SGN
Natural Gas

GD23 Draft Determination Response

MAY 2022

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PART 1: EXECUTIVE SUMMARY

SGN Natural Gas (SGN NG) welcome the opportunity to engage with the Utility Regulator (UR) on the proposed decision set out within the Draft Determination (DD). As the most recently constructed network in the UK, SGN NG is uniquely placed to be the first hydrogen ready network to transition our customers from natural gas to hydrogen and biogas and to play a leading role in delivering the NI Energy Strategy utilising local resources and local production to deliver this change.

We acknowledge the opportunities the UR has provided to engage on a number of our concerns since the DD was published. This response expands on those concerns and builds the evidence base for areas where we believe refinement is absolutely necessary.

Of these key issues we are most concerned about the current misalignment between connection targets set out in the DD and the level of marketing support and incentive proposed. As set out in the DD there is a gap that cannot be covered and will lead to under recovery of revenue for SGN NG. This gap has to be addressed in the Final Determination (FD).

If this gap is not addressed then consumers in the west of Northern Ireland (NI) will have less opportunity to connect to the gas networks than their counterparts in the east of NI, they will have received less investment into their local community, and the customers that have invested will face a greater risk of higher network transportation charges in the future.

The Final Determination needs to seize the opportunity to promote decarbonisation

Our GD23 Business Plan proposal set out an ambitious plan to support customers in the west of NI to immediately move away from more carbon intensive fuels, such as heating oil, and support their transition to green gases such as hydrogen or biogas.

Our network was designed and constructed in a manner that makes us ready to transfer our customers to hydrogen and biogas. Our business plan set out how we proposed to facilitate this by supporting the development of these two net-zero fuels. This has the opportunity to bring decarbonised energy at least cost to our customers, with substantially lower upfront costs compared to heat pumps[1].

We are disappointed that in the DD, the early initial steps towards this which were set out in our GD23 business plan have been significantly scaled back by the UR. This is out-of-step with the broader policy environment and a missed opportunity to promote a leading low carbon economy in the west of NI.

The Final Determination should support the decarbonisation through easy network extensions

In line with this transition to net zero, our business plan set out proposals to develop the network over the GD23 period by finishing the main construction work in the eight towns in which we already operate and extending the network to nine towns and villages where the IP network either passes through or goes very close by. These are 'readily accessible' towns, and the proposed extensions would bring the economic and environmental benefits of gas to over 4,000 potential customers cost effectively.

From a survey of 600 potential customers[2] 94% of them currently use heating oil, 3% use coal and 1% use LPG/tanked gas. For each customer we convert to natural gas we will typically reduce their carbon emissions

[1] Installation costs for a heat pump, the nearest alternative decarbonisation route is between £8 and £14k for an air source heat pump and £18 and £30k for a Ground Source Heat Pump (https://www.renewableenergyhub.co.uk/main/heat-pumps-information/air-source-heat-pump-cost/), this compares with a typical installation cost of gas boiler and associated systems of between £2.5 and £3k (Section 5.2.5 SGN business plan)
[2] Cognisense – Non-customers in gas supplied areas – Brand awareness and natural gas perception, Feb 2021

by almost a third[3] simply by changing fuels to natural gas. The actual savings associated with a more efficient boiler and heating system will be substantially greater. The social benefits of delivering these carbon savings should be included in the decision about whether or not to extend these as standard for public policy decision making. This will ensure that the economic benefits to customers in the west of NI are assessed on the same basis as other parts of the UK[4].

The UR DD proposal does not support these extensions and curtails the ability to connect new customers in areas where the network has recently been deployed. This curtailment in ambition undermines the environmental and economic potential of connecting customers to the gas network and the opportunity for them to decarbonise in a lower cost manner. This ambition should be reinstated in the FD.

A 70% reduction in advertising, marketing and development budget is a false economy

In the business plan we set out a clear plan for advertising and marketing the benefits of natural gas to the customers of the west of NI. Our customer research has shown 40% of the customers who had gas readily available to them were unaware their house could be connected and 62% didn't know the name of the company responsible for delivering natural gas. We have shown that there is a clear correlation between the level of advertising and marketing expenditure and the number of enquiries – the first step on the customer connection journey. As such our SGN NG business plan asked for £1.8m/year over GD23 to increase awareness of the benefits of natural gas and increase brand awareness across the 44,000 properties that our mains will pass near to by the end of GD23. This was reduced by over 70% to just over £0.5m/year in the DD.

The scale of this reduction in advertising and marketing will seriously undermine the reach of SGN NG to new customers and reduce the awareness of an alternative when it comes to replacing their boiler. This represents a missed opportunity to support connections numbers which will lock customers into a more expensive and higher carbon source of heating today and restrict the opportunity to move them onto a lower cost decarbonisation option in the future.

The UR proposal set out in the DD appears to contradict the published energy strategy, where half of the CO2e reductions modelled within the strategy are expected to come through from the residential sector[5]. It is very challenging to envisage how this strategy can be delivered if customers are not being appropriately incentivised to move to natural gas.

The final determination needs to support the connection of new customers in a meaningful manner

The west of NI has the highest rates of fuel poverty and lowest levels of disposable income in the UK. Nearly two thirds (61%) of our customers say they would not be willing to pay more for an environmentally better source of heating. For just over half our customers (51%) this was because they could not afford to pay more[6].

As the majority of our customers are not able to realise the longer-term savings from connecting to the gas network due to the upfront cost of connection and conversion, it is important to enable the upfront cost of connecting to the gas network to be spread over the lifetime of the connection. This is essential financial support to customers, particularly given the current cost of living crisis.

Within our business plan we supported an incentive mechanism through which domestic customers (owner occupier connections referred to as OO connections) would continue to be incentivised to connect and we proposed to extend this incentive mechanism to small and medium commercial and industrial (I&C) customers.

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[3] Carbon Conversion Factors take from UK Government GHG conversion factors for company reporting. – 46% CO2e benefit of converting coal, 31% for fuel oil and 14% for LPG, weighted by current heating type to provide a weighted average saving per customer.

[4] https://www.gov.uk/government/publications/valuing-greenhouse-gas-emissions-in-policy-appraisal/valuation-of-greenhouse-gas-emissions-for-policy-appraisal-and-evaluation#annex-1-carbon-values-in-2020-prices-per-tonne-of-co2

[5] https://www.economy-ni.gov.uk/sites/default/files/publications/economy/energy-strategy-path-to-net-zero-action-plan.pdf, figure 3, pg 17

[6] This survey was carried out in Feb 2021, before the current cost of living crisis

We are extremely disappointed the existing incentive for domestic customers has been removed and the proposed incentive for small commercial customers has not been progressed. The proposed 'cost to serve' mechanism is simply inadequate and will fundamentally undermine the connections we are able to generate. In the DD the UR postulated for OO connection numbers will be reduced to 60% of 2020 levels. Our submitted evidence suggests the impact will be far greater with connection volumes reduced to 15%[7] of 2020 levels. This reflects a substantial reduction in direct benefits to our customer in the west of NI.

With small and medium I&C customers our GD17 experience has demonstrated the assumption, which we made in the 2014 bid (that there would be a sufficiently compelling reason for I&C customers to convert to natural gas) was wrong. Through-out GD17 our small and medium I&C connections have been very low. As such we put forward a connection incentive targeting small and medium I&C customers.

We are extremely disappointed the UR has rejected this proposal and consider it appropriate to maintain a clearly flawed assumption in the bid. The focus on maintaining a flawed assumption directly harms businesses in the west of NI which are unable to secure the financial benefit of natural gas. It also places greater financial risk on the customers who have connected to the gas network and it blocks a valuable economic stimulus in the west of NI which gas connections would provide. We believe that it is in everyone's interest, not least the customers, to move on from a poor assumption and support I&C connections in GD23.

The conclusion reached in the DD for both domestic and I&C customers is particularly disappointing, given the early stage of network development and the compounding factors which restricted connections during GD17. These included the delay in the delivering of the High Pressure (HP) and Intermediate Pressure (IP) pipelines, a global pandemic and global cost of living crisis. It's completely inappropriate to remove the connection incentive at this time. The impact of this will be to discourage connections during the six-year duration of the price control and inevitably a lost opportunity for longer-term cost-effective decarbonisation for many consumers.

Historically consumers in the west of NI have had lower levels of investment than the rest of NI. If the UR maintains its DD proposals within the FD then the majority of customers in the west of NI will have been offered financial support for just three years, during a global pandemic and cost of living crisis, whilst consumers elsewhere in NI have had the opportunity to avail of this financial support for more than twenty-five years, a new example of this historical disparity.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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[7] Both the 60% and the 15% figures include natural gas prepped sites

[redacted]

[redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

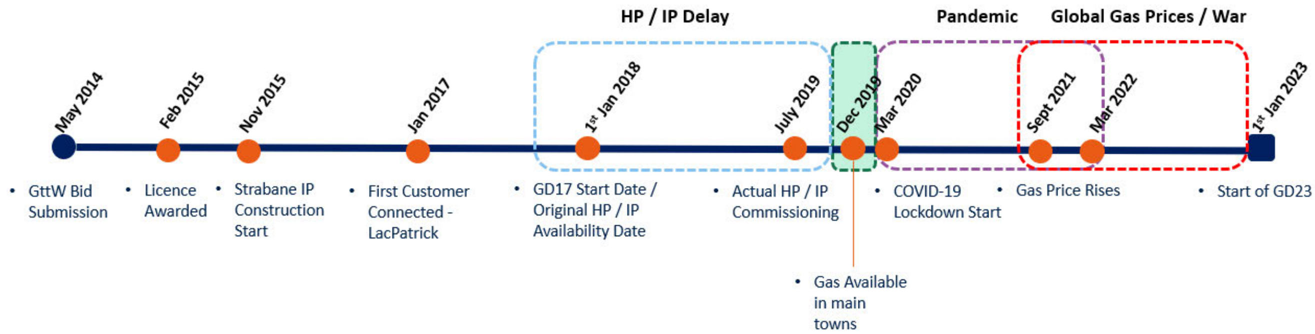
[redacted]

[redacted]

[redacted]

GD17 was not a 'normal' price control period for SGN NG.

The current price control GD17, is our first price control after our successful bid for the Gas to the West (GttW) licence in 2014, with the GD17 business plan being submitted shortly afterwards in 2015. Our plan was dependent on the successful and timely provision of HP and IP feeder mains. Delays to the HP and IP mains meant we were unable to commission the distribution network at the pace which we had envisaged with the main towns having gas available from December 2019. Three months later in March 2020, the country went into lockdown due to the COVID-19 pandemic, the economic and social duress of COVID-19 has subsequently been compounded by the war in the Ukraine, soaring energy prices and concerns of stagflation.



As such SGN NG has not had a 'normal operational year' in this price control. Rather, there was a three-month period of 'normal operation' before previously unimaginable levels of disruption came into force. This disruption coincided with the time when our marketing presence would have been strongest to build momentum in customer connections.

Given the early stages of network development, the lack of familiarity of customers with gas, the upfront cost barriers to deploying natural gas within the home and the benefits of establishing a broad customer base, it remains of vital importance to provide an appropriate advertising and market allowance and an appropriate incentive mechanism. The GD23 DD does not do this.

Furthermore, in many instances the UR has used the 2020 full-time equivalents (FTEs) employed as the basis from which to propose DD allowances. In 2020 we were at the very beginning stages of full mobilisation across the 'full network'. It would not have been appropriate to have the full complement of staff in advance of a 'full operational' requirement. In addition, recruitment was disrupted due to the pandemic and distortions that this introduced. As such the assessment should be updated for 2021 actuals.

Given the extent of changes the original 2014 bid is no longer a relevant point of comparison

Our SGN NG GD23 Business Plan represented a complete break from the 2014 bid position as the bid is no longer a valid point of reference given the level of disruption which has occurred over the last three years and time that has passed since the bid was submitted nearly nine years ago. This position is in line with the GttW applicant information pack which was clear the UR would not continue to link allowance to the application if it would be inappropriate at the time[8].

The market in 2014 has changed dramatically since 2014 to the point of being unrecognisable. Significant changes include Brexit in 2016, global pandemic 2020-22, war in Europe 2022 (Russian invasion of Ukraine Feb 2022), dramatic increases in global wholesale gas prices (2021-22), the number of energy suppliers going into administration as a result, inflation peaking at 7.2% in United Kingdom (March 2022 OBR) and the introduction into law of a binding national commitment to achieve net zero in 2050. Furthermore, during this period the NI Assembly has collapsed twice (2017-2020 RHI Scandal) and in January 2022 (Brexit Protocol). This extreme level of change and uncertainty is without precedence in recent history, will reduce investor confidence to change fuels and was clearly unforeseeable at the time of submission.

It's wholly inappropriate for the UR to return to the 2014 position to determine GD23 allowances for IT and a central service provision, as it's a complete misrepresentation of the services which are currently provided and the challenges that are currently faced.

For IT costs, there has been a fundamental shift in concerns over and the protection required for cyber security, to protect against ransomware attacks and to comply with the Network and Infrastructure Systems (NIS) Regulations[9]. These were not anticipated at the time of the submission. Similarly, the cost of moving to cloud based working, which was critical for maintaining ongoing operations during the COVID-19 period, was not considered at the time of the bid submission.

