

Appendix 08.01

Competition Action Plan



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1 Executive summary

The table below draws together and summarises what we will do leading up to, and during RIIO-2. As we demonstrate in this strategy document, competition and competitive procurement is at the heart of our business. We will continually strive to use the power of competition to drive value for our customers. Leading up to, and during RIIO-2 we will continue to take this approach to deliver efficient outcomes and value for our customers. We will continue to build on our existing established procurement procedures, and will consider the learning from all of our procurement exercises to identify further opportunities to expand competition.

Table 1 Our planned actions

Type of competition	Our plans
Late competition	HyNet - We are committed to exploring the potential for competitive delivery of the HyNet project. If the project secures Government support, Cadent would be responsible for the pipelines. We will explore all options for how we might introduce competition.
Extended Native competition	FWAC, Civil Structures and National Security Interventions We will explore opportunities for us to apply the principles of early or later competition to the benefit of customers. Our next steps, are to start to test the market with potential third party providers.
	Continuous improvement We will continue to review our list of competition candidates to see whether we can identify further opportunities to extend our approach to competition.
Native competition	Ongoing procurement We will continue to progress with our planned procurement and tendering activities reflecting the needs of our customers. We have a programme of procurement planned for RIIO-2 period, combining both new contract awards and contract renewals. We anticipate running over 500 tender events.
	Entry Capacity We will continue to engage with our customers and stakeholders to ensure our service offerings to meet their requirements. We will establish a voluntary distributed entry connections code to further facilitate improvements to the service and enable competition.
	Call Handling Service We will re-engage with the supply chain when the contract for our current call centre service provider is up to renewal.
	Our New Contracting Model We are adapting the approach we have trialled for Construction Services North West and rolling out a new contracting model across all of our regions. In part, this is aimed at creating greater competitive pressures on our procurement of construction services.

Type of competition	Our plans
	<p>Depot-centric model We kicked off a transformational initiative by moving operational decisions from central decision-making functions to our networks and depots within the networks who are much closer to the customers. This will drive further competition within and across Cadent through the performance management framework.</p>
<p>Reporting on progress</p>	<p>We plan to keep our customers and stakeholders up to speed with our progress against our competition plan through annual updates. Our annual competition progress report will present our progress across all our competitive elements – native competition, late competition and extended-native competition. We propose to present this report to our ongoing engagement groups (our Customer Engagement Group, Regional Stakeholder Groups and our online community).</p> <p>Our annual competition progress report we will consider:</p> <ul style="list-style-type: none"> • Progress against our competition plan over the past year • Milestones reached and lessons learned • Planned competitive activities for the following year <p><u>Our annual report will sit alongside publications and announcements associated with our procurement activities.</u></p>

2 Our strategy to maximise the benefits of competition in our Business Plan

2.1 Our vision: to maximise the benefits of competition for consumers

We have been proactive and at the forefront of using competition wherever it is feasible and beneficial to do so. Our commitment to competition is evidenced by how we have created room for new network companies to enter and compete in the connections market, and our extensive use of 'native' competitive processes in all of our operations.

Competition runs through all that we do at Cadent. We deliver value for our customers through rigorous, transparent and targeted contracting and procurement processes and continually assess our contracting approach to ensure we continue to deliver best value for our customers.

When we are contacted by parties who want to connect to our network we proactively direct them towards other connection providers to provide them with visibility of competitive options. This has delivered tangible success – 90% of large housing developments and industrial and commercial connections are now provided by independent connection providers.

We are proud that we are the only GDN who made it possible for competent third parties to undertake greater than seven bar pipeline design and construction activities (where we undertake assurance activities during the design, construction and commissioning process). This has increased competition and the number of projects we have been able to connect to the higher pressure tier.

Our strategic sourcing process is well established and compliant with relevant regulations. During financial year 2018/19 we ran a total of 148 tenders of which 46 were above the Utilities Contract Regulations 2016 procurement thresholds¹. We continue to use this approach to maximise transparency in our competitive tendering – a key element of our RIIO-2 Competition Plan.

2.2 What have we done to assess opportunities for competition

We support Ofgem's desire to promote the greater use of competition as this is in line with our own vision and strategy. As a consequence, we have worked hard to undertake a critical review of our plans to identify opportunities to increase competition.

We have developed a simple assessment framework to identify projects and activities in our RIIO-2 Business Plan where we can extend competition and deliver value for our customers. This framework considers the opportunities for late and early competition, as defined by Ofgem, along with opportunities to extend our approach to native competition. Our framework has the following steps:

1. We developed a set of competition assessment criteria
2. We categorise activities and projects in our Business Plan to identify opportunities for late, early and native competition
3. We applied our competition assessment criteria to each competition category
4. We present candidates for further extending native competition which we will progress during RIIO-2.

¹ Supplies and Services £363,424; Works £4,551,413.

2.3 Our competition plan to enable this

Our competition strategy describes the way that we assess the opportunities for competition across our business, the way we use competition to deliver value for our customers, and the ways that we plan to expand and enhance competitive pressure through RIIO-2.

This document is structured as follows:

- **Section 2** explains Ofgem's definitions of competition for RIIO-2. We explain how we have used these criteria to develop our competition assessment framework to assess the potential to extend competition in our RIIO-2 Business Plan.
- **Section 3** describes the current competitive landscape at Cadent. Competition, and competitive pressure, runs through the majority of our activities, for example we currently procure 71% of our totex through competitive tendering.
- **Section 4** documents the process we have been through to apply the competition criteria to our RIIO-2 Business Plan. We find that one project, Hynet North West, meets Ofgem's criteria for early competition. We explain how we will undertake further work to consider how best to use competition within the Hynet North West project during RIIO-2.

For the remainder of our Business Plan we conclude that there are no individual projects or activities that meet, in full, the criteria for late or early competition as defined by Ofgem. We have found, however, that by stretching ourselves and loosening Ofgem's competition criteria we can identify candidate projects and activities where further competitive pressure could deliver value for consumers.

- **Section 5** sets out our RIIO-2 Competition Plan. This describes the way we will progress competition through RIIO-2. This includes a description of the actions we will take to progress our competition candidate projects and activities (identified in 5), our plan to continue to deliver competition pressure through all that we do through native competition, and the steps we'll take to test and demonstrate our success.

