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GD29 Treatment of Corporation Tax Call for Evidence

Executive Summary

Kinecx Energy welcomes the Utility Regulator's (UR) Call for Evidence on the treatment of corporation tax within the regulatory framework for Kinecx Energy and Phoenix Energy. We recognise that the issues raised are important for the long-term integrity, transparency and inherent financeability within the regulatory framework.

Under the existing pre-tax WACC methodology, corporation tax is funded implicitly through the allowed rate of return. As outlined in the Call for Evidence, projected corporation tax liabilities are expected to exceed the implicit allowance embedded within allowed returns, with the shortfall increasing over time. This directly reduces funds from operations (FFO) and places pressure on key financeability metrics, particularly the post-maintenance interest cover ratio (PMICR)¹. Addressing this shortfall is therefore essential to fulfilling the UR's statutory duty to ensure that licensees are able to finance their regulated activities.

Kinecx Energy considers there are clear and compelling grounds to revise the treatment of corporation tax on a forward-looking, principle-based and transparent basis. The case for change rests on three principles:

1. Securing Sustainable Financeability

Any revised approach to the treatment of corporation tax within the GD29 price control must ensure that corporation tax liabilities are appropriately funded within allowed revenues on a forward-looking basis.

Options that provide full and transparent funding of tax directly address the UR's stated financeability concerns. Consequently, within the preliminary options set out by the UR in Section 5 of the Call for Evidence, the options most capable of achieving this are:

- Option 2: Pre-tax WACC with a top-up allowance; or

¹ See graph of PMICR ratio over time in response to Question 12



- Option 4: A move to a post-tax “vanilla” WACC with an explicit tax allowance

Both options directly address the identified financeability issue. By contrast, Options 5–7, which apply negative Total Regulatory Value (TRV) adjustments or rely on TRV-derived revenue offsets, would reduce future cashflows, increase leverage ratios, weaken interest cover and debt service metrics potentially placing pressure on debt covenants, and increase the cost of capital, to the detriment of consumers. Thereby undermining the financeability objective that underpins this review.

2. Preserving Regulatory Finality and Avoiding Retrospection

The Call for Evidence considers options involving TRV adjustments or reinterpretation of historical implicit allowances. Kinecx Energy strongly opposes such approaches.

The 2012 Competition Commission (CC) determination in relation to Phoenix Natural Gas is highly relevant in the context of this Call for Evidence. This established a clear and binding principle: historic regulatory allowances, including implicit tax components, are ex ante determinations that cannot be reopened or retrospectively re-allocated. The CC rejected retrospective TRV reductions, on the grounds that they would create a perception of regulatory instability, undermine investor confidence in the regulatory framework on which investment decisions rely and ultimately harm consumers through higher financing costs. Credit rating agencies (including Fitch) explicitly warned that such action would be viewed as poor regulatory practice and could trigger downgrades.

Similarly, Ofgem’s 2023 review of RIIO-2 inflation outcomes rejected retrospective clawbacks for the same reason: such changes undermine investor confidence and risk increasing the companies’ cost of capital which could ultimately be passed through to consumers.

Options 5, 6, and 7, which involve negative TRV adjustments or substituting TRV-derived revenues for future tax allowances, would in substance reopen historic settlements and are therefore inconsistent with these established principles of regulatory stability and finality.

3. Improving Transparency and Alignment with Modern Regulatory Practice

The current pre-tax WACC framework embeds tax within a notional allowance that is not observable or reconcilable to actual liabilities. This lack of transparency to investors, lenders or rating agencies increases uncertainty for investors and credit rating agencies.

Across the UK, regulators including Ofgem and Ofwat, have increasingly transitioned to post-tax vanilla WACC frameworks with explicit treatment of corporation tax. Ofgem’s move at the electricity Distribution Price Control Review 4 (DPCR4) provides clear precedent for transitioning to a vanilla WACC without retrospective adjustments for perceived over- or under-recovery. The UR has itself adopted a post-tax Vanilla WACC for NIE Networks, NI Water and Evolve. These models are now the established regulatory standard for transparent and predictable tax treatment.

This shift towards vanilla WACC for utilities aligns with a general move by regulators to improve transparency in cost of debt and equity, seen across the UK and Northern Ireland from 2018 onwards.



Kinecx Energy does not accept that NI gas networks are materially different in a way that would justify deviation from this established practice. A transition to a post-tax Vanilla WACC in GD29 would be consistent with this best practice, improve comparability across UK networks, strengthen investor confidence, and provide a clear and auditable funding mechanism for corporation tax.

Importantly, such a transition can be implemented prospectively and without transitional TRV adjustments, avoiding the retrospective reinterpretation risks highlighted above.

No Evidence of “Double Counting” or TRV Tax Reserves

The UR suggests that there is a potential for consumers to pay twice if a transition to a post-tax approach is not carefully managed. Kinecx Energy does not consider there to be any risk that customers would “pay twice” if the UR moves to an explicit tax allowance.

- The pre-tax WACC represents a complete ex ante determination of allowed return. It does not create a discrete tax fund, ring-fenced tax allowance or a balance capable of being carried forward through the TRV.
- Similarly, profile adjustments defer aggregate revenue for tariff smoothing purposes; they do not isolate or preserve a tax component within the TRV.
- Differences between implicit allowances and actual tax paid reflect methodological differences, not unspent tax revenue.

Therefore, negative TRV adjustments cannot be justified by reference to a supposed store of historic tax funding as no such store exists within the TRV.

Debt Financeability and Longer-Term Visibility

Kinecx Energy supports a forward-looking approach to debt financeability assessment. Formal financeability assessments should continue to focus on the six-year price control period, consistent with regulatory practice. However, given the long revenue recovery profile in Northern Ireland, it is appropriate for the UR to maintain structured visibility of debt metrics (including PMICR and interest cover) to the end of the recovery period.

The GD23 Final Determination highlights the importance of reviewing financeability metrics for the price control period and beyond. Whilst the UR concluded that their final determination was financeable for the network operators, the metrics were borderline and required substantiation with reference to a 45% gearing ratio (10% less than the 55% gearing used to determine the allowed rate of return). The declining trend of these metrics suggests an inherent issue in the UR’s price control determination methodology and was one of the drivers for this call for evidence.

The UR’s statutory duty to ensure its price controls are financeable provides a clear obligation



to monitor and review financeability metrics and, specifically when looking at financing tax liabilities, TRV based adjustments, adjustments deferred to later periods, or NPV-neutral approaches do not generate the near-term cash flows needed to support key credit metrics. Any approach must therefore allow for the timely recovery of corporation tax liabilities.

Policy Preference

Kinecx Energy considers that both Option 2 (pre-tax WACC with a top-up) and Option 4 (post-tax Vanilla WACC with explicit tax) provide effective, forward-looking solutions.

While both improve on the status quo, Option 4 is strongly preferred as it:

- provides the clearest and most transparent framework,
- secures financeability
- preserves licence regulatory stability for investors,
- aligns with UK regulatory precedent, and
- supports lower long-term consumer costs through a stable and credible regulatory environment.

Kinecx Energy strongly opposes Options 5–7, which introduce TRV adjustments or retrospective reconciliation mechanisms. These options are inconsistent with the financeability rationale for change, conflict with established regulatory precedent, and risk increasing the long-term cost of capital for consumers.

Conclusion

Kinecx Energy considers that the appropriate regulatory response is to draw a clear and principled line between past determinations and future methodology. Corporation tax should be treated explicitly and transparently on a forward-looking, notional-efficient basis, whether via a top-up mechanism or an explicit tax allowance, without reopening or reinterpreting historic price control settlements.

A forward-looking transition to a post-tax vanilla WACC, implemented without any retrospective TRV adjustments, represents the most coherent, robust, and consumer-protective approach. It provides a transparent mechanism for funding actual tax liabilities, strengthens interest cover and overall financeability, aligns Northern Ireland's framework with established UK regulatory practice, and upholds the credibility and predictability on which efficient investment depends.

By adopting a forward-looking methodology grounded in regulatory finality, the UR can deliver a framework that is robust, financeable, and firmly aligned with consumers' long-term interests.



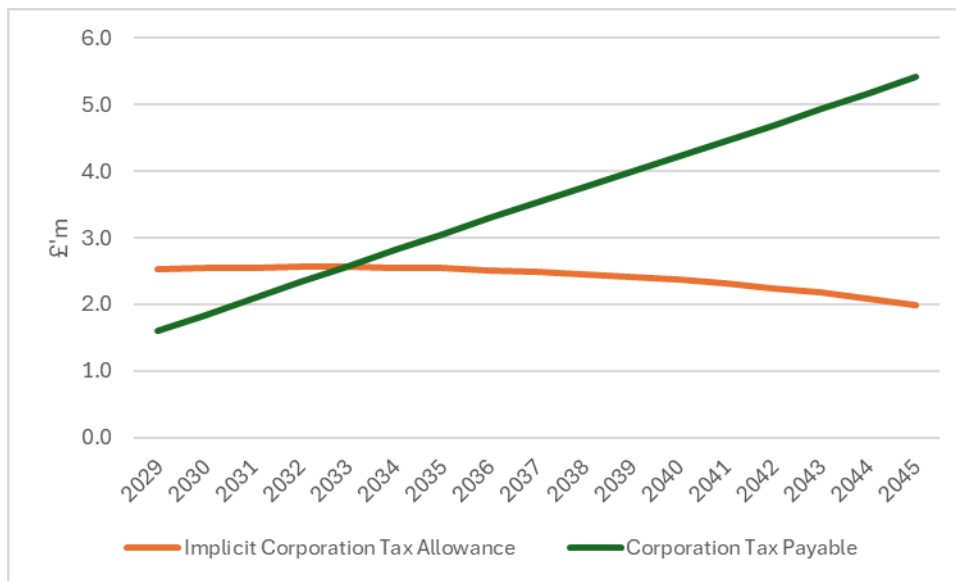
Introduction and Framing

The Utility Regulator (UR) has published this Call for Evidence to consider whether the current treatment of corporation tax, funded implicitly through a pre-tax WACC, remains fit for purpose for Kinecx Energy and Phoenix Energy, and to explore potential alternative approaches for GD29.

The UR identifies emerging financeability pressures as the primary motivation for this review, arising from the increasing divergence between corporation tax payable and the implicit tax allowance provided under the pre-tax WACC framework. Kinecx Energy agrees with this diagnosis. Under the current approach, corporation tax payable is projected to exceed the implicit allowance embedded in allowed returns, with the gap widening over time and placing increasing pressure on key financeability metrics.

The graph below shows this gap, illustrating that Kinecx Energy will be in a position where it is paying excess corporation tax over the implicit corporation tax allowance from 2033 onwards.

Figure 1: Modelled tax allowance vs tax payable (£m, nominal prices)
Based on GD23 Final Determination values and UR methodology



If financeability is the primary motivation for change, our view is that any revised approach should be assessed first and foremost against its ability to secure financeability on a sustainable, forward-looking basis, while maintaining regulatory credibility and protecting consumers over the long term.



Potential changes to the price control funding of Kinecx Energy's corporate tax liabilities

Q1. Do you consider that there are grounds for us to consider changes to the price control funding of Phoenix Energy's and Kinecx Energy's corporation tax liabilities? Please explain the rationale for your view.