Similarly, for the MSA costs the bid did not make a full provision for the extent to which SGN NG would be drawing on the knowledge and expertise for the transition to decarbonised energy and the introduction of biomethane and hydrogen onto the network. Expertise which is benefiting all NI customers. Neither had the bid anticipated the extent of legal and procurement support on the new metering solution and the associated HR requirements for the additional employees required to support SGN NG or the requirements under the UR Best Practise Frameworks programme for customers and vulnerable customers.

We submitted our business plan on the basis that all aspects of the original bid would be reset, including the cost of capital. If the UR is holding SGN NG to the costs it submitted for IT costs and the MSA and the UR is holding SGN NG to not having support to enable small and medium size I&C customers, then it's also appropriate that the cost of capital should be maintained at the original bid level. Converted to a CPIH equivalent would be a range of 5.3% to 6.21% rather than the DD range of 2.8% to 3.0%. In addition, the bid was clearly on the basis of RPI indexation and therefore, if reverting to the bid, we should not be moving to CPIH in the GD23 price control.

[redacted]

[redacted]

[8] *"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."*** *Para 3.44*

"We recognise that, over the passage of time, it is likely to become less feasible to continue to directly link allowances to the application. When allowances are set at periodic reviews we will take account of the latest information and any changes in circumstances, and ***will not continue to link them to the application if that would cause them to be inappropriate in all the circumstances prevailing at the relevant time****." Para 3.45.*

[9] In Northern Ireland the Department of Finance is the Competent Authority for electricity and gas, in the rest of GB Ofgem is the Competent Authority

[redacted]

[redacted]

[redacted]

Conclusion.

Our GD23 Business plan looked to establish SGN NG as a resilient network with a strong customer base that is transitioning our customers on the pathway to net zero and unlocking the potential for SGN NG to become the first net zero gas network in the UK.

The GD23 DD set out by the UR has chosen not to pursue this ambition, and rather than promote the growth of the network actively stifles growth and new connections. This limits the ability for us to support our customers in the transition to net zero, it reduces the size of the network and increases the financial risk exposure of customer who have connected and increases the risk that the network will become a stranded asset that customers cannot afford to use. Rather than saving the customer money, if the draft determination incentives are maintained and connections are reduced in line with our revised forecasts of 91 domestic customers a year and 22 I&C SME customers a year then there will be an 8.6% increase in bills.

In contrast, if we hold all other parameters of the DD constant and return the incentive values to a level that they will support the original BP connection volumes of 625 / yr domestic and 123 / yr I&C SME customers a year then 10.8% increase in bills. A 2% increase in customer conveyance charges for a significantly more resilient customer base.

We have structured our response to align with the structure of the published DD to support its consideration. We trust this response will form a part of the ongoing engagement which will be necessary to support the UR to finalise decisions within the GD23 FD due to be published in September 2022.

PART 2: COMMON ISSUES

Summary of response

- **It is important to recognise that during the GD17 price control period SGN NG only had three months where gas was available to the majority of consumers and was not impacted by either COVID-19 lock downs and uncertainty or global energy crisis.**
- **With the structure set out in the DD, we are unable to support the continued use of the price cap regulatory approach. We believe the price-cap regulatory approach is appropriate where there are appropriately calibrated connection targets and allowances to support these connections. The DD is not appropriately calibrated and does not provide sufficient support to drive connections to the network.**
- **An important pre-requisite to implement a revenue cap is a broad customer base that sustains network operation independent of the commercial choices of the largest I&C customers, the GD23 Final Determination needs to enable this.**
- **The proposed changes to the domestic owner occupier connection incentive significantly undermines SGN NG's ability to secure new connections. In doing so it undermines the financial resilience of the network and increases the dependency of SGN NG on a few large I&C customers.**
- **Given the experience of SGN NG in applying for Uncertainty Mechanism adjustments for GD17, it is very important the UR clearly document which costs are eligible for consideration in the proposed mechanisms, how they will be assessed and what is the process through which disagreement are resolved. Without this clarity it is very challenging to have confidence in the reopener processes proposed for costs of delivering the energy strategy or the future metering solution.**

2.1 Duration of Price GD23 Price Control

SGN NG agree that a six-year duration for the price control provides a reasonable balance between the risk to consumers and GDNs of material changes in circumstances over the price control. It is our view that a six-year price control duration provides the predictability of regulatory process that supports stability and promotes long-term delivery.

The period which GD23 covers is particularly significant in relation to the continued developments under the NI Energy Strategy. We are extremely mindful that draft decisions contained within the DD risk making it more challenging for NI to deliver decarbonisation by implementing short term measures that do not build the potential of the gas network to deliver decarbonised gas to the end consumer. We consider this to be a lost opportunity that risks costing the consumer more in the longer-term.

2.2 Delivering the network GD17

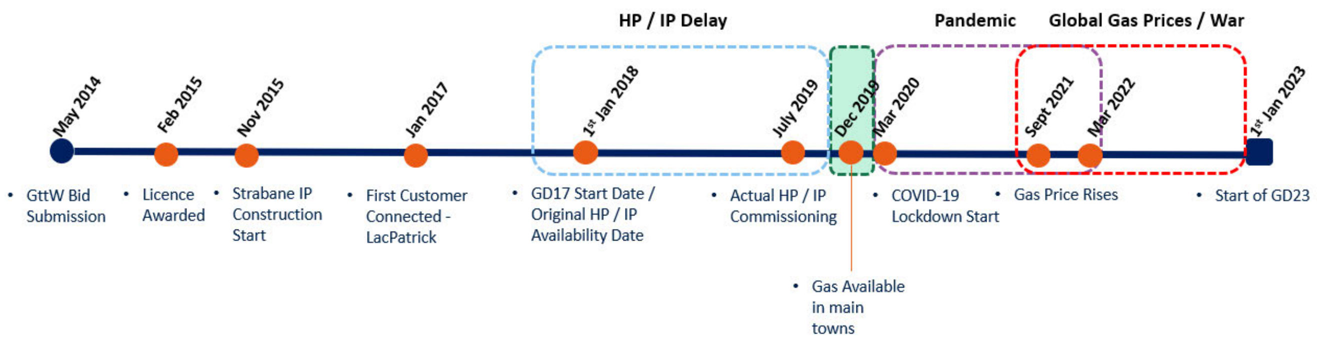
The current price control, GD17, is our first price control having successfully bid for the GttW licence in 2014. The GD17 business plan was submitted shortly afterwards in September 2015 and focused on the rapid building of the network and the connection of customers.

We anticipate that by the end of the GD17 we will have delivered 42km more mains than we originally set out in the GD17 FD. However, with delays to the delivery of the High Pressure (HP) and Intermediate Pressure (IP) feeder mains we were unable to commission the distribution network at the pace which we had envisaged at the time of the plan submission.

Of the 8 towns that we are serving in the licence area we were only able to commission one, Strabane, in January 2017. The Strabane IP pipeline was not deemed to be part of a ‘Connected System’ in the planning process and construction was able to proceed from November 2015. The other 7 towns were dependent on a more substantial extension of the transmission network, the GttW HP transmission pipeline, which required full planning consent.

So, whilst our first commercial customer was connected in January 2017 in Artigarvan, it was only in July 2019 that we were able to connect our first commercial customers from the main GttW pipeline. All four remaining anchor commercial loads for the project were connected in that month. It was then only in December 2019 that gas became available in the main towns. As a result, the anticipated January 2018 GD17 start date was only really able to start in Jan 2020 due to delays in the delivery of the GttW high pressure (HP) and intermediate pressure (IP) pipeline[10].

Figure 2.1: Delivery timeline of SGN NG



It was less than three months after gas being available in the main towns that the COVID-19 pandemic disrupted all aspects of our customers’ lives and our own operational processes. A series of lockdowns and disruption meant that any activity to build the connections pipeline was at the very least severely curtailed and the momentum that was building following the introduction of gas into these new towns was lost.

As we have started to emerge from COVID-19, global politics led to a sharp increase in gas prices, as supplies from Russia were restricted prior to the outbreak of the war in Ukraine. The outbreak of war in Ukraine further exacerbated concerns around the price of gas, whilst a ‘cost of living’ crisis has and continues to evolve, one of the driving factors of which is energy input costs across the economy. Following such sharp increases, consumers have understandably chosen to wait to see rather than make a substantial investment at a time of such economic uncertainty.

As a result, the five-year price control period that we were supposed to have operated under at this point, has in effect been limited to a three-month period. As a consequence of the delayed commissioning and the global disruption, of the 8,692 connections that we targeted across all categories of consumer, we anticipate delivering 3,425 by the end of GD17 - approximately 40% of the original target. However, because we targeted

[10] It should be noted that there were no compensation payments or other liquidated damages payable between the GttW project and SGN NG. UR were very clear at the time that late delivery should not be subject to a compensation event payable from GttW to SGN NG to cover the costs of that delay.

the largest consumers to get them connected quickly, the amount of gas we expect to deliver is 96m therms, almost 80% of our 122m therm target for GD17[11].

2.3 Price Base

The DD sets out the UR's approach to follow the price base used in each GDN's licence. For SGN NG this means financial proposals are set out in 2020 average prices. We agree that this is an appropriate approach on the basis that inflation is applied correctly, with RPI applied to the remaining years of GD17 and CPIH being applied to the years of GD23.

2.4 Form of Price Control

The UR identify two forms of price control regime, a revenue cap, where the UR determines the revenues that are permitted to be recovered, and a price cap, where UR determines the maximum amount the tariff can be set at based on volumes of gas transported. Within the GD17 FD the UR stated that:

> *"Price cap form of price controls provide an incentive to outperform on volumes as the revenue derived from outperformance can be retained. They are hence suitable in particular for GDNs in their initial years, when there needs to be a strong focus on growing the business and associated volumes."*[12]

In our GD23 business plan we confirmed we believed that a Price Cap form of price control remains appropriate for our business given the need to grow connections and volumes.

The UR noted in the DD that both Firmus Energy (FeDL) and Phoenix Natural Gas (PNGL) operated under a price cap regime for a period of ten years before moving to a revenue cap. We also note that we connected our first customer in 2017. We would however, caution against a direct ten year comparison due to the limited actual operational time for SGN NG. As set out in section 2.1 the actual operational period, where the network has been available to the majority of our customers and has not been beset by global turmoil during GD17 is approximately three months.

Further to the above, during the ten years in which both FeDL and PNGL operated under a price cap regime they operated with, and benefited from, a favourable connections incentive regime that supported the connection of customers to the network.

In the DD for GD23, the UR are proposing a change in approach in terms of encouraging connections to the network and therefore the associated volumes removing incentive support for new connections and replacing it with a cost-to-serve model. The UR has set out it anticipates this will reduce the anticipated connection rates to 60%[13] of that proposed by SGN NG. However, we believe the UR's figure significantly overestimates the actual connections that will be delivered under the proposed cost to serve model.

Therefore, as it stands under the DD, we do not consider the price cap to be the most appropriate regulatory structure and we believe that the revenue cap model would be a more appropriate allocation of risk. This is because the connections targets set out in the DD are unachievable with the permitted marketing budget and 'cost to serve' methodology.

We believe at this stage, rapidly growing the customer base is important to the long-term sustainability of the network. Accordingly keeping SGN NG on the price cap and maintaining the incentive to build the network is

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[11] Includes volumes during mobilisation period

[12] https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/2016-09-15_GD17_Final_Determination_-_final_0.pdf

[13] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 4.4, pg 22

the right approach within a well calibrated price control. The DD does not present an appropriately calibrated price control and if the DD approach is maintained then SGN NG should be moved to a revenue cap model for GD23.

Should the UR choose to maintain the 'cost to serve', minimal marketing budget and significantly reduce our connections targets to calibrate the price control then a Price Cap methodology may still be appropriate. However, SGN NG will not have been afforded a sufficient opportunity to build a customer base that can sustain a move to a Revenue Cap in the next price control period, GD29 and be financially resilient.

2.5 Adjusting for Inflation

In principle, SGN NG accept the URs proposed approach to move from away from RPI and instead adopt CPIH as a measure of general inflation as outlined within the DD. However, we note that the bid was submitted on the basis that "RPI will be used to index allowed costs and revenue in each year"[14]. SGN NG submitted its business plan on the basis that there was a complete separation from the bid position. If this is not maintained by the UR, then SGN NG should be maintained on RPI inflation for GD23.

In the application of RPI, CPIH and real price effects (RPEs) it is very important the UR update their data sets to use the most up-to-date and relevant information. This is necessary to reflect the recent increases in prices and subsequent inflation rates. Furthermore, in order to protect both consumers and networks, we believe that any differences between forecast and actual out-turn inflation rates should be trued-up through an Uncertainty Mechanism at the end of the price control[15]. This is discussed in more detail in 'Part 12 – Frontier Shift'.

The move from RPI to CPIH indexation is a complex change to the price control framework, and the DD was our first opportunity to assess the UR's proposals on how it should be implemented. To ensure value-neutrality from the switch to CPIH we would strongly recommend further opportunity is given for the GDNs to analyse its implementation and discuss this matter with the UR.