3 Our approach for enabling competition

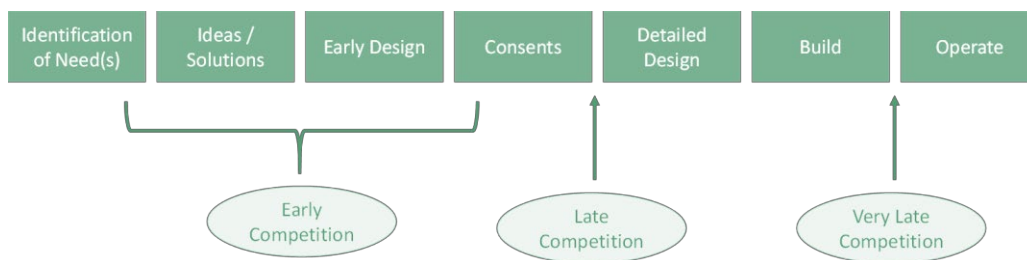
Section summary: This section explains Ofgem’s definitions of competition for RIIO-2. We explain how we have used these criteria to develop our competition assessment framework to assess the potential to extend competition in RIIO-2 Business Plan.

- We have considered the requirements of the RIIO-2 methodology to use competition: early (at the initial design phase), late (in the own and operate phase) and native (in everything else that we do).
- We have built on Ofgem’s competition criteria – used to assess the potential for opportunities for early and late competition – to take into account the specific nature of our business so that we can use this framework to maximise the use of competition in all that we do.
- We have developed a framework to assess all future competitive opportunities to ensure that we select those that are in consumer interest.

3.1 Types of competition identified by Ofgem

As part of RIIO-2, Ofgem has asked all network companies to expand competition where it is in consumers’ interest. Ofgem has identified a number of types of competition in its methodology. It identifies early and late competition as two forms of competition based on a project life-cycle as illustrated in Figure 1: **Ofgem definition of early and late competition** below.

Figure 1: Ofgem definition of early and late competition



In addition to early and late competition, Ofgem use the term ‘native competition’ to refer to the home grown initiatives that network companies take to run competitive processes to deliver projects. As part of the RIIO-2 competition plan, Ofgem has also expressed that it has greater expectations around the use of native competition already incentivised by the totex incentive mechanism.

3.1.1 Late competition

Ofgem consider that “late” competition typically commences towards the end of the project development lifecycle, when the initial design has been determined and consents have been obtained. In order to identify projects, Ofgem define the criteria for late competition, as shown in Box 1.

Box 1: Ofgem criteria for late competition²

- **New** – the project involves a new asset or the complete replacement of an existing asset;
- **Separable** – the boundaries of ownership between the assets and other (existing) assets can be clearly delineated; and
- **High value** – the expected capital expenditure of a project which is over £100m.

3.1.2 Early competition

Ofgem consider that “early” competition can reveal more cost-effective ideas for how to satisfy system needs. Early competition can either focus only on providing the idea (i.e. the high-level system solution), or could also include delivery of the idea (i.e. to construct, finance and operate the project associated with that system solution). Under early competition the design and cost would be determined through competitive tendering. Ofgem’s criteria for early competition are set out in Box 2.

Box 2: Ofgem criteria for early competition³

- Network companies will be required to identify projects which have a **value of over £50m**
- The projects should be **contestable**, that is, there is the potential for alternative solutions

Ofgem’s criteria for both late and early competition include a significant value threshold (£100m and £50m respectively). This threshold is designed in an attempt to maximise the returns on competition, which Ofgem expect to be greater for higher value projects of activities (i.e. to ensure that the benefits of running a competition process outweigh the costs).

3.1.3 Native competition

In addition to early and late competition, Ofgem defines “native” competition as occurring within the price control framework operating under the totex incentive mechanism. Ofgem requires network companies to develop a competition plan as part of their Business Plans evidencing their ambitions in aligning with its native competition best practices principles (set out in Box 3).

Box 3: Ofgem native competition best practice principles⁴

- a) Utilisation of competitive processes for all procurements and projects, except where the potential benefits of doing so are outweighed by the costs.
- b) The competitive process must be robust, transparent and ensure equal treatment of potential bidders and protect information appropriately.
- c) The complexity of the competitive process used should be proportionate to the value and time-sensitivity of the project or system need in question.
- d) All information must be provided equally to all parties, and any conflicts of interest have to be appropriately managed.
- e) Licensees should be agnostic to technology and bidder type.
- f) Competitions should be structured to generate outcomes in the interests of existing and future consumers.

² RIIO-2 Sector Specific Methodology Decision.

³ RIIO-2 Sector Specific Methodology Decision.

⁴ RIIO-2 Sector Specific Methodology Decision.

3.2 Principles based framework to enable competition

Our competition strategy seeks to apply competition to projects and activities where we can demonstrate that this is in consumers' interest. We have devoted significant effort to develop a comprehensive assessment approach to ensure that we meet Ofgem's requirement to identify opportunities for early and late competition in our Business Plan. To ensure that we maximise competition in all that we do, our assessment framework expands beyond Ofgem's definition of early and late competition, also taking into account opportunities to expand native competition.

The approach we have developed includes the following steps:

1. First, we developed a set of competition assessment criteria. These criteria start with Ofgem's criteria for early and late competition. However, we have expanded Ofgem's criteria to take into account a wider set of requirements that we think are important when assessing opportunities for competition.
2. We used these criteria to develop a simple mechanism to identify which type of competition applies to each project or activity in our Business Plan.
3. We developed an approach to maximise the power of competition, to assess whether competition in each case is in the interest of consumers.

3.2.1 Assessment criteria for competition

Ofgem's criteria to identify projects or activities for late or early competition form the basis of our competition assessment criteria set out in Table 1.

A key element of the Ofgem criteria for early and late competition is project or asset value. Whilst we agree that value is an important criterion for early and late competition, we consider that the strict application of this criterion may limit the candidates that should be considered. For example, we believe that there are lower value projects and activities in our Business Plan that could be candidates for further competition during RIIO-2 through outsourcing and procurement. This could be applied through an extension of our native competition ('extended-native' competition). We have therefore developed an assessment framework that can be applied to the whole Business Plan to identify candidate projects for early, late and extended-native competition.

Applying our competition assessment criteria to the Business Plan will ensure that we only progress competitive processes where it is appropriate for a business of our nature to do so. This will exclude activities where competition may create excessive risk or low benefits to consumers.

Table 2 Our competition assessment criteria

Criteria	Competition type	Description
Value	Late and early (as defined by Ofgem) and extended-native	Exceeds £100m (late) or £50m (early) In the case of extended-native competition, we have considered projects and activities with a value that is less than £50m.
New, separable and therefore contestable	All	Assets do not form part of the integrated network and are new network assets. There is a reasonable alternative solution to the system need and the market is sufficiently deep to facilitate meaningful competition.
Certain need	All	If the system need is uncertain, the value of competition may not be realised. Ofgem also consider certainty of specification, where high uncertainty could undermine the competitive process and make evaluation highly subjective.

