Transcript of SSMC IR call on 13th December 2023

Akshay Kaul
Good afternoon, everybody.

0:12:27.130 --> 0:12:48.990
Akshay Kaul
And a very warm welcome to this investor call on the sector specific methodology consultation for the next round of price reviews known as the RIIO-3 gas distribution and gas and electricity transmission price reviews and a very good afternoon or good morning or good evening to you wherever you are joining us from around the world.

0:12:49.700 --> 0:13:5.880
Akshay Kaul
And I'm going to make a few opening remarks in terms of housekeeping and then I'm going to hand over to our chief executive, Jonathan, really, who's going to set out the broader context and the key headlines from the consultation that we're putting out today.

0:13:6.510 --> 0:13:11.800
Akshay Kaul
Then we'll go on to our director for network price controls.

0:13:11.810 --> 0:13:28.0
Akshay Kaul
Steve McMahon will give you an overview of the sector specific methodology consultation as a whole and then I know that a lot of audience members on the call will be particularly interested in drilling into the finance details.

0:13:28.10 --> 0:13:37.250
Akshay Kaul
And so Mick Watson, our chief financial advisor, is going to take us through some of the details of the finance package and then we'll open up for Q&A.

0:13:38.650 --> 0:13:42.710
Akshay Kaul
And then finally, we'll close with some timelines and next steps.

0:13:43.360 --> 0:13:46.190
Akshay Kaul
I would ask that you hold back your questions for the Q&A.

0:13:46.200 --> 0:13:54.880
Akshay Kaul
By all means, type them into the chat if that's most convenient, or you can always raise your hand and then I will bring you in the Q&A session.

0:13:55.40 --> 0:13:59.130
Akshay Kaul
But do wait until we get to the Q&A session to raise your questions.

0:13:59.780 --> 0:14:4.50
Akshay Kaul
So with that, let me hand over to our chief executive, Jonathan Brearley.

0:14:6.60 --> 0:14:7.640
Jonathan Brearley
So, good afternoon, everyone.

0:14:7.690 --> 0:14:14.320
Jonathan Brearley
It's great to be here talking to you all about our new consultation for the next price control process.

0:14:14.490 --> 0:14:17.500
Jonathan Brearley
For those of you don't know me, I'm Jonathan Brearley, CEO of Ofgem.

0:14:17.890 --> 0:14:28.540
Jonathan Brearley
And you may know that when I started in Ofgem in 2016, it was in the networks part that I started, so welcome to all of you and I'm sure this will be a familiar conversation that we're going to be having over the coming years.

0:14:29.190 --> 0:14:39.890
Jonathan Brearley
Now I know that many of you have been involved in the RIIO-2 journey and the drive to improve our network regulation, learning the lessons from the past and repositioning the networks for the challenges that lie ahead.

0:14:40.900 --> 0:14:49.550
Jonathan Brearley
Since setting the first set of RIIO-2 controls three years ago, our energy system, like most other countries across the world, has faced enormous challenges.

0:14:50.320 --> 0:14:58.530
Jonathan Brearley
Now we've been on the net zero journey for some time, but in my view, those challenges make the case for the change stronger than it's ever been previously.

0:14:58.940 --> 0:15:7.350
Jonathan Brearley
We need an energy system that is better equipped to cope with geopolitical shocks, better for energy security, better for the planet and better for customers’ bills.

0:15:8.340 --> 0:15:28.140
Jonathan Brearley
So my main message today is that we are acknowledging the world is changing the way, therefore we need to regulate is changing and through these new price controls, we need to see the scale and pace of investment change to meet the targets and aspirations that this government and any future government will set.

0:15:28.830 --> 0:15:36.320
Jonathan Brearley

That means simplifying the processes wherever possible, speeding up delivery and taking an increasingly sector specific approach.

0:15:37.50 --> 0:15:43.550
Jonathan Brearley
And in a sense, I'm going to talk about the different sectors as the next steps of my introduction and I'm sure the team will expand on that later.

0:15:44.220 --> 0:15:58.130
Jonathan Brearley
First of all, accelerating transmission build. So starting with electricity transmission, we know that to meet our net zero goals, we are going to need to use much more electricity and the grid will need to expand to accommodate that.

0:15:58.540 --> 0:16:9.330
Jonathan Brearley
This must be done in a macroeconomic environment that is challenging with inflation increasing and the price of core materials and interest rates continuing to impact financing costs.

0:16:9.820 --> 0:16:17.340
Jonathan Brearley
But despite these challenges, the need to build out that infrastructure quickly and at low cost to consumers remains as strong as ever.

0:16:18.170 --> 0:16:23.540
Jonathan Brearley
A new strategic approach to how we plan the system has meant we have already moved forward.

0:16:23.670 --> 0:16:36.520
Jonathan Brearley
Some of the changes needed for RIIO 3 as seen by the holistic network design and ASTI decisions taken last year and through the new future system operator, a more effective approach to system planning.

0:16:37.70 --> 0:16:43.120
Jonathan Brearley
So there's a great deal to build off already in the way we will be thinking about transmission and by implication, transmission price controls.

0:16:44.380 --> 0:16:49.360
Jonathan Brearley
Then moving on to the future of the gas grids for the gas sector, working alongside government.

0:16:49.370 --> 0:17:4.170
Jonathan Brearley
There are clearly a different set of challenges we face, including the role of gas in power generation, ensuring safe and secure supplies, gas future role in industrial processes and domestic heat, and of course the hydrogen question.

0:17:5.350 --> 0:17:18.140
Jonathan Brearley
Additionally, there remains a number of strategic uncertainties we must start to consider, including

how we guard against potential asset stranding risk and tackling the potential decommissioning of gas infrastructure that is not needed.

0:17:19.30 --> 0:17:30.540
Jonathan Brearley
We have not arrived at any policy position on these yet and I really do encourage all of you to continue to engage with us as we unpack these issues and help us shape the regulatory decisions that we need to take.

0:17:31.330 --> 0:17:48.820
Jonathan Brearley
So summing up, one of the Ofgem's most important jobs is to create an environment for our energy sector that continues to grow and become more competitive, so that the huge sums of investment we know we need to make towards our net zero goals are raised successfully and at a low cost to consumers.

0:17:49.720 --> 0:17:53.260
Jonathan Brearley
That's the balance we are looking to strike through our design of the RIIO 3.

0:17:53.270 --> 0:17:56.650
Jonathan Brearley
And again, I really do welcome your engagement in this process.

0:17:57.220 --> 0:18:11.970
Jonathan Brearley
If network companies act fairly and if customers and communities are looked after with commitments delivered on time and to a high standard, then I believe this is the biggest economic opportunity that this energy sector has been given in decades.

0:18:12.220 --> 0:18:19.700
Jonathan Brearley
So in essence, if we all understand where each of us is coming from, you commit to make sure that reasonable returns are taken out of the system.

0:18:20.210 --> 0:18:28.940
Jonathan Brearley
There is a massive opportunity both for investors and companies alike and with that I will hand back to Steve or Akshay to take to the next section.

0:18:29.10 --> 0:18:29.350
Jonathan Brearley
Thank you.

0:18:31.210 --> 0:18:32.100
Steven McMahon
Thanks, Jonathan.

0:18:32.350 --> 0:18:33.840
Steven McMahon
I think it's over to me now.

0:18:34.250 --> 0:18:39.260
Steven McMahon
So just building on that introduction, I'll add my own welcome to those that are joined in the call.

0:18:39.730 --> 0:18:40.880
Steven McMahon
My name is Steve McMahon.

0:18:41.670 --> 0:19:2.120
Steven McMahon
I'm the interim director for network price controls, Ofgem and I am the SRO for the RIIO-3 programme and today marks a significant milestone in that new RIIO-3 programme coming shortly after we confirmed the future systems and network regulation framework just at the end of October, we're now setting out the next step in this journey.

0:19:2.130 --> 0:19:9.880
Steven McMahon
Consulting on the methodologies that will give effect to that framework for each of the sectors, including the financial methodology.

0:19:10.100 --> 0:19:24.690
Steven McMahon
I think as it will be known to you guys we're now just over halfway through the 1st tranche of the RIIO-2 price controls for these sectors and the same arrangements for electricity distribution only got underway earlier this year.

0:19:24.740 --> 0:19:37.650
Steven McMahon
But we are firmly focused, as Jonathan said, on the changes needed going forward to ensure that the networks are facilitating the significant acceleration towards a lower cost and more secure low carbon energy system.

0:19:37.710 --> 0:19:52.360
Steven McMahon
You know, any regulator constantly looks to make improvements through each successive price review that we're responsible for learning lessons from the past and then repositioning a regulation for the new challenges that lie ahead.