2.6 Future of Domestic Owner Occupier Connection Incentive

SGN NG strongly disagree with the UR proposal to move from the owner occupied (OO) incentive mechanism to a 'cost to serve model' which the UR acknowledges will reduce the level of activity undertaken to promote connections, and will directly correlate with a reduction in actual connections:

> *"In GD23, we propose to:*
>
> > *Transition from the OO connection incentive mechanism, which applied in GD17, to a cost to serve model which will allow GDNs to respond to connection request and support consumers through the connection process but* ***will reduce the level of activity undertaken to actively promote connections."***[16]
> >
> > *"In GD23, a cost to serve model would be introduced which will allow GDNs to respond to OO connection request and support consumers through the connection process. This would replace the connection incentive used in GD17.* ***It will result in lower levels of activity undertaken to actively promote OO connections"***[17]

As set out in section 2.1 above, SGN NG have had an approximately three-month period during the full price control operation where we have been able to connect customers whilst not being disrupted by one or more

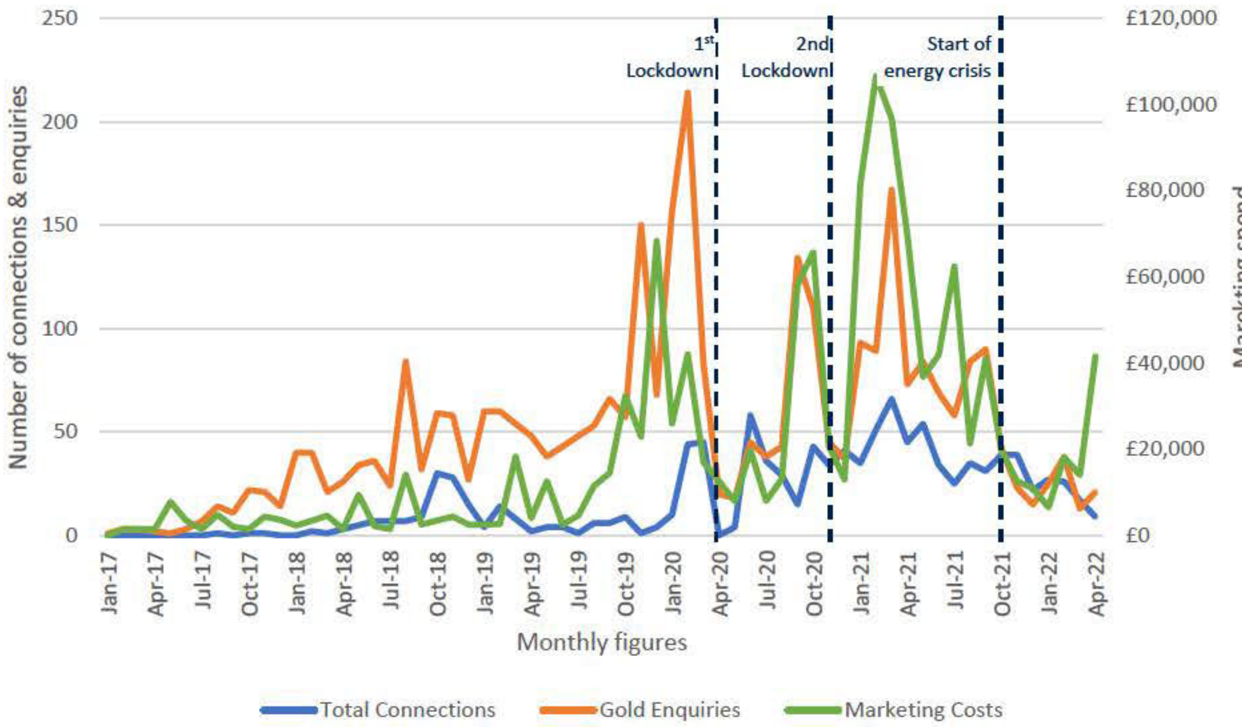
[14] Applicant Information Pack, para 3.32
[15] As was set out in letter from SGN to UR on the 13th August 2021
[16] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.26, pg 13
[17] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Annex Q, March 2022, pg 1

of a global pandemic, a global energy market crisis, and a cost of living crisis. As such, the SGN NG network has not had a sufficient opportunity to develop the business and promote connections to the network.

Moving to a cost to serve model at this stage and reducing the level of promotional activity is entirely premature as it will lead to substantially lower connections than would be the case with the connection incentive in place. In particular, we reiterate the point made in section 2.4 above that the UR's assumption of the number of connections that will be realised under a cost to serve model significantly overestimates the connections that would actually be realised.

The relationship between promotional activities/marketing expenditure, and the number of enquiries received, is shown in the figure 2.2 below. A clear correlation between the two is evident. The graph also shows the next stage in the connections process, being the relationship between the number of enquiries received and the number of actual connections realised. Again, a clear correlation between the two is evident. Accordingly, it is clear that promotional activities/marketing expenditure is critical in realising actual connections.

Figure 2.2: Relationship between marketing expenditure, enquiries and connections



It is our view the UR have mis-represented the evidence when the UR suggest:

> *"We have proposed to move from an incentive mechanism to a cost serve approach for funding the promotion of OO connections, because a combination of declining levels of connections and stable or increasing estimates of the cost of securing connections, is driving up the average cost of actively promoting connections to the point that it is becoming uneconomic."*[18]

Figure 2.2 above, shows a strong correlation between marketing expenditure the number of enquiries generated, and the number of actual connections realised. Through the year the marketing budget changes

[18] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.28, pg 13

strategically to maximise the likelihood an enquiry, so expenditure tends to be focused during the times of year when a decision is likely to be made.

In the last eight months there has also been a significant increase in global fuel prices. During this period brent oil prices have increased from approximately $70/barrel to over $100/barrel since March 2022 and gas prices doubled from 100p/therm to over 200p/therm with spikes over 500p/therm. These changes, the financial difficulty for certain suppliers, and the war in Ukraine have dominated the headlines and increased the sense of uncertainty amongst potential customers in the decision to change to natural gas. It would, however, be a mistake to attribute that sense of uncertainty to a long-term decline in connections or reduction in appetite for a gas connection. It is our expectation that these upheavals are temporary, the desire of families in NI to remain warm through a reliable, secure and price-competitive energy supply will endure.

In our GD23 business plan we recognised the importance of re-building momentum quickly in establishing connections growth, given the challenging connections environment that we had in GD17. As a result, we proposed to increase the OO connections from the £1,156/OO connection at the end of GD17 (£2020)[19] to £1,323/OO connection at the start of GD23. In addition, we proposed a marketing budget that averaged £669k/year.

Replacing this with a cost to serve of £400/OO connection and a marketing budget of £125k/year as proposed in the 'cost to serve' model put forward in the DD would be catastrophic in terms of the impact on marketing expenditure and the resulting impact on enquiries and connections. In particular, but not exclusively, SGN NG believes it is unreasonable to review Figure 2.2 and other similar data sets and conclude that a reduction in marketing budget to less than 20% of previous levels will result in anything other than a collapse in the realisation of connection opportunities.

Making this change to a 'cost to serve' model at this stage of SGN NG's network development would fundamentally undermine the connections volumes delivered and, as a result of insufficient scale, will undermine the resilience of demand on the network. Without adequate domestic connections the network could become unviable and SGN NG would be unable to finance the carrying on of its functions should the large industrial consumers switch fuel or cease operating. This is set out in more detail in Part 3 – Price Control Submissions and Current Performance.

We would also like to highlight the discrepancy in the level of financial support available to customers in the west of NI compared to customers in the east of NI. During PC02, which covered the period 2002-06;

> *"UR recognized that allowing advertising and marketing into the PNGL cost allowance had added significantly to the size of the PNGL asset base, but had helped the company to meet its connection targets. UR calculated the value of these allowances at around £37 million (2010 prices) since 1996 (increasing to about £50 million when the costs of manpower, for instance sales staff and corporate overheads, were taken into account). On balance, UR decided that it was appropriate to make allowances for promoting the gas industry given its principal objective in gas and the challenges of growing the market."*[20]

Customers in the Belfast area have benefitted from a connection incentive in place for the last 26 years. Meanwhile, customers in the west of NI have had a connection incentive in place for 3 years (a period which has been very disrupted by a global pandemic, a global energy crisis and a developing cost of living crisis). SGN NG believes the UR should ensure it has robust grounds before treating these two groups of customers, who appear to SGN NG to be very comparable, differently. SGN NG does not believe those robust grounds have been appropriately evaluated and discriminates against consumers in the west of NI.

[19] The OO was set on a glide path from £1110 to £1010in GD17 when expressed in original 2014 values
[20] Competition Commission – Phoenix Natural Gas Limited Price Determination document, Para 4.120

2.7 Future issues not covered in the GD23 Determination

2.7.1 NI Executive Energy Strategy

The UR note in the DD that the NI Energy Strategy highlights the intention to utilise modern gas infrastructure and the potential to generate and import zero carbon gases as a means of decarbonisation. Disappointingly however, the UR do not appear to recognise the level of work that is required by GDNs to achieve this.

The DD makes provision for one additional full-time equivalent in each GDN; but the UR have not considered the specialist nature of this role in determining appropriate remuneration. The URs DD provided for an additional FTE at a level of operation which is significantly below the technical specialist standard that we submitted in our business plan and necessary to facilitate green gas connections onto the network and to have a meaningful impact on delivering the NI Energy Strategy.

During GD17 SGN NG was able to have a material impact in supporting the policy development surrounding the connection of biomethane by bringing some of the knowledge and experience of biomethane in the GB market and applying it to the NI market. As the NI biomethane capacity builds and potential for biomethane injection into the NI gas networks is realised, it will be important that there are skilled representatives available locally to work with NI customers, ensuring that local solutions for delivering biomethane are implemented. This stakeholder need cannot be delivered effectively from the GB market in an unfunded manner.

The UR note that GDNs are key stakeholders and contributors in facilitating development of decarbonisation solutions and that work is currently underway to facilitate the injection of biomethane. This needs to be appropriately funded if biomethane injection is going to deliver to its potential, and the DD does not provide appropriate funding. UR's proposal is that:

> *"The GD23 draft determination does not make any allowance for future costs to support the decarbonisation other than the additional staff described above. We will consider the annual submissions the GDNs make in respect of additional costs relating to the implementation the Energy Strategy and the decarbonisation of gas and make provision for costs we determine to be necessary and efficient through the GD23 Uncertainty Mechanism."*[21]

SGN NG consider the above to be both inadequate (in terms of extent of commitment) and too vague (in terms of SGN NG's ability to rely on the statement) to support additional expenditure on implementing the energy strategy. It is important the UR provide much greater clarity on the costs that will be considered and the process in which the costs will be considered necessary and efficient. SGN NG's recent experience of presenting valid requests for additional costs to the UR under the GD17 Uncertainty Mechanism has shown that the Uncertainty Mechanism process operated by the UR cannot be relied upon.

SGN NG therefore request the UR provide greater clarity on this process to formally document what the UR classifies as busines as usual and what activities would be recognised under the proposed ring-fenced Uncertainty Mechanism. This should set out the basis on which an application will be assessed and the process through which any disagreement will be appropriately considered. Greater clarity in this area would help to build confidence in this process and is necessary to ensure that the required level of support is provided.

[21] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.34, pg 14

2.7.2 Future Metering Solution

The UR acknowledges that the DD does not take account of two potential changes to gas metering:

- Transfer of Meter Reading Responsibility
- New Domestic Pre-Payment Meter

The UR also states that GDNs are not expected to respond on these proposals as part of the DD process. However, SGN NG are concerned the UR do not recognise the significance of these projects on the network's operation.

We agree that transferring responsibility for meter reading from supply companies to network companies may be appropriate. As recognised in the DD, these changes will require careful consideration and appropriate planning.

It is also important to recognise the actual costs that will be incurred by networks to deliver this service. As an example, it appears from the drafting included in the DD that the UR considers the additional costs in relation to the new Domestic Pre-Payment Meter will only be in relation to the meter itself. This is not the case and additional costs will also be incurred by GDNs in relation to the Meter Management System (MMS). These will be new costs for each GDN that must be allowed under GD23 to ensure that GDNs are appropriately funded to deliver these services.

While an Economic Project Mechanism or the use of the Uncertainty Mechanism is being proposed, as with the decarbonisation costs, SGN NG are concerned that there is a lack of clear guidance on which costs will be considered under this Uncertainty Mechanism and how they will be assessed. SGN NG's recent experience for reopeners is that the UR regularly determine that additional expenditure is categorised as 'business as usual' expenditure that is ineligible for the reopener. Given this recent experience, it is very important that there is a shared understanding, which is fully documented, about the costs that will be considered, the basis on which efficiency will be assessed, and the process through which any disagreements are resolved to have confidence in the proposed Uncertainty Mechanism.

