Regulatory Financial Performance Reporting (RFPR) Commentary

RIIO-GD2

August 2022

Contents

Executive Summary

Overview

Our Regulatory Financial Performance Reporting (RFPR) comprises of information for each of our 4 networks in line with the Regulatory Instructions and Guidance (RIGs).

Our RFPR submission and our Strategic Performance Overview (SPO) both address the regulatory performance of Cadent. The SPO is available on our web-site at the following location: Our performance | Cadent (cadentgas.com)

The 2 documents should be read in conjunction. Specific details on our output performance can be found from page 9 and financial performance from page 11 in the SPO.

There are a number of changes in Return on Regulatory Equity (RORE) reporting relative to RIIO-GD1.

- Firstly the price index has changed from RPI to CPIH. All values are presented in real terms excluding the impact of this inflation index; as such, if the RIIO-1 values were to be re-presented relative to CPIH they would be higher by the wedge between RPI and CPIH.
- The allowed returns on equity are significantly lower. In RIIO-GD1 the baseline return to equity was 6.7% (RPI based) with this being 4.55% in RIIO-GD2 – indexed over time to the risk free rate.
- Opportunity for over and under performance is much more constrained in RIIO-GD2 with Ofgem noting that in RIIO-GD1 strong performing networks can deliver double digit returns. In RIIO-GD2 this is significantly reduced as a result of a number of new mechanisms which reduce incentive properties.
- Some of these reduced incentive properties include sharing factors which are now set to 50% sharing between customers and networks (compared to 63% in RIIO-GD1), and a reduced number and potential value from Financial Output Delivery Incentives (“ODI-F”).

As a consequence the range of returns is constrained around base level of equity return. This is not to say our standards of performance have reduced relative to RIIO-GD1. Performance levels are re-baselined for RIIO-2 with continuous improvement on cost and customer performance expected through the price control.

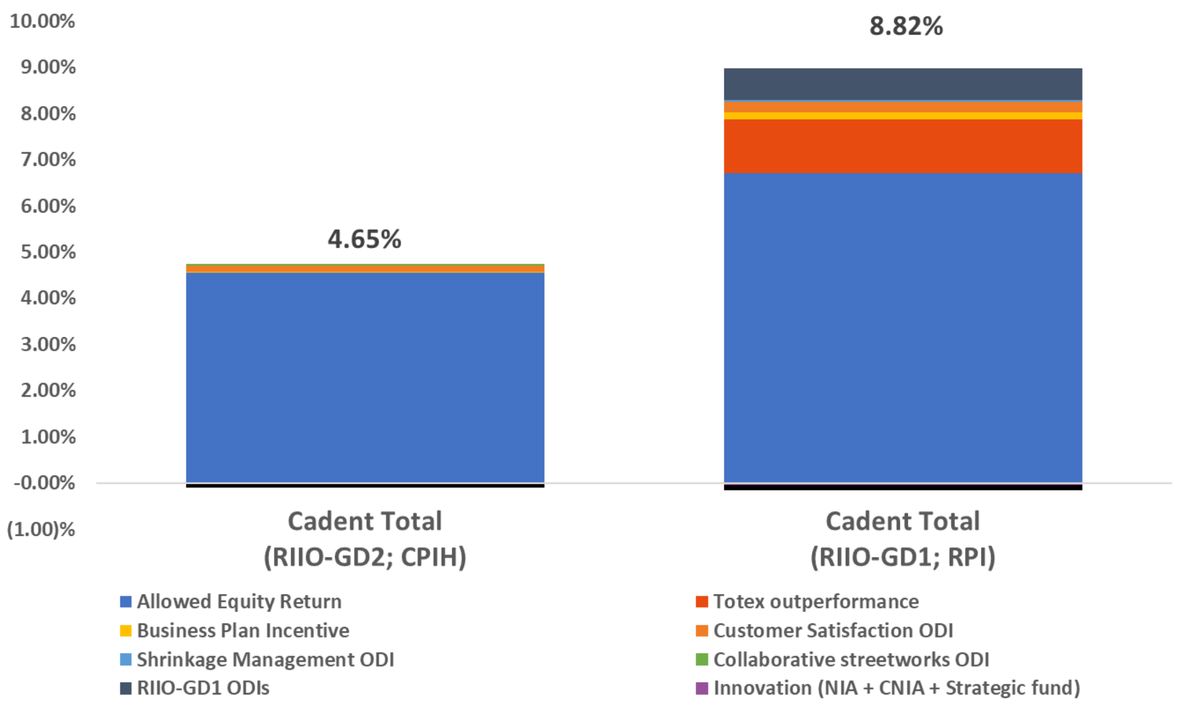
A further change to RIIO-GD2 is that allowances are reset annually based on volumes delivered in relation to outputs governed by Price Control Deliverables (“PCDs”). This would typically reduce the requirement for significant Enduring Value adjustments. However, as at the time of writing this report, further work is required, lead by Ofgem, to disaggregate allowances into their correct categories. This has created some requirement for Enduring Value adjustments to more accurately reflect performance. Further details are provided in the appendix.

Our Performance

RORE (excluding financing and tax) forecast for RIIO-GD2 period is 4.65% with the breakdown across our 4 networks set out later in this report.

Compared to RIIO-GD1 Operational RORE has reduced by 4.34% (a circa 50% drop between price controls) as summarised in the chart below, however, as noted due to the price base change the reduction is more significant than shown.

Chart 1: RIIO-GD2 vs RIIO-GD1 Operational RORE (excludes Financing and tax)



As noted above the base allowed returns has reduced from 6.7% to 4.5% over RIIO-GD2, excluding the impact on the price base adjustment from RPI to CPIH which effectively further reduces the nominal returns allowed. Given recent volatility in financial markets we expect the indexation of the Risk Free Rate ("RFR") component of the allowed equity return increase relative to the current assumptions.

Totex performance is expected to be broadly in line with the allowances over RIIO-GD2 with some networks seeing some small outperformance, however our London network in particular under performs as a result of certain regional factors not being recognised through the RIIO-GD2 price setting process and subsequent Competition and Markets Authority (CMA) Appeal. We remain confident that our networks will be setting the efficiency benchmark over the RIIO-GD2 period, including London where that efficiency is impacted by the regional factors discussed earlier[1].

Whilst overall, incorporating Enduring Value, Cadent has performed well comparing Totex spend against our allowances set in year one, the emerging cost pressures associated with rising levels of inflation are concerning. The evolving challenge is demonstrated by the rising costs of materials, energy and wages we are already experiencing highlighted by our recent pay deal settlement for our Staff and Field Force colleagues. With these pressures unlikely to reverse in the near future, delivery against our plan with continued Opex efficiency embedded will be extremely challenging, however we are mitigating this through our continued transformation programme.

Whilst the first year of RIIO-2 has been challenging, we believe that it has enabled us to create a platform that gives us confidence that we will deliver close to the efficiency benchmark across our four networks across RIIO-GD2, however there are significant macro-economic pressures noted above that add to what is already a stretching set of plans.

