



Ensuring fair returns in RIIO-2

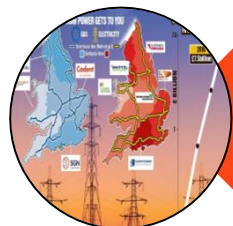
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Cadent
Your Gas Network

There are three main stakeholder challenges to legitimacy in RIIO-1 ...

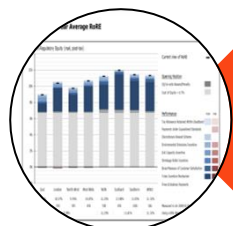
Perception



Excessive Returns



Forecast Errors



Systematic Outperformance

Reality

- Majority of returns have been a result of significant cost reductions and service improvements for customers
- In FPs Ofgem stated an expectation with increased T2 & T3 Repex workload that the median, & indeed all GDNs, would have the potential to achieve double digit RoRE

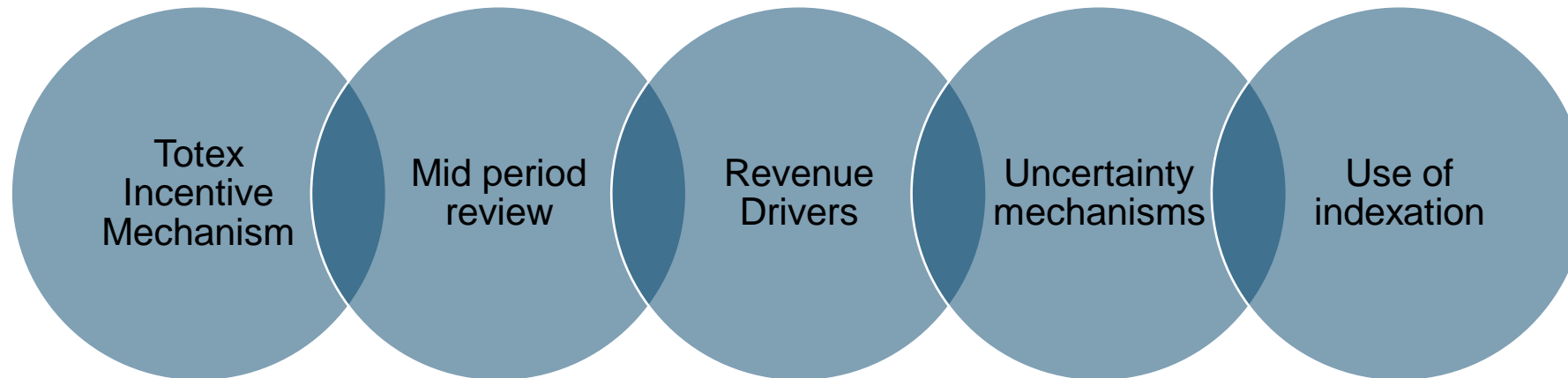
- 7 of 26 RIIO energy networks are overspending against Totex allowances, which evidences that there is upside and downside risk for network companies associated with ex ante Totex allowances.

- RIIO framework encourages collaboration
- Culture of sharing best practice has enabled all networks to deliver benefits for their customers resulting in lower bills

... and we can address them in RIIO-2 by ...

Utilising the mechanisms available within the existing framework. . .

The current framework has several ways to ensure fair returns:



...and developing the framework to. . .

Help customers understand the benefits they receive from their energy networks . . .

Build on the strong platform of RIIO-1 and evolve it for RIIO-2 to make the framework:

Simple

- Focus on the outcomes that customers want & need
- Use simple language based on what customers see and feel from the services they receive

Proportionate

- Rationalise the number of measures used to focus on what customers value most
- Explicit balance between value & complexity

