GD23 - Gas Distribution Price Control 2023-2028

Draft Determination Annex D

Operational Expenditure

March 2022

About the Utility Regulator

Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.

Our vision

To ensure value and sustainability in energy and water.

Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.

Abstract

This annex forms part of the Draft Determination for the GD23 Gas Distribution Price Control. It details the approach, business plan requests, UR (Utility Regulator) assessment of these requests as well as the resulting UR proposals with respect to operational expenditure.

Audience

Industry, consumers and statutory bodies

Consumer impact

The full implications of the effect on the consumer are covered in the GD23 Draft Determination document that covers all aspects of the control.

Contents

Executive Summary

This document forms part of the draft determination for the GD23 price control for the three gas distribution network operators (GDNs) in Northern Ireland (NI). It reviews their business plans and sets out our initial conclusions on reasonable levels of operational expenditure for GD23.

Operational expenditure covers the costs of day-to-day activities carried out by the GDNs to operate and maintain their assets, manage their businesses and interact with consumers. To provide structure to our assessment, we collect and analyse opex under 23 cost categories which form the basis for the presentation of costs in this chapter and the structure of our detailed assessments. Under each of these cost categories we consider a further breakdown by activities such as staff, materials, professional and legal fees, etc. to inform our decisions.

The table below provides a comparison of the total operating expenditure requested by each GDN for GD23 and the allowances included in the draft determination following our assessment of the company submissions.

GDN (£m 2020 prices)	GD23 Opex request	GD23 Opex Draft Determination Pre-Efficiency	Opex adjustment	Opex adjustment %
FE	60.6	48.5	(12.1)	20%
PNGL	124.3	101.5	(22.9)	18%
SGN	28.0	16.2	(11.8)	42%

Note 1. Figures may not sum due to rounding.

To supplement this analysis, a breakdown of the opex cost categories requested by each GDN and allowed at draft determination is provided. A brief explanation is provided after each table for the changes made to the five cost categories with the largest adjustments. The detailed explanation of the adjustments is included in the remainder of this document.

FE Opex Summary (Pre-Efficiency)

FE Categories (£m)	GD23 Submission	Draft Determination	Difference
Asset Management	0.7	0.5	0.2
Operations Management	1.9	1.6	0.3
Emergency Call Centre	1.9	1.4	0.5
Customer Management	2.2	1.8	0.4
System Control	1.8	1.5	0.4
Emergency	6.5	5.5	1.0
Metering	6.8	6.2	0.6
Publically Reported gas Escape (PRE) Repairs	0.9	0.7	0.2
Maintenance	5.1	4.3	0.8
Other Direct Activities	0.0	0.0	0.0
IT & Telecoms	4.4	3.4	0.9
Property Management	7.2	6.5	0.7
HR & Non-operational Training	0.8	0.7	0.1
Audit, Finance & Regulation	5.4	4.4	1.0
Insurance	2.0	1.5	0.5
Procurement	0.1	0.1	0.0
CEO & Group Management	1.3	1.3	0.0
Stores & Logistics	0.1	0.0	0.1
Advertising & Market Development - Owner Occupied (OO)	9.0	4.8	4.1
Advertising & Market Development (Non-OO)	1.4	1.4	-0.1
Trainees & Apprentices	0.5	0.3	0.2
Non-Controllable Opex	0.3	0.3	0.0
Supplier of Last Resort	0.2	0.2	0.0
Total	60.6	48.5	12.1

Note 1. Figures may not sum due to rounding.

- Advertising & Market Development - Owner Occupied (OO) – For GD23 we are proposing to replace the Connection Incentive with a 'Cost to Serve' allowance. The concept of Cost to Serve is to cover the GDNs reasonable costs of responding to customer contacts and supporting them through the connection process, including the cost of Energy Advisers. To enable preparation by the GDNs for this change, we are proposing a glide path, from the existing connection incentive allowance levels in 2022, by moving fully to what we consider a reasonable cost to serve allowance by 2028. Our proposals also include a fixed allowance, to continue to support increased understanding and awareness of the gas sector. These Cost to Serve allowances are significantly lower than the connection incentive allowances estimated by the GDNs which included greater expenditure on promotional activities and financial incentives.

- Emergency Jobs – Three factors contribute to our reduction in estimated costs of emergency jobs. The volume of emergency jobs allowed for in the draft determination is less than that submitted by FE because we have forecast lower connection numbers for the GD23 period. We have projected costs on the basis of the historic proportion of customer calls that become emergency jobs. FE had proposed an increasing proportion in GD23. The 5% cost pressure uplift that FE had applied to work being undertaken by its period contractor from 2023 onwards was not allowed, consistent with the approach we have adopted for capital investment.

- Audit Finance and Regulation – FE has requested professional and legal fees which contain uplifts over and above those requested by other GDNs for consultancy advice associated with price control reviews. Consequently, we have not allowed this scale of uplift for the draft determination. We have however allowed an allowance for price control costs at an efficient level for the 2027 and 2028 years.

- IT and Telecoms – FE requested substantial increases in this area and we note that FE costs in this area are higher than for a GDN which has more customers. We observe that FE received in GD17 a substantial allowance in 2017 (Capex), to replace its IUS/IT Transformation, but note that this development has still not occurred and is pending in 2022, in which a separate request is also made for "New IUS Distribution Replacement licensing", which is based on estimates from its connected supply business. We have rolled forward the majority of 2020 actuals costs for GD23. We plan to review this area further, for the Final Determination (FD).

- Maintenance – The main cost challenges applied to FE's maintenance allowance can be summarised as follows. Governor reactive maintenance projections were reduced to reflect the lower estimate of GD23 installations used in our Capex assessment and average unit rates derived from 2017-2020 data were applied. The job duration for strategic valve inspection was reduced by 25%. This is based on the reasonable assumption that one and a half days should be sufficient for completing inspections on average, supported by the fact this reduction delivers an overall unit cost which is more comparable to PNGL's. The number of valve covers needing replacement during GD23 was projected from a lower base (derived from historic data) than FE and the cumulative length of mains was used to estimate annual increases rather than the sizeable percentage uplifts applied by FE. We based the telemetry allowance for Daily Metered Sites on the stable customer numbers submitted in FE's Business Plan Template tables rather than the much higher number used by FE to estimate its costs. We also used the average unit cost for 2017 to 2020 to determine our allowance rather than the higher 2020 unit cost used by FE. The 5% cost pressure uplift that FE had applied to work being undertaken by its period contractor from 2023 onwards was not allowed, consistent with the approach we have adopted for capital investment.

PNGL Opex Summary (Pre-Efficiency)

PNGL Categories (£m)	GD23 Submission	Draft Determination	Difference
Asset Management	1.7	1.6	0.1
Operations Management	3.3	3.0	0.4
Emergency Call Centre	2.8	2.8	0.0
Customer Management	5.2	4.7	0.5
System Control	0.9	0.7	0.1
Emergency	9.0	8.2	0.9
Metering	14.4	12.9	1.5
v	5.8	5.2	0.6
Maintenance	15.5	13.5	2.0
Other Direct Activities	0.0	0.0	0.0
IT & Telecoms	3.4	3.3	0.0
Property Management	24.0	16.2	7.8
HR & Non-operational Training	1.6	1.5	0.2
Audit, Finance & Regulation	6.6	5.7	1.0
Insurance	6.4	4.1	2.3
Procurement	0.5	0.5	0.0
CEO & Group Management	10.7	8.3	2.4
Stores & Logistics	0.2	0.2	0.0
Advertising & Market Development - Owner Occupied (OO)	7.8	4.8	3.0
Advertising & Market Development (Non-OO)	3.3	3.1	0.2
Trainees & Apprentices	0.0	0.0	0.0
Non-Controllable Opex	0.9	0.9	0.0
Supplier of Last Resort	0.3	0.3	0.0
Total	124.3	101.5	22.9

Note 1. Figures may not sum due to rounding.

- Property Management (Mainly Network Rates) – We have used a formula linked to revenue to set the network rates allowance for PNGL. This is consistent with the approach we use for FE and SGN. PNGL has acknowledged that the figures contained within their GD23 business plan submission for network rates contained an error. We accepted the PNGL resubmission on network rates, with the exception that we profiled a 'flat rate in the pound' for all years in GD23 as this provides a consistent approach to setting network rates across both FE and SGN. While we have included a reasonable estimate of network rates for GD23, these costs will eventually be updated through the GD23 uncertainty mechanism to reflect actual costs, subject to PNGL demonstrating that it has taken appropriate actions to minimise valuations.

- Advertising & Market Development (OO) – For GD23 we are proposing to replace the Connection Incentive with a 'Cost to Serve' allowance. The concept of Cost to Serve is to cover the GDNs reasonable costs of responding to customer contacts and supporting them through the connection process, including the cost of Energy Advisers. To enable preparation by the GDNs for this change, we are proposing a glide path, from the existing connection incentive allowance levels in 2022, by moving fully to what we consider a reasonable cost to serve allowance by 2028. Our proposals also include a fixed allowance, to continue to support increased understanding and awareness of the gas sector. These Cost to Serve allowances are significantly lower than the connection incentive allowances estimated by the GDNs which included greater expenditure on promotional activities and financial incentives.

- CEO and Group Management – These costs are driven by the senior management team, as well as professional and legal fees together with other associated areas. Consistent with GD17, we have used benchmarked rates for senior positions and rolled forward 2020 actual costs for all other areas.

- Insurance – PNGL projected significant increases over the GD23 period when compared to 2020 actual costs. For the draft determination we used the 2020 actuals, apart from for Car Insurance (Large company car fleet) where benchmark data was used. We note that historically PNGL insurance costs have experienced both annual increases and decreases and there has not been any period of sustained increases. However, we may undertake further analysis of PNGL insurance costs in advance of the FD.

- Maintenance - The main cost challenges applied to PNGL's maintenance allowance can be summarised as follows. We removed costs associated with a proposal to install pressure monitoring at governor bins during the GD23 period. Costs for the installation of additional pressure monitoring sites have been allowed, which along with District stations, will provide better pressure monitoring coverage of the entire network. We are not convinced of the benefit of providing further pressure monitoring, within the network at governor bin level, at significant additional cost to consumers. Funding for work to inspect protective steel plates above strategic mains has also been removed as we do not consider that this has been investigated sufficiently enough to date to establish the risk, need and benefit. We would expect a well evidenced business case based on a representative sample of investigations to be provided to justify the level of activity and cost requested. Finally, in line with the approach established and adopted in previous price controls, we have removed the profit element from maintenance work due to be undertaken by PNGL's related company, Phoenix Energy Services (PES), during the GD23 period.

SGN Opex Summary (Pre-Efficiency)

SGN Categories (£m)	GD23 Submission	Draft Determination	Difference
Asset Management	0.3	0.2	0.1
Operations Management	1.6	1.3	0.3
Emergency Call Centre	0.7	0.6	0.1
Customer Management	0.4	0.3	0.1
System Control	0.3	0.2	0.1
Emergency	1.1	1.1	0.0
Metering	0.8	0.8	0.0
Publically Reported gas Escape (PRE) Repairs	0.1	0.1	0.0
Maintenance	3.0	2.9	0.0
Other Direct Activities	0.0	0.0	0.0
IT & Telecoms	0.8	0.2	0.6
Property Management	2.4	1.9	0.4
HR & Non-operational Training	0.1	0.1	0.0
Audit, Finance & Regulation	2.4	1.8	0.6
Insurance	0.0	0.0	0.0
Procurement	0.0	0.0	0.0
CEO & Group Management	2.8	0.6	2.1
Stores & Logistics	0.0	0.0	0.0
Advertising & Market Development - Owner Occupied (OO)	7.8	2.1	5.7
Advertising & Market Development (Non-OO)	3.0	1.4	1.6
Trainees & Apprentices	0.0	0.0	0.0
Non-Controllable Opex	0.3	0.3	0.0
Supplier of Last Resort	0.1	0.1	0.0
Total	28.0	16.2	11.8

Note 1. Figures may not sum due to rounding.

- Advertising & Market Development (OO) – For GD23 we are proposing to replace the Connection Incentive with a 'Cost to Serve' allowance. The concept of Cost to Serve is to cover the GDNs reasonable costs of responding to customer contacts and supporting them through the connection process, including the cost of Energy Advisers. To enable preparation by the GDNs for this change, we are proposing a glide path, from the existing connection incentive allowance levels in 2022, by moving fully to what we consider a reasonable cost to serve allowance by 2028. Our proposals also include a fixed allowance, to continue to support increased understanding and awareness of the gas sector. These Cost to Serve allowances are significantly lower than the connection incentive allowances estimated by the GDNs which included greater expenditure on promotional activities and financial incentives.

- CEO and Group Management (mainly Managed Service Agreement) - This service is provided by the SGN Group, which provides Head Office support for various activities. The draft determination uses SGN's estimates of Managed Service Agreement costs included by the company in its application for the Gas to the West (G2W) distribution licence. The Licence Application pack specifically indicated that beyond the 1st price control we would "not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies."

- Advertising & Market Development (non-OO) – SGN requested allowances for incentive payments to small and medium Industrial & Commercial (I&C) consumers to encourage connections. This was not requested at the time of the G2W Application process and we note that the G2W AIP stated 'only if the successful applicant has included such incentives in their application will these be funded by price control allowances'. Consequently, we have not provided allowances for incentive payments. We also note no payments have been made by SGN presently in this area. We have however provided for staff costs in this area.

- Audit, Finance and Regulation - SGN has requested professional and legal fees which contain uplifts over and above those requested by other GDNs for consultancy advice associated with price control reviews. Consequently, we have not allowed this scale of uplift for the draft determination. We have however allowed an allowance for price control costs at an efficient level for the 2027 and 2028 years.

- IT and Telecoms - SGN requested substantial increases to upgrade / introduce IT systems in GD23. As in GD17 we have considered the SGN request against the criteria which were set out in the G2W Application Information Pack. Our view is that SGN was best placed to estimate these costs at the time it applied for the distribution licence and there has been no material change in circumstance or scale of operation since then. For the draft determination we have included core IT and Telecoms allowances for the GD23 period which are consistent with the SGN G2W bid.

1. Introduction

Purpose of this document

1.1 This document forms part of the draft determination for the GD23 price control. This is the price control for the three gas distribution network operators (GDNs) in Northern Ireland (NI):

- Firmus Energy (Distribution) Ltd (FE)
- Phoenix Natural Gas Ltd (PNGL)
- SGN Natural Gas Ltd (SGN)

The price control covers the 6-year period form 1 January 2023 onwards.

1.2 More specifically, this document is an annex to the main GD 23 draft determination document. It details the approach, business plan requests, UR (Utility Regulator) assessment of these requests as well as the resulting UR proposals with respect to operational expenditure (opex).

Structure of this document

1.3 This document is structured in a number of chapters as follows:

a) Chapter 1, Introduction, provides an overview of the purpose and structure of the document.

b) Chapter 2, Detailed Approach to Opex - UR Proposals, sets out the approach we have taken in assessing the opex-related requests made by the GDNs in their business plan submissions for GD23.

c) Chapter 3, Price Control Submissions - Opex, provides an overview of the context for the GDNs' opex requests; it also summarises, for each of the three GDNs, the opex allowance requests and related key points for GD23 as set out in the respective business plan submissions.

d) Chapter 4, Firmus Energy - UR Proposals, sets out our assessment of the opex allowances requested by FE as well as the resulting proposed allowances for the GD23 price control period.

e) Chapter 5, Phoenix Natural Gas - UR Proposals, sets out our assessment of the opex allowances requested by PNGL as well as the resulting proposed allowances for the GD23 price control period.

f) Chapter 6, SGN Natural Gas - UR Proposals, sets out our assessment of the opex allowances requested by SGN as well as the resulting proposed allowances for the GD23 price control period.

2. Detailed Approach to Opex - UR Proposals

Overview

2.1 This chapter complements the chapter on approach in the main GD23 draft determination document. The approach set out in that main document, including in particular the application of our price control principles, is also relevant for our assessment of opex requests.

2.2 In addition, some aspects of our approach to the GD23 price control relate specifically to our opex assessment. These are detailed in this chapter.

2.3 Our detailed approach to the opex assessment is based on our Final Approach to GD23 price control[1].

2.4 Similar to our approach in the GD17 price control, we have undertaken a bottom-up assessment of the opex requests submitted by the GDNs, supported by targeted benchmarking of GDN costs in selected areas.

2.5 We have then adjusted the proposed pre-efficiency allowances for real price effects, and efficiencies to derive our draft determination opex profiles, net of frontier shift.

2.6 We have furthermore considered the appropriateness of having an uncertainty mechanism, similar to that in the GD17 price control, and to include in this a new mechanism for dealing with the outcome of the Energy Strategy for Northern Ireland and the ongoing review into meter reading activities. The uncertainty mechanism is further detailed in the main GD23 draft determination document and may lead to a retrospective adjustment of determined opex allowances. Further details on the energy strategy and metering specifically can be found in annex G and in Chapter 2 of the Main Document.

2.7 We re-examined in depth our previous approach to GD17 benchmarking, alongside the issues raised at that time by the GDNs and the CMA, and considered the implications for GD23 benchmarking. To assist in this endeavour, we appointed CEPA consultants who were tasked with conducting some preliminary econometric top-down benchmarking of the GDNs for GD23.

[1] Utility Regulator: Gas Distribution Networks GD23 Price Control, Our Approach to GD23, November 2020.

2.8 We re-convened the GD17 CAWG, this time including SGN (NI) as our 3rd local comparator, and CEPA led discussion with a preliminary analyses on relative efficiency of local GDNs to GB counterparts.

2.9 On 3rd June 2020 the CAWG met with GDN representatives to hear and discuss CEPA's preliminary analyses and findings.

2.10 Despite CEPA and ourselves incorporating a great many data adjustments into our modelling dataset for FE and PNGL (to try to support as 'like for like' comparison of relatively young as well as smaller network GDNs locally with their more mature, larger comparators in GB), CEPA were unable to draw robust and meaningful conclusions from their opex top-down benchmarking with GB GDNs:

- Given the wide efficiency gap range (circa +/- 30%), it was too difficult for CEPA to conclude with any confidence whether PNGL and FE were either efficient or inefficient
- CEPA's analyses highlighted the challenges of benchmarking Northern Ireland GDNs with GB GDNs
- CEPA concluded benchmarking SGN (NI) to GB GDNs would not be appropriate for GD23 given their current scale and operating model

2.11 For GD23 we found the lack of preliminary evidence to set any reliable catch-up efficiencies relative to the GB GDNs' recent performance as grounds for abandoning further top-down econometric benchmarking on this occasion.

2.12 This does not infer nor support the contention there are no further opportunities for local GDNs to release efficiencies for the consumer. Rather the complexity of relative efficiency comparison of our local GDNs is such that their dissimilarity at an aggregate, network level is such as to make this type of relative efficiency comparison unreliable at the present time.

2.13 We also considered the appropriateness of reallocating a portion of the operational expenditure allowances to be recovered by the GDNs through the connection incentive, similar to GD17 and GD14. For the GD23 draft determination we have not reallocated any portion of operational expenditure allowances to be recovered under a connection incentive. The impact of this is to reduce risk on the GDNs.

Bottom-up assessment.

Overview

2.14 We have based our bottom-up opex assessment for GD23 on the same opex cost categories as those used in the GD17 price control and subsequent annual reporting. These are:

- Work Management
    - ♦ Asset Management
    - ♦ Operations Management
    - ♦ Emergency Call Centre (Customer Management)
    - ♦ Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping)
    - ♦ System Control
- Work Execution
    - ♦ Emergency
    - ♦ Metering
    - ♦ Public Reported Escape (PRE) Reports
    - ♦ Maintenance
    - ♦ Other Direct Activities
- Business Support

- Information Technology (IT) & Telecoms
- Property Management
- Human Resources (HR) & Non-operational Training
- Audit, Finance & Regulation
- Insurance
- Procurement
- Chief Executive Officer (CEO) & Group Management
- Stores & Logistics

- Other Opex Categories
  - Advertising & Market Development Owner Occupied (OO)
  - Advertising & Market Development (Non - OO)
  - Trainees & Apprentices
  - Non-Controllable Opex

2.15 We have also carried out analysis on specific expenditure types, namely:

- Staff Costs and Agency Costs
- Network Rates

2.16 In addition, we have considered the capitalisation policies provided by the GDNs as part of their business plan submissions and accepted these for the draft determination.

2.17 Supplier of Last Resort and Shrinkage is also assessed and discussed.

2.18 Our proposed approach to the bottom-up assessment of these individual cost categories, expenditure types and of the capitalisation polices is set out in the remainder of this section.

2.19 We note that in general, where applicable, we have reviewed any internal recharges and benchmarked them against prior years and against deemed efficient third party costs for any goods/services provided. In all cases, a 'value for money' approach has been adopted, to ensure consumers gain a fair deal in not having such goods/services outsourced on a third party arm's length transaction basis.

2.20 In completing our assessment for routine and non-routine metering, maintenance and emergency activities, we have considered how the expenditure projections submitted by the GDNs compare to historic activities and costs, after the proposed increase in the customer asset base is taken into account.

2.21 We have paid particular attention to costs and activities that are not reflective of past experience and where material cost increases are evident. This includes new work items introduced by GDNs, for example due to safety concerns, which have been considered on an individual basis.

2.22 For routine maintenance activity we have also considered how projections align with the age of assets and the required frequency of activity based on industry guidance or best practice.

2.23 Comparative costs between GDNs have been considered in our analysis and costs have been adjusted to reflect our assessment of future connection numbers where appropriate.

2.24 Some of the work carried out in response to consumer requests or as a result of damage is off-set by contributions from consumers or third parties. In the individual cost category sections detailing our assessments for each GDN below, Business Plan costs and draft determination allowances are reported net of contributions and capitalisation.

2.25 Where necessary, allowances for contributions and staff costs, including any associated capitalisation, have been amended to reflect the cost adjustments applied.

Asset Management

2.26 Asset Management covers the activity of managing the network's assets. The costs collated under asset management include costs incurred in the following areas:

- Network Planning;
- Network Integrity (including gas quality monitoring);
- Network Capacity;
- Network/engineering policy/procedures (covering all policies of the network e.g. records transfer and brought in services & materials).
- Network development/analysis; and
- Management of redundant sites & remediation programmes

2.27 The GDNs asset management costs are in the main driven by its associated staff costs incurred in managing the network's assets. Our approach to determining staff costs is discussed for each GDN in the section referred to as Manpower in Chapters 4, 5 and 6.

Operations Management

2.28 Operations management includes the day to day planning and supervision of the operatives and contractors working within the work execution processes as follows:

- First Line Managers.
- Depot Managers.
- Safety, Health and Environmental.
- Operations support.

2.29 The GDNs costs for these activities are driven by staff costs. Our approach to determining staff costs is discussed in section 2.106.

Customer Management (Emergency Call Centre)

2.30 The Emergency Call Centre cost category covers the activity associated with receiving and processing calls from the public, where the member of the public believes this relates to an emergency. Due to the potential safety implications, GDNs encourage the public to call the emergency hotline if they are in any doubt as to whether an emergency situation exists.

2.31 As the definition of an emergency is broad and subject to the perception of the caller, there are many instances where the relevant GDN discovers that no emergency exists once the reason for the call has been investigated.

2.32 The processing and reporting of emergency calls is broadly the same for each GDN, but there are some slight differences for calls that aren't received on the emergency number.

2.33 All of the GDNs use Cadent as an emergency call handling service and use a common emergency contact number which goes straight to Cadent's call handling centre in England. This is intended to be the primary contact number for emergencies. Having received the call, Cadent logs it, processes it and if necessary arranges for an emergency response.

2.34 Each of the companies has a contract with Cadent. Charges are based on combination of fixed and variable costs. The fixed costs for FE and PNGL are based on a monthly call threshold which varies throughout the year on

the basis of the numbers of calls received in the past. For SGN this threshold is fixed at 50 calls per month. If call numbers remain below this threshold then there are no additional cost over and above the fixed monthly charge. If call numbers go above the threshold then they are charged at the variable rates specified in the contract for each type of call.

2.35 The GDNs also have direct lines on which they can be contacted for non-emergency matters. Inevitably some emergency calls come through on these business numbers. In most cases they are then simply transferred to Cadent for recording and processing. However, in some cases the GDN will record the details and arrange the response themselves.

2.36 The Cadent emergency call centre operates around the clock, whereas the GDN customer services and business numbers have specific operating hours. General calls taken on the customer services and business numbers outside normal operating hours must be re-routed to another call handling system. Some of the GDNs use services provided by a third party, whereas others route the out-of-hours calls straight to Cadent. These contrasting strategies make direct comparisons between the GDNs more difficult.

2.37 The key driver of costs in this expenditure category is the volume of calls, which is in turn driven by the number of connections.

2.38 In previous price controls we used a combined model to forecast the volume of emergency calls that would be received based on projected connection numbers. We revisited this model for GD23 to see if it could be used again, but found it to be unsuitable due to the need to incorporate SGN into the model, the different levels of maturity of each GDN and the variations in the call handling practices used by each company. We have therefore adopted company specific approaches to estimate call numbers in GD23. The approaches adopted for each GDN are explained in the company specific Emergency Call Centre sections below. The number of connections remains the key driver for call volumes combined with consideration of historic rates of activity.

Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping)

2.39 Customer Services (including non-emergency call centre) covers non-emergency calls and which also handle enquires and complaints. The non-emergency Customer Services also includes costs of commercial/contract department that manages all types of contracts for the whole of the business

2.40 The GDNs costs for customer service and management activities are mainly driven by staff costs. Our approach to determining staff costs is discussed in section 2.106.

System Control

2.41 System control covers the costs associated with the activity of ensuring the safe flow of gas through the network, ensuring the supply is sufficient to meet the demand of gas on a daily basis. The related costs should represent the cost of running the control room (e.g. staff costs of resource working within the control room). Our approach to determining staff costs is discussed in section 2.106.

Emergency

2.42 The Emergency cost category covers the activity associated with the GDNs initial response to emergency calls received through the 'Customer Management (Emergency Call Centre)' cost category.

2.43 This activity often includes a more detailed phone discussion between the caller and a qualified member of staff who can ascertain the nature of issue and whether it is an emergency that requires further investigation. In most cases a first responder will be sent out to investigate the emergency, categorise it, and if possible, resolve it.

2.44 In some cases the initial responder will be able to rectify the issue and close the job at a relatively low cost. If this is not possible it will be scheduled for repair taking into account the urgency of the job and any mandatory response timescales. The highest priority jobs are those that involve a gas leak. They have the shortest mandatory response times and are dealt with under the 'Publically Reported gas Escape' (PRE) Repair cost category.

2.45 The contractors used to undertake emergency jobs are often redirected from the other work activities that they also undertake for the companies to deal with these more urgent issues.