Kinecx Energy considers that there are clear and compelling grounds for the UR to consider changes to the current approach to funding corporation tax within the GD29 price control, based on the following:

1. Alignment with current regulatory best practice

UK regulators have increasingly moved away from opaque pre-tax WACC approaches towards post-tax "vanilla" WACC frameworks with explicit treatment of tax, as seen in:

- Ofgem's RIIO-2 framework and DPCR4, where post-tax WACC and explicit tax allowances were introduced.
- Ofwat PR14/PR19 determinations, which explicitly model tax in allowed revenues.
- The UR has similarly adopted a post-tax vanilla WACC for NIE Networks, NI Water and Evolve.

This approach more accurately reflects companies' tax liabilities in each price control period and is better understood by investors and debt providers. Aligning with this established regulatory practice would reduce complexity, improve comparability with other regulated networks, and support efficient financing outcomes.

Any change should be clearly forward-looking rather than retrospective in nature. While there are grounds to reconsider how corporation tax is funded going forward, this does not justify revisiting or reinterpreting historical price control settlements. Retrospective adjustments, for example through TRV reductions or clawbacks linked to historical tax outcomes, would undermine regulatory predictability and stability, risk damaging investor confidence, and ultimately increase financing costs for consumers. Regulatory best practice and precedent consistently show that changes to methodology should be applied prospectively and clearly signalled in advance.

2. Addressing financeability on a sustainable, prospective basis

The UR have noted that their primary motivation for reviewing tax allowances is emerging financeability pressure for Distribution Network Operators (DNOs) as actual corporation tax payable is projected to exceed the implicit allowance in the pre-tax WACC. Kinecx Energy agrees with the UR's assessment that this divergence is increasing over time (as illustrated



for Kinecx Energy in Figure 1 above and for Phoenix Energy in table 3.4 in the UR's Call for Evidence paper) and is reducing funds from operations, placing increasing pressure on key financeability metrics, including interest cover. This financeability pressure is illustrated in Figure 2: Illustrative graph of GD23 PMICR metrics on page 20.

Forward-looking solutions, such as a pre-tax WACC with top-up allowance or a post-tax vanilla WACC with explicit tax, directly address this issue, ensuring sustainable funding of tax liabilities, and protect consumers by maintaining stable and predictable financing conditions. In contrast, retrospective TRV adjustments are inconsistent with this objective and risk undermining both financeability and regulatory certainty.

3. Need for greater clarity and transparency

Change is warranted to improve clarity and transparency in the regulatory framework. The existing pre-tax WACC approach relies on a notional and implicit tax allowance that does not track actual tax liabilities and is not observable or transparent to stakeholders. This lack of clarity makes it difficult for investors, credit rating agencies and other stakeholders to understand how corporation tax is being funded within allowed revenues and increases uncertainty around future cashflows. A revised approach that explicitly addresses how corporation tax is treated would enhance transparency, improve regulatory credibility, and provide clearer signals to the market.

We therefore believe there are strong grounds for the UR to consider changes to the price control funding of corporation tax liabilities, driven by the need to align with modern regulatory practice, secure financeability and improve clarity and transparency. Any revised approach should be implemented on a forward-looking basis only, ensuring that future corporation tax liabilities are appropriately funded while maintaining regulatory stability and protecting consumers' long-term interests.



Q2. Do you consider that we are justified in our concern that simply moving from the current approach to funding Phoenix Energy’s and Kinecx Energy’s corporation tax liabilities (via the pre-tax WACC) to an explicit allowance for corporation tax (combined with a post-tax WACC) would pose risks of customers paying twice for Phoenix Energy’s and Kinecx Energy’s corporation tax liabilities? Please explain the rationale for your view.

Kinecx Energy considers that the UR’s concern that moving to an explicit allowance for corporation tax combined with a post-tax WACC would result in customers paying twice is not justified.

This view is grounded in established regulatory and appeal precedent, most notably the Phoenix Energy appeal of the 2012 price control determination², and in the fundamental principles of economic regulation relating to allowed returns and regulatory commitment.

Regulatory determinations must be made on a single, consistent basis

The 2012 Phoenix Energy appeal considered in detail the question of “looking back” at actual outcomes, including outperformance, and retrospectively adjusting components of the allowed return. The Competition Commission was clear that a regulatory determination must be made on one coherent basis and that it is not permissible for the regulator to retrospectively re-characterise elements of the allowed return once that determination has been made.

Investors commit capital on the basis of an overall allowed rate of return, not on the disaggregated components of that return (tax, cost of debt, or equity return). Once a determination is set, the regulator cannot subsequently seek to adjust or claw back elements of that return by reinterpreting how those components were funded without undermining regulatory certainty.

Section 5, paragraph 5.68, of the Competition Commission report sets this out as follows:

“We consider that good regulatory practice could allow for the treatment of outperformance which involves sharing with customers and time limits on the returns that could be earned on outperformance. However, we have not found any evidence that regulatory practice supports changes to the amount of outperformance that a regulated company can earn after the outperformance has been generated. The reasons for this are referred to in Section 8. we do not see that good regulatory practice of itself includes the adoption of measures with an ex post impact on the amount of outperformance included in the TRV, as it is not consistent with good practice of ex ante incentive regulation. “³

² [Competition Commission \(2012 Phoenix Natural Gas Limited determination](#)

³ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 5.68](#)



Paragraph 5.71 goes on to say:

“Furthermore, we note that the report sets out that it is generally not appropriate to claw back revenue allowed in previous price control periods where the regulator makes a decision to change future arrangements; paragraph 2.141 of the report reads:

“We consider that it is normally undesirable for previous regulatory price controls to be reopened. The RPI-X and periodic price control system does carry risks that allowed revenue may result, in some price control periods, in prices to customers which are either higher or lower than subsequently appear justified. It is right for regulators to seek to capture for customers some of the benefits of efficiency gains. It can also be appropriate to recover excess revenues for allowed capital investment which did not take place. However, we believe it is generally inappropriate to seek to claw back revenue allowed in a previous price control period, where a regulator has decided to change for the future the basis on which such revenue should be calculated, as would be the case in respect of this depreciation allowance.”⁴

On this basis, the concern regarding “double payment” implicitly relies on an assumption that customers have already overpaid for corporation tax under the existing framework and that this can or should be corrected by changing methodology. That approach is inconsistent with the Competition Commission’s findings, which rejected retrospective reassessment of outcomes based on alternative regulatory constructs.

Assessment of the double-payment concern under the WACC framework

We do not consider the UR’s concern to be justified where a move from the current pre-tax WACC to a post-tax vanilla WACC is implemented on a forward-looking basis without transitional TRV adjustments.

There is no clear evidential basis to conclude that customers will have paid twice for corporation tax liabilities. Under the current pre-tax WACC framework, tax is embedded within the allowed return as part of a single, holistic determination of the revenue required to finance the efficient delivery of services.

A pre-tax WACC is a simplified regulatory mechanism that applies a notional tax wedge to the allowed return on equity. It does not create a cash-based, ring-fenced, or banked allowance for corporation tax, nor does it track actual taxable profits or tax payments. Any “implicit

⁴ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 5.71](#)



allowance” for tax is therefore a notional construct rather than evidence of customer pre-payment. Timing differences between notional allowances and actual tax paid do not, in themselves, imply that customers have funded future tax liabilities.

Any outperformance relative to allowed revenues arises from normal regulatory incentives and risk allocation, not from customers ‘overpaying’ or ‘prepaying’ corporation tax. Outperformance is an inherent and intentional feature of incentive-based regulation, reflecting differences between ex ante assumptions and ex post outcomes. It does not follow that such outperformance equates to over-recovery of tax costs.

Crucially, outperformance cannot be selectively attributed to individual building blocks of the WACC after the fact. Attempting to do so risks blurring the distinction between regulatory incentives and accounting frameworks, and re-opening settled determinations.

To the extent there is any “double payment” risk, it would arise only from options that retrospectively reduce TRV or require TRV-derived revenues to substitute for a new explicit tax allowance (UR Options 5–7). Those approaches would reduce future revenues, weaken financeability and raise the cost of capital, to the detriment of consumers.

The Profile Adjustment does not convert notional tax allowances into customer-funded prepayments

The UR’s concern also appears to rest on the suggestion that where implicit tax allowances exceeded actual tax paid in certain years, these amounts may have been stored in the TRV via the Profile Adjustment, such that future customers could ultimately bear the cost.

Kinecx Energy does not consider this inference to be well founded. The Profile Adjustment is a tariff-smoothing mechanism designed to manage the mismatch between high upfront investment costs and a small initial customer base. It defers the recovery of allowed revenues in aggregate and releases them later as the customer base grows. It does not identify, isolate, or preserve specific elements of allowed revenue, such as corporation tax, for future recovery.

Amounts added to the TRV via the Profile Adjustment therefore represent deferred allowed revenue in total, not evidence that customers have pre-funded corporation tax liabilities.

Historical context further undermines the “double payment” concern

Prior to GD17, allowed returns were set as a fixed pre-tax rate and were not derived from a component-based WACC methodology or constructed by grossing up a post-tax return using an assumed tax wedge. These returns were policy judgements reflecting the risks of developing a new gas network, not an explicit or implicit mechanism to pre-fund future corporation tax



liabilities.

This is confirmed in the Competition Commission's determination in the Phoenix Energy appeal, which stated;

“We have seen no evidence that the allowed rates of return in 1996 and in 2006 were estimated on a detailed, bottom-up basis. No contemporaneous documentation is available to explain the calculations made. We infer from these statements that no bottom-up estimation of the 8.5 and 7.5 per cent rates of return had been undertaken at the time that they were set, and that they appeared to have been reached by negotiation:

(a) UR noted that:

PNGL's original rate of return was set at 8.5 per cent in 1996. As part of the 2007 licence determination the rate of return was reduced to 7.5 per cent, with the one per cent reduction determined as part of the overall licence package. In the absence of a detailed build-up of the typical components that constitute the cost of capital, it is difficult to set out precisely the balance between risks and returns.”⁵

The Competition Commission also cited supporting evidence from Fitch in the report, noting that:

“The licence provides for a cost of capital in terms of pre-tax WACC of 7.5% until the end of 2016. This rate includes a premium for the developer of the gas distribution network in NI as compensation for project/ construction risk and, therefore, ranges higher than comparables of Ofgem regulated entities.”⁶

In the absence of any contemporaneous modelling or communication to that effect, it is not reasonable to retrospectively re-characterise elements of historical allowed returns as tax prepayments.

Implications of changing methodology

While Kinecx Energy recognises that the UR may wish to review methodologies on a forward-looking basis, any transition from a pre-tax to a post-tax WACC framework must be implemented only to future periods and in a manner that preserves a consistent approach. If implemented correctly, there is no inherent risk of customers paying twice for corporation tax.

⁵ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 7.10](#)

⁶ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 7.80](#)



The real risk lies instead in adopting a narrative that implies historic over-recovery or double payment where none has been demonstrated, as this could undermine regulatory credibility and investor confidence by suggesting that allowed returns are subject to retrospective reinterpretation.

