Energy Network Association's response to the CMA's PR24 Provisional Determinations

Dear PR24 special reference group,

Energy Networks Association (ENA) is the industry body representing the electricity networks in the UK. Our members directly employ 26,000 people in England, Scotland, Wales and Northern Ireland, including around 1,500 apprentices and trainees. ENA's members operate a network of around 500,000 miles of lines and cables which deliver electricity to around 29 million homes and businesses across the country. Around 60% of the network is underground.

This submission is made on behalf of ENA's GB Distribution Network Operator (DNO) and Transmission Owner (TO) members. We have made this submission collectively to support the efficiency of the Competition and Market Authority's (CMA) redetermination processes.

As we explained in our response to the CMA's call for evidence, some of the issues that the CMA has considered in these redeterminations have read-across to other regulatory decisions and are critical for the investability of other GB regulated sectors, including energy, in addition to the water sector. We deliberately limit our evidence to those elements of the PR24 redetermination that are material for investability **and** have strong read-across to other sectors. We:

- welcome the CMA's recognition that debt rates are relevant evidence on equity investor requirements.
- welcome the CMA's acknowledgement that the welfare implications of under-investment are relevant considerations in cost of equity determinations.
- support the CMA's findings in respect of ongoing efficiency.
- ask that the CMA provides signals to regulators regarding appropriate regulatory decision-making and interpretation of evidence in the above three areas.
- welcome the CMA's findings on Total Market Return (TMR) – but highlight that the CMA has made an error involving the clear under-estimation of the long-term historical Equity Risk Premium (ERP) that must be corrected in the CMA's Final Determination (FD) and that more work is needed by regulators to develop an enduring TMR mechanism.
- disagree with the CMA's proposal to use the Office for Budget Responsibility's (OBR) current estimate of the long term CPIH to CPI wedge due to the flaw inherent in this figure. If the CMA concludes that it is appropriate to reflect an official CPIH forecast in its cost of debt allowance calculations, the addition of a CPI-CPIH wedge calculated using the last year of the latest OBR medium term forecasts to the OBR's long-term CPI forecast would seem to be a more appropriate approach to take.
- welcome the CMA's recognition that multiple factors are relevant when setting RCV run-off rates. If financeability concerns become apparent at FD, we ask the CMA to consider carefully proposals to accelerate RCV run-off as a possible policy measure.
- consider that the CMA should recognise financeability assessments are relevant when selecting cost of equity point estimates.

We welcome a number of important elements of the CMA's proposals.

We welcome a number of changes that the CMA proposes to make to Ofwat's decision in areas that challenge the practice of several sectoral regulators. In particular:

- We welcome the CMA's conclusion that the premium above debt rates required by equity investors is a relevant consideration in selection of cost of equity point estimates;
- We welcome the CMA's acknowledgement that the welfare implications of under-investment are relevant considerations in cost of equity determinations; and
- We support the CMA's conclusion on ongoing efficiency that there are no convincing reasons to expect productivity growth in the water sector to diverge substantially from the wider economy and that frontier shift decisions should reflect recent evidence.

In its FD, we ask that the CMA provides signals to regulators regarding appropriate regulatory decision-making and interpretation of evidence in these areas. In this way, the CMA can provide regulators with crucial advice and avoid unnecessary future redeterminations or appeals in other sectors.

We welcome the CMA's decision to take account of the current interest rate environment when setting the TMR range. However, the CMA has made an error in its calculations. Furthermore, refinement of the methodology is needed for it to be applicable more broadly.

We agree with the CMA that a mechanistic application of the 'through the cycle' approach to estimating TMR will lead to an underestimate of the cost of equity in current macroeconomic conditions.

We welcome the CMA's decision to take account of the current interest rate environment when setting the TMR range and the CMA's acknowledgement that a pure 'through the cycle' approach would not support the water sector in the PR24 price control. We also welcome the CMA's acknowledgement that a relationship exists between prevailing gilt yields and the prevailing TMR.

We agree with the CMA's position in principle, and consider that the 'through the cycle' TMR approach currently proposed by Ofgem in its RIIO-T3 Draft Determinations also risks the investability of the energy network sectors. Indeed, we have made a number of detailed representations to Ofgem on how TMR can be set in a way which

- Reflects the prevailing expectations and interest rate environment;
- Supports the long-term stability of the allowed return in the sector; and
- Is transparent and predictable.

