

To:

Gas Distribution, Gas
Transmission, Electricity
Transmission; Network
Operators; and
Stakeholders

Date: 01 June 2022

Dear Company Secretaries and Stakeholders,

Direction to modify the Regulatory Instructions and Guidance ("RIGs") for RIIO-2

We have modified the RIGs to introduce:

- the RIIO-2 Regulatory Financial Performance Reporting – Regulatory Instructions and Guidance ("RFPR RIGs") for the Electricity System Operator, Electricity Transmission, Gas Distribution and Gas Transmission licensees.

The Gas and Electricity Markets Authority (the "Authority") gave notice¹ on 01 April 2022 (the "Notice") that it proposed to make changes to the Regulatory Instructions and Guidance ("RIGs"). The Notice required any representations by licensees on the proposals to be made on, or before, 29 April 2022.

Prior to the consultation period closing the Authority received ten responses with representations on the consultation. All of the non-confidential stakeholder representations received as well as our responses to them and the reasons for any changes made to the proposed RFPR template and RFPR RIGs documents in light of consultation responses, can be found in the 'RFPR issues log' published alongside this direction.

In addition to the published issues log, we summarise below the main areas that the consultation responses pertain to.

General updates and corrections

¹ <https://www.ofgem.gov.uk/publications/notice-proposed-modifications-regulatory-financial-performance-reporting-rfpr-template-and-guidance-riio-2>

Licensees raised a number of general updates and corrections to the format and calculation of the RFPR template and consequential updates to the RIGs.

Following careful consideration of these responses, we have made the relevant changes, where appropriate, to reflect the new policies that we have implemented as part of our RIIO-2 Final Determinations and to align the terminology and calculations in the RFPR with the RIIO-2 licences.

Corporate Governance

We are introducing a new section on Corporate Governance, in the RFPR RIGs and template, including both financial and non-financial disclosures, as set out in our consultation².

Executive remuneration

Some respondents to the consultation were not supportive of the proposed reporting on executive remuneration. Some respondents requested that individual executive pay figures be redacted from publication on the grounds of commercial sensitivity or data protection, though limited specific rationale was provided to explain and substantiate these concerns.

Our decision to introduce these reporting requirements was set out in our Final Determinations³, following a previous consultation⁴. The direction to implement these measures deals specifically with the way in which these requirements are implemented within the RIGs guidance and RFPR template. We recognise that some licensees continue to raise concerns about remuneration reporting. However, we consider that this reporting is appropriate as part of our monitoring and setting of price controls for the reasons set out in our Final Determinations and as further explained below.

There has been increased scrutiny of executive pay in regulated sectors and how this impacts consumer interests over recent years, and similar approaches have been adopted in other sectors.⁵ Disclosure of individual executive remuneration figures is required in the statutory accounts for listed companies, and has been adopted sector-wide among regulated water companies, and so this information is already available in comparable settings.^[6] Our view is that the reporting and publication of this information will promote

² [Notice of proposed modifications to the Regulatory Financial Performance Reporting \(RFPR\) template and guidance for RIIO-2 | Ofgem](#)

³ [RIIO-2 Final Determinations – Finance Annex \(REVISED\) \(ofgem.gov.uk\)](#) (see 'Transparency through RIIO2 reporting', page 139)

See also our [Draft Determinations p.166-170 draft_determinations - finance.pdf \(ofgem.gov.uk\)](#)

See also our Sector Specific Methodology point 12.38 [RIIO-2 Sector Specific Methodology – Core document \(ofgem.gov.uk\)](#)

⁴ [Direction to introduce Regulatory Financial Performance Reporting \(RFPR\) | Ofgem](#)

⁵ For example see Ofwat PR19: [Putting the sector back in balance](#)

the interests of consumers, and we have considered this against any arguments around commercial sensitivity. [OBJ]As monopoly providers of an essential service, it is important that licensees' dividend and remuneration policies are transparent so as to promote accountability towards consumers, and to clarify the links of these policies to the performance and consumer obligations of the regulated business. Transparency can also promote good outcomes for consumers by engaging reputational incentives, and influencing positive policies and behaviours. This is particularly important considering monopoly companies' dominant positions. [OBJ]

Since our open letter on the RIIO-2 framework in July 2017⁶, we have referred to the concept of legitimacy of the price control. We highlighted that stakeholders are less likely to view high returns as legitimate or fair when they are perceived to be the result of companies' exploiting information asymmetry or windfall gains due to economic conditions differing from original forecasts. As part of dealing with the concept of legitimacy of the price control, we consider that disclosure of corporate governance information within regulatory reporting, including executive remuneration and dividend payments and policies, provides beneficial transparency to consumers and other stakeholders. As stated in our Final Determinations, this transparency builds customers' and other stakeholders' trust and confidence that the regulatory regime is protecting consumers' interests. Transparency in these areas enables stakeholders to better engage with regulated companies, scrutinise their actions and performance more, and to hold companies to account.

