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Mick Watson
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Dear Mick

Notice of provisional revised pension allowances

Cadent Gas owns and operates four of the eight gas distribution networks in Great Britain. Through these networks, we distribute gas to approximately 11 million offices, schools and homes.

Our response to Ofgem's notice of the above published on Friday 13 October 2017 is set out below:

Deficit Allowances

We welcome the revision of deficit allowances proposed in this letter in line with our submissions. Cadent's deficit allowances have been revised to reflect the work undertaken to sectionalise the National Grid UK Pension Scheme (NGUKPS) from January 1st this year and we welcome Ofgem's recognition of the positive impact that sectionalisation provides for consumers.

The revised deficit allowances for Cadent's four networks reflect an overall reduction in deficit allowances that gas customers will face as a result of an improvement in the funding position of the NGUKPS scheme.

PPF & Admin Allowances

Ofgem have revised the PPF Levy & Scheme Admin allowances for Cadent to reflect the post-sectionalisation split of the NGUKPS. However, allowances have not been increased to reflect the underlying increase in scheme admin costs experienced in recent years, which are only now being passed on to Cadent in terms of higher Admin contributions.

The main driver for the increase in Admin costs experienced by the NGUKPS relates to the added complexity of investment, de-risking and liability management exercises that have been considered and implemented since costs were last forecast and allowances were last set in 2013. As outlined in our submission, these exercises have led to significant benefits from a funding position and reduced gas consumers' exposure to deficit costs by several hundred million pounds.

The sectionalisation of the NGUKPS scheme is not the main driver of this increase in costs, but notwithstanding that point, the forecast NGUKPS Admin costs post sectionalisation benchmark extremely well against the other networks at just 0.03% of liabilities per annum (outlined in Table A2.2 of Ofgem's letter).

The comparison Ofgem makes in Table A2.2 underscores the efficient nature of NGUKPS's Admin costs and indicates the continuing significant economies of scale that are being passed on to Cadent's customers.

Whilst we do not agree with the basis of the proposed reset Admin allowances we do recognise that Ofgem is somewhat constrained in taking a forward looking approach to these costs. We recognise that Ofgem have increased PPF and Admin allowances marginally to reflect past costs incurred by the Company and we would expect that at the next review Admin allowances are once again reset, to reflect the actual costs then being incurred. We believe it is important that efficiently incurred Admin and PPF costs continue to be funded in order to ensure that networks are appropriately incentivised to consider all available tools to manage down funding costs and investment risks on consumers. And this is consistent with Ofgem's Pension Principles.

Despite the reservations outlined above, we are not formally challenging the allowances being proposed. We accept that if costs incurred or expected post March 2016 are not considered at this review, then 'in the round' the proposed allowances represent a reasonable balance between ensuring efficient costs continue to attract allowances, whilst minimising the costs for consumers.

Future PPF & Admin Allowances

On page three of the letter reference is made to treatment of PPF and Admin costs in RIIO2, (reproduced below):

'For the next price control, RIIO2, we propose to adopt the same approach for transmission and gas distribution NWOs that applies as part of RIIO-ED1. This is where administration and PPF levy costs are included as part of totex.'

When this approach was considered at RIIO-GD1/T1 it was rejected by Ofgem, after consultation and careful consideration, for a number of reasons. We understand that the concerns considered then largely remain in place today, and hence we don't believe this approach is appropriate and suggest that this reference is removed. We recognise that Ofgem may want to review this approach at RIIO2 but this would require full consideration of the issues involved which have not been looked at here.

We would like to remain actively involved in future discussions with Ofgem on the issues covered in this response.

If you require any further information, or if you have any questions regarding our response, please contact me directly on 0330 6780162. This response is not confidential.

Yours sincerely

Rob O'Malley
Head of Treasury