OFGEM

OPEN MEETING SERIES

Network Price Control

Cadent

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ATTENDEES

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John Crackett	Non-Executive Director – GEMA, Ofgem
Simon Wilde	Senior Financial Adviser, Ofgem
Steve Fraser	Chief Executive Officer, Cadent
Sir Adrian Montague	Chairman, Cadent
Dr Tony Balance	Chief Regulatory Officer, Cadent
Howard Forster	Chief Operating Officer, Cadent
David Moon	Director of Treasury, Cadent
Zoe McLeod	Chair of Cadent CEG
Martin Silcock	Member of Cadent CEG
Helen Fleming	Member of Cadent CEG
Roger Witcomb	Chair of the Challenge Group
Robert Hull	Member of the Challenge Group

THE CHAIR: Good afternoon. I'm Martin Cave. I'm the Chair of Ofgem and also the Chair of this hearing. Thank you for joining us today at the network price control open meeting for Cadent, delayed from the spring by the impact of Covid-19. This and similar meetings are the first of their kind for Ofgem and, despite us not being able to be in the same room, we very much encourage you to get involved as it is important that we hear a variety of voices today.

I'm confident that this meeting will allow us to have an open and constructive conversation about the consultation responses and key outstanding areas of difference ahead of our final determinations, which will be published later this year.

Cadent has advised on the topic areas they would like to discuss today. They are, in brief, cost assessment, the balance between risk and reward and the needs of customers now and in net zero.

Companies are first given the opportunity to deliver a 20-minute presentation. We also welcome today members of the company's Customer Engagement Group and Ofgem's own Challenge Group. These groups are formed of independent experts convened to review business plans in detail. They will have an opportunity to feed in their views ahead of our opening the floor to further questions.

It is very encouraging to see such a diversity of views registered for this event. Please ask your questions on the chosen topics by using the Q and A function on the side bar. Questions will also be asked by other companies, by members of the senior Ofgem team. We will be making a transcript and recording of these events which you will be able to watch and will be available on our website once all meetings have taken place.

We start with the knowledge that networks in general have delivered good service but at high cost to consumers. This is well documented through our own and other evidence. We also know that investment in the energy system is going to have to rise as we meet the net zero challenge at lowest cost to customers and to play a key role in a green recovery.

I would now like to hand over to Akshay Kaul, Ofgem's Network Director, who will give a brief update and set the scene in terms of where we have reached in the RIIO-2 process with Cadent.

AKSHAY KAUL: Thank you, Martin. Because this is a new technological environment, can I just check that you can hear me? Okay. Very good. Good afternoon, everybody. I am Akshay Kaul. I am Director for Networks at Ofgem and I would like to start by just thanking colleagues at Cadent, the Cadent Customer Engagement Group, the Challenge Group, and all the other stakeholders that have assembled today to participate in what I hope will be a rich discussion on the key areas of contention that lie in the determinations for Cadent's RIIO-2 price control.

I would also like to thank all stakeholders for providing useful feedback and information through your consultation responses which we have been spending a

great deal of time reflecting upon. Since we finished the consultation in early September, we have had very constructive engagement through a range of technical bilaterals, industry working groups, and of course asking supplementary questions directly to companies and other respondents.

I wanted to start this open meeting by just providing a transparent summary of the progress that has been made since the draft determinations were published and the consultation responses came in so that we begin the discussion on a relatively equal footing in terms of information available to all stakeholders.

First of all, I want to say something about modelling errors because this was a theme that Cadent highlighted quite early on. They said that they were concerned about errors within the econometric modelling and I wanted to flag that one of the reasons we do such a transparent consultation and we release all our models is precisely so that stakeholders can crawl over them and identify if there are any glitches in the formulae or in terms of the data inputs that have been used.

We are grateful to all stakeholders who have helped us to identify errors in the modelling. We have worked through these now with Cadent and, while there are many areas that reflect disagreements about methodology or interpretation of modelling such as, for instance, the use of top-down Totex model or the 85th percentile to set the frontier, we would not call these errors. Putting these to one side, we still accept that there are errors that need correcting in the econometric modelling and we have created an error log and worked through this with the gas distribution networks to transparently correct for any such modelling errors.

I wanted to flag that the magnitude of these is relatively modest. They have an impact of around 2 per cent of Totex allowances in the round across all of the gas distribution networks, which is roughly comparable to the modelling errors that were corrected at a similar stage in previous price controls.

There are also a wide number of other areas where I believe we have been making very considerable progress and I want to just take you through them very quickly. I will start with Totex, the total expenditure budget, and the cost assessment which I know Steve and team will come on to. I will then say something briefly about the outputs and incentives package, about Cadent's role in net zero, and then I will touch very briefly on the important question of the cost of capital and finance.

Starting with cost assessment, as I said, we've had a number of engineering bilaterals to understand better the engineering justification for a range of the Repex and Capex investments proposed by Cadent. In many cases, Cadent has provided significant additional information and evidence that we are actively considering as we develop our final determinations. We have also had a series of IT bilaterals to understand better the plans for investing in IT development across the network and, again, we have received very significant additional information from the company that will help us understand the level of confidence associated with the delivery and costs of the different projects which is leading us to consider once again the balance

between the projects that are funded through the base line versus those that are funded through reopeners.

We have listened carefully to some of the concerns about the methodology choices that were raised around the econometric modelling by Cadent and other industry stakeholders and we have been working collaboratively with industry and stakeholder groups to examine these methodological choices and also consider some further technical adjustments in the modelling such as the use of regional factors to normalise for differences between the different parts of the country and the way in which we model the impact of different urban versus rural geography, such as the particular funding needed for high-rise buildings or, as we call them, multi-occupancy buildings or MOBs. Very good progress has been made in this area but more work is required in the weeks ahead before we can arrive at a firm conclusion for final determinations.

We have had very constructive discussion about the ways in which we model Repex in particular -- this is the replacement expenditure programme for Cadent -- within our regression models and the way in which we will hold the gas distribution networks to account for delivery of their Capex and Repex projects. We are reconsidering how we develop these mechanisms towards final determinations so that they do hold the GDNs effectively to account for delivery but they are also proportionate to the task and we are not creating an overly bureaucratic or burdensome system.

Let me move on now to outputs and incentives. Cadent submitted significant proposals in the area of vulnerability and we note comments from both Cadent and their Customer Engagement Group, who is going to speak in a second, but also wider stakeholders like National Energy Action on this topic, and we are giving very active consideration to this feedback, including whether it would be appropriate for us to provide additional funding and potentially extend the scope of work that is covered by the vulnerability allowance which could mean, for example, that some of the areas of work that are currently undertaken by GDNs such as the repair or replacement of condemned boilers for consumers in vulnerable situations could potentially be funded in circumstances where it is appropriate and necessary to do so.

In our draft determinations we highlighted that there were a number of areas where we would be interested in further discussion around ideas for bespoke outputs, for instance, for Cadent in the area of coordination of street works which we know in principle are supported by many stakeholders. We have had useful discussions around these and how they could be developed and are giving active consideration to including them in final determinations.