In summary, Kinecx Energy does not agree that the proposed methodological change poses a risk of customers paying twice for corporation tax. The concern is not supported by regulatory precedent or by a proper understanding of how allowed returns, investor expectations, and outperformance function within an incentive-based regulatory framework. Any future change in approach should be applied on a clear, consistent, and forward-looking basis, without revisiting or re-labelling outcomes from previous determinations.



Q3. Do you consider that carrying out a historical assessment of the implicit allowances for corporation tax, and comparing these to Phoenix Energy’s and Kinecx Energy’s actual tax liabilities, would provide relevant evidence to help inform decisions on any changes to the regulatory approach to funding Phoenix Energy’s and Kinecx Energy’s corporation tax liabilities? Please explain the rationale for your view.

Kinecx Energy does not consider that undertaking a historical assessment of implicit allowances for corporation tax and comparing these to Kinecx Energy’s actual tax liabilities would provide relevant or reliable evidence to inform decisions on any changes to the regulatory approach to funding corporation tax on a forward-looking basis.

Methodological limitations

Corporation tax is inherently complex, and actual tax liabilities are driven by a wide range of factors that sit outside the regulatory framework. In the case of Kinecx Energy in particular, historic tax paid was determined on a consolidated group basis, reflecting a corporate structure that included multiple holding companies and, until recently, an energy retail subsidiary.

The retail business naturally experiences fluctuating profitability, and in years where losses arose, these could be offset against profits elsewhere in the group through group relief. As a result, the level and timing of corporation tax paid by Kinecx were materially influenced by group-wide performance rather than the stand-alone profitability of the regulated network company.

Attempting to retrospectively isolate or reconstruct a hypothetical “stand-alone” corporation tax position for Kinecx would therefore require extensive assumptions about assumed corporate structures and tax profiles that did not exist in reality. Any such exercise would be inherently subjective and would significantly limit the robustness and comparability of the resulting analysis.

In addition, a pre-tax WACC does not create a distinct, cash-based, or ring-fenced allowance for corporation tax. The so-called “implicit allowance” is a notional construct derived from applying an assumed tax wedge to a notional return on equity. It does not track actual taxable profits, capital allowances, or cash tax payments, and does not represent funding that can be meaningfully compared to actual tax paid. The existence of timing differences between notional allowances and actual tax outcomes does not, in itself, imply pre-funding of future tax liabilities.

From GD17 onwards, it may be possible to infer a notional implicit allowance by comparing the pre-tax and post-tax cost of equity. However, this inferred allowance was never designed to



correspond to actual tax funding or to pre-fund future corporation tax liabilities. The UR explicitly recognises that the pre-tax WACC approach does not align tax allowances and tax liabilities in any given year, further limiting the relevance of any historical comparison exercise.

Limited relevance to regulatory decision-making

More fundamentally, Kinecx Energy does not believe that comparing historic implicit tax allowances embedded within a pre-tax WACC to actual tax paid ex post is conceptually appropriate. As established regulatory precedent makes clear, determinations are made on a single, ex ante basis, with investors earning an overall allowed return rather than a series of separately reconciled building blocks.

Such a comparison conflates two fundamentally different concepts: a notional regulatory allowance derived from assumed parameters (including notional gearing, notional returns, and the statutory tax rate), and the company's realised tax position in the real world. Actual corporation tax paid reflects factors deliberately abstracted from the regulatory framework, including financing decisions, tax efficiency, group structure, and performance relative to regulatory assumptions. As a result, differences between notional allowances and actual tax paid do not provide a sound basis for assessing the appropriateness of the regulatory methodology.

Differences between assumed and actual outcomes, including tax, are an inherent feature of incentive-based regulation. They do not imply regulatory error or over- or under-recovery that should be subject to correction retrospectively. Historical re-assessment risks blending regulatory allowances with company-specific tax outcomes driven by financing, group structure, and tax planning decisions that were not, and could not reasonably have been, reflected in the regulatory determination.

Risk of misleading conclusions

Given these complexities, Kinecx Energy considers that an historical comparison exercise could be misleading and may imply a level of certainty that cannot be supported. There is a significant risk that conclusions drawn from such analysis would reflect company-specific circumstances rather than informing the appropriateness of the regulatory methodology itself.

These risks are further compounded by the fact that, prior to 2016, allowed returns were not estimated using a component-based WACC methodology. It is therefore not feasible to calculate implicit corporation tax allowances for earlier periods in a robust or non-arbitrary way. Any attempt to do so would retrospectively impose assumptions that were not part of the original regulatory settlement, undermining the credibility of the analysis.



Any changes to the treatment of corporation tax being considered by the UR must be assessed on a sound, forward-looking basis, focusing on consistent approach, transparency, and alignment with regulatory objectives, rather than on retrospective analysis of historic tax outcomes.

Kinecx Energy does not consider that a historical assessment of implicit corporation tax allowances versus actual tax liabilities would provide meaningful or reliable evidence to inform future regulatory decisions. The complexity of tax, particularly in the context of historic group structures such as Kinecx's, combined with the ex-ante nature of regulatory determinations, means that such analysis would be of limited relevance and could risk undermining regulatory clarity and certainty.



Q4. Do you have any initial views on any of the list of policy options, or any further options that might be considered?

Kinecx Energy does not propose any additional policy options beyond those identified by the UR. Moreover, when moving from a pre-tax WACC to an explicit allowance for corporation tax (combined with a post-tax WACC), regulatory precedents provide a clear pathway using only one of the options proposed (Option 4). The Call for Evidence reflects emerging financeability pressures arising from the growing divergence between corporation tax payable and the implicit allowance under the pre-tax WACC framework. Kinecx Energy agrees that any revised approach should therefore be assessed primarily on its ability to secure financeability on a sustainable, forward-looking basis.

Kinecx Energy therefore supports the following options:

- **Option 2:** retention of a pre-tax WACC with a top-up allowance where the implicit allowance is made sufficient to fund corporation tax liabilities; and, in particular,
- **Option 4:** a move to a post-tax Vanilla WACC with an explicit tax allowance and without any TRV adjustment.

Both of these options directly address the UR's stated financeability concerns by ensuring that corporation tax liabilities are fully funded on a forward-looking basis, without relying on retrospective reinterpretation of historical allowances. They are also consistent with modern regulatory practice and are comparatively simple and transparent to implement.

By contrast, Kinecx Energy strongly disagrees with **Options 5, 6 and 7**, which introduce TRV adjustments or mechanisms that effectively reduce future revenues. These options are inconsistent with the financeability motivation for change and raise significant concerns in relation to regulatory principles, implementation feasibility, and consumer outcomes. In particular, they risk undermining financeability by weakening future cashflows and increasing leverage, without providing a robust or proportionate solution to the issues identified by the UR.

Table 2 below gives a high level overview of Kinecx Energy's position on the options presented in the Call for Evidence. We proceed to set out our initial views on each of the seven options in the Call for Evidence in more detail.



Table 2: Summary of Kinecx Energy view of options set out by the UR

No.	Option	Kinecx view
1	Status quo - continue with pre-tax WACC allowance	Option does not address key financeability concerns.
2	Pre-tax WACC allowance with top-up allowance if that is insufficient	Option does address financeability concerns by guaranteeing full funding for corporate tax liability.
3	Retain pre-tax WACC subject to high-level modelling of long-term adequacy of funding	Option does not directly address the forward looking financeability challenges and the modelling of long term adequacy of funding requires simplifying assumptions and is unlikely to be accurate. We do not consider this option to be effective.
4	Move to post-tax vanilla WACC with no transitional adjustments	Option does address financeability concerns by guaranteeing full funding for corporate tax liability.
5	Move to post-tax vanilla WACC with one-off TRV adjustment intended to be Net Present Value (NPV) neutral on a forward-looking basis	Option raises significant concerns in relation to regulatory principles, implementation feasibility, and consumer outcomes as well as being inconsistent with the financeability motivation for change.
6	Move to post-tax vanilla WACC with one-off TRV adjustment to deduct unused corporation tax funding stored in the TRV	Option raises significant concerns in relation to regulatory principles, implementation feasibility, and consumer outcomes as well as being inconsistent with the financeability motivation for change.
7	Move to post-tax vanilla WACC with recognition of historical funding for future corporation tax liabilities.	Option raises significant concerns in relation to regulatory principles, implementation feasibility, and consumer outcomes. Although not as severe as the options with TRV adjustments, this option will also have a negative impact on financeability.

Kinecx Energy overview of options

Kinecx agrees with the UR’s diagnosis that, under the current pre-tax WACC, corporation tax payable is projected to exceed the implicit allowance embedded in allowed returns, creating financeability pressures (notably on interest-cover metrics). Any reform should therefore be judged principally on whether it secures financeability on a sustainable, forward-looking basis, maintains regulatory credibility, and protects consumers over the long term. On that test, Options 2 and 4 meet the objective; Options 5–7 do not.



Option 1 - Status quo: continue with pre-tax WACC

Option 1 is the simplest administratively but does not address the emerging gap between tax allowances and actual tax payable. As the UR has illustrated for GD23, implicit tax allowances are flat while tax payable trends upward, weakening funds from operations and interest-cover metrics. Persisting with the status quo would therefore leave the financeability problem unaddressed and push risk onto the notional efficient company and ultimately consumers via a higher cost of capital.

We do not support this option. It fails the financeability test and offers no durable solution to the structural mismatch between allowances and liabilities.

Option 2 - Pre-tax WACC with a “top-up” tax allowance where implicit funding is insufficient

Option 2 retains the familiar pre-tax framework but introduces a targeted top-up so that tax liabilities are fully funded when the implicit allowance falls short. Properly specified, this is a proportionate correction that can be calibrated to the notional efficient company, avoiding retrospective reinterpretation of past settlements and keeping the change narrowly focused on the identified shortfall. Implementation effort is modest relative to a full framework shift and, crucially, it secures forward-looking financeability without disturbing the TRV.

Kinecx Energy is supportive of Option 2 as a solution. It directly addresses the gap and preserves predictability, though it is less transformative than Option 4 in terms of transparency.

Option 3 - Retain pre-tax WACC subject to high-level modelling of long-term adequacy

Option 3 relies on illustrative long-term modelling to show that the pre-tax approach is, on average, adequate, over time, with a promise to revisit if conditions change. In practice, the long-term NPV balance is highly sensitive to assumptions (WACC, investment profile, inflation, capital allowances) and provides no remedy for the near-term cashflow shortfall that drives pressure on credit metrics. This option risks delaying necessary intervention while the cashflow shortfall persists, and the reliance on long-dated modelling offers limited reassurance to lenders or rating agencies focused on near-term credit metrics.

We do not support Option 3. It does not directly resolve the forward-looking financeability challenge and rests on uncertain, simplifying assumptions.

Option 4 - Move to post-tax “vanilla” WACC with an explicit corporation tax allowance (no transitional adjustments)

Option 4 replaces the implicit tax wedge with an explicit annual tax allowance alongside a post-tax (vanilla) WACC, aligning allowances with actual tax liabilities in each control period.



