNs (to ensure that the benchmark is appropriate for all GDNs), (v) using historical data only to aid in establishing the cost-cost driver relationships (to the extent that these are stable over time), and (vi) using forecast data when setting the benchmark.

On the latter, we expect, for example, an increase in the industry's Repex costs on a forward-looking basis, given the increasing effort required to deliver the same linear lengths of replacement as previous controls (i.e. there are more connection holes to dig per metre laid, the location of those holes is more within roads than paths or verges, and the time to work on those mains takes longer because of the material type). As Ofgem notes in the SSMC, the Health and Safety Executive (HSE) regulations are the primary driver of Repex.² As we approach the end of the Iron Mains Risk Reduction Programme the GD3 programme is fixed by the decisions and direction of previous HSE policy which either restricted GDNs in their selection of pipes or, quite rightly, focused GDNs to decommission the riskiest pipes (typically lower diameter cast or spun iron within close proximity to buildings).

Our analysis, as shared in a recent Repex Cost Assessment Working Group (CAWG), demonstrates the increasing level of effort required to deliver the same linear lengths of replacement as previous controls and the effect this has on unit costs across price controls (as reported within our Regulatory Reporting commentary). Existing GD2 cost drivers do not adequately account for this. The predominant share of Repex costs are thus for activity (exogenously) mandated by the HSE regulations and changes therein between price controls.

To ensure robust model development, it is important that the suite of models will continue to be iterated by Ofgem taking on feedback through the Cost Assessment Working Group, and that constructive conversations on alternative options will continue for the coming months with the objective of having multiple complementary models, supporting the conclusions being reached.

² Ofgem (2023) 'RIIO-3 Sector Specific Methodology Consultation – GD Annex', December, para. 3.6.

We also note here the link between the robustness of the model(s) (i.e. alignment with operational insight, spread of efficiency scores, precision of cost predictions, as well as statistical performance and goodness of fit) and the choice of benchmark (e.g. for GD2 Ofgem set a glide path from the upper quartile to a more stringent 85th percentile benchmark). That is, greater uncertainty around the efficient cost predictions over the GD3 period and less robust models would warrant a less stringent benchmark to account for this greater uncertainty.

GDQ51 - What alternative cost drivers and model specifications would you propose for early testing?

A key decision for Ofgem's cost modelling is the choice of cost drivers for each cost area. Any factors that influence costs but are not captured in the cost drivers/synthetic unit costs used will instead feed into the unexplained part of costs and might lead to biased efficiency estimates.

At a high-level, the RIIO-GD2 cost assessment toolkit (i.e. a range of approaches) provides a good starting point to build on for RIIO-GD3 cost assessment. However, a key difference for GD3 is the likely step change in costs going forward. This is particularly prevalent within Mains Replacement where costs are increasing (as explained in GDQ50).

Consequently, additional cost drivers for Mains should be incorporated into the synthetic unit cost used for Mains replacement including but not limited to:

- Material of Iron pipes being replaced (i.e. ductile iron, cast iron or spun iron) given the operational differences required to operate and replace these mains.
- Technique of pipe replacement (open cut, insertion).
- Road surface category and location of main (carriageway, footway, or verge); working in a carriageway is significantly more expensive than working in the footpath or the verge due to the implications on traffic management and reinstatement costs.

As such, Ofgem and GDNs should consider areas that are already, or will cause, significant cost increases in GD3 and how this can be appropriately accounted for.

When developing the cost models, operational insight should be given greater weight than the statistical diagnostics, given the relatively small sample size. As such, in the table below we summarise a number of fundamental cost drivers for different cost areas. These are based on interviews with operational experts at WWU.

<i>Cost activity</i>	<i>Ofgem's cost drivers</i>	<i>Fundamental cost drivers identified in discussions</i>
REPEX	REPEX synthetic costs	<p>HSE policy</p> <p>Mains</p> <ul style="list-style-type: none"> length diameter material technique (Open cut or insertion) road surface and location of main no. of connection type of connection length of mains runs <p>Services</p> <ul style="list-style-type: none"> no. of services technique – relay or transfer service length location (entry point, position of main) <p>Total project</p> <ul style="list-style-type: none"> size of project (mobilisation and de-mobilisation) geography of project (ability to get to site, and to service the project)
Work management	MEAV	<ul style="list-style-type: none"> size and complexity of network; customer numbers; Operational delivery; Obligation to quote connections (headcount and systems) irrespective of volumes;
Repairs	External condition reports	<ul style="list-style-type: none"> condition of assets (age sometimes used as a proxy); number of external reports (quantity of metallic mains, condition and operating pressure of mains); size of mains to be repaired; location of main or service repair; geography/sparsity (travel time, especially out of hours)
Emergency	CSV of external condition reports and number of customers	<ul style="list-style-type: none"> Workforce to meet standards during peak demand number of external reports (quantity of metallic mains, condition and operating pressure of mains); number of internal reports (number of consumers, condition of consumers' internal pipework, level of CO awareness); geographic density of calls and travel times.
Maintenance	Maintenance MEAV	<ul style="list-style-type: none"> volume of maintained assets; condition of assets (age sometimes used as a proxy);
Business support	MEAV	<ul style="list-style-type: none"> size of network group vs individual network (economies of scale) IT and cyber requirements (GDN specific, not necessarily scalable)
Connections	Connections synthetic costs	<p>For each new load:</p> <ul style="list-style-type: none"> location relative to local network; size of local mains; location of local mains; size of new load; local ground conditions; inclusion of mains work.
Mains reinforcement	Mains synthetic costs	Changes to pattern of supply and demand to the network

Data on cost drivers to be used in regression modelling needs to be consistently available across GDNs and over time. We recognise that cost drivers such as project length, number of connection points and the type of connection are important cost drivers for consideration, however, we recognise the difficulties in collating this data consistently across GDNs. We recommend that Ofgem continues working with GDNs (e.g. through the CAWGs) to identify relevant cost drivers and which additional data should be collated as part of the Business Plan Data Tables (BPDTs). Where historic information is not available, Ofgem should consider how it can collect and assess data on future projects and how that can be included in the cost assessment process. Equally, data not utilised should be removed from the process.

Based on the potential drivers for which data is available across time and GDNs, we found that Ofgem's drivers (in particular MEAV for many areas) perform well in explaining Totex and therefore is a strong driver to continue with. However, the existing cost drivers are relatively stable over time and thus cannot capture the cost increase WWU is currently experiencing and/or are not capable of capturing the expected increase going forward. This is particularly problematic in some disaggregated cost areas (such as Repex and indirect Opex). To the extent that such drivers cannot be developed and collated across GDNs, it will be important for Ofgem to appropriately account for such step changes in costs via other means (as discussed in **GDQ50**).

There is also an important interaction between cost drivers used within the models, and exclusions and normalisations applied to the data prior to the modelling. These need to be carefully evaluated in line with Ofgem's criteria on normalisations (see **GDQ57**).

There are cost areas where it is challenging to find a suitable cost driver for a regression model (for example, IT and cyber costs as part of business support costs). In this case, alternatives, such as engineering-based models, unit cost models or an evaluation of tender quotes from sub-contractors can supplement Ofgem's assessment.

As for model specifications, we consider the first critical step is developing the appropriate cost drivers and capturing the step change in costs and then considering alternative model specifications. However, we would generally consider log-log models appropriate.

GDQ52 - What are your views on the potential of middle-up modelling in RIIO-GD3?

We agree with Ofgem's SSMC position that it should revisit the middle-up models, given that 'potential middle-up models, even if not ultimately used in setting allowances, may prove useful in validating the results of the Totex benchmarking.'³ Middle-up models are an important part of the overall model-building process as they help to develop a robust top down modelling suite (as discussed in the response to GDQ50).

Our initial remodelling of the same Totex and middle-up models considered by Ofgem during RIIO Gas Distribution Period 1, 2013 – 2021 (GD1) and GD2 (modelling total controllable Opex, Capex and Repex separately), with updated outturn and cost forecast data from the RRP, suggest the following:

- The middle-up models generally perform well, in particular when considered solely on GD2 data (they perform similar to, though slightly worse than, the current Totex models).⁴ This suggests that more recent data (here GD2 outturn and updated cost forecasts) may improve model fit, and that Ofgem would need to carefully consider whether more recent data does not lead to more robust modelling and more accurate efficient cost predictions for the GD3 period.
- There is some variation in middle-up model performance, suggesting that the cost drivers used at GD2 may be less appropriate for predicting GD3 costs in certain cases. For example, our initial remodelling based on updated GD2 data from company RRP suggest that the Opex model performs best from a statistical perspective (focussing on models only over the GD2 period)⁵. In contrast, the Repex model's statistical performance has meaningfully deteriorated from Ofgem's middle-up modelling at GD2 draft determinations (DDs). This reaffirms our view that Ofgem needs to consider alternative cost driver specifications (and collect the additional data to do so), and for Repex costs in particular.

The eventual consideration of middle-up models for allowance determinations, however, should be contingent on how well they align with operational insight and how robustly they perform.

³ Ofgem (2023) 'RIIO-3 Sector Specific Methodology Consultation – GD Annex', December, para. 5.32.

⁴ Note that this is based on indicative modelling with GDN's updated forecasts for 2024 to 2026 (as published in their RRP).

⁵ The updates to the RIIO-GD2 final determinations (FD) dataset here include both (i) Ofgem's outturn data update (for costs, some normalisations and cost drivers) over 2021 to 2023 and (ii) updating cost forecasts over 2024 to 2026 in line with companies' updated RRP forecasts for 2024 to 2026.

GDQ53 - What are your views on the potential of disaggregated modelling in RIIO-GD3?

We note that, should Ofgem consider any disaggregated models to inform its benchmarking of Totex allowances in a bottom-up manner, it is important to avoid cherry picking or not accounting for operational and accounting trade-offs by identifying the benchmark at the aggregate level.

However, even with benchmarking at the aggregate level, we do not believe that the current bottom-up models, with the current cost inconsistency issues, form a reliable basis for setting allowances. As discussed in **GDQ50**, inconsistent cost allocations both within the same GDNs over time and across GDN (e.g. due to changes to company capitalisation rates in recent years) means that Ofgem will not have the consistent allocation of costs to activities necessary for bottom-up benchmarking.

Inconsistent cost allocations of this sort will bias the disaggregated models (likely with increased severity the more granular the cost categories are). This is evident, for example, in the fact that disaggregated (bottom-up, but also middle-up) models generally perform worse than their top-down counterparts, as has historically been the case⁶ (and our remodelling with the latest RRP data suggests this still holds true, with the bottom-up models generally performing even worse after recent changes to capitalisation policies).

However, more disaggregated modelling, in some areas, could help in establishing the appropriate cost-cost driver relationships, and is therefore a necessary step in the model-building process. For example, our remodelling with updated GD2 data (as discussed in **GDQ52**) suggests that the bottom-up work management models from GD1 are no longer robust and would need further development (suggesting that the relevant cost drivers in the Totex models would also need refining, either by investigating the composition of MEAV and/or including additional cost driver data beyond that which is currently collected in Ofgem's dataset).