Let me turn to net zero and particularly the issue of the uncertainty mechanisms. We proposed in draft determinations a number of uncertainty mechanisms to ensure that the price control can flex to facilitate delivery of net zero. Cadent were broadly supportive of this approach in their response,but highlighted that these mechanisms need to be agile to support developing projects for net zero. We are continuing to

work with the GDNs to ensure that the different mechanisms across the control are cohesive, that they cover the different types of net zero investment that we can anticipate, and we are giving active consideration to the setting of the appropriate thresholds and the timing for these reopeners.

Cadent also highlighted the potential need for funding for the HyNet hydrogen project within their plan and they have further refined this request within their consultation response. We have been working with Cadent to understand this project and its funding requirements over the last couple of months and, while good progress has been made, we believe more work is required over the next couple of weeks before we can arrive at a firm conclusion for final determinations.

I said I would touch on finance. Let me end with that. We have had significant engagement with Cadent and indeed across the industry to discuss the financial parameters of the package and to understand better the response to the consultation. I note in particular that since draft determinations we have had the CMA publishing their provisional findings for the PR19 appeals in the water sector and, while these are provisional and we await with interest the CMA's final determinations, even at this stage we do consider the PR19 provisional findings an important contribution to the debate on cost of capital. We think there are likely to be areas of crossover between the water and energy sectors but also there are other areas such as the question of asset beaters, the way we calculate the cost of debt, and the particular aiming up arguments that are used by the CMA which we think tend to be more specific to sector route circumstances. We would be particularly interested in stakeholder views, including today at this meeting, after read across of the CMA's reasoning to the energy sector.

In summary, ongoing engagement is key to ensuring that we have the ability to fully understand your responses and to continue to develop a robust price control which provides sufficient funding for Cadent to continue operating a reliable network, creates value for consumers, and it facilitates net zero at lowest cost. We believe we are making excellent progress towards developing our position for final determinations and we look forward to hearing your reflections in this meeting.

Let me hand back now to Martin.

THE CHAIR: Thank you, Akshay. May I now turn to the company to give its 20-minute presentation?

SIR ADRIAN MONTAGUE: Thank you very much, Martin. For those of you who don't know me, I'm Adrian Montague, I'm the Chairman of Cadent, and I'm going to say a few words of introduction before passing it over to Steve Fraser, Cadent's CEO, who will take us through the presentation and introduce his colleagues. He is also the point man for any questions you may want to ask us.

This open meeting is a very important milestone in the RIIO process and therefore it is absolutely right that as the Chairman of the company I should be participating.

Fate means we're only doing this virtually but it is important to participate as the Board of Cadent has been very closely involved with this process throughout.

Nonetheless, the main burden has been taken by the executive team and I know they have been working hard and I think constructively with Ofgem's people and the Board, frankly, would not want it any other way.

I think it's fair to say that we're looking for a significant movement from Ofgem's draft determination, first to ensure that we have a workable plan for the next regulatory period and, secondly, to create returns sufficient to continue the flow of investment as we do see the next period as crucial as a bridge to net zero.

As Akshay referred to, there have been developments recently in other utility sectors but I'm sure the Ofgem team will be taking them into account in framing their final determination and I should say very clearly that it is absolutely our wish to conclude matters without having recourse to any external agency.

So we will continue to work hard to achieve a positive outcome, as I know the Ofgem team is doing, so we can deliver what our customers have told us that they want and to provide the springboard to transforming our distribution network to meet the challenges of greening our gas supply.

With that, I will now pass you over to Steve Fraser. Steve.

STEVE FRASER: I've got Dave Moon, our head of Treasury, and Dave also headed the process for us on the determination, I've got Howard Forster, our Chief Operating Officer, who runs our day-to-day operations in our four networks, and I've got Tony Balance, our Chief Regulatory Officer, who recently joined us from Severn Trent.

If I could just start by saying a huge thank you to Akshay for his words at the start of this meeting, and I think they echo a number of things I was going to say. We were very disappointed with the initial outcome when we received it back some weeks ago from Ofgem. However, we have worked extremely hard, as have the Ofgem team, in a very collaborative way to really start to allow us to understand the areas we needed to make some movement on, we had errors in the data and the tables and clearly progress has been made, huge amounts of progress, in the last few weeks, but there is still a gap to go. So thanks to Akshay for those words.

If I could now just take you back a few years to the change of ownership from Cadent when it was bought from its last owners and our Chairman, Sir Adrian, joined the Board. In the last couple of years particularly this company began what will be a multi-year turn around and transformation plan. We do not hide from the fact that Cadent, in its previous guise, was a laggard in terms of cost efficiency and more importantly cost performance, but in the last couple of years the business has really started to transform. We've reduced our cost base hugely, both from an operational perspective and an investment perspective, and a Capex perspective. We've had a wholesale change in the leadership of the company, both at independent director

level around our Board table and also in terms of the executive leadership team. We've hugely simplified the processes in the business and we've hugely simplified the operating model to drive responsibility for the end user right out into the front line of our business with those people who interface with the customers day to day.

We set our plans out for RIIO-2. We've done so with ambition and customer at the very heart of it. We had embedded over £500 million of efficiencies and, believe me, it was very, very tough to get our Board on side, both our independent Board members and our investment Board members, to agree to that level of aggressive efficiency within a plan. That's one of the reasons we felt particularly aggrieved when we received the further £700 million of cuts in the return back in the interim form from Ofgem.

So we feel we had done what was asked and put in what we felt was an honest and stretching plan. We had also put a huge amount in the plan from an ambition perspective in relation to customers. I firmly believe – and it's been my mantra throughout my career in utilities – if you treat customers right, you get things right first time, you give a good level of customer service, you will be an efficient company. That's something we're striving to do and, as Jonathan and his team know, for the first time in a number of years this year Cadent are not propping up the customer league tables. We've moved broadly into mid pack and we will kick on to front tier from there.

The last area that we really worked hard on our plan on was doing more social good and that's an area particularly around vulnerability, for the user who normally in my background is particularly important to me, particularly around giving customers value and supporting those customers that need a little bit more help than we may as customers.

One of the things that upset us the most when we received the plan back was that we felt the perception of Cadent as the industry laggard and, as we sit here and now, it's clear we aren't. We aren't number one but we are not the laggard. I think the work we've done with Ofgem in the last couple of weeks and months has started to help us, both parties, understand why that wasn't the case and we have started to put some of those issues to bed and move forward. Teams have worked really well since the DD to resolve a significant number of issues and that's particularly pertinent to the cost assessment that Tony will talk about shortly.

The message I would like to leave you with in this opening part of the presentation is if we don't get movement, we just can't run the business. We literally couldn't field a blue-collar workforce in London, for example. The cost base just isn't there to do it; the allowance just isn't there to do it. So we have committed to working hard with Ofgem, as we have been in the last month or so, to really try and take this forward so that we can get it to a position that both them, us and our customers are happy with.

On that, I'll hand over to Tony Balance to take us through the meat of the presentation.

TONY BALANCE: Good afternoon, everybody. I want to go through the three key themes that Martin articulated at the start but it's worth saying that the material that I want to cover and the issues we want to address are quite complex in nature. While we've tried to simplify the issues to convey the key points, I thought it would be good for everyone to have in mind half a dozen really key over-arching messages which cover off the three key themes.

