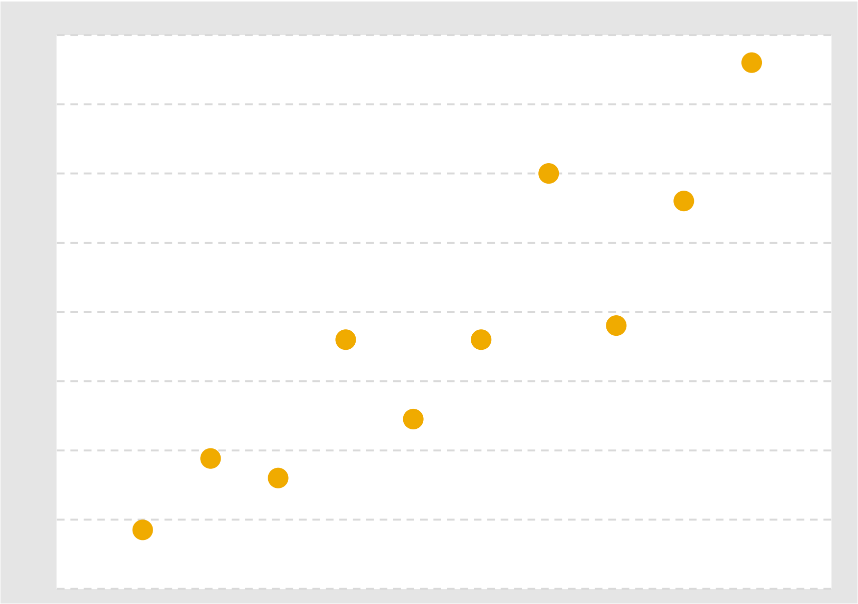
The Role of Cost Modelling in Setting Prices ï A Regulatorôs Perspective

Ynon Gablinger, Director, PR19 programme, Ofwat

The role of cost modelling in setting prices (1)

For the regulator, benchmarking is a powerful tool:

- Mitigates <u>information asymmetry</u>
- Allows us to develop <u>independent baselines</u>
- Consistent with <u>incentive regulation</u>



Cost baselines (aka ñtotex allowanceò) ï a sensible starting point for the allocation of [cost performance] risk between companies and customers.

- Triangulation helps achieve a sensible baseline. By not relying on a single (imperfect) model it reduces risk of undue gain or hardship to companies/consumers.

Cost models to reveal information and incentivise.

- Granular cost models help reveal information on the cost of different services.
- Encourage companies to challenge their approach and level of costs.
- Models based on business plan data of expected costs can be used to identify forward trends and future efficiency gains.