In response to feedback we have made a minor amendment to the RIGs at paragraph 4.17 to make clear that executive roles in relation to the regulated business should be explained. This is to ensure the narrative reporting facilitates understanding, particularly where executive directors are remunerated across different group companies. Narrative reporting can also be used to provide clarity on how remuneration costs are apportioned to the regulated business, and on differing structures between companies that may affect interpretation of reporting returns. The guidance has also been updated to ensure clarity between reporting related to all board directors, and, executive directors only.

Audit standards

Some respondents commented that the executive remuneration reporting would not be subject to the same auditing standards as equivalent reporting under the statutory reporting regime. RFP is not subject to external audit requirements, however it is subject to a Data Assurance Guidance ("DAG") process prescribed by Ofgem. The DAG provides guidance on how licensees should conduct and report their risk assessment and data assurance activities to ensure complete, accurate and timely data submission. We would

⁶ [Open letter on the RIIO-2 Framework | Ofgem](#)

welcome further engagement from licensees on whether an external audit of executive remuneration reporting would be beneficial, or how this section of the RIGs/RFPR could be further developed, in future years.

Statutory accounts

A number of respondents felt that some of the corporate governance disclosures required under the RIGs would be duplicative of their statutory accounts. While we recognise that there is a degree of cross-over, the RIGs' requirements are focussed on the regulated business (for example, disclosure of sufficiently independent directors, detail on matters reserved to parent company, and a focus on how remuneration/dividend policies align with delivery for customers), improving transparency in how network companies operate and how decisions are made. This can lead to greater accountability by enabling consumers and other stakeholders to better engage and scrutinise licensees' actions and regulatory performance. Furthermore, statutory requirements on licensees differ depending on their corporate and legal structures. The RIGs reporting requirements ensure that this information is provided consistently across the regulated companies.

Profit Reconciliation sheet

We are introducing a profit reconciliation sheet, which sets out the licensees' revenues and costs in the format of a profit and loss statement and reconciles regulated network profit to profit in the statutory accounts.

We received two responses from licensees, one from the Electricity System Operator ("ESO") which suggested the current format of the reconciliation is not suitable for the ESO and one from Wales & West Utilities Limited ("WWU") which expressed concerns around Ofgem's rationale for the reconciliation and the additional burden it would place on networks.

We have considered the responses and note that most of the inputs in the reconciliation are self-populated and therefore we do not agree that this puts an undue administrative burden on companies. The reconciliation is largely an amalgamation of the Revenue and Expenditure reconciliations that were previously submitted in the RIIO-1 RFPR template.

Furthermore, this information was previously included in the Regulatory Accounts and we note the RFPR has replaced the Regulatory Accounts and as such we would expect that this information continues to be provided. We do not agree that this results in significant extra reporting burden but it would help Ofgem understand and monitor the main differences between statutory and regulatory profits.

In the case of the ESO, we are open to further discussion explore how best to set up the reconciliation so that it shows a meaningful view of the ESO's statutory and regulatory profit.

Tax Reconciliation

We are introducing a tax reconciliation sheet, the objective of which is to highlight differences between a licensee's Corporation Tax return (CT600) and the notional tax allowance in the Price Control Financial Model ("PCFM") and to enable Ofgem to better understand these differences.

We received responses from nine licensees as well as a coordinated response letter from the ENA, which set out six salient concerns that network companies had with the proposed reconciliation. While networks were supportive of the aims of the reconciliation, there were concerns over the practical implementation of it in the version that we consulted on, relating to:

- unnecessary and/or duplicated information in the template
- superfluous variance explanations
- a lack of clarity over interaction with licence obligation
- a lack of clarity on Tax Review triggers
- Use of group relief in the template
- Comparability issues between values from the PCFM and the CT600

Following careful consideration of these responses, we have made modifications to the proposed template and RIGs to simplify the reconciliation and reduce the reporting burden on networks and to correct errors and provide further clarity in the guidance. Our detailed responses to all stakeholders including the ENA and further rationale for our decision can be found in the "Tax Reconciliation" sheet of the RFPR Issues log published on our website alongside this letter.

Our Decision

We have decided to implement the changes as set out in the RIIO-2 RFPR template and RFPR RIGs published on our website alongside this letter.