2.46 There are legal obligations regarding the response time for Emergency Jobs and first responders. These apply to all the GDNs regardless of the number of customers served, or the size and layout of their operational area. Consequently the GDNs need to ensure that they have sufficient resources, situated in suitable locations and supported by appropriate operational practices to allow them to meet their mandatory obligations.

2.47 The key driver of costs in this expenditure category is the number and type of jobs, which is in turn driven by number of emergency calls received by the company. Our assessment applies historic rates for emergency jobs to projected emergency call numbers to estimate the volume of work.

2.48 In undertaking our analysis for GD23, we noted that the percentage of calls that become emergency jobs is very different across the GDNs. This

difference was investigated and found to be due to internal processing and logging methods rather than representing a real difference in customer behaviour.

Metering

2.49 Metering covers the direct maintenance activity necessary to keep the meter asset base, including ancillaries such as regulators, in good working order.

2.50 It includes a broad range of planned and reactive work, including jobs carried out in response to consumer requests. Some of the customer requested work will be off-set by contributions from consumers.

2.51 The metering cost category incorporates activities such as planned inspection of pressure regulators, battery replacement on PAYG meters, repair/replacement of meter boxes and changing the type of meter installed as a consequence of consumer requests.

2.52 It excludes other network maintenance and emergency response work which is assessed and allowed for separately under different cost categories within the draft determination.

2.53 Our assessment for routine and non-routine activities considered how the expenditure projections submitted compare to historic activities and costs, after the proposed increase in the customer asset base is taken into account.

2.54 We have paid particular attention to costs and activities that are not reflective of past experience and where material cost increases are evident. This includes how routine maintenance projections align with the age of assets and the required frequency of activity based on industry guidance or best practice.

2.55 During GD23 the impact of an update to BS 6400 legislation, which moves the inspection timetable for medium pressure B6 regulators from 10 years to 5 years, will come into effect. These are the regulators used in domestic meters and because of the large numbers involved, this change will have a material impact on GDN activity levels and associated costs.

2.56 As part of our assessment we have considered how the GDNs have interpreted and applied this requirement. As the update came into effect on 31 December 2018, we consider that it applies from 1 January 2019 in practice. On this basis, our view is that the first 5 years inspections would be required in 2024 (i.e. 5 years later) and so we have excluded any related costs submitted by any GDN for 2023.

2.57 All of the GDNs have extended the 'principle' of the introduction of 5 year regulator inspections to medium pressure U16, U25 and U40 meter installations even though the new guidance only specifically applies to U6 meter installations. We have accepted this on the basis that it follows the practice adopted previously for 10yr inspections.

2.58 In our GD23 approach document we noted that we are proposing the transfer of meter reading responsibility from Suppliers to GDNs. This work is being progressed in parallel to the GD23 process and does not form part of the submissions made by the GDNs or our draft determination. Further details on this work stream and ongoing work to implement a common solution for domestic pre-payment meters can be found in Chapter 2 of the draft determination main document. This section of the main document also explains how any associated changes and costs might be dealt with.

PRE Repairs

2.59 The 'Publically Reported gas Escape' (PRE) Repair cost category covers the activity associated with the repair of mains and/or services where there is an escape of gas. These jobs arise when the initial first responder identifies that the emergency involves a gas leak and sends a crew to isolate the leak and effect the repair.

2.60 The contractors used to undertake the repairs are often redirected from the other work activities that they also undertake for the companies to attend these more urgent jobs.

2.61 As with Emergency Jobs, there are legal requirements regarding the response time that a company must meet when undertaking PRE Repairs and similar considerations with regard to the ability to meet these mandatory timescales apply. These requirements apply to all the GDNs regardless of the number of customers served, or the size and layout of their operational area.

2.62 Due to the safety implications associated with the escape of gas, PRE Repairs are considered the most urgent emergency jobs and have the shortest mandatory response times.

2.63 The key driver of costs in this expenditure category is the number of emergency jobs. Our assessment estimates the volume of work by applying historic rates for the number of PRE jobs to projected figures for the total number of jobs.

2.64 There are four categories of PRE Repairs. These are distinguished by the cause of the gas escape (third party damage or otherwise) and the type of asset (mains or services).

2.65 Third party damage is generally accidental damage caused when a third party is working in the vicinity of gas mains or services. In this circumstance the cost of the repair can be either be partially or fully recovered from the party at fault. Within the price control process, allowances are reported net of third party contributions.

Maintenance

2.66 Maintenance covers the direct activity necessary to keep the gas network in safe working order.

2.67 It includes a broad range of planned and reactive work on a range of network assets such as gas mains, pressure reduction stations, valves, telemetry installations and customer connections. This includes jobs carried out in response to customer requests, some of which will be off-set by contributions from consumers.

2.68 It excludes meter maintenance and emergency response work which is assessed and allowed for separately under different cost categories within the draft determination.

2.69 Our assessment for routine and non-routine activities, considered how the expenditure projections submitted compare to historic activities and costs, after the proposed increase in the customer asset base is taken into account.

2.70 We have paid particular attention to costs and activities that are not reflective of past experience and where material cost increases are evident. This includes any new work items introduced by GDNs, for example due to safety concerns, which have been considered on an individual basis.

Other Direct Activities

2.71 We assessed any costs for other direct activities on a case-by-case basis. The GDNs costs for other direct activities are mainly driven by staff costs. Our approach to determining staff costs is discussed in section 2.106.

IT & Telecoms

2.72 The IT & Telecoms cost category covers the provision of IT services for day to day service delivery and includes e.g. costs for Graphical Information Systems (GIS).

2.73 We have reviewed actual costs incurred and assessed the requested allowances against these in most circumstances. We have also benchmarked IT and Telecoms cost between the GDNs and reviewed the forecast split between opex and capex costs were appropriate.

Property Management

2.74 The Property Management cost category covers the activity of managing, providing and maintaining non-operational premises. This includes costs such as rent, rates (business), utilities costs including electricity, gas and water, maintenance/repair costs of premises and the provision of the facilities/property services such as reception, security, access, catering, mailroom, cleaning and booking conferences.

2.75 A significant element of property management costs relates to network rates. Our approach to this specific expenditure type is covered below from paragraph 2.111.

2.76 For other expenditure types under this cost category, we have reviewed actual costs incurred and assessed the requested allowances against these.

HR & Non-operational Training

2.77 This cost category covers provisions of the HR function i.e. the full range of professional activity for an individual's career path from recruitment to retirement and post retirement where applicable, e.g. management and administration of pension payments and from related professional advice to directly resolving grievances for staff.

2.78 We have reviewed actual costs incurred and assessed the requested allowances against these.

Audit, Finance & Regulation

2.79 This cost category covers performing the statutory, regulatory and internal management cost and (business support activity) performance reporting requirements as well as the customary financial and regulatory compliance activities for the network.

2.80 We have reviewed actual costs incurred and assessed the requested allowances against these. We have also benchmarked the costs associated with undertaking price controls between the GDNs given that the work undertaken for price controls is of a very similar nature for all of the GDNs.

Insurance

2.81 This cost category covers support and expertise to develop the business risk profile, managing the claims process as well as provision of information and understanding to the business in relation to insurable and uninsurable risks.

2.82 We have undertaken a detailed review of the cost make-up of the insurance sub categories. This involved assessing requested allowances against

actual costs occurred as well as reviewing GDNs insurance costs over the medium term.

Procurement

2.83 This cost category covers the procurement of goods and services in the support of the business operations, through the management of procurement contracts with suppliers.

2.84 We have reviewed actual costs incurred and assessed the requested allowances against these.

CEO & Group Management

2.85 This cost category covers costs related to communications, group strategy, legal department, corporate responsibility and investor relations, board members, incremental ring fence compliance and credit reference agencies.

2.86 We have reviewed actual costs incurred and assessed the requested allowances and benchmarked were appropriate. For SGN CEO & Group Management costs relate to Managed Service Agreements (MSA) with other group companies. Our approach to SGN Group Management costs is outlined in section 6.106.

Stores & Logistics

2.87 This cost category covers the activity of managing and operating stores.

2.88 We have reviewed actual costs incurred and assessed the requested allowances against these.

Advertising & Market Development

2.89 This cost category covers costs related to advertising, marketing and PR, incentives as well as sales related staff and shared corporate overheads.

2.90 The costs for Advertising & Market Development are classified into the following two categories:

- Advertising & Market Development - Owner Occupied (OO) properties;
- Advertising & Market development (Non-OO) properties

2.91 OO properties are those domestic premises which do not fall into the definition of:

- Domestic New Build; or

- NIHE or Housing Association

In line with this definition, OO properties can also include private rented properties. Non-OO properties comprise all other domestic / domestic and I&C (Industrial and Commercial) properties.

2.92 Our approach to Advertising & Market Development for owner occupied properties has been informed by our review of the connection incentive.

2.93 Our approach to Advertising & Market Development for non-owner occupied properties was to review actual costs incurred and to assess the requested allowances against them, taking account of projected growth in non-owner occupied connections in the price control period.

2.94 We have given consideration to the apportionment of staff between the owner occupied and non-owner occupied categories. In doing so, we have considered both actual costs incurred and projected growth in connections for both categories.

Trainees & Apprentices

2.95 This cost category covers (i) the costs of any operational training and (ii) the cost of training any employees engaged on approved formal training or apprentice programmes (either operational or non-operational).

2.96 We have reviewed actual costs incurred and assessed the requested allowances against these.

Non-Controllable Opex

2.97 This cost category covers costs that are deemed as not being within the direct control of the GDN. In the GD17 price control, the only non-controllable cost allowed was licence fees.

2.98 For the GD23 price control, we have reviewed all items suggested to be non-controllable by the GDNs on a case-by-case basis to assess the appropriateness of this proposed classification. For the GD23 draft determination we have taken a similar approach as for GD17 and allowed licence fees as non-controllable costs.

Supplier of Last Resort (SOLR)

2.99 This area refers to circumstances where we revoke a gas supplier's licence (the defaulting supplier) and then subsequently give a direction[2] to another

[2] Gas (Supplier of Last Resort) Regulations (Northern Ireland) 2009: http://www.legislation.gov.uk/nisr/2009/412/made/data.pdf

gas supply company (the SoLR supplier) to supply gas to the customers of the defaulting supplier. In a SoLR event, our intention is to direct a supplier within each distribution network area to be the SoLR supplier.

Shrinkage

2.100 The Shrinkage Factor is used to attribute shrinkage to gas flows and related suppliers, and is ultimately passed through to supplier tariffs, paid for by customers.

2.101 In December 2017, the GDNs provided the Northern Ireland Shrinkage Methodology. The methodology was developed jointly by the three GDNs. It sets out what shrinkage is and how the Shrinkage Factor is to be determined.

2.102 In line with the Northern Ireland Shrinkage Methodology, the Shrinkage Factor is calculated in the following way:

2.103 $$Shrinkage\ Factor = \frac{Gas\ Leakage + Own\ Use\ Gas + Theft\ of\ Gas}{Volume\ of\ Gas}$$

2.104 where:

- Gas Leakage = Leakage from MP and LP Systems + Leakage from Pressure Reduction Installations + Leakage because of Interference Damage
- Theft of Gas = Theft of Gas factor x Volume of Gas
- Own Use Gas = Own use Gas factor x Volume of Gas

2.105 It is noted that whilst the methodology and formula for calculating the shrinkage factor is consistent across the three GDNs, the actual shrinkage factor, and the relative importance of the different shrinkage components, can differ due to specifics of the networks.

Staff Costs and Agency Costs

2.106 Staff Costs include any form of payment, consideration or other benefit, paid or due to or in respect of employees. This also covers all staff-related additional costs that can be calculated using the presented drivers (for example, commission, entertainment, allowances, travel & subsistence, car allowance and fleet costs). Agency Costs cover costs for persons who are not under a direct contract of employment with the GDN or an affiliate of the GDN, but are hired through a third party or employment agency.

2.107 Staff Costs and Agency Costs form part of most of the cost categories within the Business Plan and Annual Cost Reporting Templates; however, they are not a cost category in themselves.

2.108 For this reason, we have not set an individual allowance for Staff Costs and Agency Costs as part of the GD17 price control, and we have applied a similar approach for the GD23 price control.

2.109 We have reviewed actual costs incurred and assessed the requested allowances against these, taking into consideration any evidence provided by the GDNs as to why the projected Full-Time Equivalents (FTE) and associated costs should differ from the base year and medium term historic actuals.

2.110 In addition, we have assessed assumptions around all inputs/driver data for Staff Costs and Agency Costs for reasonableness through benchmarking and actual outputs from previous years, where deemed appropriate.

Network Rates

2.111 This cost category covers the prescribed rates levied on distribution network assets.

2.112 For determining network rates allowances, we have retained the formula-based calculation in relation to network rates in line with our approach for the GD17 price control. However, we have considered whether the multiplier assumptions applied to revenue and the agreed rateable values as advised by the Land & Property Services (LPS) should be adjusted. For the draft determination we have profiled a 'flat rate in the pound' for all years in GD23 for all the GDNs and this is a consistent approach to network rates for both FE and SGN in GD17.

2.113 We expect GDNs to be able to demonstrate that they have taken all steps to minimise their rates valuations and have considered any related evidence presented.

Capitalisation

2.114 We have assessed the capitalisation policies and resulting proposed capitalisation rates with specific focus on any differences compared to those used in previous years.

2.115 Further work will continue on this area for the Final Determination, to address any areas arising.

Real price effects, productivity and frontier shift

2.116 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

2.117 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH). Given the CPIH is no more a measure of general inflation than RPI, not all types of cost changes will be reflected in the range of prices used to calculate the CPIH. To account for this it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

2.118 Their calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs), and the projected rate of productivity growth. The sum of these components can be a positive or a negative difference.

2.119 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

2.120 We have adopted the methodology we first introduced at PC13, PC15 and PC21 for NI Water, which aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

2.121 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	4.4	3.8	2.9	2.3	2.8	3.3	3.3	3.3
CPIH	(2.9)	(4.0)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift	CPIH + 0.4	CPIH -1.2	CPIH -0.2	CPIH -0.8	CPIH -0.3	CPIH +0.1	CPIH +0.1	CPIH +0.1
Cumulative frontier shift	0.4	-0.8	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8

Table 2.1: GD23 Opex frontier shift calculations

2.122 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

2.123 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

3. Price Control Submissions - Opex

Overview

3.1 This chapter is complemented by the introduction and price control submissions chapters in the main GD23 draft determination document.

3.2 The introduction chapter in the main GD23 draft determination document provides a high-level overview of the GDNs' networks and the strategic context within which the price control is undertaken. This sets the scene, and forms the basis, for the business plan submissions, including the opex related requested allowances therein.

3.3 When assessing the appropriateness of the assumptions made and allowances requested by the GDNs as part of their business plan submissions, it is important to do this with consideration of the stage of network development at which each GDN is and of the strategic background against which the GDNs are operating.

3.4 In particular, on an overall level, the FE and PNGL networks are now well established and largely developed. As such, and subject to the new Energy Strategy for NI, further network development is anticipated to be limited going forward compared to previous price control periods. It is anticipated that the numbers of properties passed from 2024 onwards will be mainly driven by new build developments. Whilst increasing connections to maximise the use of and benefit from the network remains important, maintenance requirements can also be expected to increase as the network ages.

3.5 The SGN network is comparatively newer, and its development will continue into the GD23 price control period. Whilst SGN notes itself that it will be transitioning from a construction and infrastructure delivery company to a customer service company during the GD23 price control period, the construction of further mains, the increase in numbers of properties passed as well the increase of connections will remain important.

3.6 Whilst the price control submissions chapter in the main GD23 draft determination document provides an overview of the overall GDN performance during the GD17 price control period this chapter focuses specifically on the GDNs' opex requests.

3.7 More specifically, this chapter provides, for each GDN, an overview over the requested opex allowances, associated key targets as well as opex-related key points highlighted by the GDNs in their submissions. We note that it

does not cover our view with respect to the submissions; this is detailed in chapters 4, 5 and 6 of this document.

Firmus Energy GD23 opex requests

3.8 Table 3.1 provides an overview of the opex allowances requested by FE in its business plan submission.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	112	113	114	114	115	116	684
Operations Management	309	312	314	321	324	326	1,906
Emergency Call Centre	293	306	319	331	344	356	1,949
Customer Management	354	357	361	364	367	371	2,174
System Control	302	304	305	310	311	313	1,845
Emergency	916	985	1,054	1,124	1,194	1,265	6,538
Metering	971	1,021	1,054	1,200	1,273	1,302	6,821
Publically Reported gas Escape (PRE) Repairs	119	127	135	164	174	183	902
Maintenance	769	775	833	878	927	950	5132
Other Direct Activities	0.3	0.3	0.3	0.3	0.3	0.3	1.8
IT & Telecoms	783	711	701	724	726	729	4,374
Property Management	1,104	1,155	1,191	1,229	1,256	1,281	7,216
HR & Non-operational Training	138	139	139	140	140	141	837
Audit, Finance & Regulation	831	838	844	850	1,156	863	5,382
Insurance	326	326	326	326	326	326	1,956
Procurement	19	19	20	20	20	20	118
CEO & Group Management	226	228	229	231	232	234	1,380
Stores & Logistics	18	18	20	20	20	20	116
Advertising & Market Development - Owner Occupied (OO)	1,692	1,618	1,536	1,454	1,378	1,306	8,984
Advertising & Market Development (Non-OO)	224	226	227	229	230	232	1,368
Trainees & Apprentices	158	73	73	73	74	74	525
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	175						175
Total	9,889	9,701	9,845	10,152	10,637	10,458	60,684

Note 1. Figures may not sum due to rounding.

Table 3.1: FE opex requests as per business plan submission, £k (Average 2020 prices)

3.9 From Table 3.2 we can observe that FE is seeking higher allowances in GD23 when compared to actual opex in 2020. On average, FE is seeking £2.9 million more allowance per year of GD23 than it spent in 2020, which is a real increase of 40%.

3.10 FE expects to deliver more connections on average in GD23 than it delivered in 2020. This reflects the FE plan for developing its network in the GD23 period. The projected connections are significantly higher than those achieved in 2020 (2,604), but marginally less than those which FE expects to connect in 2021 (3,695) and 2022 (3,961).

Cost Items	2017	2018	2019	2020	2021	2022	Average GD17
	Actual	Actual	Actual	Actual	Forecast		
Opex, £m	6.9	7.1	7.0	7.2	8.7	8.7	7.6
OO Connections	2,224	2,395	3,115	2,604	3,695	3,961	2,999
Cost Items	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Average GD23 Submission**
	FE GD23 submission						
Opex, £m	9.9	9.7	9.8	10.2	10.6	10.5	10.1
OO Connections	3,852	3,685	3,524	3,371	3,224	3,084	3,457

Note 1. Figures may not sum due to rounding. Note 2. Figures for 2017 to 2020 exclude HA.

Table 3.2: FE GD23 Submission, £m

3.11 In addition to requested opex allowances, FE has also set out in its business plan submission its targets for additional properties passed, connections and volumes as shown in Table 3.3.

	2023	2024	2025	2026	2027	2028	GD23 Total
Properties Passed	3,514	1,643	1,584	1,514	1,507	1,500	11,262
Connections	6,500	6,335	6,171	6,016	5,866	5,724	36,612
Volume (million therms)	2.9	3.9	2.2	2.1	1.6	1.4	14.1

Note 1. Figures may not sum due to rounding.

Table 3.3: FE additional properties passed, connections and volumes as per business plan submission

3.12 Table 3.4 shows FE's forecast of the total properties passed numbers, connection numbers and volumes for each year in the GD23 price control period.

	2023	2024	2025	2026	2027	2028
Properties Passed (in thousands)	195.6	197.3	198.9	200.4	201.9	203.4
Connections (in thousands)	73.0	79.3	85.5	91.5	97.4	103.1
Volume (million therms)	75.5	79.4	81.6	83.7	85.3	86.7

Note 1. Figures may not sum due to rounding.

Table 3.4: FE total properties passed, connections and volumes as per business plan submission

3.13 FE has highlighted in their business plan submission the following key points:

- Enhanced focus on maintenance related activities associated with growth, maturity and safety of the network and to comply with changing requirements (e.g. increase in frequency of inspection of medium pressure regulators).
- Growing customer base leading to increased cost for gas emergency calls and responses.
- Increase in staff levels by circa 3.5 FTEs compared to current levels, of which three FTEs to reflect the uplift in maintenance activities and half an FTE to cover additional regulatory reporting and stakeholder engagement (including with respect to consumer protection).
- Requested increase in connection incentive allowance for OO connections to reflect increased advertising and marketing requirements.
- Anticipated increase in network rates payable to LPS, calculated as a function of FE's conveyance revenue.
- Increase in professional and legal fees by circa £300k in the pre-last year of the price control period to reflect consultancy advice required with price control reviews.
- Projected increase in IT Cost with forecasts reflective of incremental customer and staffing requirements, current managed service contract for IT and projected costs for the licencing and use of a new IT platform, forecast to be purchased in 2022.
- Sustained higher level of insurance costs following significant increase in 2021 driven by the Covid-19 pandemic and Brexit.

Phoenix Natural Gas GD23 opex requests

3.14 Table 3.5 provides an overview of the opex allowances requested by PNGL in its business plan submission.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	282	282	282	282	282	283	1,693
Operations Management	563	564	552	553	554	555	3,341
Emergency Call Centre	461	461	461	461	461	461	2,766
Customer Management	884	870	859	861	861	861	5,196
System Control	146	146	146	146	146	146	876
Emergency	1,443	1,471	1,488	1,518	1,548	1,578	9,046
Metering	1,541	2,414	2,453	2,682	2,591	2,685	14,366
Publically Reported gas Escape (PRE) Repairs	934	946	956	968	981	995	5,780
Maintenance	3,277	2,901	2,588	2,276	2,253	2,221	15,516
Other Direct Activities	0	0	0	0	0	0	0
IT & Telecoms	535	535	581	575	578	575	3,379
Property Management	3,681	3,790	3,855	3,994	4,061	4,594	23,976
HR & Non-operational Training	272	273	273	273	273	273	1,637
Audit, Finance & Regulation	1,069	1,066	1,067	1,068	1,168	1,170	6,608
Insurance	1,054	1,063	1,066	1,071	1,080	1,089	6,423
Procurement	78	78	78	78	78	78	468
CEO & Group Management	1,785	1,785	1,785	1,786	1,786	1,786	10,713
Stores & Logistics	32	32	32	32	32	32	192
Advertising & Market Development - Owner Occupied (OO)	1,323	1,321	1,318	1,278	1,277	1,277	7,794
Advertising & Market Development (Non-OO)	542	545	548	542	544	545	3,266
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	158	158	158	158	158	158	948
Supplier of Last Resort	343						343
Total	20,403	20,701	20,546	20,602	20,712	21,362	124,328

Note 1. Figures may not sum due to rounding.

Table 3.5: PNGL opex requests as per business plan submission, £k (September 2020 prices)

3.15 From Table 3.6 we can observe that PNGL is seeking higher allowances in GD23 when compared to actual opex in 2020. On average, PNGL is

seeking £4.8 million more allowance per year of GD23 than it spent in 2020, which is a real increase of 30%.

3.16 PNGL expects to deliver less connections on average in GD23 than it delivered in 2020. This reflects the PNGL plan for developing its network in the GD23 period. The projected connections are significantly lower than those achieved in 2020 (5,311), and less than those which PNGL expects to connect in 2021 (5,000) and 2022 (4,700).

Cost Items	2017	2018	2019	2020	2021	2022	Average GD17
	Actual	Actual	Actual	Actual	Forecast		
Opex, £m	15.4	15.2	15.7	15.9	17.5	18.4	16.4
OO Connections	5,350	5,970	6,334	5,311	5,000	4,700	5,444
Cost Items	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Average GD23 Submission**
	PNGL GD23 submission						
Opex, £m	20.4	20.7	20.6	20.6	20.7	21.4	20.7
OO Connections	4,522	4,159	3,727	3,612	3,502	3,396	3,820

Note 1. Figures may not sum due to rounding.

Table 3.6: PNGL GD23 Submission, £m

3.17 In addition to requested opex allowances, PNGL has also set out in its business plan submission its targets for additional properties passed, connections and volumes as shown in Table 3.7.

	2023	2024	2025	2026	2027	2028	GD23 Total
Properties Passed	5,579	3,265	3,365	3,465	3,564	3,564	22,802
Connections	7,322	7,059	6,727	6,637	6,627	6,521	40,893
Volume (million therms)	1.9	1.7	1.5	1.3	1.2	1.1	8.6

Note 1. Figures may not sum due to rounding.

Table 3.7: PNGL additional properties passed, connections and volumes as per business plan submission

3.18 Table 3.8 shows PNGL's forecast of the total properties passed numbers, connection numbers and volumes for each year in the GD23 price control period.

	2023	2024	2025	2026	2027	2028
Properties Passed (in thousands)	368.7	371.9	375.3	378.8	382.3	385.9
Connections (in thousands)	258.0	265.0	271.7	278.4	285	291.5
Volume (million therms)	167.3	169	170.5	171.8	172.9	174

Note 1. Figures may not sum due to rounding.

Table 3.8: PNGL total properties passed, connections and volumes as per business plan submission

3.19 PNGL has highlighted in their business plan submission the following key points:

- Increasing maintenance and inspection programme to ensure PNGL's network continues to deliver a safe and reliable supply of gas to consumers as well as meeting changing legislative requirements (e.g. increase in frequency of inspection of medium pressure regulators).
- Anticipated increase in network rates payable to LPS.
- Sustained higher level of insurance costs following significant increase in 2021, driven by a hardening of the market in respect of Business Interruption insurance and Directors and Officers insurance and the anticipation of crime and cybersecurity attacks on companies to be becoming increasingly prevalent.
- Growing customer base leading to increased cost for provision of emergency service.
- Growing customer base and reduction of infill activities leading to increased cost for PRE Repairs.
- Changes to staff levels (both for the last two years of GD17 into the new price control period and for the new price control period itself) to support increasing maintenance programme and reinforcement, reflect reduction in domestic sales based on forecast connection activity and account for additional operational regulatory requirements (relating e.g. to NI's energy transition, consumer engagement, consumer protection and vulnerability as well as to the ongoing review of metering solutions and meter reading responsibility).
- Proposed continuation of connection incentive, with costs allocated to this mechanism expected to be similar to GD17 in the first half of GD23 and to then slightly reduce with reduction in sales force as the forecast level of connection reduces.

- Anticipated change in the profile of some IT costs from capex to opex as a result of IT suppliers moving to annual product licensing rather than perpetual licences.

- Increase in annual costs of audit, finance and regulation in the last two years of the GD23 price control period due to workload implications and need for specialist support during times of price control.

