Price Control for Northern Ireland's Gas Transmission Networks GT22

Annex 4 – Summary of responses and matters raised

May 2022

Contents

1. Introduction

1.1 Detailed responses to the assessments and proposals in the GT22 draft determination were received from the TSOs (Transmission System Operators):

a) Mutual Energy Limited (MEL)

b) GNI (UK) Limited

c) GMO NI

1.2 Each of them provided a full response and a redacted version suitable for publication.

1.3 Furthermore we received a response from the Consumer Council for Northern Ireland (CCNI).

2. Responses

GNI (UK) Response

Table 1: Responses on Comments from GNI (UK)

No.	Reference	Section and Topic	Comment	Our Response
1	GNI (UK) response	General	GNI (UK) are of the opinion that the opex allowance granted by UR is lower than the figure they have requested. They believe the proposed figure will prevent them from recovering the true cost of operation and maintenance of the transmission network during GT22 to the required standard leading to deterioration in safety and security levels in the coming years.	UR welcomed the additional information provided to inform our considerations
2	GNI (UK) response	General	GNI (UK) believes that the proposed level of allowance proposed for repex is inadequate to maintain the integrity and service level of the gas network considering the age and condition of the assets and its statutory and licence compliance requirements. They have highlighted the anticipated growth of gas in Northern Ireland in the coming years, noting the gas transmission network will be fundamental to facilitating the growth to meet increasing energy demands.	UR welcomed the additional information provided to inform our considerations
3	GNI (UK) response	WACC	GNI (UK) has raised concerns in regards to the proposed cost of capital. They have highlighted the proposed figure has been generated during a time of economic uncertainty, with the figure proposed provided no headroom to deal with the resultant potential financial challenges that may arise over the course of the forthcoming price control period.	See next point for detailed response

4	GNI (UK) response	WACC	GNI (UK) have commissioned Frontier Economics to review the approach in the WACC establishment. The following misgivings have been raised regarding the proposed outcomes of GT22: 1. The setting of point estimates for beta and other cost of equity components are at the lower end of GNI (UK)'s proposed range and below recent final determinations for PR19 and RIIO-2 in the UK 2. The basis for the proposed change to a gearing level of 60% from 65% 3. The estimation of the cost of debt using prevailing market rates and not medium to long term data	In regards to point 1, this is correct. But the differential is wholly a function of the different ways in which companies borrow. Specifically: - companies in the UK are servicing relatively expensive fixed-rate debt that was originally issued in the 2000s and 2010s; while - GNI (UK) has no such legacy debt. It is therefore natural that GNI (UK)'s cost of debt, and hence its overall cost of capital, should sit below UK peers. The Ofgem/Ofwat/CMA decisions all used a gearing figure of 60%. Using the same figure is in line with recent regulatory practice and aids comparisons across sectors. Importantly, as a matter of overarching principle, the value of the cost of capital should not change materially with gearing. There is no reason to think that the GNI (UK) cost of capital calculated at 65% gearing should be different to the cost of capital at 60% gearing. For point 3. As set out in the First Economics report that accompanied the draft determination, neither GNI (UK)

				nor its parent possesses any embedded fixed-rate debt. It is not logical to set a cost of debt allowance by reference to historical interest rates that GNI (UK) does not and need not pay. The UR can and should take account of recent volatility and any other factors that may impact future interest rates (e.g. monetary policy, COVID) before it makes it final determination. The aim will be to set a central forecast of interest rates during the GT22 period.
			4. The failure to provide an aiming up allowance to counter the significant risks being driven by current economic uncertainty.	For Point 4 the CMA last year found that Ofgem's decision not to aim up in its RIIO-2 decisions was not wrong. The UR is aligned with Ofgem and the CMA on this matter. As set out in First Economics' report, the UR's approach of setting the expected market return component of the cost of equity in line with long-term historical averages likely results in some overstatement of the prevailing cost of capital and can be said to obviate the need to aim up elsewhere.

GMO NI Response

Table 2: Responses on Comments from GMO NI

No.	Reference	Section and Topic	Comment	Our Response
1	GMO NI response	Contracts and Licences Cost Disallowance	GMO NI has noted that due to the proposed reduction of £1.84m on the GMO NI request for contracts and licences that the reduction will impact 3 sub categories – 1. Delphi Enhancements, 2. Application Upgrade and 3. Server Hosting and IT Support. • The Delphi Enhancements line item includes the functional change of Delphi to accommodate the Tier 1 projects as outlined in the GT22 submission, and therefore the impact of the 50% cut in this area means that GMO NI would need to prioritise certain projects ahead of others which may adversely impact the NI gas market as certain Delphi enhancements would not be able to proceed due to insufficient funding. • For Application Upgrade and Server Hosting and IT Support concerns have been raised that the proposed allowances will prevent the IT system from meeting obligations under the NIS Regulations leading to increased cyber security risk and reduced service quality.	UR welcomed the additional information provided to inform our considerations.

