



GD23 - Gas Distribution Price Control 2023-2028

Draft Determination Annex O
Business Plan Assessment
SGN Natural Gas
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 SGN'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 SGN Natural Gas

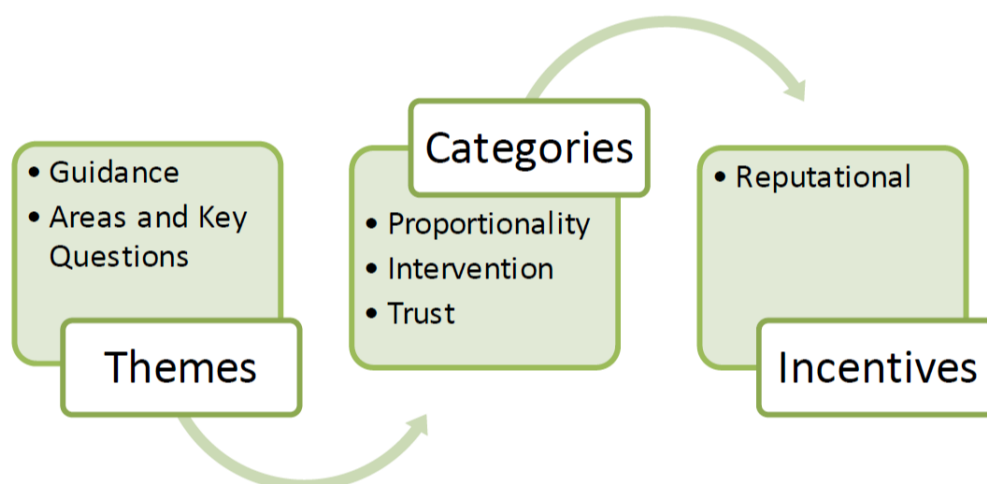
SGN Natural Gas (SGN) was asked to make a Self-Assessment of its business plans and indicated that every area of the plan was Exceptional.

The level of information in SGN Natural Gas's (SGN) Business Plan submission is less than expected to account for proposed services, rationale for tariff increases and reasons for the proposed increases in expenditure, and importantly, what value it will all generate for consumers. Additionally, SGN's request for additional opex versus the volume of new connections needs further justification. SGN has provided evidence that the proposed Rate of Return has been tested against possible alternatives, and has suitably assessed the financeability of its business plan, looking at the long-term sustainability of the company, the value to customers and reasonable levels of returns for retaining and attracting capital. It is clear that SGN have engaged with their customers and stakeholders as part of its GD23 Business Plan submission, recognising the need for a continuous, systematic loop of engagement, insight gathering and improvement, allowing for a strong commitment to engagement, and importantly, utilising the insights to create a better Business Plan submission and enhance the business going forward. When examining risks, a key consideration was balancing financial risk between its business and customers and as a result, the plan has been structured so that customers will not be disadvantaged by a change in forecasts. SGN also recognise the uncertainty around the role of the gas networks in a decarbonised energy system. In its assessment of its GD17 performance it is clear that SGN sought to understand the differences between what was expected and what was delivered, identifying areas of significant difference between its forecast and actual expenditure. Finally, SGN's business plan was professionally presented and data was available in a variety of formats, its public facing paper also being of high-quality and clearly understanding its target audience.

Overall the SGN business plan received a rating of Good with one area Meeting Basic Expectations.

