

Price Review Out- and Under-performance

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1. Introduction

This short paper summarises the performance of the UK’s regulated companies under their most recent price controls. We focus, in particular, on whether companies’ out-turn returns have exceeded or fallen short of the returns that the UK’s regulators originally factored into price control decisions.

2. Summary

Table 1 provides an overall summary picture.

Table 1: Out- and under-performance by regulator, sector/company and price control period

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
CAA, Heathrow		Red						Red						
CAA, NATS		Green			Green			Red						
CC/ CMA, Bristol Water		Red						Red						
CC, NIE		Grey					Grey							
Ofgem, GDNs		Green				Green								
Ofgem, TOs		Green				Green								
Ofgem, DNOs		Green				Green								
Ofwat, water companies		Grey						Grey						
ORR, Network Rail		Red						Red						
UR, gas distribution		Grey						Red						
WICS		Grey						Grey						

Key: green = overall out-performance of the regulator’s assumptions; grey = overall performance broadly in line with the regulator’s allowed return; red = overall under-performance against the regulator’s assumptions

3. Notes

CAA, Heathrow Airport

During the 2008-14 Q5 regulatory period, Heathrow significantly under-performed against the CAA's price control assumptions. There were especially noticeable overspends against the CAA's opex allowances in most years, even though passenger volumes repeatedly came in below the CAA's forecasts. Heathrow's out-turn annual return was generally 1% to 3% below the CAA's allowed return.

In the initial years of the most recent Q6 control period, Heathrow continued to overspend against its opex allowances, but in most years this under-performance was accompanied by strong out-performance on volumes. As a consequence, Heathrow's out-turn return exceeded its allowed regulatory return by 0.8% to 1.0% per annum over the period 2014 to 2019. The COVID-19 pandemic has since pushed Heathrow into deep losses during the final two years of the control period (2020 and 2021).

Source: Heathrow's regulatory accounts.¹

CAA, NATS

During the 2010-15 RP1 regulatory period, NATS underspent significantly against the CAA's opex allowances. (NB: NATS does not take risk on its capex programme.) Its out-turn return was typically 2% above the CAA's allowed return.

During the 2015-19 RP2 period, NATS overspent against its opex allowances, with the scale of its overspending increasing over the five-year period. NATS' average out-turn annual return, after the reconciliation of a traffic-risk sharing mechanism, will be approximately 1% below the CAA's allowed RP2 return.

Source: NATS' regulatory accounts.²

CC / CMA, Bristol Water

The Competition Commission (CC) / CMA set Bristol Water's price controls for the 2010-15 and 2015-20 regulatory periods.

Bristol Water marginally overspent versus the CC's assumptions for the 2010-15 regulatory period. Its out-turn return was 0.3% below the CC's allowed return.

The company subsequently under-performed by a similar magnitude against the CMA's 2015-20 totex allowances and outcome delivery incentives (ODIs).

Sources: NAO review of Ofwat and Ofwat's financial resilience reports.³

¹ <https://www.heathrow.com/company/about-heathrow/economic-regulation/regulatory-accounts>

² <https://www.nats.aero/about-us/company-performance/annual-reports/>

CC, NIE

The CC set Northern Ireland Electricity's transmission and distribution price control for the 2012-17 RP5 regulatory period.

NIE overspent against the CC's opex allowance and underspent against its capex allowance, with a final net position of close to zero.

Source: Utility Regulator's cost and performance report.⁴

Ofgem, energy networks

The energy networks have generally out-performed Ofgem's two most recent sets of price controls.

Companies typically underspent Ofgem's final pre-RIIO controls and at the same time were able to earn rewards under Ofgem's pre-RIIO service incentive schemes. The out-turn returns under Ofgem's GDPCR (2008-13), TPCR4 (2007-13) and DPCR5 (2010-15) price controls were approximately <1%, ~1% and ~2% respectively above allowed returns.

There has been a similar pattern under Ofgem's RIIO-1 controls. The networks' most recent reports for RIIO-1 forecast average returns that are ~1.5%, <1%, and ~1% above Ofgem's RIIO-GD1, RIIO-T1 and RIIO-ED1 allowed returns.

Sources: Ofgem's performance reports.⁵

Ofwat, water companies

The water industry as a whole marginally out-performed Ofwat's 2010-15 price controls, albeit there were significantly more companies that out-performed than under-performed. At sector level, the average out-turn return was 0.2% per annum above Ofwat's PR09 allowed return.

During the 2015-20 regulatory period, there was a very small net industry under-performance as a result overspending against totex allowances and under-performance of ODIs. Eight companies out-performed and eight companies under-performed Ofwat's PR14 assumptions. The sector average out-turn return was within -0.1% of Ofwat's allowed return.

Sources: NAO review of Ofwat and Ofwat's financial resilience reports.⁶

³ <https://www.nao.org.uk/wp-content/uploads/2014/07/The-economic-regulation-of-the-water-sector.pdf> and <https://www.ofwat.gov.uk/wp-content/uploads/2020/12/Monitoring-financial-resilience-report-2019-20.pdf>

⁴ <https://www.uregni.gov.uk/sites/uregni/files/media-files/RP5%20Cost%20and%20Performance%20report%202.00%20published%202020-07-10.pdf>

⁵ <https://www.ofgem.gov.uk/ofgem-publications/86749/gdpcr1closeoutreportfinalv2.pdf> and https://www.ofgem.gov.uk/sites/default/files/docs/2014/03/tpcr4_and_tpcr4ro_close_out_report_v3_0.pdf and https://www.ofgem.gov.uk/sites/default/files/docs/electricity_distribution_company_performance_2010-2015.pdf and <https://www.ofgem.gov.uk/regulating-energy-networks/current-network-price-controls-riio-1/riio-1-annual-performance-reports>

⁶ <https://www.nao.org.uk/wp-content/uploads/2014/07/The-economic-regulation-of-the-water-sector.pdf> and <https://www.ofwat.gov.uk/wp-content/uploads/2020/12/Monitoring-financial-resilience-report-2019-20.pdf>

ORR, Network Rail

In its two most recent price control periods, Network Rail significantly overspent and under-delivered against ORR's periodic review determinations. It had particularly big problems in the 2014-19 control period, with the company falling more than 10% short of ORR's targets for efficiency improvement and missing most of its performance targets.

Source: ORR's annual efficiency and finance assessments.⁷

Utility Regulator, Gas distribution

The Northern Ireland gas distribution network overspent against their 2014-16 GD14 opex and capex allowances. Our understanding is that there is a similar picture under the network's 2017-22 GD17 price controls.

Source: Utility Regulator's cost and performance report.⁸

WIC, Scottish Water

Scottish Water has for several years exhibited a pattern of spending broadly in line with the WIC's expenditure allowances. By way of an example, its annual opex in the 2015-21 control period has typically been within £1m of the WIC's SR15 allowances. It has also been able to meet or exceed the WIC's (non-financial) targets for service quality.

Source: the WIC's annual performance reports.⁹

Explanatory notes:

- 1) The survey covers financial out- and under-performance from totex and service quality incentives only. There is no recognition of cost of debt out- and under-performance.
- 2) Only price controls where there is visibility of performance over the whole of the price control period are considered.

⁷ <https://www.orr.gov.uk/monitoring-regulation/rail/networks/network-rail/monitoring-performance/monitoring-network-rails-efficiency>

⁸ <https://www.uregni.gov.uk/sites/uregni/files/media-files/2018-07-04%20GD14%20Cost%20and%20Performance%20report%20-%20Final.pdf>

⁹ https://www.watercommission.co.uk/view_Performance%20reports.aspx