First, we submitted an ambitious, efficient plan. When I joined Cadent back in April of this year, having just finished Ofwat's PR19 process, having produced there a very ambitious and efficient plan for Severn Trent, it was crystal clear to me that Cadent had produced a similarly ambitious, well evidenced and efficient plan.

The second point I would like to make is that Ofgem's cost assessment of the plan was therefore a total surprise to us, given its severity, and the cost assessment is simply in our mind not robust. As Steve said, as such, we simply cannot run the business based on the DD proposals, particularly given the cost assessment.

The fourth point I would make is that we think Ofgem has gone too far in its attempt to rebalance risk and return. We understand the rationale but it feels to me coming into the process that Ofgem has gone too far in this respect.

The fifth point is more could be done to support customers in vulnerable circumstances and net zero and that's an area we've pushed really hard in our plan and obviously Steve talks passionately to that in the sense of us really wanting to lead the way in that space.

Last, and really a process point, there's a huge amount to do in a relatively short space of time and we trust that the constructive dialogue that we've undertaken will manifest itself into significant changes to all these key areas in the final determination.

I want to spend a bit of time on the cost assessment. This is the biggest theme and the biggest area that to date we've been discussing with Ofgem and it's absolutely critical that we have a cost base that can run the business. That's super important for customers so that ultimately we can deliver the services that they require from us.

I talked about the surprise that we had with the £701 million inefficiency challenge that we had and the surprise really stemmed from the fact that we aimed to set the benchmark, and our analysis on the same data that Ofgem has said that we were setting that efficiency benchmark. There's lots of ways to look at the draft determinations. What I think is perhaps most insightful really is the pie chart on the right-hand side of this chart. I've circled two numbers in orange there, one at £543 million and one at £38 million. The £543 million is the number for Cadent's comparative efficiency position which compares to only £38 million for the rest of the sector. Bear in mind we are roughly half the sector, so you can see the disproportionate impact that the draft determination has on Cadent. If you dig a

little further, you can see that London, if you can see on the slide, is £210 million of challenge alone. That's more than five times bigger than the rest of the GDN sector put together. So I'm sure can you appreciate the surprise to us of being set such a huge efficiency target.

We identified four areas to really get stuck into this and those four areas make up that £701 million additional efficiency charge. What's really important to probably draw out of this chart is that's on top of the £505 million which you can see on the dark orange bar on the right-hand side, so this is £700 million on top of the £500 million baked into our plan.

The four areas very quickly were data and arithmetic errors, that's around £300 million, benchmarking errors of around £150 million, errors in regional factors of around £80 million and £158 million of ongoing efficiency errors. As Akshay and Steve talked to, we've been spending a lot of time with the Ofgem team going through these issues.

I think it's fair to say that good progress has been made on the data and arithmetic errors and on the efficiency frontier, so that's 1 and 4 on the chart. On the efficiency errors, which we total at £300 million, it has been indicated to us that Ofgem have found around £200 million of that number that will come back to us in the final determination. That £300 million is around 6 per cent or probably a bit more, I think, of around our Totex for the next five years.

While good progress has been made, I think there is some way to go. The treatment of MOBs in the MEAV factors in the modelling needs attention so we are expecting that £200 million to increase as we go through the process. There's also a number of other errors that we're finding as we go through the process.

I really, however, want to focus on 2 and 3. Ofgem are still committed to an over-arching single Totex model and we have concerns that will impact on the robustness of the methodology that Ofgem ultimately use. In terms of the benchmarking and using regional factors, Ofgem have indicated that they are looking at that and we welcome that because that's particularly important for our London area.

I want to spend a bit of time on this chart because this is really important. We commissioned NERA, the economic consultants, to review the econometric modelling when we got the draft determination and what this chart shows is a result of their analysis. I think you should be able to see it on the screen but the first of those columns that is coloured in shows the ranking of the various networks at the time of the DD. You can see the four other gas distribution networks rank 1 to 4 and Cadent's networks rank 5 to 8. If you correct for the errors that we've talked about, on our estimates, you can see in the second column that shifts the efficiency rankings considerably with the North-West network for Cadent becoming the second most efficient company and you can see how the other efficiency rankings shift. If you go from left to right thereafter, you can see how NERA have run different model scenarios with improvements to the robustness in the way in which they've done the

modelling. If you go to the far right, you can see it is entirely possible that Cadent's networks could be ranked 1 to 4 of the eight networks and even in the model before that we're ranked first, second, third and fifth. Those models are the ones that are actually more robust than the models used at the draft determination, even correcting for the errors. Why? Because they both satisfied the so-called Ramsey reset test.

It's also probably worth reflecting on this table. If you compare the modelling that has been conducted here to that that is done in water, and obviously I've had the benefit of doing that, having gone through the PR19 process, Ofwat have more data points because they've got more companies, they use multiple models and the CMA have just said that they will use an upper quartile for setting the efficiency frontier. So, I think it's almost inconceivable that an 85th percentile while using a single model can be used. The analysis that the CMA have done would suggest that something below upper quartile would be a reasonable benchmark to use for the sector. So we are urge Ofgem to apply a rich picture in its approach to the modelling and also to review the 85th percentile in its deliberations before the final determination.

In terms of ongoing efficiency, I just point out a few quick things on this. Our view very much is that Ofgem took the top end of the range. It was certainly the top end of the CEPA range, who are the economic advisers that Ofgem used, so picking 1.3 per cent. The CMA have come out with 1 per cent, which is slightly lower than Ofwat's 1.1 per cent, and we had 0.94 per cent in our plan. So we very much had that stretching efficiency in our plan which compares favourably with where the CMA are and we would again urge Ofgem to relook at the efficiency movement in regard to this.

So to summarise on the cost assessment, a few points on this slide: first, correct the data and modelling errors; secondly, really look at that rich picture in the econometric modelling in line with the CMA; ensure that regional differences in operating costs are assessed, and that is particularly important for London. The fourth point is to correct the ongoing efficiency errors and also relook at the quantum of the efficiency frontier; and, lastly, and we haven't covered this in any detail today, ensure we have adequate funding to replace and maintain our highest risk assets. If you do all of those things, there will be no catch-up, no efficiency, of the £701 million quantity that we faced at the draft determination, and that's what we're looking for in the final determination.

Turning to risk and reward, I think there are two issues here, one around incentives and one around financing and returns. Both are really important in delivering the right outcomes in the future for consumers. We understand Ofgem's desire to curb excessive returns but, as I said at the start, I think we believe that you've gone too far and in an attempt to protect customers actually could end up with destroying incentives to improve services that will be to the benefit of customers over the short, medium and longer term. We commissioned economic insights to review the various levers that one can use to out-perform, of which they identified 22. What they showed was that 12 of those levers had a negative impact on returns and 10 were

neutral. They estimated that this would impact by a negative 2.5 per cent, so a very significant impact on the level of returns that we would be able to make.

