Cadent
Your Gas Network

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Competition and Markets Authority
By e-mail to: waterdetermination2020@cma.gov.uk

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Dear sir / madam,

Provisional Findings in relation to Ofwat's 2020-2025 price control

I am writing on behalf of Cadent Gas Limited (Cadent) to provide comments to the Competition and Markets Authority (CMA) on their provisional findings (PFs) in relation to Ofwat's 2020 - 2025 price control. Cadent is regulated by Ofgem, and owns, manages and operates four of the eight Gas Distribution Networks in Great Britain, and is therefore the largest gas distribution company in the UK with over £10bn of regulated asset value (RAV).

We are passionate about serving our communities today and in the longer term and have an active interest in the PFs given its read across, and therefore potential to impact our customers.

We are generally supportive of the CMA's PFs and believe they strike a balance between the interests of both consumers and investors in UK utilities – and therefore between the short-term and long-term interests of consumers, who benefit not only from lower bills but also from continued investment.

Cadent is a member of the Energy Networks Association (ENA) and fully supports the submission made by the ENA to the CMA on this matter. We have some specific comments that we believe are important to be considered in the CMA's final determinations.

Outcomes for customers – and the cost assessment

The PFs provide an outcome whereby customers are expected to receive significant bill reductions and improving service levels - whilst networks have a tough settlement in terms of cost and efficiency. The allowed return on capital is significantly lower than previous price controls, reducing bills whilst still creating some incentive to maintain investment in the sector in the long term.

We are supportive of Ofwat's and the CMA's approach to modelling and believe it is critical to use multiple models (both aggregated and disaggregated), and set the benchmark efficiency level with reference to the quality of the models. Ofwat's suite of econometric models provide a so-called 'rich picture' of efficiency, which we understand were developed from over 1,500 models tested by Ofwat's consultants (CEPA). We are in agreement with the CMA that when there are high calibre, well tested and statistically sound models in place, setting a benchmark at the upper quartile can be appropriate. As noted by the CMA, all models have their flaws. As such, we agree with the CMA that using econometric models to set an upper quartile performance benchmark is appropriate only if a rigorous assessment of the quality of the modelling has been completed.

We agree with the CMA that setting stretching ongoing efficiency targets is important to make sure networks continue to drive efficiency and cost savings for customers. It is important that the level of continued improvement is deliverable in light of COVID-19 and the real cost pressures (above inflation) that networks are exposed to.

Attracting future investment

Overall, the PFs support investment in critical national utility infrastructure. As we seek inbound investment to fund the recovery from COVID-19 and the ambition of net zero by 2050, it is key that the perception of the UK utilities is maintained as a strong and stable environment to invest within.

The CMA has demonstrated in the PFs the strength of the UK network regulation by ensuring that the CMA referral process balances the needs of all stakeholders including those that invest capital in the sector. Continued access to capital (both debt and equity) is equally if not more important in the energy sector as we transition sustainably to a net zero carbon economy. We believe the PFs strike a necessary balance between short-term reductions to bills, and incentives to maintain investor interest to provide the long-term capital requirements of the sector.

Assessment of the cost of capital and financeability

Customer bills and cost of capital are reducing from the previous price controls reflecting the market driven reduction in returns that customers should rightly benefit from. The PFs strike a balance between a reduction in the cost of capital and maintaining incentives to invest and drive efficiencies. We agree that if the cost of capital is set too low, it could lead to an exit of capital from the sector or a reduction in options for future investment.

Assessing that the package in the round is financeable is of course a key duty of economic regulators. This assessment should include among other things the identification of asymmetric downside risk that can be alleviated in part through 'aiming up'; and should not rely on the artificial acceleration of cashflows, which does not solve financeability issues rooted in the cost of capital assessment.

The ENA response to the CMA highlights potential errors in the cost of capital assessment. The range should be higher - and we hope the CMA will continue to engage with our advisors via the ENA to resolve these issues in time for their final determinations.

A few concluding comments

We are at a crucial moment in UK regulation. Our customers and investors are seeking fair bills, a sustainable green recovery from COVID-19; and a clear path to invest in a net zero carbon future. We believe the PFs support confidence in the water sector to enable delivery of these objectives.

If you have any questions then please do not hesitate to contact me. We are also happy to confirm that nothing contained within this submission is confidential, and it can be published on the CMA's web-site.

Yours faithfully,

[redacted]

Dr. Tony Ballance
Chief Strategy & Regulation Officer