Similarly, we note that Ofgem did not consider bottom-up models for business support costs or its components (such as IT and telecoms, IT&T) at GD2. We note that this may be an area that requires closer attention at GD3, as business support costs represent the single largest Opex area, with IT and cyber expected to grow in RIIO-3. Business support costs should notionally be fairly straightforward to benchmark (if scale/multiple networks is appropriately accounted for, and appropriate costs are excluded, including IT and cyber). This is covered in more detail in **GDQ54**.

⁶ For example, whilst Ofgem's (revised) top down Totex model had a very high R-squared (as a measure of model fit) of 0.927 at GD2, the equivalent metric for the middle-up and select bottom-up models tested ranged between 0.41 to 0.90. See Ofgem, (2020) 'RIIO-GD2: Step-by-Step Guide to Cost Assessment', July (Draft Determinations), table 11.

Only if cost allocation issues can be appropriately resolved and suitable (i.e. intuitively appropriate) cost drivers can be found, such that the bottom-up models perform well from a statistical and operational perspective (e.g. are able to capture any step change in costs), should Ofgem consider these models. Alternatively, other types of models/assessment (e.g. engineering/unit-cost models and separate assessment) could be considered if suitable drivers cannot be found.

GDQ54 - In your view, what is the most suitable configuration of cost activities for middle-up or disaggregated modelling, that once combined, could form a complete bottom-up assessment of Totex?

As discussed in **GDQ50**, **GDQ52** and **GDQ53**, we believe that Ofgem should continue to pursue a top-down, Totex modelling approach for costs for which appropriate cost drivers can be identified, supported by separate assessment of other costs in the first instance (supported by cost-driver validation through bottom- and middle- up modelling).

We do not, as yet, have a view on the appropriate configuration of cost activities, that when considered collectively could provide a comprehensive and consistent assessment of companies Totex. In fact, we are sceptical that this can be achieved, for the concerns noted in **GDQ50**, **GDQ52** and **GDQ53**. This should become clearer once network Business Plans are available for RIIO-3 and Ofgem tests and develops various disaggregated models on that basis, ideally in conjunction with additional cost driver data collected.

We will note, however, that any comprehensive cost assessment should treat IT&T, cyber and physical security costs, amongst others, separately. This follows from the increased scale and scope of these costs, their lack of scalability with network size (e.g. companies with multiple networks could share IT cost overheads across them), and the distinct nature of such programmes relative to our traditional, business-as-usual operating costs. These costs represented 42% of the industry's business support costs in 2023 and will increase (similarly, IT&T costs are also driving the expected increase in other Capex forecast over 2024 to 2026). This is because increased digitalisation, data processing and accompanying cyber, and physical security needs have seen all GDNs undertake significant investment into IT&T and cyber & physical security programmes, which in turn require more significant costs to operate and maintain.

We thus urge Ofgem to conduct a more thorough, separate assessment of IT&T and cyber & physical security costs (either engineering based or some other form of IT&T-specific benchmarking), similar in principle to the approach considered for electricity distribution networks at RIIO-ED2 and taking account of the scale benefits from multiple network ownership.⁷

⁷ E.g., Ofgem, (2022) 'RIIO ED2 Final Determinations Core Methodology Document', November, paras. 7.291-7.303.

GDQ55 - What do you think would be appropriate criteria for determining cost exclusions for RIIO-GD3?

Materiality: We agree that a sensible individual materiality level should be established for determining cost exclusions, however an aggregated position should also be considered in case multiple areas, in aggregate, are material to an individual company.

Limited comparatives: where distinct projects/programmes of works require individual qualitative and quantitative assessment because each is distinct and bespoke in its own right.

Quality of historic information: the quality of historical information on which an assessment can be made. Costs should be excluded and separately assessed where there is limited or inconsistent historic data to base future expenditure decisions upon. This might be applicable to areas that were previously not excluded/separately assessed, such as Repex or where a change in legislation/policy occurs. Our list of areas for cost exclusion and separate assessment that we have, or intend to discuss at the Cost Assessment Working Group is as follows:

<i>Category</i>	<i>Description</i>	<i>Reason for separate assessment</i>
Existing in RIIO-GD2		
Capex	Diversions	Continue from RIIO-GD2 - reasons as set out in GD Annex 5.68
Capex	Growth Governors	
Opex	Streetworks	
Opex	Land remediation	
Repex	Multi-Occupancy Buildings - Risers and Laterals	
Capex	Large Capital Projects	Projects are unique in their location, materials, operational delivery, and therefore costs.
New for RIIO-GD3		
Opex/Capex	Cyber Security & Resilience (IT and OT)	Expenditure is not directly scalable between companies.
Opex/Capex	Physical Security	Expenditure is not directly scalable between companies.
Opex/Capex	Data and Digitalisation	Expenditure is not directly scalable between companies. GDNs will require different levels of investment dependant on investment plans from RIIO-GD2 (allowed in base allowances or through uncertainty mechanisms).
Opex/Capex	Non-operational IT	GDNs will require different levels of investment dependant on investment plans from RIIO-GD2 (allowed in base allowances or through uncertainty mechanisms).
Repex	Built over mains	Mains where third parties have built over our mains. From a risk perspective we need to move the main with no opportunity to recover expenditure from third parties. The location of mains on each project and therefore cost to relocate can differ significantly by GDN.
Repex	Mains in private property	Mains that require diverting out of private property. This is driven by HSE policy discussions. The location of mains on each project and therefore cost to relocate can differ significantly by GDN.
Repex	Tier 1 stub ends	Required to be completed by 2032 in line with the IMRRP.
Repex	Complex Distribution Systems	Where the GDN is responsible for the network within large commercial properties i.e. Bristol Cribbs Causeway. A defined programme of works. Expenditure for each project will vary significantly dependant on type of property (and disruption to property), condition, location of pipe, length of pipe.

GDQ56 – What are your views on the modelling treatment of workload adjustments for RIIO-GD3?

The principles of the adjustments are the same as at GD2; there is a need to adjust the costs and associated cost drivers to ensure the models remain balanced and robust and thus provide a fair relative assessment across GDNs. However, in some areas, such as Repex, the modelling should consider the greater certainty we now have over workload, as we close out the end of the IMRRP to 2032.

Such workload adjustments need to be undertaken carefully and avoided where possible, as such adjustments can introduce errors into the cost assessment. For example, in ED2, part of Ofgem's adjustment to networks' forecast low carbon technology (LCT) demand volumes (and resultant costs) was based on regression modelling.⁸ However, this was a point of contention, as it was argued that Ofgem's subsequent post-modelling adjustments were overestimated (given the particular details of Ofgem's approach).

However, it may have been possible to have avoided the need for such an adjustment in the first place. The reason for the adjustment was driven by Ofgem not mandating a consistent low carbon technology (LCT) rollout scenario for Distribution Network Operators (DNOs) to use in their BPs, as DNOs then used different scenarios in their BPs there was a subsequent need to adjust the data to be more consistent across the DNOs. That is, the LCT scenarios used by DNOs in their Business Plans were inconsistent and Ofgem was concerned that this would inflate some DNOs' forecast costs compared to other DNOs (if they have assumed higher LCT numbers than what Ofgem deemed reasonable) making them appear relatively more inefficient than was the case on a like-for-like basis.

Given the uncertainty for gas going forward, one key requirement for GD3 is to ensure that Ofgem mandates a consistent scenario for GDNs to use in their BPs as ex post adjustments are prone to error and thus risk.

⁸ Ofgem (2022) 'RIIO-ED2 Final Determinations Core Methodology Document', November, paras. 7.545-7.565.

GDQ57 - What are your views on the approach to regional factors for RIIO-GD3?

We consider the GD2 methodology to be a reasonable basis to build from. However, we expect Ofgem to carefully consider the areas that regional factors need to be applied to. A sparsity factor was applied to WWU's costs in RIIO-GD2 but only to the labour part of emergency and repair activities. Other key work activities (e.g. mains replacement and maintenance) did not receive a sparsity adjustment even though they are affected by sparsity in the same way as emergency and repair costs and utilise the same labour resources. A list of the mechanisms in which sparsity affects different cost areas was provided in WWU's regional factors annex for GD2.⁹ We see this as inconsistent and would expect to discuss this within the Cost Assessment Working Group in April 2024. There are also additional factors that were not present when setting RIIO-GD2 allowances, such as the introduction of the 20mph speed limit on Welsh restricted roads in residential areas which increases the response time for emergency activities, and increases the time to reach repair, replacement, and maintenance activities. We are assessing the impact of this and will present this during the relevant CAWG.

GDQ58 - What are your views on the approach to company-specific factors for RIIO-GD3?

Ofgem's proposed approach of using the criteria of materiality, uniqueness, outside of management control and excluded from cost drivers/other adjustments remains appropriate.

GDQ59 - In your view, which cost areas will require separate technical assessment in RIIO-GD3?

See consolidated response to **GDQ55**.

⁹ Oxera (2019), ['Regional factors in the cost assessment for GD2'](#), 29 November, Table 3.3.

GDQ60- What are your views on alternative technical assessment approaches for RIIO-GD3?

There are a number of engineering-based approaches that could be used:

- expert (engineering) review, individual project/ project by project review, unit cost analysis (e.g. of discrete, well-specified capital projects), rather than taking a top-down view of the company, this approach relies on more disaggregated information: the unit costs of assets and a standardised set of activities relating to the maintenance and/or replacement of such assets. To evaluate these activities and/or assets, the analysis may involve several professional disciplines as varied as quantity surveying, contract design, engineering, and econometrics. This approach is particularly useful to assess one-off bespoke Capex and Repex projects.
- **Process benchmarking**—this involves disaggregating the company into processes, where a process is defined as a collection of activities with identifiable inputs and outputs. These processes are then compared with other similar processes using internal or external benchmarks.¹⁰ Comparisons are undertaken based on unit costs, key performance indicators and simple productivity measures at a detailed cost line or functional level. This approach may be particularly useful to assess some business support costs, for example, compare HR, IT, finance or property functions within overheads. This approach provides an estimate of catch-up efficiency for the assessed functions.
- **Reference models**—this benchmarking approach is based on comparisons with a hypothetical efficient company ‘created’ through the use of a reference model. To create this hypothetical company, the model uses mathematical optimisation and externally sourced capital expenditure (CAPEX) unit costs either to redesign the network or to suggest improvements to the current structure. This approach is probably overly complex and dependent on the underlying assumptions to be robust enough for setting cost allowances.

In addition, Ofgem could use tender data to assess costs. While this requires procurement processes to be efficient, which Ofgem can also review, it has the advantage that contractors/operational experts carry out the costing for a specific piece of work, competing to provide the best quality/cost offering and provides additional information for Ofgem to draw on. Similarly, external verification of efficiency from experts would provide equally valuable to assess costs.

¹⁰ While top-down approaches attempt to make comparisons more like-for-like by including various cost drivers at the modelling stage, process benchmarking does so by undertaking comparisons at the business process level. This is because individual processes are likely to be similar across a wider range of companies—e.g. the human resources (HR) processes in one company are likely to resemble the HR processes in another.

GDQ61 - In your view, which cost areas will require separate non-regression analysis and benchmarking in RIIO-GD3?

See consolidated response to **GDQ55**.

GDQ62 - Which separately assessed cost activities from RIIO-GD2 could potentially be included in Totex benchmarking in RIIO-GD3?