This is consistent with modern UK regulatory practice (e.g., Ofgem/NIE/NI Water) and improves transparency, comparability, and credit-metric predictability. Significantly, implemented prospectively and without any TRV adjustments, it addresses the financeability concern while avoiding retrospective reinterpretation of historic settlements.

Option 4 is Kinecx Energy's preferred option. It is the clearest, most robust way to secure sustainable financeability and maintain regulatory credibility, while protecting consumers by lowering uncertainty and supporting efficient financing costs.

Option 5 - Post-tax vanilla WACC with a one-off “NPV-neutral” TRV adjustment

Option 5 pairs the post-tax WACC with an up-front TRV deduction intended to be NPV-neutral on a forward-looking basis. In practice, any negative TRV adjustment lowers future revenues, reduces cashflows, and can weaken financeability (higher leverage ratios, lower interest cover, potential covenant pressure), undermining the very rationale for reform. Estimating an NPV-neutral correction requires long-horizon forecasts of tax and allowances that are inherently uncertain, raising implementation risk and scope for dispute. Such adjustments are counterproductive, with adverse implications for investor confidence and consumer costs.

Kinecx Energy strongly oppose Option 5. It undermines financeability, is complex to implement, and is inconsistent with regulatory predictability and the avoidance of retrospective reopening of settled controls.

Option 6 - Post-tax vanilla WACC with a one-off TRV deduction for “unused” historic tax funding in the TRV

Option 6 explicitly seeks to calculate “unused” implicit tax allowances historically and deduct them from the TRV. Conceptually, this conflates a notional (implicit) allowance within the pre-tax WACC with actual tax paid at group/company level and presumes that the difference was stored in the TRV. The UR's has itself recognised the inherent evidential and modelling challenges (pre-GD17 breakdowns are absent; group relief and capital allowances complicate reconstruction). The Profile Adjustment is a tariff-smoothing device, not a ring-fenced store of tax, so the premise for a deduction does not hold, and any TRV reduction would directly erode future revenues and weaken financeability.

Kinecx Energy strongly oppose Option 6. It is conceptually flawed, practically challenging, and damaging to financeability and regulatory stability.

Option 7 - Post-tax vanilla WACC with recognition of historical funding via TRV-derived revenues (no one-off TRV hit)

Option 7 avoids an immediate write-down but proposes to use future TRV-derived revenues in



lieu of providing a new explicit tax allowance. Economically, this has the same effect as a TRV deduction spread over time: lower future revenues, weaker cashflows, and worse credit metrics, which raises the cost of capital borne by consumers. It also rests on the same premise that the TRV embodies a store of historical tax funding, which is not how the Profile Adjustment operates. While less immediate in its impact than Option 6, it still undermines the forward-looking financeability objective.

We oppose Option 7. Although less severe than Options 5–6 at the opening balance date, it reduces future cashflows and weakens financeability over time.

Policy preference

While both Options 2 and 4 would represent an improvement on the status quo, **Kinecx Energy's preferred approach is Option 4**, a transition to a post-tax vanilla WACC with an explicit corporation tax allowance and no transitional or retrospective adjustments.

The most appropriate way forward is to “draw a line” and move fully to a post-tax framework that establishes a corporation tax allowance which is robust, transparent and workable for both the UR and the Distribution Network Operators (DNOs). For DNOs, the allowance must be sufficient to ensure that projected corporation tax liabilities are appropriately covered within allowed revenues. For the UR, it must provide confidence that tax costs are not over-recovered relative to an efficient notional position.

This assessment should be conducted on a notional, efficient tax basis, rather than reflecting the specific realities of actual corporate structures, financing arrangements, or historic group reliefs. The regulatory framework should ensure that a notional efficient company is financeable under the allowance, recognising that it is the responsibility of the DNOs to manage their actual tax and financing positions within that framework.

Adopting Option 4 avoids the complexity, uncertainty and risk associated with transitional mechanisms or retrospective adjustments intended to reconcile historical tax outcomes. It provides regulatory clarity, aligns with established incentive-based regulatory principles, and supports a stable and predictable investment environment, while ensuring that corporation tax is treated explicitly and transparently going forward.



Q5. Are there are other facts or considerations which are not sufficiently covered in this Call for Evidence which you consider to be important at this stage for consideration of the future funding of Phoenix Energy’s and Kinecx Energy’s corporation tax liabilities?

Kinecx Energy considers that future funding arrangements for corporation tax should be clearly forward-looking, principle-based, and transparent, avoiding any retrospective reinterpretation of historical allowances. Any changes should preserve regulatory predictability and ensure the financeability of the networks, consistent with established regulatory precedent.

TRV adjustments are inconsistent with regulatory principles

We consider that the options the UR has suggested involving TRV adjustments for future funding of corporation tax liabilities are inconsistent with established regulatory principles. In substance, the UR’s proposals would have the effect of retrospectively reopening price controls that have already been settled, by reinterpreting how historical allowances should have operated.

The TRV represents a store of future revenues generated through regulatory depreciation, allowed return, and profile adjustments. Negative adjustments to the TRV would reduce these future revenues, thereby weakening Kinecx Energy’s ability to service debt and maintain financeability. This is not only a matter of principle, but also a practical credit concern. Regulatory changes should be signalled in advance, subject to consultation, and applied only on a forward-looking basis.

This reflects well-established principles of regulatory predictability, including those set out by the Department of Business, Innovation & Skills (BIS) in 2011, which state that:⁷

“...the framework for economic regulation should provide a stable and objective environment enabling all those affected to anticipate the context for future decisions and to make long term investment decisions with confidence.”

“...the framework of economic regulation should not unreasonably unravel past decisions and should allow efficient and necessary investments to receive a reasonable return, subject to the normal risks inherent in markets.”

Negative TRV adjustments would be inconsistent with these principles. Retrospective regulation risks undermining investor confidence in the stability and predictability of the regulatory regime. Investors commit capital on the basis they will recover their principal capital according to well-understood methodology along with stable and predictable returns on the part of the investment

⁷ [Department for Business Innovation & Skills \(2011\), Principles for Economics Regulation, page 5](#)



not yet recovered. A negative TRV adjustment would mean that investors fail to recover the principal of the capital.

Credit rating agencies explicitly factor regulatory predictability and TRV movements when assessing the credit quality of regulated companies⁸, and a negative TRV adjustment would be viewed adversely in that context. Any weakening of the perceived credit worthiness would increase the cost of raising finance, which ultimately feeds through to higher costs for consumers. This would be counterproductive given the stated rationale for the UR's review of the TRV.

Regulatory precedent strongly opposes retrospective TRV adjustment

There is substantial regulatory and appeal precedent against retrospective action. In 2012, Phoenix Energy successfully appealed a negative TRV adjustment to the Competition Commission. The Competition Commission rejected the UR's proposed retrospective deductions relating to the treatment of historic outperformance and capex deferral. The Competition Commission concluded that such action would create a perception of regulatory instability and harm consumers by increasing financing costs.

In reaching this conclusion, the Competition Commission considered evidence from credit rating agencies. Fitch noted that:

“The regulator’s move to propose a retrospective TRV adjustment relating to outperformance dating from the years 1996-2006 is not considered by the agency to be good regulatory practice.”⁹

Fitch indicated that a material TRV adjustment would likely have led to a downgrade of Phoenix Energy’s credit rating.¹⁰

The Competition Commission concluded that retrospective action would “create a perception of regulatory instability” thereby deterring and/or increasing the cost of funding the sector.¹¹ These effects, it found, would ultimately harm consumers by increasing financing costs and undermining future network investment.

More recently, Ofgem reached similar conclusions in its 2023 consultation on the treatment of inflation. Ofgem considered, but ultimately rejected, retrospective clawbacks of RIIO-2 inflation outperformance. Credit rating agencies again responded negatively to the prospect of retrospective intervention. Moody’s commented that:

⁸ See, for example, Moody’s (2024), [Rating Methodology: Regulated Electric and Gas Utilities](#)

⁹ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 8.39](#)

¹⁰ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 8.39](#)

¹¹ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 31](#)



“We believe the most radical option, for example by clawing back retrospective outperformance in RIIO-2, was included largely for completeness. Such a change would undermine investor confidence in the predictability and stability of the regulatory regime when significant investment is required, especially by the electricity networks, to facilitate decarbonisation objectives.”¹²

Ofgem ultimately decided against an outperformance true-up, concluding that it would likely result in a net detriment to consumers. In particular, Ofgem recognised that “[a] strong perception of regulatory stability and credibility keeps the cost of capital down for consumers”, and that even a small increase in the cost of capital could outweigh any potential short-term consumer benefit.¹³

These examples of regulatory precedent reinforce the conclusion that retrospective adjustments, particularly those affecting asset values or future revenue, are avoided by regulators because of the long-term harm they cause to financeability and, ultimately, to consumers.

Transitioning to a Vanilla WACC without TRV adjustments aligns with established Ofgem precedent

There is clear regulatory precedent for transitioning to a Vanilla WACC regime without retrospective adjustments for perceived over- or under-recovery of tax, including Ofgem’s move to a Vanilla WACC at DPCR4 (2004).

Kinecx Energy do not agree with the UR’s suggestion that the GB networks regulated by Ofgem are materially different from Phoenix Energy and Kinecx Energy in a way that is relevant to the treatment of corporation tax. Ofgem, like the UR, has statutory duties both to protect consumers and to ensure that regulated companies remain financeable. In moving to a Vanilla WACC with an explicit tax allowance, Ofgem would have considered the inter-temporal effects of the change and ensured that the change does not amount to retrospective adjustment which would have been detrimental to consumers’ long-term interests.

The absence of a defined investment recovery period in GB does not alter the relevance of this precedent. The core regulatory principles, stability, predictability, and the avoidance of retrospective reinterpretation of settled arrangements, apply equally within different regulatory frameworks. We therefore consider this precedent to be directly relevant.

Importantly, transitioning to a post-tax Vanilla WACC for future periods can be done safely without any retrospective TRV adjustments. This ensures alignment with regulatory precedent, preserves

¹² [Moody’s - credit rating, research, and data for global markets \(2023\) Ofgem outlines possible changes following high inflation, page 4](#)

¹³ [Ofgem \(2023\), Call for Input - Impact of high inflation on the network price control operation – Conclusion and Next Steps, paragraph 3.7](#)



financeability, and maintains investor confidence while still allowing the UR to adopt an explicit tax allowance moving forward.

Consistency with other regulated utilities in Northern Ireland and GB

The UR's approach to the treatment of corporation tax for Phoenix Energy and Kinecx Energy should also be consistent with its approach to other regulated utilities in Northern Ireland, including NIE Networks, NI Water and Evolve, and aligned with established regulatory practice in Great Britain.

In those frameworks, corporation tax is treated as an allowable cost and funded through an explicit, forward-looking allowance within the price control. This reflects the principle that regulated revenues should be sufficient to meet efficiently incurred costs, including tax, while maintaining financeability. There is no precedent for retrospectively revisiting historic allowances in order to offset future tax funding.

A consistent approach across regulated sectors is important for regulatory credibility and investor confidence. Divergent treatment of gas distribution networks would create avoidable regulatory asymmetry and undermine the perception of a coherent framework.