0:19:53.360 --> 0:20:21.220
Steven McMahon
In many respects the RIIO model that's been in place since 2013 has been a fantastically successful model, but the key challenge moving forward is to ensure that our network regulation can adapt to the new macro challenges that Jonathan touched on in his own introduction and particular that need to accommodate the rapid acceleration towards low carbon generation, increased domestic electrification and the transition away from natural gas.

0:20:22.600 --> 0:20:30.220
Steven McMahon
As Jonathan said, I think a lot of you folks would have been involved in similar discussions around the RIIO-2 process.

0:20:30.480 --> 0:20:36.570
Steven McMahon
I think it's fair to say we are in a very different position to where we were at the start of the method design.

0:20:36.580 --> 0:20:41.890
Steven McMahon
I think for those RIIO-2 controls, the context is different and I think the challenges are different.

0:20:42.140 --> 0:20:51.790
Steven McMahon
The early phases of RIIO-2 design in particular tended to have quite a big focus on how we should go about fixing some of the problems that we've seen in the RIIO-1 controls.

0:20:52.220 --> 0:20:59.100
Steven McMahon
I think particularly high and sustained levels of outperformance that had generally been seen across most of these sectors.

0:20:59.110 --> 0:21:3.360
Steven McMahon
So that had become the story and the narrative and everything getting tightened up.

0:21:3.590 --> 0:21:15.880
Steven McMahon
I think in response to that through the RIIO-2 arrangements, but also having that adaptability to look at what was coming ahead, clearly we don't lose sight of the need to protect consumers and keep costs low.

0:21:16.170 --> 0:21:28.840
Steven McMahon
But for RIIO-3, we need to be much more forward looking and focused on solving the problems of tomorrow and ensuring our network regulation drives that accelerated delivery to net zero.

0:21:29.860 --> 0:21:44.320
Steven McMahon
So moving on to the next slide and step it into some of the detail, broadly speaking our consultation today is structured around 4 core principles.

0:21:44.330 --> 0:22:2.280
Steven McMahon
So these are establishing infrastructure fit for a low cost transition to net zero, establishing secure and resilient supplies, ensuring a high quality of service from each of the networks, and then ensuring system efficiency and long term value for money for consumers.

0:22:3.350 --> 0:22:11.640
Steven McMahon
Now starting with the infrastructure needed for net zero and what this means for each of the sectors, Jonathan gave a really clear introduction in that.

0:22:11.950 --> 0:22:27.620
Steven McMahon

But just to maybe pick up on some of those key themes. A key change from RIIO-2 across all sectors is that we are progressing the design of the networks and a context of a system that will be more strategically planned.

0:22:27.990 --> 0:23:2.420
Steven McMahon
And this is certainly the case for electricity transmission just now, but that will shortly extend to gas transmission through the future system operator and gas distribution through the new regional energy strategic planners, a decision on which was confirmed just last month. And it will be these new strategic planners that increasingly direct the approach to network investment going forward facing up to the distinct challenges faced across each sector and providing definition for the investment needed in those sectors.

0:23:3.260 --> 0:23:15.290
Steven McMahon
In electricity transmission we are going to be planning that system more strategically through the FSO and that gives us a new foundation for how we set investment and regulate the networks.

0:23:15.880 --> 0:23:33.610
Steven McMahon
The signal is that our regulation, as adapting at pace around this, including the timing of regulatory decisions and approvals, how we approach cost assessment, how we approach the design of incentives, all of which need some degree of evolution from what we've been used to in the past.

0:23:34.310 --> 0:23:50.80
Steven McMahon
We still need a robust, coherent approach, but also must meet the objective of fast paced, high quality and low cost for consumers will still seek to provide regulatory stability and predictability to maintain investor confidence.

0:23:51.50 --> 0:23:58.160
Steven McMahon
As Jonathan said, some of these changes that we had been looking at for RIIO-3 have already been brought forward into the RIIO-2 controls.

0:23:58.870 --> 0:24:14.690
Steven McMahon
But for RIIO-3, we will be introducing a new major project through to consider investments as they arise from that strategic planning process, we will design and adapt these processes including the like the new role of the independent technical advisor.

0:24:14.900 --> 0:24:24.970
Steven McMahon
So that Ofgem can ensure speed, quality and low cost are delivered for consumers without Ofgem approvals or regulatory approvals slowing down that process.

0:24:24.980 --> 0:24:37.630
Steven McMahon
And overall, we expect that this approach will provide early certainty to the transmission owners, the supply chain and investors regarding which projects need to be built to deliver that net zero future.

0:24:39.290 --> 0:24:57.120
Steven McMahon
Thinking about gas again, as Jonathan said, we are working alongside government against a different set of challenges, whether that be the role of gas and power generation, ensuring safe and secure supplies, all the future role in industrial processes and domestic heat.

0:24:57.190 --> 0:24:59.980
Steven McMahon
And there's the hydrogen question that goes alongside that.

0:25:0.510 --> 0:25:10.390
Steven McMahon
Additionally, there remains a number of strategic uncertainties that we must start the conversation on now and key areas where we just know that the status quo regulatory position won’t be sustainable under any likely pathway to net zero.

0:25:14.600 --> 0:25:23.470
Steven McMahon
So that includes how costs are recovered over time as charges for the networks are potentially levied on a shrinking pool of gas customers.

0:25:24.100 --> 0:25:46.620

Steven McMahon
How we guard against potential asset stranding risk by moving to accelerate or potentially accelerating the depreciation profile from RIIO-3 onwards and then tackling the potential question around decommissioning of the gas network infrastructure assets that may not be needed in late 2030s and early 2040s.

0:25:46.740 --> 0:25:56.330
Steven McMahon
And clearly, as Jonathan said, look, we've not arrived at any policy position on these yet and in some cases we don't control like the policy direction on it.

0:25:56.340 --> 0:25:59.750
Steven McMahon
And we have to work quite closely, I think with government in that regard.

0:25:59.900 --> 0:26:21.660
Steven McMahon
So we've deliberately covered these issues in a balanced and neutral way that doesn't presume a particular position and that's what we're encouraging stakeholders to engage with as we unpack these issues and help shape the regulatory decisions that we need to take going forward and just moving on to this new space, our own secure and resilient supplies.

0:26:21.670 --> 0:26:35.760
Steven McMahon
I'm not going to spend too much time on the policy detail here, but what is clear is that we expect all of the companies to deliver a safe, secure and resilient network that is efficient, that is increasingly data rich and is responsive to change.

0:26:36.140 --> 0:26:46.410
Steven McMahon
And I think in particular, we recognise the significance of climate change and exacerbating extreme weather events, whether that's been wind, that's been a historical problem we've had to deal with.

0:26:46.820 --> 0:27:1.910
Steven McMahon
And going back to the Storm Arwen in 2021 or more recently, some of the challenges on assets brought by severe flooding and so there's a critical importance here of the future energy systems being developed with acceptable levels of resilience against these threats.

0:27:1.920 --> 0:27:3.510
Steven McMahon
We've seen lots of progress.

0:27:3.520 --> 0:27:18.850
Steven McMahon
I think it's been important to see across the networks since Storm Arwen 2 years ago, but it's important that we build on that and continue to build on that across all of the sectors, and we also must ensure that through our regulation, the networks are resilient to the height of cyber attacks.

0:27:19.140 --> 0:27:27.870
Steven McMahon
I think particularly is to become increasingly reliant on more automated interconnected technologies and systems as we move towards net zero.

0:27:27.940 --> 0:27:36.910
Steven McMahon
Again, significant progress made in this area under RIIO-2 and we're now looking to build on that for RIIO-3 to ensure full compliance with the relevant regulations.

0:27:37.80 --> 0:27:47.780
Steven McMahon
And I think finally on this theme, we're recognizing the need for the companies to invest in and deliver a modern, diverse, high quality, well trained workforce that's fit for the future.

0:27:48.30 --> 0:28:4.740
Steven McMahon
And I think that's particularly important given the way that economic challenges we see through the labour market and supply chains, but with certainty, we aim to provide on the investment needs, then we can expect that the companies are able to proactively manage against these challenges.

0:28:5.510 --> 0:28:19.440
Steven McMahon
So just moving on to the next slide around quality of service across all of the RIIO-3 price controls we expect and a robust package of outputs and incentives to remains a key part of the price control contract for companies and consumers.

0:28:19.450 --> 0:28:26.860
Steven McMahon
We expect outputs and incentives to drive companies to deliver higher levels of service quality across the areas that matter most.

0:28:27.280 --> 0:28:48.20
Steven McMahon
I think we're holding account to ensure that service levels don't slap, whether that be in terms of providing safe, uninterrupted supplies of power or gas, or dealing with a more iconic challenges that we currently face, for example, and the electricity networks around connections and reducing the time it takes to get connected into the grid.