Financial ODIs are expected to drive c.0.15% of RoRE as a result of improving customer scores. Our scores are already significantly improved relative to RIIO-GD1 with some of our Networks leading the sector. We have plans to further enhance performance over RIIO-GD2.

Offsetting this outperformance we have a run rate of GSOP payments which are not subject to customer sharing. We also contribute significant cashflow from equity (£4m, equivalent to 0.4% of Totex in 21/22) into

[1] We note that some of the factors not reflected in the RIIO-GD2 settlement have been proposed to be accepted in the RIIO-ED2 Draft Determination, such as the London congestion charge

our Cadent Foundation, reducing earned returns, however this is not a part of Totex and as such not shown in the regulatory performance reporting.

Financial Performance

As previously advised, Cadent currently benefits from a comparatively low relative cash cost of embedded debt as our debt was raised and refinanced largely in a single financial year when interest rates were low. As a result, we outperform the trailing Iboxx index used for allowance setting. To achieve this comparative low cost of debt significant one-off cash costs were incurred in FY2017. We have included in our analysis below the impact of incurring these one off cost as we believe this provides a fairer reflection of the true economic cost of our debt. However, currently the RIGs do not support reporting these costs in the RFPR.

Separately, Ofgem has completed cross checks on this adjustment which identified a comparable total quantum. Further details are provided in the detailed commentary below. With the emerging high inflation and consequential impact on interest rates and spreads, we expect that the significant refinancing and new capital required for RIIO-GD2 will be funded at a cost above the trailing average reducing the level of outperformance over time.

Given the comparatively high levels of inflation expected over the first 2 years of RIIO-2, we see higher outperformance of the cost of debt allowances when presented through the lens of the RFPR[2]. As inflation moves above and below long run trends this is not unexpected, as example, in the last year of RIIO-1 when RPI inflation was 1.2%, we saw significant underperformance when presented through the RFPR. We are very focused on how inflation is impacting our customers particularly in light of the cost of living crisis. We have a comprehensive customer vulnerability strategy which targets support to the most vulnerable and we have detailed the significant social benefits we have delivered in our recent Social Impact report and in our Vulnerability and Carbon Monoxide Allowance Annal report and showcase. As noted above, we are investing profits directly back into the communities we serve though the Cadent Foundation.

For our reported debt costs, we include analysis below of the impact of the adjustments which need to be made to properly reflect the true economic costs of our debt. These adjustments have a natural correcting effect on the debt outperformance. Full details of the rationale and basis of these adjustments are set out later in this document.

We also highlight the inflation assumptions that have a direct correlation to financing performance. In the last year of RIIO-1 when inflation was below long run averages the RORE from financing was negative. This reverses in RIIO-2 with the increase in inflation expectations.

Table 1: RIIO-GD2 vs RIIO-GD1 RORE from Financing and tax

	RIIO-GD1	RIIO-GD2					
% RORE Notional Company	FY20/21 Actual	FY 21/22 Actual	FY 22/23 Forecast	FY 23/24 Forecast	FY 24/25 Forecast	FY 25/26 Forecast	RIIO-GD2 Average
RORE from Finance and tax performance - excluding adjustment to reflect the true economic cost of debt	-0.04%	4.28%	5.60%	3.31%	1.99%	2.04%	3.43%
RORE from Finance and tax performance - including adjustment to reflect the true economic cost of debt	-2.59%	2.52%	4.19%	2.24%	1.11%	1.18%	2.24%
Memo: Inflation (RPI / CPIH)	*1.21%*	*4.47%*	*7.69%*	*3.33%*	*1.69%*	*1.91%*	

[2] We are responding to the RIIO-ED2 consultation on this specific matter and continue to engage with Ofgem.

Overview of Regulatory Performance

1. Return on Regulated Equity (RoRE)

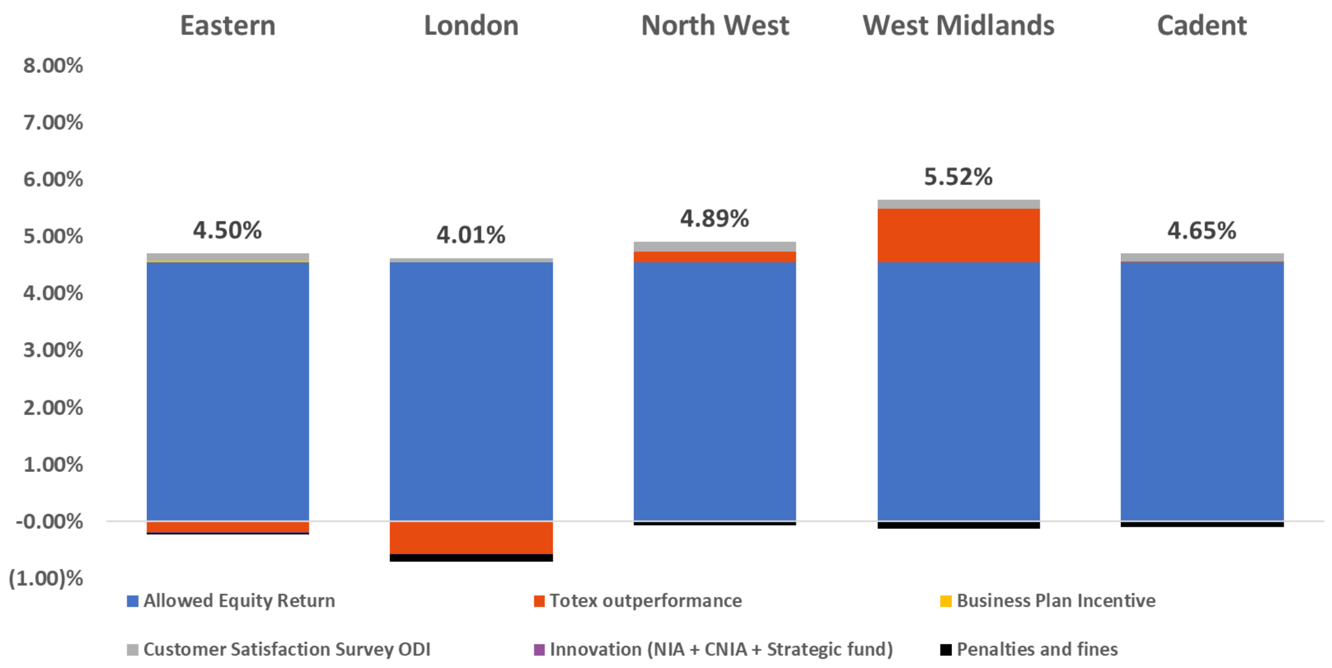
The RORE tab within the RFPR pack expresses the Return on Regulated Equity based on both notional gearing and actual gearing, as well as showing the monetary value of performance for each year of RIIO-GD2 in constant prices.