SGN Natural Gas GD23 opex requests

3.20 Table 3.9 provides an overview of the opex allowances requested by SGN in its business plan submission.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	40	40	43	60	47	47	277
Operations Management	247	247	269	279	281	281	1,604
Emergency Call Centre	105	105	105	106	138	138	697
Customer Management	48	48	64	65	67	67	359
System Control	53	53	55	56	58	58	333
Emergency	176	180	184	198	193	195	1,126
Metering	80	84	132	151	185	205	837
Publically Reported gas Escape (PRE) Repairs	13	13	15	16	17	17	91
Maintenance	449	575	468	463	513	498	2,966
Other Direct Activities	6	6	6	6	6	6	36
IT & Telecoms	136	136	136	138	145	145	836
Property Management	319	381	394	408	424	441	2,367
HR & Non-operational Training	11	11	11	11	12	12	68
Audit, Finance & Regulation	322	322	322	353	714	414	2,447
Insurance	8	8	8	8	8	8	48
Procurement	6	6	6	6	7	7	38
CEO & Group Management	400	400	400	400	650	500	2,750
Stores & Logistics	0	0	0	0	0	0	0
Advertising & Market Development - Owner Occupied (OO)	1,286	1,246	1,263	1,334	1,324	1,320	7,773
Advertising & Market Development (Non-OO)	376	419	474	591	564	545	2,969
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	85						85
Total	4,216	4,329	4,404	4,702	5,403	4,955	28,008

Note 1. Figures may not sum due to rounding.

Table 3.9: SGN opex requests as per business plan submission, £k (Average 2020 prices)

3.21 From Table 3.10 we can observe that SGN is seeking higher allowances in GD23 when compared to actual opex in 2020. On average, SGN is seeking

£2.1 million more allowance per year of GD23 than it spent in 2020, which is a real increase of 81%.

3.22 SGN expects to deliver a similar number of connections on average in GD23 than it delivered in 2020. This reflects the SGN plan for developing its network in the GD23 period. The projected connections are broadly in line with those achieved in 2020 (593), and less than those which SGN expects to connect in 2021 (752) and 2022 (811).

Cost Items	2018	2019	2020	2021	2022	Average GD17
	Actual	Actual	Actual	Forecast		
Opex, £m	1.1	1.5	2.6	3.7	3.4	2.5
OO Connections	127	82	593	752	811	473
Cost Items	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Average GD23 Submission**
	SGN GD23 submission						
Opex, £m	4.2	4.3	4.4	4.7	5.4	5.0	4.7
OO Connections	623	593	599	652	643	640	625

Note 1. Figures may not sum due to rounding.

Table 3.10: SGN GD23 Submission, £m

3.23 In addition to requested opex allowances, SGN has also set out in its business plan submission its targets for additional properties passed, connections and volumes as shown in Table 3.11.

	2023	2024	2025	2026	2027	2028	GD23 Total
Properties Passed	2,944	2,873	3,181	4,414	1,794	1,736	16,942
Connections	972	933	984	1,122	977	1,017	6,005
Volume (million therms)	1	1	1	1	1	1	5.2

Note 1. Figures may not sum due to rounding.

Table 3.11: SGN additional properties passed, connections and volumes as per business plan submission

3.24 Table 3.12 shows SGN's forecast of the total properties passed numbers, connection numbers and volumes for each year in the GD23 price control period.

	2023	2024	2025	2026	2027	2028
Properties Passed (in thousands)	30.0	32.9	36.1	40.5	42.3	44.0
Connections (in thousands)	4.4	5.3	6.3	7.4	8.4	9.4
Volume (million therms)	30.6	31.4	32.3	33.1	34.1	35.0

Note 1. Figures may not sum due to rounding.

Table 3.12: SGN total properties passed, connections and volumes as per business plan submission

3.25 SGN has highlighted in their business plan submission the following key points:

- Increased cost for inspection and maintenance as network grows and ages.
- Anticipated increase in retainer for emergency call centre provision from 2027 onwards.
- Growing network leading to increased number of PREs that require attendance and associated cost.
- Increase in IT costs in line with projected number of connections.
- Anticipated increase in network rates payable to LPS.
- Consultancy support annually with focus on regulatory modelling in addition to support preparation of the next price control.
- Increased cost for business support under a managed service agreement with the SGN group, reflective of the expanded service requirements as the business grows as well as additional group regulation support in preparation of the next price control.
- Anticipated increase in staff levels by circa 12.4 FTEs at the start of the price control period and 17.4 FTEs by the end of the price control period compared to 2020 levels, in line with the growth of the network and additional connections.

4. Firmus Energy - UR Proposals

Overview

4.1 As set out in chapter 2, we have used bottom-up analysis as the basis for our assessment of opex business plan requests.

4.2 We note that, in line with our detailed approach set out in chapter 2, we have assessed the requested opex allowances for the different cost categories. We have also undertaken additional analyses for selected expenditure types and proposed capitalisation policies. The bottom-up part of this chapter is structured accordingly.

4.3 We note furthermore that, in line with our detailed approach set out in chapter 2, we have generally used the most up to date detailed actuals as part of our assessment of business plan requests, i.e. data relating to 2020. We consider that this provides a sound basis to inform a benchmark where appropriate. In some circumstances, however, there were good reasons for deviating from this approach, and a further explanation is given in the relevant areas.

4.4 As was the case for the GD17 price control, greater scrutiny has been exercised over those cost categories that represent the greatest cost or where a material cost change is evident. We have also considered the extent to which some cost items must be separately examined because of the particular way they are treated (e.g. pass-through), or due to other specific circumstances they warrant individual treatment, irrespective of their magnitude.

4.5 The FE Supply business is undergoing a price control (SPC 23) in 2022, which is due to take effect from the 1 January 2023. We are reviewing this work area alongside GD23 to examine any connected issues/areas as appropriate, including costs classified as either capex or opex and the split of FTEs and costs between the two businesses. We intend to update the GD23 final determination to take account of this workstream.

4.6 In its GD23 submission FE advised that it had applied a cost pressure uplift of 5% to the unit rates for work due to be completed by its period contractor in GD23. Other GDNs have applied similar uplifts to capex but FE is the only GDN that has extended the application to its opex cost categories (e.g. maintenance and emergency activities). Consistent with our approach for capex, we have removed this uplift from contactor cost allowances when undertaking our opex assessments. Any other cost challenges applied have been calculated net of the 5% uplift to ensure there is no double counting.

Operating leases

4.7 FE informed us in its GD23 business plan submission that 'during 2019, the Company applied IFRS16 Leases resulting in recognition of lease assets, particularly building rental and motor vehicle leases, on the balance sheet with amortisation of those assets reflected through the Income Statement. While this is still a real cost to FE, this change effectively moved the lease costs from operating costs to an amortisation cost' and 'to aid comparison to the GD17 Determination and to ensure these cost allowances are not overlooked, building rental and motor vehicle leases have been treated as operating costs in our GD23 submission'.

4.8 We note however that these costs were excluded by FE when it compared its 2020 costs to GD17 final determination allowances although FE did discuss these leases, for example, the FE 2020 annual cost and reporting template commentary states 'costs for building rental and vehicle leasing (circa £100k) are no longer reported in our operating costs and this is part of the reason why operating costs are lower than determined allowances'. While we have taken account of these leases for the GD23 draft determination we have also modified FE opex analysis of opex performance against GD17 determination allowances to take account of these leases.

4.9 Our approach to determining the value of operating leases into the GD23 period has been to roll forward actual costs of operating leases from the 2020 year. The value of these leases was circa £38k for vehicles and circa £60k for buildings.

Bottom-up assessment

Manpower

4.10 Given that manpower is such an integral part of the price control, we consider the number of FTE necessary to run an efficient business; it is therefore appropriate to determine the cost allowance at the overall manpower level.

4.11 In common with GD17, we have not set explicit FTE allowances for the individual cost categories, since manpower forms part of most of the cost categories within the Annual Cost Reporting Template, rather than being an individual cost category. We consider that it is the choice of the GDN to decide where to allocate its resources, as business needs develop.

	GD17					
	2017	2018	2019	2020	2021	2022
FE Requested Allowances	67.2	67.2	67.2	67.2	67.2	67.2
UR Determination	58.3	58.3	58.3	58.3	58.3	58.3
FE Actual	58.1	63.7	66.6	70.3	70.5	71.7
	GD23					
	2023	2024	2025	2026	2027	2028
FE Requested Allowances	71.8	71.8	72.8	73.8	73.8	73.8
UR Determination	68.8	68.7	69.1	69.6	69.8	69.7

Note 1. Figures may not sum due to rounding. Note 2. The years 2021 -2022 are forecast.

Table 4.1: FE FTEs Requested, Actuals and GD23 Determined

4.12 Table 4.1 sets out the FE requested allowances for FTEs for both GD17 and GD23. It can be observed that FE actual number of FTEs for 2020 was above our GD17 allowances by 20%. It can also be observed that FE's FTEs have also increased by 20% since 2017. Over the same period FE customer numbers have grown by 22,443. This contrasts to PNGL who over the same period reduced FTEs by 2.5% while its customer numbers grew by 34,747.

4.13 FE has requested further increases in FTEs in the GD23 period across a range of cost areas such as asset management, system control and audit, finance and regulation.

4.14 However, we do not agree that the level of resources requested by FE is appropriate. We have therefore based the level of FTEs on the 2020 level of FTEs and taken account of areas where FE have acknowledged they require less resources such as Customer Management and AMD (non-OO). We have however provided for an additional FTE for 'energy transition'.

Asset Management

4.15 FE Asset Management costs are in the main driven by its associated manpower costs. In the 2020 year, FE had Asset Management costs of £121k and had 1.9 FTEs. FE has proposed an additional 1.29 FTEs in each of the GD23 years when compared to 2020. FE also incurred £36k in professional and legal fees in 2020.

4.16 For the draft determination we have allowed for 1.9 FTEs which is in line with our allowance for GD17 as well as FE's long run historic actuals. In GD17 we noted that in GD14 we had previously allowed FE sufficient manpower resources to undertake their plans to develop and implement an asset management system for network maintenance. We understand that FE has

now achieved its Asset Management ISO55001 accreditation and therefore has implemented its asset management system. Consequently, we have not accepted the proposed increase in FTEs versus 2020 actuals.

4.17 We have accepted FE projections for professional and legal fees of £19k given they are in line with medium term recent historical average costs.

	2023	2024	2025	2026	2027	2028
FE requested allowances	112	113	114	114	115	116
UR Draft Determination	88	88	88	88	88	88
Variance	(24)	(25)	(26)	(26)	(27)	(28)

Note 1. Figures may not sum due to rounding.

Table 4.2: Asset Management Costs, Requested and Allowed, £k

Operations Management

4.18 FE Operations Management costs are in the main driven by its associated manpower costs. In the 2020 year FE had Operations Management costs of £225k and had 13.0 FTEs employed within the Operations Management cost category. Within the £225k actual costs there was a £29.5k bad debt charge.

4.19 FE has proposed a marginal increase in FTEs in the GD23 period of 0.19 FTEs on average. We have accepted this for the draft determination as we previously provided for an increase in FTEs in this area in GD17 i.e. to 13.77 FTEs and the requested amount of FTEs from FE is lower than this level.

4.20 FE has requested £4.7k p.a. for professional and legal fees. We have accepted this for the draft determination as it in line with medium term average historical actuals. FE also requested £29.5k p.a. for bad debt. We have not accepted this for the draft determination as it is inconsistent with FE's medium term historical average actual. We also note that no other GDN has projected this type of cost and we consider that it is for FE to recover any bad debt.

	2023	2024	2025	2026	2027	2028
FE requested allowances	309	312	314	321	324	326
UR Draft Determination	271	271	271	278	278	278
Variance	(38)	(41)	(43)	(43)	(46)	(48)

Note 1. Figures may not sum due to rounding.

Table 4.3: Operations Management Costs, Requested and Allowed, £k

Customer Management (Emergency Call Centre)

4.21 An explanation of the Customer management (Emergency Call Centre) cost category and GDN arrangements for dealing with emergency calls is provided in the 'bottom-up assessment' section of this annex, starting at 2.30 above. This also explains why we were unable to use the combined modelling technique applied in previous price controls to project call volumes for the GDNs and therefore moved to company specific assessments for GD23.

4.22 Our Emergency Call Centre assessment for FE applies individual call volume figures per 10,000 customers to existing and new customers respectively. These figures were provided to us by the company through the query process. We have estimated call volumes for the draft determination by multiplying these figures by the customer numbers we have forecast for GD23.

4.23 Our forecast for the number of additional connections in GD23 is about 11% lower than the company's, which has led to a reduction of around 5,000 calls over the period.

4.24 FE uses two call handling services. Cadent is the emergency call centre that deals with calls received on the emergency contact number. Message Pad provides an out of hours service that deals with calls received on other numbers and an overflow service during normal working hours. The out of hours calls received by Message Pad would normally be dealt with by FE staff during normal working hours. Both call centres can receive, triage, action and report on emergency calls, although Cadent receives the majority of emergency calls.

4.25 When determining the suitable cost allocation for FE's Emergency Costs we used the company's submitted rates for both Cadent and Message Pad.

4.26 Section 2.34 of this document explains that the emergency call handling agreement with Cadent includes a monthly threshold for the number of calls covered by a fixed fee. In their business plan submission FE applied a reduction of circa 31% to the number of calls covered by the contractual fixed cost threshold when estimating its costs. FE advised it had made this adjustment to account for seasonal call variance and the fact that the monthly threshold can be exceeded without the annual total being exceeded.

4.27 This approach resulted in FE allowing for a higher number of calls charged at contractual variable rates. In our draft determination we have estimated variable cost allowances on the basis of exceedance of the annual call threshold total. This follows the approach we adopted in GD17. This is on the basis that predicting exceedances in any month is not possible and that

the fixed cost threshold profile agreed with Cadent should reflect seasonal variances.

4.28 With regard to the percentage of calls taken by each call service provider, FE assumed that Cadent's proportion would increase (as a percentage of the overall number of calls received) during the price control period. This resulted in an increasing cost forecast over the period as Cadent's costs per call are higher.

4.29 Our draft determination assumes that the relative proportions will not change. We have therefore calculated the average percentage of the total number of calls taken by each service provider in the first four years of GD17 and applied this throughout the GD23 period.

	2023	2024	2025	2026	2027	2028
FE requested allowances	293	306	319	331	344	356
UR Draft Determination	221	227	233	238	243	248
Variance	(72)	(79)	(86)	(93)	(101)	(108)

Note 1. Figures may not sum due to rounding.

Table 4.4: Customer Management Costs (Emergency Call Centre), Requested and Allowed, £k

Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping)

4.30 FE actual 2020 customer management costs were driven by its associated manpower costs. In the 2020 year FE had customer management costs of £334k and had 11.4 FTEs employed within the Customer Management cost category. FE has proposed a marginal decline in FTEs for Customer Management in the GD23 period i.e. from 11.4 FTEs in 2020 to 10.1 FTEs in the GD23 period.

4.31 For the draft determination we have accepted the projections by FE for FTEs and rolled this forward with 2020 actual staff costs.

	2023	2024	2025	2026	2027	2028
FE requested allowances	354	357	361	364	367	371
UR DD before re-allocation	295	295	295	295	295	295
Variance	(59)	(62)	(66)	(69)	(72)	(76)

Note 1. Figures may not sum due to rounding.

Table 4.5: Customer Management Costs (Including Non-Emergency Call Centre) & Network Support (Including System Mapping), Requested and Allowed, £k

System Control

4.32 FE system control costs are in the main driven by its associated manpower costs. In the 2020 year FE had manpower costs of £160.5k and had 3.55 FTEs employed within the System Control cost category. FE has proposed an additional 0.6 FTEs for System Control in the GD23 period.

4.33 For the draft determination we have rolled forward the 2020 FTEs and staff costs and therefore not allowed the proposed increase in FTEs. For GD17 we allowed FE an increase of 1.4 FTEs in system control to a total of 4.45 FTEs in the GD17 period due to the envisaged impact of customer switching, when other suppliers entered the market place. However, we note that no supplier for domestic customers has subsequently entered the market. We will keep the levels as set in GD17, to ensure that switching capacity is available, based on the Network code requirements.

4.34 In the 2020 year FE also incurred professional and legal costs of £92k and we have rolled this forward for the GD23 period as this is in line with medium term historical actuals.

	2023	2024	2025	2026	2027	2028
FE requested allowances	302	304	305	310	311	313
UR Draft Determination	242	242	242	243	243	243
Variance	(60)	(62)	(63)	(67)	(68)	(70)

Note 1. Figures may not sum due to rounding.

Table 4.6: System Control Costs, Requested and Allowed, £k

Emergency

4.35 The Emergency cost category relates to the costs and activities associated with the initial callout and response to an emergency call from the public that requires further investigation.

4.36 Dispatch can either come from the emergency call centre or the company's own customer contact centre. For FE this activity is undertaken by Kier Group.

4.37 In some cases the emergency call is closed without a visit as it is possible to resolve the issue over the phone. In most cases however, a trained first responder is sent to the location in question to determine the nature and severity of the incident. Further details on this cost category and company approaches to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.42 above.

4.38 The key driver of cost in this expenditure category is the number of jobs, which in turn is driven by number of emergency calls received by the company. Our assessment applies historic rates of jobs to projected emergency call numbers to estimate the volume of work in GD23.

4.39 The number of emergency calls used in our assessment was taken from our 'Emergency Call Centre' analysis. This estimated a total number of calls which was around 5,000 less than that submitted by FE. Further details on this analysis can be found in the Customer Management (Emergency Call Centre) section of this document, starting at 4.21 above.

4.40 We then calculated the proportion of calls that became emergency jobs in the first four years of GD17 and applied this to our projected call numbers. We used a flat percentage throughout GD23 as opposed to the company's analysis which showed an increasing percentage of calls resulting in jobs in GD23. This resulted in a number of emergency jobs that was around 5,100 lower than the company's and a projected profile more reflective of the historic trend.

4.41 For the draft determination we accepted the submitted costs for; materials, legal and professional fees, and the cost for additional responders requested by the company. We used the GD17 costs for the contractor's management fee and GD17 unit rates to estimate costs for emergency jobs requiring a callout and those closed without a visit. Because we used historic rates we did not need to adjust for the 5% uplift that FE applied to its period contractor rates for GD23.

4.42 Our assessment for staff followed the standard methodology. As this resulted in a number which was lower than in 2020 we allowed for 2020 staffing levels throughout the period.

	2023	2024	2025	2026	2027	2028
FE requested allowances	916	985	1054	1124	1194	1265
UR Draft Determination	816	859	901	940	978	1014
Variance	(100)	(125)	(153)	(183)	(216)	(251)

Note 1. Figures may not sum due to rounding.

Table 4.7: Emergency costs allowed in the draft determination for FE

Metering

4.43 FE requested around £6.8m for meter maintenance in the GD23 period, with routine maintenance on meters and governors accounting for 85% of the submitted costs.

4.44 The expenditure split for maintenance/inspections within the meter and governor routine maintenance cost category is roughly 57% on domestic, 28% on I&C and 15% on battery replacement. The level of I&C expenditure submitted by FE was comparatively high.

4.45 FE provided connection data to support its submitted maintenance activity for domestic and small I&C meters (up to U40) along with information on how they had derived their numbers. We were able to validate the numbers submitted using annual cost report and business plan template data apart from the percentages FE had used to derive the number of medium pressure connections in each year. We have accepted FE's low pressure/medium pressure split for the draft determination, but will ask it to demonstrate that this is reflective of the actual split of connections for the final determination.

4.46 The routine costs for domestic and small I&C meters (up to U40) have been allowed apart from a minor adjustment to reflect our slightly lower projected connection numbers for 2023 and the exclusion of 5 year and 15 year inspection costs for 2023 which is more material. The 2023 inspection costs have been disallowed because we believe the revised guidance from the updated British Standard has been applied one year too early by FE (as explained further in section 2.56), unlike PNGL who we consider have interpreted the requirements correctly. Our U6 to U40 meter routine maintenance adjustments resulted in a total deduction of around £370k from the submitted costs.

4.47 FE provided source data from its maintenance database to support the routine maintenance activities and costs requested for large I&C meters (i.e. U65 and above). When providing this information it advised it had identified some errors in the information submitted in the business plan, including some doubling counting. It did not submit any corrected figures. As a consequence we used the source data provided to derive revised figures for large I&C routine maintenance and corrected any data issues notified by FE while doing so. This reassessment resulted in cost reductions of around £220k. When undertaking this analysis we allowed costs for work on Rotary Positive Displacement meter outlet valves that FE plan to do when the meter is being replaced. For the final determination we will seek additional clarification of why this cost is justified and not covered by the Capex end of life replacement allowance.

4.48 For non-routine maintenance we considered the projected profile of the total cost per connection for all expenditure areas. This was found to be increasing disproportionality to connection numbers for FE. This was not the case for PNGL or SGN, whose profiles were either stable or reducing and we would have expected FE's to be the same. Adjusting FE's allowance to reflect a stable cost per connection profile from 2021 would result in a cost

allowance reduction of circa £155k. This was omitted from the draft determination modelling in error, but we plan to rectify this and deduct this sum in the final determination.

4.49 In line with the approach outlined in section 4.6, we have removed the 5% uplift that FE has applied to its period contractor rates. This resulted in a circa £216k reduction in the allowance.

4.50 The outcome of our draft determination assessment for metering is detailed in the table below.

	2023	2024	2025	2026	2027	2028
FE requested allowances	971	1,021	1,054	1,200	1,273	1,302
UR Draft Determination	686	995	990	1,072	1,221	1,222
Variance	(285)	(26)	(64)	(128)	(52)	(80)

Note 1. Figures may not sum due to rounding. An additional £154,286 will be removed in the final determination to deliver stable non-routine maintenance over the period in line with the profiles submitted by the other GDNs. This planned deduction was omitted from the draft determination modelling in error.

Table 4.8: Metering Costs, Requested and Allowed, £k

PRE-Repairs

4.51 The 'Publically Reported Escape' (PRE) Repair cost category covers the activity associated with the isolation and repair of mains and/or services involving an escape of gas, following assessment by the first responder.

4.52 Due to the safety implications these are considered the most urgent emergency jobs and have the shortest mandatory response times. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.59 above.

4.53 The key driver of costs in this expenditure category is the number of emergency jobs. Our assessment estimates the volume of work by applying historic rates for the number of PRE jobs to projected figures for the total number of jobs.

4.54 The number of emergency jobs used in our assessment was taken from our 'Emergency Response' analysis. This estimated a total number of emergency jobs which was around 5,100 less than that submitted by FE. Further details on this analysis can be found in the Emergency section of this document, starting at 4.35 above.

4.55 We then calculated the proportion of emergency jobs that became PRE jobs in the first four years of GD17 and applied this to our overall projected job numbers. We used a flat 4.2% throughout GD23, in contrast to the company

who applied a percentage that increased from 4.89% in 2023 to 5.26% in 2028.

4.56 When calculating our percentage we used a revised number of PRE Repair jobs undertaken in 2017 and 2018 provided by FE. This represented an increase of nearly 80%, with the total number of PRE jobs completed in 2017 and 2018 rising from 133 (as submitted in the annual information returns) to 238. We are satisfied that this increase is warranted and therefore included the additions in our calculations.

4.57 Our analysis estimated a total number of PRE jobs that was 538 less than the company's.

4.58 To determine the split between the different types PRE job, we used the average proportions seen over the first four years of GD17 to date. FE's submission decreased the proportion of 3rd party repair jobs which are offset by contributions and increased the proportion of gas escape jobs which are not.

4.59 The GD17 blended contractor's rate stated in FE's business plan has been used to forecast the PRE Repair allowances for GD23. This blended rate was calculated by the company from the contractual rates and the proportion of jobs done in the first four years of GD17. As we have used the GD17 rates provided by FE we did not need to adjust for the 5% uplift that FE applied to its period contractor rates for GD23.

	2023	2024	2025	2026	2027	2028
FE requested allowances	119	127	135	164	174	183
UR Draft Determination	113	117	121	123	127	131
Variance	(6)	(10)	(14)	(41)	(47)	(53)

Note 1. Figures may not sum due to rounding.

Table 4.9: PRE-Repair Costs, Requested and Allowed, £k

Maintenance

4.60 FE requested just over £5.1m for maintenance in the GD23 period. Distribution Mains (43%) and Governor Maintenance (26%) account for the majority of the costs.

4.61 Valve maintenance represents almost 90% of the Distribution Mains costs and almost 40% of FE's proposed maintenance expenditure overall. The rest of the Distribution Mains expenditure is allocated to work associated with the mains themselves.

4.62 The majority of cost items related to the mains are low in value. They have been allowed on the basis of this and the fact that the projected costs remain broadly stable relative to historic expenditure.

4.63 There is however a step change in expenditure on mains commencing in 2021. This is a result of FE's proposal to undertake a leak survey of the network using a hand held device with a GPS tracker. The aim is to identify and locate leaks so that they can be addressed proactively. FE has advised that the last time they undertook a similar comprehensive survey was in 2010, pointing out that significant lengths of mains have been laid since.

4.64 Whilst the costs for the leak survey have been allowed in the draft determination we remain unsure of the benefits this will deliver over and above FE's previous targeted approach, which focused on valves and purge points. We are also unclear how FE has accounted for the cost savings that would be delivered by the move away from the previous targeted approach and the impact that the proactive activity would have on reactive Public Reported Escape repairs. We will check this for the final determination and if necessary adjust allowances accordingly.

4.65 The costs FE have allocated for valve maintenance also show some stepped increases within the GD23 period. These are primarily driven by proposals to undertake external and internal inspections at the company's most critical valves; to undertake planned inspections at a significant proportion of its other valves and purge points; and, to allow for increased reactive maintenance costs associated with the replacement of higher numbers of valve chamber covers than in the past.

4.66 PNGL has also included a critical valve inspection programme within its submission for GD23 and FE's proposal to inspect around one third of critical valves on a prioritised basis during GD23 does not appear unreasonable as it appears to account for the comparative age of its assets. However FE's unit cost is high compared to PNGL's. This seems to be mainly driven by the allowance of 2 days work for the team undertaking the inspections. For the draft determination we have allowed all the activity proposed, but have adjusted the duration of the inspection team to one and half days on average, which we do not consider unreasonable. This represents a 25% reduction in the allowance for the inspection team, with all other associated costs remaining unchanged. This reduces FE's total allowance by around £150k and brings its unit cost closer to that submitted by PNGL.

4.67 FE's investment proposal for its other valves (in-line, service and riser) and purge points is based on it undertaking planned inspections at circa 25% of these remaining assets during GD23 (or circa 30% over the 8 year period commencing 2021). Costs have been allowed in the draft determination

based on the numbers and unit costs submitted. We will consider the extent of the activity further for the final determination to satisfy ourselves that the proposed level of intervention is justified.