0:28:48.340 --> 0:28:53.740
Steven McMahon
The incentive packages across each of these sectors will be developed through the consultation process.

0:28:53.930 --> 0:29:25.400

Steven McMahon
It's another key area that we're looking to simplify, I think largely rolling forward the RIIO-2 arrangements where these are functioning well and proposing only changes where there is a strong case to do so in many areas, as you would seem to, there are consultation questions on these mechanisms and the incentive properties that go alongside them are deliberately left open, I think, largely reflecting the fact that we're only midway through the RIIO-2 controls, but that's something that we expect to evolve between now and the methodology decision into next year.

0:29:26.400 --> 0:29:41.990
Steven McMahon
And then finally from me, just in terms of system efficiency and long term value for money, clearly from any regulator you would be expecting the network companies to deliver an efficient cost to service, minimizing the cost to consumers from the system transformation.

0:29:42.50 --> 0:29:56.200
Steven McMahon
And ensuring consumers and network users get a fair deal. That gets down into the detail of our cost assessment approaches and that again develops as we move through the different phases of the price review.

0:29:56.210 --> 0:30:16.240
Steven McMahon
But it's important for us to set out some of the key principles and foundations that we then build up over time, and I think some of that clarity will come through the business plans guidance that we publish next year. Broadly speaking, in our framework we concluded that from a cost assessment perspective, the RIIO-2 framework provides a suitable adaptable starting point for RIIO-3.

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Steven McMahon
Nonetheless, I think we also committed to exploring simplification opportunities and the cost assessment process and more generally for cost efficiency incentives wherever possible.

0:30:28.260 --> 0:30:32.30
Steven McMahon
The key thing for us here is learning some of the lessons that we had from RIIO 2.

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Steven McMahon

But critically, I think positioning that cost assessment for the specific challenges that we face in each of the sectors. So in the consultation today we set out some of the key thinking and design areas across that approach and nothing is set in stone.

0:30:49.290 --> 0:30:55.60
Steven McMahon
Again, it's an area that we would expect to evolve through the technical working groups with the companies.

0:30:55.230 --> 0:30:58.220
Steven McMahon
So that's probably all I was going to say in the policy context.

0:30:58.230 --> 0:31:3.570
Steven McMahon
I'll stop there and I'll hand over to my colleague, Mick Watson, who will cover the financial framework.

0:31:5.470 --> 0:31:6.200
Mick Watson
Good afternoon.

0:31:7.850 --> 0:31:11.670
Mick Watson
My name is Mick Watson, the chief financial advisor at Ofgem.

0:31:12.690 --> 0:31:22.710
Mick Watson
I'm going to give you an overview of the themes within the financial framework for RIIO-3 before providing a high level overview of the key proposals we are making.

0:31:22.780 --> 0:31:28.640
Mick Watson
I will be happy to take any questions that you have and anything to do with the financial framework at the end of the presentation.

0:31:33.880 --> 0:31:43.960
Mick Watson
So the overall the message is that we're proposing a financial framework for RIIO-3 that is broadly stable and follows the familiar one package approach that we used in RIIO-2.

0:31:44.940 --> 0:32:5.860

Mick Watson
As we flagged in the FSNR framework decision, we believe that this consistency in our approach towards risk and returns will help to maintain investor confidence in the sector and ultimately will help to ensure that consumers benefit from the investment in infrastructure that Steve mentioned and that they can do so at the best possible value.

0:32:6.980 --> 0:32:11.560
Mick Watson
To this end, we have introduced the concept of investability alongside financeability.

0:32:13.550 --> 0:32:24.80
Mick Watson
And acknowledging that there may be particular challenges related to the raising the significant amounts of capital that will be required to help support the government's net zero ambitions.

0:32:24.90 --> 0:32:32.30
Mick Watson
As ever, we are also looking to make targeted improvements to our methodologies and policies.

0:32:32.380 --> 0:33:5.490
Mick Watson
These typically reflect best practice in regulation, such as incorporating the recommendation in the 2023 UKRN cost of capital guidance and making sure we are thinking proactively about financial resilience measures. Improvements that we flagged in the FSNR framework decision, such as the potential benefit of setting beta at the network type rather than for the energy network sector as a whole and updates to regulatory depreciation policies to make sure we are aligned with net zero policy development.

0:33:6.120 --> 0:33:22.420
Mick Watson
And as you have seen from our announcement last week, we are incorporating our findings in relation to the inflation call for input into the ongoing consultation about ways we might be able to improve and refine our approach to setting the allowed return on debt.

0:33:24.860 --> 0:33:31.510
Mick Watson
As an overview point, I want to flag that we are not providing an indicative cost of capital range at this stage.

0:33:32.140 --> 0:33:43.290
Mick Watson
I see the proposals in the SSMC as an opportunity to share our thoughts on best practice and to engage with the range of stakeholders to make sure that we are getting the building blocks of the methodologies right.

0:33:44.310 --> 0:33:59.830
Mick Watson
We expect to start providing an early view on the cost of capital in our sector specific methodology decision, the SSMD, based on evidence that we receive in this consultation, we expect to publish the SSMD by the end of quarter 2024.

0:34:0.760 --> 0:34:10.680
Mick Watson
The clarity, a final decision on returns, will be provided in our final determinations in late 2025 and this will factor in prevailing market conditions at that time.

0:34:13.550 --> 0:34:27.930
Mick Watson
To that next slide, moving on the cost of equity, that's the slide shows we are proposing approach to calculating the cost of equity that is very much in line with both the approach that we used in RIIO-2 and the recommendations within the UKRN guidance.

0:34:29.110 --> 0:34:39.400
Mick Watson
While there were many small tweaks to any element of calculation methodology, if there was evidence to, well, there may be small tweaks to any element of the calculation methodology.

0:34:39.530 --> 0:34:47.640
Mick Watson
If there's evidence to do so. I would like to highlight two main areas where we are proposing incremental improvements to the approach used in RIIO-2.

0:34:49.180 --> 0:34:59.420
Mick Watson
But the calculation of TMR within the CAPM framework, the UKRN guidance recommends placing weight on evidence from both historical ex post and historical ex ante approaches.

0:35:0.990 --> 0:35:5.920
Mick Watson
The TMR estimate in RIIO-2 was primarily focused on historical ex post data.

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Mick Watson
So we're proposing a methodological update here, and we'll be seeking evidence on the most appropriate way to implement this.

0:35:14.850 --> 0:35:17.160
Mick Watson
I would also like to flag the potential changes on beta.

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Mick Watson
We expect the basic mechanics of the calculating beta will be very consistent with RIIO 2 and the UKRN guidance recommendations.

0:35:26.690 --> 0:35:48.200
Mick Watson
However, in the FSNR framework decision, we did flag that it may be appropriate to set different betas for different network types if there was sufficient evidence of risk profiles diverging in the future. This would be a change to RIIO-2 aimed at ensuring that the risk that investors are facing continue to be appropriately reflected in the allowed return.

0:35:49.710 --> 0:36:9.390
Mick Watson
This updated approach may involve introducing new comparators within the data, or may involve keeping the same comparators but being more selective on the historical timeframes of the data we consider. We welcome evidence on this topic from stakeholders. And moving on to cost of debt.

0:36:11.300 --> 0:36:27.480
Mick Watson
As we look at the cost of debt, the key challenges we are seeking to address in RIIO are the higher and more uncertain rate environment, elevated capital requirements compared to historic periods for electricity transmission.

0:36:29.80 --> 0:36:32.150
Mick Watson
Greater divergence in a capital requirement between licensees.

0:36:33.770 --> 0:36:40.210
Mick Watson
Mitigation or removal of the alt underperformance risk associated with inflation variances.

0:36:41.720 --> 0:36:49.840
Mick Watson
We seek to build upon the strong foundations of the current cost of debt methodology while addressing the highlighted areas.

0:36:52.450 --> 0:36:55.620
Mick Watson
This will be conducted in line with the UKRN guidance.

0:36:55.930 --> 0:37:2.520
Mick Watson
The key areas to call out are: the proposal to weight the trailing average by RAV growth and a refinancing assumption.

0:37:3.650 --> 0:37:13.920
Mick Watson
We believe this will improve the responsiveness of the allowance to changes in the rate environment and also help to address future diverging capital requirements between licensees.

0:37:15.200 --> 0:37:32.160
Mick Watson
The second change to call out is the treatment of inflation, which I explored in detail in the next slide. Our cost of debt methodology is not expected to change significantly, but we will refresh evidence used to inform the sizing and qualification criteria of the various allowances.

0:37:34.720 --> 0:37:35.960
Mick Watson
On inflation.