2	GMO NI Response	Cost & Output Reporting	GMO NI has noted that there is consideration from UR to add additional areas to the annual RIGs reporting and request that this is developed with input from GMO NI and other TSOs to prevent it being disproportionate.	Noted.
3	GMO NI Response	PRISMA Cost Treatment	The Draft Determination has stated that PRISMA costs will continue to be treated as controllable operating expenditure with consideration set for GT27 if the costs during GT22 increase by over 50% from forecast. GMO NI have questioned why the 50% threshold has not been set for allowances to be revisited, particularly when TSOs will have to finance any increased costs.	Noted.

CCNI Response

Table 3: Responses on Comments from CCNI

No.	Reference	Section and Topic	Comment	Our Response
1	CCNI response, page 6	Governance Review of MEL	CCNI has suggested that UR investigates the level of MEL salary costs and the incentives on its managers to deliver outcomes that are in the customer's best interests.	Noted.
2	CCNI response, page 6	Business Plan Assessments	CCNI considers that UR should focus on areas where the company plans showed greatest weaknesses or required greatest regulatory testing, with further requirements that the companies update those specific sections to bring the business plans up to "exceptional" quality. With particular focus placed on outputs to demonstrate that customers are willing and able to pay the outputs proposed.	Noted.

3	CCNI response, page 6	Operating Expenditure and Replacement Expenditure	CCNI has stated they do not believe the draft determination provides sufficient information for consultees to determine whether the UR has allowed an appropriate amount of expenditure for the TSOs involved. Sufficient detail has not been provided to confirm whether the allowance is appropriate. From a consumer stand point there does not appear to be enough information present. Consumers should have visibility of: - Evidence the companies have proper engaged all stakeholders. - That companies have taken on board consumer concerns about price increases and the delivery of value for money. CCNI has noted that although the TSO spending in Northern Ireland is less than that of their GB counterparts, however GB TSOs have been required to work with *"Customer Challenge Groups"* who represent customer interests to ensure that asset expenditure is sufficient and offers value for money. CCNI believe that UR should consider how to enhance consumer-focused scrutiny of TSO spending.	UR has added an opex report to the FD to provide additional information UR has asked the TSOs to more clearly outline their stakeholder engagement activities by reporting through the RIGs
4	CCNI response, page 7	Innovation Incentives	CCNI has stated their surprise that there are no current plans to introduce mechanisms to encourage innovation. They have noted the inclusion of such mechanisms could be beneficial for projects that will impose costs as part of GT22 but will not deliver benefits until GT27 or beyond. The delivery of such projects if implemented would be expected to be efficient and in line with customer requirements.	UR engaged with CCNI to explain how innovation projects can be added through the existing uncertainty mechanism.

5	CCNI response, page 7	Stakeholder Engagement and Joint Working	CCNI has questioned whether it is sufficient to only promote engagement alongside setting out four expectations for GT27. CCNI has suggested the tracking of stakeholder engagement be integrated into the business plan assessment process for GT27 to ensure the quality and effectiveness of TSO's stakeholder engagement is a core part of the UR business plan assessments.	UR has asked the TSOs to more clearly outline their stakeholder engagement activities by reporting through the RIGs.
6	CCNI response, page 8	Consumer Impact	CCNI has noted that given the increased international wholesale fuel costs and the small nature of transmission costs on the consumer (10% of the domestic gas customer tariff) that UR should ensure that the rate of return afforded to GNI (UK) is the lowest possible that the market will bear after accounting for business risk to ensure for the best affordability for consumers.	Noted.

MEL Response

Table 4: Responses on Comments from MEL

No.	Reference	Section and Topic	Comment	Our Response
1	MEL response, page 21	Average Annual Operating Costs	MEL have requested that the price control submission for the annual operating cost be increased to the requested £1,405,881.	UR welcomed the additional information provided to inform our considerations.

3. Appendices

Table 5: Links to Consultation Responses

Document	Document Link
CCNI draft determination response	https://www.uregni.gov.uk/files/uregni/documents/2022-05/ccni-draft-determination-response.pdf
GMO NI draft determination response redacted	https://www.uregni.gov.uk/files/uregni/documents/2022-05/gmo-ni-draft-determination-response-redacted.pdf
GNI UK draft determination response redacted	https://www.uregni.gov.uk/files/uregni/documents/2022-05/gni-uk-draft-determination-response-redacted.pdf
MEL draft determination response redacted	https://www.uregni.gov.uk/files/uregni/documents/2022-05/mel-draft-determination-response-redacted.pdf