Criteria	Competition type	Description
Not time critical	All	If the need is urgent, a competition process may result in a delay to the solution, therefore reducing the benefit of competition.
Safe for our customers	All	Safety for customers should not be jeopardised. We will consider where third party involvement would present such a great a risk to customer safety that it is infeasible to outsource/compete.
Non-business critical	All	Are there projects/services where third party's involvement would present such a great a risk or liability to us that it is infeasible to outsource/compete? For example, this might be because third party involvement would create risk around the operability of the system or where the complexity of the solution risk operability it will be best to ensure that the basis of managing the assets remains with us.
Legislation	All	There are no legislative barriers (including network code and licence requirements) that would prevent us from outsourcing the project or activity.
Expected benefits outweigh costs	All	The process of running the competition or tender (including costs for us and for participants, i.e. transaction costs) should be lower than the expected benefits.

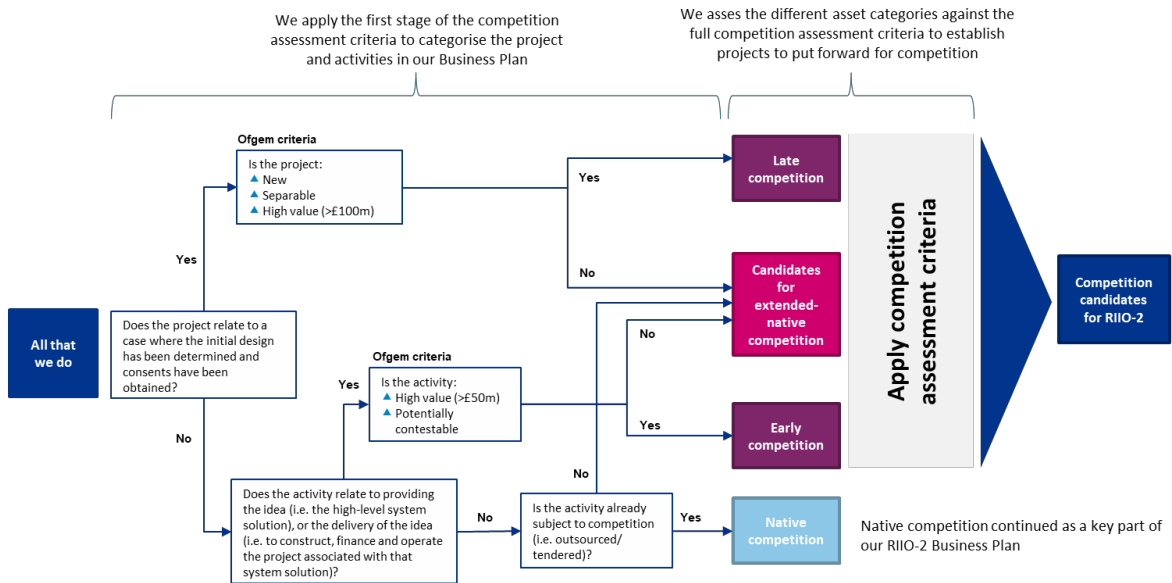
3.2.2 Identifying the appropriate form of competition

We have used these criteria to develop a simple logic chain, illustrated in Figure 2 below, to demonstrate how we assess which form of competition is most appropriate. The first stage of this assessment is to apply the Ofgem criteria for late and early competition. This will identify any high value, new and separable (late) and high value and contestable (early) projects or activities.

Where projects or activities do not meet the Ofgem criteria in full, the second stage of the assessment approach is to use this framework to identify where there may be opportunity to extend native competition across our business. Just because a project does not meet the £50m threshold for early competition does not necessarily mean that there is not additional value from extending our native competition. We have used the term '*extended-native competition*' to categorise projects where we think that further competitive pressure through third party procurement and tendering could deliver value for our customers. Within this extended-native competition category we consider whether there are opportunities for competition in the design and build phase (following the principles of early competition) and/or competition in ownership or operation (following the principles of late competition).

Figure 2 shows how this assessment framework can be used across our full Business Plan to identify candidates for competition.

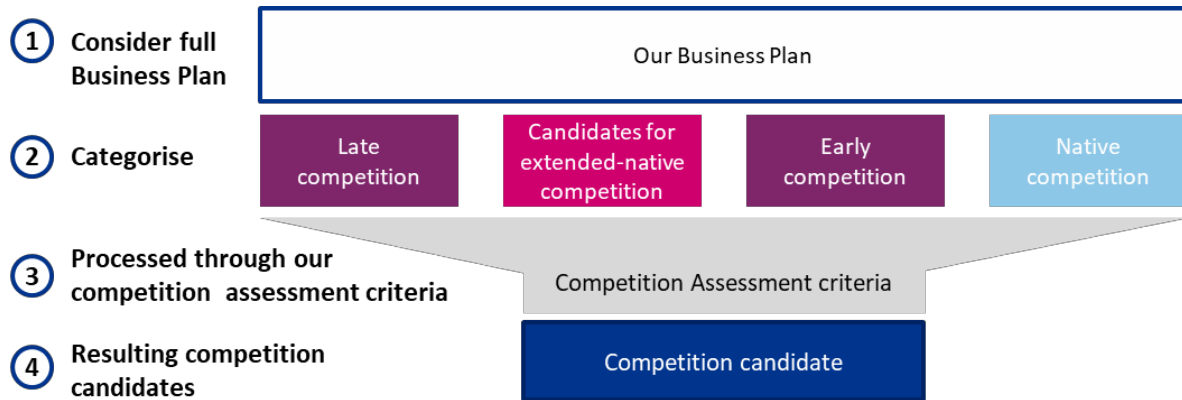
Figure 2: Identifying which form of competition we use



3.2.3 Identifying candidate activities for our Business Plan

Our approach will ensure that we take into account the full Business Plan. The Business Plan is based on the logic in Figure 3, then subject to a competition assessment using our competition assessment criteria. Applying our assessment criteria to the candidate projects identified through this framework will determine the short-list of competition candidates for our Business Plan.

Figure 3: Funneling process for project assessment



4 The role competition currently plays in our business

Section summary: We are committed to deliver value for our customers in all that we do. One of the main tools we use to deliver value is competitive procurement. Our procurement strategy provides a robust and transparent framework to ensure competition is fair, to maximise value for our customers.

In this section of our strategy we explain the extent to which competition is already used across our network to deliver value for consumers. This includes a description of the procurement approach that we use, the scale of competitive tendering already in use, and examples of specific projects and activities that demonstrate our approach to competition.

4.1 The nature of our network

The scale and scope of competition differ across our business which comprises a complex, integrated network of assets. The gas distribution network is a complex, integrated set of network assets. For these reasons, large portions of the integrated network are not obvious candidates for competition and third party ownership or operation. It is likely to be more economic and efficient for us to own and operate these parts of the network as a natural monopoly. However, we continue to challenge ourselves to make sure we are not automatically dismissing opportunities for competition just because assets appear “complex and integrated”.

In other parts of the network, third party competition has developed successfully with these parties designing, building, owning and operating the network infrastructure. This has been most successful in entry and exit capacity where the network assets can be separated from the wider network and offer a high value investment opportunity for third parties. In these areas of the network, the introduction of Independent Gas Transporters (IGTs) and Utility Infrastructure Providers (UIPs) offers a real competitive choice for parties wishing to connect to our network.