We suggested a whole bunch of things that Ofgem could do to improve the incentives on the right-hand side of this chart. I'm not going to go through this in great detail but if you adopt some of those proposals, then we'll end up in a much better balance in the final determination.

One area that really surprised us was how Ofgem has approached outputs, in particular NARMs, which is a measure for looking at asset risks, which has real strong incentive properties notwithstanding its complexity to drive us to deliver the lowest risk in our assets for the lowest cost. What Ofgem have proposed in the draft determination is something that is extremely complicated and you can see some of the points on the slide there. The outcome of this is what I would kind of describe as regulation of inputs rather than regulation of outputs and outcomes. It won't really drive us to the incentives to really get us to deliver much more efficient asset base going forward and we would urge therefore Ofgem to relook at this, either to simplify the methodology that we have in the draft determination or indeed go back to the methodology that was there in RIIO-1.

I won't spend much on this slide. Suffice to say we believe that Ofgem's view on the cost of capital has gone too far. It sits below the CMA range. We believe we took a reasonable view on the WACC in our planning. You can see that on the chart, how that compares to the CMA's provisional position, and ultimately when one runs this through the modelling, you correct for the various errors, our plan is simply not financeable based on a couple of the key financial ratios that you can see at the bottom of the chart there. Our investors are talking to us about the need for movement in this space to encourage that long-term investment which is so crucial to delivering net zero and improving services for customers over time.

To ensure a fair balance of risk and reward, I think three things: look again at the incentives which risk being bad for customers; look again at the WACC to encourage long-term investment in the sector to deliver net zero and green recovery and, in particular, remove the outperformance wedge.

I move to the third and final area where I think there's a huge opportunity to do more for customers and society in two particular areas, vulnerable customers and net zero.

The plan that we put forward was developed with customers, with considerable challenge in terms of putting the plan together. We had an extremely clear strategy in terms of vulnerability and we set out 16 individual bespoke measures in the form of output delivery incentives. Ofgem's draft determination has come back with a different package of things, with a Use It or Lose It allowance, and an annual show case event. We don't have a particular issue with that. There may be better ways of holding us to account for delivery. The real issue is the amount of funding that has been provided in the draft determination. We've only allowed £50 million compared to the £120 million that we had in our plan. We think a return to a level

like that is necessary to deliver the huge ambition that we put into our plan and, if anything, things like Covid have shone a greater light on this and the need to actually get after things that were going to be important for vulnerable customers or customers in vulnerable circumstances.

I won't dwell long on this slide around net zero because, as Akshay said, we and the rest of the sector are working very closely with Ofgem to get to a more kind of nimble, agile set of measures that will allow the advancement of investment that's necessary for net zero. We set out in our response to the draft determination the idea of a net zero planning allowance, which is a kind of Use It or Lose It allowance, if you like, and we know that's getting some traction and we would encourage Ofgem to move that forward to allow us to obviously get that investment in due course for net zero.

I just wanted to highlight one particular issue for us, which is the industrial cluster in the north-west of our region, HyNet, which is one of a number of industrial clusters. We've applied for funding from the government through the Industrial Decarbonisation Challenge fund, or IDC fund, which if we're successful with that funding requires match funding from the company. This is something that we've suggested to Ofgem that is allowed in the final determination and is crucial for driving this forward. We're undergoing good and intense discussions with Ofgem about trying to get this over the line and obviously this is really important to get this over the line for the benefits of creating a hydrogen economy in the UK.

In summary of this section, I think a few things: one, to review the policy decision on the size of the Use It or Lose It allowance; second, to ensure that the net zero reopeners are agile and flexible, and, thirdly, to support the delivery of HyNet, which is a crucial project for decarbonisation.

At that point I will hand back over to Steve. Thank you.

STEVE FRASER: Thanks, Tony. Just to summarise, we are looking here for a workable cost base, one with which we can run the business. The company isn't the company it was …

(Technical issues)

I'll start that again. I'm sorry; we had a technical problem. So this company is a different company than it was two or three years ago. It's got different owners and a different management team. I have personally surrounded myself with people who have put customers at the heart of everything we do and that is our mantra for the next five or six years, being the number one distribution business in the UK. To do that, we need a workable cost base with which to run the business and the investors need a reasonable return, and that's all we're asking for here.

So we support Ofgem's work to make sure that there is a fair and equitable spread across that piece and we will continue to work effectively with them, as we have been doing in the last couple of months, to try and close the gap and get this

determination into a shape that allows us to deliver for our customers in an efficient way and leave a sustainable and long-term business well into the next generation. On that, I think I am handing back to Martin.

THE CHAIR: Thank you, Cadent, for that. We now turn to comments from Cadent's Customer Engagement Group.

ZOE McLEOD: Good afternoon, everyone. My name is Zoe McLeod. I am Chair of Cadent's independent Customer Engagement Group. I'm also joined today by my colleague, Martin Silcock. Martin is a member of the CEG Investment Working Group and also a member of our CEG consumer vulnerability subgroup, two key areas which we will touch upon today.

We very much welcome the opportunity to share some of our views as part of today's meeting and are looking forward to the discussion.

I thought it would be useful just to very briefly give a bit of background about the CEGs for those that might not be familiar. Ofgem required all GDNs to have a Customer Engagement Group. Our role is outlined in our Terms of Reference but, briefly, it is to strengthen the consumer voice in the price control process, in particular, to improve the quality of the business plan and ensure that it is better aligned to the needs and preferences of current and future consumers.

In undertaking our role at the start, we were very mindful of Cadent's historic performance and efficiency as the worst in the sector and, as you have heard today from Steve Fraser, there has been progress much more recently in this area. We've undertaken extensive scrutiny since September 2018 but we should flag that while we've had discussions with the Board on the draft determination, we've not seen the detail of the new evidence that is submitted, given the speed of discussions and pace of change at the moment.

Our draft determination outlines 12 key messages to Ofgem. Today we're going to focus on the three key things that have been raised by Cadent. We actually thought we would do these in reverse order, starting with theme 3, the need to better reflect the needs of consumers now and in a net zero future.

Our first point to make really is that we would encourage greater transparency in how Ofgem has taken into consideration stakeholder and customer views in the draft determination in the final determination. It's very clear that they have done it in certain areas but that's not explicit. We recognise that stakeholder insight is, of course, but one of many inputs that the Regulator has to consider but it's important to have transparency in this area for both legitimacy and trust and, of course, many, many people have been involved in this engagement process.

We broadly welcome the approach to managing net zero uncertainties, including the package of reopeners and innovation funding, but to make this work in practice we would encourage Ofgem to urgently develop and deliver a clear road map for the

decisions. We also ask Ofgem and Cadent to consider how the significant customer engagement necessary to support net zero will be taken forward.

Ofgem has rejected 22 of Cadent's 23 bespoke ODIs and all of its bespoke PCDs. On the surface of it, this is worrying; particularly, in the Regulator's words, as these are designed to reflect the needs of and feedback that companies have received from their consumers and other stakeholders. The CEG recognises the significant task that Ofgem has faced in reviewing more than 200 bespoke proposals in a relatively short space of time, in literally pandemic conditions, in the last few months. We agree that a large number of Cadent's proposals were not robust enough or not appropriate for ODIs. We're also aware that some of the so-called rejected bespoke proposals are being adapted and turned into common ODIs, which is very welcome. We would encourage, through this process, Ofgem to make sure in setting these common ODIs that they do not set the bar for performance lower than Cadent themselves had proposed. For example, Cadent proposed a gas theft ODI, proposed to share 60 per cent of funds recovered with their customers, compared to the 50 per cent share which Ofgem has proposed.