0:37:39.50 --> 0:37:48.520
Mick Watson
So, last Thursday, we published the responses and a next step document associated with our call for input on the impact of high inflation on the price control.

0:37:49.630 --> 0:38:0.580
Mick Watson
Having reviewed the responses from the next stage, we intend to take 3 distinct options to consultation and fold further consideration of this issue fully within RIIO-3.

0:38:1.620 --> 0:38:7.460
Mick Watson
We believe these options best address the consumer interest over the wider options we outlined in the original call for input.

0:38:7.470 --> 0:38:39.70
Mick Watson
The options to be included within the SSMC and as shown in this slide are providing a nominal rather than real allowance for fixed rate debt to effect this change a portion of RAV aligned to the notional fixed rate debt assumption would be delinked from outturn inflation to avoid compensating investors twice. The indexation for the assumed index, linked debt and equity finance portions would remain unchanged and indexed to outturn inflation.

0:38:40.600 --> 0:38:48.250
Mick Watson
The second option is to match indexation of the RAV to the long run assumption in proportion to the fixed rate debt notional assumption.

0:38:48.720 --> 0:38:57.990
Mick Watson
As with the first option, the indexation for the assumed index-linked debt and equity financed portion would remain unchanged and indexed to outturn inflation.

0:39:0.0 --> 0:39:15.610
Mick Watson
The third option, which would work with both option one or two or independently, is utilising the existing methodology and review the long run assumption it took to consider whether a better measure exists to estimate long run inflation expectations.

0:39:17.290 --> 0:39:30.560
Mick Watson
We will seek to utilise the implementation mechanism to provide an appropriate transition for companies and their capital structures to the new methodology. The details of these implementation options are set out in the SSMC.

0:39:32.490 --> 0:39:55.720
Mick Watson
We wish to stress that we intend to consult on this subject in a comprehensive and deliberate manner, recognising the sensitivity of the issue. For the avoidance of doubt inflation protection is considered a cornerstone of our price control framework and the policy options outlined only consider the cost of debt mechanism in relation to the effect we wish to also emphasise.

0:39:55.840 --> 0:40:0.440
Mick Watson
We are not considering changes to the overarching principle or providing inflation protection.

0:40:2.60 --> 0:40:13.470
Mick Watson
We intend to express a preferred methodology, including any transition mechanism at SSMD so that it can be included in the business plan financial model as the basis for companies to prepare their business plans.

0:40:14.860 --> 0:40:26.980
Mick Watson
We remain open to consider alternative plans, evidence or policy options that stakeholders may

wish to discuss with us and look forward to continuing the positive engagement already undertaken to date.

0:40:29.340 --> 0:40:33.730
Mick Watson
And move on to financeability assessment and the concept of investability.

0:40:35.180 --> 0:40:45.30
Mick Watson
We expect our approach to assessing financeability at finance ability to be broadly in line with the approach used in RIIO-2, as was flagged in the FSNR framework decision.

0:40:46.190 --> 0:40:53.900
Mick Watson
We are open to evidence on ways that we could potentially broaden or lengthen our assessment methodologies in order to better assess financeability.

0:40:56.220 --> 0:41:1.780
Mick Watson
Following feedback from stakeholders, the FSNR framework Decision also introduced the concept of investability.

0:41:3.970 --> 0:41:26.520
Mick Watson
While we have always considered equity financeability as an important element of the price control setting process, we are highlighting that we're aware of that potential challenges that companies could face in the coming periods and will carefully consider evidence in the relation to whether the allowed return on equity in RIIO-3 is sufficient to retain and attract the equity capital that the sector requires.

0:41:28.140 --> 0:41:44.630
Mick Watson
This issue is likely to be likely to be increasingly important in the coming years as funds needed to support investment in electricity transmission infrastructure rises significantly and we are aware that different sectors and regions are typically competing for investor funds at the same time.

0:41:44.640 --> 0:41:56.630
Mick Watson
We expect that our existing approach to setting allowed returns on capital room will remain appropriate and sufficient for companies to attract and retain capital that they need.

0:41:57.300 --> 0:42:7.910
Mick Watson
But we will consider evidence on the cost and challenges that companies face as they seek to secure financing for large investment projects in what may be a competitive capital market environment.

0:42:10.680 --> 0:42:12.960
Mick Watson
Move on to depreciation.

0:42:15.670 --> 0:42:16.850
Mick Watson
Wait for the slide to move forward.

0:42:19.730 --> 0:42:24.740
Mick Watson
So regulatory depreciation is integral part of the RIIO network price control.

0:42:25.730 --> 0:42:34.740
Mick Watson
At its simplest, it determines the speed at which the regulatory asset value, which is returned to investors and therefore paid by gas and electricity consumers.

0:42:35.390 --> 0:42:48.260
Mick Watson
It is the largest lever for allocating when investment in network infrastructure is paid for, and can have a significant impact on domestic bills.

0:42:48.460 --> 0:42:53.560
Mick Watson
For the electricity transmission sector we are taking the opportunity to assess whether our current assumptions remain appropriate.

0:42:55.570 --> 0:43:5.830
Mick Watson
For gas, targets to achieve net zero carbon emissions by 2050 raise questions, including about the way that we depreciate the gas RAVs going forward.

0:43:7.260 --> 0:43:22.730
Mick Watson
We are consulting on ways to manage our role in this process to help address the perception of asset stranding risk and the potential impact of a declining user base on gas networks charges for the remaining gas customers.

0:43:24.330 --> 0:43:30.820
Mick Watson
We have not made any decisions about the appropriate approach to take that rear three and beyond at this stage.

0:43:30.830 --> 0:43:36.900
Mick Watson
We are seeking to set out the issues and invite evidence and views on how they can best be addressed.

0:43:39.470 --> 0:43:40.790
Mick Watson
Moving on to financial resilience.

0:43:44.290 --> 0:43:51.700
Mick Watson
We recognise that energy network consumers already benefit from a protective suite of financial resilience measures and license conditions.

0:43:53.250 --> 0:44:0.910
Mick Watson
However, we never want to stand still in this area and we want to make sure we are taking learnings and emerging best practice from other sectors and regulators.

0:44:2.670 --> 0:44:11.180
Mick Watson
As a result, we are considering a small set of incremental improvements that we think will better protect consumers without undue cost to companies.

0:44:12.720 --> 0:44:22.670
Mick Watson
As you will see from this slide, our proposal largely strengthens existing measures rather than injury, introducing completely new concepts.

0:44:22.720 --> 0:44:36.110
Mick Watson
On credit ratings we are exploring the potential benefit of moving the requirement from reasonable endeavours to require in relation to maintaining an investment grade rating.

0:44:36.200 --> 0:44:42.290
Mick Watson
On availability of resources we're considering extending certification to cover the forward price control period or a minimum of three years.

0:44:43.320 --> 0:44:48.850
Mick Watson
This is up from the current 12 months.

0:44:48.860 --> 0:44:56.610
Mick Watson
On dividend lock up triggers we are considering making this the earlier of BBB minus with a negative watch outlook or 80% regulatory gearing.

0:44:59.670 --> 0:45:14.890
Mick Watson
We also want to engage with stakeholders on what, if anything, we should consider when looking at whole group debt structures, in particular mid Co and hold Co level debt financing approaches and the resulting levels of leverage against the regulatory asset value.

0:45:16.10 --> 0:45:27.580
Mick Watson
We are keen to proactively assess whether such financing approaches could in extreme such scenarios negatively influence the decisions making at the licensee level, which could have negative consequences for consumers.

0:45:28.270 --> 0:45:35.830
Mick Watson
We welcome stakeholder evidence and views on all of these issues through the SSMC consultation process.

0:45:37.820 --> 0:45:44.630
Mick Watson
We are also considering whether to request further disclosure on information related to group financings and dividends.

0:45:45.470 --> 0:45:57.60
Mick Watson
The current thinking is that we outline these fully in an amendment to the RIIO reporting process for the years 23-24 and consult on them for the normal consultation process.

0:45:59.280 --> 0:46:8.710
Mick Watson
The extra information we are considering includes disclosure around debt covenants, covering defaults and cash lock ups, disclosure around mid Co and hold Co financings.

0:46:9.700 --> 0:46:17.860
Mick Watson
Disclosure of the licensees distribution policy, and disclosures of the licensees process and decision making around distributions.

0:46:19.20 --> 0:46:22.880
Mick Watson
If implemented, we will ensure that there is a consistent and clear template for submissions.

0:46:25.300 --> 0:46:26.130
Mick Watson
Onto the next slide, please.

0:46:28.810 --> 0:46:40.950
Mick Watson
In summary, the key themes for the finance framework are broadly consistent approach that we think will maintain investor confidence in the energy network sectors and support achieving the best long-term value for consumers.