PART 3: PRICE CONTROL SUBMISSIONS AND CURRENT PERFORMANCE

Summary of response

- **Given the limited dialogue between business plan submission and the draft determination we were surprised by the extent of changes put forward in the draft determination.**
- **The UR's assessment of GD17 under-states the challenges that SGN NG had to respond to and the extent to which SGN NG had to over-spend its allowances to deliver its outputs.**
- **Having operated throughout GD17 with a financial model that shared capital costs with consumers on a 25:75 basis (where SGN incur 25% of the costs of any overspend, benefit of underspend), it is not correct for the UR to change the sharing factor to 75:25.**

3.1 GD23 Business Plan Submissions

SGN NG submitted the GD23 Business Plan template and commentary document alongside twenty nine other supporting documents in June 2021. SGN NG received surprisingly little engagement with the UR during the nine month business plan assessment period. We received only a limited number of formal clarificatory questions and limited discussion on proposals and evidence presented in the business plan. We were therefore very surprised by the extent of the changes proposed in the DD.

We were particularly disappointed regarding the lack of any discussion of the major policy put forward in the DD to introduce a Cost to Serve model in GD23 as a replacement to the GD17 connection incentive. In the UR's draft timeline provided during 2019 the schedule set out the intention to carry out formal consultation on the Connection Incentive in April 2020, alongside the consultation on the approach to GD23. While the consultation on the approach took place, consultation on the Connection Incentive did not. Instead, the UR took the decision to change approach in this area without any engagement with SGN NG. This lack of transparency is extremely disappointing and limits any opportunity for constructive dialogue between the UR and GDNs, which in turn impacts on our ability to collectively ensure the most appropriate outcome for NI consumers.

3.2 GD17 Delivery

Mains Laid and Properties Passed

Despite the delay in the HP and IP pipelines, SGN NG continued to progress with main laying throughout the period to ensure that GD17 targets could be met. By the end of 2020 this resulted in 11% more mains being laid than expected.

While mains laying targets were exceeded during this time, it was not possible to meet the properties passed targets that were included in GD17. This was because the length of mains by property passed included within GD17 was shorter than the actual length required. In GD17 the target length of mains per property passed was 11.04m/property. The actual length of mains per property passed realised to date is 12.06m/property and as such it would never have been possible to achieve the properties passed targets.

For the GD23 business plan SGN NG have carried out a much more detailed analysis on the length of main required by property passed specific to the network. It is important the UR uses the results of this analysis which provides an updated value of 12.09m/property when determining the lengths of mains required by property rather than drawing comparisons to other networks to ensure that realistic targets are set for this price control. Currently the DD proposes to use 11.5m/property this should be changed to 12.09m/property passed.

Connections

SGN NG agree with the UR's assessment of connections to the network during the years 2018 to 2020. Delays to the delivery of the HP and IP network and the impact of COVID-19 created significant challenges in this area. The UR have suggested that as the rate at which Small I&C consumers has been less than envisaged for GD17, the connection projections for GD23 have been reduced accordingly. We agree this is an appropriate approach as the Small I&C connections were greatly overestimated within the GD17 FD, but we also believe it is necessary to provide financial support to this type of consumer to reduce the barriers to connection and create an equal playing field across the three gas networks in NI. We discuss this further in Part 4 – Volume and Connections.

3.3 GD17 Cost and Performance Review

The brief review of SGN NG's performance during GD17 (2018-2020) within the main DD document gives a factually accurate reflection of delivery against targets, however it does little to consider the circumstances which hinder SGN NG's ability to achieve the GD17 targets.

Specifically, the UR highlights the overspend on Opex but does not mention the circumstances outlined by SGN NG in the GD23 Business Plan which contributed to this. We believe it is necessary to consider these factors to ensure performance is reviewed in context of the challenges faced by SGN NG. These included:

- **Marketing cost recovery**. In GD17 the allowance for marketing was reduced as SGN NG was not in a position to deliver the 4,000 OO connections due to factors entirely outside of our control (the delay to commissions the HP and IP pipeline, COVID-19 and the current global fuel crisis). As a result of not achieving connection and volumes as set out in GD17 we lost revenue of £7.3m (£2020).
- **Maintaining Safety**. Within the bid, SGN NG did not include the costs associated with the need to drive the length of the IP and critical mains on a daily basis to spot potential safety hazards of construction activity taking place in proximity to the gas pipeline. This process is standard industry practice and is necessary to minimise the risk of 3rd party damage to the network. These costs were not included in the bid as the move from a HP dominated to HP/IP solution for GttW had not been designed yet.
- **Operational costs**. We acknowledge that in the original bid under-estimated the number of staff that would be required to run and build the SGN NG business and the extent to which we would have to draw upon group services under the maintenance services agreement and IT costs, was significantly greater than anticipated at the time of the bid, with much greater involvement of the legal, procurement, regulatory and technical support
- **Support for biomethane and net zero innovation**. SGN NG provided significantly more support for the delivery of biomethane and the sharing of knowledge from GB about biomethane connections and network operation. This was not considered at the time of the bid but is clearly to the benefit of all stakeholders.

The UR DD focuses on actual costs for Opex from 2018 to 2020 identifying a £0.1m over expenditure in operating costs on an unadjusted basis and £2m over-expenditure on an adjusted basis. The SGN NG business plan highlighted that by the time we reach the end of GD17 this over-expenditure is anticipated to increase to £3.4m and once allowance adjustments are taken into account this over-expenditure will increase to £5.8m.

3.3.1 Application of GD17 Uncertainty Mechanisms

In GD17 Uncertainty Mechanisms were agreed to adjust determined allowances for differences between actual and allowed costs or outputs and to reduce the risk to network businesses for costs incurred above a Materiality Threshold of £100k. Also included in the Uncertainty Mechanism for SGN NG only during GD17 was the application of Capex Risk Sharing.

Following extensive discussions with the UR, SGN NG submitted a formal request to the UR to consider a number of areas under the Uncertainty Mechanism Materiality Threshold in August 2021. These are discussed below and included:

- Capex relating to meters and services
- Capex relating to Special Engineering Difficulties (SPEDs)
- Opex relating to COVID-19
- Opex relating to plant protections cost
- Opex relating to decarbonisation
- Changes to the GD17 sharing mechanism

These are discussed below.

Capex relating to meters and services

While SGN NG agrees with the inclusion of the costs for the meters, we believe the UR has been inconsistent without good rationale by not allowing the additional costs for the respective services.

SGN NG requested the cost of both meters and services under the Capex Materiality Threshold for the costs associated with 5 large I&C meters and their associated service costs. In the UR response[22], the UR that only additional costs for the installation of meters at the five largest customer connections would be allowed and that the additional costs of services would not be being allowed under the Materiality Threshold. The reason given is that SGN NG were aware of these potential connections at the time of the GD17 FD and saw no reason to vary determined rates.

SGN NG were aware of these potential connections at the time of the GD17 FD but there was insufficient information available to determine the costs of either the meters or the services and therefore sufficient allowances were not included. It is important to recognise that services to large I&C customers are not standard services that are included in the standard basket of works, they are bespoke to that customer and subject to the same uncertainty as the meters. As such it is unreasonable that the additional costs should not be considered under the Capex Materiality Threshold these were detailed for each of the sites in SGN NG ‘s Materiality Threshold submission[23].

[22] Letter received on the 28th April 2022. John Mills to David Butler RE: GD17 Uncertainty Mechanism – Areas of Difference.
[23] Materiality Threshold Requests: GD17 Uncertainty Mechanism Submission, August 2021

Capex relating to Special Engineering Difficulties (SPEDs)

The GD17 FD provided ring-fenced allowances of £2.7m (£2020) for 6 specified river crossings that were known at that point in time. The ringfence would be applied to costs associated with design and construction of the crossings and would be determined when the works had been designed and tenders received[24]. During the course of construction, a further 14 SPEDs were identified. SGN NG presented evidence and associated costs for the 6 initially identified SPEDs and the 14 additional SPEDs to the UR for consideration under the Materiality Threshold[25].

In response to the request for additional allowances under the Materiality Threshold for SPEDs which were unforeseen at the time of the GD17 FD and cost in excess of £100k, the UR stated that:

> *"we do not consider it appropriate to selectivity identify particular issues which have arisen as the mains were constructed and add to the Uncertainty Mechanism to fund the associated costs."* [26]

We consider that this response is in direct contradiction to the intention set out within the GD17 FD.

Opex relating to COVID-19

SGN NG requested additional costs incurred as a result of COVID-19. Additional costs associated with COVID-19 and the scale of the impact associated with necessary changes as a direct result of COVID-19 could not have been foreseen at the time of the submission. These costs were essential to ensure appropriate resources could be retained by our contractor for the provision of emergency support when connections and mains laying activity were suspended during the initial lockdown period (March 2020 to June 2020). The UR suggested these costs do not fall under the scope of the Uncertainty Mechanism as they are not linked to additional outputs.

SGN NG disagree with the URs assessment on the basis that the costs were unforeseen at the time of the GD17 price control and are material to SGN NG. The GD17 FD states:

> *"Consideration will also be made for any issues arising that could not reasonably have been foreseen, or for which realistic estimates with respect to the associated costs could not reasonably be made, at the time of the price control determination and which are reasonably outside the control of the GDNs, such as European Directives or equivalent local legislation which the GDNs are required to implement."*[27]

The GD17 FD is clear that costs that outside of the control of the GDNs for which realistic estimates could not reasonable have been made and which GDNs are required to implement will also be considered. COVID-19 clearly fits all aspects for consideration, and this consideration is separate to the delivery of new outputs set out in para 9.36. Accordingly, we request the UR are specific about why the costs associated with COVID-19 are not being considered, and if they are to remain outside of the scope of the Uncertainty Mechanism then we request an equivalent sum should be provided for in the GD23 FD for the impacts of the next pandemic that requires an economic lockdown.

Opex relating to decarbonisation

SGN NG raised the request for additional allowances to support the significant increase in workload in this area. SGN NG has provided significant support to this area both locally and through the MSA to provide expertise from GB for the benefit of the entire industry. We are extremely disappointed that the UR has decided against these costs given that their team have benefited from the expertise provided. We believe it is

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[24] Price Control For Northern Ireland's Gas Distribution Network, GD17, Final Determination, Sept 2016, Para 7.303, Pg 245
[25] Letter to UR SGN NG GD17 SPED Submissions - FINAL
[26] Letter received on the 28th April 2022. John Mills to David Butler RE: GD17 Uncertainty Mechanism – Areas of Difference.
[27] Price Control For Northern Ireland's Gas Distribution Network, GD17, Final Determination, Sept 2016, Para 9.38, Pg 271

not in the spirit of the Materiality Threshold/Uncertainty Mechanism to refuse these additional costs and it has damaged SGN NG's trust in the process given the engagement with the UR prior to this request.

3.3.2 [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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[redacted]

PART 4: VOLUME AND CONNECTIONS

Summary of response

- **There is a clear link between Marketing and Advertising expenditure and enquiries. The proposed reduction in funding for marketing and advertising will reduce the number of enquiries we receive, which in turn will reduce the number of connections we are able to deliver in GD23.**
- **In addition, there will be a significant reduction in the likelihood of each enquiry realising a new connection due to the removal of the connection incentive and the introduction of a limited 'cost to serve'.**
- **Making these changes at this early stage of SGN NG's operational history will create a significant challenge in terms of the ability to recover costs from its customer base in future years as the customer base will be insufficiently developed. This proposed change risks undermining the financial resilience of the SGN NG network.**

4.1 Introduction

The connections and volumes forecast in the GD23 business plan were based on an incentive mechanism that would encourage customers to connect to the network by recovering an element of that cost over the lifetime of the asset and reducing the upfront cost of connection.

Given the economic challenges, the low-income base and the high rates of fuel poverty to the west of NI, it is important that the level of incentive and support is appropriate to the needs of the community in which we operate if they are going to realise the environmental and financial benefits of a natural gas supply.

We welcome, and share, the URs view "*that incentives are an important part of the regulatory framework to ensure that GDNs continue to develop the network, in the most efficient manner possible*"[31]. It is vitally important that as a network grows and pipes are installed in the streets of the towns in which we serve, value for money is achieved through connections to the growing network.

The proposal set out in the DD does not support growth of the network or protect consumers.

4.2 Adjustments to Connections and Volumes

In the GD23 business plan SGN NG submitted an owner-occupier (OO) connections incentive of £1,323[32]/OO connection and identified that this incentive was necessary to support an average of 625 connections/year in the owner occupier market over the GD23 period.

Learning from our experience in GD17 we also identified the need for a connection incentive for smaller and medium size industrial and commercial customers of £679/small I&C connection and £3,365/medium I&C connection. This was necessary to support an average of circa 74 small I&C connections and circa 50 medium I&C customer connections a year.

In the DD, the UR has proposed a significant shift in policy from the connection incentive approach that promoted the uptake of connections by OO customers during GD17 to a proposed 'cost-to -serve' model. The

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[31] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 7.16, pg 47
[32] Submitted economic assessment plus new areas allowance.

'cost-to-serve' model looks to provide an allowance for reasonable costs incurred in responding to contacts, providing energy advice and supporting the customers through the connection process.

In the DD the UR have determined that the £1,323/OO connection incentive SGN NG proposed in the GD23 business plan should be reduced to a £400/connection 'cost-to-serve'.