We have worked with Frontier Economics since 2023 to propose an approach to Ofgem which the ENA considers meets the three objectives above.[1] We are therefore well-placed to consider in detail the CMA's proposals in this area.

[1] Frontier Economics, Assessing regulators' approach to setting the TMR - Implications for RIIO-3, 22 August 2025.

While we welcome the CMA's recognition of the need to reflect prevailing conditions in setting the TMR range, there are several elements of the CMA's proposed methodology for this that we have concerns with. These concerns are set out in detail in a technical note prepared by Frontier Economics that we enclose with this submission.[2] We also provide a brief summary below.

The CMA has made an error involving a clear under-estimation of the long-term historical ERP that should be remedied in the CMA's PR24 FD.

The CMA has under-estimated the long-term ERP used in its TMR range. The CMA has estimated the long-term ERP using the DMS data but arrived at an estimate materially lower than the actual figure produced by DMS without any clear explanation on the difference or why its estimate is preferred over the one from DMS. This must be corrected in the CMA's PR24 FD.

While the CMA's methodology may represent a pragmatic approach for the current redeterminations, more work is needed by sector regulators to develop an enduring methodology to address this issue.

There are a number of methodological issues with the specification of the CMA's proposed TMR. Frontier Economics identifies (a) concerns around the responsiveness of TMR to Risk Free Rate implied by the CMA's approach and (b) concerns around the reliance on the historical ex ante approach. For these reasons, we do not believe the CMA's TMR method as proposed can be directly used as a de facto precedent by other regulators in future price controls.

We recognise that the CMA has only a limited amount of time to explore how to address this important issue in the PR24 redetermination. We also recognise that the CMA may conclude that its approach, once the ERP estimation error is corrected, may be a pragmatic approach in the limited timescales of the current redetermination.

Given this, the ENA seeks clarity from the CMA that the specific methodology used in its PR24 TMR decision is not intended to be precedent setting or to be used in its current form by other regulators in future price controls, and that further refinement of the methodology is needed for it to be applicable more broadly. We therefore ask that the CMA signals that more work is needed by regulators to develop an enduring mechanism to reflect this important issue going forward.

[2] Frontier Economics, Response to the CMA's proposed PR24 PD TMR methodology using fixed ERP, 6 November 2025

We disagree with the CMA's proposal that the OBR's long-term CPIH forecast should be used in the calculation of the allowed return on debt.

The approach to take to inflation forecasts when calculating real cost of debt allowances has been explored extensively in recent energy price control discussions. We recognise that forecasting of inflation can be a difficult task because the underlying parameters are challenging to estimate. Energy networks support Ofgem's proposed move to introduce a semi-nominal cost of debt from the start of the next energy price controls, removing the need to forecast inflation for the nominal-debt portion of debt allowances.

At the outset of CPIH-indexed price controls, regulators effectively assumed that – in the long run – CPI and CPIH would not be materially different and that using CPI forecasts as a proxy for CPIH was reasonable. The OBR's recently-introduced CPIH forecasts raises the question of whether this assumption remains valid.

It is a matter of fact that the CPI and CPIH indices are constructed differently and that some difference between the two indices may therefore be expected. The key question is whether a material difference is to be expected and, if so, by how much.

To date, we have considered this an empirical question and advocated that the OBR's CPI forecast should continue to be used as an appropriate adjustment to apply in the calculation of the index-linked portion of the cost of debt allowance. This position was largely influenced by historical evidence not supporting the existence of a stable or predictable CPI–CPIH wedge. Indeed, more recent history has seen a negative wedge. For example, in the ten year period between June 2013 and June 2023 CPI was, on average, 14bps higher than CPIH.[3]

In light of the lack of evidence of a stable or predictable wedge, we are surprised that the OBR suggested such a material long-term difference between CPI and CPIH can be expected. For such a significant, enduring difference to be achieved, very strong assumptions about significant above-CPI increases to owner occupiers' housing costs and council tax must be assumed. We do not believe that the OBR's current assumptions used to calculate its long-term CPIH forecast are realistic. In particular, the long-term productivity assumption that the OBR relies on in determining its 40bps CPI-CPIH wedge seems unrealistically high. The OBR itself has acknowledged the uncertainty around its productivity assumption saying:

> "*The outlook for trend productivity is one of the most important and uncertain forecast judgements. Successive past forecasts for trend productivity have proven to be too optimistic as productivity growth has continued to disappoint … the uncertainty around our productivity assumption remains high.*"[4]

The CMA has also acknowledged this optimism bias in its assessment of ongoing efficiency assumptions for PR24.[5]

[3] Oxera, RIIO-3 draft determinations—CAPM parameters and debt-based cross-checks, 22 August 2025, section 2.2.
[4] OBR, Economic and fiscal outlook – March 2025, 26 March 2025, p28, Box 2.1.
[5] CMA, Water PR24 references – Provisional Determinations, volume 1, 9 October 2025, para 4.162.