In addition, the revenue profile of gas distribution networks means that taxable profits are expected to increase over time as revenues grow while operating expenditure remains relatively stable. Without an explicit and properly calculated tax allowance, this dynamic gives rise to a structural funding shortfall.

Addressing this shortfall through a transparent, forward-looking allowance would ensure consistency with other regulated entities, maintain financeability, and better protect consumers' long-term interests. Failure to do so risks eroding financeability or requiring corrective action in later periods, increasing regulatory risk and ultimately raising costs for consumers.

Methodology for calculating the tax allowance

Economic analysis carried out for GD17 demonstrated that how corporation tax is incorporated into allowed revenues can materially affect whether tax is fully funded. As corporation tax is levied on nominal earnings, converting a real post-tax cost of equity directly to a real pre-tax allowance in a 'one-step' conversion understates the tax uplift as it effectively ignores tax on the inflation-linked component of returns.

A multi-step conversion via nominal (i.e., post-tax real → post-tax nominal → pre-tax nominal → pre-tax real) is required to avoid under-funding. In analysis carried out for, a one-step conversion understated the allowance by c.30–34 basis points using the same statutory tax rate assumption; this is a material shortfall for financeability.



This methodological issue for the treatment of tax in pre-tax cost of capital estimate is directly relevant to options 1-3 in Section 5 of the Call for Evidence:

- **Option 2 (pre-tax WACC with a targeted top-up)** — which Kinecx Energy broadly supports (not our preference), requires the UR to quantify the shortfall between implicit and actual tax funding. Any top-up mechanism must therefore be based on a nominal multi-step methodology to avoid replicating the structural understatement identified at GD17.
- **Options 1 and 3 (retention of the pre-tax WACC)** — while not supported, would also require careful consideration of conversion methodology if the UR continues to rely on implicit tax uplifts. The GD17 evidence demonstrates that the choice of uplift methodology alone can materially affect financeability outcomes, irrespective of broader policy design.

Options 4-7 all move to a post-tax cost of capital with a specific allowance for taxation. The above issues, whilst not directly applicable, highlight the importance of ensuring an appropriate methodology for the calculation of any allowance for taxation.

In light of the points set out above, Kinecx Energy considers that the appropriate course for GD29 is to adopt a clearly forward-looking and principle-based approach to the treatment of corporation tax. This should involve the introduction of an explicit allowance that is transparently calculated and recovered on a contemporaneous basis and derived using a robust multi-step nominal methodology to ensure that tax on nominal returns is fully funded.

Such an approach would align allowances with actual liabilities, avoid retrospective reinterpretation of settled price controls and preserve the integrity of the TRV. It would provide clarity, consistency and predictability within the price control framework, secure financeability, and maintain investor confidence. In doing so it would promote a stable and credible regulatory environment that supports efficient financing costs and protects the long-term interests of consumers.



Historical price control allowances for Phoenix Energy and Kinecx Energy corporate tax liabilities

Q6. Do you consider that there has been an "implicit allowance" for corporation tax (provided as part of the pre-tax WACC allowance) under the price control arrangements for Phoenix Energy and Kinecx Energy? Please explain the rationale for your view.

Kinecx Energy does not agree with the underlying premise that it is appropriate or necessary to look back at previous determinations and attempt to reconstruct or reinterpret historical tax allowances in order to inform the treatment of corporation tax in future price controls. Any assessment of future tax funding should be conducted on a strictly forward looking basis, consistent with established regulatory principles of predictability and not hindsight.

Whether an “implicit allowance” may have existed in the past has no bearing on the appropriate future treatment of corporation tax and historical allowances, implied or otherwise, should not be treated as creating a basis for offsetting or adjusting future tax entitlements. The relevant question for GD29 is how to ensure corporation tax liabilities are appropriately and transparently funded going forward, not how past price controls may be retrospectively re-characterised.

Notwithstanding our fundamental objection to retrospective reinterpretation, we recognise that an implicit allowance for corporation tax can be said to have existed under the pre-tax rate of return / pre-tax WACC applied to both Phoenix Energy and Kinecx Energy. That allowance, however, was embedded within the headline rate of return rather than modelled explicitly as a separate building block. The scale of the allowance cannot be reliably quantified for periods prior to GD17, although post-GD17, the adoption of a bottom-up WACC methodology and the use of an assumed UK corporation tax rate allow for an indicative estimate of the implicit tax allowance.

Under historic NI gas distribution price controls, corporation tax was not modelled explicitly. Instead, tax was assumed to be recovered implicitly through the pre-tax rate of return, which was intended to represent an “all-in” return sufficient to cover the post-tax cost of equity, the cost of debt, and the associated tax burden. This is consistent with a traditional pre-tax WACC framework, in which the tax allowance is embedded within the overall return but not separately observable.

The UR’s concern appears to rest on an implicit assumption that a pre-tax WACC systematically provides funding for future corporation tax liabilities. However, it is important to distinguish between the existence of a notional tax wedge within a pre-tax WACC and the suggestion that



such an approach systematically funds future corporation tax liabilities. A pre-tax WACC is a simplified regulatory mechanism that applies a notional tax wedge to the allowed return on equity. It does not create a discrete, cash-based, ring-fenced allowance for tax, nor does it track actual taxable profits, capital allowances or cash tax payments. The resulting “implicit allowance” is therefore a notional construct, not a funded balance.

Evolution of the framework

The indeterminate nature of any historic implicit allowance is reinforced by the evolution of the price control framework.

For **Phoenix Energy**, pre-GD17 returns were set on a headline pre-tax basis without publication of a breakdown between equity, debt and tax components. Any tax element was inseparable from broader assumptions embedded in the allowed return.

For **Kinecx Energy**, from 2005 to 2016 a single blended pre-tax return of 7.5% applied. This was not derived from a component-based WACC methodology and was not constructed by grossing up a post-tax return on equity using a tax wedge. Rather, it was a policy judgement reflecting the risks of developing a new gas distribution network with high upfront costs, long asset lives and a very limited initial customer base. It was not communicated, modelled, or described as embedding a specific allowance for corporation tax, still less an allowance intended to be carried forward to meet future liabilities.

This understanding is reinforced by the Competition Commission’s 2012 determination in the Phoenix Energy appeal. The Commission found that the historic 8.5% and 7.5% allowed returns had not been derived through a detailed bottom-up WACC estimation and that no contemporaneous documentation existed explaining their calculation. It inferred that the returns appeared to have been reached by negotiation rather than by explicit modelling of individual components such as equity, debt and tax. In those circumstances, it is not possible to isolate or reconstruct a specific “tax wedge” embedded within the historic headline return.¹⁴

From GD17 onwards, it is possible to infer a notional implicit allowance by comparing the pre-tax and post-tax cost of equity, as illustrated by the UR in Table 3.2¹⁵. However, this allowance was never designed to pre-fund future corporation tax liabilities. It represents an approximate tax wedge applied to a notional return, and the UR explicitly recognises elsewhere in the Call for Evidence that the pre-tax WACC approach does not align tax allowances and tax liabilities in any given year. The existence of timing differences between notional allowances and actual tax paid does not, in and of itself, imply pre-funding.

¹⁴ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 7.10](#)

¹⁵ Note Oxera’s concerns, previously referenced, in relation to the calculation of this implicit corporation tax allowance



No basis for retrospective re-characterisation

Historical allowed returns were not intended to pre-fund future corporation tax liabilities. At the time of licence award and in subsequent determinations, there was no explicit methodology or agreement that any element of the allowed return was to be set aside for future tax. In the absence of such communication or modelling, it would not be reasonable to retrospectively re-characterise part of the historical allowed return as funding set aside for future corporation tax.

The Competition Commission further emphasised in its 2012 determination that it is generally inappropriate to reopen previous regulatory settlements or to claw back revenue allowed in earlier price control periods where the regulator has decided to change the methodology for the future. The Commission made clear that regulatory determinations must be assessed on the coherent basis on which they were made and that it is not consistent with good regulatory practice to retrospectively adjust or re-characterise elements of an allowed return after the fact. This principle applies equally to any attempt to disaggregate historic headline returns into component parts that were never explicitly modelled or identified at the time.

“We believe it is generally inappropriate to seek to claw back revenue allowed in a previous price control period, where a regulator has decided to change for the future the basis on which such revenue should be calculated...”¹⁶

Quantification challenges

Retrospective quantification of any implicit allowance is not feasible because:

- The pre-tax return was set as a single composite parameter rather than through an explicit WACC build-up (particularly prior to GD17).
- Company-specific tax drivers (e.g. gearing, interest deductibility, capital allowances and group relief) evolved over time and were not reflected in the regulatory return.
- Changes in headline allowed returns were driven by multiple regulatory considerations, not tax assumptions alone.

These features are consistent with wider regulatory experience in GB, where regulators have moved away from pre-tax WACC frameworks in part because implicit tax allowances are opaque and difficult to reconcile with actual liabilities.

Kinecx Energy accepts that an implicit allowance for corporation tax has historically existed within the pre-tax returns applied to Phoenix Energy and Kinecx Energy. However, that allowance was embedded and not explicitly modelled, cannot now be reliably identified or quantified (particularly pre-GD17), and was never designed or communicated as a mechanism

¹⁶ [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraph 5.71](#)



for pre-funding future corporation tax liabilities.

These limitations highlight the inherent vagueness of the historic framework and support consideration of a clearer and more transparent treatment of corporation tax on a forward-looking basis rather than the retrospective reinterpretation of settled price control determinations.



Q7. Do you consider that for the period from GD17 onwards, the level of implicit allowance can be calculated based on the parameters used to build up WACC, as illustrated in Table 3.2. Please explain the rationale for your view, and if you disagree, explain an alternative calculation method.

Kinecx Energy acknowledges that from GD17 onwards it is possible to infer a notional implicit allowance for corporation tax from the parameters applied in the bottom-up WACC determination, as illustrated in Table 3.2 of the Call for Evidence. Using these inputs, the implicit allowance can be calculated as a notional percentage of the pre-tax return. However, this calculation is indicative only and has significant limitations.

Why estimation is possible post-GD17

From GD17, the UR adopted a bottom-up approach to setting the allowed rate of return, explicitly specifying:

- an assumed capital structure (gearing),
- the cost of debt,
- the cost of equity, and
- an assumed UK corporation tax rate.

This change in approach means that, unlike earlier price controls, an implied tax component can be inferred by comparing pre-tax and post-tax returns within the WACC framework.

It is worth noting that, under our response to Question 5, we outline the concerns that Oxera have with the tax allowance included in the real pre-tax weighted average cost of capital and their assertion that the UR has underestimated allowed returns in applying its tax wedge within the WACC estimate. Their concerns would call in to question the methodology used in the Call for Evidence to calculate an historic implicit corporation tax allowance (Table 3.2).

Further transparency at GD23

Kinecx Energy recognises that GD23 added further improved transparency by:

- explicitly stating the assumed statutory UK corporation tax rate (“going rate”) used in the determination, and
- introducing a mechanism to adjust for changes in the statutory rate over the price control period.

These developments reduced regulatory ambiguity and provided greater clarity than existed prior to GD17. However, they did not fully remove the embedded nature of tax within the allowed return. As such, even under GD23, the allowance for corporation tax remained implicit, rather than being provided as a fully explicit cash-flow building block.