For the industrial and commercial sector, the UR's DD has proposed that small and medium I&C connection incentive should not be provided for due to its absence in the original GttW bid[33]. This translates to zero incentive or 'cost-to-serve' allowance being provided for the small and medium size I&C sector.

In addition to the above adjustments, the UR have also reduced the allowance available for advertising and marketing. In the GD23 business plan SGN NG proposed an advertising and marketing allowance that averaged £669k[34]/year across GD23. SGN NG also proposed a customer grant of £500 to support with the cost of conversion from an oil boiler to a gas fired boiler.

The DD suggested that an advertising allowance that averaged £125k/year across GD23 is sufficient and that no customer support towards the cost of conversion is necessary. This is contrary to our experience during GD17 and does not appear to consider the evidence we submitted within our GD23 business plan supporting papers[35].

The UR has recognised in their DD that the connections and volumes will be reduced as a result of the move to a cost to serve mechanism in the OO market, and that OO connection rates will be reduced by 40% (by 2028 on an equal glidepath per annum) and 25% for the small and medium I&C market. It is our view that the submitted evidence is clear, the URs revised arbitrary connection rates fundamentally overstate the connections that will be achievable under the proposed changes to the connection incentive mechanism. We also believe that this is at odds with the UR's statutory duty to *'promote the development and maintenance of an economic and coordinated natural gas industry'* .

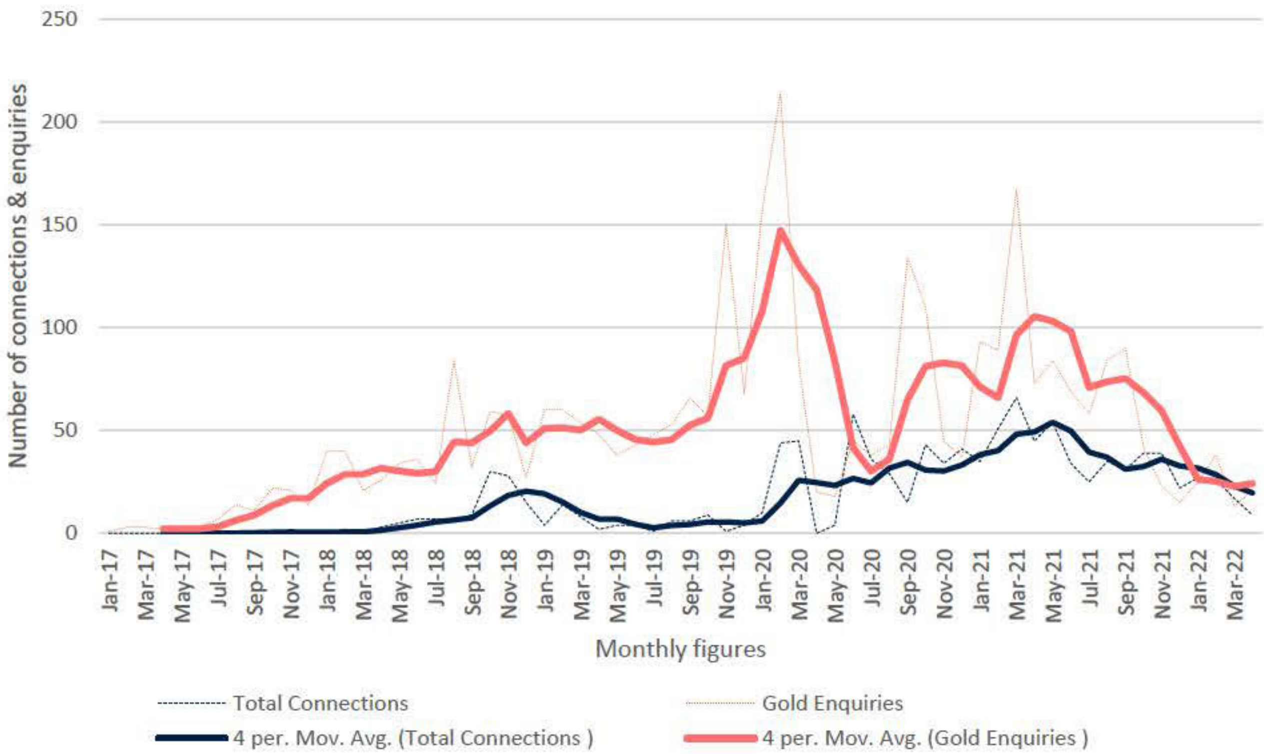
4.2.1 **Owner Occupied - Updated forecasts based on the draft determination**

In Figure 4.1 below we traced the relationship between marketing expenditure during GD17 and connection enquiries, while Figure 4.2 shows the relationship between connection enquiries and number of connections. Figure 4.1 shows a strong correlation between the four-month moving average for marketing expenditure and enquiries. Data was assessed up to Dec 2020[36] as part of our submission and on average over this four-year period, each high-quality enquiry 'cost' £258/OO connection. The period to December 2020 also gives an average ratio of 0.240 connections per high-quality enquiry.

[33] GD23 – Gas Distribution Price Control 2023 - 2028 – Draft Determination - Main Report March 2022. Para 5.8, Section C
[34] Based on historical evidence of marketing expenditure vs enquiries and connections achieved.
[35] SGN NG GD23-020 Connection Incentive Paper, SGN NG GD23-021 Consumer Engagement and SGN NG GD23-028 Sales and Marketing Plan
[36] Point in time cut off for Business Plan submission data.

Figure 4.1: Relationship between marketing expenditure and high-quality enquiries

Figure 4.2: Relationship between enquiries and the number of connections



Applying this evidence from GD17 to the UR's DD proposal demonstrates the harm that will arise. We have highlighted this in Table 4.3 below.

Table 4.3 sets out the marketing budget provided for in GD17, the marketing budget requested in GD23 and the marketing budget proposed for GD23 in the DD. As set out above the average cost of a high-quality enquiry is £258/OO connection, which allows us to estimate that under the DD the number of OO enquiries will fall from 47/month to 31/month, whilst our business plan proposed to increase enquiries to 216/month.

For every enquiry we identified in GD17 we were able to realise 0.24 connections and, on this basis, we can determine that the average annual connection rate for OO customers will fall from 136/year in GD17 to 90/year in GD23, rather than increasing to 622/year as we set out in our GD23 business plan.

Figure 4.3: Relationship between marketing expenditure and allowances vs enquiries and connections

	2017 to 2020 (4 years)	GD23 Submission (6 years)	GD23 DD (6 years)
Marketing Budget (£' s)	586,026	4,011,750	580,992
Monthly marketing budget (£'s)	12,209	55,719	8,069
Cost per enquiry (£/enquiry)	258	258	258
Average Enquiries per month	**47**	**216**	**31**
Connections per enquiry ratio	0.240	0.240	0.240
Average connections per month	11.4	51.8	7.5
Average annual connections	**136**	**622**	**90**

In Figure 4.4 below we demonstrate the same conclusion using a cost-based approach. Our customer survey evidence[37] submitted as a part of the GD23 business plan demonstrated that around two thirds (66%) were unwilling to pay anything extra for an environmentally friendly heating source. The main reason cited for being unwilling to pay anything extra was that consumer surveyed could not afford to pay extra (51%).

As such, we need to anticipate that, from the funding provided, we will need to continue to support with a £500/customer financial support for changing the boiler, which we see as critical to supporting the roll out of gas connections given the high levels of fuel poverty and low income in the region.

When this is netted off the fixed and variable income provided for in the GD23 DD, along with the cost of advertising per connection and the FTE costs per connection, it is clear that the income in the GD23 DD proposal does not align with the costs necessary to deliver those connections. This gives rise to a shortfall of £630k per year or £3.8m over the price control period compared to a variance of £1k under the original business plan submission and the revised DD value detailed in Figure 4.4.

[37] SGN NG GD23-020 Connection Incentive Paper, section 4.1.1, pg 30

Figure 4.4: Forecast OO connections vs DD allowance

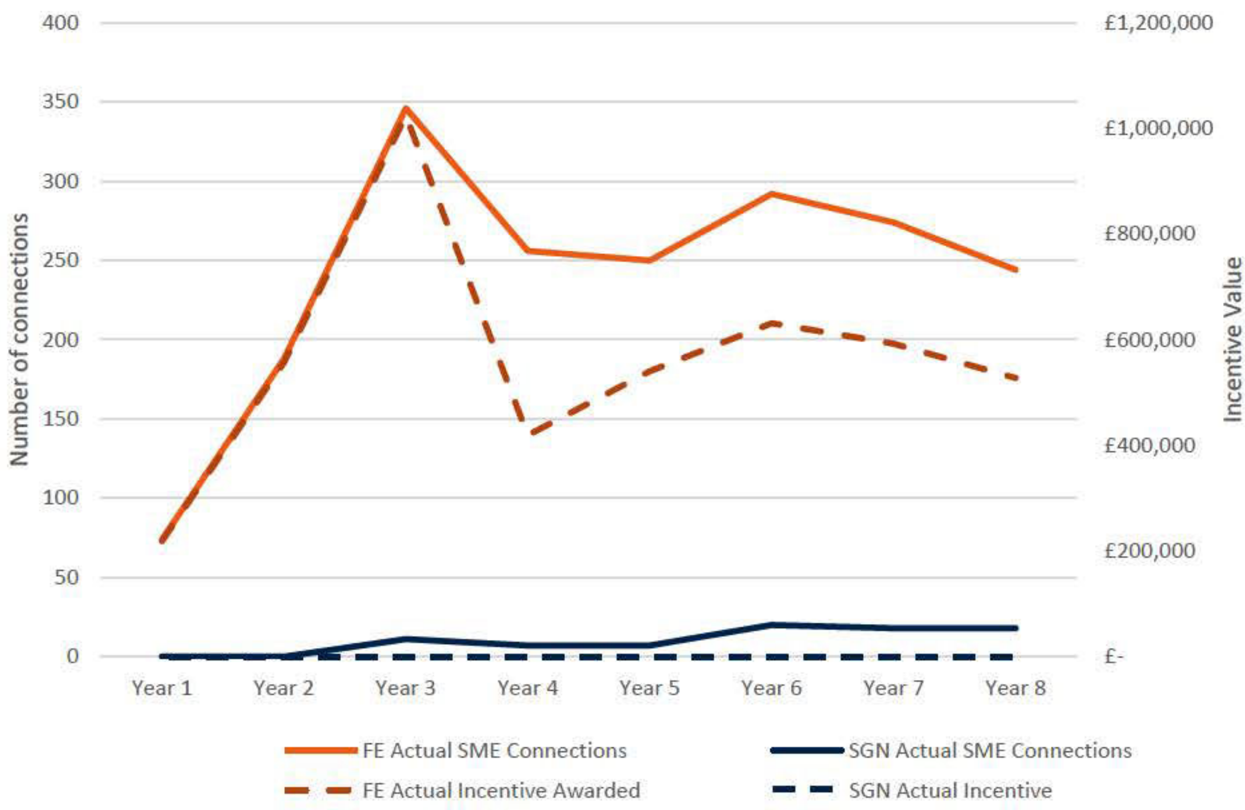
		BP Proposal	DD Proposal	Revised DD Value
Connection incentive and marketing budget	£/yr	1,113,125	0	0
'Cost to Serve' Fixed Marketing Income	£/yr	0	125,000	125,000
'Cost to Serve' Variable connection Income	£/yr	0	218,200	36,206
TOTAL INCOME	£/yr	1,113,125	343,200	161,206
Average Number of customers connections	customers/yr	625.0	545.5	90.5
Customer incentive of £500 towards boiler	£/customer	500	500	500
Incentive Outlay	£/yr	312,500	272,750	45,257
Advertising & Marketing cost per connection	£/connections	1,070	1,070	1,070
Advertising & Marketing Outlay	£/yr	668,625	583,576	96,832
FTE cost per connection	£/connections	211	211	211
OO Manpower Outlay	£/yr	132,000	115,210	19,117
TOTAL OUTLAY	£/yr	1,114,406	972,817	162,487
Variance	£/yr	-1,281	-629,617	-1,281

4.2.2 I&C Customer - Updated forecasts based on the draft determination

We can also look back at the GD17 period and assess the impact of removing the proposed incentive for small and medium scale I&C customers. As set out in our GD23 business plan, GD17 did not have an incentive for small and medium I&C customers. We recognised that the expected benefits of natural gas and its ability to attract I&C customers was over estimated and the propensity to convert to natural gas was much lower than anticipated at the time of the bid.

The relationship between the value of an incentive and the number of connections is clearly demonstrated in Figure 4.5 below which illustrates the correlation between incentive value and number of connections for FeDL during their first and second price control periods. This compares to the experience of SGN NG which did not have allowances for a connection incentive to support small and medium I&C customers and is shown on the same graph for comparison.

Figure 4.5: Relationship between I&C incentives values and number of connections



As a result, we have clear evidence from GD17 that without an I&C connections incentive there is no reason to expect that the actual connections will vary significantly from the average 18 connections per year forecast in the last years of GD17. Based on the DD proposal we anticipate the connection of an average of 22 small and medium I&C customers during the GD23 period which is significantly less than the 9238 connections per year assumed by the UR in the DD.