The overall operational RORE is 4.65% for Cadent and the table below shows the split by network;

Chart 2: 5 Year Average RORE Performance by Network

Price Control Average	RIIO-GD2				
Category	Eastern	London	North West	West Midlands	Cadent
Allowed Equity Return	4.55%	4.55%	4.55%	4.55%	4.55%
Totex outperformance	(0.18)%	(0.57)%	0.18%	0.94%	0.01%
Business Plan Incentive	0.02%	(0.00)%	(0.00)%	(0.00)%	0.01%
Customer Satisfaction Survey ODI	0.14%	0.07%	0.18%	0.15%	0.14%
Complaints metric ODI	-	-	-	-	-
Unplanned Interruption Mean Duration ODI	-	-	-	-	-
Shrinkage Management ODI	0.00%	(0.00)%	0.05%	(0.00)%	0.01%
Collaborative streetworks ODI [Cadent Lon & EoE]	0.03%	0.10%	-	-	0.04%
Other RIIO-1 ODI's	-	-	-	-	-
Network innovation input for RORE	(0.02)%	(0.01)%	(0.02)%	(0.02)%	(0.02)%
Carry-over Network innovation input for RORE	(0.00)%	(0.00)%	(0.00)%	(0.00)%	(0.00)%
Strategic innovation input for RORE	-	-	-	-	-
Penalties and fines	(0.03)%	(0.13)%	(0.05)%	(0.11)%	(0.08)%
OPERATIONAL RORE PERFORMANCE	**4.50%**	**4.01%**	**4.89%**	**5.52%**	**4.65%**

Chart 3: 5 Year Average Operational RORE Performance by Network



We discuss the performance on the individual RFPR tables below.

2. Reconciliation to Revenue and Profit

This table reconciles the collected revenues reported within the RRP to the Annual Report and Accounts. As we have 4 networks a reconciling item is bringing in the revenues from the other 3 networks to reconcile back to a Cadent level total. Specific procedures are completed to provide assurance over collected income (Agreed Upon Procedures) and reported revenues (external audit).
Information being sourced from the RRP and Annual Report and Accounts.

For details of revenues in the first year of RIIO-GD2 please refer to our SPO. This also contain details of customer bills over time and how Cadent has delivered on-going efficiencies for customers driving down bills in real terms over time.

For details of forecast revenues, further information can be found in the Price Control Financial Model ("PCFM"). This model will be published by Ofgem in November 2022 and shows expected revenues over the 5 years of RIIO-GD2.

3. Totex Reconciliation & Performance

3.1. Totex performance

The tables below show the Totex performance by network projected out for the 5 years of the price control.

Chart 4: Totex Forecast by Network relative to allowances (post-Enduring Value)

Eastern	Actual	Forecast						
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total	Allowed	Variance
Opex	134.5	138.3	130.0	125.8	123.4	**651.9**	653.7	1.9
Capex	69.5	97.9	71.8	63.4	55.1	**357.7**	315.5	(42.2)
Repex	129.0	136.5	138.3	138.4	139.6	**681.7**	697.9	16.2
Totex	**333.0**	**372.7**	**340.0**	**327.6**	**318.1**	**1,691.3**	**1,667.1**	**(24.2)**
Allowance	328.1	344.1	349.4	330.4	315.1	**1,667.1**		
Out / (Under) Performance	**(4.8)**	**(28.5)**	**9.4**	**2.8**	**(3.0)**	**(24.2)**		
Cumulative Performance	(4.8)	(33.4)	(24.0)	(21.2)	(24.2)			

London	Actual	Forecast						
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total	Allowed	Variance
Opex	96.9	101.2	102.3	103.3	103.1	**506.9**	523.1	16.1
Capex	27.4	39.2	44.0	35.7	33.7	**180.0**	164.9	(15.1)
Repex	129.7	142.6	155.7	145.8	142.5	**716.4**	659.7	(56.7)
Totex	**254.1**	**283.1**	**302.0**	**284.8**	**279.3**	**1,403.3**	**1,347.6**	**(55.7)**
Allowance	261.5	292.2	279.8	265.4	248.7	**1,347.6**		
Out / (Under) Performance	**7.3**	**9.1**	**(22.2)**	**(19.4)**	**(30.6)**	**(55.7)**		
Cumulative Performance	7.3	16.5	(5.7)	(25.1)	(55.7)			

Cadent
Your Gas Network

North West

	Actual	Forecast						
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total	Allowed	Variance
Opex	89.6	90.8	91.6	89.6	89.2	**450.8**	455.4	4.5
Capex	40.1	62.6	53.8	37.5	30.2	**224.2**	212.0	(12.1)
Repex	105.4	94.0	101.7	91.1	92.3	**484.4**	508.6	24.2
Totex	**235.0**	**247.3**	**247.1**	**218.2**	**211.7**	**1,159.4**	**1,176.0**	**16.6**
Allowance	238.3	250.9	256.9	217.8	212.2	**1,176.0**		
Out / (Under) Performance	**3.3**	**3.6**	**9.7**	**(0.4)**	**0.4**	**16.6**		
Cumulative Performance	3.3	6.9	16.6	16.2	16.6			

West Midlands

	Actual	Forecast						
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total	Allowed	Variance
Opex	62.4	64.3	65.9	66.6	67.6	**326.7**	361.8	35.1
Capex	21.2	41.6	30.3	28.6	23.2	**145.0**	150.5	5.5
Repex	75.7	72.3	77.3	77.8	74.0	**377.1**	403.0	25.9
Totex	**159.3**	**178.2**	**173.6**	**173.0**	**164.7**	**848.8**	**915.3**	**66.5**
Allowance	181.1	197.4	186.1	177.0	173.7	**915.3**		
Out / (Under) Performance	**21.8**	**19.2**	**12.6**	**4.0**	**8.9**	**66.5**		
Cumulative Performance	21.8	41.0	53.5	57.5	66.5			

Cadent

	Actual	Forecast						
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total	Allowed	Variance
Opex	383.3	394.6	389.8	385.3	383.3	**1,936.4**	1,994.0	57.6
Capex	158.3	241.4	199.9	165.2	142.1	**906.9**	842.9	(64.0)
Repex	439.8	445.3	473.0	453.0	448.4	**2,259.6**	2,269.2	9.6
Totex	**981.4**	**1,081.3**	**1,062.7**	**1,003.6**	**973.9**	**5,102.8**	**5,106.1**	**3.2**
Allowance	1,008.9	1,084.7	1,072.2	990.6	949.7	**5,106.1**		
Out / (Under) Performance	**27.6**	**3.4**	**9.5**	**(13.0)**	**(24.2)**	**3.2**		
Cumulative Performance	27.6	30.9	40.4	27.4	3.2			

Our five-year RIIO-GD2 delivery plan envisaged that the first year would be a transitional one. Not only from the perspective of embedding our new outputs and managing our spend against the challenging allowances set to deliver these outputs, but also as we transform our delivery model and how we work with our supply chain. Whilst it has been a challenging year, we believe that it has enabled us to create a platform that gives us confidence that we will deliver close to the efficiency benchmark across our four networks across RIIO-GD2, however there are significant macro-economic pressures. Looking forward we plan to accelerate investment work during the next two years of RIIO-GD2 so are forecasting costs to increase in these years. We also expect that the cost pressures we have seen coming, including those deriving from inflation, will become more visible and this will drive enormous challenges to manage our costs relative to our ambitious plans.

