



GD23 - Gas Distribution Price Control 2023-2028

Draft Determination Annex N
Business Plan Assessment
Phoenix Natural Gas Ltd
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 document provides an explanation of the process the Utility Regulator has used in assessing the Business Plans of each Gas distribution network company and this document specifically provides the a more thorough summary of PNG's business plan.

Audience

This document is made specifically for the gas distribution network companies.

Consumer impact

Given the nature of the assessment, this information is unlikely to have a direct consumer impact, monetary or otherwise.



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Executive Summary

Business Plan Assessment for Phoenix Natural Gas Ltd

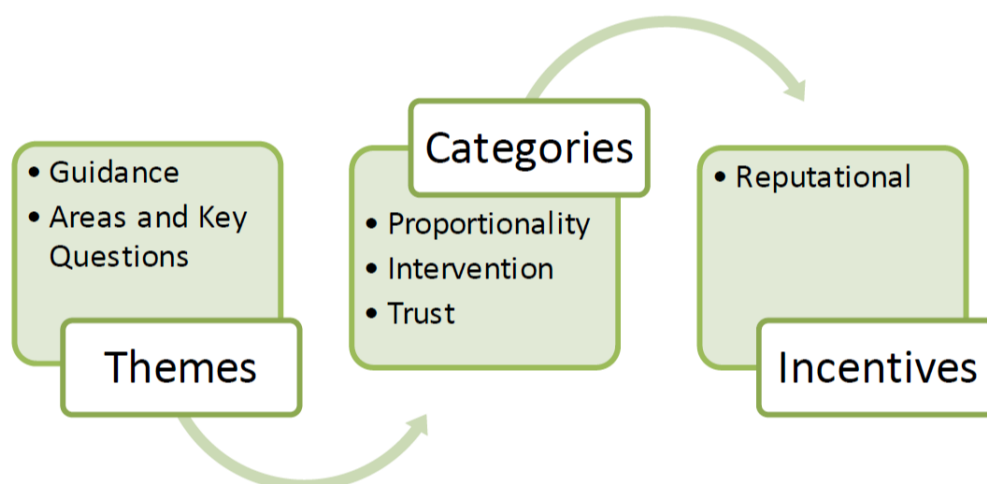
Phoenix Natural Gas Ltd (PNGL) was asked to make a Self-Assessment of its business plans and indicated that every area of the plan was Exceptional.

PNGL details how it intends to develop its business during GD23, giving a clear and comprehensive explanation of services that will be provided and any that fall outside its scope. PNGL's submission has been subject to review from external consultants (NERA) and also sought to benchmark their financial structure against other companies in the sector to ensure that they are aligned to industry standards. PNGL has undertaken a robust programme of consumer and stakeholder engagement, across core audiences, and importantly, hard-to-reach audiences, to inform its business strategy and to ensure it continues to deliver the best possible service and value for money for its consumers and the communities during the GD23 period. In addition to this, they have provided explanations of how they will ensure that their services deliver the right outcome or where enhancements could be made and have made clear where sections of their Business Plan have been shaped by their stakeholder and consumer engagement. PNGL has prepared its Business Plan under the assumption of 'business as usual' throughout the GD23 period. Reasonable endeavours have been made to forecast for key activities and considerations have been made for specific market indicators that will affect opex and capex forecasts. PNGL provided the detailed risk analysis it has undertaken in assessing the ongoing resilience of its asset, and its GD17 performance report was clear and succinct, providing a strong overview of the key outcomes from the GD17 period. The public facing version of PNGL's business plan was also presented in a clear and accessible fashion.

Overall the PNGL business plan was rated as Good with one area identified as Exceptional.