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 SGN 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 SGN'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
		Meeting Basic Expectations
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>A higher degree of granularity needs provided in the explanation of proposed services, rationale for tariff increases and reasons for the proposed increases in expenditure, and importantly, what value it will all generate for consumers. The level of information is adequate but just falls below the level of detail required to reach the next tier.</p>	<p>When comparing SGN's GD23 P1 tariff to the 2020 P1 tariff, there is an increase of 30.4%. The tariff increase proposed by SGN is due to a change in estimated volumes of and an increase in opex compared to GD17.</p> <p>SGN's request for additional opex (over 100% increase) versus the volume of new connections (c. 6,000) needs further justification as to how this represents fair value for money for consumers.</p> <p>The explanations provided in the business plan submissions could have been articulated more clearly.</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
		Good
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>SGN's presentation quality was high and while an excellent and professional format for a public facing document, this approach felt somewhat detrimental to delivering clear and concise information to the Utility Regulator.</p>	<p>SGN's business plan was professionally presented with a range of graphics and corporate imagery that provided an overall polished finish.</p> <p>Data was available in a variety of formats throughout the document, including tables and charts.</p> <p>A small presentational note is that the double column formatting makes the report harder to read.</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>SGN could have gone further with their proposed rate of return and offered a deeper explanation of assumptions.</p>	<p>SGN has provided evidence that proposed Rate of Return structure has been tested against possible alternatives, taking account of cost to customers and other factors. It was well presented and understandable.</p> <p>SGN's licence allows for a vanilla WACC and separate remuneration of tax. This is 3.44% for GD23 based on as assumed gearing ratio of 55%.</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>While SGN's unique position in regard to their financial resilience is understood, an exceptional score here should include proposals on how to manage financiability issues should they arise.</p>	<p>SGN suitably assessed the financeability of its business plan, including looking at the long-term financial sustainability of the company, the value to customers of a strong financial position, reasonable levels of returns for retaining and attracting capital, and ensuring strong credit metrics.</p> <p>SGN also considered its unique situation i.e. it is currently too small to issue its own debt with a credit rating and that it is part of the SGN group. This means its financing decisions are considered within group strategy and are therefore different to the other GDNs.</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>SGN could go into more detail, both in which groups are targeted with engagement initiatives, and the statistical findings of those initiatives. This would present a stronger case for engagement overall.</p>	<p>It is clear that SGN have engaged with their customers and stakeholders as part of its GD23 Business Plan submission.</p> <p>SGN has recognised the need for a continuous, systematic loop of engagement, insight gathering and improvement. The aim of this being to acquire a deeper understanding of its customers' needs.</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>SGN need a deeper examination of the suitability of the evidence showing its benefits and drawbacks; this would go further in showing how engagement has informed the plan.</p>	<p>SGN has shown a good commitment to engaging with stakeholders, and importantly, utilising the insights to create a better Business Plan submission.</p> <p>For example, commissioning Cognisense (formerly Kantar Millward Brown) to engage with over 2.5% of its entire properties passed market to help inform awareness of the company, natural gas as a product and key drivers for converting.</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 deeper breakdown of SGN's engagement loop, based on engagement already undertaken, would better demonstrate the company's ongoing commitment to, and use of, its engagement.</p>	<p>It is clear that SGN aim to continue applying the learnings from its consumer engagement to develop its business plan, and in particular when considering the need for the continuation and enhancement of the business going forward.</p> <p>SGN states that it will prioritise the most important improvement opportunities, based on the value to its customers and business.</p> <p>This is supported by two supplementary papers, which outline the broad range of activities SGN aim to carry out in relation to consumer engagement.</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>For an exceptional rating in this area, SGN could look to provide more in depth and concise proposals for controlling/mitigating the risks identified.</p>	<p>A key consideration was how SGN will balance financial risk between its business and customers.</p> <p>Importantly, its plan has been structured so that customers will not be disadvantaged by a change in forecasts and recognises the uncertainty around the role of the gas networks in a decarbonised energy system.</p> <p>SGN are realistic when it notes that it is not possible to mitigate against all risks and make a fair effort to identify all relevant risks and how to control or mitigate against such risks.</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>To be exceptional, SGN could have gone into more depth when examining the outlook to the final years of the price control, following its assessment of its current performance.</p>	<p>SGN assessed its progress to date against the targets set out in the GD17 Final Determination. It is clear that SGN sought to understand the differences between what was expected and what was delivered.</p> <p>SGN made good use of graphics, tables and timelines to showcase the results of its GD17 efforts. Data was readily available and presented in an easy to digest manner.</p> <p>SGN also reviewed its GD17 experience and identified areas of significant difference between its forecast and actual expenditure. This allowed SGN to assess where similar variations could occur in GD23.</p>	

Table 1.11: Question 9