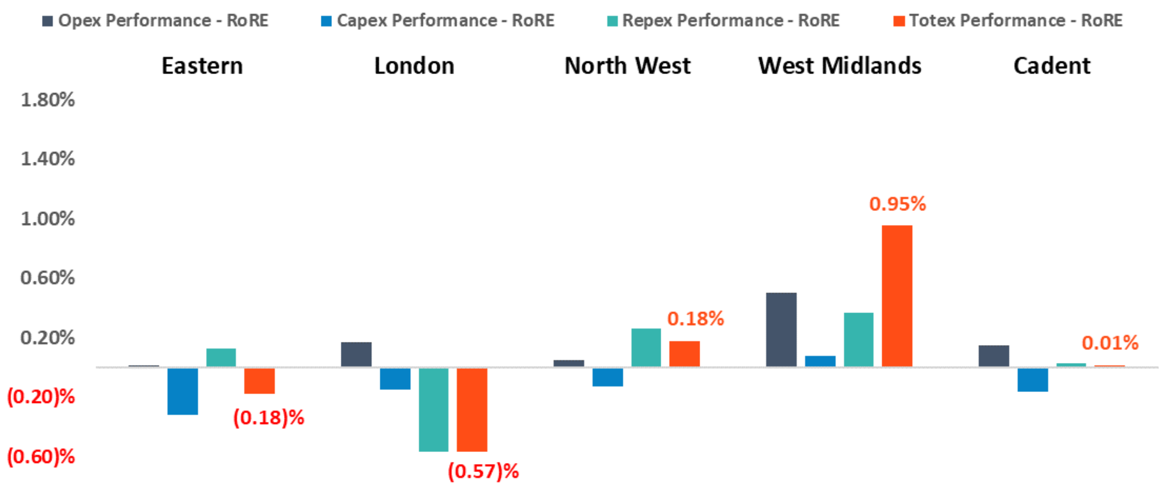
Following a period where COVID-19 resulted in deflationary pressures, we are now seeing significant price growth across all our labour markets, materials and fuel / energy costs. Whilst we have benefitted from fixing some of these costs in the year to March 2022 (e.g. fuel and labour costs), the unwinding of these effects will materialise in future years as prices are reset in what is a very challenging environment. Whilst the current view from most economic forecasts is the currently high inflation will return to a normalised level over the coming 12-24 months, there is no certainty in that.

As such, we continue to deliver our RIIO-GD2 business plan efficiency challenge and have accelerated our organisational transformation in some areas to mitigate these emerging cost pressures as much as possible.

We remain confident that our networks will be setting the efficiency benchmark over the RIIO GD2 period, including London where that efficiency is impacted by the regional factors discussed earlier.

The chart below shows the expected over / (under) performance relative to Totex allowances presented in RORE terms. This is shown after the impact of Enduring Value adjustments and demonstrates that the level of outperformance and underperformance is expected to be relatively tightly constrained around the baseline of allowed returns.

Chart 5: Totex over / (under) performance relative to allowances after adjustment for Enduring Value, RIIO-GD2 5 year average



3.2. Enduring Value

We make enduring value adjustments to take account of two distinct items.

Firstly, in relation to disaggregation of costs, as noted above, there are differences in how Allowances are referenced in the Gas Transporter Licence compared to what we expect the Allowances to be following disaggregation. We expect the outcome post disaggregation to be aligned to the values as per the Ofgem released PCFM in July 2022.

Following Ofgem direction, concluding with an email sent to Cadent on August 8th, 2022, the pre-enduring value adjusted values for Cadent's Allowances and associated unit rates are to match those as prescribed in the Gas Transporter Licence issued June 2022. Enduring value adjustments are then made to convert Allowance figures from those prescribed in the Gas Transporter Licence back to those as per the July 2022 PCFM.

As a simple example, the below table shows the values in the Gas Transporter Licence for Tier 1 Repex, Tier 1 Services and Baseline Network Risk Output (NARMs) and compares these to the values in the latest published PCFM for London.

Chart 6: Enduring Value adjustment example based on disaggregation expected values

Baseline Network Risk Output (NARMt)	£m - 18/19 prices	Actual FY 21/22	Forecast FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
	Gas Transporter Licence - June 2022	36.8	37.3	38.4	36.4	36.1	185.0
	OFGEM PCFM - July 2022	31.2	32.0	31.0	30.2	27.8	152.2
	Enduring Value Adjustment	**(5.6)**	**(5.3)**	**(7.5)**	**(6.2)**	**(8.3)**	**(32.8)**

Tier 1 Services Repex (T1SRt)	£m - 18/19 prices	Actual FY 21/22	Forecast FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
	Gas Transporter Licence - June 2022	30.6	29.6	28.8	28.5	28.2	145.7
	OFGEM PCFM - July 2022	26.1	24.8	25.1	24.5	25.6	126.1
	Enduring Value Adjustment	**(4.5)**	**(4.9)**	**(3.6)**	**(4.0)**	**(2.6)**	**(19.6)**

As can be seen there are material differences and as such we have completed Enduring Value adjustment to synthetically replicate how the disaggregation process may amend the published Licence values.

At the point of completing the RFPR, across all our networks the Licence values are c. £160m (see appendix section of this document) higher than our understanding of the correct position following disaggregation. Ofgem are still in the process of performing the disaggregation and therefore there remains uncertainty over the final allowance values. We will up-date RFPR and other Regulatory Reports next year with a more definitive view.
It should be noted that these Enduring Value adjustments will impact RAV and consequently RoRE performance.

We note that we expect a Statutory Consultation to be completed on this by October 2022 to drive consistency across documents and models including the Gas Transporter Licence and PCFM

Secondly, the Baseline Network Risk (NARMt) is a new Price Control Deliverable for RIIO-GD2. We were unable to complete a rephasing of allowances through the Regulatory Reporting Pack (“RRP”) that feeds into the PCFM modelling. Given the disaggregation process noted we expect the values to change and so we just illustrate the impact through Enduring Value pending completion of the statutory consultation process.

With this Enduring Value adjustment, there is no change to the overall value of the Allowance, the profiling of the Allowance is just re-phased accordingly

Chart 7: Enduring Value adjustment example-based Allowance rephasing

Baseline Network Risk Output (NARMt)	£m - 18/19 prices	Actual FY 21/22	Forecast FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
	OFGEM PCFM - July 2022	36.8	37.3	38.4	36.4	36.1	185.0
	Monetised Risk Adjusted Allowance Profile	23.8	51.9	38.7	37.4	33.3	185.0
	Enduring Value Adjustment	**(13.0)**	**14.6**	**0.2**	**1.0**	**(2.9)**	**-**

Uncertainty Mechanisms; Re-openers

We have included in the Totex allowances the re-opener pipeline log as included in the RRP. However, adjustments have been made to exclude certain projects, seen in the table detail below, where there remains uncertainty over whether these projects will be charged to distribution customers and funded via the RAV and Gas Distribution charges or socialised with distribution customers more broadly.