0:46:42.390 --> 0:47:15.700
Mick Watson
We are acutely aware of the potential challenges in mobilising a step change in investment and if there is sufficient evidence, we will look to provide appropriate support. And finally, we will look to make incremental improvements where it makes sense, including in areas as updating the cost of debt methodology for our inflation findings and considering how our approach to regulatory depreciation interacts with net zero policies. We will be actively engaging with stakeholders through the consultation period and welcome views and evidence that will help us to reach appropriate decisions.

0:47:16.810 --> 0:47:21.330
Mick Watson
I would now hand back, I think it may be to Steve, who will coordinate taking your questions.

0:47:22.50 --> 0:47:26.250
Mick Watson
We have a full complement of area leads.

0:47:26.260 --> 0:47:30.240
Mick Watson
Who will help will also help to answer any detailed questions that you may have.

0:47:32.250 --> 0:47:32.880
Steven McMahon
OK.

0:47:32.930 --> 0:47:34.80
Steven McMahon
Thanks Mick.

0:47:34.90 --> 0:47:34.280
Steven McMahon
Yeah.

0:47:34.290 --> 0:47:37.940
Steven McMahon
And a slight change to the arrangements and I'm obviously not Akshay Kaul.

0:47:37.950 --> 0:47:46.640
Steven McMahon
I have agreed to step in it and just facilitate the Q&A. Akshay had to step away. And there are instructions are on the screen.

0:47:46.990 --> 0:47:51.40
Steven McMahon
So to ask a question, please use the hand raise function.

0:47:51.50 --> 0:47:52.540
Steven McMahon
I think that's easier for people on teams.

0:47:52.550 --> 0:47:58.350
Steven McMahon
If you're on the phone, you need to do something slightly different, so please type Star 5 on your keypad.

0:47:58.360 --> 0:48:2.220
Steven McMahon
That will raise your hand and I think for everybody you might need to unmute yourself.

0:48:2.230 --> 0:48:7.160
Steven McMahon
And certainly if you're on the phone, press Star 6 on the keypad to unmute yourself.

0:48:7.170 --> 0:48:10.430
Steven McMahon
And I would ask anyone just before asking your question.

0:48:10.440 --> 0:48:15.320
Steven McMahon
Can you please say your name and your institution.

0:48:16.180 --> 0:48:17.450
Steven McMahon
So there are a few hands up already.

0:48:17.460 --> 0:48:18.270
Steven McMahon
I think it's Deepa.

0:48:18.700 --> 0:48:22.210
Steven McMahon
So hopefully we can get, Deepa ready.

0:48:23.220 --> 0:48:27.690
Steven McMahon
You should be unmuted now and do you want to introduce yourself?

0:48:27.390 --> 0:48:27.740
Deepa Venkateswaran
Thank you.

0:48:27.700 --> 0:48:28.280
Steven McMahon
And then go ahead.

0:48:29.460 --> 0:48:29.810
Deepa Venkateswaran
Sure.

0:48:29.820 --> 0:48:30.190
Deepa Venkateswaran
Thank you.

0:48:30.200 --> 0:48:32.120
Deepa Venkateswaran
This is Deepa Venkateswaran from Bernstein.

0:48:32.170 --> 0:48:34.270
Deepa Venkateswaran

Thank you for helping me to take the first question.

0:48:34.740 --> 0:48:39.450
Deepa Venkateswaran
I wanted to ask a bit more about the concept of investability.

0:48:39.920 --> 0:48:42.590
Deepa Venkateswaran
This is obviously new for RIIO 3.

0:48:43.260 --> 0:48:49.870
Deepa Venkateswaran
You know, maybe in the last Rio 2 there was a lot of pushbacks against, you know, the sector not being investable.

0:48:49.880 --> 0:48:51.90
Deepa Venkateswaran
Maybe it's in response to that.

0:48:51.100 --> 0:49:6.200
Deepa Venkateswaran
So could you talk a bit more about practically how this might get reflected, particularly for electricity transmission where we see obviously the biggest spike in investments, I think in the document there were a few examples of maybe differing betas, et cetera.

0:49:6.440 --> 0:49:22.560
Deepa Venkateswaran
But could you elaborate a bit more and to what extent investability will be applied maybe differently. For example into the gas sector, which is not seeing much investment and in fact be declining, so maybe some practical explanation of how you might implement it would be helpful.

0:49:23.850 --> 0:49:24.750
Steven McMahon
Good question.

0:49:24.760 --> 0:49:40.230
Steven McMahon
And this is definitely an emerging concept, I think in in the RIIO-3 controls, it's one that we trailed I think in the framework that decision it's a really important one I think especially in that world where you need a phenomenal amount of network investment especially in the electricity transmission side.

0:49:40.280 --> 0:49:47.270
Steven McMahon
I think fundamentally deeper what we're seeking to ensure is that the cost of equity is high enough to attract the levels of capital that is required.

0:49:47.280 --> 0:49:52.50
Steven McMahon
But I'll let Chris maybe follow up just in terms of some of the specifics of your questions.

0:49:52.60 --> 0:49:52.810
Steven McMahon
So, Chris, over to you.

0:49:54.310 --> 0:49:55.20
Chris Connor
Thanks, Steve.

0:49:55.30 --> 0:49:55.730
Chris Connor
Hi, Deepa.

0:49:56.10 --> 0:50:15.120
Chris Connor
I think I'll start by reiterating what I think Steve and Mick have said that we think our existing approach to setting the allowed return on equity remains appropriate and we will continue to use

cross checks and use other market data to make sure that it is. We've introduced investability at this really early stage because we want to be proactive, and we want to recognize that the challenges may be different in this price control going forward for the different sectors.

0:50:23.700 --> 0:50:38.910
Chris Connor
And so we're open minded to what that might look like. If I think across all the sectors we've said we would like to reflect the risks on a forward looking basis in our actual calculations and to make sure that's as accurate as possible.

0:50:39.140 --> 0:50:45.590
Chris Connor
So we're open to different ways to thinking about beta to make sure that the cost of equity really does reflect the risk that's being taken.

0:50:46.510 --> 0:51:10.670
Chris Connor
And then if you think about electricity transmission in particular, what we said is we're open to evidence and if there are particular challenges or costs associated with, for example, raising much more fresh equity than we've had to do in previous price controls and we think that that evidence is sufficient and we can find solutions that are in the consumer interest, we will take that into account as we come to our final decisions.

0:51:14.620 --> 0:51:15.190
Chris Connor
Does that help.

0:51:14.430 --> 0:51:17.140
Steven McMahon
OK, I think so.

0:51:17.170 --> 0:51:17.510
Deepa Venkateswaran
Thank you.

0:51:18.990 --> 0:51:19.940
Steven McMahon
Thank you very much.

0:51:19.950 --> 0:51:20.680
Steven McMahon
Thanks, Chris.

0:51:21.10 --> 0:51:24.290
Steven McMahon
And Next up, I believe it's.

0:51:24.450 --> 0:51:27.440
Steven McMahon
Have an Mahbubani I think from JP Morgan.

0:51:27.450 --> 0:51:30.880
Steven McMahon
If my screens telling me correctly do you want to introduce yourself?

0:51:33.310 --> 0:51:34.340
Pavan Mahbubani (JP Morgan)
Hi, everyone.

0:51:34.350 --> 0:51:35.20
Pavan Mahbubani (JP Morgan)
Good afternoon.

0:51:34.680 --> 0:51:35.50
Steven McMahon
Hi there

0:51:35.310 --> 0:51:37.20
Pavan Mahbubani (JP Morgan)
Yeah, Pavan from JP Morgan.

0:51:37.30 --> 0:51:38.510
Pavan Mahbubani (JP Morgan)
Thank you for taking my questions.

0:51:38.520 --> 0:51:39.840
Pavan Mahbubani (JP Morgan)
I have two please.

0:51:40.410 --> 0:51:52.80
Pavan Mahbubani (JP Morgan)
Firstly I noted, I think it was in the finance annex, there was a mention of considering viewing the potential for increasing levels of mid Co and hold Co debt within group corporate structures.

0:51:52.290 --> 0:52:2.350
Pavan Mahbubani (JP Morgan)
So my question on that was how you see that actually happening and whether you actually have any sort of jurisdiction above the actual appointee.

0:52:2.510 --> 0:52:8.700
Pavan Mahbubani (JP Morgan)
Just wanted to get some more thoughts on how you think you could actually implement that and how far you're looking to go.

0:52:8.710 --> 0:52:15.440
Pavan Mahbubani (JP Morgan)
That's my first question and my second question is specifically on the beta and the potential update to comparators.

0:52:15.730 --> 0:52:20.580
Pavan Mahbubani (JP Morgan)
Do you have any initial view of what that expansion of comparators could look like?