There were good reasons for excluding certain costs from the regression benchmarking at GD2 — given the discrete and idiosyncratic nature and/or because these costs are not explained by cost drivers in the modelling. For example, major Capex projects were not benchmarked by means of regression modelling (but rather technical assessments) due to their large, once-off nature and/or unique characteristics (and thus lack of historical comparators). Similarly, there is a significant variation in the costs of maintaining and replacing/refurbishing risers for MOBs between areas (and thus GDNs), resulting in higher/lower costs that are not related to relative efficiency.

Unless the nature of these costs has changed, we would not expect it to be possible to re-introduce these cost activities into the regression benchmarking for GD3.

GDQ63 - What are your views on retaining the RIIO-GD2 pass-through cost items for RIIO-GD3?

Ofgem and Department for Energy Security and Net Zero (DESNZ) are proposing to move to Code Managers from Code Administrators for the Uniform Network Code. This Code Manager will have their own licence and hence will not be controlled by the Gas Transporters. The Code Managers will set their own budgets in accordance with their licence. These arrangements are expected to come into effect during the GD3 period and it seems likely that Gas Transporters will fund at least a share of the Code Manager's costs. As the Gas Transporters will no longer control the expenditure of the Code Manager, these are costs over which the Gas Transporters have no control and they should therefore be pass through costs. To simplify the licence drafting it would be easier to make Code Administration and Code Governance costs pass through for the whole GD3 period.

GDQ64 - What are your views on suitable approaches to the disaggregation of Totex allowances for RIIO-GD3?

We believe it is important to have the Totex allowances disaggregated at an activity level.

The methodology used for the disaggregation of RIIO-GD2 allowances was generally appropriate. However, there were discrepancies in the split of non PCD and NARM Repex allowance, and we suggest the disaggregation of allowances at activity level in line with the RIIO-GD3 Business Plan submission.

GDQ65 - In your view what are the high-priority areas of reporting inconsistency between GDNs within the RIIO-GD2 BPDTs and RRP, and how can these be addressed for RIIO-GD3?

There have been a number of sessions between GDN's and good engagement with Ofgem ensuring there is consistency in the information provided since the RIIO-GD2 BPDT to the current RRP and where applicable updated the Regulatory Instructions and Guidance (RIG's) document through Ofgem with enhancements to definitions and instructions for table completion.

We have identified inconsistencies of a minor nature and agreed to rectify going forward.

The operating model of GDN's can determine the level of detail cost can be reported at or where costs can be reported across Totex. As an example, WWU have an in-source model and all training costs in line with accounting standards are included in Opex whereas some GDN's where they outsource elements of work, may see costs included in the total invoice cost of contractors and therefore not be able to break out or have a different approach to capitalisation. There is little that can be done with this due to the capitalisation policy in place in GDN's and also the level of detail provided on invoices from external parties.

The RRP in current format now gives the best view of how costs and workload should be reported.

GDQ66 - We invite views on current reporting requirements and reporting structure at the cost activity level and how this may be adapted to better suit RIIO-GD3 and related development of BPDTs.

We believe that the current RIIO-GD2 RRP reporting structure provides an appropriate level of data and we encourage Ofgem to ensure the BPDT's are not data intensive and are relevant to the information that is required for the Business Plan assessment.

There has been a good level of engagement between GDN's and Ofgem on the development of the BPDT's for GD3. We are encouraged that the formulation of the BPDT's follows the structure and format of the current RRP with any further data requirements added into these tables. From the first view of some of the shared draft BPDT tables for Opex, they are aligned to the discussions we have had.

We will review the draft templates as provided and feedback any issues or further enhancements we feel would be beneficial.

Wales & West Utilities RIIO-2 Consultation Detailed Response

Finance Annex

SECTION 1 OF THE FINANCE ANNEX: INTRODUCTION

We welcome many comments in the Finance Annex to the Sector Specific Methodology Consultation (“SSMC”) for RIIO-3. For example, Ofgem’s recognition of the different evolving challenges facing gas and electricity networks and greater competition for capital within the UK and globally.¹¹

The Gas Distribution Network (“GDN”) companies are keen to engage with Ofgem to support policy development in strategically important areas such as:

- (i) **orderly transition** for GDN sector evolution towards Net Zero carbon by 2050, including RAV, asset stranding and other considerations,
- (ii) **investability** to support investor confidence to invest new capital and their retention of existing capital commitments when refinancing debt, and
- (iii) **resilience** in assets, workforce and IT/Cyber

This is against a background of ongoing funding required for the significant and critical HSE mandated Repex investment programme to embed further decarbonisation, safety and reliability into the network and other investment. Concurrent with that ongoing investment, our workforce, systems and processes that underpin safety, reliability and service across our network must remain resilient and support orderly progress towards a Net Zero economy.

We acknowledge that some finance areas will be challenging to calibrate, particularly where gas and electricity are likely to evolve very differently in the coming years. We and our GDN peers are keen to engage with Ofgem to assist where we can.

There are some areas where we have different views to Ofgem, supported by evidence gathered to date. Following extensive effort, we continue with evidence gathering in what has been a challenging timeframe for consultation. We ask Ofgem, as we have noted in our bilateral engagements, to remain receptive to further evidence submissions and these have been highlighted as follows for ease of identification.

¹¹ For example, in paragraphs 1.6, 1.7 and 3.75

The reports and other documents forming part of this submission are listed in the table below:

Document title	Type	Status	Scope	Sender
ENA response to Ofgem RIIO-3 SSMC Finance Annex	Letter with expert reports	Public	Cross sector	ENA
RIIO-3 cost of equity	Expert report	Public	Cross sector	ENA
Equity investability in RIIO-3	Expert report	Public	Cross sector	ENA
The low beta puzzle	Expert report	Public	Cross sector	ENA
Additional costs of borrowing for the RIIO-3 price control	Expert report	Public	Cross sector	ENA
Initial considerations of using breakeven inflation for price control purposes	Expert report	Public	Cross sector	ENA
Impact of GDNs' Reduced Debt Tenor on Additional Cost of Borrowing at RIIO-3	Expert report	Public	GDN sector	WWU
Risks and investability of the GB gas distribution sector	Expert report	Public	GDN sector	WWU
Credit Rating Agencies perception of risk for GDN's under RIIO-3 and beyond	Expert report	Private	GDN sector	WWU
Debt Market Analysis : Gas Distribution Networks and UK regulated comparators	Expert report	Private	GDN sector	WWU

The documents listed above are part of our response, even though we do not comment on every paragraph or matter in them. Consequently, if we do not comment on a particular paragraph or matter, this does not mean we disagree with it or that there is nothing more that we could say in respect of it.

Finally, to facilitate Ofgem’s review, our responses are structured to minimise repetition of content in documents referenced in this submission and we preface some sections with overview comments to provide context and specifics on our position.

SECTION 2 OF THE FINANCE ANNEX: Allowed return on debt questions.

Overview from WWU:

WWU will continue to seek a reasonable company specific allowance for its actual efficiently incurred and prudently managed debt costs, taking derivatives into account, and controlled for notional gearing. Because the position for RIIO-GD2 on this matter is subject to a forthcoming Judicial Review at the High Court of the CMA’s Final Determination, in which GEMA is an interested party, we will restrict our comments in our response below to FQ4 to avoid repetition.

We relate our concerns to Ofgem regarding its policy objective to remove the “effect” relating to inflation and nominal fixed rate debt, including its suggested removal of the index linked debt assumption.

Regarding the gas distribution sector, we present evidence showing the sector is facing higher debt costs and rating agencies are giving increasing attention to asset stranding risk.

FQ1. Do stakeholders consider there to be good reasons to deviate from the overall approach set out under UKRN Recommendation 8?

Yes. Please refer to our response to FQ4 below.

FQ2. Do stakeholders have evidence in support of, or opposition to, one or more of the updated indexation or inflation remuneration methodologies under consideration?

Firstly, regarding Indexation (i.e. using cross sector wide average cost of debt excluding derivatives from which a trailing Iboxx index is calibrated): Subject to our response to FQ4 below, in the context of Ofgem's determination of an efficient debt pool for the three sectors (Gas Distribution, Gas Transmission and Electricity Transmission), we ask Ofgem to:

- A. Define efficiency, and how that definition will be applied.
- B. Reaffirm its definition of prudence provided in paragraph 2.43 of the RIIO-2 FD Finance Annex (i.e. compliance with the licence requirement for investment grade rating).
- C. If cross currency swaps are to continue to be included, provide a rationale for their inclusion for RIIO-3, whilst excluding all other types of swaps.
- D. Explain why the ED debt pool is excluded, other than by accident of its price control period not being concurrent.
- E. Explain the significance and weighting that Ofgem will give to avoiding "exposing" consumers to company or sector specific allowances, given the significant concentration of RAV in a small number of companies.

Second, regarding "inflation remuneration methodologies" (proposed by Ofgem in pursuit of its policy intent to remove the inflation leveraging effect associated with the risk for outturn inflation to be higher from assumed long run inflation in setting the KD allowance with a large proportion of fixed rate debt), we have the following comments:

A. Removal of outturn inflation to RAV.

To our surprise, even though Ofgem's policy objective (that emerged in 2023) to eliminate the "effect" is clear, the approach taken by Ofgem in this SSMC does not involve any consideration of the merits of retaining the current approach of outturn inflation to RAV against the other options outlined by Ofgem in this SSMC.

Firstly, WWU does not accept the premise that something must be done about the “effect”. It is not self-evident that a change needs to be made. Second, given that the current approach has a long and consistent history and therefore reflects investors' entrenched expectations, it is inappropriate not to consult on its retention as at least one of the options that Ofgem will be open to considering. While Ofgem does not generally need to consult on every possible policy option, fairness requires that it consults on retaining the status quo in a case where, as here, it embodies long-held expectations, and a number of consultees may wish to make a case for its retention. Leaving it out of the consulted-on options suggests that Ofgem has pre-empted the outcome and has a closed mind in relation to an issue on which it is required to remain open minded.

Moreover, removing the “effect” needs to be distinguished for its impact on (i) existing RAV and (ii) new RAV, and the SSMC is defective for not drawing attention to this potentially very important distinction. Regarding (i), removing future outturn inflation from **existing** RAV would be retrospective – existing investors would expect existing RAV (i.e. past investments) to continue to be protected from outturn inflation given the long-standing regulatory practice. Regarding (ii), removing outturn inflation from **new additions to RAV** post RIIO-2 may not be retrospective, but would be a significant change by itself.

At paragraph 2.26, Ofgem states that it is considering changes to: “Ensure the mechanism is fair for consumers and does not result in excessive remuneration for licensees. It is important that the cost of debt methodology does not have an inherently positive **expected return** over the long run for licensees (and so negative for consumers) by underestimating inflation expectations priced into debt.” (WWU emphasis on “expected return”).