Transparent

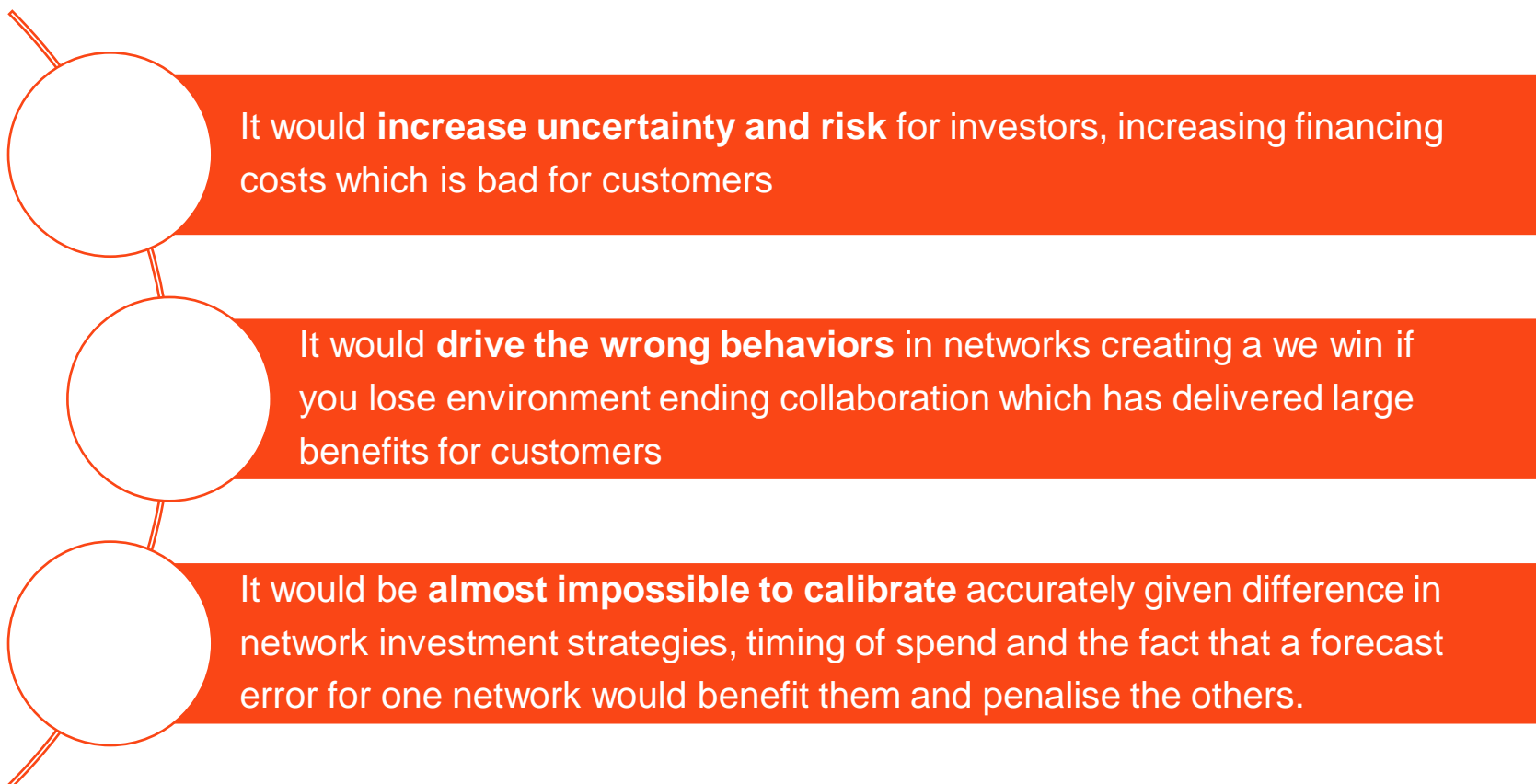
- Where complexity adds value use transparency as substitute for simplicity
- Easily understandable performance reporting
- Clear up front descriptions of how all mechanisms will work

Comparable

- RoRE is misleading & magnifies outperformance
- It is not comparable across sectors or with other industries

Proposed mechanisms such as anchoring of returns would not deliver long term value for customers

Three key reasons being . . .