The complexities and challenges of separation and management have meant that third party ownership and operation has not developed in the integrated network, but in this integrated network we continue to deliver value for our customers through our competitive procurement of assets and services across our business.

Our business model is reliant on competitive markets, through which we procure services, to maintain and operate our network efficiently and effectively. We contract out 71% of our totex to third parties and we are incentivised through the totex incentive mechanism to ensure that this is done as efficiently as possible. Over half of this spend is through our Gas Distribution Strategic Partnerships (GDSP), where these partnerships have been developed through competitive procurement. Delivery of this work for RIIO-2 has been reviewed in detail and a number of large tenders are in progress for commencement at the start of the regulatory period.

Our procurement strategy is grounded in best practice principles that seek to provide best value for customers. Our procurement processes are well developed and are designed so that our tenders comply with the Utilities Contracts Regulation 2016. We use the Achilles Utilities Vendor DataBase (UVDB) system as our primary method to pre-qualify vendors or we formally advertise our requirements to the marketplace where this will provide wider market access.

We provide further discussion on our current expenditure and our procurement strategy below, before highlighting a number of examples of where we have used, and continue to use, competition to deliver value across our business.

4.2 Our procurement strategy

Our procurement strategy is core to our success in delivering value for customers, particularly given the scale of spend that we outsource. The Utilities Contracts Regulations 2016 (UCR) is the core legislative framework underpinning our approach and because of our size, relative to the other networks, more spend categories will be captured by UCR than in other GDNs.

We have a Strategic Sourcing Process that has a number of steps and stage gates that ensures that we drive best value and comply with UCR. This process sets out a minimum set of requirements for all of our procurement activity, that encourages competition and compliance above the UCR contract value threshold. We seek to apply these competitive principles in everything that we do, regardless of value.

We will implement a new SAPHana system in 2020 which will help us further improve our sourcing processes and improve the quality of data that we use to manage our supply base and make our decisions.

We continually review our contracting strategies and operate a number of routes to market, through: Strategic Relationship, Frameworks With Call Offs, Dynamic Purchasing Systems, mini-tenders and spot-buys. The markets in which we operate are forecast to show largely inflationary pressures over the next price control period and we therefore plan to enter into longer term strategic contracts with greater certainty on contract duration, work volumes and pricing. We also plan to source and manage a selection of contracts at a Network level, where service and cost can be delivered more efficiently by geographically local suppliers than national suppliers.

The processes which we follow through our procurement approach is fully in line with Ofgem's best practice principles for native competition:

- We utilise competitive processes for the majority of our procurements and projects.
- We always aim for our competitive processes to be robust, transparent and to ensure the equal treatment of potential bidders. Information is provided equally to all parties.
- We protect the commercially sensitive information provided by our suppliers.
- We adopt a range of different procurement processes, proportionate to the value and time-sensitivity of the project or system need in question.
- Where relevant, we ask our suppliers to establish arrangements to manage any conflicts of interest.
- Whilst there will be instances where we are looking for suppliers who deploy a particular technical solution (for example, when we are looking for support to implement a particular IT software solution), as far as practicable, we are agnostic to technology and bidder type.
- We set high standards for our suppliers. When appropriate, we require our suppliers to prove further compliance around health and safety, quality, environmental capabilities and corporate social responsibility. We also expect our suppliers to adhere to our Supplier Code of Conduct. This Code spans: business ethics, health and safety, data protection, protecting the environment, resilience and business continuity, work and human rights, the use of conflict minerals, community and supplier diversity, monitoring and reporting, and their subcontracting and supply chain.⁵

4.3 The scope of our competitive procurement

Our most significant procurement activity relates to our totex spending under the price control. 71% of our totex spending is contracted out and sourced through competitive tendering. The remaining totex relates to fixed item spend that cannot be bid (3%) or spend on activities that we conduct ourselves (26%).

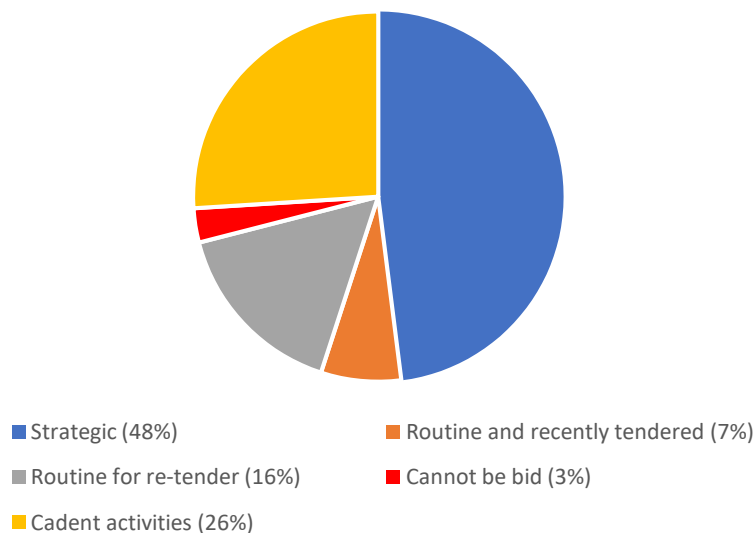
⁵ In our Environmental Action Plan (Appendix 07.04.00) we provide further details of how we expect to work with the supply chain to deliver sustainable environmental outcomes on waste and embedded carbon emissions.

Our totex spend profile can be categorised as follows:

1. **Large strategic spend areas** that have been subject to a business wide strategic review and tendering during RIIO1 (48% of totex), e.g. mains replacement, IS
2. **Routine spend areas that have been subject to recent review and tendering** (7% of totex)
e.g. management consultancy, contiguous reinforcement projects (IGT connections), temporary resource, customer led diversions
3. **Routine spend areas that will be subject to future review and re-tendering** (16% of totex)
e.g. service agreements for asset maintenance, civil and mechanical engineering works, upgrade of pre-heat systems, fleet purchase and management, tools and consumables, pipes and fittings, logistics operation
4. **Cadent activities which we are not planning to subject to tendering** (26% of totex) e.g. Emergency Response and Repair, the operation of our call centre, system control (the network control centre) and reactive maintenance.

Figure 3 show the breakdown of our RIIO-2 totex by key spend areas, identifying how we apply native competition across our business.

Figure 3 Breakdown of totex for RIIO-2



There is an ongoing cycle of procurement activities that is driven by the performance of our current contracts, contract renewals or extensions and new business requirements that need procuring. The numbers of tenders issued each year will therefore vary by year, but as an indication, we ran a total of 148 tenders in 18/19 of which 46 were above the Utilities Contract Regulations 2016 thresholds.

