

RIIO 2
Simplifying the price controls

ofgem



Last of the series of workshops based around the themes we set out in the RIIO 2 open letter. Get your views on some of the key issues we will be considering as part of our work to review RIIO framework.

To ensure regulated network companies deliver the flexible services that consumers want and need.*

RIIO 2 will aim to achieve this by:

- Giving consumers a stronger voice in setting outputs, shaping and assessing business plans;
- Allowing regulated companies to earn returns that are fair and represent good value for consumers, properly reflecting the risks faced in these businesses, and prevailing financial market conditions;
- Incentivising companies to respond in ways that benefit consumers to the risks and opportunities created by potentially dramatic changes in how networks are used;
- Using the regulatory framework, or competition where appropriate, to drive innovation and efficiency; and
- **Simplifying the price controls by focusing on items of greatest value to consumers.**

**I do worry about very clever schemes in price controls such as the IQI sliding scale that are virtually unfathomable to all but the most fanatical price control groupie.
(Alistair Buchanan, 2008)**

Any intelligent fool can make things bigger and more complex. It takes a touch of genius — and a lot of courage to move in the opposite direction

Purpose of workshop

- Inform sense of scale and scope of the problems
- Feedback on priorities to resolve
- Help shape next steps

Agenda

- 2.00 – 2.15 Introduction
- 2.15 – 2.45 Input: simplifying elements of the price control
- 2.45 – 3.15 Transparency and reporting
- 3.15 – 4.00 Input: transparency and reporting
- 4.00 – 4.10 Wrap up
- 4.10 – 4.30 Q&A

- Number of outputs and secondary deliverables
- Number of incentive mechanisms – is value attributable them appropriate
- Number of uncertainty mechanisms – adding more to cope with uncertainty but adds complexity
- IQI
- NOMS & secondary deliverables
- Difficulty in translating price control for stakeholders
- Cost assessment toolkit and process

Price controls are complicated – so what?

- Do regulator & regulated companies all understand how they fit together – the interaction of incentives?
 - If not – there is a risk that the price control doesn't do what it is meant to.
- Do others understand it?
 - If not – how can they engage with it and challenge it?
 - How do they know networks are earning a fair return?
 - Negates consumer engagement?
- There is benefit is complexity if it results in better outcomes but:
 - Are the benefits of complexity always outweighed by the additional costs?
 - Do we need to trade off complexity with accuracy?
 - How can we protect consumers without adding in more complexity?

Should we take action to simplify the price controls?

- Trade offs/link to other thinking in RIIO 2
- Should we reduce the number of mechanisms?
- Combined incentive mechanism – wrap incentives into one overall reward/penalty?
- Should we have greater emphasis on proportionality
 - Materiality threshold – only have incentives mechanisms if they have monetary value above a certain level?
- Cost assessment
 - More focus on historic cost and linked more closely to RIIO 1 performance?
 - Longer time horizon for certain cost – only revisit periodically
- How we manage uncertainty?
 - Should consumers/companies accept more risk?
 - A shorter price control?

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- What types of mechanism are most complex to understand?
 - What types of mechanism are most resource intensive and complex to operate?
 - Is this complexity proportionate to the value that these add?
 - To what extent should simplicity drive our thinking compared to other drivers in RIIO 2?

Summary of the ED1 price control provided to aid discussions.

3 ideas to make RIIO 2 simpler

- Things might need to be complicated but if they are explained clearly they seem less complicated.
- The way in which company performance is monitored and reporting plays a key role – particularly given increasing focus on network companies performance.
- A transparent price control would mean:

- Performance data is accessible and targeted at the right audience;
- Its published in a timely manner;
- Information is accurate;
- It is presented in a balanced way regardless of performance.

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- Volume of reporting requirements on companies
 - Amount of data collected – do Ofgem use it all?
 - Do we collect right level of data – should we ask for higher level information?
 - Should publish more comparative data during the price control period
 - We need to automate data collection

From Ofgem's perspective, the annual monitoring process fulfils several functions:

- **Performance Management:** to understand and report on financial (incl. incentives) and output performance - annual, to date and forecast for RIIO 1. Inform the AIP.
- **Improvements for RIIO 2:** by understanding how well RIIO 1 is informing - inform and drive policy, cost assessment, incentive and output setting.
- **Cost assessment including benchmarking:** for re-openers, SWW, RIIO2, FOIs, ad-hoc requests and for RIIO2
- **Legitimacy:** reporting on company performance provides transparency and confidence

	Who	For	Why?
RIGS	Annual data returns from companies	Ofgem understanding	Monitors performance against business plans.
Annual report	Ofgem report	External audience	Ofgem summarises company performance against outputs and allowances.
Infographics	Ofgem report	Consumers	Summary data on performance in visual format
Data files	Ofgem report	Experts	Underlying data used in RIGs
Business commitment report	DNO	Stakeholders	Sets out delivery of business plan commitments.
Performance report	TO	Stakeholders	Short form report on company performance
Other reporting e.g. connections	Companies	Ofgem	As required under licence/other statutory obligations – monitor specific obligations

RIIO accounts

- A set of accounts to provide investors and other stakeholders with more transparent and relevant information for the regulated part of business.
- Increase investor confidence which will ultimately benefit consumers by providing a clear statement from the Board on what the company performance is.
- Replaces regulatory accounts.

Strategic performance overview

For Ogem, to accompany RIGs.

- Strategic, top-down narrative around the drivers of performance. Peeling back the top layer of headline numbers and giving a clear account of what is happening.
- Improve Ofgem ability to interrogate data and provide clear report

Ofgem data architecture project

- Considering the way we collect and manage data across Ofgem – sought input from wide range of stakeholders including network companies
- Testing methods to improve data
- Using IIS to test alternative approaches

- Reduce mechanisms which contain reporting requirements
- Be clearer about purpose of different reporting and target audience – not one size fits all
- Be clearer who is best placed to provide information to different audiences
- Stronger requirement on companies to make accessible and transparent data available to companies
- Better understanding of data that is submitted to us – supported by network companies
- More comparative analysis and benchmarking during the price control period

- To help us focus on the right issues – we would like your views on what good looks like and what we need to do to achieve this?
- Breakout sessions to consider:
 - If price controls were transparent:
 - what performance information would stakeholders want to receive
 - how would they receive it (frequency, medium)?
 - what would it look like?
 - what differences would there be between the sectors?
 - If we want to achieve this – what things need to change?