Cadent
Your Gas Network

Chart 8: Detail of the re-openers by Network, including those within the Pipeline log but not in the RRP or RFPR Allowances

East (£m - 18/19 prices)

	Actual	Forecast				
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
Diversions and Loss of Development Claims policy Re-opener	1.2	4.2	8.3	8.3	4.7	26.8
Tier 1 Stubs Repex policy Re-opener	0.1	5.1	4.5	2.5	2.7	14.9
New Large Load Connections Re-opener	1.5	1.6	1.5	1.5	1.5	7.6
Heat policy and energy efficiency Re-opener	-	-	2.9	1.7	1.9	6.4
Cyber Resilience IT Non-Baseline	-	0.4	0.7	0.8	0.9	2.9
Cyber Resilience OT Non-Baseline	-	0.2	0.5	0.8	0.8	2.4
Non-operational IT Capex Re-opener	0.0	1.3	0.3	0.1	-	1.7
TOTAL Re-openers in RFPR Allowance Submission	**2.8**	**12.9**	**18.7**	**15.8**	**12.5**	**62.7**
East Coast Hydrogen FEED Reopener; Net Zero Pre-construction Work	-	-	5.3	10.7	10.7	26.7
Re-openers in Pipeline log but Excluded from RFPR submission	**-**	**-**	**5.3**	**10.7**	**10.7**	**26.7**

London (£m - 18/19 prices)

	Actual	Forecast				
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
Diversions and Loss of Development Claims policy Re-opener	0.3	1.0	1.5	1.5	1.0	5.2
Tier 1 Stubs Repex policy Re-opener	0.0	2.3	4.3	4.0	2.4	13.0
Cyber Resilience IT Non-Baseline	-	0.2	0.4	0.5	0.5	1.6
Cyber Resilience OT Non-Baseline	-	0.1	0.3	0.5	0.5	1.3
Non-operational IT Capex Re-opener	0.0	0.7	0.1	0.0	-	0.9
TOTAL Re-openers in RFPR Allowance Submission	**0.3**	**4.4**	**6.7**	**6.4**	**4.4**	**22.1**
Re-openers in Pipeline log but Excluded from RFPR submission	**-**	**-**	**-**	**-**	**-**	**-**

North West

	Actual	Forecast				
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
Diversions and Loss of Development Claims policy Re-opener	1.8	3.4	13.3	0.3	0.3	19.2
Tier 1 Stubs Repex policy Re-opener	0.1	3.6	2.4	1.9	1.9	10.0
New Large Load Connections Re-opener	0.2	0.9	1.6	0.8	1.4	4.9
Cyber Resilience IT Non-Baseline	-	0.3	0.5	0.6	0.6	1.9
Cyber Resilience OT Non-Baseline	-	0.1	0.3	0.6	0.6	1.6
Non-operational IT Capex Re-opener	0.0	0.9	0.2	0.0	-	1.1
TOTAL Re-openers in RFPR Allowance Submission	**2.1**	**9.2**	**18.4**	**4.2**	**4.8**	**38.7**
HyNet Phase 2; Net Zero Reopener	-	4.8	42.0	0.9	-	47.8
Hydrogen Village Conversion - Whitby Stage 2; Net Zero Pre-construction	-	3.4	-	-	-	3.4
Hydrogen Village Conversion - Whitby Stages 3-5; Net Zero Re-opener	-	-	20.6	20.6	8.4	49.7
Re-openers in Pipeline log but Excluded from RFPR submission	**-**	**8.2**	**62.6**	**21.6**	**8.4**	**100.8**

West Midlands

	Actual	Forecast				
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
Tier 1 Stubs Repex policy Re-opener	0.0	0.6	0.7	0.6	0.6	2.6
Heat policy and energy efficiency Re-opener	-	-	-	1.4	1.6	3.0
Cyber Resilience IT Non-Baseline	-	0.2	0.4	0.4	0.4	1.4
Cyber Resilience OT Non-Baseline	-	0.1	0.2	0.4	0.4	1.2
Non-operational IT Capex Re-opener	0.0	0.6	0.1	0.0	-	0.8
TOTAL Re-openers in RFPR Allowance Submission	**0.0**	**1.6**	**1.4**	**2.9**	**3.0**	**9.0**
Re-openers in Pipeline log but Excluded from RFPR submission	**-**	**-**	**-**	**-**	**-**	**-**

Cadent

	Actual	Forecast				
	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
Diversions and Loss of Development Claims policy Re-opener	3.3	8.6	23.2	10.1	6.0	51.2
Tier 1 Stubs Repex policy Re-opener	0.2	11.7	11.9	9.0	7.7	40.5
New Large Load Connections Re-opener	1.6	2.5	3.1	2.3	2.9	12.5
Heat policy and energy efficiency Re-opener	-	-	2.9	3.2	3.4	9.5
Cyber Resilience IT Non-Baseline	-	1.2	2.0	2.3	2.4	7.9
Cyber Resilience OT Non-Baseline	-	0.5	1.4	2.3	2.3	6.5
Non-operational IT Capex Re-opener	0.1	3.6	0.7	0.1	-	4.6
TOTAL Re-openers in RFPR Allowance Submission	**5.2**	**28.0**	**45.2**	**29.3**	**24.7**	**132.5**
East Coast Hydrogen FEED Reopener; Net Zero Pre-construction Work	-	-	5.3	10.7	10.7	26.7
HyNet Phase 2; Net Zero Reopener	-	4.8	42.0	0.9	-	47.8
Hydrogen Village Conversion - Whitby Stage 2; Net Zero Pre-construction	-	3.4	-	-	-	3.4
Hydrogen Village Conversion - Whitby Stages 3-5; Net Zero Re-opener	-	-	20.6	20.6	8.4	49.7
Re-openers in Pipeline log but Excluded from RFPR submission	**-**	**8.2**	**68.0**	**32.3**	**19.1**	**127.6**

Cadent
Your Gas Network

RIIO-GD1 Close out

We have not factored into the RFPR any RIIO-GD1 close out adjustments which we do not expect to be material relative to output delivery in RIIO-GD1. We continue to work with Ofgem to ensure that these adjustments are included in time for charge setting for next years (FY23/24) revenues. Our expectation at this point is that this will mainly impact the RAV within our London network in relation to closing out disposal proceeds.

4. Incentives & Other Revenue Allowances

Overview

Financial Output Delivery Incentives ("ODI-Fs") are an important component of the RIIO price control framework and incentivise network companies to drive continuous performance improvements relevant to customers.

In RIIO-GD2, there is not a time lag between earning incentives and recognising the allowed income for them. The forecast completed in this RFPR is used to generate future revenues with true ups relative to actual performance over time.

For detailed analysis of our output performance please refer to the SPO. We have ambitious customer plans that results in a forecast improvement in Customer Service scores over RIIO-GD2. This is the primary driver of increasing RORE over the RIIO-GD2 period from incentives.

There is less opportunity to drive outperformance of the regulated return from incentives in RIIO-GD2 relative to RIIO-GD1. This comes from both the incentive strength (i.e., the amount that can be earned) reducing and from fewer incentives available to networks.

