

**Reference**

Cadent Response to Tier 1 Iron Stubs Re-opener Draft Determinations

**Date**

5<sup>th</sup> December 2024

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**Cadent**  
Your Gas Network

Correspondence sent by email to  
[ReopenerConsultations@ofgem.gov.uk](mailto:ReopenerConsultations@ofgem.gov.uk)

Dear Catherine,

**Consultation on the Tier 1 Iron Stubs Re-opener Draft Determinations.**

I am writing in response to your consultation, published on 7<sup>th</sup> November 2024, regarding Ofgem's draft determination of Tier 1 Iron Stubs re-opener submission from March 2024.

We agree with Ofgem's assessment of our needs case and optioneering within our Tier 1 Iron Stubs re-opener submission. Our approach enables us to deliver safety-critical work at an efficient cost, meeting the needs of our customers. We do not agree with the reduction of our stub remediation unit cost and Ofgem's assessment of the overhead rates we applied. We have provided further evidence and clarification to justify these costs.

The annex to this letter provides responses to the specific questions set out within your consultation of the Tier 1 Iron Stubs re-opener submission.

We have valued Ofgem's constructive engagement throughout the re-opener process, and hope you find our feedback helpful in making your final determination. If you would like to discuss any of our comments further, please contact [jahirul.kashem@cadentgas.com](mailto:jahirul.kashem@cadentgas.com).

Yours sincerely



**Howard Forster**

**Chief Operating Officer, Cadent Gas Ltd**

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**National Gas Emergency Service**

0800 111 999\* (24hrs)

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Page 1 of 4



## Annex – Cadent’s response to specific questions

### Q1. Do you agree with our assessment of applications under the Tier 1 Stubs Repex Policy Re-opener and our Draft Determinations? Please include your views on our assessment of the needs case, optioneering and draft allowance

We agree with Ofgem’s assessment of our needs case and optioneering for the workload we have included within the Tier 1 Iron Stubs Re-opener. This assessment of our approach will enable us to remain compliant with the HSE requirement to decommission and remove redundant Tier 1 Stubs safely.

However, we disagree with Ofgem’s cost assessment, namely the reduction of our unit costs for stub remediation and the reduction in our overhead costs. We provide further explanation below.

#### Unit costs

Whilst we understand Ofgem’s intention to take a consistent approach across all GDNs, we do not believe the unit costs being compared are like for like.

As outlined in our application (and Ofgem’s Draft Determination), Cadent’s [REDACTED] unit cost is for stub remediations only and does not include the cost of undertaking an on-site assessment to determine whether a stub can be left in situ or requires decommissioning. Ofgem has proposed to set a PCD against this, which we agree with, allowing us to claim costs for confirmed stub remediations only and not instances where a stub is not found and therefore no remediation is required.

[REDACTED PARAGRAPH].

#### Overhead rates

##### *Attributable overhead:*

Whilst we agree with Ofgem’s proposal to provide funding for attributable overhead costs for stub assessment activities, we disagree with the assessment of efficient levels and therefore the proposal to reduce the rate from 15% to 11%. As explained in our January 2024 re-opener draft determination response our attributable overheads represent a distinct allocation and distribution of costs. While traditionally, these costs would be classified as direct costs, our internal finance guidance categorises them as overheads. In the case of Tier 1 Stubs, these costs relate to the following:

- Project supervision and operational management (mandated by construction design management laws)
- Project planning and programming
- Where applicable, data capture, environmental, and reinstatement specialists

The above activities are delivered via our Construction Management Office (CMO). To develop an accurate attributable overhead rate, we calculated the total CMO overhead incurred on Repex activities and divided this by the overall value of our Repex workload, which equates to the 15% applied in our submission. This rate is consistent with that applied across all our Repex which formed part of our cost base which set the industry benchmark at RIIO-2. Therefore, we consider this rate to be efficient when encompassing the items detailed above.

##### *Allocated overhead:*



We also disagree with Ofgem's proposals to disallow our allocated overhead on the basis that "back-office" functions - IT, HR, and Finance - have no direct correlation to stubs work. Ofgem has stated that these activities have been funded through baseline allowances. However, as we had no baseline allowances for stubs in RIIO-GD2, the back-office element of our allowances would not have accounted for the additional activities and resources required for stubs at the time.

The allocated overhead applied against assessments relates to key support activities that allow us to undertake stubs assessments. This includes a comprehensive desktop assessment to confirm its current and future risk and determine whether a Tier 1 stub can remain in situ. This assessment involves a multi-stage process involving our network's asset investment and design functions.

The allocated overhead includes several costs which we will incur in order to deliver robust desktop and on-site assessments. These include, but are not limited to:

- **IT Costs:** Software licensing, maintenance, and support for the specialised applications employed by both the asset investment and design teams during data acquisition and assessment execution. This also includes IT support for hardware and network infrastructure used in these activities.
- **HR Cost:** Salaries for the personnel within both the asset investment and design teams directly involved in the assessment process. This includes the management and administration overhead associated with their time and resources.
- **Finance Costs:** Accounting, budgeting, reporting, and other financial administration tasks directly supporting the cost tracking for the stubs assessment process.

It is standard economic theory that in the case of semi-variable and variable costs, which this overhead relates to, as the level of direct work increases (i.e. stubs in this case), semi-variable costs will also rise to support the delivery of the activity. Therefore, excluding these back-office functions from our overhead calculation undermines the necessary and cost-effective nature of our stub assessment process by not providing any funding for these variable and semi-variable costs. The allocated overhead accurately reflects the resources required to ensure the safety and compliance of our operations.

## **Q2. Do you agree with our proposal to fund Cadent's on-site assessment activities, given there is a variance in approach between licensees?**

We agree with Ofgem's proposal to fund our on-site assessment activities. On-site assessments allow us to determine if a stub can be left in situ or if it requires decommissioning. The on-site assessment process agreed with the HSE is part of our risk prioritisation system and demonstrates an efficient approach to remediation as opposed to a blanket removal of all stubs.

The decision to conduct on-site assessments is also guided by the minimisation of disruption to customers and its cost-effectiveness. We included the example below as part of our re-opener submission to demonstrate the significant cost increase by not carrying out the assessment process.

[TABLE REDACTED]

Table 1 – Cost apportionment including on-site assessment

[TABLE REDACTED]

Table 2 – Cost apportionment without on-site assessment

Funding this activity encourages and ensures we remain as efficient as possible in decommissioning Tier 1 Stubs.



### Q3. Do you have any views on the Draft Directions contained in Appendix 1?

The Draft Direction includes a table setting out the adjusted allowances relating to Tier 1 stubs. We have provided our views on the calculation of the overhead rate in the questions above, however, we have noticed that the overhead rate (11%) has not flowed through into the allowances. As we cannot trace back the calculations to Ofgem's assessed efficient costs of [REDACTED] (in table 5), the table below shows the submitted on-site assessment value of [REDACTED] excluding the overhead in full and the value with Ofgem's proposed 11% overhead included. Therefore, the 'Ofgem assessed efficient cost' for 'On-site assessments' in table 5 should state [REDACTED], and this should also be reflected in annex 1 of the Draft Direction.

<b><u>Assessments</u></b>	<b><u>Value (£m) 18/19</u></b>
Without Overhead	£ REDACTED
With 11% Overhead	£ REDACTED
<b>Value Difference</b>	<b>£ REDACTED</b>

Table 3 - Overhead rate calculation discrepancy