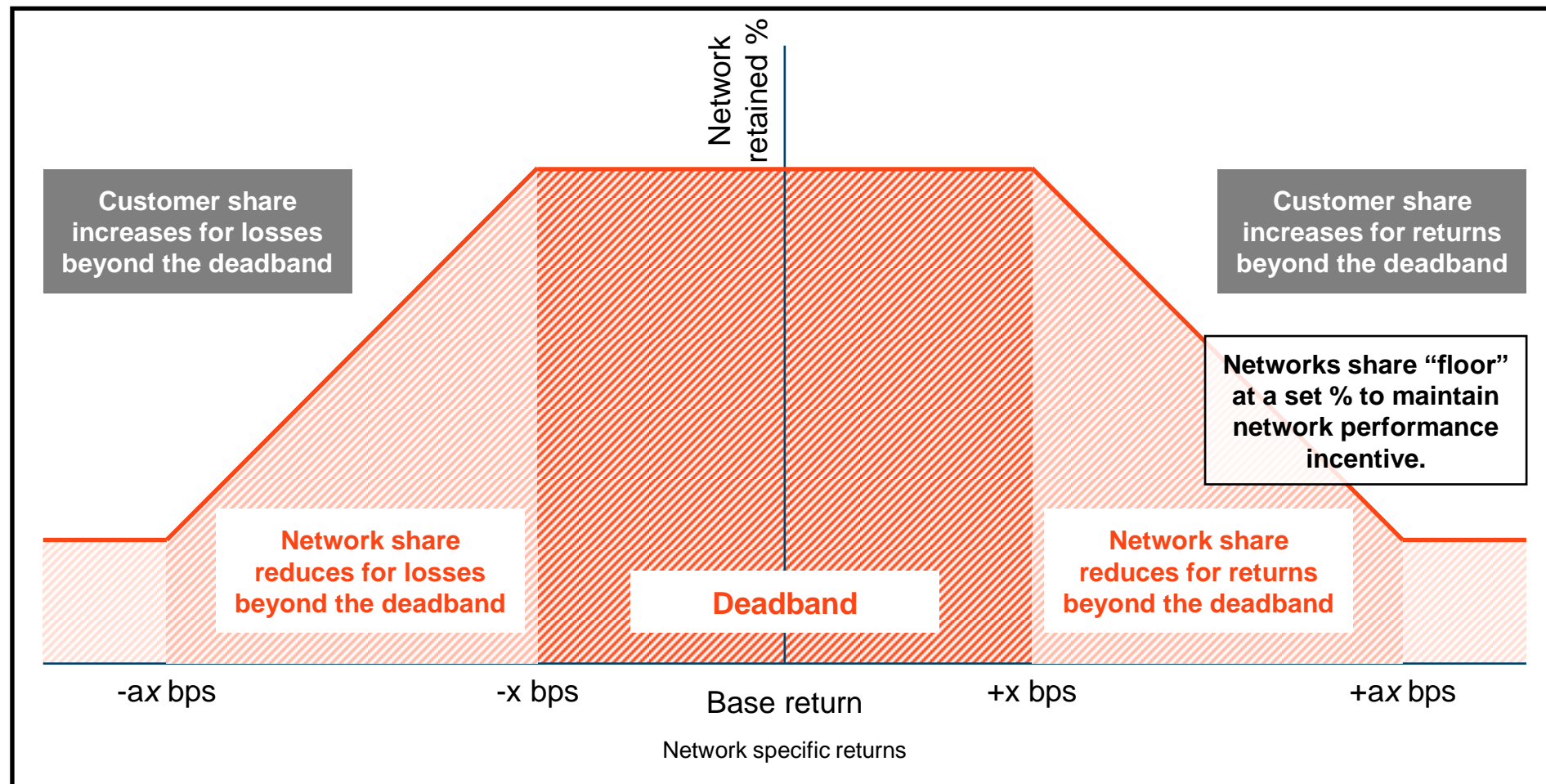


We could develop sharing factors to offer customers and networks backstop protection...

Networks share floor at a set % to maintain network performance incentive.

By widening sharing with customers to all areas of performance above / below base return it would:

- > Provide predictability of returns for network investors
- > Maintain the right behaviour incentives resulting in lower bills.
- > Protect customers & networks from forecasting errors
- > Be simple to calibrate



In summary...

This is a critical time in the development of the energy networks and its important we build on the success of RIIO-1. We should. . .

Utilise, refine and develop existing mechanisms to manage areas of uncertainty and address 'windfall gains'

Develop the framework in RIIO-2 to make it simple, proportionate, transparent and comparable

Be clear on the outcomes we are trying to achieve with any fair returns mechanisms to ensure they deliver in the interests of current and future customers



Thank you

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