We have the following reasons for retaining the current approach with continuation of using the 5th year OBR projection as a long run assumption in setting allowances:

- Firstly, in response to Ofgem’s CFI in 2023, the ENA’s submission to Ofgem included a report to the ENA from Frontier Economics. We agree with Frontier’s view (paragraph 64): “**In expectation**, there is no reason to believe that the long-run inflation assumption used in setting the cost of debt will systematically over/under-forecast inflation over time, since the Bank of England has the mandate to keep inflation (as measured using CPI) stable and at the target rate of 2%. We therefore see no reason to believe that the potential existence of a leverage effect will lead to companies expecting to receive more or less than Ofgem’s intended level of allowed return over time, regardless of the make-up of debt portfolios as between fixed and index- linked debt.” (WWU emphasis)

- Second, in response to Ofgem’s argument that the legitimacy of the price control may be undermined because variations to returns on equity would not correspond to consumer outcomes, such as service, the impact of inflation leverage is to move value in real terms between equity and fixed rate debt investors. Consumer bills in real terms would not be affected. We agree with Frontier’s view (paragraph 66) “The leverage effect should therefore not be considered a value transfer between the company and the customer. “
- Third, the bar to evidence for changing the current approach should be set high given the core investor expectation for regulatory stability and predictability unless the current approach is fundamentally wrong. The recent, and short lived, inflation spike is rapidly trending back to BOE target (month on month inflation since September 2023 has been below the BOE target of 2%) and had very specific and exceptional causes for which it is not possible to place any reliable judgement of repetition (Russia/Ukraine war and post COVID impact on supply chains etc).
- Fourth, and taking the arguments above, in the context of ensuring regulatory stability and predictability – which as Ofgem rightly affirms is critical,¹²- we do not consider removal of the leveraging effect to be justified.

B. Options proposed by Ofgem

- a. Regarding Option 1, this would remove a cornerstone of regulatory design – i.e. RAV would not be maintained in real terms, as adjusted for actual outturn inflation. Rating agencies may adjust cover ratio thresholds to neutralise the impact to cover metrics.¹³ We await a justification and quantification from Ofgem on the consumer bill impact for RIIO-3.
- b. Regarding Option 2, this would remove RAV maintenance in real terms if outturn inflation turned out higher than the long run assumption applied. The change from application of outturn inflation to a long run assumption applied to the nominal fixed rate debt portion of RAV would be a fundamental change to the regulatory model with no apparent net overall benefits.

¹² Paragraph 1.2 :“This broad regulatory stability gives investors the confidence to continue to invest in the sector.”

¹³ For RIIO-2, both Moody’s and Fitch indicated they would reverse out speed of money adjustments from changes to capitalisation – noted by Ofgem in its Draft Determination, page 214.

- c. Regarding Option 3, it will be clear from our views above that retention of the current approach is appropriate unless compelling evidence can be adduced by Ofgem to support a clearly superior alternative long run assumption. In any event, Ofgem needs to be open-minded about the option of retaining the current approach. Given the importance of regulatory stability and predictability, we are surprised with Ofgem's intention to reconsider breakeven inflation rates, having switched from RPI breakeven rates in RIIO-1 to OBR 5th year projections for RIIO-2.¹⁴

We refer Ofgem to Frontier's report on breakeven inflation.¹⁵ We agree with Frontier's arguments.

FQ3. Do stakeholders have views on the potential approaches to implementation of the proposed methodology changes, including assumptions relating to ILD weights?

ILD weighting

In paragraph 2.43, Ofgem is considering removing the notional company's inflation linked assumption in debt.¹⁶ Ofgem states: "It would remain possible under either option 1 or 2 for the effect to persist *given licensees may finance the assumed portion of ILD with fixed rate debt in their actual capital structures.*" (WWU emphasis). Ofgem then seeks evidence on the likely economic impact if licensees no longer raise ILD debt.

Removal of the "effect" noted earlier would be a significant change and removal of the ILD assumption would further increase that significance. Specifically:

- All licensees in the GDN sector maintain some portion of debt in index linked form, either with IL Debt or using IL swaps overlaid on nominal rate debt.
- The IL debt market is an important source of capital. Removing the ILD assumption sends out a signal that this source of finance is no longer preferred by Ofgem. That would not be an appropriate signal at a time when the gas sector seeks to refinance debt in an orderly transition towards Net Zero carbon and other sectors expect to raise significant amounts of debt finance.¹⁷ Signalling that companies should no longer access the IL debt market would limit the pool of debt capital and hence the ability of companies to achieve an efficient cost of debt across their overall debt portfolios.

¹⁴ Ofgem RIIO-2 Draft Determination – Finance annex, paragraphs 2.73-2.77.

¹⁵ Frontier Economics : Initial considerations for using breakeven inflation across price controls

¹⁶ For RIIO-GD2, this is 30% of debt at notional gearing, based on Ofgem observations of licensee positions. (Note : In the

RIIO-2 consultation, Ofgem did not present evidence to support that 30% estimate)

¹⁷ Ofgem has recognised the competition for capital in other UK sectors and globally – see paragraph 1.6 Finance Annex

- The premise is not a reasonable one – i.e. that licensees may refinance out of ILD debt to nominal rate debt to seek an inflationary gain over a 5-year period. This would be a highly dubious basis for such refinancing by investment grade networks, leaving aside make whole premia in terminating long term embedded debt and other transaction costs.
- If GDN licensees, through their business plan submissions, do not expect to make significant reductions to their ILD debt amounts in RIIO-3, this would add further evidence against any such change. Ofgem’s notional company would then have a significantly different debt mix than the licensees it seeks to regulate, not due to licensee changes, but due to a significant change by Ofgem.

Actual Company ILD debt positions

At paragraph 2.46, Ofgem acknowledges that licensees may have adopted different inflation profiles than the notional company assumption and state: “We believe that a new inflation sensitivity of this nature could adversely impact financial resilience in a manner which could not have been reasonably anticipated when licensees made these capital structure decisions.”

WWU undertook a long-term hedge of inflation in RAV in 2007 using RPI derivatives. Currently, these derivatives expire from 2035 to 2039. Together with one RPI index linked bond expiring in 2035, WWU’s projected ILD percentage of total debt at notional gearing currently averages 45% for GD3. Ofgem will be familiar with the details of those derivatives from past RFPR and other submissions. WWU intends to continue with those derivatives until their final expiry up to 2039.

Because WWU has much higher index linked debt (including IL swaps) in its capital structure than Ofgem’s notional company, for WWU there is less potential for inflation mismatch between RAV outturn inflation and costs of debt implied by the “effect” than Ofgem seeks to eliminate. This is implicitly acknowledged by Ofgem in paragraph 2.30. When considered in the context of Ofgem’s long held view that companies are best placed to manage financial risks, this further supports the case for retention of the current approach to outturn inflation and the ILD assumption.

Removal of outturn inflation to RAV would undermine the structural long term inflation hedge WWU undertook in good faith in 2007. Transitional measures proposed in paragraphs 2.45 and 2.46 defer and spread out, but do not remove, the cumulative adverse effects for WWU should outturn inflation exceed a long run assumption. Any adverse effect accumulates and damages long term financeability, and possibly has a materially adverse impact in RIIO-3.

If Ofgem nonetheless proceeds to remove the “effect”, our position is that any transitional mechanism should cover the remaining maturity of the RPI swaps.

FQ4. Do stakeholders wish to propose any other alternatives that have not been proposed?

As for RIIO-GD2, and as noted in our overview above, WWU will continue to seek a company specific allowance, including derivatives for its efficiently incurred and prudently managed costs of debt, controlled at notional gearing. That approach is founded on market efficiency and prudence represented by investment grade status. The rationale for this approach was comprehensively explained in the Oxera Cost of Debt report submitted to the CMA in 2021. Ofgem has a copy of that report. For RIIO-GD3, we will consider if any refinements are appropriate.

As for RIIO-GD2, and as related to Ofgem in bilateral meetings for RIIO-3, WWU intend to submit to Ofgem an updated cost of debt report prior to the SSMD. We anticipate that this report will be further updated after the SSMD and prior to the Draft Determination, for market developments and any financing actions taken by WWU. ¹⁸We will also consider whether further updates are required in advance of Final Determinations.

Regarding recommendation 8 of the UKRN report, this does not explicitly preclude the use of a company specific approach for actual costs at notional gearing provided these were efficiently and reasonably incurred. We disagree with the UKRN's stance to exclude derivatives. Our rationale and evidence for their inclusion are contained in Oxera's cost of debt report referred to above. However, should Ofgem nonetheless proceed to exclude derivatives from the cost of debt allowances for RIIO-GD3, their inclusion in actual costs for tax clawback purposes would be inconsistent and therefore wrong.¹⁹

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

We refer Ofgem to the following reports:

1. The NERA report on additional costs of borrowing submitted by the ENA. The report is not sector specific.
2. The NERA report on additional costs of borrowing for the GDN sector covering transaction costs and costs of carry. The GDN licensees expect to review other additional costs on a GDN sector specific basis post SSMC response and may submit a NERA report to Ofgem for the GDN sector specifically.
3. KPMG survey of debt investors for the GDN licensees. This will be submitted shortly after the SSMC response deadline to allow for some final debt investor responses.
4. KPMG report (private and confidential) on rating agency views on the GDN sector.²⁰

¹⁸ As noted with Ofgem in bilateral meetings, we expect to submit WWU specific cost of debt reports for GD3 prior to the SSMD.

¹⁹ See our response to FQ20 in the area of tax clawback.

²⁰ KPMG report: "Credit Rating Agencies perception of risk for Gas Distribution Networks (GDN's) under RIIO-3 and beyond"

5. KPMG report (private and confidential) on debt markets for the GDN licensees.²¹

For the GDN sector, the KPMG reports provide strong evidence that (i) GDN companies are facing higher debt costs than electricity companies and the GDN company debt tenors are shortening, and (ii) regarding Rating Agency views, and as KPMG note, the current ratings of GDN licensees do not reflect asset stranding risk²². However, KPMG concluded: “the risk associated with long-term gas demand uncertainty in the UK is well-known to the agencies and is being monitored. If the risk is not addressed appropriately and results in a pronounced likelihood of asset stranding for the GDNs, the CRAs would likely revisit their assessment of the business risk and tighten their target credit ratios for the sector. The timing and degree of tightening would depend on many variables and would involve analytical judgement. This could cause a downward rating migration of gas distribution networks and could negatively affect their ability to refinance debt unless the networks manage to de-lever in accordance with new ratio targets (which may not be entirely under their control). The actions of the regulator are considered by the CRAs as key in managing the risk of asset stranding.”²³

SECTION 3 OF THE FINANCE ANNEX: Allowed return on equity questions Overview from WWU:

- **Baseline** (i.e. before GDN sector specific considerations) cost of equity.
 - We refer to the following key outcomes from two expert reports that we use to set a baseline cost of equity position:
 - The Oxera cost of equity report.²⁴ That report indicates a range of 5.08% to 6.48%, with a midpoint of 5.78%, and does not take account of sector specific forward looking risks.²⁵
 - Within that report, Oxera’s ARP-DRP cross check supports the upper bound of that range – Oxera concluded :“ The application of the ARP–DRP framework, taking into account the pricing of debt risk over a five-year horizon, suggests that the appropriate point estimate of the CoE needs to be above the top end of the Ofgem rolled-forward range from RIIO-2, and close to the upper end of the Oxera range..”²⁶

²¹ KPMG report : “Debt Market Analysis : Gas Distribution Networks and UK regulated comparators”

²² KPMG report : “Credit Rating Agencies perception of risk for Gas Distribution Networks (GDN’s) under RIIO-3 and beyond”, Executive Summary, section 1.2.1

²³ Ibid, Executive Summary, section 1.2.1

²⁴ Oxera : RIIO-3 cost of equity.