4.68 FE's submission for valve cover replacement represents a significant increase when compared to historic activity and cost. FE has based this on an assumption that the number will increase based on the age and extent of the network. We did not find evidence of this within recent historic data. When we adjusted the number of jobs for 2017 and 2018 using the number of covers per job quoted for 2020 it would suggest a year on year reduction from 2017 to 2019. The company also suggested that the higher than expected figures in 2021 provided evidence of year on year increases. However FE also indicated that activity in 2021 included some carryover from 2020, which it advised was atypical due to a widespread valve and pressure point cover inspection programme carried out during lockdown in spring 2020. We therefore do not consider this compelling evidence.

4.69 For our draft determination assessment we used the ratio of lids per defect from 2020 to estimate the number of lids replaced in 2017 and 2018. This was necessary because FE had reported the number of defects prior to 2019 rather than the number of lids replaced. We then used the 2017-2020 four year average for the number of lids replaced to generate a revised starting position for our forward projections. We adopted this approach due to the atypical nature of the 2020 figures as noted in FE's submission. We consider this to be conservative as our four year average includes the unusually high figure from 2020.

4.70 We projected numbers for 2021 onwards from this revised base figure proportionally, using the annual increase in the length of the network allowed for in our Capex assessment. This approach acknowledges that the number of covers, and therefore the amount of potential work, will be related to the size of the network in some way. FE had assumed much higher annual increases (5% per annum for Transport Northern Ireland numbers and 10% per annum for internal inspections) which did not appear to be supported by any of the 'typical' data submitted.

4.71 To derive the valve cover replacement allowance we applied the 2019 unit rate due to the similar the level of activity in that year. This was the same unit rate used by FE. The outcome of our assessment was a cost reduction of around £135k compared to FE's submission. For the final determination we will seek to update our assessment with actual historic data in areas where assumptions have been applied if this is available. We will also consider whether FE can provide any additional evidence to support its higher level of projected activity.

4.72 In our Capex assessment we used the average level of activity from 2017 to 2020 to estimate the number of District Governors and Governor Bins that would be installed annually during GD23. When assessing the historic data we found a misalignment between the cost of the additions and how FE had allocated numbers between each asset type. For our Capex assessment we therefore reallocated the historic figures based on cost.

4.73 We carried this reallocation forward to our opex governor maintenance assessment to maintain consistency and recalculated the total number of sites in each category for 2017 to 2020 using the 2017 starting figures quoted in the ACRT. We then used the annual additions derived through our Capex assessment to project revised totals for each governor category for each year of GD23. This resulted in a lower number of sites than FE had projected.

4.74 Using historic activity and cost data for 2017 to 2020 which FE provided we were able to calculate the average percentage of reactive jobs per site and the average historic unit cost for each cost category. We applied these to our revised projections for the total number of sites to determine the annual allowance for governor reactive maintenance. This resulted in a total reduction of around £275k over the GD23 period. The split of this reduction between District Governors and Governor Bins is roughly 15% and 85%.

4.75 In undertaking our assessment, we have been unable to reconcile the number of historic sites quoted by PNGL in its query response to the numbers quoted in the ACRT. We will ask FE to provide a reconciliation for the final determination to address any ongoing uncertainty in the numbers. We will also ask for clarification on the historic allocation by governor category which does not appear to align with installation costs.

4.76 FE's submission for installing of telemetry equipment at Daily Metered SMPs with an annual quantity greater than 75,000 therms assumes an increase of 7 sites per annum from 2021 onwards. The reason for this sustained level of increase throughout the GD23 period is not clear and the addition of another 49 sites with annual quantity >75,000 therms between 2021 and 2028 (i.e. an increase of 53%) does not seem reasonable or reflective of other elements of FE's submission.

4.77 Our assumption for the draft determination is that the addition of 40 Daily Metered Sites in 2020 following the change in the Network Code and the addition of a further 7 sites in 2021 will have addressed any backlog. This is reinforced by the data submitted by FE in table 2.0g of its business plan template which shows a static number of >75,000 therm sites throughout the period. This number is broadly consistent with the figure quoted in the submission for the end of 2021. We have therefore based our assessment

on the number of sites quoted in table 2.0g and applied the average unit cost for 2017-20 rather than the higher unit cost for 2020 used by FE. Our analysis results in a cost reduction of around £70k for these telemetry installations.

4.78 We have allowed the pressure logging maintenance costs submitted by FE but will explore the linkage to the projected number of governors and the high level of non-routine jobs further for the FD.

4.79 In line with the approach outlined in section 4.6, we have removed the 5% uplift that FE has applied to its period contractor rates. This resulted in a reduction of around £172k in the allowance.

4.80 The outcome of our draft determination assessment for maintenance is detailed in the table below.

	2023	2024	2025	2026	2027	2028
FE requested allowances	769	775	833	878	927	950
UR Draft Determination	689	671	706	727	761	763
Variance	(80)	(103)	(127)	(151)	(166)	(188)

Note 1. Figures may not sum due to rounding.

Table 4.10: Maintenance Costs, Requested and Allowed, £k

Other Direct Activities

4.81 FE's other direct activities costs are driven by manpower costs. In the 2020 year FE had actual manpower costs of £992 and 0.04 FTEs. FE has requested other direct activity costs on average of £335 in GD23. We have rolled forward actual 2020 FTEs and staff costs and this provides for allowances of £530 in each year for GD23. The allowances are lower than 2020 actuals as the projected capitalisation rate is higher in GD23 than for the 2020 year.

IT & Telecoms

4.82 FE IT & Telecoms costs are in the main driven by its associated manpower costs and costs for professional and legal fees as well as nominal expenditure on stationary, communications and billing. In the 2020 year, FE had IT & Telecoms costs of £574k.

4.83 FE had 1.17 FTEs employed within the IT and Telecoms cost category in 2020 and has proposed a marginal increase in FTEs for the GD23 period as well as a 27% increase on average in professional and legal fees and stationary, communications and billing costs (combined) in the GD23 period when compared to 2020 actuals. FE has explained that this is based on

'forecast IT opex costs primarily reflecting incremental customer and staffing requirements and have been modelled based on our current managed services contract for IT and projected costs for the licencing and use of a new IT platform, forecast to be purchased in 2022'.

4.84 In relation to the FE rationale for its projected increases in IT and Telecoms we note that both FE 2020 actuals for 2020 IT and Telecoms are higher than for PNGL by 13% and its average projected GD23 IT and Telecoms costs are 30% higher. We also note that PNGL, who use a similar GIS system to FE and have 60% more FTEs and over 4 times more customers than FE in the 2020 year, while having lower overall opex expenditure than FE on IT and Telecoms. For the draft determination we have rolled forward FE actual 2020 FTEs together with 2020 staff costs as well as 2020 professional and legal fees and stationary, communications and billing costs.

4.85 We observe that FE in GD17 was granted approval of £460k Capex in 2017 to replace its IUS/IT Transformation, but note that this development has still not occurred and is still pending in 2022, in which a separate request is also made in the GD23 business plan of £100kpa for 'New IUS Distribution Replacement licensing', which is based on estimates from its connected supply business. We plan to review this area further and update for the final determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	783	711	701	724	726	729
UR DD before re-allocation	574	574	574	574	574	574
Variance	(209)	(137)	(127)	(150)	(152)	(155)

Note 1. Figures may not sum due to rounding.

Table 4.11: IT & Telecoms Costs, Requested and Allowed, £k

Property Management

4.86 The most significant cost item under FE property management costs are in relation to network rates. We have in the past set network rates using a formula which links the allowance to FE revenues.

4.87 We are comfortable with the approach of using a formula linked to revenue in order to set the network rates allowance for FE. We have used this approach historically both in GD14 and GD17. The network rates allowances have therefore been calculated accordingly.

4.88 For the draft determination we are of the view for the GD23 period that uncertainty mechanism should be updated to reflect actual costs for network rates, subject to FE demonstrating that it has taken appropriate actions to

minimise valuations. We will expect FE (as well as the other GDNs) to provide a copy of its actual network rates bill and accompanying verification of payments to the Utility Regulator alongside its annual Uncertainty Mechanism submission which is usually submitted with the Annual Cost Reporting Template.

4.89 FE also has rent and rates costs in relation to its offices including leases and we have rolled these costs forward from 2020 actual costs which in total are in line with FE projected costs or 2021 and 2022.

FE had 1 FTE under the Property Management cost category in 2020 and has not proposed any increase for the GD23 period and consequently we have allowed for 1 FTE in the GD23 period and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
FE requested allowances	1,104	1,155	1,191	1,229	1,256	1,281
UR Draft Determination	991	1,029	1,066	1,102	1,133	1,161
Variance	(113)	(126)	(125)	(127)	(123)	(120)

Note 1. Figures may not sum due to rounding.

Table 4.12: Property Management Costs, Requested and Allowed, £k

HR & Non-operational Training

4.90 FE HR and non-operational training costs are in the main driven by staff costs and professional and legal fees.

4.91 In the 2020 year FE had HR and non-operational training costs of £119.2k. FE had 1.3 FTEs employed within the HR and Non-operational training cost category in 2020 and projected a 0.1FTE deduction in FTEs in this area for the GD23 period.

4.92 We have accepted this projection in FTEs and consequently provided for 1.2 FTEs in the GD23 period. This consistent with our approach for the GD17 price control which also provided for 1.2 FTEs. We have also rolled forward 2020 staff costs and 2020 professional and legal fees.

	2023	2024	2025	2026	2027	2028
FE requested allowances	138	139	139	140	140	141
UR DD before re-allocation	115	115	115	115	115	115
Variance	(23)	(24)	(24)	(25)	(25)	(26)

Note 1. Figures may not sum due to rounding.

Table 4.13: HR & Non-Operational Costs, Requested and Allowed, £k

Audit, Finance & Regulation

4.93 FE Audit, Finance and Regulation costs are in the main driven by staff costs and professional and legal fees.

4.94 In the 2020 year FE had audit, finance and regulation costs of £477k. FE had 8.2 FTEs employed within the Audit, Finance and Regulation cost category in 2020 and has proposed an increase of 1.5 FTEs in this area for the GD23 period.

4.95 We note that FE have only provided an explanation for an increase of 0.5 FTEs. FE's explanation for this increase is in relation to workstreams to support the Utility Regulator in delivering projects currently identified within its Corporate Work plan such as our Consumer Protection Programme.

4.96 We note however that FE has already employed an additional 0.8 FTE above that provided for in the GD17 final determination at 8.2 FTEs versus 7.4 FTEs. We consider that the additional 0.8 FTEs already employed by FE should be sufficient to deal with the workstreams described by FE.

4.97 FE has projected professional and legal fees which contain uplifts of £300k in 2021 and 2027 'to reflect the necessary consultancy advice associated with price control reviews'.

4.98 We note that the £300k uplifts in relation to price control costs projected by FE are significantly above those projected by another GDN which operates under the same price control process as FE. Consequently, we have not allowed this scale of uplift for the GD23 draft determination. We have however allowed an allowance for price control costs at an efficient level for the 2027 and 2028 years.

4.99 For all other years we have accepted FE projected professional and legal fees as they are in line with medium term historic average actuals.

	2023	2024	2025	2026	2027	2028
FE requested allowances	831	838	844	850	1,156	863
UR DD before re-allocation	695	695	695	695	815	815
Variance	(136)	(143)	(149)	(155)	(341)	(48)

Note 1. Figures may not sum due to rounding.

Table 4.14: Audit Finance & Regulation Costs, Requested and Allowed, £k

Insurance

4.100 The main element of FE insurance costs is business insurance, which in turn is dominated by Public Liability cover as well as Employee Protection.

4.101 The total insurance costs requested by FE represent a significant increase on 2020 actuals. The increase between 2020 actuals and the request for GD23 from 2023 is around 36%. We queried FE about these increases and FE provided substantial documentation on their insurance premiums together with an industry benchmarking report. However, the response from FE noted that the expected increase in their insurance costs for the 2021 year were less than set out in their GD23 business plan submissions.

4.102 For the GD23 draft determination we have rolled forward FE actual 2020. Insurance costs, including costs which relate to office and car insurance. While we note the increased insurance costs overall in 2021 and for part of 2022 we are mindful that FE insurance costs have experienced both annual increases and decreases over the medium term i.e. from 2013 and that there has been no period of sustained cost increases. However, we may undertake further analysis of FE insurance costs in advance of the GD23 final determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	326	326	326	326	326	326
UR Draft Determination	244	244	244	244	244	244
Variance	(82)	(82)	(82)	(82)	(82)	(82)

Note 1. Figures may not sum due to rounding.

Table 4.15: Insurance Costs, Requested and Allowed, £k

Procurement

4.103 FE procurement costs are driven by staff costs. In the 2020 year FE had procurement costs of £13k. FE had 0.35 FTEs employed within the Procurement cost category in 2020.

4.104 For the draft determination we have rolled forward 2020 actual FTEs and staff costs and accepted FE projected professional and legal fees as they are in line with medium term historic average actual costs. The draft determination allowances are marginally above FE business plan requests as 2020 staff costs are marginally higher than projected staff costs for this cost category.

	2023	2024	2025	2026	2027	2028
FE requested allowances	19	19	20	20	20	20
UR Draft Determination	22	22	22	22	22	22
Variance	3	3	2	2	2	2

Note 1. Figures may not sum due to rounding.

Table 4.16: Procurement Costs, Requested and Allowed, £k

CEO & Group Management

4.105 FE CEO & Group Management costs are driven by associated staff costs as well as professional and legal fees. FE CEO & Group Management costs were £233k in 2020, made of £156k in staff costs and £76k in professional and legal fees. FE employed 1.2 FTEs in the CEO and Group Management cost category in 2020. FE proposed a flat profile of 1.2 FTEs for the GD23 period which is the same as 2020 actuals together with a reduction in professional and legal fees.

4.106 For the GD23 draft determination we have rolled forward 2020 actual FTEs and staff costs and accepted FE projections on professional and legal fees as they are similar to our GD17 allowances.

4.107 We have also analysed information from FE on how they allocate FTEs between their supply and distribution businesses (including for FTEs and associated costs with the CEO and Group Management cost category) and we intend to examine this information further and in conjunction with FE business plan submission for the SPC23 supply price control, for the GD23 final determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	226	228	229	231	232	234
UR Draft Determination	219	219	219	219	219	219
Variance	(7)	(9)	(10)	(12)	(13)	(15)

Note 1. Figures may not sum due to rounding.

Table 4.17: CEO and Group Management Costs, Requested and Allowed, £k

Stores & Logistics

4.108 FE has proposed allowances for staff costs for stores and logistics in the GD23 period based on an average of 0.63 FTEs in the GD23 period. In 2020 FE had no actual costs in relation to stores and logistics.

4.109 FE rationale for the requested average 0.63 FTEs in GD23 is that it currently lacks a dedicated resource to manage stock especially as its 20 year replacement program of works is reached in 2026. FE further advised that

its external auditor has highlighted that an area of improvement is required in stock management.

4.110 We note that PNGL (which has been in existence longer than FE) and which also has asset management accreditation does not employ FTEs for this area. We also note that FE has had a significant increase in FTEs since 2014 to 2020 i.e. circa 30% and therefore should have sufficient staff resources to manage this area.

	2023	2024	2025	2026	2027	2028
FE requested allowances	18	18	20	20	20	20
UR Draft Determination	0	0	0	0	0	0
Variance	(18)	(18)	(20)	(20)	(20)	(20)

Note 1. Figures may not sum due to rounding.

Table 4.18: Stores and Logistics Costs, Requested and Allowed, £k

Advertising & Market Development (Owner Occupied)

Introduction

4.111 In GD17 the allowances for costs associated with advertising and marketing (Owner Occupied) were recovered via a connection incentive. We set out in the GD17 final determination[3] our intention to review the connection incentive in advance of GD23.

4.112 Early development and engagement on GD23 began in the autumn of 2019 and our approach to the connection incentive review was discussed with the GDNs and key stakeholders in bilateral and round-table meetings. Following this there was a Round Table discussion on GD23 connection incentives with all GDNs in December 2019 and subsequent follow up meetings, connected to this area.

4.113 This was followed up with an information request to all GDNs in November 2020, which comprised of 2 broad categories as set out below:

a) Confirmation of historical data on the costs and performance in this area.

b) Questions to the GDNs relevant to the connection incentive as follows:

(i) The relationship between expenditure and connections delivered.

[3] 2016-09-15_GD17_Final_Determination_-_final_0.pdf (uregni.gov.uk) Paragraph 13.15

(ii) The approach and activities used to acquire connections and how this has developed based on experience and learning.

(iii) The structure of the incentive mechanism and the incentive value of the Connection Incentive.

4.114 FE provided a response to the questions, including extensive information on the area within its GD23 business plan submission, as follows:

- Surveys
- Marketing portfolios
- Monthly RDSE Graphs
- Competitor analysis
- Integrated marketing plan
- Qualitative research
- Working with GDNs
- Boiler replacement stats
- New gas leads
- Marketing spend
- Energy Advisor training programme
- Domestic Specifiers Guide
- Installer Charter
- Battlefield analysis of areas

4.115 The above outlined its approach, strategy, techniques, costs, observations/criticism on the current mechanism and the challenges that it faces to acquire new customers, in the context of the Energy Strategy.

4.116 In summary it requested a connection incentive allowance of £506 per connection, to support its current activities and projected level of customer growth by 20,740 for new OO connections, based on staff costs, corporate overhead and incentive/marketing elements.

4.117 We have carefully considered this material as presented, in conjunction with the submissions made by the GDNs, which has led to the following assessment and approach to be take in this area.

Previous GD17 Mechanism

4.118 The connection incentive for GD17 was based on a principle that once the network has been constructed the marginal revenue of any future connection will reduce costs for all consumers. An economic rate for a standard connection incentive rate was calculated which allowed part of the marginal revenue of a new connection to be 'invested' to promote connections while the balance would benefit all consumers through lower tariffs.

4.119 The economic rate for a standard connection incentive rate was calculated, based on some simple assumptions, which required a degree of judgement as follows: average rate of gas consumed in a year by a typical domestic customer, appropriate suitable payback period, the conveyance charge to cover the costs of the network, rate of return of the project and the capital costs of the gas main, service and meter costs. The economic level of the connection incentive is the value which would minimise tariffs in the long term.

4.120 The connection incentive payment was subject to a non-additionally threshold set for each GDN to reflect the 'maturity' of their network. The incentive is then paid on each connection over the non-additionally threshold. In the past we have explained the non-additionally threshold as the number of connections which would occur without any effort to promote connections.

4.121 The mechanism set specific connection targets on the acquisition of new customers and implemented a collar such that, where a GDN underperforms the annual connection target by more than 50%, a 25% collar (i.e. 25% * 'per connection' allowance) would operate.

4.122 Another component of the mechanism was that certain costs were to be recovered via the connection incentive mechanism. These costs were mainly related to Business Support activities that supported this area that reduced the fixed allowances. This was to incentivise GDNs to achieve the target connections or to suffer some risk on Business Support Costs allowances.

4.123 An additional 'new areas' allowance was added to the standard connection incentive rate to reflect some of the challenges of promoting gas in new extension areas such as East Down and Gas to the West, in which we signalled that the "new areas" allowance would be removed at the end of GD17.

4.124 In the last year of the allowance, in 2022, the figure is £343 per connection (Excluding New Areas allowance, removal of 25% Non Additionality, post efficiency.)

New Approach - Cost To Serve

4.125 After considering the current mechanism and the comments made by the GDNs in the information supplied and taking regard on the stage of development for each Network Operator, we have decided to replace the existing economic incentive mechanism.

4.126 We propose in replacing it with a 'Cost to Serve' allowance. The concept of Cost to Serve is to cover GDNs' reasonable costs of responding to contacts and supporting consumers through the connection process, including the cost of Energy Advisers.

4.127 To enable preparation by the GDNs of this change, we are proposing a glide path from existing levels in 2022 down to what we consider a reasonable cost to serve allowance by 2028 for each GDN.

4.128 Outlining this approach to the GDNs caused some concern over the implications in the wider industry context and for positioning in the market place. GDNs suggested the marketing and development activity funded from the Connection Incentive also supported wider awareness of the gas industry for the public, customers, stakeholders, community and elected representatives, ensuring that they are suitably informed, understand the emergency response, non-routine and asset maintenance activities general adverting etc. The GDNs made the point that this was necessary as part of their core responsibilities as a network operator.

4.129 PNGL have suggested an allowance of £150k pa to deal with these types of issues. We believe this is a reasonable comprise to provide a fixed allowance for all GDNs to support and aid the understanding of wider gas issues that may be lost as marketing and advertising activities funded through the connection incentive are wound down. This allowance would be for the wider promotion and awareness of the gas industry, which may prompt connection requests, but would not be linked to the connection target. We propose a fixed amount of £150k for FE.

4.130 Since this 'fixed' allowance is already included in the advertising and marketing costs allocated to OO connections incentive rate, the glide path rate from GD17 incentive rate to Cost to Serve must be adjusted in the early years to deduct the allowance for advertising and marketing in the embedded rate.

4.131 For moving to a Cost to Serve allowance the following changes are made to the mechanism:

a) A glide path which starts from the GD17 incentive rate for 2022 excluding the new areas allowance.

b) Sets different cost to serve rates for each GDN at 2028 based on 2020 actual staff costs, stationary, communications and billing costs as well as any entertainment costs with reasoned adjustments for each GDN.

c) Adds a fixed allowance for limited marketing and advertising that is adjusted in the early years to take account of an allowance for advertising and marketing, already included in the glide path (e.g. £150k pa).

d) Use the projected connection numbers by each GDN as at 2022 and glide path down to 60% by the end of GD23.

e) Connection Targets are now removed and removal of the Collar and any reduction in allowances.

f) Non-Additionality is now removed and every connection qualifies for the same allowances, which removes risk from each GDN.

g) Corporate Overhead Costs, that had to be recovered via the previous mechanism, are now dropped, which removes this risk from each GDN.

4.132 All connections allowances claimed by GDNs must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

4.133 Table 4.19 provides the allowance, per connection, which excludes the fixed allowance with regard the limited marketing and advertising as discussed above. Table 4.20 compares the draft determination owner occupied (OO) connection numbers against the FE GD23 submission.

FE	2023	2024	2025	2026	2027	2028
Connection allowance per customer	274	242	210	187	180	173

Note 1. Figures may not sum due to rounding.

Table 4.19: OO Connection Allowance, £

4.134 The allowances set out in Table 4.19 translates to an average allowance over the 6 years of GD23 for FE of £211 per connection, subject to the fixed allowance as described above.

	2023	2024	2025	2026	2027	2028
FE submission	3,852	3,685	3,524	3,371	3,224	3,084
UR Draft Determination	3,697	3,433	3,169	2,905	2,641	2,377

Note 1. Figures may not sum due to rounding.

Table 4.20: OO Connection Numbers and Allowances

4.135 Table 4.21 shows the comparison of the draft determination allowances against the FE GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
FE requested allowances	1,692	1,618	1,536	1,454	1,378	1,306
UR Draft Determination	1,162	982	817	693	625	560
Variance	(530)	(636)	(719)	(761)	(753)	(746)

Note 1. Figures may not sum due to rounding.

Table 4.21: Advertising & Market Development (Owner Occupied) Costs, Requested and Allowed, £k

Advertising & Market Development (Non - Owner Occupied)

4.136 The Advertising and Market Development (non-OO) cost category covers advertising and market development expenditure in relation to NIHE, New Build and I&C properties.

4.137 FE Advertising and Market development costs are driven by staff costs and market development costs and a small amount for stationary, communications and billing. In the 2020 year FE had advertising and market development (non-OO) costs of £214k.

4.138 FE had 5.7 FTEs employed within the advertising and market development (non-OO) category in 2020 and is proposing to reduce the level of FTEs to 4.85 in GD23. We note that the 2020 actual number of FTEs for advertising and marketing (non-OO) is significantly more than that planned by FE in the GD17 period which was 3.4 FTEs.

4.139 We consider that the FE proposed reduction in FTEs for advertising and marketing on non-OO reflects FE focus in the GD23 period on the owner occupied sector. However, we have facilitated an additional FTE over the GD23 period in relation to energy transition. This is consistent with our approach for the other GDNs in GD23. We have rolled forward our allowance for FTEs i.e. 5.85 FTEs using 2020 staff costs. We have also

carried forward 2020 costs for Market Development Review allowance and stationary, communication and billing costs. The allowances appear higher than FE GD23 business plan requests as FE projected capitalisation rate for advertising and market development (non-OO) is lower for the GD23 period than in the 2020 year.

	2023	2024	2025	2026	2027	2028
FE requested allowances	224	226	227	229	230	232
UR Draft Determination	237	237	237	237	237	237
Variance	13	11	10	8	7	5

Note 1. Figures may not sum due to rounding.

Table 4.22: Advertising & Market Development (Non-Owner Occupied) Costs, Requested and Allowed, £k

Trainees & Apprentices

4.140 FE trainees and apprentices' costs are driven mainly by professional and legal fees as well as staff costs. FE has requested trainees and apprentices' allowances of £158k in 2023 and £73k for each of the subsequent years in GD23. FE actually spent £41k on trainees and apprentices in 2020. The requested increase in allowances is driven from an increase in professional and legal fees of circa 129% on average across the GD23 period.

4.141 For the GD23 draft determination we have based our allowances on 2020 FTEs and staff costs as well as 2020 professional and legal fees. The allowances for the GD23 draft determination appear higher than 2020 actual costs as FE have shown 0% capitalisation of staff costs for GD23 when compared to 35% in 2020.

	2023	2024	2025	2026	2027	2028
FE requested allowances	158	73	73	73	74	74
UR Draft Determination	49	49	49	49	49	49
Variance	(109)	(24)	(24)	(24)	(25)	(25)

Note 1. Figures may not sum due to rounding.

Table 4.23: Trainees & Apprentices Costs, Requested and Allowed, £k

Non-Controllable Opex

4.142 The only costs under non-controllable opex are FE licence fees. We have accepted FE forecast costs of for licence fees of £50k per annum for the draft determination but further work will continue in this area to ensure allowances are sufficient going forward. Any difference between forecast licence fees and actual licence fees will be taken account of by the uncertainty mechanism in GD29.

Supplier of Last Resort

4.143 With regard to the Supplier of Last Resort (SOLR), we believe that there is merit in including an allowance to cover any unforeseen costs that may occur, if an event were to happen. This amount is ring fenced and will be removed at the time of the next price control, if an incident fails to materialise. For the GD23 draft determination we have accepted the proposal made by FE and allowed £175k for these costs in 2023 only to cover the duration of the price control.

Other Issues - Shrinkage

4.144 The shrinkage forecast from FE across the GD23 price control period are forecast to be stable at 0.26% across the price control period. There is a slight increase from 0.23% for 2020 however it is consistent with the shrinkage forecast for the final 2 years of GD17. Given the network extension in the final 2 years of the price control, we do not consider this increase unusual.

4.145 We do not propose any shrinkage-related changes to existing regulatory arrangements and/or the introduction of a shrinkage-related incentive mechanism at this stage.