Our understanding is that the appointments/time slots proposal by Cadent is more stretching than other GDNs and on street works, customers, consumers, want collaboration on street works but they want it not just for London, they want it for all of Cadent's networks, so a little bit of a plea here that in setting these common ODIs we make sure that we're genuinely driving up standards. It would feel uncomfortable, perverse even, if Ofgem ended up setting standards of performance that were lower than the ones that Cadent had proposed in its business plan.

So while a large number of bespoke proposals have rightly been rejected, some have been rejected or have been taken on board as part of the common ODIs; some have been rejected as they have not yet been properly developed. We would encourage Ofgem to work with Cadent to improve the robustness of a number of the bespoke ODIs and PCDs which are generally valued and wanted by customers and offer real value to individuals and to communities.

We have listed here on the slide some of those that we believe, in particular, the ODIs, most of which are at no additional cost to customers. In particular, on PCDs, we welcome Ofgem keeping the door open on personalising welfare services and today are pleased to hear what Akshay said about repairing and replacing unsafe appliances.

I think one of the areas we wanted to shine a spotlight on today is the consumer vulnerability funding and again pleased to hear that it is a priority for Ofgem in their discussions to date. We do think there is a case for revisiting the funding envelope allocated to Cadent in this area. We are not proposing Cadent's funding be adopted in its entirety and we flagged in our report to Ofgem a number of areas where we have concerns about the evidence base. We acknowledge that the proposed £30 million Use It or Lose It allowance is an increase in funding for consumer vulnerability overall excluding the FPNS element, relative to RIIO-1, and we are really conscious as well of Ofgem's views towards keeping cost subsidy low.

However, Cadent does have a good evidence base for a number of its proposals, can demonstrate stakeholder and customer support and positive social return investment. We don't know precisely how willingness to pay and customers' attitudes have changed as a result of the Covid pandemic. The research that we have seen coming through from other sectors suggests that, if anything, there is an increasing willingness to pay to cross-subsidise social support rather than declining, and this would certainly be a useful area for Cadent to do its own research on.

One argument that has been put forward is that the Use It or Lose It money has been allocated to GDNs in proportion to the number of customers each network has in order to avoid what is called a postcode lottery. The reality is there is already significant variation in terms of the services offered, the eligibility, the scale of support. and this will increase under the Use It or Lose It allowance because actually companies can use that fund in any way that they like.

Importantly, each network has very different vulnerability needs. The South-East of England, for example, has much lower levels of debt and fewer affordability challenges. Of the top 20 local authorities in England most affected by fuel poverty, 19 are within Cadent's boundaries. We think there is a need then for this support, there is a willingness to pay for this support and there is an increasing need with the Covid pandemic as well and, arguably, an increased onus in this new context on all companies to play their part.

The other issue we wanted to mention in this area was to encourage Ofgem to consider further Cadent's ambition to deliver a wider range of affordability support and, again, really heartening today to hear what Akshay said at the introduction to this meeting about the thought that has been given to this area. We acknowledge that fuel poverty is traditionally an area for government and we understand the decisions that you made in your sector methodology, but we nonetheless believe that Ofgem could and should have some discretion in this area around energy efficiency measures and income advice in particular.

Since the decision, the Regulator has issued its updated consumer vulnerability strategy, government policy has changed with net zero, and of course changing need, and government recognises the value of these kinds of whole house approaches that Cadent has proposed. Alternative measures are, of course, better aligned to the low carbon agenda and importantly it is worth flagging that Cadent customer research indicated that people felt that network affordability support should not just be limited those of the gas network. They felt that this approach was unfair.

So it brings us now very briefly on to Theme 1. To a large extent, again, Akshay has stolen our thunder on this. We welcome Ofgem's focus on cost efficiency. It's reasonable to assume that customers do not want to pay more than is necessary for the outcomes that they've expressed they want and need. We outlined in our December 2019 CEG report to Ofgem how we had scrutinised the company's efficiency plans, given that this is a critical element of the price control in delivering

value for money for network customers but we also acknowledge that ultimately the Regulator and the Challenge Group are better placed to give a view on this area, given their greater access to information and their ability to compare across the plans. We're pleased to hear about the progress that is being made on the disagreements around efficiency modelling and we look forward to hearing the outcomes of those discussions.

Cadent today has told us that the draft determination is unworkable. We are not in a position to validate this assessment of the impact. We are mindful, of course, that in RIIO-1 all GDNs significantly underspent their Totex allowances and therefore we welcome Ofgem's strong focus on this area. Nonetheless, we do seek reassurances that Ofgem's cost disallowances will not be at the expense of wider outcomes valued by customers, especially safety, which is of course a high priority for customers.

We pull out two areas where we have particular concerns and both of these have already been mentioned. The first is Ofgem's disallowance of Repex workloads associated with steel and iron which Cadent considers to be high-risk but for which pay back is beyond 2037. This Repex relates to mains that Cadent has said should be replaced on safety grounds and which aren't covered by the mandated IMRRP scheme. There are also some areas of expenditure that Ofgem has removed from the Totex and is proposing to fund via uncertainty mechanisms despite the fact that it appears a significant proportion of that expenditure is likely to be required anyway. IS and London medium pressure projects are notable examples and we are happy to talk about those further.

On Theme 2, some aspects of financeability, such as cost of capital, are outside of the scope of the CEG so we don't make a comment on them. However, we wanted to make a general comment around the theme of balance of risk and reward. We wrote a concern that the combined impact of Ofgem's decisions means there is insufficient incentive for Cadent to deliver some of the outcomes that really matter to customers. As mentioned, the vast majority of the bespoke proposals have been rejected. This, coupled with no reward under the CDP, plus a strong reliance on soft reputational drivers in some areas, such as on environment, consumer vulnerability, engagement, makes us wonder if there is enough incentive here.

On the one hand you could argue that a company that is focused, as Cadent says it now is, on this new vision on delivering standards that customers love and others aspire to should still deliver the outcomes promised in the business plan. On the other hand, we are worried that the practical reality is, particularly in the context of what might be seen by the company at least as a tough financial settlement, that these become a lower priority. Certainly, the scale and ambition level risk reducing without clear funding and accountability and so we've made some suggestions of things that could be done in order to better safeguard the delivery of these outcomes that really matter to consumers.

That is a summary of what we have to say on the key themes and I hand over now back to Ofgem.

THE CHAIR: Many thanks for that, Zoe and Martin. I now hand over to the Ofgem Challenge Group independent review.

ROGER WITCOMB: Thank you, Martin. For those who don't know me, I am Roger Witcomb. I'm Chair of the Ofgem Challenge Group for RIIO-2.