We have set ourselves stretching ambitions to deliver efficient solutions for our customer in our RIIO-2 Business Plan. Our competition strategy and competition plan supports this ambition. We seek to find the most cost effective solutions for our customers across all that we do, using competition where appropriate to manage increasing cost pressure and find best value where possible.

We present below a set of competition case studies which demonstrate our ambitious and value driven approach to procurement – specifically our approach to mains replacement, and our new depot-centric model.

4.4 Competition case studies

We demonstrate how we use competition across our business, both through procurement and facilitating market entry through a set of competition case studies. These projects, activities and procurement methods demonstrates the scale and scope of competition across our network and in our business. Through these case studies we demonstrate how we:

- Facilitate competition in some market segments by stepping back to allow third parties to offer alternative options to meet system needs (Entry and exit connections).
- Have tested the market to understand the benefits of competitive alternatives to current in-house services (Emergency Call centre).
- Used third parties to run targeted competitive processes on our behalf to maximise efficiency and improve solutions for our customers (Affordable Warmth Solutions).
- Use procurement to deliver value for large scale projects where we outsource elements of the asset planning and design, along with asset build/delivery (Construction Services North-West).
- Used our depot-centric and local accountability model to drive competition and innovation and deliver better performance at the both local and regional level.

For each case study we identify how and where competition is used across the project lifecycle – Design, Build, Ownership and Operation. This categorisation is used by Ofgem to define early and late competition – however it is a useful framework to show where we currently apply competitive pressure in our current activities.

Table 3 Competition across the project lifecycle

Projects/activities	Design	Build	Own	Operate
Connections – Exit	Competitive	Competitive	Competitive / Cadent	Competitive / Cadent
Connections – Entry	Competitive	Competitive	Competitive / Cadent	Competitive / Cadent
Fuel poor	Competitive	Competitive	Cadent	Cadent
Emergency call handling	Cadent	Cadent	Cadent	Cadent

Table 3 shows how we use competition most commonly to outsource the design and build elements of projects and activities on our network. This approach delivers value for customers through competitive delivery of assets, with the completed asset vested to us once commissioned. The exception is entry and exit connections, where third parties may own and operate assets⁶, providing we are able to assure that the works meet minimum technical and safety standard. This is a framework we have set up to facilitate third party market entry by stepping back from the market only providing connection services as a last resort. We explain our role in connections further in Section 4.4.1.

In addition to these key projects and activities in Table 3, we also present areas of our procurement framework that demonstrate how we are thinking about procurement in new and different ways in order to maximise value for our customers. We also provide detail so these procurement methods through 2 case studies, summarised in Table 4.

⁶ Some elements of the connection assets, such as telemetry, will still be owned by us.

Table 4 Procurement case studies

Procurement activity	Description
Construction Services North-West	The aim of CSNW was to rebalance the allocation of responsibility between Cadent and its delivery partners and to foster greater competition between our suppliers.
Depot-centric model	Our RIIO-2 operating model will move from central decision making to regional, 'customer facing networks'. This will enable fast and effective local decision-making using some local agile contractors to deliver our needs. It will increase the scope for "internal competition", by allowing greater comparison between regional areas.

For each of the case studies we provide a short summary of how competition is used to deliver value for our customers.

4.4.1 Entry capacity: Facilitating third party design, build, ownership and operation for new connections (>7bar)

The landscape of connections has seen a significant change since 2012 with the introduction of biomethane injection into the gas grid. Through continual customer engagement and feedback we have reviewed and refined our service offering such as: reducing the footprint of the equipment housing bringing reduction in costs, providing customers greater procurement powers and project delivery. We are very proud that we are the only GDN to offer the facility for competent 3rd parties to undertake >7 bar pipeline design and construction with our team undertaking assurance activities during the design, construction and commissioning. This approach has facilitated an increase in the number of projects we have been able to connect to the higher pressure tier and welcomed by our customer community.

To facilitate competition and third party engagement, we have put in place an engagement framework with our customers pre- and post-connection to share relevant connection information and ensure parties understand their operation obligations and compliance requirements.

We have continued to develop and evolve our approach to commercial connections since we opened the market to competition in 2014. Through our continual customer engagement we recognised that our customers were interested in designing, building as well as owning and operating the major elements of their connections. We have therefore moved from a model where we own and operate network connections, to a model where we only provide an assurance role to ensure the safety and technical proficiency on commissioning. This approach facilitates third party market entry whilst maintaining network standards and ensure interoperability between all network assets.

We continue to engage with our customers and stakeholders to ensure our service offerings meet their requirements. In our RIIO-2 plan we set out our commitments to establish a voluntary distributed entry connections code which looks to further facilitate improvements to the service and enable competition where appropriate. This includes creating a governance model to allow third parties to propose changes to the commercial framework for consultation where this will deliver benefits to end customers. We have also recently launched our intent to undertake a charging and access review to consider a change to the charging treatment of wide reinforcement works. This might enable these works to be socialised and hence encourage greater capacity to be made available to new or renewable gas developers. These commitments are detailed in our whole system thinking approach set out in Chapter 6 and the environmental commitments in Section 7.4 of the main RIIO-2 business plan document.

4.4.2 Exit capacity: Fully competitive non-domestic market with Cadent acting as provider-of-last-resort

We proactively encouraged customers to explore competitive options promoting the services available from Independent Connection Providers (ICPs), rather than simply buying services from Cadent.

Our exit connections approach is highly competitive for non-domestic premises where we only have 6% (approx.) of the market, with the remainder of the market demand is met by Independent Gas Transporters (IGTs) and ICPs.

Connections for domestic customers fall into two groups: new developments (which typically involve multiple connections) and one-off connections. The former are largely carried out by IGTs and ICPs as they are for non-domestic connections. In the case of one-off connections, we remain the dominant providers largely because:

- we are required to subsidise one-off connections through the Domestic Load Connection Allowance); this subsidy makes it difficult for ICPs to compete on price
- one-off connections are typically dispersed geographically and low value, which makes them less attractive to the commercial market, and
- IGTs are not allowed to connect one-offs from our network under the Gas Act Section 2.

Competition has developed in the connections market as competitors are often quicker, cheaper and more flexible and able to offer innovative and bespoke solutions that customer demand (such as multi-utility services). The high value and separable nature of non-domestic connection means that third parties are incentivised to compete to deliver these valuable contracts where benefits strongly outweigh the costs.

We still play an important role in the market by offering a provider-of-last-resort connection service where the connection may be less economic / lower value and therefore of little interest to our competitors. This typically involves activities that are technically challenging, in built up areas or in small developments where our competitors are less able to take advantages of economies of scale to achieve a viable margin.