4.146 However, we consider that FE should continue to establish the annual shrinkage factor in line with the common Northern Ireland Shrinkage Methodology which was developed, and should be maintained and amended as may be appropriate from time to time, jointly by all three GDNs. We furthermore consider that shrinkage should continue to be monitored as part of the annual cost and performance arrangements.

Capitalisation

4.147 For the GD23 draft determination we have accepted FE capitalisation rates. These may be reviewed further for the final determination.

Real price effects, productivity and frontier shift

4.148 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

4.149 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH). Given the CPIH is no more a measure of general inflation than RPI, not all types of cost changes will be reflected in the range of prices used to calculate the CPIH. To account for this it is common practice to calculate and make adjustments for the

difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

4.150 This calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs), and the projected rate of productivity growth. The sum of these components can be a positive or a negative difference.

4.151 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

4.152 We have adopted the methodology we first introduced at PC13, PC15 and PC21 for NI Water, which aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

4.153 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	4.4	3.8	2.9	2.3	2.8	3.3	3.3	3.3
CPIH	(2.9)	(4.0)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift	CPIH + 0.4	CPIH -1.2	CPIH -0.2	CPIH -0.8	CPIH -0.3	CPIH +0.1	CPIH +0.1	CPIH +0.1
Cumulative frontier shift	0.4	-0.8	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8

Table 4.24: GD23 Opex frontier shift calculations

4.154 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

4.155 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

Summary of bottom-up assessment findings

4.156 Table 4.25 shows the opex allowances for FE in the GD23 period. The total pre-efficiency opex allowances (excluding allowances associated with AMD-OO) for FE in GD23 on average are 31% higher than 2020 actuals.

FE Categories	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	88	88	88	88	88	88	528
Operations Management	271	271	271	278	278	278	1,647
Emergency Call Centre	221	227	233	238	243	248	1,410
Customer Management	295	295	295	295	295	295	1,770
System Control	242	242	242	243	243	243	1,455
Emergency	816	859	901	940	978	1,013	5,508
Metering	686	995	990	1,072	1,221	1,222	6,186
PRE-Repairs	113	117	121	123	127	131	731
Maintenance	689	671	706	727	761	763	4,317
Other Direct Activities	0.5	0.5	0.5	0.5	0.5	0.5	3
IT & Telecoms	574	574	574	574	574	574	3,444
Property Management	991	1,029	1,066	1,102	1,133	1,161	6,482
HR & Non-operational Training	115	115	115	115	115	115	690
Audit, Finance & Regulation	695	695	695	695	815	815	4,410
Insurance	244	244	244	244	244	244	1,464
Procurement	22	22	22	22	22	22	132
CEO & Group Management	219	219	219	219	219	219	1,314
Stores & Logistics	0	0	0	0	0	0	0
Advertising & Market Development - Owner Occupied (OO)	1,162	982	817	693	625	560	4,840
Advertising & Market Development (Non OO)	237	237	237	237	237	237	1,422
Trainees & Apprentices	49	49	49	49	49	49	294
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	175						175
Total: Pre-Efficiency	7,955	7,983	7,936	8,006	8,317	8,328	48,524
Frontier Shift %	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8	
Total: Post Efficiency	7,875	7,831	7,762	7,846	8,159	8,178	47,651

Note 1. Figures may not sum due to rounding.

Table 4.25: FE GD23 Opex Draft Determination Pre and Post Efficiency, (£k)

5. Phoenix Natural Gas - UR Proposals

Overview

5.1 As set out in chapter 2, we have used bottom-up analysis as basis for our assessment of opex business plan requests.

5.2 We note that, in line with our detailed approach set out in chapter 2, we have assessed the requested opex allowances for the different cost categories. We have also undertaken additional analysis for selected expenditure types and on the proposed capitalisation policies. The bottom-up part of this chapter is structured accordingly.

5.3 We note furthermore that, in line with our detailed approach set out in chapter 2, we have generally used the most up to date detailed actuals as part of our assessment of business plan requests, i.e. data relating to 2020. We consider that this provides a sound basis to set-up a benchmark where appropriate. In some circumstances, however, there were good reasons for deviating from this approach, and a further explanation is given in the relevant areas.

5.4 As was the case for the GD17 price control, greater scrutiny has been exercised over those cost categories that represent the greater cost. We have also considered the extent to which some cost items must be separately examined because of the particular way they are treated (e.g. pass-through), or due to other specific circumstances calling for individual treatment, irrespective of their magnitude.

5.5 Significant elements of PNGL's network maintenance work is carried out by a related company, Phoenix Energy Services (PES). In previous price controls we established and adopted the policy of disallowing profit margins of any related party. We have maintained this approach in our GD23 assessments and removed the profit element from the costs for any emergency, maintenance and metering work that PNGL has advised will be undertaken by PES within period.

5.6 In GD17, PNGL estimated the PES profit element as 9.85% based on its accounts for 2012 to 2014. To establish an appropriate percentage to apply for GD23, we asked PNGL to provide updated figures. The revised percentage based on PNGL's accounts for 2017 to 2020 was 7.9% and this has been applied to derive the costs to be disallowed. We consider that the use of a four year average is more appropriate than use of the figure for a single year as the information submitted shows that the margin can go up as well as down, with a percentage in 2018 balancing a lower one in 2020.

5.7 The adjustment for the PES profit margin was applied following completion of our staffing salary assessment for a particular area. This was done to avoid a reduction in salary costs being applied as a result of the profit margin being disallowed.

Bottom-up assessment

Manpower

5.8 Given that manpower is such an integral part of the price control, we consider the number of FTEs necessary to run an efficient business; it is therefore appropriate to determine the cost allowance at the overall manpower level.

5.9 In common with GD17, we have not set explicit FTE allowance for the individual cost categories, since manpower forms part of most of the cost categories within the Annual Cost Reporting Template, rather than being an individual cost category. We consider that it is the choice of the GDN to decide where to allocate its resources, as business needs develop.

	GD17					
	2017	2018	2019	2020	2021	2022
PNGL Requested Allowances	127.8	128.2	128.7	129.1	189.6	130.0
UR Determined	121.8	121.8	121.8	121.8	121.8	121.8
PNGL Actual	115.9	117.4	119.1	113.1	119.2	123.9
	GD23					
	2023	2024	2025	2026	2027	2028
PNGL Requested Allowances	126.9	126.3	123.9	122.9	122.9	122.9
UR Determined	118.6	118.4	117.0	117.1	117.1	117.1

Note 1. Figures may not sum due to rounding. Note 2. The years 2020/21 and 2021/22 are forecast.

Table 5.1: PNGL FTEs Requested, Actuals and GD23 Determined

5.10 Table 5.1 sets out the PNGL requested allowances for FTEs for both GD17 and GD23. It can be observed that PNGL actual number of FTEs for 2020 was below our GD17 allowances by 7% and below the PNGL GD17 business plan submission by 12%. It can be also observed that PNGL FTEs have marginally decreased from 2017. PNGL have explained that part of the reason for this decrease was in relation to a reduction in workstreams for a period of the 2020 year brought about by COVID restrictions.

5.11 PNGL has requested increases in FTEs in the GD23 period across a range of cost areas such as operations management, customer management and audit finance and regulation.

5.12 However, we do not agree that the level of resources requested by PNGL is appropriate. We have therefore, in general, based the level of FTEs on the 2020 level of FTEs and taken account of evidence provided by PNGL of where additional FTEs are required (e.g. in customer management), to recognise that the reduction in workstreams arising from COVID restrictions had a temporary impact. We have also provided for an additional FTE for 'energy transition'.

Asset Management

5.13 PNGL Asset Management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had Asset Management costs of £263k and had 3.7 FTEs. PNGL has requested a marginal increase in FTEs in the GD23 period to 3.8 FTEs. PNGL also incurred £99k in professional and legal fees in 2020 as well as £6k in materials costs.

5.14 For the draft determination we have rolled forward 2020 actuals of 3.7 FTEs as well as 2020 staff costs. This is line with PNGL medium term historical actual FTEs. We have also rolled forward PNGL 2020 actual costs for professional and legal fees and materials costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	282	282	282	282	282	283
UR Draft Determination	267	267	267	267	267	267
Variance	(15)	(15)	(15)	(15)	(15)	(16)

Note 1. Figures may not sum due to rounding.

Table 5.2: Asset Management Costs, Requested and Allowed, £k

Operations Management

5.15 PNGL's Operations Management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had Operations Management costs of £411k and had 17.3 FTEs employed within the Operations Management cost category. PNGL have proposed that there should be on average 20.1 FTEs for Operations Management in the GD23 period.

5.16 PNGL have explained that part of the reason for the proposed increase in FTEs in the GD23 period is to recruit and train technicians for additional workload in the GD23 period due to ageing assets.

5.17 For the draft determination we have provided for an additional FTE as this is consistent with medium term historical actual averages which is higher than 2020 actuals. We have rolled forward 2020 actual staff costs with the 18.3 FTEs allowed for, for the draft determination.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	563	564	552	553	554	555
UR Draft Determination	497	497	491	491	491	491
Variance	(66)	(67)	(61)	(62)	(63)	(64)

Note 1. Figures may not sum due to rounding.

Table 5.3: Operations Management Costs, Requested and Allowed, £k

Customer Management (Emergency Call Centre)

5.18 An explanation of the Customer management (Emergency Call Centre) cost category and GDN arrangements for dealing with emergency calls is provided in the 'bottom-up' assessment section of this annex, starting at 2.30 above. This also explains why we were unable to use the combined modelling technique applied in previous price controls to project call volumes for the GDNs and therefore moved to company specific assessments for GD23.

5.19 The key driver of costs in this expenditure category is the volume of calls, which is in turn driven by number of connections. For PNGL our assessment applies historic rates of calls to projected connection numbers to estimate call volumes in GD23.

5.20 Our draft determination additional connection numbers for GD23 are around 11% lower than those submitted by PNGL in their business plan. As this is the main driver for the number of calls received this reduction has had a direct impact on projected call volumes.

5.21 To estimate the volume of calls received from PNGL's customers we calculated the average percentage of calls per customer in the first four years of GD17 (i.e. 2017 to 2020) and applied this to our revised cumulative connection numbers.

5.22 In previous price controls we treated existing and new customers differently when forecasting the number of emergency calls. This was based on the assumption that new customers, who are unfamiliar with the gas network and their new equipment, are more likely to call with a perceived emergency than those who are familiar with using gas. For GD23 we have treated all customers the same, accepting the rationale that the differential impact

would be immaterial based on PNGL's large existing customer base and the low number of new connections planned.

5.23 Our analysis indicated the historic average call rate was 10.75% which we applied as a flat rate over the GD23 period. PNGL adopted a similar approach but used percentages which increased from 10.86% in 2023, to 10.9% in 2028.

5.24 The lower connection number and call rates used in our analysis resulted in a total number of emergency calls for the GD23 period which was around 3000 lower than submitted by PNGL in its business plan.

5.25 This did not impact the submitted cost for the Emergency Call Centre as both PNGL's and our figures were below the fixed cost threshold for the Cadent Contract. The full cost requested has therefore been allowed in the draft determination.

5.26 Our lower call numbers however do affect the cost allowances for Emergency and Public Reported Escape repair jobs, as both are directly related to the number of emergency calls received from customers.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	461	461	461	461	461	461
UR Draft Determination	461	461	461	461	461	461
Variance	0	0	0	0	0	0

Note 1. Figures may not sum due to rounding.

Table 5.4: Customer Management Costs (Emergency Call Centre), Requested and Allowed, £k

Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping)

5.27 PNGL's customer management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had customer management costs of £764k and had 32.2 FTEs employed within the Customer Management cost category. PNGL have advised us that the 2020 FTEs were low as a result of reduced workstreams for a period of the year brought about by COVID restrictions, coupled with a challenging environment for new recruitment'.

5.28 For the draft determination we have considered the points made by PNGL and have used 2019 actual FTEs at 34.8 FTEs is a reasonable allowance for the GD23 period as it is also in line with medium term historical actual average FTEs (excluding the 2020 year). We have rolled forward 2020 staff costs with this profile of FTEs.

5.29 PNGL have also proposed that we develop an adjustment mechanism of the GD23 price control i.e. through the GD23 Uncertainty Mechanism to deal with any potential material increases in switching levels given their view that this could impact upon Customer Management resource levels. Currently, capacity of Customer Switching is set as per the Network code and we are not presently unaware of any capacity issues occurring over the present GD17 period, but recognise that if a new supplier did enter the market, some pressures may be experienced initially, but over the longer term would settle down. In light of this, we would not be persuaded to add this to the Uncertainty Mechanism.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	884	870	859	861	861	861
UR Draft Determination	790	790	788	789	789	789
Variance	(94)	(80)	(71)	(72)	(72)	(72)

Note 1. Figures may not sum due to rounding.

Table 5.5: Customer Management Costs (Including Non-Emergency Call Centre) & Network Support (Including System Mapping), Requested and Allowed, £k

System Control

5.30 PNGL's system control costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had manpower costs of £118k and had 5.45 FTEs employed within the System Control cost category. PNGL has proposed an additional 0.35 FTEs for System Control in the GD23 period.

5.31 For the draft determination we have rolled forward the 2020 FTEs and staff costs and therefore not allowed the proposed increase in FTEs. Our allowance for FTEs for system control is in line with PNGL medium term historical actuals and in line with our allowances in GD17.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	146	146	146	146	146	146
UR Draft Determination	122	122	122	122	121	121
Variance	(24)	(24)	(24)	(24)	(25)	(25)

Note 1. Figures may not sum due to rounding.

Table 5.6: System Control Costs, Requested and Allowed, £k

Emergency

5.32 The Emergency cost category relates to the costs and activities associated with the initial callout and response to an emergency call from the public that requires further investigation.

5.33 In some cases the emergency call is closed without a visit as it is possible to resolve the issue over the phone. In most cases however, a trained first responder is sent to the location in question to determine the nature and severity of the incident. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex.

5.34 The key driver of costs in this expenditure category is the number and type of jobs, which is in turn driven by number of emergency calls received by the company. Our assessment applies historic rates of jobs to projected emergency call numbers to estimate the volume of work in GD23.

5.35 The number of emergency calls used in our assessment was taken from our 'Emergency Call Centre' analysis. This estimated a total number of calls which was around 3000 less than that submitted by PNGL. Further details on this analysis can be found in the Customer Management (Emergency Call Centre) section of this document, starting at 5.18 above.

5.36 We then calculated the proportion of calls that became emergency jobs in the first four years of GD17 and applied this to our projected call numbers. We used a flat percentage throughout GD23 which was also the approach adopted by PNGL in its submission.

5.37 Our analysis indicated that 61.9% of emergency calls became emergency jobs in first four years of GD17. PNGL used a figure of 62.5%. Although the difference between these figures is small it has a material impact on the level of activity and total costs because it is being applied to a large number of calls over a 6 year period.

5.38 To forecast the number of lower cost jobs that could be closed without a first responder visit, we again applied the historic proportion from the first four years of GD17. This calculated figure was also similar to the company's, with less than 1% variance.

5.39 The lower emergency call numbers and percentages used in our analysis has resulted in a total number of emergency jobs for the GD23 period which is around 3,000 lower than that submitted by PNGL.

5.40 When assessing the unit rate applied to callout jobs, we initially attempted to use the company's stated rates from their submission and intended to

reduce only the variable element of these rates to reflect the changes in work volume.

5.41 However, following discussion with PNGL it became apparent that this was subject to a high degree of interpretation. Consequently we assessed the contractor's rates at a high level and noted a slight overall improving trend over the price control period which compared well to historic expenditure rates. We therefore applied the annual high level rate submitted in the business plan to the volume of jobs for each year in GD23 to estimate costs. If PNGL are able to provide data to clarify the cost breakdown and allow us to move away from the application of the higher level unit rate we will consider this for the final determination.

5.42 The emergency job contract work is performed by Phoenix Energy Services (PES) which is a related Phoenix company. For GD23 we have removed the 7.9% profit margin from costs associated with the work undertaken by PES. This follows the approach adopted in previous price controls, as described in sections 5.5 to 5.7.

5.43 When all contractor and staffing costs are included, the unit rates used in the draft determination are very similar to those submitted by PNGL and the difference is largely attributable to the removal of the PES profit margin. The vast majority of the draft determination deductions are therefore due to the change in the volume of work. This results from the reduction in connection numbers (and therefore volume of calls) and the slightly lower percentages used to determine the number of calls that become emergency jobs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,443	1,471	1,488	1,518	1,548	1,578
UR Draft Determination	1,316	1,341	1,354	1,375	1,395	1,413
Variance	(127)	(130)	(134)	(142)	(153)	(165)

Note 1. Figures may not sum due to rounding.

Table 5.7: Emergency costs submitted by PNGL

Metering

5.44 PNGL requested around £14.4m for meter maintenance in the GD23 period. Routine maintenance on meters and governors accounts for 84% of the submitted costs.

5.45 Domestic regulator inspections (70%) and battery replacement (21%) represent the vast majority of expenditure within the meter and governor cost category,

5.46 PNGL provided source data for its domestic and I&C meter stock which allowed us to check most of the activity data submitted either directly or indirectly. PNGL also provided explanations of how it had estimated its meter maintenance figures and advised that in some circumstances it had used operational reports to derive its numbers rather than the meter stock data.

5.47 When providing this source information, PNGL advised it had underestimated the number of domestic prepayment meter battery replacements that would be required during the GD23 period. Analysis of the detailed meter data provided confirms that this was the case and so we have allowed additional costs of around £410k in the draft determination.

5.48 PNGL also advised that the numbers relating to 'B6 10-year inspections completed 5 years previous' had been overstated for 2024 and 2025 in its submission. We were able to validate the revised figures provided by PNGL indirectly using its meter stock data and have adjusted the allowance accordingly. This has resulted in a 9% reduction in the number of inspections and a cost reduction of around £160k.

5.49 The majority of the remaining routine meter maintenance costs were allowed following validation using the information provided by PNGL. Any exceptions are detailed below.

5.50 PNGL advised that its figures for 5 year inspections on U6 meter regulators 'installed 5 years previously' were based on the actual proportion of new connections that this type of installation represented in 2020. Our analysis of the meter stock data indicated this was around 70% and applying this percentage to submitted connection numbers gave a GD23 total which was within 1% of PNGL's figure. This confirmed the stated approach and that the meter stock data aligned with it.

5.51 Further analysis of the meter stock data showed that the percentages for this type of installation for the four year period 2017 to 2020 was 67% on average and that 2020 was an outlier. We have therefore adjusted this element of the 5 year inspection allowance to reflect the 4 year average, rather than using the 2020 figure in isolation. This has resulted in a 6% reduction in the number of jobs allowed, which translates into a cost reduction of just over £100k for GD23.

5.52 Our assessment of the U6 meter inspections required in 2024 for '20-year end of life replaced 5 years previous' based on meter stock data was 29% lower than PNGL's submitted figure. Extrapolation of 2020 meter stock data gave a figure which was 20% lower. Using the original service install date to estimate the number of inspections required 5 years after 20yr end of life

replacement gave a GD23 total which was 27% lower than PNGL's, which broadly correlated with previous results.

5.53 We queried the 2024 difference with PNGL who advised that their figure was higher because approximately 1,000 'regulator only' replacement jobs had been included in their submission. Through engagement it was established that this had resulted in the number of inspections being overstated and that basing the forecast on a more strategic methodology would be more appropriate. We therefore used the average of our 2019 and 2020 assessments to establish a proportional adjustment which was applied to PNLG's figures. This resulted in a 23% reduction in inspections which translates into a cost reduction of around £555k. Options for refining this adjustment will be considered for the final determination.

5.54 Like the other GDNs, PNGL has extended the 'principle' of the introduction of 5 year regulator inspections to medium pressure U16, U25 and U40 meter installations even though the new guidance only specifically applies to U6 meter installations. We have accepted this on the basis that it follows the practice adopted previously for 10yr inspections.

5.55 However PNGL has incorporated inspections for the U16 to U40 meters with medium pressure regulators from 2021 onwards. This does not align with its approach to B6 regulator 5 year inspections which commence in 2024 (i.e. 5 years after the guidance comes into effect). PNLG has indicated they plan to commence these inspections earlier due to concerns over a specific type of regulator installed from 2014 onwards, which has a built-in safety device that is susceptible to ‘sticking'. We have excluded the 5 year costs for 2023 in our assessment. This is on the basis that the installation of suitable regulators is the company's responsibility; other GDNs have not asked for the U16 to U40 meter regulator inspections to commence earlier than the B6 inspections; the revised industry guidance doesn't specifically apply to these sizes of regulators and is only being extended by way of good practice; and, PNGL have previously operated on a 10yr inspection cycle for these sizes of regulator which would equate to 2024 based on the first year of installation for this type of regulator.

5.56 The meter stock data submitted by PNGL was used to try to validate the inspection figures for the U16 to U40 meter regulator inspections. In this case we arrived at different figures to those submitted by PNGL for the 1st cycle of inspections/tests (Installation date + 5 years), the 2nd cycle of inspections/tests (1st cycle + 5 years) and 20-year replacement jobs undertaken 5 years previously. We also did not identify any additional 'growth' requirement as we believe our 1st cycle inspection figures include any relevant new installations. We have used our estimated figures for U16 to U40 meter regulator inspections for the draft determination. These are

around 27% lower than those submitted by PNGL which equates to a cost reduction of around £70k. We will seek further information from PNGL to try to clarify and reconcile any differences in the numbers for the final determination.

5.57 Finally we assessed the amount of work that PNGL's related company. Phoenix Energy Services (PES) would be undertaking using the original proportions from the submission and removed the 7.9% profit margin. This follows the approach adopted in previous price controls, as described in sections 5.5 to 5.7, and resulted in a reduction in the allowance of around £980k.

5.58 For non-routine meter maintenance we considered the projected profile of total cost per connection for all expenditure areas and found this to be stable or falling from 2021 onwards. We allowed the submitted costs on this basis. These will be reviewed against connection numbers for the final determination to ensure they remain proportionate.

5.59 The outcome of our draft determination assessment for metering is detailed in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,541	2,414	2,453	2,682	2,591	2,685
UR Draft Determination	1,494	2,107	2,208	2,433	2,286	2,383
Variance	(46)	(307)	(245)	(249)	(305)	(303)

Note 1. Figures may not sum due to rounding.

Table 5.8: Metering Costs, Requested and Allowed, £k

PRE-Repairs

5.60 The 'Publically Reported Escape' (PRE) Repair cost category covers the activity associated with the isolation and repair of mains and/or services involving an escape of gas, following assessment by the first responder.

5.61 Due to the safety implications these are considered the most urgent emergency jobs and have the shortest mandatory response times. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.59 above.

5.62 The key driver of costs in this expenditure category is the number of emergency jobs. Our assessment estimates the volume of work by applying historic rates for the number of PRE jobs to projected figures for the total number of jobs.

5.63 The number of emergency jobs used in our assessment was taken from our 'Emergency Response' analysis. This estimated a total number of emergency jobs which was around 3,000 less than that submitted by PNGL. Further details on this analysis can be found in the Emergency section of this document, starting at 5.32 above.

5.64 We then calculated the proportion of emergency jobs that became PRE jobs in the first four years of GD17 and applied this to our overall projected job numbers. We used a flat percentage throughout GD23 which was also the approach adopted by PNGL in its submission.

5.65 Our analysis indicated that 4.99% of emergency jobs became PRE Repair jobs in first four years of GD17. PNGL used a figure of 5.27%. This difference reduced the total number of jobs and therefore the allocated costs. Our number of PRE repair jobs was around 469 lower than the company's.

5.66 Initially our cost analysis was based on the assumption that PES attended 'gas escapes' jobs and Kier attended incidents caused by third parties. This was based on information in the business plan submission. In subsequent discussions with PNGL we were informed that this was not the case, so we instead analysed the GD17 costs incurred by PES and Kier against PRE Repair work in its entirety.

5.67 Our assessment of the high level unit cost of repair jobs for both contractors showed they were gradually decreasing over the period (due largely to the diminishing impact of the fixed management fee spread over an increasing number of jobs). We accepted these annual unit rates on this basis and applied them to the forecast number of jobs for GD23 to determine the draft determination allowance.

5.68 The costs of PRE Repair jobs undertaken as a result of third party damage are recoverable and any contributions received offset the costs incurred by the company. When we assessed the extent of recovery in PNGL's business plan we found it was less, as a percentage of the overall cost incurred, than in GD17 to date. We are unclear why this cost should be increasing relative to expenditure and so have maintained the historic recovery levels for our draft determination so that consumers are not disadvantaged.

5.69 Finally we assessed the amount of work that PNGL’s related company. Phoenix Energy Services (PES) would be undertaking using the original proportions from the submission and removed the 7.9% profit margin. This follows the approach adopted in previous price controls, as described in sections 5.5 to 5.7.

5.70 The final cost allocation following all volume and cost adjustments can be seen in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	934	946	956	968	981	995
UR Draft Determination	839	850	858	866	873	879
Variance	(95)	(97)	(98)	(102)	(109)	(116)

Note 1. Figures may not sum due to rounding.

Table 5.9: PRE-Repairs Costs, Requested and Allowed, £k

Maintenance

5.71 PNGL requested just over £15.5m for maintenance in the GD23 period. Other maintenance costs (47%) and Miscellaneous (31%) account for the majority of the costs.

5.72 Purge point maintenance represents the majority of the expenditure on 'other maintenance' (71%) and around 22% of maintenance costs overall. Strategic Mains Inspection is also a material item in this cost category. Miscellaneous expenditure is split roughly 50:50 between Valve maintenance and Telemetry.

5.73 In overall terms the proposed maintenance expenditure has increased significantly compared to GD17. The step change is largely attributable to three new projects (purge point maintenance, strategic valve inspections and strategic main inspection) and an increase in Telemetry costs. The costs for the majority of the remaining maintenance items and staff costs remain broadly stable. For the draft determination we have focused on the expenditure areas that have resulted in material cost increases.

5.74 At almost £3,5m, purge point maintenance is the largest maintenance expenditure item overall and the main driver of the significant increase in the 'other maintenance' cost category. PNGL advised that they identified the need for this new project through an ISO 55000 asset management audit in 2020-21, which highlighted the need for a condition assessment and remedial project to maintain purge points to an appropriate standard. They noted that the site inspections undertaken had identified corrosion to a point of material loss, weakening the integrity of the pressurised fitting, and highlighted the risk that failure could pose to members of public, operatives and network supply.

5.75 PNGL is aiming to inspect all purge points that are 20 years or older by the end of GD23. This includes addressing some backlog before moving to an annual 20 year inspection programme from 2029 onwards. The percentages

used to determine the number of lower cost maintenance jobs and higher cost replacement jobs are based on the outcome of a survey covering all asset age ranges. These have been applied correctly to the total number of assets in each age bracket to generate the submitted activity levels and costs.