Customer Satisfaction Survey ("CSAT")

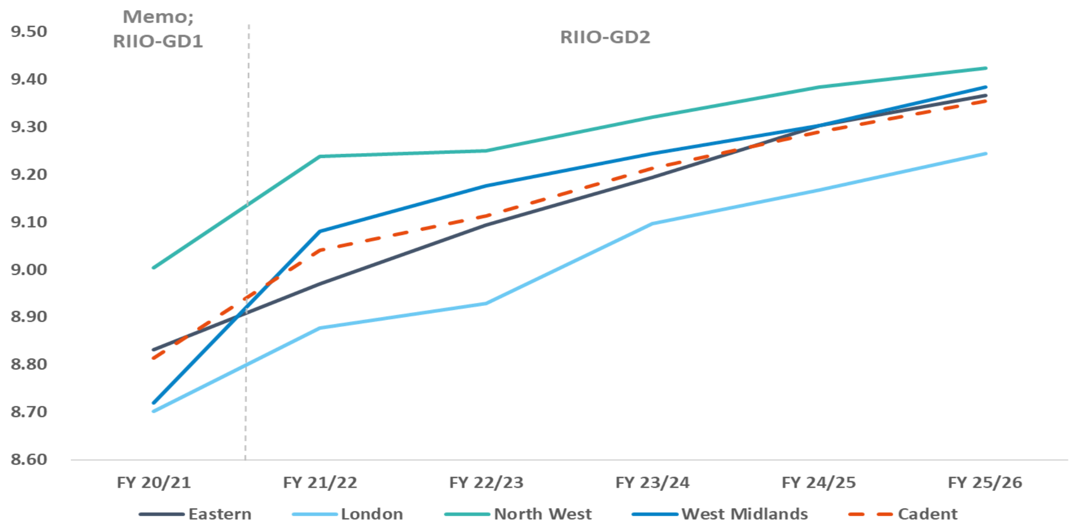
In 2021/22 we have made transformational improvements in our customer service which is reflected in our excellent customer satisfaction scores in all four networks across the three core processes: Planned Works, Emergency Response and Repair, & Connections. Our aggregate CSAT score significantly improved since last year from 8.80 to 9.05 We are particularly proud of our performance in NW and WM and expect these networks to be positioned amongst the leading performers in the sector.
More information on our CSAT performance can be found in our Strategic Performance Overview document, pages 30-31.

Chart 9: CSAT improvement relative to FY20/21

	2021/22	2020/21	Movement
Eastern	8.97	8.83	+0.14
London	8.88	8.70	+0.18
North West	9.24	9.00	+0.24
West Midlands	9.08	8.72	+0.36
Cadent	**9.05**	**8.80**	**+0.25**

Our ambition has not stopped, and the chart below shows our planned improvement in customer scores over RIIO-GD2 with all networks expected to deliver performance improvements over time.

Chart 10: Forecast CSAT improvement over remainder of RIIO-GD2



Other Output Delivery Incentives

In RIIO-GD2, Cadent has the opportunity to earn reward and/or incur penalties through financial output delivery incentives (ODI-F). There is potential for reward or penalty through Shrinkage Management, reward through delivery of Collaborative Streetwork projects (only in Eastern and London networks), and mitigation of penalty through performance against Unplanned Interruptions and the Complaints Metric.

Shrinkage Management is key to help us in tackling climate change and improving the environment. See pages 43-47 of our SPO for more information on our Shrinkage performance and strategies.

Collaborative Streetworks encourages collaboration between utilities and local authorities to minimise disruption. We have had a very strong year of performance and delivered 10 projects between our London and Eastern networks reducing disruption in total by 190 days. This maximises the ODI-F potential reward in London Network and generated positive performance in the Eastern network. The incentive is capped at 10 collaborative projects per year, and only within our Eastern & London Networks. We have taken this approach to collaborative work and implement similar strategies in the North West and West Midlands too. Therefore for our customers, we deliver more value and efficient working than the ODI generates as incentive revenue

Cadent incurred no penalties on Unplanned Interruptions and Complaints metrics in 21/22 and forecasts the same for the remainder of RIIO-GD2

Other Revenue Allowances

Other Revenue allowances (ORAs) relate to, Network Innovation Allowance, Carry-over Network Innovation Allowance from RIIO-GD1, and Strategic Innovation Fund. Allowed expenditure on these items is 90% of actual expenditure, the 10% company funded proportion contributes to negative RoRE performance.

5. Financing and Net Debt Position

As previously explained in the Financial Performance section of this paper, we benefit from a comparatively low cash cost of debt. This is as a result of significant capital structure changes to create a separate Gas Distribution business (the "segmentation"). The low cost of debt results in an outperformance of the allowed funding for debt and an increase in reported RORE; however, this excludes the one-off costs associated with the segmentation. If the repayment of old legacy National Grid debt had not happened, then the current cost of debt for the Gas Distribution business would be higher over the medium term.

Cost of debt allowances are set assuming debt is raised evenly over a trailing average period from 10-14 years to fund investment in the network over time. However, the majority of our current debt portfolio was priced largely in a single year (FY17) due to the segmentation when market rates were low.

The intent of the segmentation was to transfer National Grid's debt across to Cadent. However, due to the complexity and cost of this process, the novation of all debt requirements was not possible. As such, expensive National Grid legacy debt was repaid and new cheaper debt was issued at the low prevailing market rates. However, significant costs were incurred in order to repay the old legacy debt and secure a much lower ongoing cost of debt effectively accelerating future cash payments.

Chart 11: RORE including and excluding adjustment for Cost of Debt segmentation

5-Year Average RORE - Including Financing and Tax					
	Eastern	London	North West	West Midlands	Cadent
Financing and Tax RORE Excluding Adjustment	3.12%	3.02%	3.31%	3.43%	3.43%
Financing and Tax RORE Including Adjustment	1.88%	1.76%	2.08%	2.18%	2.24%

(All RORE numbers quoted above are based on notional gearing)

Ofgem has completed cross checks and note in footnote 11 of their publication "RIIO-GD2 Sector Methodology Decision – Finance" that the cross checks support the total quantum of the adjustment.

Bondholders and banks were paid the difference between the cost of the old expensive debt and the market rate of new debt as compensation. These one-off costs incurred at various points during the segmentation are recorded in the statutory accounts of various entities, including the 2017 statutory accounts of National Grid Electricity Transmission plc ('NGET' or 'the electricity business') and National Grid Gas plc ('NGG' or 'the gas business'), as well as in the 2017 regulatory accounts for Cadent.

Current Ofgem RIGs do not support the adjustment to be included in reported results and as such we are providing RFPR tables with and without the adjustment. We firmly believe adjusting the cost of reported debt to reflect the true economic cost provides stakeholders with a more meaningful view on our performance.

The current high level of inflation influences the cost of debt and our (and all GDNs) performance against the respective allowance. The result of inflation over RIIO-GD2 can be seen in table 1 within Financial Performance section of this paper.