²⁵ Ibid, Executive Summary, page 11

²⁶ Ibid, Executive Summary, page 13

- Oxera concluded: “Overall, the weight of evidence suggests that the CoE for RIIO-3 is most likely to be towards the upper end of the Oxera range based on CAPM parameter estimates”.²⁷
- The Frontier Economics report on investability (including cross checks on baseline cost of equity)²⁸. Frontier concluded, inter alia...”the suite of investability tests show that an appropriate allowed CoE is likely to be at least in line with the top end of Oxera’s estimated RIIO-3 range (i.e. 6.48%) – and if anything higher than this (i.e. 6.48% tends to be the lower end of the range implied by our suite of tests). This is consistent with Oxera’s view that the approach it has adopted may not yet capture all relevant risks...”²⁹

- **GDN sector considerations**

- In its report on gas distribution sector risks,³⁰ Oxera state:
“Whenever a specific (material) risk introduces a negative asymmetry in the range of expected outcomes and/or has systematic characteristics—i.e. is correlated with the wider economy—this provides a reason to account for this risk in the allowed return on equity. Cash-flow remedies, such as accelerated depreciation and re-openers, which Ofgem is considering using to address the asset stranding risk in RIIO-GD3, are useful in mitigating the risk. However, they do not eliminate it, because uncertainty around networks’ future ability to recover their costs remains—for example, due to customer bills having to increase to an untenable level, especially if the user base shrinks in the future. Therefore, an uplift to the allowed return on equity relative to the ‘baseline’ allowance for a steady-state GB energy network would be justified.”³¹
- Oxera presents evidence showing asset beta’s in European countries higher than electricity asset beta in the same countries and evidence from the debt markets of higher costs of debt with implications for cost of equity.³²

²⁷ Ibid, Executive Summary, page 13

²⁸ Frontier Economics : Equity investability in RIIO-3

²⁹ Ibid, paragraph 18.

³⁰ Oxera report : “Risks and investability of the GB Gas Distribution Sector”

³¹ Oxera report, “Risks and investability of the GB Gas Distribution Sector”, Executive Summary, page 4

³² Ibid, paragraph 3.5, table 3.1 and Section 2C. Also, see paragraph 3.4 which explains that Italy and Spain were used because they are the only two European countries with gas and electricity networks with traded equity shares.

FQ6. Do stakeholders agree with our interpretation and proposed application of UKRN Recommendations 2-7?

Please refer to our comments above and the reports referred to therein. Both reports are consistent with UKRN guidance, with Oxera placing more emphasis on ex post TMR evidence.³³

FQ7. Do stakeholders consider there to be good reasons to deviate from the respective approaches set out under UKRN Recommendations 2-7?

Please refer to our response to FQ5 and the reports referred to therein.

FQ8. Do stakeholders agree with our proposed methodologies where not specifically covered by the UKRN Guidance recommendations or our approach in previous price controls, such as the proposed approach to converting the RPI-real yields to CPIH-real inputs in the RFR calculation?

Please refer to section 2.12 of the Oxera cost of equity report.

FQ9. What comparators and/or timeframes are likely to provide the most accurate estimate of beta for the energy network sectors on a forward-looking basis?

Please refer to section 2.3 of the Oxera report and to our overview comments above relating to gas sector risk considerations and evidence. **We are concerned about the relevance and weighting of UK water sector companies, and although that concern is not referenced in the reports mentioned, we may review this matter further post SSMC response and submit evidence.**

³³ Ibid, Executive Summary, page 8

SECTION 4 OF THE FINANCE ANNEX: Allowed WACC questions

FQ10. Do stakeholders consider there to be good reasons to deviate from the respective approaches set out under UKRN Recommendations 1 and 9?

UKRN recommendation 1 relates to WACC overall, and we do not agree with the “notional company “ approach to setting a cost of debt allowance. Regarding UKRN recommendation 9, relating to notional gearing, we do not see good reasons to deviate.

FQ11. Do stakeholders consider there to be good reasons to deviate from the notional gearing assumptions (with respect to the level of gearing and the mix of debt types) applied to GD, GT and ET companies in the RIIO-2 price controls?

We do not see good reasons to deviate from notional gearing of 60% for the GDN sector. With respect to debt type, please refer to our response in FQ3 regarding Ofgem’s suggestion to remove the ILD assumption.

FQ12. Do stakeholders agree with the proposal that notional gearing levels should be maintained for each year of the price control? Do stakeholders have a preference for how this assumption is managed within the price control process?

To support regulatory stability and predictability, continuation with notional gearing of 60% for the GDN sector is appropriate for a 5 year control period in the context of a sector that will need to continue with its comparatively predictable and stable Repex programme to at least 2032. This is consistent with Ofgem’s comments in paragraph 4.10, where Ofgem currently expects to continue with the RIIO-GD2 gearing thresholds but will be updated for investment plans. We would expect the GDN sector’s underlying investment intensity, assuming no material Net Zero Carbon investments, to be comparatively stable in the round from RIIO-GD2 to RIIO-GD3, with the possible exception of IT and cyber, which may increase.

We agree with Ofgem that accelerated cashflows from a decision it may make to accelerate RAV depreciation should be assumed to be applied on a constant gearing basis to support financeability. This is suggested or implied by Ofgem in paragraphs 1.12, 5.15 and 6.12. It is important that such accelerated RAV depreciation cashflows can be utilised to repay both equity and debt capital invested in the GDNs consistent with the need for ongoing investment grade status. Unduly restrictive policy on returning equity capital would impair investor confidence and trap capital that could be redeployed to other sectors.

Finally, unduly conservative gearing levels lean against capital efficiency, increase customer bill levels and impede a reasonable return of equity in a context of an acceleration of RAV depreciation and maintenance of investment grade status. This would impede investability.

SECTION 5 OF THE FINANCE ANNEX: Financeability questions

FQ13. What, if any, improvements should Ofgem make to the assessment of financeability in the next price control?

Our stance for RIIO-GD3 on Ofgem's finance duty and the associated assessment of financeability for RIIO-GD3 remains consistent with the arguments made and evidence submitted by WWU to the CMA in our appeal against the RIIO-2 price control and our subsequent submissions to the High Court in our Judicial Review of the CMA's Final Determination.

Subject to this position, we make a general comment that if Ofgem is seeking to place greater reliance on investment grade status to enhance financial resilience, we ask it to consider how this should impact its approach to financeability assessment. For example, if a rating agency(s) decides to reverse speed of money adjustments, would Ofgem align its financeability assessment to that approach?

Specifically, and noting the comments in paragraphs 5.15, we would agree that longer term assessment of financeability would be an improvement, particularly:

- (i) where large speed of money changes may be made (e.g. RAV depreciation acceleration and/or nominal cost of debt), because this acts to check that presumed NPV neutral measures do not undermine financeability now or in the future, and
- (ii) perhaps more importantly, when gas and electricity are facing very different challenges.

FQ14. What evidence, if any, should Ofgem consider in relation to expanding its assessment of financeability to account for 'investability'?

Please refer to:

- (i) sections 1-4 of the Frontier Economics report,³⁴ and
- (ii) section 5 of the Oxera report regarding the GDN sector and how investability should be applied in this context³⁵

SECTION 6 OF THE FINANCE ANNEX: Financial resilience questions

Overview from WWU:

Ofgem proposes four significant new measures for RIIO-3.³⁶

A key consideration is to achieve a fair enduring balance between a robust regulatory ring fence whilst avoiding undue burden on licensees and investors. This relates to both new measures and the total suite of measures which has been growing from one control period to the next. Concentrating all additional burdens on investors is not an unbounded cost and risk option. Disproportionate measures could deter new investment and motivate existing investors to seek exit.

We ask Ofgem to reflect on its stated view of prudence in RIIO-2,³⁷ if it intends to change this view and what its rationale would be.

Except in relation to the change proposed for the minimum number of ratings (from one to two, with the caveat on the use of debt ratings set out below), we do not consider that the other proposed significant new measures are appropriate for RIIO-GD3.

³⁴ Frontier Economics report: "Equity investability in RIIO-3".

³⁵ Oxera report : "Risk and investability of the GB Gas Distribution Sector", Section 5.

³⁶ SSMC Finance Annex, Paragraph 6.31, table 3

³⁷ Stated in paragraph 2.43 of the Final Determination for RIIO-2

FQ15. What is your view on the proposed financial resilience measures? Are these appropriate and/or are there any other measures that you would propose?

We have the following comments on proposals in paragraph 6.31, table 3.

Ratings: In principle, we are supportive of the proposal to require two credit ratings instead of one rating, provided certain conditions apply. WWU's background position is:

- WWU (the licensee) has maintained solicited public ratings with Fitch and S&P since 2010. Fitch provides the Issuer Credit Rating, in addition to debt ratings. S&P provides debt ratings only and is unable to provide an issuer rating due to WWU's highly secured financing structure. Both debt ratings are required by lenders to WWU.
- WWU would need lender consent to replace either of these agencies with Moody's. That could require a large consent fee. Alternatively, we could add an issuer credit rating from Moody's and have three rating agencies. The net benefit to WWU and its stakeholders from a financial resilience perspective are not apparent.
- For WBS structures, S&P cannot provide an issuer credit rating for the licensee. S&P have advised us that they are willing to discuss this matter directly with Ofgem.
- Ofwat allows debt ratings from S&P to be treated as permissible credit ratings under certain circumstances. (see link to [Credit Ratings - Ofwat](#)). Changing the licence definition to allow for this would not be difficult, on the contrary it should be a straightforward drafting task.
- WWU will have just class A debt from 2026/27. There will therefore be no subordinated class B debt in the licensee from then. WWU has maintained an A-rating for its class A debt from the two rating agencies since 2010, a unique track record in the sector.
- We therefore propose that the Class A debt rating should be allowed as a qualifying credit rating provided only one class of rated debt exists, in addition to any Issuer Credit Rating.

We ask Ofgem to consider our position. In principle, and as noted, we are supportive of extending the requirement to two ratings as a further significant step to support financial resilience. However, the definition of Issuer Credit Rating should be widened to include a debt rating for a single debt class in the licensee where no subordinated rated debt class exists in that licensee, aligned with Ofwat's approach. We also note that Ofwat permits a licensee to make a formal request on Ofwat to request that only one rating be used. This flexibility should be built in, as it may take some time to replace a qualifying rating with another in circumstances where a minimum of two ratings are required.

Removal of “reasonable endeavours”

Before we turn to our comments, we set out below some points made by Ofgem in paragraph 6.14 which are seen as “potential shortfalls or disadvantages” in the context of financial resilience:³⁸

- “The flexibility within the rating boundaries, along with information asymmetry, can mean that companies are able to take risks with aggressive financial policies and instruments in a way that might be contrary to the consumer interest (e.g. over hedging, 'kick the can ' inflation swaps, inappropriately high leverage and complex corporate structures with debt issued above the licensee entity which is reliant on regular dividend flows for servicing). Locking up distributions at the lowest investment grade rating with a negative outlook/watch may be too late an intervention; “
- “It is untested, and therefore not entirely clear, as to how effective the suite of early warning indicators is. For example, a ‘reasonable endeavours’ or ‘appropriate measures’ threshold is untested and could create unnecessary uncertainty for investors and consumers. It also offers less protection for consumers than an absolute requirement to maintain investment grade”.