1. GD23 Business Plan Assessments

- 1.1 One of our aims for GD23 is that GDNs should produce high quality, well evidenced business plans which can be accepted following limited scrutiny.
- 1.2 When we set out our approach to GD23, we signalled that we planned to carry out an assessment of the GD23 Business Plan submissions. We committed to discuss further with GDN's and then provide more detailed guidance on our expectations for the Business Plan submissions including a list of test questions.
- 1.3 In our recent price control for SONI we introduced a process of Business Plan Assessment. The assessment was structured around keys questions to be asked of the business plan submissions. The questions were grouped around key areas, or 'themes'.
- 1.4 We issued a draft business plan assessment document to the GDNs in December 2020. This was followed with discussion on the assessment approach with the GDNs during January 2021. A final version of the business plan assessment document was issued February 2021.
- 1.5 The assessment considers how each GDN has performed in relation to the established criteria. This section of the document is our assessment of the Business Plans as part of our draft determination. We expect to extend this approach to other network sectors providing a consistent comparative assessment of all network companies.
- 1.6 Our approach consists of areas which we will review ('themes') and categories we will consider. Our view on the quality of the GDN's business plans is based upon this. The illustration below summarises the process and key features of the approach.



- 1.7 In coming to our view, we have received and taken on board helpful input and suggestions from the SONI Business Plan Assessment as published in its Draft Determination.
- 1.8 We consider that our view provides a picture of our expectations of what is important. GDN's business role, services and activities should be well aligned with the interests of customers, consumers, other stakeholders and the wider energy system. We consider that the categorisation, when coupled with our framework and other expectations/guidance on business plans:
- allow GDN's to take ownership of its plan. It should also be answerable to stakeholders for what follows from it.
 - clarifies that lesser regulatory intervention can be expected in the GDN's business plan if it is of higher quality.
 - gives GDN's greater opportunity to shape its role over the price control period, what activities and level of service is funded through the price control, and aspects of the regulatory framework.
 - clarifies that there will be a higher degree of trust in GDN's if its business plan is of higher quality.

Theme areas

- 1.9 As we indicated, the themes provide a strong basis for us to provide clear regulatory expectations and policy priorities.
- 1.10 The themes have been structured according to three areas:
- Service contribution to good outcomes
 - Services and costs
 - Trust in delivery
- 1.11 In relation to the number and type of theme areas, we were conscious of balancing the need of having enough distinct areas of key importance, whilst ensuring there are not too many such that overall focus is diminished.

Categories

- 1.12 Our business plan assessment is built up from the categorisation below for each of the theme areas. This is structured around a number of questions, which we ask when assessing the quality of the business plan submissions.

1.13 These are grouped under three key themes and areas which are set out below:

- Theme 1 - Service contribution to good outcomes.
 - ◆ Area 1: Delivering value for money for Consumers.
- Theme 2 - Services and costs.
 - ◆ Area 2: Delivering services and outcomes.
 - ◆ Area 3: Aligning Risk and Return.
- Theme 3 - Trust in delivery
 - ◆ Area 4: Engaging customers, consumers and other stakeholders.
 - ◆ Area 5: Ensuring resilience.
 - ◆ Area 6: Accounting for past delivery.

1.14 The questions within each area are set out in the table below.

Areas	Questions
Area 1: Delivering Value for Consumers	Q1. How well has the company demonstrated that its proposed services and tariffs requested for GD23 provide value for money?
Area 2: Delivering services and outcomes.	Q2. To what extent has the company set out and clearly described, in an accessible way, the full range of services that it proposes to provide?
Area 3: Aligning risk and return.	Q3. To what extent has the company explained and justified its proposed Rate of Return?
	Q4. What confidence has the company given about its financial resilience under its business plan proposals?
Area 4: Engaging customers, consumers and other stakeholders.	Q5. What is the quality of the company's engagement?
	Q6. How well has the company demonstrated that findings from its engagement have been incorporated into its business plan proposals?
	Q7. How well has the company demonstrated that its engagement will be incorporated into ongoing activities?
Area 5: Ensuring resilience.	Q8. How well has the company demonstrated an understanding of the range of risks that could impact on its delivery, service quality, performance, viability and costs?
Area 6: Accounting for past delivery.	Q9. How well has the company given evidence for, and explained, its performance over the GD17 period?