Why the implicit allowance remains conceptually limited

The pre-tax WACC represents a regulatory construct that embeds an estimated tax component within the allowed return on equity. It does not correspond to a separately identifiable or cash-backed pool of funds for paying corporation tax, nor does it reflect the company's actual taxable profits or cash tax payments.

Accordingly, the notional tax allowance implied by the WACC was never intended to provide advance funding for future tax liabilities, and any differences between this implied allowance and actual tax payments cannot be interpreted as pre-funded amounts.

As recognised in the Call for Evidence, the pre-tax WACC does not align tax allowances and tax liabilities in any given year, and timing differences between notional allowances and actual tax paid do not imply pre-funding.

Important limitations of any calculated allowance

Even with GD17 and GD23 improvements, Kinecx Energy considers it important to emphasise that any calculated value remains an estimate rather than a precise or explicitly defined allowance, for several reasons:

- Implicit by design - the allowance for corporation tax remains implicit, embedded within a pre-tax WACC, rather than being provided as an explicit cash-flow building block.
- Model-dependent - the calculated allowance is entirely dependent on regulatory assumptions, including assumed gearing, cost of equity, cost of debt and statutory tax rate, rather than company-specific financing or actual tax positions.
- Not comparable to outturn tax - the inferred allowance does not reflect actual corporation tax paid, which depends upon factors such as capital allowances, interest deductibility, loss utilisation and group relief.
- Cross-company comparability - Differences in financing structures or tax positions between companies are not captured within the WACC-based estimate.

While the implicit allowance may be estimated mechanically from WACC parameters, it should not be interpreted as an available fund for actual tax payments, nor used directly to reconcile historical tax liabilities. It is not a direct measure of tax recovery and cannot be readily aligned with outturn tax.

Alternative calculation methods

Given the structure of the pre-tax WACC framework, Kinecx Energy does not consider that there is a more accurate alternative method for calculating the implicit tax allowance than that illustrated in Table 3.2 (subject to the concerns raised by Oxera). Any alternative would face the



same fundamental limitation: corporation tax is not explicitly modelled and therefore cannot be isolated with certainty. This limitation is inherent in pre-tax WACC methodologies and has been widely recognised by UK regulators. It underpins the broader move in other regulated sectors towards post-tax vanilla WACC frameworks with explicit treatment of corporation tax.

UK regulators commonly distinguish between different WACC formulations, for example, the vanilla WACC (where the cost of equity is post-tax and the cost of debt is pre-tax) and a pre-tax WACC (which embeds tax assumptions within the return calculation). This distinction reflects an understanding that implicit tax allowances cannot be directly reconciled with actual tax liabilities when tax is not modelled explicitly.

Guidance published for UK economic regulators¹⁷ notes that under a vanilla approach the cost of equity is measured net of tax and the cost of debt pre-tax, without the embedded tax wedge used in pre-tax WACC calculations, underlining why regulators often prefer vanilla or explicit post-tax treatment to improve transparency in the allowance for tax.

This conceptual distinction, and the practice of shifting toward vanilla or post-tax approaches, underpins the broader move within UK regulation to frameworks that provide a more transparent treatment of corporation tax rather than relying on pre-tax gross-ups that embed tax implicitly.

Kinecx Energy considers that the difficulty in precisely identifying the implicit tax allowance, even post-GD17, reinforces the case for explicit treatment of corporation tax in future price controls. While GD17 and GD23 represent improvements in transparency and allow for a notional estimate of the allowance they do not fully resolve the conceptual and practical limitations of relying on a partially implicit tax component embedded within the pre-tax WACC. Forward-looking, explicit allowances provide greater certainty, improve financeability and align regulatory incentives with actual tax liabilities

Kinecx Energy agrees that post-GD17, a notional implicit allowance can be estimated from the parameters used in the WACC, as illustrated in Table 3.2. However, this allowance is not a cash-backed or funded component, remains dependent on regulatory assumptions, and does not correspond to actual corporation tax payments. As such, it is indicative only and cannot be relied upon for reconciling historical tax liabilities or informing pre-funding decisions. This limitation underscores the importance of adopting forward-looking, explicit tax allowances for GD29.

¹⁷ https://ukrn.org.uk/app/uploads/2023/03/CoC-guidance_22.03.23.pdf



Q8. For the period before GD17, what evidence might be used to estimate the implicit allowance for corporation tax if there is no explicit breakdown of the corporation tax element of the pre-tax WACC?

Kinecx Energy considers that it is not possible to reliably estimate the implicit allowance for corporation tax for the period prior to GD17. Pre-GD17 price controls applied a single blended pre-tax rate of return, with no published breakdown of the cost of equity, cost of debt, assumed gearing or tax assumptions. In the absence of this information, there is no robust evidential basis on which to isolate or reconstruct a tax component ex post, and any attempt to do so would rely on speculative assumptions rather than regulatory decisions of that period.

In particular, prior to GD17, Kinecx Energy received a fixed pre-tax return of 7.5%, which was not derived from a component-based WACC methodology and was not constructed by grossing up a post-tax return on equity using a tax wedge. Rather this fixed return was a policy judgement designed to compensate investors for the risks of developing a new gas distribution network with high upfront costs, long asset lives, and a very limited initial customer base.¹⁸

The return was not communicated, modelled, or described as embedding a specific allowance for corporation tax, still less an amount intended to be carried forward to meet future tax liabilities. There was no explicit methodology or agreement at the time of licence award that part of the allowed return would be reserved for tax.

Any attempt now to estimate an implicit tax allowance would therefore require speculative assumptions about notional tax rates, capital structures and taxable profits, none of which formed part of the regulatory determinations at the time. Such an exercise would risk arbitrarily reinterpreting the historical regulatory settlement rather than reflecting the framework that actually applied.

¹⁸ The 7.5% rate of return was specified in the licence which did not contain explanation for how it was derived. However, the CC undertook an ex-post rationalisation of the fixed allowed return in the 2012 Phoenix determination where it noted that the 7.5% allowed return was in the public interest on the basis of project specific risks related to developing a new network. [Competition Commission \(2012\) Phoenix Natural Gas Limited price determination, paragraphs 9.19 to 9.37](#)



Q9. Under the current pre-tax WACC approach, there may be cases where the implicit allowance for corporation tax in a given year has exceeded Phoenix Energy's and Kinecx Energy's corporation tax liability for that year. Is it reasonable to view this difference as an amount available to meet Phoenix Energy's and Kinecx Energy's corporation tax liabilities in subsequent (or previous) years? Please explain the rationale for your view.

Kinecx Energy does not consider it reasonable to view any difference between the implicit tax allowance in a given year and the actual corporation tax liability for that year as an amount available to meet tax liabilities in other periods.

The implicit allowance is not a cash reserve

Under the current pre-tax WACC framework, the allowance for corporation tax is implicit, notional and non-ring fenced. It is embedded within the overall allowed return on capital and is not provided as a separately identified cash flow allowance. Like other components of the WACC (debt and equity), it is assessed based on notional assumptions and not tied to actual cash flows. A pre-tax WACC applies a notional tax wedge to the allowed return on equity; it does not create a discrete, cash-based allowance for tax, nor does it track actual taxable profits, capital allowances or cash tax payments. The resulting "implicit allowance" is therefore a notional construct, not a funded balance.

This reflects the fundamental mismatch between the mechanics of the framework and real-world tax outcomes. Corporation tax liabilities are inherently volatile and non-linear, driven by capital allowances, financing costs, loss relief and statutory rate changes. By contrast, the implicit tax allowance embedded within a pre-tax WACC is smooth and formulaic, based on notional assumptions and the regulatory asset base rather than actual taxable profits. Year-by-year divergences therefore reflect differences in methodology, not economic surpluses. This issue is not unique to the corporation tax component of regulatory allowances. Similar divergences can occur between the implicit allowances for the cost of debt or equity, and the actual costs incurred by the company in a given year. In practice, regulators do not treat such differences as "stored" funds available for future periods. Financeability assessments and banking covenants focus on actual performance metrics within a given period, rather than relying on surpluses from previous periods or projected revenues from future periods. This illustrates that the regulatory framework is designed to operate on contemporaneous, forward-looking assumptions, rather than maintaining hypothetical balances for inter-temporal use.

Accordingly, there is no mechanism within the licence or price control framework to record, carry forward, or carry back implicit tax "surpluses" or "deficits." Any apparent over- or under-recovery in a particular year is a mathematical product of the WACC methodology, not a bankable amount available for inter-temporal use.



Price controls are set with reference to the expected efficient costs of delivering the service over the control period, including an appropriate allowance for remunerating the providers of equity and debt capital. Allowances will never exactly align with the actual costs and there will naturally be under and out performance. The approach of most regulators is to allocate risk to those parties which are best placed to manage it. Companies maintain significant discretion over their own financing and capital structure arrangements, but they also bear the risks of their decisions in these areas in the context of the price control and the wider regulatory framework.

This question implies that taxation should hold a unique position within determined allowances and that the UR should be able to review and redetermine historic allowances on the basis that there has been a perceived excess of allowances granted. This would create a precedent that is contrary to the recognised principles of regulation.

Financeability is assessed within each period

Regulatory financeability metrics, including interest cover and cashflow adequacy, are evaluated within the period in which revenues are earned. Lenders and credit rating agencies do not consider notional surpluses from prior years or expected future allowances when assessing a company's ability to meet its debt obligations. Treating over-recovery in one period as a "banked" amount for another period is therefore inconsistent with standard regulatory and commercial practice.

Timing differences do not imply pre-funding

From GD17 onwards, it is possible to infer a notional implicit allowance by comparing the pre-tax and post-tax cost of equity. However, this allowance was never designed to pre-fund future corporation tax liabilities, and the UR recognises elsewhere in the Call for Evidence that the pre-tax WACC approach does not align tax allowances and tax liabilities in any given year. Any differences are timing effects rather than pre-funded amounts. This mirrors other WACC components: a cost of debt or equity allowance may, in any year, exceed actual costs, but these differences do not generate a store of funds for future periods.

Implications for TRV adjustments (Options 6 and 7)

Under Options 6 and 7, the UR proposes to compare an estimate of historic implicit tax allowances with actual corporation tax paid and to adjust the TRV accordingly. This approach conflates two fundamentally different concepts:

- a notional regulatory allowance derived from assumed parameters; and
- the company's realised tax position, which reflects actual financing decisions, performance relative to regulatory assumptions, and company-specific/group tax factors.



Actual tax paid depends on the company's real capital structure and commercial choices, which may differ from the notional structure assumed in the WACC. It is also affected by whether the company has outperformed or underperformed regulatory allowances.

In addition to performance against regulatory allowances, within the last three years, Kinecx Energy has seen swings in variances between actual and allowed revenues (under/over recoveries) of over 10% of allowed revenue and these have a material impact on the corporation tax calculations for those specific years. Period to period under/over recoveries sits outside of the parameters for the price control determination and this historical performance would be extremely difficult to factor into any retrospective review.

Adjusting the TRV to claw back differences between actual tax paid and a notional implicit allowance would therefore retrospectively penalise legitimate financing decisions and the outcomes of incentive-based regulation.