As to the first point, none of the noted concerns apply to WWU. We note Ofgem does not refer to its existing financial resilience reporting regime. The reporting measures in that regime are triggered in advance – i.e. at a higher level than the lowest level of investment grade with a negative outlook. That regime provides Ofgem early access to forward looking information to assess financial risk **before** BBB- negative outlook is reached. This should also mitigate perceptions of information asymmetry concerns. Armed with this forward looking information on an early warning basis places Ofgem into a unique position to consider if the licensee is using and/or has plans to use reasonable endeavours to maintain investment grade status.

As to the second point, the qualifying language relating to “reasonable endeavours” on the Investment Grade licence obligation is very important.³⁹ It reflects that shareholders are not the ultimate guarantors of financial resilience in all circumstances and at all times, and there can be circumstances where despite reasonable endeavours, a financial issue exists.

³⁸ Paragraph 6.14

³⁹ Ofgem did seek to apply “best endeavours” at the RIIO-2 licence drafting process, but did not pursue this. It also removed the language “all appropriate steps”

Removal of the qualifying language would impose an absolute unconditional requirement on licensees to maintain investment grade in all circumstances and at all times. It would be tantamount to imposing an indemnity on shareholders that, irrespective of circumstances (including those entirely outside their control), they must fund whatever is required to maintain investment grade. By definition, removing the reasonable endeavours qualification entails changing the obligation to one in which shareholders must take steps even where it would be entirely unreasonable for them to have to do so. It would therefore be a disproportionate and erroneous step by Ofgem. We doubt that it can be justified at all, but certainly no adequate justification has been provided in the SSMC.

Moreover, the change would involve an inappropriate and invalid delegation by Ofgem of its authority. On the basis of the proposed change, what was required for compliance with the licence condition would in future be wholly dictated by the requirements of the credit rating agencies (in the light of the circumstances then prevailing) with no room for any element of discretion to be exercised by Ofgem. This outsourcing of all responsibility from a public authority to private bodies cannot be justified and is fundamentally inconsistent with basic regulatory principles of accountability. In this area, Ofgem's general approach seems to be to seek to minimise its own obligations under its statutory finance duty, and to transfer all responsibilities to investors and third party agencies. WWU does not consider that this is an appropriately balanced or proportionate approach, or indeed consistent with the intention of the statutory regime.

We have three additional points:

1. Risk and return

- Removal of the qualifying language comes with an underlying premise that Ofgem could never make an error in discharging its Gas Act duties in setting allowances and therefore any adverse consequences from insufficient allowances on ratings are for investors alone to bear. As experience has demonstrated, Ofgem (like all regulators) does make such errors from time to time, as various determinations by the CMA have made clear. However, it takes time for CMA decisions to be reached and during that time agencies can act to downgrade. Further, were it necessary for a company to challenge the CMA by Judicial Review, that process can take years. Agencies can act in that time to downgrade. It is not reasonable therefore to place this risk solely on investors by subjecting them to an absolute obligation during these time periods without appropriate compensation in the cost of equity allowance.
- With regard to Ofgem's aim to ensure that investors have certainty and assurance in the context of investment (paragraph 2.1), equity investors will take note of the additional risk above.

2. **Finance duty.** Ofgem must engage with its finance duty in this area: if the qualifying language is removed, how can Ofgem determine allowances with sufficient confidence such that investment grade status will be maintained in all circumstances with two rating agencies for an efficient and prudent operator to be able to finance its functions (in the context of an absolute licence requirement to maintain IG status with two agencies at all times)?
3. **Investor confidence.** We are concerned that this potential change would adversely impact equity investor confidence and willingness to invest in the sector.

In summary, removal of the qualifying language, which has been a longstanding feature of the Investment Grade licence condition would be a significant and detrimental step by Ofgem.

Adequacy of finance resources

Ofgem's proposal to extend the timeframe does not come with sufficient detail for evaluation at this stage.⁴⁰ We note that a minimum of three years could create complications for assumptions when this period would extend into a next control period and before the related Final Determination would be made for it.

The SSC A37 certificate on adequacy of financial resources is typically issued at a different timepoint in every year than when (i) audited financial statements are published, from when the legal going concern test with a minimum 12 month period is applied, and (ii) when annual rating agency reports are issued. Therefore, in practice, at various time points throughout any year, there is a rolling basis of assurance that extends beyond the 12 months at the time the certificate is issued.

If Ofgem intends to move to a "viability" style statement⁴¹ this would impose additional financial reporting burdens for those licensees whose equity is not listed. These viability statements in listed entity accounts require materially higher resourcing and external audit review.

We would not be supportive of extending the timeframe for A37 if this led to increased liquidity costs at least without a corresponding revenue allowance.

For the reasons above, extending to a minimum of three years would be disproportionate, particularly in the context of a proposed move to two IG ratings.

⁴⁰ Finance Annex page 59, table 3 : "...it has sufficient financial resources to cover the entire price control period or a minimum of three years ahead" – therefore in the latter years of GD3 will extend into GD4 and so on.

⁴¹ Of the type required by Provision 31 of the Corporate Governance Code. https://media.frc.org.uk/documents/UK_Corporate_Governance_Code_2024_kRCm5ss.pdf

FQ16. Are there better ways to protect against excessive leverage and financial risks, in particular leverage via acquisition finance, by utilising existing powers rather than imposing new requirements in the licence?

- Ofgem’s stated view (RIIO-2 Final Determination, paragraph 2.43) is that prudence is represented by the requirement to maintain an investment grade rating as is currently defined and clearly qualified by the language in SSC A38, i.e. “reasonable endeavours”. Is Ofgem considering changing its formal position as to what is prudence?
- We ask Ofgem to clarify what is meant by “excessive leverage”.⁴² There is a reference to 80% and “regulatory gearing”. Is that intended to apply to cover Midco and Holdco debt?
- We do not see material scope/reason for improvement, within the existing regulatory measures, which we view as broadly adequate, particularly if Ofgem moves to two IG ratings - see our response on this at FQ15 above.

FQ17. For the SSMC we have not proposed dividend controls or dividend policy requirements. How should we think about protections to ensure that leverage at MidCo and/or HoldCo does not become disproportionately influential in decision making at the licensee with the potential for negative outcomes for consumers?

- We are not clear on the potential range of harms to consumers that Ofgem has seen or envisages. We ask Ofgem to detail these in the SSMD with commentary on the likelihood of each potential harm and if there is any evidence to support.
- Holdco/Midco structures are legitimate ways for shareholders of structuring capital employed and have been in force for many years in the GD/GT/ET and ED sectors. We are not aware of such structures being disproportionately influential on decision making at licensee level in the regulated energy networks and we would be interested to see any evidence Ofgem may have to the contrary.

⁴² SSMC, Finance Annex, Paragraph 6.31, table 3. In relation to Ofgem’s proposal to amend the dividend lock up by introducing a gearing test of 80%

- Additional dividend controls and policy requirements would likely be detrimental to existing and future equity investors in the gas distribution sector. Equity investment into long term infrastructure assets in this sector with its ongoing and comparatively low real growth rate carry an expectation of (i) an ongoing dividend and (ii) flexibility in varying that dividend for performance and market conditions.⁴³ Such measures would at least lean directly against investability and send the wrong signals from a regulatory stability and predictability perspective, as it has been a long established attribute of the regulatory construct that actual companies should be allowed to determine their own dividend policies within an investment grade context.

We ask Ofgem to consider very carefully any proposed action that would risk retrospective capture of, or impact on, prior legitimate decisions on capital structure, no matter how indirect that action may be. If it nonetheless intends to proceed with any such actions, it is essential that these are applied prospectively and only to (i) new midco and holdco capital transactions that relate to regulated operating companies and (ii) disproportionate actions. This may require a separate consultation process given the complexities involved and significant signalling implications for investors.

FQ18. Is there merit in amending the RFPR RIGs to include requirements for Licensees to undertake stress-testing, and to provide the results to Ofgem, as in the Retail sector and as the Prudential Regulatory Authority/Bank of England does for banks, to test for financial resilience?

- We do not believe so, in light of the financial resilience reporting requirements already in force and particularly should Ofgem decide to require two IG ratings instead of one.

⁴³ See Ofgem's statement in the RII0-2 draft Determination page 208 : "We do not restrict dividends for actual companies so to the extent they exhibit lower growth or outperform compared to our notional company assumptions we consider it acceptable for companies to determine their own dividend policy, provided they are transparent and well justified"

SECTION 7 OF THE FINANCE ANNEX: CORPORATION TAX

Corporation tax questions

FQ19. Do you agree with our proposal to align the RIIO-3 tax approach with RIIO-2 and RIIO-ED2 including; to maintain Option A - notional allowance with added protections; the approach to capital allowances, and "glide path"?

We agree with the proposals.

Regarding the scope of the TAXAt term, we are not clear with the language used paragraph 7.3. in the context of the existing RIIO-2 TAXAt provisions. Ofgem state at paragraph 7.3 that "the mechanism serves in the best interest of the consumers and is in line with the principal statutory objectives of Ofgem, ensuring that licensees do not benefit from undue financial gains if their actual tax liability is materially different from the notional tax allowance".

There can be many legitimate circumstances where actual tax is materially different to notional tax for a variety of reasons. This is particularly relevant to WWU, whose cost of debt including derivatives (efficiently incurred and prudently managed) is, as Ofgem is aware, significantly higher than the Kd allowance, and therefore has a lower actual tax charge. We seek confirmation from Ofgem that the TAXAt term is not intended to be applied in these circumstances. This would have significant adverse financeability consequences for WWU where consumers are not bearing WWU's actual cost of debt, and lead to a perverse outcome.

The scope of TAXAt in RIIO-2 is strictly limited to circumstances where there is material, unexplained differences between the Calculated Tax Allowance and Actual Corporation Tax Liability. We seek confirmation from Ofgem that for RIIO-3 a tax review may only be triggered by Ofgem where there are material, unexplained differences between a licensee's Calculated Tax Allowance and Actual Corporation Tax Liability because paragraph 7.3 does not make this point clear.

FQ20. Do you agree with the proposed revision to tax clawback methodology?

We do not agree.

Ofgem will be aware that Ground 4 of our submission to the High Court deals with the inconsistency within tax clawback regarding derivatives. This is in the context if Ground 3 (cost of debt) fails. Should Ground 4 succeed, derivatives should not therefore be included in actual interest costs or in tax deductible net interest and adjusted net debt due to inconsistency of treatment of derivatives, all within the context of tax clawback. Separately, we have an important point to raise in respect of tax clawback (TCB) methodology relating to excess interest, as follows:

Excess interest should be a fair reflection of the cost of excess gearing

- a. The policy objective of TCB is clear and not in dispute, i.e. to deter excess gearing.
 - b. Consequently, the determination of excess interest (i.e. the “positive benefit” test) should be a direct consequence of excess leverage- i.e. there should be logical consistency between excess gearing and excess interest.
 - c. The current methodology to determine excess interest does not achieve this logical consistency. If the gearing test fails, (i.e. actual gearing exceeds notional gearing) the excess interest test applies. Comparing all actual interest to the allowance for interest necessarily presumes that all the excess actual interest is caused by excess gearing. This will not be true in all cases, particularly for WWU.
 - d. WWU has significant excess interest even though gearing is currently less than notional gearing. Therefore, if actual gearing might exceed notional gearing in a future year by a very small amount – say 0.1% - the entire excess interest amount would be subject to clawback. This is clearly perverse.
 - e. Whilst determination of the exact amount of excess interest that is caused by excess gearing may be a time consuming and subjective task, a reasonable and proportionate approach to this end would be to pro rate the actual interest amount by reference to actual and notional gearing, i.e. $\text{actual interest} \times (\text{actual gearing} - \text{notional gearing}) / \text{actual gearing}$. This approach would appropriately disallow that element of the excess interest which should reasonably relate to excess gearing only.
 - f. Therefore, we ask Ofgem to make this proposed change in (e) above to the determination of the excess interest amount.
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SECTION 8 OF THE FINANCE ANNEX: Regulatory depreciation and economic asset lives

Overview from WWU:

The increased uncertainty on future demand for gas is a significant issue for the GDN sector. It is also a complex matter. The GDN's commissioned Oxera to produce a report⁴⁴ on this area. We trust Ofgem will find it helpful and we encourage Ofgem to engage with the GDN sector in the coming weeks and months.