Table 1.1: Areas and their respective questions.

1.15 We set out our categorisation expectations in the table below

Categories	Features
A: Exceptional	Exceptional and stretching business plan. Excellent responses across most test areas. Limited regulatory intervention to translate to price control package. Relatively high degree of trust in company.
B: Good	Good plan but falling short of being an exceptional and stretching plan. Excellent responses in some test areas. Some regulatory intervention and therefore less trust than category A.
C: Meeting Basic Expectations	Plan does not evidence how best to serve customers and stakeholders. Significant concerns and lack of excellent responses across all test areas. Extensive regulatory intervention and therefore less trust than category B.
D: Poor	Self-serving business plan with poor responses in multiple test areas. Extensive regulatory intervention to translate to price control package. Severe concerns about company's ability to deliver outcomes for stakeholders and consumers. Requirement for detailed monitoring of company during the price control period.

Table 1.2: Business plan categorisation expectations

GDN Self-Assessments

1.16 We also asked GDNs to complete a self-assessment against the criteria set out below as part of their business plan submissions:

- A brief statement setting out how the GDN has approached delivering an exceptional business plan in each theme area.
- A reference to the key documentation in the business plan, which provides the supporting evidence to these statements.

1.17 From a presentational perspective, the GDNs opted for a range of file formats to present the information, from spreadsheet to MS Word based.

1.18 This in turn provided for a range of lengths, amounts of detail and background and associated text in the self-assessment submissions.

1.19 For future price control processes, we are open to discussing the pros and cons of different approaches to the self-assessment area with the GDNs.

For example, continuing with the current approach which gives GDNs some flexibility in presentation, or in agreeing a more uniform approach across the industry.

- 1.20 The GDNs were asked to make a Self-Assessment of their business plans and PNGL indicated that every area of their respective plan was at the Exceptional level.

UR Assessment

- 1.21 We have reviewed the GDNs business plans including self-assessments and have made our own assessment of the submissions made to us. In the tables below we set out our assessment for PNGL's business plan, by the structured questions we had previously provided to the GDNs.

Question 1: How well has the company demonstrated that its proposed services and tariffs requested for GD23 provide value for money?	Score
	Good
Guidance for Exceptional	Summary of Assessment
<p>This is an overarching question that brings together different elements of the business plan.</p> <p>The plan should offer an exceptional and compelling proposition overall.</p> <p>There must be a clear need or rationale expressed for any proposed changes to costs/activities for GD23.</p> <p>For an exceptional score, PNGL would need provide evidence to indicate how it has made operational savings from the previous price control and make this clear in the Business Plan submission.</p>	<p>PNGL details how it intends to develop its business during GD23, the key outputs and outcomes it intends to achieve, as well as the investment anticipated to be needed to do this. PNGL also explains the rationale it has applied in deriving its opex and capex forecasts from 2021 and any proposed step change to individual cost lines.</p> <p>When utilising PNGL's GD23 P1 tariff versus the 2020 P1 tariff, there is an increase of 0.4%. This is in contrast to the 3.6% reduction in average distribution tariff from PNGL's business plan.</p> <p>The reduction in tariffs by PNGL is mainly around the reduced rate of return and changes in volumes, which compensate for proposed increases in opex.</p>