Please find enclosed the Directions setting out our changes issued pursuant to the relevant Licence Conditions for each sector.

As part of the enclosed Directions, we provide the following documents:

- RFPR RIGs guidance – a “clean” version; and
- RFPR RIGs template.

All of the stakeholder representations received as well as our detailed responses to them and the reasons for the differences between the proposed template and the template that we are directing can be found in the RFPR issues log published alongside these directions.

Timeline

The modifications to the RIGs will take effect on 01 June 2022. For the avoidance of doubt, this means that the data submitted in August 2022 (in respect of the 2021/22 reporting year) will use the RFPR RIGs as modified.

Yours faithfully,

Jonathan Gorrie

Chief Financial Advisor, Analysis and Assurance

Duly authorised on behalf of the Authority

**Cadent Gas Limited
Northern Gas Networks Limited
Scotland Gas Networks plc
Southern Gas Networks plc
Wales & West Utilities Limited**

(each one a “Licensee”, and together, “the Licensees”)

**Direction under paragraph 3 of the Standard Special Condition A40
(Regulatory Instructions and Guidance) (“SSC A40”) of the Gas Transporter
Licence (the “Licence”) granted to the Licensees under section 7 of the Gas
Act 1986 (the “Act”).**

Whereas –

1. The Licensee holds a Gas Transporter Licence (the “Licence”) granted or treated as granted under section 7 of the Gas Act 1986 (the “Act”) and is subject to the conditions contained in the Licence.
2. The RIGs are the primary means by which the Authority directs the Licensees to collect and provide information to the Authority, to enable it to administer the Special Conditions of the Licence and, where not referenced in the Licence, the RIIO-GD2 Final Determinations.⁷
3. SSC A40 sets out the process for issuing and modifying the RIGs. In accordance with paragraph 8 of SSC A40, the Authority gave notice to the Licensees on 01 April 2022⁸ that it proposed to modify the RIGs, as set out in that notice.
4. The notice required any representations by licensees on the proposals made in that notice in relation to amending the RIGs to be made on, or before, 29 April 2022.
5. Prior to the consultation period closing the Authority received ten responses. The Authority has considered the representations in those responses and has made a number of changes to the RIGs proposed as part of the consultation.
6. We have set out our responses to the non-confidential representations received and the modifications made to the RIGs as a result of these in the “RFPR issues log” published on our website.

⁷<https://www.ofgem.gov.uk/publications-and-updates/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

⁸ <https://www.ofgem.gov.uk/publications/notice-proposed-modifications-regulatory-financial-performance-reporting-rfpr-template-and-guidance-riio-2>

7. The modifications refer specifically to information required to be submitted to the Authority on or before 31 August 2022 in relation to:
 - The RIIO-2 Regulatory Financial Performance Reporting excel template and guidance document
8. The modifications are summarised in the attached Decision letter and can be seen in the versions of the RIGs documents specified above and published alongside this Direction.

Now Therefore –

9. Pursuant to paragraph 3 of SSC A40 of the Licence, the Authority hereby modifies the RIGs in the manner specified in the attached Schedule.
10. The reason for the amendments made in this Direction is to collect additional information in line with our Final Determinations for RIIO-GD2 and to align the template and guidance with the latest special licence conditions and Price Control Financial Model. Further details are contained in the Decision letter attached to this Direction.
11. The modifications will take effect on 01 June 2022.
12. The Licensees must complete and return the reporting pack referred to above as part of the 2021/22 RIGs process.

Jonathan Gorrie
Chief Financial Advisor, Analysis and Assurance
Duly authorised on behalf of the Authority
01 June 2022

National Grid Gas plc (with respect to its gas transmission network) (the "Licensee")

Direction under paragraph 3 of the Standard Special Condition A40 (Regulatory Instructions and Guidance) SSC A40 of the Gas Transporter Licence granted to the Licensee under section 7 of the Gas Act 1986 (the "Act").

Whereas –

The Gas and Electricity Markets Authority (the "Authority")⁹ hereby gives notice under paragraph 10 of SSC A40 as follows:

Direction to modify the Regulatory Instructions and Guidance

1. The Licensee holds a Gas Transporter Licence (the "Licence") granted or treated as granted under section 7 of the Gas Act 1986 (the "Act") and is subject to the conditions contained in the Licence.
2. The RIGs are the primary means by which the Authority directs the Licensee to collect and provide information to the Authority, to enable it to administer the Special Conditions of the Licence and, where not referenced in the Licence, the RIIO-GT2 Final Determinations.¹⁰
3. SSC A40 sets out the process for issuing and modifying the RIGs. In accordance with paragraph 8 of SSC A40, the Authority gave notice to the Licensee on 01 April 2022¹¹ that it proposed to modify the RIGs, as set out in that notice.
4. The Notice required any representations by licensees on the proposals made in that notice on amending the RIGs to be made on, or before, 29 April 2022.
5. Prior to the consultation period closing the Authority received ten responses. The Authority has considered the representations in those responses and has made a number of changes to the RIGs proposed as part of the consultation.
6. We have set out our responses to the non-confidential representations received

⁹The "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Office of Gas and Electricity Markets (Ofgem) supports the Authority in its day to day work.

