

**Date**  
23<sup>rd</sup> May 2025

**Cadent Gas Limited**  
Pilot Way Ansty Park  
Coventry CV7 9JU  
United Kingdom  
cadentgas.com



**Michael Smith**  
10 South Colonnade,  
Canary Wharf,  
London,  
E14 4PU

Dear Michael Smith,

**Response to statutory consultation to modify the standard and special conditions of the Gas Transporter, Electricity Distribution and Electricity Transmission licence and the Price Control Financial Instruments (PCFIs) for RIIO-GD2, RIIO-GT2, RIIO-ED2 and RIIO-ET2.**

I am writing in response to Ofgem's consultation on proposals to modify the GT2, ET2, ED2 and GD2 Price Control Financial Instruments and licence conditions, which was published on the 25<sup>th</sup> April 2025.

Of the eight proposed modifications, our response relates specifically to the three that directly impact Cadent. We are not providing comments on any modifications related to Gas Transmission, Electricity Distribution, or Electricity Transmission. Our response addresses the following three changes:

- 1. Proposed Modification to Special Condition 5.4 Vulnerability and carbon monoxide allowance (VCMt).
- 2. Proposal to Incorporate [margin on] DRS into the determination of Calculated Revenue in the GD2 PCFM.
- 3. Non-variant allowances proposed to be amended in the GD2-PCFM.

We support the proposed modifications to Special Condition 5.4 Vulnerability and carbon monoxide allowance, which reflect policy intent and aligns with the Gas Network VCMA Governance Document.

However, much more engagement is needed on proposals to incorporate DRS margins into the determination of Calculated Revenue in the GD2 PCFM.



Cadent currently recovers revenue from DRS activities directly from customers who benefit from the service. As a result, the associated costs are excluded from Totex and our Calculated Revenue, meaning they do not impact transportation charges.

GDN's margins for DRS services reflect the risks associated with operating in this market. As such, the ability to apply and retain a margin should be maintained.

Cadent's participation in the DRS market provides added value to consumers by increasing choice. In areas where other providers may be unable to operate, Cadent is well-positioned to fill the gap due to the strategic distribution of our resources.

It would be more appropriate to consider these changes as part of RIIO-3 policy working groups, allowing for a comprehensive reassessment of the DRS definition to ensure alignment with overarching policy objectives and in the customer's best interest.

The Non-Variant allowances proposed to be amended in the GD2-PCFM contain several spreadsheet errors, which need to be remedied to match our agreed disaggregated allowances. We have attached our revised remedy handover files as part of this response.

I have detailed a more comprehensive response to each of the three proposed modifications above in the appendix attached to this letter.

We welcome further discussion on these topics as we appreciate the importance of making the right decision to benefit the end consumer.

Yours faithfully,

**Hannah Wellings**  
Head of Financial Planning and Analysis



## Appendix 1

### 1. Special Condition 5.4 Vulnerability and carbon monoxide allowance

Cadent supports the proposed amendment to SpC 5.4, which enables greater collaboration between the Gas Distribution Networks (GDNs) beyond the ringfenced 25% set in the Gas Transporters Licence.

The proposed amendment supports policy intent and aligns with the Gas Network VCMA Governance Document:

*“1.2 The allowance is set at £171m. Of that £171m, 25% is ring-fenced for Collaborative VCMA Projects between GDNs. The remaining 75% is split between each network based on the forecast number of GB domestic gas customers served and can be used either individually or in collaboration with other GDNs.”*

### 2. Incorporate DRS into the determination of Calculated Revenue in the GD2 PCFM

The proposed amendments to the PCFM will reduce our Calculated Revenue by the difference between directly remunerated services (DRS) revenue collected and costs.

#### Overstated surplus in the latest PCFM

As part of the consultation, Ofgem has issued a GD2 PCFM indicating that Cadent holds a surplus of £26.5m (in 2018/19 prices) related to DRS activities. This figure is based on our 2023/24 RRP submission and is incorrect due to how the data has been extracted from the RRP. RRP templates are in the process of being amended to correct this issue (details highlighted below). This will reduce the surplus to nearer £2m (in 18/19 prices) across RIIO-2.