If, despite this evidence, the UR determine that support is not required under the FD, then volume and connection targets need to be adjusted to reflect the average 22 small and medium I&C customers over the GD23 period.

4.2.3 Impact of over-estimating connection volumes

Based on the evidence presented above it is clear that in the DD the UR have vastly underestimated the impact of their proposed policy decision on the number of connections. This has significant implications for the operation of the next price control period and the long-term sustainability of the network.

Specific issues include:

- **Price Cap Regime.** As set out in the DD, SGN NG currently operates under a price cap price control regime and this is proposed to continue into GD23 on the basis that it provides a strong incentive to

[38] As per Draft Determination query process, engagement ongoing regarding the calculation of small and medium IC target.

connect new customers at the early stages of the network[39]. This is the position that SGN NG supported in its business plan on the basis of the connections incentives and marketing strategy proposed within that plan. Under the connection volumes proposed in the DD the price cap will be set on an inflated estimate of the volumes of connections and hence the volume of gas we are likely to transport. If those connections, and therefore volumes, cannot be delivered, then we will not secure the revenues necessary to enable us to finance continuation of our activities. Due to these flawed inputs, we do not have confidence that a price cap regime would provide a valid regulatory structure for the operation of a distribution network. It is essential this issue is resolved within the GD23 FD.

- **Recovery of the TRV (total regulatory value).** The UR have set out in the DD that the long-term expectation is that the networks should move to a revenue cap once they have established a revenue basis, typically after ten years. Without an appropriate customer base however, the limited customer base will constrain the ability to recover the TRV (total regulatory value) whilst maintaining the affordability of conveyance charges to the consumer and any potential financial credit rating of SGN NG. Accordingly, the elements of the DD that militate against the required customer base being achieved by SGN NG must be changed.
- **Exposure to customer loss.** With fewer customers, the cost per customer to support the network will be significantly higher and, as a result, there will be a greater risk of customers, who are able to switch away from gas to an alternative fuel, doing so. The customers with the ability to migrate, and the strongest incentive to migrate away from the gas network, are the large I&C customers with the greatest volumes. This will leave the remaining customers, who are unable to switch, exposed to picking up the costs that would otherwise have been absorbed by those large I&C customers. SGN NG believes that a decision by the UR that makes this outcome more likely will not facilitate the achievement of the UR's statutory duties to protect the long-term interests of consumers. It is important the UR changes their approach to ensure this outcome does not manifest.

Given the uncontrollable circumstances of GD17 with the global pandemic, followed by the global energy crisis, and now an evolving cost of living crisis, it is essential that SGN NG is given the full opportunity to establish its customer base. Not doing so will undermine the long-term financial stability of the network and be contrary to the basis on which SGN NG bid to operate the network.

4.2.4 Rationale for moving to 'cost to serve' for owner occupiers

In addition to the fundamental points set out above regarding the impact of the DD on connection forecasts, and financial sustainability of the network, there are a number of points where we disagree with the basis on which the UR has reached its conclusions.

In the DD the UR propose to move to 'cost to serve' due to "*a combination of declining levels of connections and stable or increasing estimates of the cost of securing connections, is driving up the average cost of actively promoting connections to the point that it is becoming uneconomic.*"[40] The UR go onto explain that the decision to move to a 'cost-to-serve' approach is informed by "*considering the current mechanism and the comments made by the GDN's, and taking regard on the stage of development for each Network Operator*"[41].

- **Existing stage of development**. We see no clear rationale or evidence for how the UR has taken into consideration the stage of development of SGN NG and determined that it was comparable with the

[39] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.9, pg 9
[40] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.27, pg 13
[41] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Annex Q, March 2022, para 6.1, pg 14

other networks. PNGL have had a connections incentive for 26 years. The majority of consumers in the SGN NG network area have only been able to take advantage of a connection incentive since the wider project went live in late 2019, a period which the UR has acknowledged was impacted by delayed completion of the HP and IP pipelines and the onset of COVID-19[42].

- **Expectation of declining connections**. In the DD the UR suggest that there will be a trend of declining connections in GD23 and that this is expected to continue beyond GD23[43]. This is contrary to the actual expectations for SGN NG as set out in business plan where connections were forecast as constant (when the impact of Natural Gas 'prepped' sites has been considered). In our GD23 business plan submission we explained that Natural Gas 'prepped' sites have boosted our connections numbers but that this type of connection would not be available during GD23, and in our business plan[44] we cautioned about reading too much into connection numbers due to this fact.

  The existence of 'prepped' sites provided a stock of properties that are somewhat 'ready to convert' to natural gas. These could be drawn down on as the network expanded reaching each 'prepped' site. Taking this into consideration, it explains inflated annual connection numbers through-out GD17 despite the headwinds of a global pandemic and global energy crisis.

  The UR provide two reasons for their expectation of declining connections, pent up demand and construction, and a reduction in the number of customers available. The second reason is logical, but current SGN NG connections numbers make it irrelevant. The first reason is unfounded - construction is just one of seven touchpoints that it takes for an average consumer to enquire about a product or service. In their survey of non-gas customers who currently have gas available, Cognisense found that 40% were unaware that their home was connectable to gas and 62% did not know the name of the company responsible for delivering natural gas[45].

- **Evidence base for declining connections.** In response to a question raised post DD, the UR responded regarding the evidence for declining connections:

  > *"We have seen evidence for high rates of connections in the first two to three years after properties are passed with connection rates cubsequently [sic] declining to lower rates. This is also evident in SGN's economic assessment of new areas for GD23 declines from 5% in Year 1 to 1.5% by the fifth year after properties are passed."*

  The economic assessment of new areas referred to in the response shows an initial period of momentum followed by 1% connection numbers on an ongoing basis[46] as set out below. There is nothing to suggest an ongoing decline in connections.

  > *"This support would be instrumental in achieving penetration rates of 5.0% for the 1st year properties are passed, 4.0% year 2, 3.0% year 3, 2% year 4 and 1.5% year 5 – 20 and 1% year 21 onward, representing the benefit of the momentum to be gained from the initial passing of the property / area / town etc."*

  We have also demonstrated in the GD23 business plan[47] that once 'prepped' sites were removed, and the main towns connected, underlying connections increased on an annual basis from 63 in 2019, 359 in 2020, 458 in 2021 and 532 in 2022.

- **Cost of securing connections.** In the UR's response it is suggested that the cost of securing connections is being driven to a point where it is becoming uneconomic, however the basis for this assertion is

[42] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Annex C, March 2022, para 5.4, pg 15
[43] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Annex Q, March 2022, para 3.3, pg 6
[44] SGN NG GD23-020 Connection Incentive Paper, section 2.7, pg 10
[45] SGN NG GD23-021 Consumer Engagement Paper, Section 3.2.2, pg 11
[46] SGN NG GD23 – 005 Infill Paper, section 6.2.4, pg 47
[47] SGN NG GD23-011 Detailed Business Plan Commentary, section 2.4.5, table 2.8

unsubstantiated. In the economic assessment made by SGN NG in their business plan submission[48] the evaluation was based on the economic benefit that each customer brings to the network, through convayance charges, over the recovery period. This is network specific and demonstrates the marginal value benefit of each customer and gave a value of £1,134 per OO connection with a new areas allowance of £189 per OO connection. The £1,134 is demonstrably an economic value assessment of the net revenues generated from an OO connection across the remaining revenue recovery period (approximately 35 years). .

- **Alignment of incentives.** The UR clearly recognise[49] that incentives are important to continue to develop the network. It is counterintuitive to incentivise laying the mains in the towns, but not incentivise consumers to connect to those mains or provide an appropriate marketing and advertising budget to inform them of the mains that are outside their houses. No evidence has been presented by UR to support the 'build it and they will come' hypothesis postulated by the DD - rather the experience of GD17 has been the opposite.

4.2.5 New Areas Allowance

The new areas allowance was introduced in GD17 recognising that greater incentives may be required to educate customers on the benefits of natural gas given the UR's principal objective to expand the network[50]. In the DD the UR propose to remove the New Areas Allowance that was introduced in GD17, referencing back to the GD17 FD where "*we noted that this additional allowance would only be applied in the GD17 period and we did not anticipate further new areas allowances in GD23 and beyond.*"[51].

We note however that statement for SGN NG in its respective section was drafted to indicate that, although no commitment had been made in the mind of the UR, the final decision would need to have regard to facts arising between the date of the GD17 decision and the conclusion of future price controls. The UR also note: "*In the case of SGN the New Area allowance would apply to properties passed in the entire SGN area given that the SGN network is at the beginning of its development.*"[52]

It is SGN NG's view that, given (i) the delay to the start of the network and the disruption experience over recent years as a result of COVID-19, we have not had the opportunity to educate customers on the benefits of natural gas; and (ii) we are now faced with the headwinds created by the evolving cost of living crisis, it is essential to extend this allowance into GD23 and to treat the entire SGN NG areas as a new area.

The lack of awareness about natural gas amongst potential customers is a barrier that is clearly established. In the areas where the SGN NG network is readily available to connect - i.e., properties passed - 2 in 5 people (40%)[53] were unaware their home was connectable to natural gas.

When new products enter the market, or an existing product enters a new market, consumers can only be made aware of them through marketing activity. The fact that a consumer will not look to find a solution to a problem that they are unaware exists was the overarching theme in the Cognisense research submitted as a part of GD23 business plan, and one of the most frequently recurring responses was "I'm happy with oil". The SGN NG area consists of 94% oil heating systems. This has been the case for a prolonged period of time and the majority of consumers are either unaware of the options available to them, unaware of the advantages of those options, or both.

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[48] SGN NG GD23-020 Connection Incentive Paper, section 2.4, pg 8
[49] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 7.16, pg 47
[50] GD17 – Price Control for Northern Ireland's Gas Distribution Networks GD17, Final Determination, September 2016, para 6.129 pg 129
[51] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Annex Q, March 2022, para 5.4, pg 10
[52] GD17 – Price Control for Northern Ireland's Gas Distribution Networks GD17, Final Determination, September 2016, para 6.593 pg 165
[53] SGN NG GD23-021 Consumer Engagement Paper, Section 3.2.2, pg 11

These factors mean there is a significant job to be done to sell both the brand and product to a closed consumer mindset. We note from the Competition Commission[54] report in 2012 the UR held a similar belief at a point in time when PNGL had been in existence for circa 16 years

> *"We were told by both main parties that natural gas was still a relatively new fuel to most Northern Ireland consumers and that there was a significant job to be done to 'sell' the fuel to the Northern Ireland public. The use of oil, we were told, was ingrained and there was a reluctance and mistrust of converting to natural gas, even apparently in homes where income might be well above the average and so the conversion costs would be more affordable."*

In our GD23 Business plan we clearly set out the challenge we face with regard to the newness of our network and the marketplace in which we are selling. Some points of reference in this document include:

> *"Findings from the International Journal of Economics and Management Sciences confirm that consumer attitudes towards a brand are intrinsically linked to the image of the brand and the frequency in which they are engaged with. As a new company in a new network area selling a product which is entirely new to the vast majority of residents within the network emphasises the scale of the challenge for SGN NG"[55].*
>
> *"As the newest gas network, SGN NG has a bigger challenge as we are starting with little to no consumers with product knowledge or brand awareness. We in essence require further financial assistance with regard to marketing and communications."[56].*
>
> *"As natural gas is still a new product in the west of Northern Ireland, it is important to ensure that the installation costs of natural gas and oil are similar. Natural gas as a product is not well known enough and consumers will not be prepared to pay a premium to move away from their tried and tested oil boilers. It is imperative that SGN NG is able to continue to stimulant the marketplace through GD23 by providing this level of customer grant."[57]*

SGN NG is requesting that consumers in our network are afforded the same opportunities that the consumers in both the PNGL and FeDL networks were when they were respectively at a similar level of maturity regarding consumer education and grant assistance. This is education of the marketplace through marcomms channels, empowering consumers to make educated decisions, and finally be provided with the *same* level of grant assistance to make the switch to natural gas and potentially have the opportunity to avail of biomethane in the future should they decide to proceed with a conversion. Biomethane offers gas consumers a route to net zero carbon with lower conversion costs than those not connected to the gas network compared to other options e.g., heat pumps. It is important to recognise the benefit of this when considering the importance of supporting new connections to the gas network.