FQ21. GD & GT: assuming re-openers are available and there is no adjustment to the allowed WACC, how should regulatory depreciation be used to address the uncertainty around the future path for gas and perceived asset stranding risk?

Our key observations and comments at this stage are:

1. We note Ofgem's policy statement in paragraph 8.1: "Our existing policy for RIIO-1 and RIIO-2 is to depreciate the RAV at a rate that broadly approximates the useful economic life of the network assets and incentivises investment efficiency".
2. The FES scenarios referenced by Ofgem are widely divergent in pathway trajectories, and each involves a downward trajectory in gas demand by 2050.
3. In paragraph 1.7, Ofgem contemplates possible payors to fund GDN RAV balances at 2050, and inter alia, notes in regard to investors paying: "Investors, although we recognise this would create asset stranding risk, could undermine regulatory stability and predictability and is likely not in the consumer interest". We agree with that statement and ask Ofgem to affirm this is its view throughout the remainder of the RIIO-3 consultation.
4. In paragraph 8.12, Ofgem states: "We recognise that a scenario where a RAV balance remains beyond the point of decarbonisation of the energy network could give rise to a perception of 'asset stranding' risk among investors in the gas networks. Asset stranding arises where a 'sunk' asset becomes unusable for its original purpose and unsuitable for resale or repurposing. Asset stranding without associated mitigations could lead to investors failing to recover their investment in the network over time. If material, this perceived risk could result in investors seeking compensation via the cost of capital for the gas networks."

⁴⁴ Oxera : Risks and investability of the Gas Distribution Network (GDN's) sector

5. Taking the Oxera report into consideration, we emphasise the following points:
- a. The risk is not confined to stranding of RAV - it includes the risk of not recovering future costs required to maintain a safe, reliable and resilient network serving customers every day, efficiency risk and outputs delivery risks.⁴⁵
 - b. We believe Ofgem has accepted the premise of asset stranding risk in the SSMC. It would be helpful if Ofgem confirmed this in the SSMD and used clearer language from SSMD onwards by removing text such as “perceived” or “perception” of this risk, or “could give rise to a perception of asset stranding risk”. Such language creates some uncertainty as to Ofgem’s actual policy stance.
 - c. The risk is asymmetric to the downside. There is no counterbalancing upside risk of over recovery of revenue. The risk has systematic components.⁴⁶
 - d. There are regulators internationally that apply both regulatory tools, the accelerated depreciation and the cost of equity uplift, to address the asset stranding risk.⁴⁷
 - e. Subject to our comments above and noting Ofgem’s key principle on intergenerational fairness in paragraphs 1.9 and 8.4, we would agree in principle with Ofgem that acceleration of RAV depreciation should help to reduce consumer bill impact in later control periods (e.g. GD5-GD7) approaching 2050 (we note figure 4 on consumer bill estimate) against a counterfactual of no acceleration.
 - f. However, RAV depreciation acceleration would not remove risk completely. Oxera noted :”Cash-flow remedies, such as accelerated depreciation and re-openers, which Ofgem is considering using to address the asset stranding risk in RIIO-GD3, are useful in mitigating the risk. However, they do not eliminate it, because uncertainty around networks’ future ability to recover their costs remains—for example, due to customer bills having to increase to an untenable level, especially if the user base shrinks in the future. Therefore, an uplift to the allowed return on equity relative to the ‘baseline’ allowance for a steady-state GB energy network would be justified.”⁴⁸
 - g. Sections 2A-2B, and section 4 of the Oxera report are particularly relevant here.⁴⁹

⁴⁵ Oxera ; Risks and investability of the Gas Distribution Network (GDN's) sector, paragraphs 2.2-2.5.

⁴⁶ Ibid, Executive Summary : “The **asset stranding risk** is a revenue shortfall risk, which is **asymmetric** and is likely to have **systematic** components.”

⁴⁷ Ibid, section 4.

⁴⁸ Ibid, Executive Summary, page 4.

⁴⁹ Oxera report : “Risks and Investability of the GB gas distribution sector”.

FQ22. GD & GT: what long-term path should regulatory depreciation aim to follow between 2026 and the assumed de-energisation point to promote fairness for current and future consumers? What unit metrics should this be based on? Is this resilient to the various scenarios under FES 2023?

Our key comments for the GD sector are:

- Balancing intergenerational fairness in the context of bill impact falls within a statutory duty (i.e. consumer interest duty) on Ofgem. We have noted Ofgem's interpretation of their policy options in this context in paragraph 1.9. Ofgem has other statutory duties that must be weighed properly in its decision making on the long term path of regulatory depreciation and also implications of demand risk more widely.
 - An orderly transition for the sector should be sought for all stakeholders. This is likely to be supported by, inter alia, making policy decisions that can be applied from the outset of RIIO-3, instead of deferring a policy decision on RAV depreciation through the channel of reopeners in RIIO-3 or worse, deferral of policy decision making to future control periods. We note Ofgem's comments in paragraph 1.8 that it must make decisions of RIIO-3 even though government policy may change. Ofgem should use the best information available at the time it makes its decisions, noting that future information, including government decisions, may change this at a subsequent price control.
 - We understand Ofgem has not modelled the impact of extending accelerated RAV depreciation to include RAV additions for GD3 because it does not have that information. It will have such information later in 2024. Given Ofgem's comment in paragraph 8.22 that new investment would be very unlikely to have a useful life into the 2060's in the context of a successful transition to Net Zero carbon by 2050, we therefore assume Ofgem will apply any accelerated depreciation change to such investment in addition to RAV at 31 March 2026. We ask Ofgem to confirm this point as soon as possible for business plan preparation and submission purposes.
 - The unit charge basis for consumers should await FES scenario updates in summer 2024 and further modelling by Ofgem to take account of RAV investment for GD3. We agree with Ofgem that the principle of smoothing charges across years is sensible in the context of seeking to achieve intergeneration fairness, recognising that the final decision for RIIO-3 is a matter for Ofgem to determine.
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We make the following final points:

1. If a change to RAV depreciation to greater acceleration would be constrained by consumer bill impact such that RAV balances at 2050 would likely still exist, we do not accept the premise that there would be purchasers available to buy network assets for repurposing to hydrogen, as is implied by paragraph 1.7 and also paragraph 1.8 where Ofgem states: “ Investors in the residual RAV would be made whole by the purchaser of the RAV, thereby mitigating asset stranding risk.” At this time, it is not possible to reliably determine investor appetite at 2050 for residual RAV given the significant uncertainty facing the sector.
2. We disagree with Ofgem’s rationale in 8.15: “Increases in the allowed returns on capital would increase consumer bills which may ultimately prove to be unnecessary with greater clarity, such as around the approach to RAV recovery or on government policy, in future periods. This suggests that consumers would be funding increased returns to investors for no tangible benefit, which would not be in the consumer interest. There would also be practical constraints to assessing and implementing an adjustment that was suitably commensurate with the perception of risk.” We refer Ofgem to Oxera’s report which makes the case for cost of capital adjustment.⁵⁰

FQ23. GD & GT: assuming there is a relevant gas reopener for government policy, is there a need to reopen regulatory depreciation policy intra-period?

We do not currently see a need for a reopener in GD3 for RAV depreciation. A reopener would not be suitable within a 5 year control period for a significant and complex decision such as acceleration of RAV depreciation.

Decommissioning strategy is a matter for UK Government and we ask Ofgem to work with UK Government to bring strategic proposals forward into GD3. It could be harmful to investor confidence to leave this matter strategically unresolved beyond GD3. In that context, a reopener for additional revenue charging at some point in RII0-3 (not just for the GDN sector) to establish a decommissioning fund would be appropriate as indicated in paragraph 8.24, to support cost allocation for intergenerational fairness.

⁵⁰ Oxera report : paragraph 4.9. “A cost of capital uplift also has the advantage of being flexible: if uncertainty around the scale or the timing of the asset stranding risk is removed, the cost of capital uplift can be adjusted accordingly, or even removed, which ensures that there is no double-counting of the risk in favour of networks.”

FQ24. GD & GT: what considerations are raised by asset repurposing and how might these affect the decisions to be made on regulatory depreciation policy? What guidance is sought for the SSMD so that licensees have sufficient clarity for their business plans?

We do not rule out the continued use or potential for repurposing gas network assets in the lead up to 2050 and thereafter. However, it is not possible to reliably determine timing and quantum at this time. We think it is unlikely that government policy will be sufficiently clear by Final Determination in December 2025

We see no evidence that willing purchasers would exist at 2050 to buy network assets for repurposing as suggested in paragraph 1.8.

For Business Plan purposes, we therefore ask Ofgem to assume no repurposing of network Assets in setting RIIO-3.

FQ25. ET: do stakeholders consider there to be a need for amending the existing RIIOET2 asset life and/or profile assumptions, on either a company-specific or sector basis? If so, please set out your evidence base and potential consumer benefits and costs of changing the existing methodology.

Not applicable to WWU.

FQ26. If a 'semi-nominal' cost of debt and WACC approach were to be adopted which results in an acceleration of cashflows, would this impact your responses to any of the questions above?

This would not materially change our comments on RAV depreciation acceleration. It would lead to considerably more complexity for Business Plan and financial modelling purposes.

SECTION 9 OF THE FINANCE ANNEX : Return Adjustment Mechanisms questions
FQ27. Do stakeholders have views or evidence as to why RAMs should or should not continue?

We have no issue with the concept of RAMs, but they should be appropriately calibrated and used.

FQ28. Do stakeholders have views or evidence as to whether the RAMs methodology should be amended, such as recalibrating the threshold or rates or including financial performance?

At this stage we continue to maintain our view stated in the RIIO-2 consultations, i.e. debt and tax performance should be included. Otherwise, the usefulness of RAMs is very limited, and makes it inconsistent with RFPR submissions on RORE. Therefore, we do not see how it can be used as a tool to support Ofgem's compliance with its finance duty or consumer interest's duty.

FQ29. Do stakeholders have views or evidence as to whether there should be separate RAMs for 'BAU' parts of the business and specific programmes, such as ASTI?

This would introduce complexity to what should be an all-encompassing measure. The potential benefits of a separate RAMs are not apparent.