In our 2023/24 RRP submission, the prescribed RRP template meant that we were unable to distinguish between consented revenue and DRS revenue within table 2.09 (DRS Revenue). Through the 2024/25 RIGs consultation, Ofgem has revised this table to allow GDNs to report consented revenue and DRS revenue separately, aligning with the cost reporting structure in table 4.17 (DRS Costs).

We agree with this amendment to the RRP template. Once the PCFM is updated for 2024/25 RRP submission data, the surplus will correctly show as nearer to £2m (in 18/19 prices) across RIIO-2.

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## Our Position on the Proposed Changes to the PCFM and Licence Regarding DRS

Cadent currently recovers revenue from DRS activities directly from customers who benefit from the service. As a result, the associated costs are excluded from Totex and our Calculated Revenue, meaning they do not impact transportation charges.

This is demonstrated within our RFPR submission, an extract of which can be seen below, where we reconcile from the expenditure per our accounts to the regulatory expenditures included within Totex.

<b>R3 Totex Reconciliation</b>		<b>Actuals £ms (Nominal)</b>			<b>Actuals £ms (18/19 Prices)</b>		
		<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
Total Expenditure Incurred		2,025.2	2,228.0	2,331.3	1,866.9	1,888.2	1,871.9
Reconciling Adjustments	Depreciation and Amortisation	(402.5)	(422.0)	(462.0)	(371.0)	(357.7)	(371.0)
	Total expenditure relating to excluded services (deminimis, excluded, consented and metering)	(10.4)	(12.3)	(12.4)	(9.6)	(10.5)	(9.9)
	Other Opex Adjustments	26.6	15.1	(18.4)	24.5	12.8	(14.8)
	Capex Adjustments	(74.2)	(47.8)	(61.8)	(68.4)	(40.5)	(49.6)
Total Costs per latest RRP submission		1,564.7	1,760.8	1,776.8	1,442.4	1,492.3	1,426.7
Remove Passthrough Costs		(500.2)	(500.0)	(367.2)	(461.1)	(423.8)	(294.9)
<b>RFPR Table R3 Totex Reconciliation Total</b>		<b>1,064.6</b>	<b>1,260.8</b>	<b>1,409.6</b>	<b>981.4</b>	<b>1,068.5</b>	<b>1,131.8</b>
<b>PCFM/ RRP reported Totex</b>		<b>1,064.6</b>	<b>1,260.8</b>	<b>1,409.6</b>	<b>981.4</b>	<b>1,068.5</b>	<b>1,131.8</b>

We follow the same approach for Revenue, please refer to Table R2 of our RFPR submission.

DRS costs include elements of fixed costs that would otherwise be included within totex costs and consequently feed through into calculated revenue if we were not using these for other activities. By deducting all associated costs, we ensure that customers are not charged for resources already funded through other means.

In delivering these services, GDNs assume a range of commercial risks. These include, but are not limited to, the procurement of materials, supply chain management, and the operational execution of services outside our core regulated remit. Our pricing is competitive, and we believe the margin we earn reflects the risks associated with operating in this market. The regulatory regime is designed to emulate the dynamics of a competitive market, and as such, it is both reasonable and appropriate for GDNs to apply a margin in recognition of the commercial exposure they accept.

Therefore, the ability for GDNs to apply and retain a margin on DRS activities should be preserved. Should the regulatory framework evolve in such a way that the margin is instead passed through to end consumers, it would be necessary to reallocate the associated commercial risks accordingly. In such a scenario, those risks should no longer be borne by shareholders but instead be reflected in the Totex allowance and ultimately recovered through consumer charges.

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Furthermore, Cadent's participation in the DRS market provides added value to consumers by increasing choice. In areas where other providers may be unable to operate, Cadent is well-positioned to fill the gap due to the strategic distribution of our resources.

*Our Position on the Proposed Changes to the PCFM and Licence Regarding DRS*

We believe further consideration is needed before implementing the proposed changes to the PCFM and licence in relation to DRS. There are additional inconsistencies within the licence, beyond the discrepancy between Special Condition (SC) 2.1.7 (Calculated Revenue) and SC 9.7 ('DRS')—particularly concerning the treatment of recovered revenue and the definition of DRS.