4.4.3 Fuel poor/affordable warm homes: Outsourced tendering to deliver efficient, and targeted solutions for our customers

In order to deliver on the fuel poor connections allowance, we have developed an outsourcing relationship with Affordable Warmth Solutions Ltd (AWS). AWS specialise in fuel poverty solutions, providing two primary services: 1) identifying potential customers who need and are eligible for support, 2) designing mains extensions, liaising with landlords and putting contracts out for delivery.

AWS provide more efficient solutions compared to other contractors which we typically use, maximising the benefits of the fuel poor connections allowance. We benchmark their costs against our own providers, GDSPs and in-house. AWS have 3-4 preferred suppliers in the community and they are able to achieve highly efficient prices, ensuring that they deliver within the voucher value for the scheme.

Typically, they will be involved in the design and build of the solution, providing valuable insight given their knowledge of communities and access to commonly used suppliers. Once construction is complete, typically the ownership and operation will pass back to us.

This case study demonstrates how we have relied on a competitive process of our own outsourced provider to deliver targeted solution for our customers.

4.4.4 Call handling service: Market testing for a new service provider

We are responsible for managing the gas emergency contact centre on behalf of all GDNs, IGTs and National Grid Gas. The call centre operates 24 hours a day and employs around 180 staff, offering a critical service to all network customers.

This service is currently provided in-house by our call centre team. In 2018 we decided to explore the benefits of outsourcing all of our call centre activities, both personnel and IT/technology, to test whether we could achieve cost efficiencies in operating this service. We undertook an initial market testing exercise whereby we approached a selection of potential third party service providers to test capability and offerings. This process was managed by our procurement team to ensure robust procurement best practice around data and bid handling. We held a market testing event, providing suppliers with our requirements and asking for indicative non-binding offers. Through this process, and following evaluation of the offers we received, we found that the critical nature of the call centre service, and the liability this would place on potential suppliers, resulted in these potential suppliers incorporating a substantial risk premium in the pricing of their offering. The bids we received were non-competitive when compared against our internal cost of service and we therefore concluded not to procure these services.

This exercise provided a good opportunity to consider how we could further drive competitive pressure in our business. Whilst we concluded that competition would not drive a better outcome for consumers in this instance, we gained valuable experience that we continue to use in our competitive tendering and procurement. We plan to re-engage with the supply chain in due course when the contract for our current call centre service provider is up for renewal.

4.4.5 Construction Services North-West: A new contracting model

As explained in **Chapter 03 Learning from Past Performance**, we adopted a Gas Distribution Strategic Partnership (GDSP) approach in RIIO-1. Whilst this approach delivered material benefits for customers, we found that the GDSPs were focusing on delivering to price at the expense of seeking improved customer service. Drawing on this experience, we recognised the need to refresh our contracting approach. However, we wanted to trial the new approach before implementing a full roll out across all of our regions. We undertook this trial through our Construction Services North West (CSNW) initiative.

The aim of CSNW was to rebalance the allocation of responsibility between Cadent and its delivery partners and to foster greater competition between our suppliers. Under the old model, GDSPs were responsible for developing, managing, constructing and closing jobs. Under the CSNW model, we sought to obtain greater clarity in the split of three roles:

- Cadent as the principal designer,
- the Principal Contractor which we termed the Construction Management Organisation (CMO), and
- Contractors who are responsible for carrying out the work on the ground.

The creation of the CMO structure allowed us greater strategic oversight over the works. We took on responsibility for developing and closing jobs. The CMO was responsible for construction activities. Management activities were split across Cadent and the CMO. The CMO arrangement allowed us to contract directly with Local Delivery Partners.

We tendered for the CMO for CSNW at the end of 2018 and Arcadis and Gallagher were appointed in this role in February 2019. The first work under the new arrangement commenced in June 2019. Whilst the trial is still ongoing we have already seen benefits. We have onboarded new Local Delivery Partners which has expanded the pool of competitive suppliers. Moreover, as we have begun the process of rolling out the trial across our regions, we have already got strong indications that the market is responding favourably to the opportunities that this presents.

4.4.6 Depot-centric model: Driving internal competition through local accountability

Our RIIO-2 operating model will move from central decision making to regional, 'customer facing networks'. This approach to operation will enable fast and effective local decision making. Where

there is a need for contracts which predominantly rely on the use of people and equipment, we will introduce more local contractors who can provide better service at lower costs, due to their proximity. These local depots will be engaged in our investment process and have full visibility and control over local workloads.

This model relies on local accountability to drive “internal competition” and innovation across our networks and deliver better performance across our company as a whole. We expect this new operating model to result in fast-adoption of new technology with local teams competing to deliver innovation network solutions which could in turn be applied across our network to benefit our full customer base. This will drive further competition within, and across, our network and the impact of the internal competitive drive is included in our cost projections.

5 What we're planning during 2021-2026

Section summary: In this section, we describe how we applied the competition assessment framework we describe in Section 3.2 to our Business Plan. We first apply the Ofgem criteria for late and early competition and conclude that only one potential project meets these criteria. We then go on to apply the assessment framework by relaxing the threshold to consider whether there are projects in our Business Plan which would meet the criteria for extended native competition. We identify three projects that we think could benefit from extended-native competition. We will take these projects forward as part of our RIIO-2 competition plan.

5.1 Inspecting our Business Plan

Our Business Plan provides the initial and complete list of projects that we subjected to a competition assessment. Our Business Plan already incorporates competition and competitive processes across a range of projects and activities. We have not replicated the full Business Plan here, but identify in Table 5 the projects and activities with a projected cost in excess of £50m during RIIO-2. This is Ofgem's value threshold for early competition.

Table 5: Projects and activities with value over £50m over RIIO-2

Cost type	Cost category	RIIO-2 cost £m	Value >£100m (late)	Value >£50m (early)	Existing native competition	Commentary
Mains Replacement - Iron Mains Replacement Programme	Repex	1,361	✓	✓	✓	Repex: Contracted under third party, competitive GDSP framework, total spend made up of a large number of smaller value works and services therefore not separable or contestable
Services - Mains Replacement	Repex	528	✓	✓	✓	Repex: Contracted under third party, competitive GDSP framework, total spend made up of a large number of smaller value works and services therefore not separable or contestable
HyNet	Strategic innovation project	>200	✓	✓		Candidate for late competition – see Section 1.1
Services Reactive	Repex	193	✓	✓	✓	Repex: Contracted under third party, competitive GDSP framework, total spend made up of a large number of smaller value works and services therefore not separable or contestable
Mains Replacement - Safety Threshold Work	Repex	133	✓	✓	✓	Repex: Contracted under third party, competitive GDSP framework, total spend made up of a large number of smaller value works and services therefore not separable or contestable
Connections - Existing Housing	Connections	74		✓	✓	Existing competitive market – see Section 5.3
Connections - New Housing	Connections	66		✓	✓	Existing competitive market – see Section 5.3
Vehicles and Mobile Plant	IS, Property, Fleet	60		✓	✓	Procured through competitive tender to multiple vendors.
Medium-Rise Building Risers (MOBs) Replacement and Remediation	Repex	59		✓	✓	Repex: Total spend made up of a large number of smaller value works and services therefore not separable or contestable
Corporate Property	IS, Property, Fleet	57		✓	✓	Procured through competitive frameworks.