SECTION 10 OF THE FINANCE ANNEX : OTHER FINANCE ISSUES

Capitalisation rates questions

FQ30. Is there a case for altering the capitalisation rate modelling approach between sectors (e.g. removing the multiple bucket approach for GD)?

We understand that over the course of a price control, regulatory capitalisation rates or fast/slow split, are broadly expected to be in line with the split of capital expenditure and operating expenditure and accordingly the modelling approach chosen should be the one that achieves this outcome. We do not consider there to be a case for altering the modelling approaches between sectors because the financial reporting standards that exist, and which apply across all sectors, determine what represents capital and operating expenditure.

FQ31. What are your views on retaining an ex-ante capitalisation rate for allowed totex, but reporting an outturn capitalisation rate for the purpose of calculating the totex incentive mechanism?

We do not agree with capitalisation rate modelling and totex incentive mechanism (TIM) approaches that are based on different methodologies. Retaining an ex-ante capitalisation rate for allowed totex and subsequently applying TIM to outturn capitalisation rates creates asymmetry to the extent outturn rates differ to those set ex-ante and could subject licensees to cash flow timing differences on Totex over/underspend.

Reopeners should have a bespoke capitalisation rate reflecting the approved spend mix under each reopener.

Directly Remunerated Services questions

FQ32. Are there any reasons why the RIIO-3 approach to directly remunerated services should differ from RIIO-2?

At this stage, we see no such reasons.

FQ33. Do stakeholders have any reasons or evidence to suggest more directly remunerated service categories are necessary?

At this stage, we do not have such reasons or evidence.

Disposal of assets questions

FQ34. Do stakeholders have views or evidence in support of or objection to treating all asset disposals as fast money? Would the existing or alternative approaches have greater merit?

To date, asset disposals have been negligible in size and we would expect this to continue for GD3. On that basis we suggest no change for assets with disposal proceeds up to a certain threshold.

However, large asset disposals (e.g for repurposing) might warrant different treatment and be subject to a reopener provision with a proposal to treat slow/fast percentages under the circumstances at the time – see our comments on FQ 35 below.

FQ35. Do stakeholders have views or evidence as to what reporting information should be provided to Ofgem (under the RPFs or other forms) to ensure objective identifiability of repurposed assets and cost data remains appropriately like-for-like?

We do not see scope for material repurposing in GD3, at this time. Should any material repurposing projects emerge, we would expect these to be dealt with by reopener applications. Data requirements can be set as part of that process.

We note Ofgem's comments in paragraph 10.29. Given Ofgem's Net Zero Carbon duty, the repurposing process should be given a strong incentive impulse underpinned by efficient process. We look forward to Ofgem's comments in this area.

Transparency through RIIO-3 reporting questions

FQ36. Do you consider that the existing reporting requirements on executive pay/remuneration, dividends and corporate governance previously introduced for RIIO-2 price controls remain appropriate in helping demonstrate the legitimacy and transparency of company performance?

RIIO-2 introduced Corporate Governance reporting into annual RFPR submissions and statutory financial statements contain significant details on executive remuneration and performance against core regulatory outputs. We have not received any feedback from Ofgem in these areas from RFPR submission in RIIO-GD2 to date. We would welcome any feedback.

We have taken note of Ofgem comments on paragraph 10.40 :

"As flagged in Chapter 6, we will be reviewing and likely consulting separately on the RIGs to highlight the importance of financial resilience reporting and ensure we have a comprehensive suite of early warning indicators for financial resilience issues. We believe that at a minimum we need to have greater scrutiny over the decision making around distributions and licensee groups financial structures. We are also open to views and suggestions on how we should think about and manage the risks of high levels of leverage at MidCo and HoldCo companies that could negatively impact decision making and the resilience of the licensee."

And we have noted Ofgem's extensive references to Ofwat's actions.

It is not obvious why Ofgem seeks greater scrutiny on decision making for distributions in the context of financial resilience. Such scrutiny does not necessarily lead to greater financial resilience, which typically comes with a cost. With regard to Midco/Holdco structures, we refer Ofgem to our comments thereon in FQ17. Ofwat's measures are not necessarily appropriate for energy.

FQ37. Do you have any other suggestions for clarifying or strengthening the reporting requirements with regard to executive pay/remuneration, dividends or corporate governance?

At this time, we do not have suggestions for additional reporting in these areas.

Financial modelling questions

FQ38. Do you have any suggestions on how to improve and future-proof the price control financial model, or use cases it could better support?

There have been significant improvements to the RIIO-2 Price Control Financial Model (PCFM) since the step-change from RIIO-1. It is transparent, fit for purpose, and inputs/mechanisms are familiar to, and understood by, stakeholders. Therefore, we do not have any suggestions to further improve the PCFM for RIIO-3. Any further enhancements should be well understood and flagged early to ensure no surprises and buy-in from users.

Whilst we appreciate Ofgem's intention to create a consistent set of "core" calculations and better documenting/simplifying PCFM calculations, we do not consider that a further step-change from the RIIO-2 PCFM is appropriate for RIIO-3, particularly due to the constrained timeframe, because it increases regulatory burden and the scope for modelling errors and might also reduce transparency and understandability.

We note Ofgem's ambition and reasons⁵¹ for removing reliance on excel-based transmission of regulatory data and implementing new reporting systems and will engage with Ofgem in respect of the application of this to the PCFM in the external engagement phase from January 2025.

Given Ofgem's decision in the July 2023 Open Letter⁵² to implement a medium-term streamlined ex-ante price control for RIIO-3, with the enduring framework being designed to start at the end of the next price control period, we do not consider RIIO-3 to be the appropriate price control to future-proof the PCFM to enhance the adaptability of the model to handle new policies and mechanisms being added/removed as Ofgem is aiming to achieve a price control broadly similar to RIIO-2 but with simplifications where possible.

⁵¹ [RIIO-3 Sector Specific Methodology Consultation – Overview Document](#) paragraph 13.11

⁵² Open Letter on Future of Gas Price Controls: <https://www.ofgem.gov.uk/publications/open-letter-decision-future-gas-price-controls>

During the RIIO-3 price control, following the Government decision in 2026 on whether hydrogen is part of the solution to decarbonising home heating, it will be important to consider how the PCFM for subsequent price controls commencing after 31 March 2031 should be improved/future-proofed once the policy decision has been made.

FQ39. What are your views on allowing licensees to self-publish the PCFM with their charging statements, rather than relying on an Ofgem publication or direction to determine allowed revenue?

Ofgem's rationale in paragraph 10.50 is:

"We believe this proposal to be a continuation of the decisions we made in the RIIO-GD&T2 price controls, that is, to move away from a directed AIP in recognition that the licence itself determines how much revenue licensees can collect. Moving towards a process that can run with less intervention from the regulator would also enable licensees to more easily reflect changes to their variable values where those are subject to volatile fluctuations and would make the price control more cost-reflective. This proposal has received broad support from electricity distribution licensees in our discussions to date. "

We do not, in principle, oppose PCFM self-publication subject to:

- The PCFM remaining a Price Control Financial Instrument governed by the appropriate statutory modification process
- Comprehensive and unambiguous guidance being provided by Ofgem in respect of how to update the PCFM Variable Values
- Ofgem retaining ownership of, and responsibility for, the PCFM and making any required policy/methodology changes to the model following any updated Special Conditions of the Gas Transporters Licence (GTL) post consultation
- Ofgem acknowledging that there will continue to be PCFM Variable Values subject to direction e.g., Supplier of Last Resort costs via Miscellaneous Pass-through (MPt), legacy close-out adjustments, and other revenue allowances and uncertainty mechanisms

FQ40. What are your views on applying a single time value of money in the financial model to all prior year adjustments, based on nominal WACC?

This is a simplification measure, which we support.

RIIO-3 Consultation Glossary of Terms

AER – Annual Environmental Report
ARP4 – Adaption Reporting Power
BAU – Business As Usual
BPDT – Business Plan Data Tables
BPI – Business Plan Incentive
CAF – Cyber Assessment Framework
CAWG – Cost Assessment Working Group
CBA - Cost Benefit Analysis
CDS - Complex Distribution Systems
CISBOT - Cast Iron Joint Sealing Robot
C-MeX - customer measure of experience
CNI – Critical National Infrastructure
CNIA - Carryover NIA
CSNP – Centralised Strategic Network Plan
CPIH - Consumer Price Index
CV – Calorific Value
CVP – Consumer Value Proposition
DAG – Data Assurance Guidance
DESNZ - Department for Energy Security and Net Zero
DLCA - Domestic Load Connection Allowance
DNO – Distribution Network Operator
DPLA - Digital Platform for Leakage Analytics
EAP - Energy Action Plan
ENA - Energy Networks Association
EUSE - End User Safety Group
FEED - Front End Engineering Design
FES -Future of Energy Scenarios
FPNES - Fuel Poor Network Extension Scheme
FRS – Future Regulation Sandbox
FSO – Future System Operator
GD1 - RIIO Gas Distribution Period 1, 2013 - 2021
GD2 - RIIO Gas Distribution Period 2, 2021 – 2026
GD3 – RIIO Gas Distribution Period 3, 2026 – 2031
GDN – Gas Distribution Network
GEMA - Gas and Electricity Markets Authority
GSoPs -Guaranteed Standards of Performance
GSUIR - Gas Safety Installation and Use Regulations
GW-SHIFT - Great Western Supercluster of Hydrogen Impact for Future Technologies
HSE – Health and Safety Executive
HTBM – Hydrogen Transport Business Model
IMRP – Iron Mains Replacement Programme
ISG – Independent Stakeholder Group

IT&T – IT and Telecoms
KPIs – Key Performance Indicators
LAEP – Local Area Energy Plans
LCT – Low Carbon Technology
LDZ - Local Distribution Zone
LTR – Long Term Risk
MEAV - Modern Equivalent Asset Value
MOBs - Multi Occupancy Buildings
NARM – Network Asset Risk Metric
NESO – National Energy System Operator
NIA – Network Innovation Allowance
NIC - Network Innovation Competition
NRSWA - New Roads And Street Works Act
NSPCC - The National Society for the Prevention of Cruelty to Children
NZARD - Net Zero and Reopener Development Fund
NZASP - Net Zero Pre-construction Works and Small Net Zero Projects Reopener
ODI-R - Reputational Output Delivery Incentive
ODI-F - Financial Output Delivery Incentive
OE – Ongoing Efficiency
OFWAT - The Water Services Regulation Authority
PCDs – Price Control Deliverables
PSR – Priority Service Register
RESP – Regional Energy Strategic Planners
RIGs - Regulatory Instructions and Guidance
RPEs – Real Price Effects
RPI-x - Retail price inflation - x
RRP – Regulatory Reporting Pack
SI - Statutory Instrument
SIF - Strategic Innovation Fund
SMART - Specific, Measurable, Achievable, Relevant, and Time-Bound
SPS - Strategy and Policy Statement for Energy Policy in Great Britain
SRoI - Strategic Return on Investment
SSMC – Sector Specific Methodology Consultation
SSMD – Sector Specific Methodology Decision
TFP – Total Factor Productivity
TIM - Totex Incentive Mechanism
TRL – Technical Readiness Level
UIOLI – Use It Or Lose It
UKRI – UK Research and Innovation
UM – Uncertainty Mechanism
VCMA - Vulnerability and Carbon Monoxide Allowance
WWU – Wales & West Utilities