0:52:20.590 --> 0:52:22.680
Pavan Mahbubani (JP Morgan)
Are you still just looking for evidence at this stage?

0:52:23.90 --> 0:52:23.490
Pavan Mahbubani (JP Morgan)
Thank you.

0:52:24.330 --> 0:52:28.140
Steven McMahon
OK, thanks two good questions, I think I'll go to Rob.

0:52:28.150 --> 0:52:30.840
Steven McMahon
First around the financial resilience questions.

0:52:30.850 --> 0:52:33.700
Steven McMahon
So Rob, just down in the London office, do you want to pick that one up?

0:52:33.710 --> 0:52:34.750
Steven McMahon
And then I'll come back to Chris.

0:52:35.540 --> 0:52:36.450
Robert Nesbitt
Thank you, Pavan.

0:52:36.460 --> 0:52:37.660
Robert Nesbitt

Thank you for the question.

0:52:37.670 --> 0:52:39.60
Robert Nesbitt
It's a very good, good question.

0:52:40.370 --> 0:52:47.410
Robert Nesbitt

As you'll see in the finance annex, it is something we're asking the question about in terms of mid Co and hold Co debt and how we should consider that.

0:52:48.690 --> 0:52:57.760
Robert Nesbitt
And we are as part of, as Mick outlined in part of the RIG consultation in the new year, looking to get more information about those debt levels from companies. We're going to consult on that in the new year and if it gets approved, we agreed to do it, then we'll kind of increase our knowledge of those type of structures.

0:53:12.40 --> 0:53:24.270
Robert Nesbitt
But I think in terms of jurisdiction within the current licence, we obviously regulate the licensee, but

we also have certain requirements from the ultimate shareholder as well and which kind of looks through this structure too.

0:53:24.550 --> 0:53:47.860
Robert Nesbitt
So we're happy to hear people's views on whether we have the jurisdiction to look at midco and holdco structures, but we believe to the extent that those risks are impacting the licensee, that it will give us a certain element for jurisdiction to look at those structures and take a view as to whether the whole financing package for the whole construction is appropriate.

0:53:52.690 --> 0:53:54.790
Robert Nesbitt
I hand it to Chris, for the second question.

0:53:58.420 --> 0:53:58.960
Chris Connor
Thanks, Pavan.

0:53:58.970 --> 0:53:59.830
Chris Connor
It's good question.

0:54:0.780 --> 0:54:3.370
Chris Connor
I think we’re thinking about this in two ways.

0:54:3.380 --> 0:54:4.960
Chris Connor
One is on the comparators.

0:54:4.970 --> 0:54:7.240
Chris Connor
We haven't prejudged what those might be.

0:54:7.380 --> 0:54:15.230
Chris Connor
We recognize that beta typically uses historic data and then tries to project forward in terms of what that represents for a risk exposure.

0:54:15.240 --> 0:54:33.970
Chris Connor
And so if there is evidence that the risk exposures will be very different going forward, it might be sensible to include companies with some of those characteristics that are being added to the sector. And also that might also be much more practical to stick with the existing comparators, but use a tool to time scale.

0:54:34.20 --> 0:54:44.30
Chris Connor
So if you think by the time we're making decisions in late 2025, a lot of the issues that we're talking about will be well known in the share prices of network companies.

0:54:44.280 --> 0:54:53.970
Chris Connor

So it could be that we use a shorter look back and see that as much more representative of the risk return that investors see in these investments on a forward looking basis.

0:54:59.280 --> 0:55:0.130
Steven McMahon
Thanks, Chris.

0:55:0.380 --> 0:55:1.210
Steven McMahon
Is that OK, Pavan?

0:55:1.220 --> 0:55:3.500
Steven McMahon
In terms of answering your question here.

0:55:2.270 --> 0:55:3.680
Pavan Mahbubani (JP Morgan)
Yeah, that's great.

0:55:4.450 --> 0:55:4.900
Pavan Mahbubani (JP Morgan)
That's great.

0:55:4.700 --> 0:55:5.40
Steven McMahon
OK.

0:55:4.910 --> 0:55:5.250
Pavan Mahbubani (JP Morgan)
Thank you.

0:55:6.280 --> 0:55:6.950
Steven McMahon
Thank you.

0:55:7.0 --> 0:55:12.440
Steven McMahon
And next up on my list is, I think it's Jenny Ping. Do you want to unmute and introduce yourself?

0:55:14.50 --> 0:55:15.70
Jenny Ping [Citi]
Thanks very much.

0:55:15.110 --> 0:55:16.590
Jenny Ping [Citi]
Jenny Ping from city here.

0:55:16.600 --> 0:55:17.680
Jenny Ping [Citi]
Two questions, please.

0:55:17.690 --> 0:56:4.410
Ping, Jenny [Citi]
Just going back to the point around investability, I just wondered how you square the circle with

your commentary in the annex about the fact that you don't want to be aiming up in the WACC in that process and how as a result you get this sort of investability element into it.
And I remember in the RIIO-T2 consultation process,
You know, this is when you introduce this outperformance wedge.

Are you going to be splitting out the investability element away, or is it all just going to be commingled with the beta that we will never be able to tell exactly what is the investability element of it?
So that's question one please.

0:56:5.920 --> 0:56:36.460
Jenny Ping [Citi]
And then secondly, just thinking ahead in terms of UK elections next year. I wondered whether there are any actions, a new government a New Labour government that could bring that changes your approach meaningfully, specifically thinking about some of the commentaries around GB energy and competition and how that could sort of meaningfully change how you're thinking about the T3 [RIIO-3] process?

0:56:39.20 --> 0:56:41.940
Steven McMahon
Chris, you want to take the first one and then I'll maybe pick up the 2nd.

0:56:43.340 --> 0:57:35.890
Chris Connor
Yeah, thanks, Jenny. So in terms of Investability versus aiming up, I would characterize them quite differently. I would say that, you know, aiming up as it has traditionally been applied is providing extra return on an almost just in case basis to make sure that there is headroom, and the investment happens. At least at this stage, we're trying to take a more scientific approach than that.

We think our existing approach is sufficient, but we're trying to flag to stakeholders that if they can provide evidence of specific costs and challenges that maybe aren't well captured in the current framework, we will take this into account. So the message to investors is really that we're not just going to turn the handle and not think about it again.

We are trying to be really proactive and work with the companies to make sure that they are in a position to be able to fund these investments that we think are so important.

0:57:37.880 --> 0:57:40.440
Chris Connor
Steve, want to pick up on the UK election?

0:57:39.930 --> 0:57:43.180
Steven McMahon
So yeah, that may need to be built out a little bit.

0:57:43.190 --> 0:57:44.380
Steven McMahon
I think it's a good question.

0:57:44.390 --> 0:57:47.640
Steven McMahon
So clearly, we are approaching elections.

0:57:47.710 --> 0:57:55.400
Steven McMahon
Those elections might have quite important implications around the direction of the energy system, potentially bringing forward.

0:57:55.410 --> 0:57:57.80
Steven McMahon
I think net zero targets.

0:57:57.810 --> 0:58:14.310
Steven McMahon
I think what we've been aware of, especially through RIIO-2, is that when we are undertaking our price reviews, they don't tend to fit a nice, neat, kind of cycles that perfectly align with the change and the policy environment that's set by government.

0:58:14.320 --> 0:58:20.610
Steven McMahon
So there's been a deliberate shift towards much more adaptability, much more flexibility.

0:58:20.760 --> 0:58:24.570
Steven McMahon
I think in the way that we have to regulate.

0:58:25.100 --> 0:58:39.510
Steven McMahon
Now clearly, there are potential changes that could come through that might mean that the pace of change has to accelerate, or we have to deal with things that we’re just not fully aware of or in control of as things stand at the moment.

0:58:39.520 --> 0:58:50.350
Steven McMahon
But I think the key position for us is building enough for agility in the price control that we can adapt to any of these circumstances that we face through time.

0:58:50.360 --> 0:58:54.190
Steven McMahon
So that's price controls now tend to be less about what you set up front.

0:58:54.200 --> 0:59:5.210
Steven McMahon
It's more of it, the mechanisms that you've got in place, I think to manage changes as they come forward and make sure our regulations are reflective of like the wider economic environment that we see.

0:59:5.220 --> 0:59:14.820
Steven McMahon
But I think going back to the point at the start, like the way that we are planning the system more strategically that in some sense it gives us a much stronger foundation for the big I think set piece

infrastructure investments, especially in the transmission side and we would expect that model to endure any new government and extending that. I think the gas over time.

0:59:25.730 --> 0:59:27.300
Steven McMahon
Does that answer your question enough, Jenny.

0:59:28.550 --> 0:59:29.580
Jenny Ping [Citi]
Yes, thank you.