In substance, such an adjustment would reopen settled price controls by reinterpreting how historical allowances should have operated. That would amount to retrospective regulation and would undermine the forward-looking, parameter-driven nature of the price control framework.

In summary, Kinecx Energy considers that:

- Differences between implicit tax allowances and actual tax liabilities do not represent recoverable balances.
- It is not reasonable to treat such differences as amounts available to meet tax liabilities in other years.
- Doing so would rely on hindsight, conflict with the structure of the pre-tax WACC, and undermine regulatory predictability.



Q10. In cases where part of Phoenix Energy’s and Kinecx Energy’s price control allowances are being deferred until future time periods (via Profile Adjustment additions to the TRV), and in a scenario where the implicit allowance for corporation tax have historically exceeded Phoenix Energy’s and Kinecx Energy’s corporation tax liabilities, is it reasonable to view TRV as including a store of funding for Phoenix Energy’s and Kinecx Energy’s (future) corporation tax liabilities? Please explain the rationale for your view.

Kinecx Energy does not consider it reasonable to view the TRV as including a store of funding for future corporation tax liabilities, even in circumstances where implicit corporation tax allowances have historically exceeded actual corporation tax payments and where elements of price control allowances are deferred to future periods through Profile Adjustment additions to the TRV.

The nature and purpose of the Profile Adjustment

The Profile Adjustment is a tariff-smoothing mechanism, introduced to support efficient network development, particularly in the early years when customer numbers were low and investment requirements were high. It defers the recovery of allowed revenues to later periods in order to moderate early customer bills.

Crucially, the Profile Adjustment does not identify, isolate or preserve individual components of allowed revenue. It does not distinguish between debt, equity, opex, depreciation or tax elements. Any amounts added to the TRV via the Profile Adjustment represent deferred allowed revenue in aggregate. The Profile Adjustment therefore does not “store” a corporation tax allowance, nor does it convert the notional tax wedge embedded within a pre-tax WACC into a dedicated fund for future tax payments.

Accordingly, the inference that implicit tax allowances could have been accumulated within the TRV as a reserve for future tax liabilities is not well founded.

Conceptual flaw in comparing implicit allowances and actual tax

The suggestion that TRV contains unused tax funding rests on comparing an estimate of historic implicit allowances under the pre-tax WACC with actual corporation tax paid.

As noted in our response to Question 9, this approach is conceptually incorrect. The pre-tax WACC applies a simplified, notional tax wedge to the allowed return on equity, based on assumed parameters such as notional gearing and the statutory tax rate. While it may be possible (from GD17 onwards) to infer a notional implicit allowance from the difference between pre- and post-tax equity returns, this is not a measure of actual tax funding and was never intended to correspond to cash tax payments.



Actual corporation tax reflects company-specific factors deliberately abstracted from in the regulatory model, including financing decisions, capital allowance timing and performance relative to regulatory assumptions. Conflating a notional regulatory construct with real-world tax outcomes does not establish the existence of a recoverable balance within the TRV.

Retrospective reinterpretation and regulatory principle

Adjusting the TRV by reference to historical differences between implicit allowances and actual tax paid (as envisaged under Options 5–7) would in substance reopen settled price controls. It would reinterpret how historic allowances should have operated, despite no such mechanism having been specified in the original determinations.

The TRV represents a store of future revenues through regulatory depreciation, allowed return and profile adjustment. A negative TRV adjustment reduces those future revenues. Whether framed as a one-off correction, an NPV-neutral mechanism or a recognition of historical allowances, the economic effect is the same: future cashflows are reduced.

Options 5 and 6 would result in an immediate reduction in TRV, increasing leverage ratios and potentially placing pressure on debt covenants. Option 7 avoids an immediate reduction but has the same economic effect over time, as future revenues from the TRV are used in lieu of funding for corporation tax. In both cases, financeability metrics would weaken and the cost of capital could increase, ultimately to the detriment of consumers.

For these reasons:

- Deferred revenues within the TRV arising from Profile Adjustments should not be regarded as containing a notional reserve for future corporation tax liabilities.
- The TRV does not “store” unused tax allowances.
- Adjusting the TRV on the basis of historical differences between implicit allowances and actual tax paid would rely on retrospective reinterpretation and would weaken financeability.

Any future treatment of corporation tax should therefore be determined prospectively, through clear and explicit regulatory decisions, rather than inferred from historical differences under a pre-tax WACC framework.



Q11. Are there other facts or considerations which are not sufficiently covered in this Call for Evidence which you consider to be important at this stage for understanding the historical context for Phoenix Energy’s and Kinecx Energy’s corporation tax allowances and historical corporation tax liabilities?

Kinecx Energy considers that historical corporation tax allowances, whether implicit within the pre-tax WACC or otherwise, must be treated as final ex ante determinations. They cannot reasonably be revisited or “unpicked” retrospectively. Any perception that these allowances were generous in hindsight reflects the regulatory assumptions and methodology at the time and does not create an obligation on the regulated company to repay or adjust past allowances.

Historical TRV and WACC context

Historical allowances were determined based on regulatory parameters at the time and were not designed to track actual corporation tax payments. Differences between implicit allowances and actual liabilities reflect inherent volatility in taxable profits and smoothing in the regulatory framework; they do not constitute recoverable balances. Regulatory determinations including TRV and pre-tax WACC components were made at a point in time and should be respected as fixed under the licence.

Competition Commission 2012 precedent

As has already been referenced earlier in this response, in 2012, Phoenix Energy successfully appealed a proposed retrospective TRV adjustment to the Competition Commission. The Competition Commission upheld the existing licence and allowances as they were determined, concluding that the regulatory framework (including allowed returns and TRV elements) should not be altered retrospectively.

Key points from the Competition Commission decision include:

1. **Finality of historical allowances** – The Competition Commission emphasised that the licence design, including revenue profiling and the fixed pre-tax return, was based on the economic assumptions at the time. The regulatory asset base and recovery mechanisms were agreed with those assumptions embedded. Historical allowances must remain in place.
2. **Regulatory certainty and investor confidence** – The Competition Commission recognised that changing incentive or return structures retrospectively would undermine regulatory certainty, deter investment, and increase the cost of funding the sector, ultimately harming consumers. Fitch noted that retrospective TRV adjustments for outperformance dating from 1996–2006 “is not considered by the agency to be good regulatory practice,” and a material TRV adjustment would likely have led to a downgrade of Phoenix Energy’s credit rating.
3. **Forward-looking nature of regulation** – The Competition Commission emphasised that



regulatory determinations form part of the legitimate ex ante bargain between the regulator and the company. They are designed to support efficient long-term investment and cannot be revisited simply because actual outcomes differ from assumed outcomes.

Additional precedent

More recent regulatory practice reinforces the Competition Commission's conclusions:

- Ofgem (2023) considered, but ultimately rejected, retrospective clawbacks of RIIO-2 inflation outperformance. Moody's noted that such retrospective action "would undermine investor confidence in the predictability and stability of the regulatory regime... especially by the electricity networks, to facilitate decarbonisation objectives."
- These cases confirm that retrospective adjustments to settled allowances are avoided because they harm long-term consumer interests and undermine regulatory stability.

Implications for corporation tax allowances

The Competition Commission decision and subsequent precedent make clear that:

- Historical corporation tax allowances, implicit or otherwise, cannot be retrospectively revised.
- Retrospective reinterpretation would conflict with regulatory principles, financeability considerations, and credit rating expectations.
- Any perceived over-recovery is a function of regulatory methodology and not a mechanism for retrospective recovery by the regulator.

To maintain regulatory predictability, changes must be forward-looking, clearly signalled, and subject to proper consultation. Investors commit capital based on the expectation that TRV, WACC, and other licence-determined allowances are stable and enforceable; retrospective revisions would undermine this expectation, increase financing costs, and ultimately harm consumers.

We therefore conclude, historical corporation tax allowances, whether implicit in the pre-tax WACC or otherwise, must be treated as final ex ante determinations. The UR cannot retrospectively "claw back" allowances or adjust historical TRV values without undermining regulatory predictability and financeability. Any perceived generosity of past allowances is a regulatory issue, not a justification for revisiting settled entitlements of the company. This approach aligns with the Competition Commission 2012 decision, subsequent Ofgem precedent, and established regulatory principles of stability, transparency, and investor confidence.



Potential changes to the debt financeability assessment

Q12. Do you consider that it would be feasible and worthwhile for the assessment of debt financeability metrics carried out at GDN price control reviews to be refreshed to end of the revenue recovery period, and do you think there is anything further that should be considered in this calculation?

Kinecx Energy recognises that the GD23 financial modelling presented in the Call for Evidence (Table 3.4) highlights an emerging issue within the current price control framework. Forecast corporation tax liabilities may exceed the implicit tax allowance embedded within the pre-tax WACC. As noted by the UR, this issue is expected to arise for Phoenix Energy during GD23 and is likely to arise for Kinecx Energy at the subsequent price control under the same methodology. This has direct implications for funds from operations and therefore for key credit metrics, particularly interest cover.

We therefore recognise the rationale behind examining financeability over a longer horizon, including to the end of the revenue recovery period. In principle, such modelling is feasible. Long-term financial modelling already underpins elements of the regulatory framework, particularly through the Profile Adjustment mechanism, which smooths revenue recovery over an extended period. Because revenues are recovered over a period significantly longer than the six-year price control, it is reasonable that the Regulator maintains visibility of financeability metrics beyond the immediate control period. The existing regulatory framework therefore has the technical foundations to support extended scenario analysis.

However, Kinecx considers that the UR's primary statutory duty in setting a price control is to ensure that a notional efficient GDN is financeable over the defined price control period. The established regulatory approach assesses financeability over that six-year horizon, with the opportunity for metrics, including gearing, interest cover and PMICR, to be reassessed and recalibrated at the subsequent review. Provided the allowed revenues are set at a level sufficient to cover efficiently incurred costs, provide an appropriate return, and ensure that interest obligations are covered at a level consistent with regulatory assumptions (for example, interest cover of approximately 1.4x on a notional basis), the framework is functioning as intended for that period. This periodic reassessment is a core feature of UK economic regulation and is intended to ensure that any emerging financeability challenges can be addressed through future determinations without reliance on long-range projections that are inherently sensitive to significant assumptions.