5.76 For the purpose of the draft determination we have allowed the purge point inspection allowance in full. However we note that PNGL did not commence a full inspection programme immediately after the audit. We will therefore explore the stated urgency further for the final determination. This will include whether work should start earlier, or alternatively, whether the inspection profile could be smoothed over a longer period.

5.77 In addition, we will also want to consider further whether the issues identified could have been reasonably foreseen and mitigated at the time of original installation. This is to ensure that customers are not unnecessarily paying for work twice. We will also seek to assure ourselves that PNGL's proposals for ensuring its new installations mitigate against the issues identified to date are reasonable

5.78 Some of the cost increase in 'other maintenance' also results from another new project for inspecting protective steel plates installed at critical points over strategic mains. PNGL have submitted the cost required to inspect all steel plates that have been in place for at least 20 years, with the aim of assessing their condition and verifying they are still able to provide the protection required. The submission totalled just under £600k for inspecting around 3,400 steel plates.

5.79 We have excluded all of the costs for the strategic mains project from the draft determination. This is because we don't consider that the risk, need and benefit for this level of activity and cost has been evidenced sufficiently through investigation or through reference to known performance issues. We will consider the company's proposals to undertake this work further in the future when it is in a position to present a well evidenced business case to justify the expenditure.

5.80 Under Telemetry, PNGL submitted proposals to expand their pressure monitoring capability through the installation of monitors at 60 additional network monitoring points and the provision of monitoring at 438 governor bins. We have accepted the provision of the 60 additional pressure monitoring points which will complement the monitoring already provided at District PRSs and allow PNGL to achieve pressure monitoring coverage across the entire network.

5.81 We have not allowed the costs relating to the installation of pressure monitoring at the 438 governor bins as we are not convinced of the additional benefit of providing further monitoring within the network at this level at significant additional cost to consumers. This results in a reduction of around £1m in the costs submitted for telemetry. A further reduction of around £110k was made as a consequence of PNGL identifying an error in the submission. This was due to the annual costs of their new Gascore platform and the calibration of telemetry being allowed for twice.

5.82 The majority of the remainder of the telemetry increases relate to the need to replace or update software, systems and hardware which are becoming obsolete. This includes the impact of PSTN copper wire phone lines reaching end of life in 2025 and costs have been allowed on this basis.

5.83 The step change in the valve maintenance expenditure almost entirely results from a strategic valve inspection programme proposed by PNGL. PNGL identified this requirement through an ISO 55001 asset management audit in 2020, which found that PNGL's 'Critical Valves' asset group did not fully correspond with current standards. As a consequence PNGL upgraded its original inspection list to include valves at a list of additional strategic locations. PNGL quoted examples of condition deterioration found through operational activities and of valve failures linked to corrosion. It also highlighted that these types of valves have been installed since 1996 and that some will have reached 25 years of age by the start of GD23.

5.84 PNGL provided data to support the numbers and unit costs in the submission and we have allowed the strategic valve inspection costs of just over £1.1m taking into account the age and criticality of these assets.

5.85 The scope of work in the service risers and laterals cost category has increased due to the inclusion of a proposal to inspect house entry tees, cellar entry fittings and hockey sticks from 2021 onwards. This has been proposed as a consequence of an industry safety alert. As PNGL are planning to carry out these inspections when undertaking meter end of life replacements we tried to reproduce numbers using meter stock data provided by the company, but got figures which were slightly lower. PNGL provided additional information to clarify its submission but this did not explain the apparent difference to the meter stock data. We have allowed these costs in full in the draft determination but will seek to clarify and reconcile any differences in the figures for the final determination

5.86 Finally, we removed the 7.9% profit margin from the element of maintenance work that PNGL's related company, Phoenix Energy Services (PES), would be undertaking. This follows the approach adopted in previous price

controls, as described in sections 5.5 to 5.7 and resulted in a reduction of around £11.7k.

5.87 The outcome of our draft determination assessment for maintenance is detailed in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	3277	2,901	2,588	2,276	2,253	2,221
UR Draft Determination	2736	2360	2107	2130	2107	2074
Variance	(540)	(541)	(480)	(146)	(146)	(147)

Note 1. Figures may not sum due to rounding.

Table 5.10: Maintenance Costs, Requested and Allowed, £k

Other Direct Activities

5.88 PNGL has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and therefore we have not provided for any allowances for the GD23 period.

IT & Telecoms

5.89 PNGL IT & Telecoms costs are in the main driven by its associated manpower costs and costs for stationary, communications and billing. In the 2020 year, PNGL had IT & Telecoms costs of £507k.

5.90 PNGL had 3.15 FTEs employed within the IT and Telecoms cost category in 2020 and projected a flat profile in FTEs for the GD23 period as well as a 12% increase on average in stationary, communications and billing costs in the GD23 period when compared to 2020 actuals. PNGL has explained that it 'expected a switch of IT costs from capex to opex from 2025 onwards as a result of IT suppliers moving from annual product licensing (opex) rather than perpetual licences (capex)' and therefore requested that we consider the aggregated IT forecasts for opex and capex when setting PNGL's overall IT allowances for GD23.

5.91 For the draft determination we have rolled forward PNGL actual 2020 FTEs together with 2020 staff costs. In relation to stationary, communications and billing costs we have accepted PNGL projections, as we recognise some of the increase in opex costs arise from a switch in capex to opex costs in the GD23 period.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	535	535	581	575	578	575
UR Draft Determination	529	529	575	569	572	569
Variance	(6)	(6)	(6)	(6)	(6)	(6)

Note 1. Figures may not sum due to rounding.

Table 5.11: IT & Telecoms Costs, Requested and Allowed, £k

Property Management

5.92 The most significant cost item under PNGL property management costs are in relation to network rates. We have in the past set network rates using a formula which links the allowance to PNGL revenues.

5.93 We are comfortable with the approach of using a formula linked to revenue in order to set the network rates allowance for PNGL. We have used this approach historically both in GD14 and GD17. The network rates allowances have therefore been calculated accordingly.

5.94 PNGL have acknowledged that the figures contained within their GD23 business plan submission for network rates contained an error. We accepted the PNGL resubmission on network rates with the exception that we have profiled a 'flat rate in the pound' for all years in GD23 as this has a consistent approach of how we have set network rates for both FE and SGN.

5.95 PNGL also requested that we treat network rates in GD23 as a cost pass-through item as it considers that 'network rates is something that PNGL as an entity has limited / no control over and therefore one that should be pass-through regardless of the choice of methodology utilised by LPS'.

5.96 For the draft determination we are of the view for the GD23 period that uncertainty mechanism should be updated to reflect actual costs for network rates, subject to PNGL demonstrating that it has taken appropriate actions to minimise valuations. We will expect PNGL (as well as the other GDNs) to provide a copy of its actual network rates bill and appropriate payment verification to the Utility Regulator alongside its annual Uncertainty Mechanism submission which is usually submitted with the Annual Cost Reporting Template.

5.97 PNGL also has rent and rates costs in relation to its offices. We have reviewed these costs and consistent with our approach in GD17 made an adjustment to take account of our view that PNGL has an opportunity to sub-let part of its premises. We have therefore based the cost on 2020 actuals, with a reduction of 1/6 to recognise the premise could be sublet. PNGL have

indicated that a rent review was underway in 2021 and will we update this for the final determination if appropriate.

5.98 PNGL had 1.55 FTEs under the Property Management cost category in 2020 and proposed an increase for the GD23 period to 2.11 FTEs for the GD23 period. We have allowed this for the draft determination given it is in line with average medium-term historic actuals and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	3,681	3,790	3,855	3,994	4,061	4,594
UR Draft Determination	2,777	2,709	2,696	2,684	2,671	2,655
Variance	(904)	(1,081)	(1,159)	(1,310)	(1,390)	(1,939)

Note 1. Figures may not sum due to rounding.

Table 5.12: Property Management Costs, Requested and Allowed, £k

HR & Non-operational Training

5.99 PNGL HR and non-operational training costs are in the main driven by staff costs and professional and legal fees as well as some materials costs.

5.100 In the 2020 year PNGL had HR and non-operational training costs of £244k. PNGL had 3.1 FTEs employed within the HR and Non-operational training cost category in 2020 and projected a flat profile in FTEs in this area for the GD23 period.

5.101 We have accepted this projection in FTEs and consequently provided for 3.1 FTEs in the GD23 period and rolled this forward with 2020 staff costs. We have also rolled forward 2020 professional and legal fees and materials costs as when taken together they are broadly in line with medium term historical actuals.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	272	273	273	273	273	273
UR Draft Determination	242	243	243	243	243	243
Variance	(30)	(30)	(30)	(30)	(30)	(30)

Note 1. Figures may not sum due to rounding.

Table 5.13: HR & Non-Operational Costs, Requested and Allowed, £k

Audit, Finance & Regulation

5.102 PNGL Audit, Finance and Regulation costs are in the main driven by staff costs and professional and legal fees as well as some costs for stationary, comms and billing.

5.103 In the 2020 year PNGL had audit, finance and regulation costs of £965k. PNGL had 12.2 FTEs employed within the Audit, Finance and Regulation cost category in 2020 and has proposed an increase of 1.2 FTEs in this area for the GD23 period.

5.104 PNGL has explained that given its 'operational and strategic resource is fully utilised, PNGL has determined that 1 additional senior business analyst is required to deliver upon the suite of additional regulatory requirements of the department'.

5.105 We note that PNGL has actually reduced the number of FTEs employed within its Audit, Finance and Regulation department over the medium term i.e. from 12.7 FTEs in 2014 to 12.2 FTEs in 2020. We also note that in GD17 PNGL stated that it required 13.5 FTEs but only actually employed 12.2 FTEs in 2020. We have rolled forward 2020 FTEs together with 2020 staff costs which are marginally higher than GD17 medium term historical averages (i.e. over the 2017 to 2020 period).

5.106 PNGL has projected professional and legal fees which contain uplifts in the 2027 and 2028 years in relation to price control costs as they consider it is 'more cost effective to buy in specialist services from the market as required' as 'its scale does not justify retention of core services based on the breadth of activities that such core resources would need to cover'.

5.107 We have compared PNGL submission in this area to the submissions received from the other GDNs and we have also compared PNGL previous professional and legal fees in years where price controls taking place e.g. 2015 and 2016 for the GD17 price control.

5.108 Overall we found the PNGL submissions in this area reasonable. We took the average of medium term (2017 to 2020) professional and legal fees actual costs and have applied this to non-price control years in the GD23 period and provided an uplift for price control years in line with PNGL submission. We also rolled forward PNGL 2020 actuals for stationary, comms and billing as they are in line with medium term historical actuals.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,069	1,066	1,067	1,068	1,168	1,170
UR Draft Determination	907	907	907	907	1,012	1,012
Variance	(162)	(159)	(160)	(161)	(156)	(158)

Note 1. Figures may not sum due to rounding.

Table 5.14: Audit Finance & Regulation Costs, Requested and Allowed, £k

Insurance

5.109 The main element of PNGL insurance costs is business insurance, which in turn is dominated by Business Interruption and Public Liability cover as well as Directors & Officers, Crime Professional Indemnity.

5.110 The total insurance costs requested by PNGL represent a significant increase on 2020 actuals. The increase between 2020 actuals and the request for GD23 from 2023 is around 48%. We queried PNGL about these increases and PNGL provided substantial documentation on their insurance premiums including their 2021 actual costs.

5.111 PNGL also explained that 'there is no evidence to suggest that these increases i.e. circa 40% increase from 2020 to 2021, will only apply in the short term and therefore the increases costs experienced by PNGL in 2021 are reflected in its overall insurance forecast for the GD23 price control period'.

5.112 However, we have noted the evidence provided by FE in terms of a benchmarking report showed that envisaged increases for 2021 / 2022 were not as significant as previously assumed albeit the increases are still significant. We also note that the claimed increases by PNGL are significantly higher than that claimed by FE.

5.113 For the GD23 draft determination we have rolled forward PNGL actual 2020 insurance costs except for car insurance. While we note the increased insurance costs overall in 2021 we are mindful that PNGL overall opex costs have actually decreased over the medium i.e. from 2010, and in that period PNGL insurance costs have experienced both annual increases and decreases and there has not been any period of sustained increases. However, we may undertake further analysis of PNGL insurance costs in advance of the GD23 final determination.

5.114 In relation to office insurance we have based our allowances on 2020 actual costs. In relation to car insurance we note that the projected insurance per car profiled by PNGL is significantly above that of both industry benchmark reports and other GDNs operating in Northern Ireland. Therefore, we

reduced the projections by PNGL to those contained within average policy price referenced in a recent industry report.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,054	1,063	1,066	1,071	1,080	1,089
UR Draft Determination	688	688	688	689	689	689
Variance	(366)	(375)	(378)	(382)	(391)	(400)

Note 1. Figures may not sum due to rounding.

Table 5.15: Insurance Costs, Requested and Allowed, £k

Procurement

5.115 PNGL procurement costs are driven by staff costs. In the 2020 year PNGL had procurement costs of £62k. PNGL had 1.55 FTEs employed within the Procurement cost category in 2020. PNGL has projected 2.11 FTEs for the GD23 period.

5.116 For the draft determination we have accepted PNGL's projection of FTEs as it is line with medium term historic actual FTEs and rolled this forward with 2020 actual staff costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	78	78	78	78	78	78
UR Draft Determination	85	85	85	85	85	85
Variance	7	7	7	7	7	7

Note 1. Figures may not sum due to rounding.

Table 5.16: Procurement Costs, Requested and Allowed, £k

CEO & Group Management

5.117 PNGL CEO & Group Management costs are driven by the senior management team costs as well as professional and legal fees together with stationary, communications and billing costs. The number of FTEs PNGL has allocated for the GD23 period is similar to that for 2020 actuals at 3.9 FTEs.

5.118 For the draft determination allowances for CEO & Group Management are rolled forward from GD17. We have also rolled forward 2020 actual costs for professional and legal fees as well as for stationary, communications and billing costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,785	1,785	1,785	1,786	1,786	1,786
UR Draft Determination	1,381	1,381	1381	1,381	1,381	1,381
Variance	(404)	(404)	(404)	(405)	(405)	(405)

Note 1. Figures may not sum due to rounding.

Table 5.17: CEO and Group Management Costs, Requested and Allowed, £k

Stores & Logistics

5.119 PNGL stores and logistics costs are driven by transport and plant costs. In 2020 PNGL actual costs were £28k and PNGL have requested allowances of £32k in the GD23 period. For the draft determination we have rolled forward 2020 actuals costs as they are in line with medium term average historic actual costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	32	32	32	32	32	32
UR Draft Determination	28	28	28	28	28	28
Variance	(4)	(4)	(4)	(4)	(4)	(4)

Note 1. Figures may not sum due to rounding.

Table 5.18: Stores and Logistics Costs, Requested and Allowed, £k

Advertising & Market Development (Owner Occupied)

Introduction

5.120 In GD17 the allowances for costs associated with advertising and marketing (Owner Occupied) were recovered via a connection incentive. We set out in the GD17 final determination [4] our intention to review the connection incentive in advance of GD23.

5.121 Early development and engagement on GD23 began in the autumn of 2019 and our approach to the connection incentive review was discussed with the GDNs and key stakeholders in bilateral and round-table meetings. Following this there was a Round Table discussion on GD23 connection incentives with all GDNs in December 2019 and subsequent follow up meetings, connected to this area.

5.122 This was followed up with an information request to all GDNs in November 2020, which comprised of 2 broad categories as set out below:

[4] 4 2016-09-15_GD17_Final_Determination_-_final_0.pdf (uregni.gov.uk) Paragraph 13.15

a) Confirmation of historical data on the costs and performance in this area.

b) Questions to the GDNs relevant to the connection incentive as follows:

(i) The relationship between expenditure and connections delivered.

(ii) The approach and activities used to acquire connections and how this has developed based on experience and learning.

(iii) The structure of the incentive mechanism and the incentive value of the Connection Incentive.

5.123 PNGL provided a response to the questions, including extensive information on the area, as follows:

- Consumer Contact Inventory
- Stakeholder Engagement in Action
- Influence of Stakeholder and Consumer Engagement
- Ipsos MORI PNG Consumer Engagement Research
- Ipsos MORI PNG Stakeholder Engagement Event
- Customer Vulnerability Internal Staff Training 2021

5.124 The above provided insight in its approach, strategy, techniques, costs, observations/criticism on the current mechanism and the challenges that it faces to acquire new customers, in the context of the Energy Strategy.

5.125 In summary it requested a connection incentive allowance of £508 per connection or a £1.74M pa Average total Advertising, Marketing and Development including overheads, to optimising OO activity across the PNGL licenced area for 22,918 new OO Connections.

5.126 We have carefully considered this material as presented, in conjunction with the submission made by the GDNs, which has led to the following assessment and approach to be taken in this area.

Previous GD17 Mechanism

5.127 The connection incentive for GD17 was based on a principle that once the network has been constructed the marginal revenue of any future connection

will reduce costs for all consumers. An economic rate for a standard connection incentive rate was calculated which allowed part of the marginal revenue of a new connection to be 'invested' to promote connections while the balance would benefit all consumers through lower tariffs.

5.128 The economic rate for a standard connection incentive rate was calculated, based on some simple assumptions, which required a degree of judgement as follows: average rate of gas consumed in a year by a typical domestic customer, appropriate suitable payback period, the conveyance charge to cover the costs of the network, rate of return of the project and the capital costs of the gas main, service and meter costs. The economic level of the connection incentive is the value which would minimise tariffs in the long term.

5.129 The connection incentive payment was subject to a non-additionally threshold set for each GDN to reflect the 'maturity' of their network. The incentive is then paid on each connection over the non-additionally threshold. In the past we have explained the non-additionally threshold as the number of connections which would occur without any effort to promote connections.

5.130 The mechanism set specific connection targets on the acquisition of new customers and implemented a collar such that, where a GDN underperforms the annual connection target by more than 50%, a 25% collar (i.e. 25% * 'per connection' allowance) would operate.

5.131 Another component of the mechanism was that certain costs were to be recovered via the connection incentive mechanism. These costs were mainly related to Business Support activities that supported this area which reduced the fixed allowances. This was to incentivize the GDNs to achieve the target connections or to suffer some risk on Business Support Costs allowances.

5.132 An additional 'new areas' allowance was added to the standard connection incentive rate to reflect some of the challenges of promoting gas in new extension areas such as East Down and Gas to the West, in which we signalled that the "new areas" allowance would be removed at the end of GD17.

5.133 In the last year of the allowance, in 2022, the figure is £307 per connection (Excluding New Areas allowance, removal of 25% Non Additionality, post efficiency).

New Approach - Cost To Serve

5.134 After considering the current mechanism and the comments made by the GDNs in the information supplied and taking regard on the stage of development for each Network Operator, we have decided to replace the existing economic incentive mechanism.

5.135 We propose in replacing it with a 'Cost to Serve' allowance. The concept of Cost to serve is to cover the GDNs reasonable costs of responding to contacts and supporting consumers through the connection process, including the cost of Energy Advisers

5.136 To enable preparation by the GDNs of this change, we are proposing a glide path down from the existing levels in 2022 by moving fully to what we consider a reasonable cost to serve allowance by 2028 for each GDN.

5.137 Outlining this approach to the GDNs, caused some concern for the implications in the wider industry context for positioning in the market place. They suggested that the marketing and development activity funded from the Connection Incentive also supported wider awareness of the gas industry for the public, customers, stakeholders, community and elected representatives, ensuring that they are suitably informed, understand the emergency response, non-routine and asset maintenance activities general adverting etc. The GDNs made the point that this was necessary as part of their core responsibilities as a network operator.

5.138 PNGL have suggested an allowance of £150k pa to deal with these type of issues. We believe this is a reasonable comprise to provide a fixed allowance for all GDNs to support and aid the understanding of wider gas issues that may be lost as marketing and advertising activities funded through the connection incentive are wound down. This allowance would be for the wider promotion and awareness of the gas industry which may prompt connection requests but would not be linked to the connection target. We propose a fixed amount of £150k for PNGL.

5.139 Since this 'fixed' allowance is already included in the advertising and marketing costs allocated to OO connections incentive rate, the glide path rate from GD17 incentive rate to Cost to serve must be adjusted in the early years to deduct the allowance for advertising and marketing in the embedded rate.

5.140 For moving to a Cost to Serve allowance the following changes are made to the mechanism

a) A glide path which starts from the GD17 incentive rate for 2022 excluding the new areas allowance.

b) Sets different cost to serve rates for each GDN at 2028 based on mainly 2020 actual staff costs, stationary, communications and billing costs as well as any entertainment costs with reasoned adjustments for each GDN.

c) Adds a fixed allowance for limited marketing and advertising that is adjusted in the early years to take account of an allowance for advertising and marketing, already included in the glide path (e.g. £150k pa).

d) Use the projected connection numbers as at 2022 for the GDNs and glide path down to 60% by the end of GD23.

e) Connection Targets are now removed and removal of the Collar and any reduction in allowances.

f) Non-Additionally is now removed and every connection qualifies for the same allowances, which removes risk from each GDN.

g) The Corporate Overhead Costs, that had to be recovered via the previous mechanism, is now dropped removing this risk from each GDN.

5.141 All connections allowances claimed by GDNs must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

5.142 Table 5.19 provides the allowance, per connection, which excludes the fixed allowance with regard the limited marketing and advertising as discussed above. Table 5.20 compares the draft determination owner occupied (OO) connection numbers against the PNGL GD23 submission.

PNGL	2023	2024	2025	2026	2027	2028
Connection allowance per customer	244	211	179	146	130	130

Note 1. Figures may not sum due to rounding.

Table 5.19: OO Connection Allowance, £

5.143 The allowances set out in Table 5.20 translate to an average allowance over the 6 years of GD23 for PNGL of £173 per connection, subject to the fixed allowance as described above.

	2023	2024	2025	2026	2027	2028
PNGL submission	4,522	4,159	3,727	3,612	3,402	3,396
UR Draft Determination	4,387	4,073	3,760	3,447	3,133	2,820

Note 1. Figures may not sum due to rounding.

Table 5.20: OO Connection Numbers and Allowances

5.144 Table 5.21 shows the comparison of the draft determination allowances against the PNGL GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,323	1,321	1,318	1,278	1,277	1,277
UR Draft Determination	1,218	1,011	822	652	557	517
Variance	(105)	(310)	(496)	(626)	(720)	(760)

Note 1. Figures may not sum due to rounding.

Table 5.21: Advertising & Market Development (Owner Occupied) Costs, Requested and Allowed, £k

Advertising & Market Development (Non - Owner Occupied)

5.145 The Advertising and Market development (non-OO) cost category covers advertising and market development expenditure in relation to NIHE, New Build and I&C properties.

5.146 PNGL Advertising and Market development costs are driven by staff costs and market development costs and a small amount for stationary, communications and billing and entertainment. In the 2020 year PNGL had advertising and market development (Non-OO) costs of £454k.

5.147 PNGL had 7.6 FTEs employed within the advertising and market development (non-OO) category in 2020 and is proposing to increase the level of FTEs to 8.7 FTEs in GD23. We queried PNGL on this proposed increase and PNGL informed us that it had allocated an envisaged 'Energy Transition Manager' role to this cost category and that it had recruited this role part way through 2021.

5.148 We note that the 2020 actual number of FTEs for advertising and marketing (non-OO) is significantly more than that planned by PNGL in the GD17 period which was 7 FTEs. We also note that other GDNs have profiled lower FTEs in this area for the GD23 period and that connection numbers for the AMD (Non-OO) for PNGL are expected to decline in the GD23 period.

5.149 We have based the advertising and market development (Non-OO) cost allowance for GD23 on the PNGL 2020 actual FTEs but provided for an additional FTE for energy transition which is consistent with our approach for

the other GDNs. This means we have provided for 8.6 FTEs against the 8.7 FTEs requested by PNGL and we have rolled forward 2020 staff costs. We have also carried forward 2020 costs for stationary, communication, billing and stationary costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	542	545	548	542	544	545
UR Draft Determination	514	514	514	514	514	514
Variance	(28)	(31)	(34)	(28)	(30)	(31)

Note 1. Figures may not sum due to rounding.

Table 5.22: Advertising & Market Development (Non-Owner Occupied) Costs, Requested and Allowed, £k

Trainees & Apprentices

5.150 PNGL has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and therefore we have not provided for any allowances for the GD23 period.

Non-Controllable Opex

5.151 The only costs under non-controllable opex are PNGL licence fees. We have accepted PNGL forecast costs of licence fees of £158k per annum for the draft determination, but will work on the area further and update for the FD. Any difference between forecast licence fees and actual licence fees will be taken account of by the uncertainty mechanism in GD29.

Supplier of Last Resort

5.152 With regard to the Supplier of Last Resort (SOLR), we believe that there is merit to including an allowance to cover any unforeseen costs that may occur, if an event were to happen. This amount is ring fenced and will be removed at the time of the next price control, if an incident fails to materialise. For the GD23 draft determination we have accepted the proposal made by PNGL and allowed £343k for these costs in 2023 only to cover the duration of the price control.

Capitalisation

5.153 For the GD23 draft determination we have accepted PNGL capitalisation rates however these may be reviewed further for the final determination.

Shrinkage

5.154 Having assessed the PNGL business plan submission with respect to shrinkage, we noted that the shrinkage factors, are forecast to be stable at

0.22% across the GD23 price control period. They are also consistent with the shrinkage factor for 2019 and 2020 and those forecast for the last two years of the GD17 price control period.

5.155 We do not propose any shrinkage-related changes to existing regulatory arrangements and/or the introduction of a shrinkage-related incentive mechanism at this stage.

5.156 However, we consider that PNGL should continue to establish the annual shrinkage factor in line with the common Northern Ireland Shrinkage Methodology which was developed, and should be maintained and amended as may be appropriate from time to time, jointly by all three GDNs. We furthermore consider that shrinkage should continue to be monitored as part of the annual cost and performance arrangements.

Real price effects, productivity and frontier shift

5.157 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

5.158 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH). Given the CPIH is no more a measure of general inflation than RPI, not all types of cost changes will be reflected in the range of prices used to calculate the CPIH. To account for this it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

5.159 This calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs), and the projected rate of productivity growth. The sum of these components can be a positive or a negative difference.

5.160 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

5.161 We have adopted the methodology we first introduced at PC13, PC15 and PC21 for NI Water, which aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

5.162 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	4.4	3.8	2.9	2.3	2.8	3.3	3.3	3.3
CPIH	(2.9)	(4.0)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift	CPIH + 0.4	CPIH -1.2	CPIH -0.2	CPIH -0.8	CPIH -0.3	CPIH +0.1	CPIH +0.1	CPIH +0.1
Cumulative frontier shift	0.4	-0.8	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8

Table 5.23: GD23 Opex frontier shift calculations

5.163 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

5.164 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

Summary of bottom-up assessment findings

5.165 Table 5.24 shows the opex allowances for PNGL in the GD23 period. The total pre-efficiency opex allowances (excluding allowances associated with AMD-OO) for PNGL in GD23 on average are 10% higher than 2020 actuals.