Very interesting presentations we've had so far and I have to say that quite a number of our foxes have been shot in the process but there are still some other points we would like to make.

I think right at the top of this is the notion of the adaptive price control in the context of net zero, in particular. We're glad to see that both the company and Ofgem and indeed the CEG have identified this. We think it's absolutely critical. Obviously, we agree with the adaptive price control approach to addressing this. This is clearly a challenge for the companies but possibly even more of a challenge for Ofgem and, as a Challenge Group I think we can challenge in both directions because these sorts of decisions will be made, have to be made, quickly and in a coordinated way and in a robust way, I think. As part of this process, we need Ofgem to be quick and decisive but also to demonstrate transparency and to make sure the right governance is in place because there are huge amounts of money here which are going to be dispersed, as it were, between price controls where the normal checks and balances won't of themselves be there.

I have to say actually that one of the things we look at is quality of the plan and, at the risk of selling myself too far down the river, the Cadent plan actually is really not bad at all, I think prompted to a large extent by prodding from Zoe's group, but I think the actual quality of the analysis in most places was as good as anyone's. However, you won't be surprised to hear, around the numbers, in particular on expenditure, as a Challenge Group we don't have the resources to do the detailed analysis which is needed. I'm glad to see that it's being done. Clearly, the Cadent new modelling is something we really can't comment on and we will have to see what comes out of that.

The turnaround in Cadent, if Cadent are right, would be absolutely huge. You could understand why there's a certain level of scepticism around that and why it needs particularly careful scrutiny, so we rely on Ofgem to do that now.

In the context of expenditure overall we, as Zoe also noted, have noted that there was a 7 per cent underspend in RIIO-1. We don't know that that wasn't as a result of expenditure being inefficiently referred to RIIO-2 and, again, we have to rely on Ofgem to do that work.

Generally speaking, we agree with the Ofgem approach to setting baseline expenditure. The one thing which we think Ofgem could look at in more detail is the impact of reduced network utilisation around RIIO-2 with the fall in demand. I think that means that certainly quite a lot of the maintenance expenditure and Repex is worth a closer look.

I think that's about as far as we can go on expenditure. Things are moving very quickly and we haven't had a chance to come to grips with the work that has been done since the draft determination.

We very much agree with both the company and the Consumer Engagement Group that it wasn't at all obvious in the draft determination how stakeholder views had been taken into account in the determination. I think it is important for all sorts of reasons that that omission is put right in the final determination. The enhanced engagement model has, I think, led to significant improvement particularly through, as I say, the prompting of the Customer Engagement Group in Cadent, of improving the plan and probably improving the quality of the decision-making as well. So I really would urge Ofgem to look again at the way in which they have taken those stakeholder views into account.

We would also agree that Ofgem should look again at the funding for vulnerability, particularly in the light of Covid-19 and potential increased hardship around the economy.

We also agree, I think, that some of the incentive measures, particularly around vulnerability and environmental issues, rely rather too much on reputational incentives and we share the concern that that might, in a tight financial environment, lead to them being undervalued, shall we say, in the overall scheme of things. Again, we think there is a case for Ofgem to consider putting rather sharper incentives on some of these very important areas.

Finally, I think we got to finance and WACC. Again, I note with considerable interest all that has been said about that. Our view, as I suspect you know, is that we thought the Ofgem proposals both in the draft determination and indeed even in the methodology paper put out in December were pretty well spot on. Two issues here: one is are the rates of return there market rates of return? We think, yes, they are. Do they lead to a financeable outcome? We thought again, yes, they did.

Clearly, the CMA provisional decision has raised interest and raised the stakes in this particular debate. We haven't been into the level of detail you would need to go into to fully evaluate what the CMA's provisional decision is based on. On what we've seen so far, we see absolutely no reason to change our original view. In fact, our view is that Covid-19 in particular has increased the attractiveness of companies like Cadent and, if anything, there is a case for reducing returns but on balance we would certainly feel very strongly at the moment, on the basis of what we know now, that what we said in our response to the draft determination and indeed in our response to the business plans should stand.

I think that's it actually so I will stop there. I will just check with Bob, who I hope is also on the line. Have I forgotten anything?

ROBERT HULL: No, all good.

ROGER WITCOMB: In that case, I'll stop there and wait for questions.

THE CHAIR: Thank you, Roger and Bob. I'm now going to hand over to Akshay to organise the Q and A and then our CEO, Jonathan Brearley, will conclude after that has been finished. So, Akshay, it's yours.

AKSHAY KAUL: Thank you, Martin, and thank you once again to all our speakers for a very clear set of debating points there. I hope you can see very clearly the lines of contention marked out both on Totex and on the incentives but also, as Roger indicated more recently, a burgeoning debate on the cost of capital.

I'm actually going to start with the stakeholder questions and then I'll go back to the Ofgem Panel given that we have just about 25 minutes. Let me start with a question from Simon Holden who is asking that if net zero is an objective, then an accurate base line of emissions is needed. Can Cadent comment on one of the consultation responses regarding the inaccuracy of measurement of its own gas use, which is a significant source of emissions from Cadent's gas network? Steve, do you want to respond to that one?

STEVE FRASER: That's not something we are certainly prepared or are able to comment in detail on here. I'll hand to Dave in a sec just to say how we actually went about calculating that. In terms of the exact numbers that's referred to, I'm not really sure what we can say and we'll have to take it away and have a look at it. Dave, can you just comment on how we went about looking at that?

DAVID MOON: I think what the question is referring to is our shrinkage modelling. It is modelled, so gas leaks from the gas network through holes in the pipe or joint leakage, et cetera. It is modelled so there is a degree of estimation within that but I think, broadly, I think the key issue here is that, you know …

(Technical issues)

Hello. There we go. So, yes, it is modelled. The key issue really for us is that the mains replacement programme is taking out masses of leakage. We're reducing our emissions massively over the period. We're ahead of all our targets that we set on leakage removal and it's a really critical part. We put a really ambitious environmental action plan within our business plan that looked at leakage but also looked at a range of other issues across the business, from greening our fleet through to greening our property and working with colleagues to make sure that we can have a green and efficient company. Sustainability is right at the heart of everything that we do and right up there on the agenda for the Board and our executive team.

AKSHAY KAUL: Thank you, Steve and David. Once again, just to stakeholders who are listening in, feel free to add your questions or comments as they come up on the feed and I can ask the question on your behalf.

Let me now turn back to the Ofgem Panel and let us take the first set of questions from Jonathan Brearley, our CEO.

JONATHAN BREARLEY: Hello there, everybody. To the Cadent team, you mentioned at the start of this the amount of work that we've had to do together. What I would like to do before we start is just to check in with you and make sure you're getting the engagement you need and the right conversations with us as another organisation to make sure we get to at least understand the issues before we get to the final determination. So is there anything you're concerned or worried about?

STEVE FRASER: I'll hand to Tony in a second, Jonathan, for the detail but, no, at the moment I think we've particularly welcomed the changes in the modelling team. We've seen the huge amount of interaction and that has been pleasing. I think both sides have seen the benefit of that so thank you for that. I will ask Tony to comment on any specifics.