These inconsistencies contribute to a lack of clarity and have led to varying interpretations across the sector. The proposed amendment to SC 9.7 and the PCFM is not only a policy change but does not sufficiently address these issues. Therefore, we recommend that this matter be subject to broader discussion.

Cadent believes it would be more appropriate to consider these changes within the context of the wider policy decisions currently under review as part of RIIO-3. This would allow for a comprehensive reassessment of the DRS definition to ensure alignment with overarching policy objectives. It would also provide an opportunity to review all DRS categories in detail and determine the appropriate treatment for each.

Such a review would help clarify how DRS-related costs should be reflected within totex, promoting consistency and transparency across the framework. Currently, DRS categories 1, 2, and 3 are included in the Totex Incentive Mechanism (TIM) and accounted for in the allowed revenue calculation via the PCFM, as required through the RRP and RIGs. However, for Cadent, the remaining DRS categories are not treated in the same way.

**3. Non-variant allowances proposed to be amended in the GD2-PCFM**

Ofgem plans to update the Non-Variant allowances and incorporate the updates within the GD2 PCFM.

We have reviewed the files shared and, while we agree with the overall level of allowances reflected in the updated Finance Handover file, we have identified several spreadsheet errors in the totex disaggregation input file. These errors must be corrected to align with the disaggregated allowances agreed in 2023.

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Additionally, the Fuel Poor Network Extension Scheme (FPNES) allowance for our North West network does not reflect the agreed disaggregated values from 2023. This discrepancy is not due to spreadsheet errors but rather the omission of a reduction in allowances to account for the ex-ante reduction in baseline FPNES connections. This adjustment was necessary following the reallocation of FPNES funding into the VCMA.

We have outlined these issues in more detail below and in the accompanying files submitted with this letter. In light of the above, we kindly request that our revised remedy handover files be used to replace the updated remedy files circulated in April 2025.

Spreadsheet errors:

In the file “Remedy 2\_Allowances\_PCD\_VD\_noRPEs” in the final sheet “Out\_DisaggAllow\_Final” the cells we have highlighted in yellow have been amended, so they pull from the correct preceding sheet “Cal\_PCD\_Final”. In the version circulated, the wrong sheets were being picked up for these lines and this is causing a discrepancy between the top-down totex allowance and the disaggregated allowance, as signalled by the checks at the bottom of each section for each network which appeared as FALSE in the check row (these now show TRUE).

Change to North West FPNES disaggregated ex-ante allowance:

Whilst having the errors remedied based on the step above means all checks cells are TRUE, at the time disaggregated allowances were agreed in 2023, a policy decision was made by Ofgem to reduce the cap on FPNES connections per network and repurpose funding to the VCMA. Following discussions with Neil Munro at the time, the approach agreed to implement this in the disaggregated allowance files was:

- where revised caps for FPNES connections remained above baseline volumes within disaggregated allowances, no adjustment was needed (this is the case for our Eastern, London and West Midlands Networks); but
- where revised caps for FPNES connections fell below baseline volumes within disaggregated allowances, the ex-ante allowances would be set by multiplying the new cap by the volume driver unit cost.

As this policy change was new and not implementable in the current model suite, the required adjustment was calculated in a working sheet within one of the attached emails shared and agreed to by Ofgem. File: “GD\_Totex\_Disagg\_Share\_Latest\_Cadent\_Edits\_13.07.23”, sheet:

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“VCMAFPNESCyberOT”, rows 33-36. Here you can see the calculation performed to result in a revised (and lower) ex-ante FPNES allowance for our North West network (row 36).

Consistent with how this was done in 2023 in the file “Remedy 2\_Allowances\_PCD\_VD\_noRPEs” we have made the same changes in the North West section of the sheet “Out\_DisaggAllow\_Final” and shown these in blue. These copy over the revised FPNES allowance from the other sheet mentioned above and then amend other related rows so totals add up in the disaggregated allowances and all agrees.

Resulting impact on the finance handover file:

Having made these changes, we have then copied across the new “Out\_DisaggAllow\_Final” sheet into the file “Remedy 2\_GD2\_Finance\_Handover” to set out the revised allowances.