The key findings of the Cognisance survey[58] of customers in the SGN NG area that are reproduced below were;

"Brand awareness

- *None of the residents in connectable properties were able to name the natural gas company operating in their area;*
- *Some recognised the logo from signs near roadworks or vans but could not name the company or its function.*

Awareness of natural gas availability

- *The majority had witnessed roadworks in their area, mentioned the disruption caused and attributed it to laying of natural gas pipes, but none were aware that it was currently available to them;*
- *Some regarded the roadworks as a sign it would soon be available;*

[54] https://assets.publishing.service.gov.uk/media/551948b8e5274a142b000186/phoenix_natural_gas_limited_price_determination.pdf para 4.100
[55] SGN NG GD23 -028 Sales & Marketing Plan Para 2.1
[56] SGN NG GD23 -028 Sales & Marketing Plan Para 5.2
[57] SGN NG GD23 -028 Sales & Marketing Plan Para 6.2
[58] SGN NG GD23 – 021 Consumer Engagement, section 3.2.2, pg 11

- *They were not aware of anyone in their area who had natural gas, and this was considered a strong indication that it was not available.*

Perceptions of natural gas

- *Some gaps in their knowledge in terms of the benefits of natural gas, beyond similarities to oil;*
- *This was due to the fact they did not know they could currently avail of it, so they did not need to know about it."*

4.2.6 Connection Incentives

During PC02 for PNGL, which covered the period 2002-06:

> *"UR recognized that allowing advertising and marketing into the PNGL cost allowance had added significantly to the size of the PNGL asset base, but had helped the company to meet its connection targets.* ***UR calculated the value of these allowances at around £37 million (2010 prices) since 1996 (increasing to about £50 million when the costs of manpower, for instance sales staff and corporate overheads, were taken into account)****.* ***On balance, UR decided that it was appropriate to make allowances for promoting the gas industry given its principal objective in gas and the challenges of growing the market.*** *However, in the PNGL12 determination it considered it appropriate to move to an output-based mechanism that would still grant PNGL an allowance, but only for connections actually achieved. In the medium to long term, UR envisaged reducing this allowance downwards, with the possibility of eventually doing away with it altogether at some point in the future."*[59]

The UR calculated these allowances at £50 million in 2010 prices for PNGL's first 16 years of operation, which in average 2020 prices is over £65million. The URs decision to move to an output-based mechanism from year 17 of PNGL's license is broadly in line with our GD23 business plan submission (year 4 for SGN NG from the wider project commissioning date) where the bulk of marketing costs are delivered via a per connection basis.

In FeDL's PC01 and PCR02 price controls, which covers FeDL's first 8 years of operation, the UR determined over £12m (average 2020 prices) for AMD, and it is worth noting that in PCR02, due to FeDL's outperformance in the connections, the awarded allowance is likely much higher (estimated by SGN NG to be an out-turn closer to £16m in average 2020 prices).

SGN NG estimate that to date the UR have provided allowances in the region of £100m for Advertising and Marketing to consumers in the PNGL and FeDL networks.

With such investment being permitted in the PNGL and FeDL networks, and taking into account that the UR determined the positive impact of allowances to incentivise consumers to increase connections in the early years[60], it is reasonable to assume the UR holds evidence to base their previous decisions and subsequent determinations on.

Again, we would reasonably expect this evidence would relate to both the requirement of incentives and the correlation between appropriate value and connection numbers to thereby determine the allowance amount. A more transparent approach would be for the UR to publish this evidence in the GD23 FD along with any analysis that shows why their previous evidence has now be superseded.

By the end of the GD17 price control (a 5-year period for SGN NG, with 3 fully operational years), consumers in our network will have benefitted from little over £2m. Our total request for the 6 year period of the GD23 price control is approximately £6.5 million (including headcount, marketing and customer grants).

[59] Competition Commission – Phoenix Natural Gas Limited Price Determination document, Para 4.120

[60] https://www.uregni.gov.uk/files/uregni/media-files/2013-12-20_GD14_Price_Control_for_NI_GDNs_2014-2016_Final_Determination.pdf para 5.24, 5.25 and 5.28

We are not proposing that because the UR allowed such support in the past is justification in isolation for a similar approach in our network. Our rationale for highlighting this is that we believe the evidence supports the continued provision of the current connection incentive mechanism. We have also provided details of the economic assessments[61] we have carried out to determine the appropriate levels of connections incentives which ensures long-term benefits for all consumers.

SGN NG understands the logic of the economic model currently being proposed to generate marketing allowance for a mature gas network, but it is important to remember that scale also plays a role in the success of this model. To ensure the GDN can generate the level of marketing budgets required, the economic model needs to support sufficient numbers of OO connections.

A model which supports an established gas network with a high number of properties passed, and the potential to connect large numbers of OO properties, does not necessarily support the needs of a new network with much fewer properties passed. Providing allowances per connection does not always scale up to a reasonable budget when you consider the ‘potential to earn’ this allowance is much less and that an immature network must launch their new brand and product into a new marketplace. An economic model requires traction in the marketplace to generate income to be utilised for marketing. This traction can only be developed through sustained brand presence over a long period of time.

For example, a new network (Network A) with the potential to connect 600 owner occupied connections per annum at a rate of £1,000 per connection means the likely connection allowances for that year would £600,000. However, a more established network (Network B) with the potential to connect 4,000 customers, but at only half the connection allowance of £500, still has the potential to have an annual connection allowance of £2m.

On the basis that many marketing mediums used to promote natural gas will incur similar costs for each company, it is reasonable that a newer gas network is provided with additional financial support to that of established networks to ensure all companies can educate consumers and enhance product knowledge to the same level. This allows the establishing network to successfully promote and grow to a point at which an economic model for connection allowances becomes a realistic proposition.

It is important that the UR consider the impact of maturity and scale when determining a suitable economic model for the provision of connection incentives for SGN NG.

The Price of Gas

It has been suggested to SGN NG in recent engagement with the UR that the rising cost of natural gas is a ‘barrier to entry’ for consumers with regard to converting to natural gas. Whilst it understandable that current volatility in natural gas prices (and the events giving rise to that volatility) create uncertainty amongst potential customers, that should not be considered an enduring outcome.

In addition, there is often a wide gap between perception of gas vs oil prices and the reality of that relationship. For example, the gas price on the SGN NG network is the most expensive it has been during the current cost of living crisis at 7.155p/kWh for a pay as you go tariff[62]. This is still significantly cheaper than the current price of oil at approximately 97p per litre or 9.51p/kWh for 500 litres[63]. For those living in fuel poverty, or close to it, it is unlikely that they will be able to afford to bulk purchase 500 litres. These consumers

[61] SGN NG GD23-020 Connection Incentive Paper, section 2.4, pg 8

[62] Source: airtricitygasni.com

[63] Source: cheapestoil.co.uk – Correct at the time of drafting

will be purchasing smaller quantities and will be penalised in price for doing so, with the cost of a 20-litre drum being as high as 135p per litre or 13.235 p/kWh.

As is clear from the above, it is important that both prospective customers, and the UR, are given the opportunity to analyse the cost of alternative fuels to understand the price point of where natural gas is respectively.

SGN NG is confident that by communicating the facts to our customers in a clear and transparent manner and providing them with the support they require to migrate to natural gas that our forecast connection figures can be reached.

Equally clear is the fact that, if marketing budgets are cut by 80% and the incentive mechanism is changed to a 'cost to serve' of £400, the impact on realised gas connections will be catastrophic.

4.2.7 £500 domestic fund

Our GD23 business plan outlined the need for customer grants to be utilised to incentivise the customer towards natural gas. It will contribute to the customer's conversion cost when switching from their current fuel and will be paid after the conversion to natural gas has been completed.

The estimated cost of converting to natural gas is circa £2.5k whereas a customer that is simply replacing their oil boiler with a newer version will likely have an estimated cost of circa £2k. In GD17, SGN NG assessed that the conversion grant available to customers should be £500 on this basis as this brings the cost of installing natural gas in line with the cost of replacing an oil boiler.

As natural gas is still a new product in the west of NI, it is important to ensure that the installation costs of natural gas and oil are similar. Natural gas as a product is not well enough known and consumers will not be prepared to pay a premium to move away from their tried and tested oil boilers.

As summarised by the Competition Commission[64] in 2012 – Phoenix Natural Gas Limited price determination (para 4.106):

> *"Paradoxically, low-income owner occupiers purchasing oil in smaller than 500-litre refills and who would probably make the most savings from switching to natural gas will, in all likelihood, be those who can least afford the £2,000 to £3,000 outlay to switch to natural gas (or for that matter upgrade to a condensing oil boiler)."*

The reality is it is the conversion costs that will prohibit consumer's choice with around two thirds (66%) of respondents saying that they were unwilling to pay anything extra for an environmentally friendly heating source, with the main reason being they could not afford to pay extra (51%)[65].

It is imperative that SGN NG is able to continue to stimulate the marketplace through GD23 by providing this level of customer grant. The UR proposal within the DD to provides nothing to support this requirement.

4.2.8 Small and medium I&C customers

In 2014, when SGN entered the competitive tender which ultimately resulted in the award of the current conveyance licence, circumstances and understanding of the NI gas environment were very different to our current understanding and experience.

[64] https://assets.publishing.service.gov.uk/media/551948b8e5274a142b000186/phoenix_natural_gas_limited_price_determination.pdf
[65] SGN NG GD23 – 021 Consumer Engagement, section 3.2.2, pg 11

The SGN bid included a zero-incentive request in relation to I&C connections having been led by the Fingleton McAdam (FMA) study into the belief that significant connections would be available in this area. This is now proven to be incorrect.

The previous published price controls for NI GDNs also suggested that the incentive requirement was reducing in this market area. PNGL12[66] allowed PNGL fixed allowances of £30k/year and gave the impression that customer knowledge of natural gas in the SME market was more advanced than in reality.

As part of the PNGL12, the UR determined that in relation to I&C connection incentives that fixed allowances of c£30k per annum were granted:

> *"in the region of what PNGL has requested for I&C incentives. And note that this will be the last time that we grant an explicit allowance for I&C incentives".*[67]

The PCR02 Supplemental Market Development Review12 (MDR), which was undertaken to cover the 2010 to 2013 years of PCR02 for the Ten Towns area (after circa 5 years of operation of the Ten Towns network) supported the connection of SME businesses with allowances of £2,161[13] per connection (converted to £2020).

Subsequently, as part of the GD14 FD[14], the allowances to support such connections were fully removed for the Greater Belfast area (after circa 19 years of network operation) and reduced significantly to a fixed allowance equating to £120[15] (£2020) per connection targeted (after circa 10 years of operating) for the Ten Towns network operated by FeDL.

Therefore, at the time of the submission, it was reasonable to agree with the UR that once momentum and a satisfactory connections rate was achieved in the early days of properties being passed using this significant support, the support would cease at the appropriate time and SME connections would continue naturally on the back of prior education once natural gas is seen as the 'fuel of choice' in the network area.

In reality our experience of GD17 is that in the market for smaller I&C connections (particularly SME, IC1 (P1) and IC2 (P2)) there is a significant resistance to connect due to a lack of knowledge or trust in the area of natural gas, the SGN NG brand and/or the savings and environmental benefits that can be achieved by conversion. When this uncertainty amongst SME business owners is factored in alongside the upfront capital costs to convert, the hesitancy to proceed is clearly demonstrated by our penetration levels to date in this area. This hesitancy has been compounded by a global pandemic, Brexit, the impacts of these on GDP, decarbonisation[68].

Since our business plan was submitted in June 2021 our SMEs customers have had to contend with further uncertainty due to rising inflation and expected stagflation, unprecedented energy cost rises and the war in Ukraine. During subsequent engagement[69] with the UR it was suggested that these events are considered 'business as usual' when they clearly are not.

As we set out in our business plan submission, increasing our I&C customer base is important to growing the network and incentivising those customers to connect is appropriate. A position the UR have rejected[70] on the basis of that the 2014 GTTW application pack process stated *"only if the successful applicant has included such incentives in their application will these be funded by price control allowances"*[71]*.* Elsewhere however the application pack recognises the need for flexibility "*However, we will consider requests for different allowances*

[66] https://www.uregni.gov.uk/files/uregni/media-files/2012-01-10_PNGL12_Final_Decisions_FINAL.pdf
[67] 2012-01-10_PNGL12_Final_Decisions_FINAL.pdf (uregni.gov.uk) table 9
[68] SGN NG GD23 -028 Sales & Marketing Plan, 2.2, pg 4 and SGN NG GD23-020 Connection Incentive Paper, section 2.1
[69] Meeting between SGN NG and UR, 28 April 2022
[70] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 5.8 (c), pg 36
[71] Gas Networks Extensions in Northern Ireland. Gas to the West: Applicant Information Pack, Feb 2014, para 4.36, pg 32

where these are the result of unforeseen significant changes in the market since the application was submitted." [72] and that *"When allowances are set at periodic reviews we will take account of the latest information and any changes in circumstances."*[73]

Therefore, within the SGN NG business plan, we identified the need to extend the connections incentive to the small and medium size industrial and commercial customers[74]. The need for this incentive was evidenced by the low uptake of I&C customers in these groups in GD17, the comparison with connection volumes for networks that had a connections incentive for I&C customers and the application of the same economic principles that were applied to OO customers. This is set out in more detail in appendix A.

4.2.9 Connection and volumes forecasts

Due to a variety of reasons and changing circumstances, we've reassessed our connections and volumes in the large I & C sector and have taken into account the level of support proposed by the UR in the DD for OO and SME connections to reflect what is realistic. This results in the following overall summary table with further detailed analysis provided below.

For the reasons set out above we disagree with the conclusions the UR have reached in the DD and the basis on which they have reached those conclusions given the evidence that SGN NG presented in its business plan submission. The GD23 business plan forecasts were bottom-up forecasts based on evidence set out in Part 5 of the document and on the expectation that an appropriate incentive mechanism and support would be in place.

In the DD the UR have applied alternative forecasts without a clear evidenced basis on how these were determined. We are particularly concerned the UR have failed to consider the direct link between connection forecasts and the removal of the connection incentive mechanism and the significant reduction in marketing and advertising allowance requested.