Looking materially beyond the price control period raises more complex questions. To base determinations on projections extending far beyond the control period risks embedding assumptions about future WACC, inflation, capital allowances, taxation and investment profiles

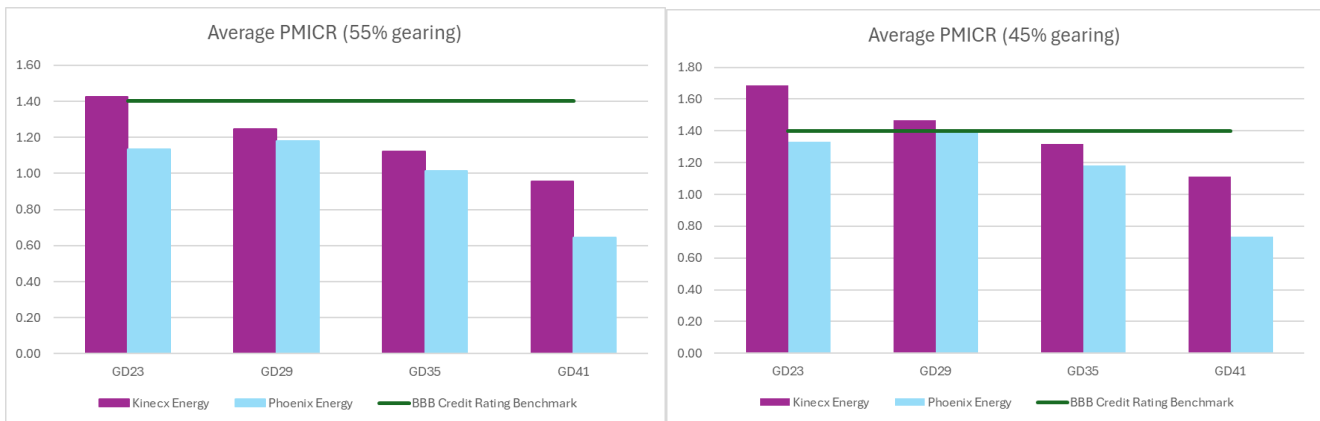


that are fundamentally uncertain and subject to change at future reviews. There is also a risk that extending the assessment horizon could implicitly distort the calibration of the current control period in order to manage projected outcomes many years ahead, rather than addressing financeability through the normal cycle of periodic resets.

Experience, including the position faced by Phoenix Energy beyond 2024, demonstrates that companies may appear financeable within successive individual price control periods yet face material pressure when viewed over a longer horizon. This issue is particularly relevant in the Northern Ireland context because the Profile Adjustment mechanism smooths revenues to the end of the recovery period, meaning that mismatches between cashflows and funding requirements may occur outside the immediate price control window. Projected corporation tax liabilities may also exceed the implicit tax allowances embedded in the pre-tax WACC, creating further potential misalignment between allowed revenues and actual cash outflows.

While DNOs may appear financeable within an individual control period, misalignments, especially relating to tax treatment and revenue profiling, may place pressure on cashflows beyond the price control period. In this context, it is prudent for the UR to monitor longer-term projections to identify emerging financeability issues at an early stage.

Figure 2: Illustrative graph of GD23 PMICR metrics



The evidence from rating agency reports, as well as analysis conducted by other UK regulators, indicates that a GDN will normally need to maintain post-maintenance interest cover ratio (PMICR) of at least 1.4 times and gearing of no more than 70% in order to obtain a BBB credit rating¹⁹.

The chart above summarises the UR's view of GD23 PMICR metrics, highlighting financeability challenges beyond the six-year price control horizon. The PMICR ratios for GD23 itself are borderline compared to the 1.4x benchmark and the picture for future periods gets progressively worse. It should be noted that the financeability challenges inferred from these diminishing metrics are not

¹⁹ GD23 Final Determination, paragraph 10.63



solely down to taxation allowances and may indicate other pressures that the UR should consider when reviewing financeability for its GD29 Price Control.

These charts do however highlight the importance of reviewing metrics beyond the price control horizon, they provide early indications of future challenges and may reflect that a change is needed now.

Accordingly, Kinecx's view is that:

- The formal financeability assessment for price control determinations should remain focused on the price control period itself.
- However, the UR should maintain structured and transparent longer-term monitoring to the end of the revenue recovery period, particularly in light of the projected divergence between tax allowances and tax payable highlighted in Table 3.4; and
- Where longer-term projections indicate emerging funding pressure (for example, sustained tax under-recovery affecting funds from operations), consideration should be given to whether targeted regulatory mechanisms are required to address the underlying issue, rather than allowing pressures to accumulate until the start of a subsequent control.

If longer-term refreshes of debt metrics are undertaken, they should be clearly identified as monitoring and contextual analysis rather than as automatic triggers for intervention. A number of factors must be considered in the context of longer-term assessment. As well as the interaction between tax allowances and actual corporation tax liabilities, the impact of the Profile Adjustment on cashflow timing and debt servicing capacity, sustainability of interest cover and PMICR metrics over the full recovery period and ensuring consistency with the URs notional credit assumptions and cost of debt allowances must be considered.

Kinecx Energy considers that financeability over the price control period remains the appropriate basis for formal regulatory determination. Nevertheless, given the distinctive features of the Northern Ireland framework, particularly the long-range revenue recovery profile and the impact of emerging tax dynamics within the current framework, it is prudent for the UR to maintain forward visibility to the end of the recovery period in order to identify and address potential structural issues at an early stage and in a proportionate manner.



Q13. Do you have any other views on the way that debt financeability assessment should be carried out for Phoenix Energy and Kinecx Energy at future price control reviews, given the issues raised in this Call for Evidence document?

UR's GD17 and GD23 financeability analysis showed minimal headroom on interest cover in most years, while third-party commentary linked the packages to potential rating pressure. We therefore consider it important that any explicit corporation tax allowance be recovered contemporaneously with liabilities rather than via long-dated, NPV-neutral balancing that offers limited comfort to lenders or rating agencies focussed on near-term ratios.

In that context, deferring corporation tax recovery (e.g., via TRV or other back-ended devices) does not address the near-term cashflow needed to support period-by-period credit metrics (e.g., PMICR/interest cover).

The UR's historical debt financeability assessments have focussed on demonstrating investment-grade credit quality based on determined cashflows and a notional level of gearing. Whilst these are generally accepted regulatory principles, it is important for the UR to consider positive and negative "real-world" scenarios that may influence these metrics and create headroom or pressures on the metrics.

To date within the GD23 period we have experienced the following cost pressures, unforeseen at the time of the price control determination, that have materially impacted the actual credit metrics of Kinecx Energy:

- Unavoidable cost inflation for material line items (up to 40% increase in some cases)
- Notification of withdrawal of support for the current PAYG meter, resulting in the requirement to purchase c. 2-3 years' worth of meter stock
- Uncertainty mechanism items that, whilst envisaged at the time of the determination, were not quantifiable at the time and only a mechanism and not a placeholder allowance was provided – e.g. new metering solution
- Disposal of subsidiary retail business, firmus energy Supply, resulting in costs of separation, diseconomies of scale and new investment in rebranding and marketing

All of the above have materially impacted the actual cashflows and credit metrics of Kinecx Energy. Whilst unquantifiable at the time of the price control determination, they underline the importance of allowing for headroom and modelling downside scenarios when reviewing metrics and assessing financeability within the price control period under review.



Historical financeability assessments for the UR have focussed on the “notional” company, assuming a mirroring of regulatory allowances and a level of gearing that the UR deems to be appropriate. We understand that this is generally accepted regulatory practice, however, there have been circumstances whereby, when these results do not provide the necessary level of comfort to Kinecx Energy, they have been justified with reference to “actual” company performance. This ‘mix-and-match’ approach is concerning and leads to uncertainty, inconsistency and a lack of confidence in the determination and future determinations.

A consistent approach is key to understanding, confidence and encouraging future investment in regulated entities, particularly in relation to securing efficient levels of external debt financing.

Kinecx Energy considers that debt financeability assessments at future price control reviews should continue to be forward-looking and aligned with the statutory duties of the UR. Specifically, assessments should focus on:

1. **The relevant price control period** – Financeability analysis should reflect the period under review, rather than attempting to project across multiple future periods. This ensures that the assessment aligns with the ex-ante nature of regulatory determinations and maintains regulatory predictability. Financing challenges beyond the current period can and should be addressed through the next price control review.
2. **Alignment between allowed returns and actual tax liabilities** – Under the current pre-tax WACC framework, the implicit corporation tax allowance may be lower than the actual tax payable, which can reduce funds from operations and weaken key financeability metrics such as interest cover. Kinecx Energy considers that adopting a Vanilla WACC with an explicit tax allowance would better align regulatory allowances with actual liabilities, supporting debt financeability while maintaining transparency and regulatory consistency.

The calculation of any explicit tax allowance should be robust and allow Kinecx Energy to fund an efficient level of corporation tax liability based on nominal outputs (revenues).

3. **Forward-looking modelling of key financial metrics** – Any assessment should continue to consider core metrics such as interest cover, cash flow sufficiency, and debt service coverage ratios under plausible scenarios of revenues, costs, and tax obligations. Assumptions should be clearly documented and consistent with the regulatory framework, avoiding retrospective adjustments or reliance on historical surpluses or deficits.
4. **Avoiding retrospective or ex post adjustments** – Financeability assessments should not be based on historical differences between allowed and actual tax payments or TRV adjustments. Doing so would risk undermining regulatory certainty, disrupt the financing assumptions of investors, and conflict with established regulatory precedent.



In summary, Kinecx Energy supports a forward-looking, period-specific, and parameter-consistent approach to debt financeability assessment. This approach should ensure that companies remain financeable over each price control period, while maintaining regulatory transparency and predictability for investors and consumers alike.

Conclusion

Kinecx Energy agrees with the UR's assessment that, under the current pre-tax WACC framework, corporation tax payable is projected to exceed the implicit allowance embedded in allowed returns, leading to future financeability pressures as key credit metrics deteriorate.

Kinecx Energy considers that Option 4 (a move to post-tax vanilla WACC with no transitional adjustments) directly addresses the UR's stated financeability concerns by ensuring that corporation tax liabilities are fully funded on a forward-looking basis. This option is aligned with regulatory best practice, is conceptually coherent, and is more straightforward to implement than the alternative options under UR consideration.

For the reasons set out in this response, Kinecx strongly considers the alternative options involving complex modelling and/or downward adjustments to the TRV or future revenues are not appropriate for addressing the identified financeability challenges. These approaches are inconsistent with regulatory principles, would be difficult to implement robustly, and will result in negative consumer outcomes. In particular, Options 5 and 6 would result in an immediate reduction in TRV, mechanically increasing leverage ratios overnight and potentially placing pressure on existing debt covenants. This is clearly counterproductive to the stated objective of enhancing financeability and could increase financing costs over time.

The issues addressed in this call for evidence and the options proposed will have a material impact on the GD29 price control and beyond. It is important that Kinecx Energy clearly understands the next steps following this Call for Evidence, the nature of any future associated consultations and the method for adoption of any determined changes to the treatment of Corporation Tax.

Clarity is required regarding the procedural status of any decision taken following this Call for Evidence. While the price control framework provides defined mechanisms for appeal following a Final Determination, the Call for Evidence paper does not indicate what recourse, if any, would be available if a material policy decision were taken in advance of the GD29 determination. If such a decision is intended to bind the subsequent price control, it is important to confirm whether it forms part of the appealable determination under the established statutory



framework.

In Kinecx Energy's view, any material change to the regulatory framework should therefore be implemented through the GD29 price control process itself, ensuring full consultation, transparent modelling, and access to established appeal rights. This would preserve procedural fairness, regulatory certainty, and investor confidence, while continuing to protect consumers' long-term interests.

We welcome any further engagement in this area and look forward to working with the UR to address any queries and develop a future treatment of corporation tax that is transparent, robust and closes any gap between allowances and actual liabilities.

Kind regards,

A handwritten signature in blue ink, appearing to read 'Mark W. Stevenson'.

Mark Stevenson
Director of Business Development