0:59:29.590 --> 0:59:40.370
Jenny Ping [Citi]
Can I just follow up on Chris in terms of a piece around the separation of investability or is that just going to be embedded in the overall WACC numbers?

0:59:42.110 --> 0:59:42.530
Chris Connor
Yeah.

0:59:42.540 --> 0:59:46.400
Chris Connor
I mean, at least currently we think it would be embedded.

0:59:46.910 --> 0:59:52.20
Chris Connor
It's very much dependent on the evidence that we receive. You sort of mention beta.

0:59:52.30 --> 0:59:59.570
Chris Connor
I wouldn't see beta as an element of necessarily investability or aiming up if that number was to change.

0:59:59.580 --> 1:0:3.400
Chris Connor
That's really about trying to make that as accurate as possible.

1:0:3.610 --> 1:0:6.360
Chris Connor
In reflection of the risks that are being taken.

1:0:6.610 --> 1:0:9.740
Chris Connor
So this stage, we expect the process to run as usual.

1:0:9.810 --> 1:0:14.350
Chris Connor
We are really just flagging that we're open to evidence of additional things that we might need to consider.

1:0:17.230 --> 1:0:17.790
Jenny Ping [Citi]
Thank you very much.

1:0:19.160 --> 1:0:19.690
Steven McMahon
OK.

1:0:19.780 --> 1:0:20.550
Steven McMahon
Thanks, Jenny.

1:0:20.560 --> 1:0:23.700
Steven McMahon
So Next up and old colleague Martin Young, hope you're well.

1:0:27.530 --> 1:0:27.760
Martin Young
Yep.

1:0:29.410 --> 1:0:29.790
Martin Young
Hi Steve.

1:0:29.800 --> 1:0:30.870
Martin Young
Hope you're well too.

1:0:30.880 --> 1:0:31.130
Martin Young
Hi.

1:0:31.140 --> 1:0:31.470
Martin Young
Hi, Mick.

1:0:31.730 --> 1:0:35.30
Martin Young
And couple of questions from me.

1:0:35.880 --> 1:0:41.670
Martin Young
The first is to continue on that theme of investability.

1:0:42.500 --> 1:1:12.870
Martin Young
And what Chris was saying about it being potentially embedded within the calculation. If you think about when some of the equity needs will really materialize, you could argue that they are potentially going to be back ended in the five-year RIIO 3 and timeline in so much that you know a lot of those projects ultimately you know 2030 maybe 2031, you know delivery dates.

1:1:13.910 --> 1:1:39.70
Martin Young
How do you feel people could have the necessary depth and breadth of evidence at this stage to make the case that perhaps there needs to be a little bit more in terms of the cost of equity. For ET, I feel that some of that might only materialize during the five year window, and if so, how do you think about mid period changes?

1:1:39.510 --> 1:1:51.780
Martin Young
And then my second question was on the debt, you know, slide where you talk about the allowances for additional costs of borrowing and maybe some changes versus RIIO 2.

1:1:52.430 --> 1:2:8.320
Martin Young
Will they still be a size fits all at the individual sector level or could we be thinking about more bespoke numbers on a company-by-company basis? Thanks.

1:2:9.240 --> 1:2:10.170
Steven McMahon
OK, question one.

1:2:10.180 --> 1:2:12.520
Steven McMahon
Chris on the common theme on investability

1:2:12.530 --> 1:2:14.400
Steven McMahon
Then I'll go to Stefan on debt.

1:2:16.160 --> 1:2:16.950
Chris Connor
And thanks Martin.

1:2:16.960 --> 1:2:24.310
Chris Connor
And it's a really good question and I think it speaks to why we haven't put an addictive range in the SSMC.

1:2:24.390 --> 1:2:25.790
Chris Connor
We really are keen that we get the building blocks of the financial framework right, and it has to work across, for example, macro environments. We've seen in recent years how quickly market rates can change and we can't design a framework that only works in a certain sort of situation.

1:2:43.730 --> 1:2:51.960
Chris Connor
So we think that the overall report approach will remain appropriate and remains flexible enough to be there as needed.

1:2:51.970 --> 1:2:58.280
Chris Connor
As you know, we index the cost of equity and the cost of debt to help keep up with rates that happen in the future.

1:2:59.410 --> 1:3:7.480
Chris Connor
So what it's like there are still ways that we might be able to think about additional costs or challenges well in advance.

1:3:8.770 --> 1:3:20.100
Chris Connor
So as an example, we might look again at the equity issuance allowance, which is really there to help cover the costs of issuing fresh equity.

1:3:20.350 --> 1:3:31.380
Chris Connor
It might be that stakeholders have evidence that those costs are rising in certain market environments, or they increase at certain levels of equity issuance.

1:3:31.710 --> 1:3:45.70
Chris Connor
And so we might be able to look at that as something we can take into consideration, so that if the notionally capitalised companies are increasing their equity over time, that's a cost that can kick in.

1:3:45.160 --> 1:3:46.230
Chris Connor
That's just one example.

1:3:46.520 --> 1:3:52.200
Chris Connor
We are very much waiting to see what stakeholders come back with in terms of where they think those pressures might be.

1:3:54.880 --> 1:3:55.190
Steven McMahon
OK.

1:3:55.200 --> 1:3:57.140
Steven McMahon
Thanks Chris and hand it over to Stefan.

1:3:58.650 --> 1:3:59.580
Stefan Blanchard
Thanks Martin.

1:3:59.590 --> 1:4:2.600
Stefan Blanchard
It's great to have you with us and, it's a good question.

1:4:3.190 --> 1:4:15.990
Stefan Blanchard
So just in terms of and make sure that I framed your question properly, but in terms of the additional borrowing allowances, we still think of this as a sort of sector wide allowances.

1:4:16.90 --> 1:4:35.620
Stefan Blanchard
And so we don't anticipate going to an individual licensee level, but we may consider looking at it from the perspective of different allowances for gas and different allowances for electricity, for example, say maybe it's breaking them out by subsector is a possibility given the unique demands on both those sectors.

1:4:36.390 --> 1:4:38.460
Stefan Blanchard
I don't anticipate we would drop down to that sort of licensee level basis, which is consistent with the rest of the cost of debt methodology.

1:4:45.30 --> 1:4:45.280
Martin Young
Thank.

1:4:45.290 --> 1:4:45.600
Martin Young
Thank you.

1:4:47.70 --> 1:4:47.900
Steven McMahon
Thanks Martin.

1:4:47.950 --> 1:4:50.580
Steven McMahon
Next up in my list I think is Bartek.

1:4:54.790 --> 1:4:55.920
Bartek Kubicki [SG]
Yeah, hello, good afternoon.

1:4:50.590 --> 1:4:56.610
Steven McMahon
So do you want to unmute yourself and ask your question and introduce yourself.

1:4:56.500 --> 1:4:59.260
Bartek Kubicki [SG]
Yeah, this this is Bartek Kubicki from SG.

1:4:59.690 --> 1:5:1.980
Bartek Kubicki [SG]
Couple of technical questions.

1:5:1.990 --> 1:5:10.360
Bartek Kubicki [SG]
I mean, I wanted to ask you one question on why you are not providing with any financials in this paper because five years ago was plenty of details.

1:5:10.370 --> 1:5:12.80
Bartek Kubicki [SG]
But I guess it was already answered.

1:5:12.470 --> 1:5:29.630
Bartek Kubicki [SG]
So another thing is on your cost of equity calculations you want to stick to the TMR, ERP way of calculating this a TMR is fixed ERP’s calculated as a set of TMR minus risk rates.

1:5:30.120 --> 1:5:55.260
Bartek Kubicki [SG]

But I just wonder what is your view on the fact that it's not fully protecting networks from rising interest rates because you can imagine a situation that bond yields go up to 6.5% and then your ERP goes to zero and basically you're allowed cost of equity equals your risk free rate, which makes investments in networks absolutely unattractive versus risk free rates.

1:5:55.410 --> 1:6:12.230
Bartek Kubicki [SG]
So I just wonder how you're looking at this and whether you are thinking about potentially modifying this. Although in the consultation paper, of course you are mentioning this is how other regulators are using this, but this may not necessarily be correct when bond yields are rising.

1:6:12.700 --> 1:6:24.90
Bartek Kubicki [SG]
Second thing on financeability and fast and slow money. In the consultation paper you are talking about sticking to the natural rate.

1:6:24.180 --> 1:6:27.210
Bartek Kubicki [SG]
But I wonder how open you are on perhaps changing the proportions, allowing for a bit more fast money in TOTEX in order to improve financeability. And the last very technical point if you don't mind, because in RIIO-2 you introduced indexing of the cost of equity when the risk free rate is calculated only on one month observation period.