TONY BALANCE: I don't think there's too much to add, Steve. I think we've had good engagement, Jonathan. It sounds a bit of a glass half full answer but there's still a long way to go so I think we're still working through issues but with Akshay, Michael, and the team we are working through. I don't know if Dave wanted to come in on anything specific.

AKSHAY KAUL: Thank you. Let us move on then to our next question from the Ofgem Panel. Michael Wagner is the Deputy Director for Gas Networks. Michael, are you on the line?

MICHAEL WAGNER: Hello. I think it would be interesting to hear from Cadent. Obviously, they've put forward a number of DDPs, if there are specific ones that you would be really keen that Ofgem should reconsider and why, and I suppose why do you think those proposals specifically that go a long way beyond BAU both for you as a company and for the industry as a whole and why do you think those are specifically ones that would be justified in receiving a reward that is funded by consumers?

STEVE FRASER: Thanks, Michael. Dave will take that one for us.

DAVID MOON: Thanks, Michael. So, yes, we put forward a range of outputs, 61 bespoke outputs, all of which were supported by customers with a huge amount of customer engagement – I was going to say over the summer, but over the last 18 months, two years. It has been a real significant undertaking, a real lesson for us as well as we've been going through it, but we think we work with the best people and we did a really good job and really understood what our customers wanted.

To pick out just a couple, I think fuel poverty is a real issue. We're living in uncertain times and people really feel this and they feel every penny. I think we put forward what we thought was a really interesting innovative approach to fuel poverty to try and join up the services, join up the funding, and really push the boundaries. I think that's an area that really should be looked at again because I think there's a tremendous amount of value that that could add.

Another area that we've picked out which again is important to customers, and particularly our vulnerable customers, is personalised welfare. We put forward a really ambitious plan again around providing really bespoke tailored welfare services to people. I can't comment precisely on the details around the SORI but we worked through the social return on investment and all of these things paid back and we included that detail clearly within our plan.

That's just two areas that I think you could look at and we would encourage you to look at and happened through the draft determination response. There are many more and I think it's really important that particularly that that Use It or Lose It fund is looked at again. I think the scale of that, really we could spend that four times over and our customers would be willing to pay for that and they would be willing to pay for more, in fact. So I think it really does need another look at.

AKSHAY KAUL: Thank you, Dave. I would like to go next to John Crackett for questions.

JOHN CRACKETT: I was going to ask you something about vulnerability but I think you've probably just covered that one, unless there's anything you want to add. You'll be very much aware that what you've asked for is greatly in excess of the other gas networks and considerably in excess of Ofgem's vulnerability allowance plans.

I'm interested to know why you particularly think this is right for your customers and perhaps other particular proposals you want to highlight which you think would be your top thing that would make the most difference or the top couple?

STEVE FRASER: Thanks, John. If you look at Tony's and my background, we come from a sector where customer vulnerability is a life need in terms of making sure customers actually can live day to day with water. So we've really pushed the team here, particularly when I first arrived and we still hadn't submitted the plan, to just make sure we had covered off every potential aspect of vulnerability enhancement that we could. We tested that with the CEG; more importantly, we tested it with customers, and customers were willing to pay, and there was a return on investment from a social perspective.

I'll just pass to Tony for the detail but it's something that is the mantra of everything that we do here and we certainly wouldn't go down the line of doing anything that didn't add value to those customers.

TONY BALANCE: Thanks, Steve. I will actually hand over to Howard who can talk through some of the detailed issues in relation to the plan. I think the one thing that I saw when I came into the company was the embracing of this kind of idea of social purpose of which we had done a great deal at Severn Trent and Cadent had recognised that it wasn't just enough to deliver base services to customers. So I'm not surprised at all that our plan was more ambitious than the rest of the sector and therefore had more funding against it because that was the intent. It was there to

derive that social purpose agenda, to get to those customers, particularly under normal circumstances, services that otherwise they wouldn't be able to obtain.

I'll get Howard to talk through some of the detail because he was a part of that.

HOWARD FORSTER: Thanks, Tony. The greatest validation, I think, and Steve has touched on it, we had 4,000 customers engaged through the process, over 40 charities engaged in the process, and probably the greatest validation is their voices really in that. So the areas of vulnerability that we were looking at was awareness of vulnerability in the PSE, fuel poverty and its effects that I think Dave has already touched on, carbon monoxide and reducing the devastating impact of that within communities and, as Dave has touched on already as well, I think really stretching as far as we can, actually formalising some of the welfare arrangements we do put in place today that extends beyond the scope of the service we would ordinarily offer the customers. We are very aware, certainly as we are entering the winter, particularly in 2020, just the degree of vulnerability that we can expose customers to when we isolate supply, when the issues are beyond the meter. So we are absolutely intent on addressing those and not leaving the customer in that situation.

We do many of those things informally today. The 16 bespoke outputs we've included really begin to lock in some of that into the way we do business and we believe the greatest validation is that. We had over 90 per cent acceptance from those touch points with customers, charities, industry experts, and on a willingness to pay basis over 90 per cent acceptance is, I think, a huge validation to the plan that we put forward.

JOHN CRACKETT: Tony, thanks for that. We've certainly got a clear message with the social purpose and we've got some pointers there on the areas that you think are important. Thank you very much.

AKSHAY KAUL: Thank you, John, and thank you, Cadent. Let me turn next to Simon Wilde for the next question.

SIMON WILDE: Thanks to the Cadent team for lots of very useful information. On page 13 of your presentation, you compared your WACC proposals with that of the CMA and that of the draft determination.

Three questions. One is would you agree that WACC is the wrong measure given that the CMA is proposing a cost of debt that is double Cadent's and that we really ought to focus on cost of equity? Secondly, could you just clarify exactly what your cost of equity ask is at this point? Thirdly, how does that number relate to the converging level across multiple European Regulators of 4 per cent or very close to 4 per cent in CBIH(?) terms? I would point out that if you compare the number in the draft determination, it is above levels set recently in Belgium, France, Finland, Sweden and in Austria.

STEVE FRASER: Simon, thank you for that. Just before I hand over to Dave, on the first point, cost of debt, cost of equity, for me both of those things are actually

critical in encouraging an efficient business. If you look, all these businesses have a large element of debt in them and to not incentivise companies to be able to outperform on that element of the portfolio probably, in my view, isn't the right thing. I know it's a debate that is raised for many years across gas, water and electric but, on the actual detail, I think I'm going to just hand to Dave to take your points in turn. Thank you.

DAVID MOON: Thanks, Steve. Simon, thanks for the question. WACC is the wrong measure? We could have put any of the components up on that chart so we chose WACC because it's the overall position but, as Steve said, they're all important.

I think if you look at our cost of equity ask, we've been really consistent throughout this whole process. I think we've tried to take a realistic view, a sensible view, of what we think a fair cost of equity is, what a fair central estimate is. It's an important number, this, and we all get lost in it and we got lost in the impact, but it's really important in terms of the attractiveness of these businesses, these networks, for the future. It is really important that we get it right.