PNGL Categories	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	267	267	267	267	267	267	1,602
Operations Management	497	497	491	491	491	491	2,958
Emergency Call Centre	461	461	461	461	461	461	2,766
Customer Management	790	790	788	789	789	789	4,735
System Control	122	122	122	122	121	121	730
Emergency	1,316	1,341	1,354	1,375	1,395	1,413	8,195
Metering	1,494	2,107	2,208	2,433	2,286	2,382	12,912
PRE-Repairs	839	849	858	866	873	879	5,165
Maintenance	2,736	2,360	2,107	2,130	2,107	2,074	13,514
Other Direct Activities	0	0	0	0	0	0	0
IT & Telecoms	529	529	575	569	572	569	3,343
Property Management	2,777	2,709	2,696	2,684	2,671	2,655	16,192
HR & Non-operational Training	242	243	243	243	243	243	1,457
Audit, Finance & Regulation	907	907	907	907	1,012	1,012	5,652
Insurance	688	688	688	689	689	689	4,131
Procurement	85	85	85	85	85	85	510
CEO & Group Management	1,381	1,381	1,381	1,381	1,381	1,381	8,286
Stores & Logistics	28	28	28	28	28	28	168
Advertising & Market Development - Owner Occupied (OO)	1,219	1,011	822	652	557	517	8,287
Advertising & Market Development (Non OO)	514	514	514	514	514	514	3,084
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	158	158	158	158	158	158	948
Supplier of Last Resort	343						343
Total: Pre Efficiency	17,396	17,049	16,753	16,844	16,701	16,729	101,472
Frontier Shift %	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8	
Total: Post Efficiency	17,221	16,725	16,384	16,507	16,384	16,428	99,650

Note 1. Figures may not sum due to rounding.

Table 5.24: PNGL GD23 Opex Draft Determination Pre and Post Efficiency, (£k)

6. SGN Natural Gas - UR Proposals

Overview

6.1 As set out in chapter 2, we have used bottom-up analysis as basis for our assessment of opex business plan requests.

6.2 We note that, in line with our detailed approach set out in chapter 2, we have assessed the requested opex allowances for the different cost categories. We have also undertaken additional analysis for selected expenditure types and on the proposed capitalisation policies. The bottom-up part of this chapter is structured accordingly.

6.3 We note furthermore that, in line with our detailed approach set out in chapter 2, we have generally used the most up to date detailed actuals as part of our assessment of business plan requests, i.e. data relating to 2020. We consider that this provides a sound basis to set-up a benchmark where appropriate.

Implications of the G2W Application Process

6.4 In some circumstances, however, we have good reasons for deviating from the normal approach in setting allowances.

6.5 We believe the circumstances are warranted for some cost lines. The reason for the deviation, is that in the context of the award of the SGN licence, reference was made to certain areas that would last beyond the GD17 price control period. To that end we need to examine the SGN business plan submission in some areas, in tandem with the application process for the G2W licence, specifically:

a) IT and Telecoms costs,

b) CEO Group Management (Largely Managed Serves Agreement (MSA)

c) Advertising and Market Development (non-OO) category.

6.6 In order to facilitate an analysis of the SGN GD23 business plan submission against the G2W bid we requested SGN to provide its G2W bid in a structure consistent with the GD23 business plan template. SGN responded to the Utility Regulator stating that 'this information is not readily available and can only be derived through a set of assumptions on how the original bid was compiled. Neither the original bid nor the underlying calculations contained this information and would require spurious assumptions to be made.'

6.7 SGN also stated 'SGN NG no longer consider the values within the bid to be an appropriate point of reference. The forecast figures were prepared in 2014 and were based on assumptions that we believed were appropriate at that time. Since then, many of these assumptions have been proved to be incorrect which therefore impacts the validity of these forecasts. The GttW project delivery has also been delayed since the bid submission, which has had significant impacts on many aspects of our original forecasts. We consider that our operating costs for the GD17 period are now the most appropriate point of reference, and therefore render the bid figures obsolete. Therefore, our GD23 submission is based around our GD17 actual expenditures that have been incurred efficiently over the price control. We feel that many bid assumptions (derived from the FMA study) have been shown to be unreliable when considering the actual outturns witnessed, therefore as this information is not part of our GD23 submission, we do not see the relevance of completing this spreadsheet for years 7 to 10'.

6.8 SGN also responded that the GD17 final determination stated 'Thus in advance of GD17, it was clear that we intended to put significant weight on the figures used in the G2W licence competition. It was also clearly identified that adjustments would be considered to reflect changes to assumptions on customer numbers and volumes. However, otherwise there was a high bar to making changes from the AIP and this was particularly true for the first price control'.

6.9 On 6 February 2014, we published the G2W Applicant Information Pack (AIP).[5] In addition to details on the licence application process itself, this document also contained clarifications on links between the information revealed as part of the application process and subsequent price control processes. This was to incentivise applicants to submit realistic bids.

6.10 With respect to opex allowances we stated: “we believe that a direct link between the cost information revealed in the application and the allowances provided in subsequent price controls will act as a powerful incentive to ensure that applicants reveal realistic cost information and that some link should be maintained beyond the first price control period. In particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies. However, we will consider requests for different allowances where these are the result of unforeseen significant changes in the market since the application was submitted[6].” We also clarified that, “[as] set out [...] under capex, a number

[5] Utility Regulator: Gas Network Extensions in Northern Ireland, Gas to the West: Applicant Information Pack, 6 February 2014.
[6] Utility Regulator: Gas Network Extensions in Northern Ireland, Gas to the West: Applicant Information Pack, 6 February 2014, paragraph 3.44

of items are adjusted under an 'uncertainty mechanism' and we intend this to be applied to the new licence".[7]

6.11 There was further guidance specifically in relation to incentivising IC customers where Paragraph 4.36 of the AIP stated "[no] incentive payments for non-owner occupier connections have been included in the workbook. However, if an applicant believes that in order for them to meet the target for industrial and commercial connections they will require funding for financial incentives they have an opportunity to include such costs in the Operating Expenditure worksheet. They should also explain in their operational business plan how such payments would facilitate connections by non-owner occupier supply points. Only if the successful applicant has included such incentives in their application will these be funded by price control allowances".

6.12 The Applicant Information Pack also clarified that we intended to use the pattern of volumes and connections derived from the FMA study[8] to set the first and future price controls. However, we also clarified that, should significant changes in expected supply points/consumption patterns arise between the licence application process and the setting of the first price control, we would consider if these needed to be reflected in the development plan and price control values.

6.13 In August 2014, the Preferred Applicants chosen were NIEH for the HP pipeline and SGN for the LP pipeline.

6.14 Thus, in advance of GD17 and GD23, it was clear that we intended to put significant weight on the figures used in the G2W licence competition. It was also clearly identified that adjustments would be considered to reflect changes to assumptions on customer numbers and volumes. However, otherwise there was a high bar to making changes from the AIP and this was particularly true for the first price control.

6.15 In its GD17 submission and in its GD23 submission, SGN proposed significant changes to opex figures compared to those it submitted in their G2W application. We have examined these carefully against the criteria we set out in designing the G2W licence application competition.

6.16 For GD17 we provided for increased costs only for those cost categories which were related to a change in customer numbers and volumes as the G2W AIP stated ''if there are significant changes in expected supply points /

[7] Utility Regulator: Gas Network Extensions in Northern Ireland, Gas to the West: Applicant Information Pack, 6 February 2014, paragraph 3.47

[8] A study by Fingleton McAdam (FMA) to determine the technical and economic feasibility of extending the natural gas network in Northern Ireland which was used by DETI in its assessment of G2W and the basis for the figures used in the Application Workbook.

consumption patterns between the licence application process and the setting of the first price control we will consider if these need to be reflected in the development plan and the price control values'.

6.17 In GD17 it was clear that there had been a significant change in projected customer numbers and volumes since the licence application and this warranted an adjustment to the opex that was submitted by SGN in its licence. Consequently, in GD17 we provided for an uplift in opex costs which we considered to be most impacted by increased customer numbers.

6.18 For GD23 we have reviewed actual customer numbers versus those projected in the GD17 final determination. We note that the actual number of customers is materially lower than that projected in GD17 for example actuals connections over the 2018 to 2020 period were 1,320 versus 4,940 connections projected over the same period in the GD17 final determination. This means that the scale of the SGN business is smaller than that projected in GD17.

6.19 We note the SGN reference to paragraph 4.39 in the GD17 final determination, however we do not consider our approach to determining SGN opex allowances for GD23 to be inconsistent with the paragraph cited by SGN.

6.20 Finally, to check that our GD23 draft determination opex allowances for SGN (excluding costs associated with the connection incentive) for 2028 are reasonable we compared them to assumptions made in the G2W low pressure workbook. Specifically, paragraph 4.32 of the G2W applicant information pack stated: 'In subsequent years the pattern of operating expenditure in years 11 to 40 reflects experience from existing distribution networks in Northern Ireland. For year 11 the average operating expenditure for years 1 to 10 excluding mobilisation will be uplifted by 15%'. In relation to SGN year 11 is equivalent to the 2028 year.

6.21 For the GD23 draft determination our opex allowances for SGN in 2028 are above the assumptions provided for in the G2W low pressure workbook, even though the scale of the SGN network is not as envisaged in the G2W FMA. We consider that our opex allowances for SGN for GD23 therefore provide SGN with adequate headroom in which to operate.

6.22 We consider that these assumptions from the G2W low pressure workbook are relevant as we note that the total operating expenditure of other two GDNs in Northern Ireland has been stable over the medium term as for example PNGL actual opex has reduced by 7% from 2010 to 2020 and FE actual opex has remained stable since 2013.

Bottom-up assessment

Manpower

6.23 Given that manpower is such an integral part of the price control, we consider the number of FTEs necessary to run an efficient business; it is therefore appropriate to determine the cost allowance at the overall manpower level.

6.24 In GD17, this area was set as per the G2W bid, which had a range of 17-19 FTEs employed during this control.

6.25 For GD23, we have adopted the approach as used for FE and PNGL, which does not set explicit FTE allowance for the individual cost categories, since manpower forms part of most of the cost categories within the Annual Cost Reporting Template, rather than being an individual cost category. We consider that it is the choice of the GDN to decide where to allocate its resources, as business needs develop.

	GD17				
	2018	2019	2020	2021	2022
SGN Requested Allowances	13.7	19.8	21.0	20.0	20.0
UR Determined	19.0	19.0	19.0	17.0	17.0
SGN Actual	16.8	19.3	20.6	27.0	28.0
	GD23				
	2023	2024	2025	2026	2027	2028
SGN Requested Allowances	33.0	33.0	36.0	37.0	38.0	38.0
UR Determined	27.8	27.8	28.0	28.1	28.2	28.2

Note 1. Figures may not sum due to rounding. Note 2. The years 2020/21 and 2021/22 are forecast.

Table 6.1: SGN FTEs Requested, Actuals and GD23 Determined

6.26 Table 6.1 sets out the SGN requested allowances for FTEs for both GD17 and GD23. It can be observed that SGN actual number of FTEs for 2020 was above our GD17 allowances by 8% but in line with the SGN GD17 business plan submission.

6.27 SGN has requested increases in FTEs in the GD23 period across most cost areas with the most significant increases requested in operations

management, audit, finance and regulation and advertising and marketing for owner occupied and non-owner occupied properties.

6.28 However, we do not agree that the level of resources requested by SGN is appropriate. We have therefore in general based the level of FTEs on the 2020 level of FTEs and provided for additional FTEs where we considered there was evidence to support the requested increase. We have also provided for an additional FTE for 'energy transition'.

Asset Management

6.29 SGN Asset Management costs are in the main driven by its associated manpower costs. In the 2020 year SGN had Asset Management costs of £34k and had 1.08 FTEs. PNGL has requested a marginal increase in FTEs in the GD23 period to 1.16 FTEs on average. SGN also requested contractor costs of £11.5k on average for the GD23 period.

6.30 For the draft determination we have rolled forward 2020 actuals of 1.08 FTEs as well as 2020 staff costs. We have not accepted SGN projected contractor costs as we note SGN has not incurred these costs in its historical actuals.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	40	40	43	60	47	47
UR Draft Determination	31	31	29	31	32	32
Variance	(9)	(9)	(14)	(29)	(15)	(15)

Note 1. Figures may not sum due to rounding.

Table 6.2: Asset Management Costs, Requested and Allowed, £k

Operations Management

6.31 SGN Operations Management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had Operations Management costs of £157k and had 5.19 FTEs employed within the Operations Management cost category. SGN have proposed that there should be on average 9.1 FTEs for Operations Management in the GD23 period.

6.32 SGN have explained that the forecast increase in FTEs is required as 'with the construction workload reducing significantly over time, it believes this model (using a combination of direct-employed and out sourced resources) offers the greatest flexibility and we will move to having more direct employees as justified by the changing workload over time.'

6.33 For the draft determination we have provided for an additional 2 FTEs as this is consistent with increase in FTEs in the FE and PNGL network areas when they were in a similar stage of their network development. We have rolled

forward 2020 actual staff costs with the 7.19 FTEs allowed for, for the draft determination.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	247	247	269	279	281	281
UR Draft Determination	227	227	213	220	221	221
Variance	(20)	(20)	(56)	(59)	(60)	(60)

Note 1. Figures may not sum due to rounding.

Table 6.3: Operations Management Costs, Requested and Allowed, £k

Customer Management (Emergency Call Centre)

6.34 An explanation of the Customer management (Emergency Call Centre) cost category and GDN arrangements for dealing with emergency calls is provided in the bottom up assessment overview section, starting at 2.30 above.

6.35 SGN based their call forecast on the number of properties passed. We are not convinced that this is an appropriate driver for emergency calls and so have used connection numbers for our forecasts. This follows the approach we have adopted in previous price control and for the other GDNs.

6.36 We therefore calculated the annual percentage of calls to connections based on SGN's submission and applied this to our forecast connection numbers to generate a total number of calls for each year of GD23.

6.37 Our forecast for the number of additional connections in GD23 is about 18% lower than the company's, which has led to a small reduction of around 108 calls over the period.

6.38 During the draft determination process SGN identified an error in the original submission related to the costs for the call handling service provided by Cadent. SGN advised that the increase from £63,000 in 2026 to £93,000 in 2027 was an error and this has been removed for the draft determination. This correction accounts for the majority of the reduction in this cost category.

6.39 Section 2.34 of this document explains that the emergency call handling agreement with Cadent includes a monthly threshold for the number of calls covered by a fixed fee.

6.40 In their business plan submission SGN had included additional costs for calls exceeding the contractual monthly threshold in years when the cumulative annual threshold had not been reached. In our draft determination we have estimated variable cost allowances on the basis of exceedance of the annual

call threshold total. This is on the basis that predicting exceedances in any month is not possible and that SGN could reasonably have agreed a fixed cost threshold profile with Cadent, based on their experience of other local GDNs, which might have better reflected seasonal variances.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	105	105	105	106	138	138
UR Draft Determination	103	103	103	104	106	106
Variance	(2)	(2)	(2)	(2)	(32)	(33)

Note 1. Figures may not sum due to rounding.

Table 6.4: Customer Management Costs (Emergency Call Centre), Requested and Allowed, £k

Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping)

6.41 SGN customer management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had customer management costs of £17k and had 0.55 FTEs employed within the Customer Management cost category. SGN have proposed an uplift of FTEs to 2 FTEs on average in the GD23 period.

6.42 For the draft determination we have provided for an additional 0.54 FTEs i.e. doubled 2020 actuals as this is consistent with increases in FTEs in the FE and PNGL network areas when they were in a similar stage of their network development. We have rolled forward 2020 staff costs with this profile of FTEs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	48	48	64	65	67	67
UR Draft Determination	48	48	51	51	52	52
Variance	0	0	(13)	(14)	(15)	(15)

Note 1. Figures may not sum due to rounding.

Table 6.5: Customer Management Costs (Including Non-Emergency Call Centre) & Network Support (Including System Mapping), Requested and Allowed, £k

System Control

6.43 SGN system control costs are in the main driven by its associated manpower costs. In the 2020 year SGN had manpower costs of £37k and had 0.94 FTEs employed within the System Control cost category. SGN has

proposed an additional 0.5 FTEs on average for System Control in the GD23 period.

6.44 For the draft determination we have rolled forward the 2020 FTEs and staff costs and therefore not allowed the proposed increase in FTEs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	53	53	55	56	58	58
UR Draft Determination	35	35	34	34	35	35
Variance	(18)	(18)	(21)	(22)	(23)	(23)

Note 1. Figures may not sum due to rounding.

Table 6.6: System Control Costs, Requested and Allowed, £k

Emergency

6.45 The Emergency cost category relates to the costs and activities associated with the initial callout and response to an emergency call from the public that requires further investigation.

6.46 In some cases the emergency call is closed without a visit as it is possible to resolve the issue over the phone. In most cases however, a trained first responder is sent to the location in question to determine the nature and severity of the incident. Further details on this cost category and the companies' approach to managing this work can be found in the bottom up assessment overview section, starting at 2.42 above.

6.47 A deduction was made to the emergency cost allowance as a result of a mistake in the submission data. Correcting this mistake resulted in a reduction in contractors costs of £1.8k per annum.

6.48 To assess the appropriate level of expenditure and activity for emergency jobs in GD23, we used a model supplied by SGN through the query process. The model categorises emergency jobs based on the number of calls in each year of GD17 to date and the number of each type of emergency or PRE job that resulted from them. It then monetises the jobs using the contractor rates and average hours allocated to each type of job.

6.49 The proportions of each job type and the costs submitted by the company in the model were accepted and used to forecast the Emergency and PRE Repair draft determination allowances.

6.50 We calculated the number of emergency jobs to be entered into the model using the company's submitted proportion of emergency calls that became emergency jobs. This was found to be 57.8% and was applied to the call

numbers that we had estimated for GD23 as a flat rate throughout the period.

6.51 Our slightly lower call numbers resulted in a number of jobs which was 63 lower than that submitted by the company.

6.52 The variable cost outputs from the model were split between PRE Repairs and Emergency Jobs according to the proportions identified by the company and added to the contractor fixed costs to determine the GD23 allowances.

6.53 From the company's submission, we calculated a drop in the ratio of calls to connections in 2028 which exceeded the number of additional connections. This is why our emergency allowance is slightly lower in 2028 than 2027.

6.54 The higher cost in 2026 is due to additional involvement of the SGN NG services contractor in that year. Although this is a related company, SGN have assured us that there is no profit margin associated with this work and so no further adjustment is required.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	176	180	184	198	193	195
UR Draft Determination	175	179	182	194	187	186
Variance	(1)	(1)	(2)	(4)	(6)	(9)

Note 1. Figures may not sum due to rounding.

Table 6.7: Emergency costs allowed in the draft determination for SGN

Metering

6.55 SGN submitted costs of around £840k for meter maintenance in the GD23 period. Routine maintenance on meters and governors accounted for 81% of the contractor costs.

6.56 SGN's meter stock is relatively young and low in number as meter installations only commencing in 2017. This means that some activities such as 10 year battery replacement and 10 year regulator inspections only start late in the period with low levels of activity and costs. Others such as 20 year end of life meter replacement will not occur until after GD23.

6.57 Annual Cost Report and Business Plan Template meter installation data was used to check the submitted activity data for annual inspections (U65+ meters); 10 year battery replacement (domestic prepayment); 5 year inspections (U6 to U40 MP meter regulators); 6 year inspections (U65+ meter regulators) and 10 year inspections (U6 to U40 MP meter regulators).

6.58 The submitted figures were found to be correct, assuming the low pressure/medium pressure percentage split applied by SGN for domestic meter installations is accurate. The split was found to be broadly reflective of figures quoted for 2018 and 2019 and so has been accepted for the draft determination on this basis. However for the final determination we will seek further evidence to support the figure applied.

6.59 All of SGN's routine meter maintenance costs have been allowed in the draft determination on the basis of the validation checks undertaken, apart from the following. The 5 year inspection costs for 2023 have been excluded and a minor adjustment has been made to the 5 year inspection costs for 2028, to account for our slightly higher projected connection numbers for 2023. These adjustments resulted in a small deduction of £16k.

6.60 The 2023 five year inspections have been disallowed because we believe the revised guidance from the updated British Standard has been applied one year too early by SGN (as explained further in section 2.56) unlike PNGL who we consider have interpreted the requirements correctly.

6.61 For non-routine meter maintenance we considered the projected profile of total cost per connection for all expenditure areas and found this to be stable or falling from 2021 onwards. We allowed the submitted costs on this basis. These will be reviewed against connection numbers for the final determination to ensure they remain proportionate.

6.62 We note that SGN has a higher net cost per connection than PNGL and FE for non-routine meter maintenance. We assume this is due to the potential for its greater proportion of large I&C meters to generate higher maintenance costs. For the final determination we will test this assumption further to satisfy ourselves that the cost differential is appropriate.

6.63 The outcome of our draft determination assessment for metering is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	80	84	132	151	185	205
UR Draft Determination	60	84	132	151	185	210
Variance	(20)	0	0	0	0	5

Note 1. Figures may not sum due to rounding.

Table 6.8: Metering Costs, Requested and Allowed, £k

PRE-Repairs

6.64 The 'Publically Reported Escape' (PRE) Repair cost category covers the activity associated with the isolation and repair of mains and/or services involving an escape of gas, following assessment by the first responder.

6.65 Due to the safety implications these are considered the most urgent emergency jobs and have the shortest mandatory response times. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.59 above.

6.66 The key driver of costs in this expenditure category is the number of emergency jobs.

6.67 The PRE Repairs cost allocation has been determined using the model supplied to us by SGN through the draft determination query process. This model was used to calculate the contractor's costs for the work volume forecast for the period. The SGN model and its origins are described in more detail above, starting in section 6.48.

6.68 We changed the model input values to reflect the reduced call numbers generated by our slightly lower connection numbers for the GD23 period. Our number of PRE jobs was 4 lower than the company's which has led to a reduction in the allowed contractor costs.

6.69 For our draft determination we accepted the standby and callout rates provided to us by SGN, as well as the time allocated to each repair job.

6.70 In SGN's case we couldn't check the figures submitted for contributions received from third parties against past experience due to the lack of historic data. We therefore compared SGN's figures to the levels recovered by the other GDNs and found its recovery forecast to be reasonable.

6.71 The company's submission indicated a drop in the calls to connections ratio in 2028, which is why our PRE Repairs allowance is slightly lower in 2028 than 2027.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	13	13	15	16	17	17
UR Draft Determination	13	14	15	16	16	15
Variance	0	0	0	(1)	(1)	(2)

Note 1. Figures may not sum due to rounding.

Table 6.9: PRE-Repairs Costs, Requested and Allowed, £k

Maintenance

6.72 SGN's maintenance submission for the GD23 period totals circa £2.9m. IP Mains (54%) and telemetry (23%) account for the majority of the costs. Plant protection represents almost 85% of the IP Mains costs and over 45% of the proposed maintenance expenditure overall.

6.73 SGN's maintenance submission was assessed both at a high level and through consideration of individual material expenditure items.

6.74 As indicated above, plant protection accounts for nearly half of SGN's proposed maintenance expenditure. This cost item covers activities designed to reduce the risk of the company's gas mains being damaged by third parties (e.g. driving the entire route of its feeder mains). We requested and reviewed information on the build-up of these costs and concluded they were not unreasonable. The high length of mains relative to the number of connected properties explains why this expenditure item represents such a significant proportion of SGN's cost. Costs were allowed apart from a minor reduction of around £1,500 per annum which results from us projecting a slightly lower length of mains than SGN over the price control. This reduction amounts to circa 0.5% of the total requested cost for this project.

6.75 An additional reduction of around £23,000 was made as a result of a mistake which was identified through the price control query process. Given that this was an error in the submission rather than a reduction in forecasted work, staffing costs were not altered as a result.

6.76 For the draft determination we focused on the material cost items and in overall terms, the reductions made to the submission are only minor. For the final determination we will consider whether a further review of other individual expenditure lines is necessary. We will also review allowances against forecasted lengths of mains and connection numbers to determine whether any adjustments are required.

6.77 The outcome of our draft determination assessment for maintenance is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	449	575	468	463	513	498
UR Draft Determination	445	570	463	457	507	492
Variance	(4)	(5)	(5)	(5)	(6)	(6)

Note 1. Figures may not sum due to rounding.

Table 6.10: Maintenance Costs, Requested and Allowed, £k

Other Direct Activities

6.78 SGN Other Direct Activities costs are in the main driven by its associated manpower costs. In the 2020 year SGN had Other Direct Activities costs of £9k and had 0.35 FTEs employed within the Other Direct Activities cost category. SGN have proposed a marginal reduction in FTEs for Other Direct Activities in the GD23 period.

6.79 For the draft determination we have rolled forward 2020 actual staff costs with the 2020 actual FTEs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	6	6	6	6	6	6
UR Draft Determination	7	7	7	7	7	7
Variance	1	1	1	1	1	1

Note 1. Figures may not sum due to rounding.

Table 6.11: Other Direct Activities Costs, Requested and Allowed, £k

IT & Telecoms

6.80 SGN IT and Telecoms costs are driven mainly by the cost of annual licences and its GIS system as well as some staff costs. In 2020 SGN had IT & Telecoms costs of £105k. £95k of this was related to GIS and licence cost and £10k was related to staff costs. In 2020 SGN had 0.20 FTEs employed in the IT & Telecoms cost category.

6.81 SGN have projected a significant uplift in IT & Telecoms costs in the GD23 period i.e. to an average of £140k. SGN have explained that the reason for this projected increase is that it's 'asset management system requires user licences, which are renewed on an annual basis. In addition, the provision of a helpdesk support service is also included in these costs and the number of licences has increased to 30 as the scale of the business increased'.

6.82 SGN has also explained that 'another element included with the IT opex costs is the GIS data licence supplied by OSNI which is a non-negotiable fixed price and for GD23 we are forecasting further increases to £130k for our IT costs in line with the projected number of connections'. We note that the IT and Telecoms allowances sought by SGN for GD23 are more than 3 times that provided by SGN in its G2W bid.

6.83 We also note that SGN had similar arguments for projected increases in IT costs in GD17 which we did not accept[9] . As in GD17 we have considered the SGN request against the criteria which were set out in the overview as

[9] 2016-09-15_GD17_Final_Determination_-_final_0.pdf (uregni.gov.uk) Paragraph 6.516 - 6.518

discussed in paragraph 6.4 above. We have not seen any strong reason to conclude that such costs were unforeseen.

6.84 Our view is that it was up to SGN to identify the full costs of any IT system it deemed necessary for G2W at the time of the licence application. The analysis that SGN has undertaken since being awarded the licence could have been undertaken when SGN formulated its licence application.

6.85 Again, and as set out in the GD17 final determination we would expect that investments in an IT system would provide robust long term capability for the network and do not accept that increased customers would justify any significant changes in IT costs.