Table 1.3: Question 1

Question 2: To what extent has the company set out and clearly described, in an accessible way, the full range of services that it proposes to provide.	Score
	Exceptional
Guidance for Exceptional	Summary of Assessment
<p>The plan should include any services provided by GDN to its customers and focus on services rather than simply activities.</p> <p>There should be a clear and comprehensive explanation of what services are covered by GDN control, and what activities of the company fall outside its scope.</p> <p>It should have accessible explanations of GDN services which are tailored for different audiences (e.g. domestic energy consumers) and a focus on the services the GDN provides to vulnerable consumers.</p> <p>A high-degree of granularity should be provided in the explanation of proposed services and the GDN should be able to demonstrate that it has a plan in place to check/verify delivery of the right outcome.</p>	<p>PNGL provided an excellently structured Business Plan submission.</p> <p>PNGL gave a clear and comprehensive explanation of its services that will be provided and any that fall outside its scope. In addition, there are accessible explanations of its services, which are tailored for different audiences, including vulnerable consumers.</p> <p>Importantly, PNGL has provided explanations of how it will ensure that its services deliver the right outcome or where enhancements could be made. This has been based on information derived from its consumer engagement activities.</p> <p>PNGL's public facing business plan was succinct and easily accessible with a variety of relevant infographics to make information more digestible. It is clear that effort went into creating this standalone document.</p>

Table 1.4: Question 2

Question 3: To what extent has the company explained and justified its proposed Rate of Return?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>The response should include explanation of its proposed mix of equity and debt finance.</p> <p>Fresh perspective on Rate of Return, with clear and comprehensive explanation of assumptions and evidence that proposed Rate of Return structure has been tested against possible alternatives, taking account of cost to customers and other factors.</p> <p>It should also be well-presented and have understandable supporting analysis as part of the submission.</p> <p>PNGL could have done more to critically examine possible alternatives to its proposed rate of return.</p>	<p>PNGL are proposing a weighted average cost of capital (WACC) for the GD23 period of 3.33%.</p> <p>PNGL's submission provides a clear and comprehensive explanation of the assumptions used. Its submission has been subject to challenge from external consultants (NERA) and stakeholders.</p> <p>A reducing return on capital will challenge the financeability ratios, which regulators have applied in past determinations.</p>	

Table 1.5: Question 3

Question 4: What confidence has the company given about its financial resilience under its business plan proposals?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>The plan should include explanation of how planned financial structure differs from assumed notional efficient financial structure.</p> <p>It should include similar scenario risk analysis as used for notional efficient licensee as well as clear explanation of planned financial structure for 2023-28 period.</p> <p>It should include high-quality scenario analysis and stress-testing and give strong evidence of financial resilience under planned financial structure.</p> <p>PNGL's plan could have included measures toward fixing financiability issues, should they arise during the GD23 period.</p>	<p>Backed by a supplementary paper and guidance from external consultants (NERA), PNGL highlights the rationale for its required cost of capital, and how rating agencies and debt providers will perceive this.</p> <p>Importantly, PNGL has also sought to benchmark its financial structure against other companies in the sector, as well as wider comparator companies across Ireland and the UK to ensure that it is aligned to industry standards.</p>	

Table 1.6: Question 4

Question 5: What is the quality of the company's engagement?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>Within the plan, engagement is expected to include, but not be limited to, customers, suppliers, consumer representatives, environmental stakeholders and NI Government.</p> <p>Engagement should recognise diversity within each broad category and develop engagement to accommodate this. It should also be targeted and proportionate, demonstrating a clear understanding of different consumer and other stakeholders to engage with and the issues which are likely to matter most to them.</p> <p>It should show engagement initiatives across a range of diverse consumer groups and other stakeholders, using a variety of approaches that are both tailored to the GDN services, but also drawing on tools and approaches from other regulated sectors and elsewhere.</p> <p>It should also be clear that Engagement has provided a platform for future improvements and explore plan(s) of how the engagement will be used to bring into effect these changes/improvements, which will result in better service.</p> <p>PNGL looked to other companies to benchmark its financial structure, and this is an approach that could have been applied to their engagement, to ensure a more robust engagement process.</p>	<p>PNGL has undertaken a robust programme of consumer and stakeholder engagement, which captures insights and informs its business strategy with the hope to ensure it continues to deliver the best possible service and value for money for its consumers and the communities in which it operates throughout the GD23 period.</p> <p>This is well evidenced within a supplementary paper, which includes a number of ongoing stakeholder and consumer engagement activities to ensure that engagement is suitably representative across core audiences, and importantly, hard-to-reach audiences.</p>	