While we continue to be of the view it is too early to introduce a CPIH forecast, given the lack of historical evidence and lack of a tried and tested forecasting methodology, we believe that the modelling assumptions that the OBR makes to derive its medium-term (up to 5 year) CPI and CPIH forecasts are likely to provide a more accurate reflection of the current longer-term CPIH to CPI wedge. If the CMA concludes that it is appropriate to reflect an official CPIH forecast in its cost of debt allowance calculations, the addition of a CPI-CPIH wedge calculated using the last year of the latest OBR medium term forecasts to the OBR's long-term CPI forecast would seem to be a more appropriate approach to take.

We welcome the CMA's view that there are several relevant factors to consider when setting Regulatory Capital Value (RCV) run-off rates.

The matter of regulatory depreciation is not central to the PR24 redeterminations, but is relevant to the cases of some companies and signals by the CMA on this topic can nevertheless be important. We support the CMA's views that there are other relevant factors when setting RCV run-off rates, including inter-temporal fairness, affordability and financeability, rather than trying to match historical cost depreciation or "accurately" account for asset depreciation.[6]

We have direct experience of a move from relatively short regulatory depreciation lifetimes to longer ones based on the expected economic lifetimes of the assets which is having substantial unintended consequences, such as (1) leading in the long term to substantially higher customer bills due to a larger RAV; (2) being social NPV negative on a green book assessment; and (3) having detrimental consequences for investability in light of weak near-term cashflows.

Should financeability constraints become apparent in its FD, even after making necessary adjustments to the allowed return, we would encourage the CMA to consider carefully proposals, such as those from Anglian, to accelerate RCV run-off as a policy measure which can bring other substantial additional benefits and is social NPV positive.

Financeability is a relevant cross-check to consider when selecting the point estimate for the cost of equity.

We disagree with the CMA's proposal that it does "*not consider financeability as a direct cross check when selecting a point estimate for the allowed return on equity*".[7] This statement contradicts the CMA's conclusion in its PR19 redeterminations that "*financeability should be a valuable cross-check when picking an appropriate point estimate from a calculated cost of capital range*"[8] and "*Our judgement of the point estimate of the cost of equity is based on the following considerations… …cross-checks, including the need for the WACC to be sufficiently high to support financeability*".[9] Such polar changes in the CMA's position are unhelpful to regulatory predictability and undermine investor confidence.

[6] CMA, Water PR24 references – Provisional Determinations, volume 4, 9 October 2025, para 8.212.
[7] CMA, Water PR24 references – Provisional Determinations, volume 4, 9 October 2025, para 7.571.
[8] Competition and Markets Authority, Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations, Final Report, 17 March 2021, para 9.1383.
[9] Competition and Markets Authority, Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations, Final Report, 17 March 2021, para 14.43.

Furthermore, this position seems to fail to reflect the reality that there is an inevitable relationship between financeability and the returns required by equity investors. At its simplest, at times when very limited headroom exists to targeted financial ratios, equity investors effectively bear those increased risks. Investors will factor those risks, such as the risk of under-performing against debt cost allowances, the risk of financeability constraints restricting dividend distributions and, ultimately, the risk that they do not recover their investment in their expectations of required returns. To the extent that these risks are not fully factored into CAPM cost of equity mid-point (for example due to the forward-looking risks not being reflected in beta assumptions), financeability is a very relevant consideration in selecting the point estimate for the cost of equity.

We trust that our views and evidence are clear and helpful. If it would be helpful to the CMA, we can provide further detail, copies of relevant reports by our consultants or access to our consultants.

If you have any questions regarding our submission, please contact me in the first instance (Paul.McGimpsey@energynetworks.org).

Kind regards,

[redacted]

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