¹⁰[RIIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator | Ofgem](#)

¹¹ <https://www.ofgem.gov.uk/publications/notice-proposed-modifications-regulatory-financial-performance-reporting-rfpr-template-and-guidance-riio-2>

and the modifications made to the RIGs as a result of these in the “RFPR issues log” published on our website.

7. The modifications refer specifically to information required to be submitted to the Authority on or before 31 August 2022 in relation to the Regulatory Financial Performance Reporting excel template and guidance document.
8. The modifications are summarised in the attached Decision letter and can be seen in the versions of the RIGs documents specified above and published alongside this Direction.

Now Therefore –

9. Pursuant to paragraph 3 of SSC A40 of the Licence, the Authority hereby modifies the RIGs in the manner specified in the attached Schedule.
10. The reason for the amendments made in this Direction is to collect additional information in line with our Final Determinations for RIIO-GT2 and, to align the template and guidance with the latest special licence conditions and Price Control Financial Model. Further details are contained in the Decision letter attached to this Direction.
11. The modifications will take effect on 01 June 2022.
12. The Licensee must complete and return the reporting pack referred to above as part of the 2021/22 RIGs process.

Jonathan Gorrie
Chief Financial Advisor, Analysis and Assurance
Duly authorised on behalf of the Authority
01 June 2022

National Grid Electricity Transmission plc
National Grid Electricity System Operator Limited
SP Transmission plc
Scottish Hydro Electric Transmission plc

(each one a "Licensee", and together, "the Licensees")

Direction under paragraph 3 of Standard Condition B15 (Regulatory Instructions and Guidance) ("SC B15") of the Electricity Transmission Licence (the "Licence") granted to the Licensees under section 6(1)(b) of the Electricity Act 1989 (the "Act").

Whereas –

1. The Licensees each hold an Electricity Transmission Licence (the "Licence") granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 (the "Act") and are subject to the conditions contained in the Licence.
2. The RIGs are the primary means by which the Authority directs the Licensees to collect and provide information to the Authority, to enable it to administer the Special Conditions of the Licence and, where not referenced in the Licence, the RIIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator.¹²
3. SC B15 sets out the process for issuing and modifying the RIGs. In accordance with paragraph 8 of SC B15, the Authority gave notice to the Licensees on 01 April 2022¹³ that it proposed to modify the RIGs, as set out in that notice.
4. The Notice required any representations by licensees on the proposals made in that notice in relation to amending the RIGs to be made on, or before, 29 April 2022.
5. Prior to the consultation period closing the Authority received ten responses. The Authority has considered the representations made in those responses and has made a number of changes to the RIGs proposed as part of the consultation.
6. We have set out our responses to the non-confidential representations received and the modifications made to the RIGs as a result of these in the "RFPR issues log"

¹² [RIIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator | Ofgem](#)

¹³ <https://www.ofgem.gov.uk/publications/notice-proposed-modifications-regulatory-financial-performance-reporting-rfpr-template-and-guidance-riio-2>

published on our website.

7. The modifications refer specifically to information required to be submitted to the Authority on or before 31 July 2022 in relation to the Regulatory Financial Performance Reporting excel template and guidance document.
8. The modifications are summarised in the attached Decision letter and can be seen in the versions of the RIGs documents specified above and published alongside this Direction.

Now Therefore –

9. Pursuant to paragraph 3 of SC B15 of the Licence, the Authority hereby modifies the RIGs in the manner specified in the attached Schedule.
10. The reason for the amendments made in this Direction is to collect additional information in line with our Final Determinations for RIIO-ET2 and RIIO ESO and, to align the template and guidance with the latest special licence conditions and Price Control Financial Model.
11. The modifications will take effect on 01 June 2022.
12. The Licensees must complete and return the reporting pack referred to above as part of the 2021/22 RIGs process.

Jonathan Gorrie
Chief Financial Advisor, Analysis and Assurance
Duly authorised on behalf of the Authority
01 June 2022