5.2 Our opportunities for late competition

Applying Ofgem's criteria for late competition (value that exceeds £100m, new and separable) to our Business Plan identifies 5 potential opportunities.

The majority of this spend relates to Repex. Our Repex contracts are already competitively procured, as explained in detail in Section 3. The works captured under our Repex spend are also very hard to separate from the wider integrated network and are made up of a large number of small value activities and work items. Whilst the total spend on Repex is significant, and represents the majority of our spend during RIIO-2, we conclude that the nature of our Repex means that these activities are therefore not suitable candidates for late competition.

5.2.1 HyNet North-West: A potential candidate for early competition

The only other project or activity in the AIP that exceeds the late competition threshold is the HyNet North West project. HyNet is a ground-breaking project being used to demonstrate decarbonisation at scale through the use of hydrogen networks. Whilst the project is not funded through the main price control, we still consider this a relevant project to consider in our competition strategy.

This project is at an early stage, it is a joint venture of a consortium of organisations each of whom is interested in providing part of the overall solution.

If the project secures Government support and proceeds, Cadent would be responsible for the pipelines. The investment would require a suitable funding mechanism and the development of an appropriate regulatory framework. We are exploring funding mechanisms for the various parts including Carbon Capture and Storage in the Mersey bay and for the detailed design. We believe that the hydrogen pipeline element of the project could cost in the region of £200m.

We are already committed to exploring market solutions for this project. Once the project has progressed far enough to clarify how the work will be allocated between consortium members, we will explore the best way to engage with the market.

For further information on the HyNet project, our role and the potential funding mechanisms we are exploring with BEIS and Ofgem, please refer to **Chapter 6 Net Zero and a whole system approach**.

5.3 Our opportunities for early competition

Inspecting our Business Plan using Ofgem's criteria for early competition (value that exceeds £50m where the project is contestable⁷) gives a longer list of projects or activities subject to our competition assessment framework, identified in Table 5.

For Repex, we conclude that our contracts for works and services are not contestable as they comprise a large number of small piece of work and services. We therefore exclude Repex from our assessment of early competition given the nature of the activities and the competitive nature in which we award these contracts.

The remaining projects or activities identified in Table 4 with a value greater than £50m for RIIO-2 are:

- Connections (Existing Housing and New Housing)
- Vehicle and mobile plant
- Corporate property

⁷ Ofgem defines contestable as having a reasonable probability of being addressed by an alternative solution

5.3.1 Connections

As explained above, we are subject to extensive competition in the non-domestic connections market. Whilst the domestic market is open to competition, competitive pressure is currently limited. This is because the Domestic Load Connection Allowance subsidises the cost of connections and makes it difficult for independent providers to compete on price.

The total capex for **existing** and **new housing connections** only exceeds the £50m threshold across our 4 regional networks. Furthermore, the work we undertake on domestic connections are small in nature, are distributed across the network and are currently undertaken as part of our GDSP contract (therefore subject to competitive outsourcing). We conclude that our spend associated with domestic connections is not a suitable candidate for early competition.

5.3.2 Vehicle and mobile plant, and corporate property

As part of our day-to-day activities of running the network we use a range of commercial vehicles, plant and equipment and offices. Our procurement approach ensures that we achieve a competitive price across our business using formal competition. We achieve economies of scale in our procurement by contracting across all four network areas.

Our spend across these cost categories represents the combined cost of a large number of small and integrated activities and services. As these activities are already procured from third parties through a competitive framework, we do not think these cost categories represent candidates for early competition.

The table below summarises our assessment of these activities against our assessment criteria.

Table 6 Application of our early competition assessment criteria

Criteria	Connections	Vehicle and mobile plant	Corporate property
Value >£50m	Yes – across 4 network areas		
New, separable and therefore contestable	Yes – Already a competitive market	Yes – as part of current procurement strategy	
Certain need	Yes, although precise volume subject to demand	Yes – core business requirement	
Not time critical	Yes - ongoing activity		
Safe for our customers	Yes – existing competitive market	Yes – the risk are understand and the service is currently procured	

Criteria	Connections	Vehicle and mobile plant	Corporate property
Non-business critical	Yes – as evidence by the fact that this is an existing competitive market	Yes – as evidenced by the fact that this is currently procured	
Avoids the need for a legislative / regulatory change	Yes – existing competitive market	Yes – Currently procured	
Expected benefits outweigh costs	Yes – Existing competitive market	Yes – Demonstrated through existing procurement	

5.4 Challenging ourselves to consider competition throughout our Business Plan

As we have set out elsewhere in our Business Plan, we are challenging ourselves to transform our business to deliver standards that all our customers require and to create an environment for our people to thrive. We believe that thinking differently about the role of competition will help us to achieve this.

To ensure we are pushing ourselves to deliver competition across our network we have extended our competition assessment by applying our assessment criteria to the whole of our Business Plan regardless of project or activity value.

As these projects and activities do not meet Ofgem’s value criteria, they are not candidates for early or late competition as defined by Ofgem. They may, however present opportunities for us to apply the principles of early or later competition for lower value projects and/or to extend our use of native competition to new areas of our business.

5.5 Inspecting the expenditure in our plan to identify candidates for extended native competition

Following this second, full inspection of the expenditure in our plan, we identify the following competition candidates for further competition:

- Metering services associated with assessment of **Flow Weighted Average Calorific Value** (RIIO-2 total value of £22m)
- Activities associated with assessing and maintaining **Civil Structures** that we own (RIIO-2 total value of £14m capex and £7m opex)
- **National Security Interventions** (RIIO-2 total value of £24m)

We provide a detailed assessment of each of these areas against our criteria below.

5.5.1 FWAC

We have identified the work under FWAC as a possible candidate for early-native competitive. We currently carry out this activity but we see an opportunity to test the market for a new solution to measure calorific value. This presents an opportunity for early-native competitive as the competitive element could apply to the early stage design, and depending on the potential providers, a third party could also own and operate the solution.