As cost of debt allowances are calculated using a long tail trailing average, the current high inflation rates will possibility influence the capital allowances for future price controls.

6. RAV

The RAV has been calculated based on the Totex allowances relative to spend as detailed in section 3 adjusted for the impacts of enduring value noted above. RAV is reported in real, 18/19 prices, however it will be a product of underlying Totex spend and increases in RPEs, which are influenced by inflation.

Total return on RAV is calculated using cost of capital. These values were set for the RIIO-GD2 price control period by Ofgem, following consultation with the GDNs and CMA, at the Final Determinations. Cost of capital is influenced by real world market conditions, including inflation. Currently, cost of capital, and therefore proportionate return on RAV is fixed for RIIO-GD2.

See Section 3.1 above for details on the enduring value adjustments made. The RAV does not include the impact of RIIO-GD1 close out adjustments. We remain in dialogue with Ofgem with the ambition of including provisional close out values impacting legacy RAV additions during the November 2022 Annual Iteration Process. We understand that the final close out numbers will not be concluded upon until 2023.

Over and under spend relative to allowances is shared 50:50 with customers in RIIO-GD2 and this impacts RAV as well and transportation charges.

7. Tax and Tax Reconciliation

The tax reconciliation table R8a will not be completed till July 2023 due to the CT600 submission timing.

Lower actual tax deductions overall compared to notional allowances and accordingly higher tax liabilities means that we have underperformance against the tax allowance. The main reason for the tax underperformance on the tax table across the 5 years is the effect of the notional interest deducted in the calculation of the tax allowance being greater than the actual interest forecast to be deducted and so giving rise to a higher tax allowance.

8. Corporate Governance

We provide the details as requested, however, we recommend that for further details the Directors' Remuneration Committee Report included in our Annual Report and Accounts (Finance documents | Cadent (cadentgas.com) from page 101) is read in conjunction with the RFPR.

9. Pension & Other Activities

Prior to the separation of the business from National Grid and the subsequent sectionalisation of the Defined Benefit pension scheme, allowances were applied to National Grid Gas Transmission and allocated indirectly to each network via an NTS recharge. From 2017, following sectionalisation of the National Grid UK Pension Scheme allowances, all liabilities are now applied to each network directly and there is no NTS recharge. This has led to an increase in the deficit contribution shown in table R10.

The reported pension details align to the Pension Deficit Allocation Methodology ("PDAM") and the associated reasonableness review completed in 2020.

Data Assurance

Where available we have used information from the Regulatory Reporting Pack ("RRP") for the year to March 2022, the Licence as published in June 2022, the PCFM published on Ofgem's website on July 22nd, 2022, statutory accounts published in July 2022 and outputs from the Pensions Reasonable Review in relation to the Pension Deficit Allocation Methodology ("PDAM"). All of these documents have been through thorough assurance review processes including data accuracy and completeness checks as well as independent reviews wherever the table is deemed to be a high-risk table.

The information submitted in the RFPR has been subject to a high level of internal reviews and followed Ofgem's Data Assurance Guidance (DAG) structure of Planning, Review, and Sign-off.

Cadent
Your Gas Network

Appendices

1. Enduring Value Adjustments

Disaggregation of allowances impacting Licence values

As noted in section 3 of this document, there are differences in how Allowances are referenced, and values quoted in the Gas Transporter Licence relative to what we expect the Allowances to be following disaggregation.

As per Ofgem direction, concluding with an email sent to Cadent on August 8th, 2022, the pre-enduring value adjusted values for Cadent's Allowances and associated unit rates are to match those as prescribed in the Gas Transporter Licence issued June 2022.

For the basis of our Enduring Value (EV) adjustments, for now we assume the values post disaggregation will match the Allowance values as per the Ofgem published PCFM (July 2022). At a Cadent level, the EV adjustments required to transpose from the Licence values to those as per the July 2022 PCFM are shown in the table below.

A Statutory Consultation is expected to be completed on this by October 2022 to drive consistency across documents including the Licence and PCFM.

Chart 12: Cadent level total Enduring Value adjustments required to align Allowance values in the Gas Transporter Licence to those in the July 2022 PCFM

	Actual	Forecast				
£m - 18/19 prices	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
Baseline Network Risk Output	(13.1)	(14.7)	(17.7)	(15.3)	(17.2)	**(78.0)**
Tier 1 Mains decommissioned Price Control Deliverable	(9.3)	(11.8)	(10.6)	(11.2)	(8.6)	**(51.4)**
Tier 1 Services Repex Price Control Deliverable	(1.6)	(5.8)	(4.9)	(5.2)	(3.7)	**(21.2)**
Capital projects Price Control Deliverable	5.0	(1.9)	0.4	0.2	(4.5)	**(0.9)**
Commercial fleet Price Control Deliverable	1.2	0.0	0.0	0.1	0.0	**1.3**
London Medium Pressure Price Control Deliverable	7.5	(4.5)	0.8	(0.0)	(3.6)	**-**
Personalising welfare facilities Price Control Deliverable	2.4	(0.6)	(0.6)	(0.6)	(0.6)	**-**
Net zero and Re-opener development fund use it or lose it allowance	2.7	(0.7)	(0.7)	(0.7)	(0.7)	**(0.0)**
Tier 2A mains and services replacement volume driver	(0.0)	(0.1)	(0.2)	(0.2)	(0.2)	**(0.8)**
Fuel Poor Network Extension Scheme volume driver	(1.2)	(0.6)	(0.3)	(0.2)	(0.1)	**(2.5)**
Domestic Connections volume driver	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	**(0.6)**
Total Enduring Value Adjustments - pre RPEs	**(6.5)**	**(40.8)**	**(34.0)**	**(33.3)**	**(39.3)**	**(154.0)**
Impact on RPEs	(0.3)	(1.4)	(1.2)	(1.3)	(1.9)	**(6.1)**
Total Enduring Value Adjustments - pre RPEs	**(6.8)**	**(42.2)**	**(35.2)**	**(34.6)**	**(41.2)**	**(160.0)**

PCD & Volume Driver Allowances; per the Gas Transporter Licence	**476.0**	**508.9**	**496.9**	**479.7**	**474.6**	**2,436.1**
Enduring Value Adjustments	(6.8)	(42.2)	(35.2)	(34.6)	(41.2)	**(160.0)**
Allowance Values post Enduring Value Adjustments	**469.2**	**466.7**	**461.7**	**445.1**	**433.3**	**2,276.1**

Re-phasing of NARMs allowances

Within RIIO-GD2, the RRP allows for more dynamic re-phasing of Allowances compared to RIIO-GD1, where they were fixed for the 8 years of that price control. Through the RIIO-GD2 RRP, rephasing Allowances to match actual and forecast workload and delivery of outputs measures each year lessens the need for EV adjustments in RIIO-GD2. The primary purpose for EV adjustments now will focus on non-variant allowances including Use it Or Lose it Allowances, but these have less correlation to drivers for variability, such as workload.