I think the point you raised around the converging at 4 per cent, the CMA view did not converge at 4 per cent. They are looking at a UK regulated business and the UK environment, and one of the key things that they spoke about is the need to attract investment into the UK and making sure that you get that balance right. This is important for customers. This isn't just a conversation about shareholders. This is about customers and the value and ensuring that you attract that investment over the long term. It is absolutely critical, and that's critical to my kids, your kids, everybody. That's really important and if we lose sight of that, then it's at our peril. So we point to the CMA, I think it makes a lot of sensible points and that importance of attracting investment in the long term is just absolutely paramount.

AKSHAY KAUL: Thank you, Cadent. Thank you, Simon, for that one. Let me ask a question. Tony, when you were running through your modelling critique, I was reminded of the joke about the economist who goes in for an interview and was asked "What is two plus two?" and he lowers his voice and says to the Panel "What do you want it to be?"

What I would like you to do is just take the opportunity here, and you're talking to members of the Ofgem Board, and tell us in terms of a real-world sense check, you made a claim that the efficiency levels are simply unworkable or undeliverable. What kind of real-world cross checks can you offer that the draft determination position is wrong, it's not in the right place?

STEVE FRASER: I will take an initial point and then I will hand to Tony. If you remember when you and I spoke, and I think Jonathan was on the call, we talked a lot about the Repex cost and various costs in our London network. Obviously, as you know, my background has been in the supply chain previously as well, putting gas pipe in the ground, for want of a better description.

Our allowance for Repex in London is a long, long way away from the price contractors will tender into us to do the work. Now, if you then take that and compare it to say the price of doing that work in Scotland, you're looking at double the cost in London plus. If you asked us to provide evidence to you on that basis, we could run a tender scenario that showed the costs in one network versus London. It would be double the price, literally. Since we had that meeting, I've checked that with some of our supply chain to see what their thoughts were and they weren't out of kilter.

So that's a real-world example of one of the networks but on a more general point I will hand to Tony just to talk about it.

TONY BALANCE: Thanks, it's a good question. I could respond with a few economist jokes myself but probably we don't have time for that.

I think, to me, having been in this space for some considerable time, that it's useful to compare the quality of the modelling with the outcome in terms of its plausibility. I think when you sit in the company, you have that benefit, so actually could we deliver those level of costs? Steve has talked about that and maybe Howard wants to chip in here.

I think that the main point I would bring across is econometrics is a bit of a dark art. We all know that to rely on a single model, I think, is tricky, hence the main point we bring out is that looking at a rich picture of different models because, at the end of the day, econometric models, we are using error terms to determine levels of efficiency or inefficiency, and hence it is sensible to look across the piece at different models. We deliberately didn't put in the presentation lots of things about how it couldn't work because we simply didn't have enough time. We focused on, to some extent, a critique of the modelling itself.

I'll probably hand over to Howard who might want to say more about the ability to run the network with the level of costs that we've been given because he's the expert of those kinds of things.

HOWARD FORSTER: Thanks, Tony. I worked in Northern Gas and joined Cadent just short of two years ago, and I've got a real sense of what good looks like in terms of the ability to run an efficient company in this sector.

I think it's really the effect as it flows through. I think we touched on this at a bilateral session and I think Steve touched on this in his earlier opening remarks., how it flows into the emergency and repair. I think we've done a huge amount over the last two years to address the levels of efficiency and productivity and that dial has moved substantially. So I look at the norms today for repairs per repair team, PREs per FCO, I look at meters, I look at Repex even today, I look at a couple of things such as the duration of interruptions. We are comparable with the industry today, the top of the benchmark for many of those indicators, and I am very, very confident on the starting point where we are. As it flows through, as the model flows through as presented, as it affects the emergency repair process, and I think

Steve touched on it, it equates to 30 to 40 per cent reduction in our costs starting on April 1 next year. That's the equivalent of our entire first cooperative emergency engineer workforce in our London network. So I think at a very practical level, as it flows through the model and into the allowances and as that lands, if you like, into budgets by myself and the team and how we might land that and stand up a rota to support the upcoming winter, it just is not a workable plan in a very practical sense in the way it flows through. I note the economic arguments. I live in a very practical world and I see what have we available to run the business?

AKSHAY KAUL: Thank you, Howard and Tony. There are lots of other good questions I can see on the stakeholder chat but, unfortunately, we're short of time. Perhaps we could take some of those, Steve, off line, in particular the question from Citizens Advice on your leakage targets, which I think is important to a lot of stakeholders, and they want to understand how you are fully accounting for leakage from the network and the question of reducing that substantially. Let us take that off line. Let me hand over now to Jonathan Brearley, our CEO, for some closing remarks.

JONATHAN BREARLEY: Hello, everybody. I just want to start by saying thank you to all of you, thank you to the Cadent team, to the stakeholder groups, the Challenge Panel, and in particular thank you to everybody who has dialled into this session.

Equally, I would like to say thank you to the Ofgem team for setting this up and really to all of you involved in this process for the huge amount of work that has gone into it. These price controls are incredibly important and the dedication that all of us have shown in trying to get to the right answer is something that I just would like us ---

On this session, I would like to reiterate some of the comments Martin made upfront. We know these price controls play a huge role in supporting a green recovery and helping the country hit its net zero at lowest cost to consumers. Equally, as I've said before, I do believe that there is strong consensus on the strategic directions these price controls should take. Many of us accept that returns need to be lower, we all accept there needs to be greater efficiency, and a clear recognition from everyone, including Ofgem, that we're going to need greater investment to get towards net zero. Equally though, it is obvious that we disagree on the extent of this change and that is something that we are working together to try and resolve.

Coming to this session in particular, I do want to acknowledge and to appreciate how we are all committed to working together on these issues and I would like to say thank you to Steve and the team for the constructive way they've approached the process in the last few months in terms of working with us.

Equally, I hope you do not mind me saying this, but I think we all agree that Cadent has some way to go on customer service and on efficiency, although I do want to

acknowledge the progress that has been made, particularly in the last couple of years.

On a personal note, I would like to acknowledge the progress that has been made on multiple occupancy buildings, which you know is something that Ofgem has been focused on in the past.

Finally, before I talk about the areas where we may need to work together, I should acknowledge Roger Witcomb's assessment of the plan as "not bad at all". Knowing Roger, I think the Cadent team really should take heart in that comment.

Equally though, there are areas where we can work constructively and actually this has highlighted for us that there is more work we can do together on vulnerability and, equally, on net zero. We are committed to designing a framework that will be agile and will be responsive and will support the investment we need to get to net zero, and that does include developing hydrogen.

Finally, we should acknowledge that there are some areas that I would describe as more work to do. You mentioned cost assessment and you mentioned benchmarking and the scale of efficiencies. I think Akshay has put it eloquently with the joke he described but all I would point out on benchmarking is some of the views expressed here will be disagreed with by other companies that will have their own views on what the ranking might be. Equally, there is a discussion on cost of capital I won't spend more time talking about here but I note both the comments of Akshay, your comments, and indeed some of the comments of the Challenge Panel around that.

To sum up, there are big differences and we are working through those constructively. I want to say thank you to all of you for the input you have given today and I look forward to working with everyone to make sure we get to the right place which we all want to do by the end of the year. Thank you.