Table 1.7: Question 5

Question 6: How well has the company demonstrated that findings from its engagement have been incorporated into its business plan proposals?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>The plan should make clear how sections of business have been informed and improved by consumer and other stakeholder engagement.</p> <p>The plan should include a clear mapping of how its proposals have been shaped by engagement, along with compelling evidence that engagement has made a real difference, in a way that will improve outcomes.</p> <p>A plan should recognise the benefits and drawbacks of evidence gathered from different types of engagement and clearly demonstrate sound judgement in using engagement to inform the plan.</p> <p>To reach exceptional, PNGL could discuss the benefits and drawbacks of its various types of engagement and how this effected the evidence received.</p>	<p>Importantly, PNGL has provided explanations of how it will ensure that its services deliver the right outcome or where enhancements could be made. This has been based on evidence derived from its consumer engagement activities.</p> <p>PNGL has provided a clear mapping of how sections of its GD23 Business Plan submission have been shaped by its GD23 stakeholder and consumer engagement programme and how this engagement has made a real difference across its business plan, influencing its service offering to consumers now and into the future.</p>	

Table 1.8: Question 6

Question 7: How well has the company demonstrated that its engagement will be incorporated into ongoing activities?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>Plans should include explanations of how engagement has been used in the past and commitments for the incorporation of engagement as part of plans for the future.</p> <p>The plan should give confidence that engagement with consumer and other stakeholders lies at the heart of the company's approach to providing services.</p> <p>The plan should examine: the frequency of engagement, looking at how often it was reviewed; the quality, looking at what type/depth of engagement and its audience; the output, looking at what evidence was gathered and analysed from engagement; and the outcome, looking at what has been put in place to ensure better services and appropriate protections.</p> <p>It should show how ongoing engagement is used in an effective way, with genuine influence on growing the customer base through deployment of engagement activities which support "actionable data".</p> <p>A more granular examination when discussing engagement, to better outline the overall process, would improve the score here. A tighter focus on frequency, quality, output, and outcome, would make this aspect of the plan exceptional.</p>	<p>PNGL has completed a stakeholder and consumer engagement programme to inform its GD23 Business Plan submission. Notably, in one of PNGL's supplementary papers, it identifies five consumer priority themes that have helped to shape the GD17 period and will carry forward into the GD23 period.</p>	

Table 1.9: Question 7

Question 8: How well has the company demonstrated an understanding of the range of risks that could impact on its delivery, service quality, performance, viability and costs?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>This question concerns the risks that the company cannot deliver on the service and cost proposals provided in response to themes 1 and 2.</p> <p>The plan should outline and explore high-quality risk analysis covering a diverse range of risks. And examine how the GDNs will keep the Gas Industry relevant for the future.</p> <p>PNGL's risk analysis could have covered a more diverse range of risks.</p>	<p>PNGL has prepared its Business Plan under the assumption of 'business as usual' throughout the GD23 period. Reasonable endeavours have been made to forecast for key activities and considerations have been made for specific market indicators that will affect opex and capex forecasts.</p> <p>PNGL has also provided the detailed risk analysis it has undertaken in assessing the ongoing resilience of its asset, which was outlined through three supplementary papers.</p>	

Table 1.10: Question 8

Question 9: How well has the company given evidence for, and explained, its performance over the GD17 period?		Score
		Good
Guidance for Exceptional	Summary of Assessment	
<p>Any such adjustments must be clearly mapped to the relevant provisions of the GD17 control and complemented with high-quality supporting evidence.</p> <p>There must be clear explanation and strong evidence for any adjustments/changes during GD17 period.</p> <p>PNGL's performance report was strong; to achieve exceptional, it could provide more depth in its examination overall, including a more granular focus on the outlook for delivery for the remaining years of the price control.</p>	<p>PNGL's GD17 performance report was clear and succinct, made good use of infographics, and provided a strong overview of the key outcomes from the GD17 period. Additional footnotes and worksheets were provided to ensure additional transparency.</p>	

Table 1.11: Question 9