1:6:50.600 --> 1:7:1.330
Bartek Kubicki [SG]
I just wonder whether you are happy with that or not, because in the past we actually have seen quite the volatility between one month and the other month in terms of the risk-free rates.

1:7:1.980 --> 1:7:2.270
Bartek Kubicki [SG]
Thank you.

1:7:3.340 --> 1:7:3.850
Steven McMahon
Thanks, Bartek.

1:7:3.860 --> 1:7:5.170
Steven McMahon
I think on that first point.

1:7:5.180 --> 1:7:25.530
Steven McMahon
I mean, I think your view was with answered the question. I think his history and I think the experience of RIIO-2 told us when you had the numbers early the numbers became the focal point of the conversation rather than a kind of objective evidence based like discussion and focus and consultation around the methodologies. I think we've been quite deliberate at this time.

1:7:25.640 --> 1:7:36.580
Steven McMahon
We want this process to focus and the actual methodology, and then I think being driven by that and the data that will take us to the numbers that we expect to publish alongside our SSMD.

1:7:36.590 --> 1:7:38.880
Steven McMahon
So there's probably definite expectations around that.

1:7:38.890 --> 1:7:43.360
Steven McMahon
Some might be quite happy that we're not backing ourselves in too early in that regard.

1:7:43.370 --> 1:7:51.480
Steven McMahon
Others may I like a clearer signal where the direction of travel would be, but would certainly by the time we get to the methodology decision, I think we'll start to make that clear.

1:7:51.890 --> 1:7:54.530
Steven McMahon
Chris do you want to maybe follow up in the second point?

1:7:55.770 --> 1:8:6.80
Chris Connor
Yeah, I'll pick up maybe TMR 1st and I agree that stable TMR versus stable ERP is absolutely not a no brainer.

1:8:6.710 --> 1:8:18.350
Chris Connor
But we have, other regulators have, and the UKRN have all considered this topic in recent years and have concluded that TMR is probably the more stable of the two metrics.

1:8:19.650 --> 1:8:22.480
Chris Connor
We also think that there are benefits to that approach.

1:8:22.490 --> 1:8:42.50
Chris Connor
It does smooth returns over cycles and for investors that we think are typically long horizon investors that predominate in this sector, there’s a real benefit to that and you don't get the peaks and troughs that you would if we had an absolute one to one relationship with the risk free rate especially through the sort of environment we've seen recently.

1:8:44.50 --> 1:9:1.90
Chris Connor
We do understand that as rates rise, we may have a compression of that equity risk premium over the debt risk premium and that's something we will have to take into account that will get picked up through financeability as you would expect, but will be thinking about it all the way through the process.

1:9:2.170 --> 1:9:40.70
Chris Connor
What I would want to flag is that that's a structural feature that smoothing of returns over the cycle, and it's really important we don't fix it for investors on one side of the cycle and don't fix it for consumers on the other side, if we only ever top it up when it gets compressed and we don't reduce it when it expands, then consumers will structurally overpay over the cycles and we need to be really careful about that in terms of meeting our duties. In terms of fast versus slow money, I think

everything is on the table in terms of what we might need to do to help this quite unusual scenario, especially in electricity transmission where we are investing so much so quickly.

1:9:41.160 --> 1:9:53.750
Chris Connor
And I think the only caveat there is that it helps if changes are structural going forward and all the credit rating agencies can take a dim view if they think we are moving things temporarily, that will unwind.

1:9:53.760 --> 1:10:0.600
Chris Connor
And so we will always take that into account. And on indexing the risk free rate, there is a trade-off here.

1:10:0.610 --> 1:10:8.130
Chris Connor
I would say if we weren't indexing, there would be a strong case for taking a longer average to take out some of that volatility.

1:10:9.170 --> 1:10:22.480
Chris Connor
I think because we're indexing, we're pretty comfortable with the one month. We're only ever gonna be a year away from that figure. And you start to get into a trade off of how quickly or how much you're actually updating if you start and doing longer sort of rolling averages, so at this point we are very comfortable with the one month, but happy to receive evidence if people think they're improvements that we can make.

1:10:32.540 --> 1:10:33.100
Bartek Kubicki [SG]
Very clear.

1:10:33.110 --> 1:10:33.670
Bartek Kubicki [SG]
Thank you very much.

1:10:37.530 --> 1:10:38.350
Steven McMahon
Thanks Bartek.

1:10:38.410 --> 1:10:47.240
Steven McMahon
I'm not seeing any other hands, so just I'll pause there in case there are people that are trying to I'm ask a question it's just not visible to me.

1:10:51.90 --> 1:10:55.400
Steven McMahon
No, even for another minute or so, we do have time.

1:10:55.410 --> 1:10:56.420
Steven McMahon
If people do have questions.

1:10:59.60 --> 1:11:6.590
Steven McMahon
And just remainder of the process, I think if you are joining by phone, I think you, type Star 5 on your keypad that should raise your hand.

1:11:7.150 --> 1:11:14.120
Steven McMahon
And then I think it's star 6 to unmute yourself and give it another minute before we start looking at the timelines and next steps.

1:11:19.510 --> 1:11:20.390
Steven McMahon
I don't see anyone.

1:11:22.530 --> 1:11:24.920
Steven McMahon
Well, maybe I'll go on and I'll describe the process anyway.

1:11:24.930 --> 1:11:28.100
Steven McMahon
We can come back at the end of this if there's any further questions.

1:11:28.160 --> 1:11:38.20
Steven McMahon
And so just looking at what happens now, so that the consultation period will run for 12 weeks from today, that takes us through to early March.

1:11:38.30 --> 1:11:46.920
Steven McMahon
I think we're running for the full 12 weeks to make sure that we get the best feedback possible from companies and wider stakeholders across the full range of issues.

1:11:46.930 --> 1:11:48.760
Steven McMahon
We are inviting views on.

1:11:49.170 --> 1:11:58.230
Steven McMahon
We then expect to confirm the methodology decisions and Q2, 24 I think we've given ourselves a little bit of flexibility on the timing.

1:11:58.460 --> 1:12:43.400
Steven McMahon
I think erring on the side of caution when it comes to the length of the consultation period and ensuring sufficient time for our robust set of method decisions to be set for the business planning phase. And just to support that we expect to publish our draft business plan guidance and the corresponding data and templates for that by the end of February with a final version confirmed for that and the spring. As we've set out previously as an intention to minimise and streamline the business plan and process. I think making it more targeted with the aim of driving a higher degree of consistency and comparability across each of the companies plans that we get back.

1:12:43.590 --> 1:12:50.540
Steven McMahon
And so we don't have a formal requirement for a draft business plan submission in 2024.

1:12:50.550 --> 1:13:1.310
Steven McMahon
I think we're focusing instead next summer on the companies business plan data templates and the key engineering support and information that would go alongside that. Moving forward, we would have final business plans submitted to Ofgem by around this time next year, December 2024, with our draft determinations, then come in 2025, this summer 2025 and final determinations in two years time.

1:13:17.260 --> 1:13:22.790
Steven McMahon
I think it was indicated earlier on the call there will be a separate process for the next electricity distribution price controls. Those price controls obviously just started earlier this year, will run until 2028, but we do expect that we'll start the consultation phase on that framework and next summer like with the publication of an open letter.

1:13:35.620 --> 1:13:36.780
Steven McMahon
So that will come after.

1:13:37.30 --> 1:13:41.990
Steven McMahon
I think the SSMD for this first transfer of sectors, so do look out for that too.

1:13:43.510 --> 1:13:51.200
Steven McMahon
And I think just in terms of summing up, clearly this is a an early, but it's an important milestone in this RIIO-3 journey.

1:13:51.540 --> 1:14:6.830
Steven McMahon
And there's clearly still lots of detail, lots of numbers that need to be settled as we look to ensure our robust set of arrangements that allows the networks to realize that our net zero goals whilst keeping the overall cost of the transition low for consumers.

1:14:6.840 --> 1:14:14.970
Steven McMahon
So that's the balance that we need to strike, and I think we do very much look forward to your continued support and engagement on that process.

1:14:15.440 --> 1:14:17.930
Steven McMahon
So I'll pause there for a final chance.

1:14:17.940 --> 1:14:18.870
Steven McMahon
Any questions?

1:14:18.880 --> 1:14:23.910
Steven McMahon
Otherwise, we will probably just wrap up the call at that point, so any final hands?

1:14:26.330 --> 1:14:27.160
Steven McMahon
Not seeing any.

1:14:27.170 --> 1:14:39.740
Steven McMahon
Well, thank you everybody for joining and thank you to my full team across the country and I do hope you have a lovely Christmas and New Year and we look forward to your continued engagement in this process.

1:14:39.750 --> 1:14:40.540
Steven McMahon
So thank you very much.