However, citing and using the 2021/22 RRP template, we were unable to complete a rephasing adjustment of the Baseline Network Risk (NARMt) allowance. Given the disaggregation process noted we expect the values to change and so we just illustrate the impact through Enduring Value pending completion of the statutory consultation process.

With this Enduring Value adjustment, there is no change to the overall value of the Allowance, the profiling of the Allowance is just re-phased accordingly. See Chart 7 from earlier in this paper, and copied in below

Chart 7: Enduring Value adjustment example based Allowance rephasing

Baseline Network Risk Output (NARMt)		Actual	Forecast				
	£m - 18/19 prices	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26	Total
	OFGEM PCFM - July 2022	36.8	37.3	38.4	36.4	36.1	185.0
	Monetised Risk Adjusted Allowance Profile	23.8	51.9	38.7	37.4	33.3	185.0
	Enduring Value Adjustment	**(13.0)**	**14.6**	**0.2**	**1.0**	**(2.9)**	**-**

2. Allocations and Estimates

Existing revenue and cost allocation methodologies have been used to populate the RFPR. For any revenues and costs that are not network specific the amounts have been allocated in line with the revenue and cost methodologies set out in our cost allocation methodology statements which are reported to Ofgem annually and are applied to all regulatory reporting. This is subject to agreed upon procedures set by Ofgem.

General

Costs that relate to more than one activity, or that have arisen from shared services such including human resources, central operation and network strategy activities, IS, etc. have been allocated between activities using drivers that reflect, in management's opinion, the relative consumption of the services that give rise to the costs. Where this has not been possible, such costs have been allocated on a basis that reflects the relative size of those activities or using the relative numbers of staff. Management have applied the principals within the Methodology Statement.

In reaching an opinion on suitable cost drivers, management's objective has been to produce a fair and reasonable allocation of costs, after taking into account the materiality of the costs, the availability and accuracy of cost drivers and the cost of maintaining the drivers.

Following finalisation of the RIIO-GD2 settlement we have reviewed approaches to allocating centrally incurred operational costs in light of the approaches utilised to set network allowances for the GD2 period. For the majority of these costs the drivers utilised remain appropriate and we have not made any changes to their methods of allocation.

However, for those elements of Work Management, Other Direct Activities and Business Support costs that have previously been allocated evenly across our Networks, we have changed the method of allocation to one using network shares of RIIO-GD2 average Modern Equivalent Asset Value (MEAV), as a measure of relative scale. Taking this approach has the advantage of providing greater alignment with how allowances were set for the GD2 period, reducing the risk of providing an unfair advantage or disadvantage to customers in different networks due solely to differences in cost allocation. Ofgem have also used this approach to underpin their network specific efficiency targets and benchmarking. In making this change Cadent have ensured that it is consistent with the principles within the methodology statement and the associated unified cost allocation methodology.

- ## Revenue

The second section of the Revenue table involves adding back all items of revenue that are included within the statutory accounts but excluded from the collected regulatory network revenues. These items include:

- De-minimis revenue
- Excluded services
- Consented activities
- Bad debt
- Supplier of last Resort
- R&D Tax Credit
- Accruals
- Customer contributions
- IFRS 15 Contribution released
- Theft of Gas recoveries
- Other three networks – revenue relating to other three networks needs to be added to get back to the total amount for Gas Distribution

For any revenue that is not network specific the revenue has been allocated in line with the methodologies used within the Regulatory Accounts and the Revenue RRP which are either subject to an audit or agreed upon procedures.

- ## Totex

For the reconciliation to Totex on tab R3, each of the network tables start with total costs per the Cadent Gas Statutory Accounts. An adjustment is then required to remove the other three networks based on their RFPR table R3 submission.

The nature of the reconciling items for total expenditure are largely consistent with those previously reported - the principal adjustments relate to:

- An adjustment to fully reflect the costs relating to Excluded Services which are included in the statutory accounts operational cost figure but do not form part of the Totex figure in the RRP 1.01 table.
- The removal of non-cash items (e.g. depreciation/amortisation, provision releases/additions) reported within the statutory accounts as these are not part of operating costs within the RRP.
- Adjust for any Profit or Loss on disposals not included within Totex
- The exclusion of GSOP payments as these do not form part of Totex.
- The inclusion of cash spend against provisions (e.g. environmental provision utilisation) and any cash costs charged directly to exceptional items in the accounts.
- Adjusting for capital contributions received for new connections – these are included within turnover in the IFRS accounts but netted off Capex in the RRP Totex.
- Adjusting for leases previously deemed operating but now under the new IFRS16 standard are capitalised as a Right of Use Asset.
- Bad debt costs which are included as a revenue recovery item and therefore excluded from RRP Totex.

Cadent
Your Gas Network

- Theft of gas income recoveries are treated as turnover in the statutory accounts but included within Totex in the RRP.
- Reconciling items specifically in respect of the atypical events which are included in the Statutory Accounts but have been excluded from the RRP. Please see below
    - The removal of costs associated with the Grenfell tower investigation and public enquiry as these do not form part of the normal course of operating a GDN.
    - The exclusion of costs in relation to the funding for Cadent foundation (our community fund) to support customers in vulnerable areas which is excluded from Totex and reported separately in the RRP.
    - Pension costs in respect of the pension deficit recovery plan payment, which we have split between Established and Incremental. These are reported in RRP total expenditure incurred figure but not in the Statutory Accounts operational costs.
    - Non controllable costs' as reported in table 4.01 of the RRP which include costs such as Network Rates, National Transmission System (NTS) Exit costs, Shrinkage – these form part of statutory costs but are excluded from Totex.

Innovation

The NIA and CNIA actual information in this table has been extracted from the RRP tables already submitted to Ofgem.

Financing

Debt instruments that are expected to be refinanced in the medium-term are excluded from existing debt at the point in time of the planned refinancing and replaced with new debt.

New debt is forecast to support the Totex investment levels included in our RRP forecast.

RAV

We use the Ofgem PCFM to generate the output in the format required by the RFPR templates. As such items such as Enduring Value adjustments can be modelled through into allowances to note the impact on the RAV.

Tax

As per the RFPR RIGs, with no CT600 unavailable for the RIIO-GD2 period to date, we use post Enduring Value adjusted performance figures to generate output required by the RFPR templates. The forecast tax liability is allocated to Networks from a Cadent level based on RAV allocation. Further information will be provided in subsequent RFPRs where CT600 reconciliations will be available.

Corporate Governance

Within the RFPR, we have allocated dividends and remuneration across the networks based on their respective RAV balances.

- **Pensions**

The network splits within this table have been based on the PDAM methodology.

Within the table the deficit payments have been based on amounts paid to the scheme. These payments have then been split into the established and incremental deficit elements of the scheme.

The pre cut-off assets and liabilities have been based on the PDAM submission, with these lines being completed based on the overall pension scheme (section a, b and c).

The post-cut off assets and liabilities have also been based on the PDAM submission, but have been populated for our scheme only (section C).

The licensee elements of the total incremental deficit has been determined using an allocation driver consistent with the cost allocation methodology.

The licensee established deficit based on the gas distribution networks element of the total deficit, which has been allocated in line with the PDAM methodology.