Applying the competition assessment criteria does not flag any immediate concerns with exploring a competitive solution for FWAC. In particular:

- The metering activity itself can be easily defined and therefore we expect there will be a number of parties from across the utilities sector who would be able to undertake the task making it **contestable** with a **reasonable expectation of market demand**.
- The activity is a core part of supporting the operation of the wider gas market and accurate consumer billing, and this will continue into the future - **the need is certain**.
- We currently undertake this activity and can continue to do so. The need is **not time critical** such that a competitive approach would cause undue and costly delay.
- It is a critical activity, required to ensure **accurate industry billing**
- We are confident that we can put in place sufficient assurance to maintain **safety standards**.
- This is a core current transporter obligation and the activity itself is **done on behalf of the wider gas market**.
- The activity can be clearly defined (i.e. we have specific metering requirements) and we do not think that awarding this contract to a third party would introduce **interoperability** challenges with the wider network. This may also make the opportunity attractive to potential third parties, driving competitive pressure between potential providers.
- We have not identified any **legislative** reasons why a third party could not undertake this activity. We note however, that extending competition in this area may require a change in obligations such that this activity could become fully competitive. For example, the obligation could be transferred to gas shippers or passed to a separate licenced party in a new industry role. We will explore the governance options for this change with our stakeholders as part of our market testing exercise.
- As we currently undertake this activity, we will be able to evaluate the cost and quality of third party offerings to ensure **benefits of the competitive alternative exceed the costs**.

We therefore conclude that there are no immediate reasons why we could not start to explore the opportunity to run a competition for this activity during RIIO-2.

Our next steps are to start to test the market with potential third party providers (see Section **Error! Reference source not found.** for further details of our competition plan for RIIO-2).

5.5.2 Civil Structures

We own a number of civil structures, such as bridges and railway crossings, that currently or that have previously supported part of our network. These legacy assets require inspection and maintenance to ensure they remain safe, with a RIIO-2 cost expectation of £14m.

Whilst the total value of the works is relatively small, our initial evaluation indicates that they may be suitable and attractive candidates for competition.

Applying our competition assessment criteria does not flag any concerns. In particular:

- We believe there are elements of these assets that could be re-purposed, either sold or dismantled, therefore there are elements that are **contestable**.
- The **need is certain** to the extent that we are legally required to maintain these assets and will be in future.

- We currently undertake this activity, and can continue to do so, therefore the need is **nottime critical**.
- It is a critical activity, required to ensure the safety of our customers, however we are confident that we can put in place sufficient assurance to maintain **safety standards**.
- We are required to inspect and maintain these assets to ensure they remain safe. In addition, **our assets are integrated with the civil structures**.
- The assets themselves are stand alone and separable and distinct to our gas network (although the assets may still be embedded in the infrastructure, for example a railway crossing). If the civil assets were sold through a competitive process we would ensure we still had a lease-type arrangement in place for our infrastructure. **The complexity of the situation will depend on the particular circumstances of the assets**.
- We have not identified any **legislative** reasons why a third party could not inspect and maintain these assets, or even re-purpose them altogether.
- As we currently undertake this maintenance and inspection of civil structures, we will be able to evaluate the cost and quality of third party offerings to ensure **benefits of the competitive alternative exceed the costs**.

Competition in this case could simply result in outsourcing of further elements of the inspection and maintenance of these assets, extending current native competition. Alternatively, these assets may be of interest to investors who wish to re-purpose them, providing an opportunity for early competition (i.e. the competition could include early stage design and innovation).

Our next steps are to start to test the market with potential third party providers to understand the range of solution to meet this system need (see Section **Error! Reference source not found.** for further details of our competition plan for RIIO-2).

5.5.3 National Security Interventions

A key security element of any network business is to ensure that assets are secure and safe. We spend approximately £5m per year carrying out this activity. Scaled across all GDNs, DNOs and transmission companies this represents a significant cost for consumers.

Every network which has assets defined as critical national infrastructure must meet the BEIS requirements for protecting the infrastructure against security threats. At present network companies are procuring this separately. Hence there is an opportunity to explore whether there is a more effective way to use the competitive market to exploit an overall solution or whether as a more radical option, a single provider of a security service could be put in place to meet all network company requirements.

Applying our competition assessment criteria does not flag any concern with exploring a competitive solution for our National Security Interventions. In particular:

- As National Security Interventions are currently undertaken by all network companies, there are a number of potential providers for this service suggesting a **potential deep and contestable market**. However, this will need to be tested.
- The **need is certain** and increasingly important as security remains a critical issue for us and for society as a whole.
- We currently undertake this activity, and can continue to do so, therefore the need is **nottime critical**.
- It is a critical activity, required to ensure the safety of our customers, however we are confident that we can put in place sufficient assurance to maintain **safety standards**.
- Whilst the activity itself is **critically important** and **business critical**, we expect to be able to put in place appropriate assurances to ensure that the security standards do not change should a third party engage in this activity.
- The activity is standalone with no **interoperation** with the wider network. Our requirement can be easily defined and could be met in a number of ways (technology agnostic), which

provides a good basis for a third party to offer innovative alternative solutions to meet our core system need.

- Whilst national security is a legislative requirement, we have not identified any **legislative** reasons why we cannot explore the opportunity for third party competition, providing we can put in place sufficient contracting arrangements to manage our liability through third party contracting.
- As we expect strong market demand for this service, this indicates that the outcome of a competition process could deliver a cost effective solution for our customers. Furthermore, as we currently undertake this activity, we will be able to evaluate the cost and quality of third party offerings to ensure **benefits of the competitive alternative exceed the costs**.

Table 7 summarises our assessment of our extended-native competition candidates against our competition assessment criteria.

Table 7 Application of our extended-native competition assessment criteria

Criteria	FWAC	Civil structures	NSI
New, separable and therefore contestable	Yes – deep, contestable market for cross-utility metering services	Yes/No – potential for third party use of assets, but requires market testing	Yes – cross-network activity has the potential to create a contestable market, but requires coordination
Certain need	Yes – core activity	Yes – we have a legal requirement to maintain assets	Yes – we have legal obligations
Not time critical	Yes – we currently undertake these activities and can continue to do so	Yes – we currently undertake these activities and can continue to do so	Yes – we currently undertake these activities and can continue to do so
Safe for our customers	Yes – but we think risks can be managed	Yes – but we think risks can be managed	Yes – but we think risks can be managed
Non-business critical	Yes/No – although the activity is not critical to Cadent’s business, it is critical to industry billing processes	No – Some of our assets are integrated with civil structures	Yes/No – we expect to be able to be able to provide assurances of effective delivery eg we will consider options to pass on liability to a third party
Avoids the need for a legislative / regulatory change	Yes/No – no requirement for new legislation but requires changes to the Unified Network Code	No – none foreseen	Yes / No – depends on the nature of the arrangement and the interplay with legislation
Expected benefits outweigh costs	TBC – to be tested through market testing	TBC – to be tested through market testing	TBC – to be tested through market testing

5.5.4 Next steps

Our next steps for these competition candidates are to start to test the market with potential third party providers. We plan to use the broad approach described in the figure, below.

Figure 5 Our proposed approach to test competition



We will continuously to review our list of competition candidates during RIIO-2 to see whether we can identify further opportunities that we have not identified in the methodology applied in this strategy. We will highlight any candidates we identify as part of our annual competition reporting, explained in Section **Error! Reference source not found.**