6.86 Consequently, for the draft determination we have provided core IT and Telecoms allowances for the GD23 period which is consistent and in line with the SGN G2W bid as we consider that these costs were reasonably foreseeable and not therefore unforeseen. The staff costs are based on 2020 actuals rolled forward with a marginal increase in FTEs which are in line with the SGN GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	136	136	136	138	145	145
UR Draft Determination	33	33	33	33	34	35
Variance	(103)	(103)	(103)	(105)	(111)	(110)

Note 1. Figures may not sum due to rounding.

Table 6.12: IT & Telecoms Costs, Requested and Allowed, £k

Property Management

6.87 The most significant cost item under SGN property management costs are in relation to network rates. For GD23 we are using a formula which links the allowance to SGN revenues.

6.88 We are comfortable with the approach of using a formula linked to revenue in order to set the network rates allowance for SGN. We have used this approach historically both in GD14 and GD17 for FE and PNGL. The network rates allowances have therefore been calculated accordingly.

6.89 SGN in a response to a query from us, updated their business plan assessment of projected network rates payable in the GD23 period. We have taken account of this for the draft determination.

6.90 For the draft determination we are of the view for the GD23 period that uncertainty mechanism should be updated to reflect actual costs for network rates, subject to SGN demonstrating that it has taken appropriate actions to

minimise valuations. We will expect SGN (as well as the other GDNs) to provide a copy of its actual network rates bill along with appropriate evidence of bill payment to the Utility Regulator alongside its annual Uncertainty Mechanism submission which is usually submitted with the Annual Cost Reporting Template.

6.91 SGN also has rent and building rates costs in relation to its offices as well as some materials costs. We have rolled medium term historic average costs for rent, building rates and materials (2018 - 2020) into the GD23 period. We note that some aspects of SGN facilities management e.g. site security, come under the Managed Services Agreement (MSA).

6.92 SGN had 0.1 FTEs under the Property Management cost category in 2020 and proposed an increase for the GD23 period to 0.18 FTEs on average for the GD23 period. We have allowed for this for the draft determination and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	319	381	394	408	424	441
UR Draft Determination	302	310	322	332	337	343
Variance	(17)	(71)	(72)	(76)	(87)	(98)

Note 1. Figures may not sum due to rounding.

Table 6.13: Property Management Costs, Requested and Allowed, £k

HR & Non-operational Training

6.93 SGN HR and non-operational training costs are driven by staff costs. In the 2020 year SGN had HR and non-operational training costs of £7k. SGN had 0.13 FTEs employed within the HR and Non-operational training cost category in 2020 and proposed an average increase in FTEs in this area for the GD23 period to 0.19 FTEs. We note that some aspects of Human Resources e.g. employee relations management, come under the Managed Services Agreement (MSA).

6.94 We have accepted this projection in FTEs and consequently provided for 0.19 FTEs in the GD23 period and we have rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	11	11	11	11	12	12
UR Draft Determination	10	10	10	11	12	12
Variance	(1)	(1)	(1)	(0)	(0	(0)

Note 1. Figures may not sum due to rounding.

Table 6.14: HR & Non-Operational Costs, Requested and Allowed, £k

Audit, Finance & Regulation

6.95 SGN Audit, Finance and Regulation costs are in the main driven by staff costs and professional and legal fees.

6.96 In the 2020 year SGN had audit, finance and regulation costs of £147k made up of £3k for professional and legal fees and £144k for staff costs. SGN had 2.8 FTEs employed within the Audit, Finance and Regulation cost category in 2020 and has proposed an increase to 5.6 FTEs on average in this area for the GD23 period.

6.97 SGN has projected professional and legal fees which contain uplifts of £400k in 2027 and 2028 due to 'increased workload and specialist knowledge required for Price Control preparation'. For the remaining years in GD23 SGN has proposed professional and legal fees which are significantly higher than 2020 actual costs and in addition projected £5k of stationary, communication and billing costs.

6.98 For the draft determination we have allowed for 5 FTEs (an uplift of 2.2 FTEs) compared to 2020 actuals as we consider that some aspects of the work that SGN undertake under this cost category may be similar to that undertaken by the other GDNs who have more FTEs than SGN for this cost category, though we note that some workstreams e.g. treasury support and audit management come under the Managed Services Agreement (MSA). We have rolled forward the 5 FTEs with 2020 actual staff costs.

6.99 We note that the £400k uplifts in relation to price control costs projected by SGN are significantly above those projected by the other GDNs which operate under the same price control process as SGN. Consequently, we have not allowed this scale of uplift for the GD23 draft determination. We have however allowed an allowance for price control costs at an efficient level for the 2027 and 2028 years.

6.100 For all other years we have based SGN projected professional and legal fees on medium term historical actuals but not accepted projected stationary, communications and billing costs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	322	322	322	354	714	414
UR Draft Determination	267	267	267	269	375	375
Variance	(55)	(55)	(55)	(85)	(339)	(39)

Note 1. Figures may not sum due to rounding.

Table 6.15: Audit Finance & Regulation Costs, Requested and Allowed, £k

Insurance

6.101 SGN Insurance costs are driven by staff costs and buildings insurance costs. Other aspects of SGN insurance such as commercial and travel insurance, and insurance of the pipeline are covered under the Managed Services Agreement (MSA).

6.102 In the 2020 year SGN had building insurance costs of £4k and staff costs of £2.5k. SGN had 0.04 FTEs employed in the insurance cost category for 2020 and projected this this number of FTEs into the GD23 period. SGN has projected an increase in buildings insurance into the GD23 period to £5k.

6.103 We have rolled forward SGN 2020 FTEs and staff costs for insurance into the GD23 period together with 2020 actual building insurance costs as this is broadly consistent with medium term historical actuals.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	8	8	8	8	8	8
UR Draft Determination	6	6	6	6	6	6
Variance	(2)	(2)	(2)	(2)	(2)	(2)

Note 1. Figures may not sum due to rounding.

Table 6.16: Insurance Costs, Requested and Allowed, £k

Procurement

6.104 SGN procurement costs are driven by staff costs. SGN procurement staff costs were £4k in 2020 and SGN employed 0.07 FTEs under the Procurement cost category in 2020. We note that some aspects of SGN procurement activities e.g. support for local managers in contract negotiations come under the Managed Services Agreement (MSA).

6.105 SGN has projected a marginal increase in FTEs for the GD23 period to an average of 0.10 FTEs. We have accepted this projection into the GD23 period and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	6	6	6	6	7	7
UR Draft Determination	5	5	5	6	7	7
Variance	(1)	(1)	(1)	0	0	0

Note 1. Figures may not sum due to rounding.

Table 6.17: Procurement Costs, Requested and Allowed, £k

CEO & Group Management

6.106 SGN CEO and Group Management charges are driven by costs associated with its Managed Service Agreements (MSA's) with other group companies. In 2020 the actual costs of Managed Service Agreements were £250k which was over 6 times that outlined in the SGN G2W bid at £39k.

6.107 SGN requested MSA allowances for the GD23 period that are on average 4.5 times that set out in the G2W bid and almost double that of 2020 actual costs. In its GD23 business plan submission SGN have explained that MSA covers the following activities:

- Human resources
- Gas control and operational control centre
- Legal and compliance
- Finance
- Stakeholder Management
- Information Technology

6.108 In relation to the requested allowances for GD23 SGN explained that 'following the bid submission SGN provided the Utility Regulator with the business plan submission for GD17. In this document we set out necessary adjustments to the bid submission as a result of changes in external factors which meant that the bid submitted did not include sufficient cover, given the level of group support necessary has been significantly higher than originally anticipated'.

6.109 SGN further explained that 'we further clarified the current position in the GD23 business plan which details how the MSA continues to offer value for money alongside the flexibility to adjust services in line with business needs, where it is economic to do so. The costs currently incurred via the MSA are reflective of required services to allow SGN to continue to operate as a reasonable and prudent operator and those presented in the GD23 business plan reflect the costs that will be necessary in future. The rebasing of allowances as part of the GD23 price control will allow for more realistic costs being considered as those cost presented within the bid submission are no longer reflective of actual requirements under the MSA'.

6.110 We do not agree with the arguments put forward by SGN. Costs associated with the MSA should have been well known to SGN when it formed its G2W bid as mentioned in from paragraph 6.4 above. SGN was best placed to

provide a robust estimate of these costs in the G2W application. There has been no material change of circumstances or change in the scale of the business which would explain the increase.

6.111 Furthermore the G2W applicant information pack was very clear in relation to how the MSA charge would be treated in future price controls for example paragraph 3.44 states 'as set out in the Conclusions paper we believe that a direct link between the cost information revealed in the application and the allowances provided in subsequent price controls will act as a powerful incentive to ensure that applicants reveal realistic cost information and that some link should be maintained beyond the first price control period. In particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies'.

6.112 We further note that the costs outlined in the G2W bid for MSA's were constructed using a customer numbers ratio and we note that the actual customer numbers in the SGN area are less than envisaged by SGN in its GD17 business plan submission.

6.113 SGN requested MSA allowances for GD23 included requested allowances of £350k for costs associated with undertaking price controls. SGN explained that these costs 'relate to the time needed over and above 'normal business' activities as part of the MSA, from SGN Group staff (Regulatory team), at a point when our workload increases significantly due to Price Control Business Plan and modelling preparation.

6.114 We note that SGN also requested allowances for work associated with price controls under the Audit, Finance and Regulation cost category and these requests were above those requested by the other GDNs.

6.115 We consider that we have provided SGN with sufficient allowances for work associated with price controls under the Audit, Finance and Regulation cost category and therefore have not provided an allowance under the CEO & Group Management (MSA) cost category.

6.116 Consequently, for the Draft Determination we have provided for MSA costs which are consistent and in line with the G2W Bid, with a reasonable uplift for the 2028 year, in line with previous year increases.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	400	400	400	400	650	500
UR Draft Determination	75	85	95	105	116	126
Variance	(325)	(315)	(305)	(295)	(534)	(374)

Note 1. Figures may not sum due to rounding.

Table 6.18: CEO and Group Management Costs, Requested and Allowed, £k

Stores & Logistics

6.117 SGN has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and therefore we have not provided for any allowances for the GD23 period.

Advertising & Market Development (Owner Occupied)

Introduction

6.118 In GD17 the allowances for costs associated with advertising and marketing (Owner Occupied) were recovered via a connection incentive. We set out in the GD17 final determination[10] our intention to review the connection incentive in advance of GD23.

6.119 Early development and engagement on GD23 began in the autumn of 2019 and our approach to the connection incentive review was discussed with the GDNs and key stakeholders in bilateral and round-table meetings. Following this there was a Round Table discussion on GD23 connection incentives with all GDNs in December 2019 and subsequent follow up meetings, connected to this area.

6.120 This was followed up with an information request to all GDNs in November 2020, which comprised of 2 broad categories as set out below:

a) Confirmation of historical data on the costs and performance in this area.

b) Questions to the GDNs relevant to the connection incentive as follows:

(i) The relationship between expenditure and connections delivered.

(ii) The approach and activities used to acquire connections and how this has developed based on experience and learning.

[10] 2016-09-15_GD17_Final_Determination_-_final_0.pdf (uregni.gov.uk) Paragraph 13.15

(iii) The structure of the incentive mechanism and the incentive value of the Connection Incentive.

6.121 SGN provided a response to the questions, including extensive information on the area, as follows:

- Marketing & Communications
- Media Channel Analysis
- Media Buying Approach
- Fixed Marketing
- Budget – Activity & Cost per Year

6.122 The above provided insight in its approach and strategy and detailed analysis of why marketing and customer incentive are critical in the SGN fledgling network.

6.123 In summary SGN made a connection incentive request of £1,323 per OO connection over a forecast projected number of 3,750 for the duration of GD23.

6.124 We have carefully considered this material as presented, in conjunction with the submissions made by the GDNs, which has led to the following assessment and approach to be taken in this area.

Previous GD17 Mechanism

6.125 The connection incentive for GD17 was based on a principle that once the network has been constructed the marginal revenue of any future connection will reduce costs for all consumers. An economic rate for a standard connection incentive rate was calculated which allowed part of the marginal revenue of a new connection to be 'invested' to promote connections while the balance would benefit all consumers through lower tariffs.

6.126 The economic rate for a standard connection incentive rate was calculated, based on some simple assumptions, which required a degree of judgement as follows: average rate of gas consumed in a year by a typical domestic customer, appropriate suitable payback period, the conveyance charge to cover the costs of the network, rate of return of the project and the capital costs of the gas main, service and meter costs. The economic level of the connection incentive is the value which would minimise tariffs in the long term.

6.127 The connection incentive payment was subject to a non-additionally threshold set for each GDN to reflect the 'maturity' of their network. The incentive is then paid on each connection over the non-additionally threshold. In the past we have explained the non-additionally threshold as the number of connections which would occur without any effort to promote connections.

6.128 The mechanism set specific connection targets on the acquisition of new customers and implemented a collar such that, where a GDN underperforms the annual connection target by more than 50%, a 25% collar (i.e. 25% * 'per connection' allowance) would operate.

6.129 Another component of the mechanism was that certain costs were to be recovered via the connection incentive mechanism. These costs were mainly related to Business Support activities that supported this area that reduced the fixed allowances. This was to incentivize the GDNs to achieve the target connections or to suffer some risk on Business Support Costs allowances.

6.130 An additional 'new areas' allowance was added to the standard connection incentive rate to reflect some of the challenges of promoting gas in new extension areas such as East Down and Gas to the West, in which we signalled that the "new areas" allowance would be removed at the end of GD17.

6.131 In the last year of the allowance, in 2022, the figure is £512 per connection (Excluding New Areas allowance, removal of 25% Non Additionality, post efficiency).

New Approach - Cost To Serve

6.132 After considering the current mechanism and the comments made by the GDNs in the information supplied and taking regard on the stage of development for each Network Operator, we have decided to replace the existing economic mechanism.

6.133 We propose in replacing it with a 'Cost to Serve' allowance. The concept of Cost to serve is to cover the GDNs reasonable costs of responding to contacts and supporting consumers through the connection process, including the cost of Energy Advisers.

6.134 To enable preparation by SGN of this change, we are flat lining the costs for the duration of GD23, due to its size and scale.

6.135 Outlining this approach to the GDNs, caused some concern for the implications in the wider industry context for positioning in the market place.

They suggested that the marketing and development activity funded from the Connection Incentive also supported wider awareness of the gas industry for the public, customers, stakeholders, community and elected representatives, ensuring that they are suitably informed, understand the emergency response, non-routine and asset maintenance activities general adverting etc. The GDNs made the point that this was necessary as part of their core responsibilities as a network operator.

6.136 PNGL have suggested an allowance of £150k pa to deal with these type of issues. We believe this is a reasonable comprise to provide a fixed allowance for all GDNs to support and aid the understanding of wider gas issues that may be lost as marketing and advertising activities funded through the connection incentive are wound down. This allowance would be for the wider promotion and awareness of the gas industry which may prompt connection requests but would not be linked to the connection target. We propose a fixed amount of £125k for SGN, due to its size and scale.

6.137 Since this 'fixed' allowance is already included in the advertising and marketing costs allocated to OO connections incentive rate, the glide path rate from GD17 incentive rate to Cost to serve must be adjusted in the early years to deduct the allowance for advertising and marketing in the embedded rate.

6.138 For moving to a Cost to serve allowance the following changes are made to the mechanism:

a) A flat lined amount over the entire GD23 period, due to size and scale.

b) Sets different cost to serve rates for each GDN at 2028 based on 2020 actual staff costs, stationary, communications and billing costs as well as any entertainment costs with reasoned adjustments for each GDN.

c) Adds a fixed allowance for limited marketing and advertising that is adjusted in the early years to take account of an allowance for advertising and marketing, already included in the glide path (e.g. £125k pa).

d) Use the projected connection numbers as at 2022 as provided by GDNs and glide path down to 60% by the end of GD23.

e) Connection Targets are now removed and removal of the Collar and any reduction in allowances.

f) Non-Additionally is now removed and every connection qualifies for the same allowances, which removes risk from each GDN.

g) The Corporate Overhead Costs, that had to be recovered via the previous mechanism, is now dropped, which removes this risk from each GDN.

6.139 All connections allowances claimed by GDNs must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

6.140 Table 6.19 provides the allowance, per connection, which excludes the fixed allowance with regard the limited marketing and advertising as discussed above. Table 6.20 compares the draft determination owner occupied (OO) connection numbers against the SGN GD23 submission.

SGN	2023	2024	2025	2026	2027	2028
Connection allowance per customer	400	400	400	400	400	400

Note 1. Figures may not sum due to rounding.

Table 6.19: OO Connection Allowance, £

6.141 The allowances set out in Table 6.20 translate to an average allowance over the 6 years of GD23 for SGN of £400 per connection, subject to the fixed allowance as described above.

	2023	2024	2025	2026	2027	2028
SGN submission	623	593	599	652	643	640
UR Draft Determination	735	659	583	508	432	356

Note 1. Figures may not sum due to rounding.

Table 6.20: OO Connection Numbers and Allowances

6.142 Table 6.21 shows the comparison of the draft determination allowances against the SGN GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	1,286	1,246	1,263	1,334	1,324	1,320
UR Draft Determination	419	389	358	328	298	267
Variance	(867)	(857)	(905)	(1006)	(1026)	(1053)

Note 1. Figures may not sum due to rounding.

Table 6.21: Advertising & Market Development (Owner Occupied) Costs, Requested and Allowed, £k

Advertising & Market Development (Non Owner Occupied)

6.143 SGN costs for Advertising and Marketing (non-OO) are driven by manpower costs and Market Development costs. In 2020 SGN costs for Advertising and Marketing (non-OO) were £189k made up of manpower costs of £179k and advertising and marketing costs of £10k. SGN employed 4.3 FTEs for Marketing and Development (non-OO) in the 2020 year.

6.144 SGN has requested an additional 1.8 FTEs for the GD23 period on average as well as an average increase in Marketing and Development costs of 2000% against 2020 actuals to an average of £217k in the GD23 period. SGN has explained these increases are reasonable because the Utility Regulator facilitated I&C incentive allowances for PNGL in the PNGL12 price control (2012-13) and for FE in the PCR02 price control (2009 to 2013).

6.145 SGN explained that a blended incentive rate of £1,762 in GD23 for non-OO potential customers compares well to the £2,161 afforded to FE in the PCR02 price control. SGN have explained that if the Utility Regulator granted this allowance then SGN would gain an additional 425% in IC1 average annual connections against 2022 forecast connections and an additional 1,142% in average IC2 connections against 2022 forecasts and 'this represents value for money in ensuring the opportunity for the positive impact each connection brings is not foregone'.

6.146 We note that the PNGL12 (published January 2012) and PCR02 (published December 2008) price control documentation was publicly available information available to SGN at the time SGN formed its G2W bid (submitted May 2014). If it had wished, SGN could have put similar or indeed greater amounts in its G2W bid for I&C incentives as contained in these price controls. The fact SGN choose not to do so is a matter for SGN and we note that other Applicants did submit a request for allowances in this area.

6.147 We note that the G2W Application Information Pack (AIP) paragraph 4.36 stated in relation to incentivising I and C customers states '"[no] incentive payments for non-owner occupier connections have been included in the workbook. However, if an applicant believes that in order for them to meet the target for industrial and commercial connections they will require funding for financial incentives they have an opportunity to include such costs in the Operating Expenditure worksheet. They should also explain in their operational business plan how such payments would facilitate connections by non-owner occupier supply points. Only if the successful applicant has included such incentives in their application will these be funded by price control allowances.'

6.148 The amounts in the SGN bid for G2W were to cover costs in relation to provision of a 0% finance offer (only available for 2 years) and assumed that 75% of small I & C's would avail of this offer.

6.149 Furthermore, and again as repeated in the GD17 final determination, Annex 8 of the G2W information pack clarifies that Marketing Advertising & PR for Non-OO Connections comprises costs for the promotion of connections to non-OO customers (e.g. NIHE, Industrial and Commercial (I&C) customers, New Build developers), and covers such costs as:

- Market Research;
- Marketing;
- Advertising;
- Public Relations;
- Engagement with Key Stakeholders;
- Any other relevant costs deemed necessary by the applicant; and
- Incentives i.e. costs used in assisting non-OO in converting from existing fuel source to natural gas.

6.150 Consequently, the Utility Regulator is of the view that it will only allow opex for non-OO connections as set out by SGN in its G2W licence application for the GD23 period, with the exception of rolling forward actual 2020 FTEs and staff costs into the GD23 period.

6.151 As we also stated in the GD17 final determination and repeated here we would also note that a significant element of the SGN request to adjust the licence application figures relates to incentivising the industrial and commercial business. As set out in paragraph 4.36 above the AIP was particularly clear on this point stating that “Only if the successful applicant has included such incentives in their application will these be funded by price control allowances”. We don’t consider it appropriate to change from a figure provided by SGN for incentives for non-owner occupied customers which was submitted as part of a competitive application. This is particularly true in the circumstances where the other applicants included substantially higher incentive costs than SGN.

6.152 Finally, we note that SGN within its GD23 business plan submission did not forecast spending any additional money in 2021 or 2022 beyond that spent in 2020 on advertising and marketing for I & C customers of £10k.

6.153 We consider that the form of price control for SGN i.e. price cap, provides a strong financial incentive for SGN to outperform against volume targets. To assist in outperforming these targets SGN could have provided incentives such as, for example, financial assistance to non -OO customers in order to encourage them to connect to gas, which SGN has not done so, to date, nor has any plans to do so in the GD17 period.

6.154 For the GD23 draft determination, in conjunction from paragraph 6.4 above, we have provided for an additional FTE for energy transition which is consistent with our approach for the other GDNs. This means we have provided for a total of 5.34 FTEs compared to the SGN request for 6.15 FTEs (on average) in the GD23 period. We have rolled forward 2020 staff costs with the 5.34 FTEs for the GD23 period. We have also rolled forward 2020 actuals for advertising and marketing costs as SGN have confirmed that they did not pay any cash incentives to I&C customers in the GD17 period.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	376	419	473	591	564	545
UR Draft Determination	179	179	179	179	179	179
Variance	(197)	(240)	(294)	(412)	(385)	(366)

Note 1. Figures may not sum due to rounding.

Table 6.22: Advertising & Market Development (Non-Owner Occupied) Costs, Requested and Allowed, £k

Trainees & Apprentices

6.155 SGN has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and therefore we have not provided for any allowances for the GD23 period.

Non-Controllable Opex

6.156 The only costs under non-controllable opex are SGN licence fees. We have accepted SGN forecast costs of for licence fees of £50k per annum for the draft determination. Any difference between forecast licence fees and actual licence fees will be taken account of by the uncertainty mechanism in GD29.

Supplier of Last Resort

6.157 With regard to the Supplier of Last Resort (SOLR), we believe that there is merit to including an allowance to cover any unforeseen costs that may occur, if an event were to happen. This amount is ring fenced and will be removed at the time of the next price control, if an incident fails to materialise. For the GD23 draft determination we have accepted the

proposal made by SGN and allowed £85k for these costs in 2023 only, for the duration of the price control.

Capitalisation

6.158 For the GD23 draft determination we have accepted SGN capitalisation rates however these may be reviewed further for the final determination.

Shrinkage

6.159 Having assessed the SGN business plan submission with respect to shrinkage, we noted that the shrinkage factors, as provided are recast to increase from 0.15% (for 2023) to 0.16% (for 2024 and 2025) and 0.18% (from 2026 onwards).

6.160 This is a slight increase from the shrinkage factor of 0.14% for 2020 and also forecast for the last two years of the GD17 price control period. We do not consider this to be unusual given the planned further development of the SGN network for GD23.

6.161 We do not propose any shrinkage-related changes to existing regulatory arrangements and/or the introduction of a shrinkage-related incentive mechanism at this stage.

6.162 However, we consider that SGN should continue to establish the annual shrinkage factor in line with the common Northern Ireland Shrinkage Methodology which was developed, and should be maintained and amended as may be appropriate from time to time, jointly by all three GDNs. We furthermore consider that shrinkage should continue to be monitored as part of the annual cost and performance arrangements.

Real price effects, productivity and frontier shift

6.163 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

6.164 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH). Given the CPIH is no more a measure of general inflation than RPI, not all types of cost changes will be reflected in the range of prices used to calculate the CPIH. To account for this it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

6.165 This calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs), and the projected rate of productivity growth. The sum of these components can be a positive or a negative difference.

6.166 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

6.167 We have adopted the methodology we first introduced at PC13, PC15 and PC21 for NI Water, which aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

6.168 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	4.4	3.8	2.9	2.3	2.8	3.3	3.3	3.3
CPIH	(2.9)	(4.0)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift	CPIH + 0.4	CPIH -1.2	CPIH -0.2	CPIH -0.8	CPIH -0.3	CPIH +0.1	CPIH +0.1	CPIH +0.1
Cumulative frontier shift	0.4	-0.8	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8

Table 6.23: GD23 Opex frontier shift calculations

6.169 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

6.170 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

Summary of Bottom-up Assessment Findings

6.171 Table 6.24 shows the opex allowances for SGN in the GD23 period. The total pre-efficiency opex allowances (excluding allowances associated with AMD-OO) for SGN in GD23 on average are 38% higher than 2020 actuals.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	31	31	29	31	32	32	186
Operations Management	227	227	213	220	221	221	1329
Emergency Call Centre	103	103	103	104	106	106	625
Customer Management	48	48	51	51	52	52	302
System Control	35	35	34	34	35	35	208
Emergency	175	179	182	194	187	186	1,104
Metering	60	84	132	151	185	210	823
PRE-Repairs	13	14	15	16	16	15	89
Maintenance	445	570	463	457	507	492	2,935
Other Direct Activities	7	7	7	7	7	7	42
IT & Telecoms	33	33	33	33	34	35	201
Property Management	302	310	322	332	337	343	1,946
HR & Non-operational Training	10	10	10	11	12	12	65
Audit, Finance & Regulation	267	267	267	269	375	375	1,820
Insurance	6	6	6	6	6	6	36
Procurement	5	5	5	6	7	7	35
CEO & Group Management	75	85	95	105	116	126	602
Stores & Logistics	0	0	0	0	0	0	0
Advertising & Market Development - Owner Occupied (OO)	419	389	358	328	298	267	2,059
Advertising & Market Development (Non OO)	179	179	179	179	179	179	1,074
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	85	0	0	0	0	0	0
Total: Pre Efficiency	2,627	2,685	2,606	2,638	2,813	2,807	16,176
Frontier Shift %	-1.0	-1.9	-2.2	-2.0	-1.9	-1.8	
Total: Post Efficiency	2,601	2,634	2,549	2,585	2,760	2,757	15,885

Note 1. Figures may not sum due to rounding.

Table 6.24: SGN GD23 Opex Draft Determination Pre and Post Efficiency, (£k)