We note in the DD, the UR reduces the average consumption attributable to P1 and P2 customers due to *"limited experience of consumption per property in the SGN area"* [75]. We submitted our GD23 business plan on the basis of our estimated consumptions though we accept the UR would have information from longer term GDNs that would support their viewpoint and we therefore accept this change.

Given these changes our new connections forecasts for GD23 should be:

Figure 4.6: Updated GD23 Connections based on the DD

GD23 Reassessed Connections		2023	2024	2025	2026	2027	2028	Total GD23
P1	OO	91	91	91	91	91	91	546
	NB	200	203	182	108	81	43	817
	NIHE / HA	25	0	70	111	37	184	427
	Small I&C	5	7	10	17	18	20	77
P2	Medium I&C	4	4	7	12	12	13	52
P3	Large I&C	4	1	2	4	3	0	14
P4	CHP	0	0	0	0	0	0	0
P5	Firm	1	4	0	0	0	0	5
P6	Interruptible	0	0	0	0	0	0	0
P7	Super User	0	0	0	0	0	0	0
TOTAL		330	310	362	343	242	351	1,938

[72] Gas Networks Extensions in Northern Ireland. Gas to the West: Applicant Information Pack, Feb 2014, para 3.44, pg 20
[73] Gas Networks Extensions in Northern Ireland. Gas to the West: Applicant Information Pack, Feb 2014, para 3.45, pg 20
[74] SGN NG GD23-011 Detailed Business Plan Commentary, section 5.8, pg 111 and SGN NG GD23-020 Connection Incentive Paper, section 3.1, pg 10

[75] Para 5.17 and Table 5.11 of Annex C

Figure 4.7: Updated GD23 Volumes based on the DD

GD23 Reassessed Volumes (therms)		2023	2024	2025	2026	2027	2028	Total GD23
P1	OO	782,230	816,810	851,390	885,970	920,550	955,130	5,212,080
	NB	131,520	196,000	257,600	304,000	334,240	354,080	1,577,440
	NIHE / HA	226,145	230,020	240,870	268,925	291,865	326,120	1,583,945
	Small I&C	35,945	41,405	49,140	61,425	77,350	94,640	359,905
P2	Medium I&C	140,000	160,000	187,500	235,000	295,000	357,500	1,375,000
P3	Large I&C	461,200	574,700	637,900	749,038	869,791	908,191	4,200,821
P4	CHP	303,479	303,479	303,479	303,479	303,479	303,479	1,820,872
P5	Firm	14,643,795	15,075,509	15,263,777	15,263,777	15,263,777	15,263,777	90,774,411
P6	Interruptible	0	0	0	0	0	0	0
P7	Super User	11,241,926	11,241,926	11,241,926	11,241,926	11,241,926	11,241,926	67,451,558
TOTAL		27,966,240	28,639,849	29,033,582	29,313,540	29,597,978	29,804,843	174,356,032

Domestic Connections and Volumes

Owner Occupier (OO)

In the light of the evidence presented above, OO connections are assessed at 91 per annum, based on the level of support provided within the DD. If the level of support for connections remains as per the DD, then SGN NG would expect the FD to reflect these revised connection numbers accordingly.

New Build (NB)

The UR has stated in its DD that it has accepted SGN NG Business Plan connection target for New Build connections. The UR states w*e have accepted the company's estimates for the DD*[76]*.* We welcome the UR's DD connection figures for New Build, which include a total of 817 during GD23. We do not expect this figure to change for the FD.

Northern Ireland Housing Executive (NIHE)/Housing Association (HA)

The UR has stated in its DD that it has accepted SGN NG Business Plan connection target for NIHE/HA. The UR states "*we **have accepted the company's estimates but excluded estimated connections in the 9 new areas** which we have not included in the DD"*[77]*.* SGN NG welcome the UR's DD connection figures for NIHE with the 9 new areas removed, this is a GD23 total of 427. With the above in mind, we have not included any additional information for our connection forecast over and above that which was previously submitted as part of our GD23 Business Plan submission.

For the avoidance of doubt, our acceptance of the NIHE connection figures is subject to the provision of one additional non-OO FTE requested in our Business Plan submission in the area of NIHE. SGN NG require an additional FTE in the role of NIHE Sales Rep as our OO Domestic Sales Rep(s) will be solely focused on delivering OO connection targets.

There is a significant amount of engagement required with not just the NIHE, but also the various Housing Associations, to deliver the social housing connection numbers proposed in the DD. As SGN NG is operating with a lean model headcount, there will be no resource available to conduct the engagement, and subsequently connect the properties without the UR providing the additional FTE required.

Commercial Connections and Volumes

Small and Medium Enterprises (SME)

In light of the evidence presented above, SME connections are assessed at the current run rate averaging 22 per annum (129 across GD23) based on the level of support provided within the DD. If there is no support as per the DD, then SGN NG would expect the FD this to be reflected in the connection numbers accordingly.

[76] Para 5.9 of Annex C Connection & Volumes
[77] Para 5.10 of Annex C Connection & Volumes

Large I&C

For large P3-P5 I&C connections we have reassessed these on an individual basis as follows:

- Connected customers - latest consumption data used to assess volume (upward or downward)
- Unconnected customers – Strategic engagement to assess latest proposed connection dates and volumes (removal of customers that are not intending to proceed)
- Super User P7 - no amendments are required at this time.

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Figure 4.10 – Large I&C (P5) Reassessed Connections & Volumes

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4.3 Energy Efficiency Adjustment.

We note that within the DD the UR proposed a position where different networks have different assumptions surrounding the energy efficiency developments of their regional housing stock. Irrespective of the actual value used it is important to note that it will be very challenging to deliver this scale of energy efficiency particularly with the levels of fuel poverty and low-income levels to the west of NI.

To achieve these levels of energy efficiency we believe that all parties will need to work closely to deliver these ambitious targets. There is an opportunity for this to be closely aligned with an appropriately calibrated Advertising Marketing and Development allowance.

As a part of GD23 business plan we set out a £500 customer grant as a part of our Sales and Marketing budget to support the changes necessary to support the change of heating supply from fuel oil to natural gas. This will be an important feature delivering these levels of energy efficiency.

We note that the energy strategy suggests that that a half of the CO2e reductions modelled within the strategy is expected by 2030 are anticipated to come from the residential sector[78]. This will be very challenging to achieve this target and will require the rapid uptake of natural gas and associated fuel switching. It is very difficult to envisage how this strategy can be delivered if customers are not being appropriately incentivised to move to natural gas

[78] https://www.economy-ni.gov.uk/sites/default/files/publications/economy/energy-strategy-path-to-net-zero-action-plan.pdf, figure 3, pg 17

PART 5: OPERATING EXPENDITURE

Summary of response

- **There is a substantial gap between the GD23 business plan and the draft determination of nearly £12m over GD23, a 42% reduction in the allowances.**
- **The majority of this £12m gap is due to the reduced funding for advertising marketing and development (£7m) for both owner occupiers and small and medium size I&C customers. This reduction in funding will have a direct impact on the number of connections that we are able to deliver.**
- **It is no longer appropriate to hold SGN NG to the 2014 bid for IT costs, MSA costs and non-owner occupier incentives. Substantial changes have taken place that either the original bid position could not have foreseen, or the original bid position has proven to be incorrect.**
- **Basing operational costs on the number of FTEs in place in 2020 will distort the actual operating costs necessary to run the network effectively. In 2020 recruitment was largely postponed due to COVID-19, training and development costs were not reflective of a normal year and travel was hugely disrupted.**

5.1 Introduction

SGN NG are disappointed with the substantial gap in the DD proposed Opex allowed by the UR and the GD23 Business Plan presented in June 2021. In the GD23 DD the UR states the most up to date actuals as part of their assessment of the business plan requests i.e., data relating to 2020[79].

We recognise the difficulty is assessing the costs to date given the limited level of data and the many extenuating circumstances which have been encountered during GD17. However, while 2020 may appear to be the most appropriate base year, due to the impacts of COVID-19 on our business over the year, we do not believe it provides an accurate reflection of costs going forward. Examples of this impact include the requirement to pause construction and mains laying activity for 3 months, a complete change to our sales and marketing approach and the pausing of all recruitment whilst the new ongoing restrictions became clear due to the massive levels of uncertainty faced at that time. This is a particular issue for SGN NG given our relative immaturity as a network.

We suggest that greater consideration should be given to the factors which significantly influenced the way in which the business operated during 2020. It is therefore necessary for the UR to make adjustments to accurately reflect these circumstances when setting allowances for the FD.

Figure 5.1 below sets out these differences in proposed opex allowances and our GD23 Business Plan. This shows that under the UR's DD, the proposed operating allowances for SGN NG are approximately 42% of those put forward within the business plan prior to an assumed improvement in network efficiency expectation (frontier shift) being applied.

[79] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.3

Figure 5.1: Comparison of Submitted business plan and allowed opex (pre-frontier shift).

GD23 Total £' 000 (£2020)	SGN NG GD23 BP	Draft Determination	Difference	% reduction from business plan
Work Management and Work Execution	8,326	7,642	684	8%
Business Support	8,580	4,708	3,872	45%
Advertising, Marketing and Development (AMD) (both OO and Non-OO)	10,742	3,441	7,301	68%
Non-Controllable & SOLR	385	385	0	0%
Total Opex	**28,033**	**16,176**[80]	**11,857**	42%

We are keen to address the shortfall allowed in these areas so that appropriate allowances can be set in the GD23 FD.

5.2 Link to 2014 Bid

Our GD23 Business Plan represented a complete and deliberate break from the 2014 bid position as the bid is no longer a valid point of reference for the SGN NG business given that it was submitted nearly nine years ago and given the level of disruption that has occurred over the last three years. This break from the 2014 bid position is in line with the GttW applicant information pack which was clear that the UR would not continue to link allowances to the application if it was as a result of unforeseen market changes or that it would be inappropriate to apply them given the prevailing circumstances[81].

It is SGN NGs contention that the market in 2014 has changed dramatically since 2014, in fact the market is completely unrecognisable since 2014. Factors to support this statement include Brexit in 2016, global pandemic 2020-22, War in Europe 2022 (Russian invasion of Ukraine Feb 2022), Dramatic increases in global wholesale gas prices (2021-22), unstable energy market in the United Kingdom resulting in numerous gas suppliers going into administration, Inflation peaking at 7.2% in United Kingdom (March 2022 OBR) and the negative impact on fossil fuel as a result of net zero 2050 and COP26. In NI the Assembly has collapsed twice since 2014 (2017-2020 RHI Scandal) and in January 2022 (Brexit Protocol).

We are therefore surprised that in the DD the UR still considered the application process a relevant point of reference[82] in 3 areas:

- IT & Telecoms
- CEO Group Management (largely Managed Services Agreement)
- Advertising and Marketing (non-OO) category

[80] Table 6.24 of Annex D component parts add up to £15,866 - £308 has been omitted from the Non-OO activity

[81] *"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.**" Para 3.44*

*"We recognise that, over the passage of time, it is likely to become less feasible to continue to directly link allowances to the application. When allowances are set at periodic reviews we will take account of the latest information and any changes in circumstances, and **will not continue to link them to the application if that would cause them to be inappropriate in all the circumstances prevailing at the relevant time.**" Para 3.45.*

[82] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Annex D Operational Expenditure, March 2022, para 6.5(c), pg 102

Each of these three areas have been subject to either unforeseen market changes, that could not have been anticipated at the time or are no longer appropriate to the business as it has currently developed.

5.2.1 IT & Telecom costs

There has been a fundamental shift in focus with regard to cyber security, with increased concerns over the threats and significant increases in the level of protection required for cyber security, to protect against ransomware attacks and to comply with the Network and Infrastructure Systems (NIS) Regulations[83]. The high growth in cyber risk, the increasing sophistication of the actors and the social and political consequence of high-profile cyber events could not be anticipated at the time of the bid submission where annual IT costs of £23k per annum (uplifted to £2020) was assumed.

Similarly, the critical move to cloud-based operations and supporting our team to work from home full time could not have been anticipated at the time of the bid but was critical to maintain operations during COVID-19 lockdowns. The costs relating to COVID-19 and home working could not have been anticipated at the time of the bid.

SGN NG also invested in a new CRM System in 2016 that was not within the original bid, as at the time of the bid it was envisaged the existing SGN GB system could be utilised for NI. Following the grant of the licence it was possible to carry out a more detailed cost benefit analysis on system requirements for NI and it was determined it would be more cost effective to develop a bespoke system specific to NI given the considerable differences between GB and NI market structure. This system is essential for asset management, network code requirements and to support customer service. None of these costs were considered at the time of the bid submission and account for why the accurate point of reference for GD23 costs is on average £125k per annum (£2020).

SGN in the original bid included the assumption that the corporate Geographical Information System (GIS) would be appropriate to support the mapping for the development of the network. SGN NG has absorbed the costs of developing a new GIS platform over the course of GD17 but there is the ongoing Opex for licensing the mapping data from OSNI, which amounts to £56k per annum.

The fast pace of change and unanticipated increase in expenditure is demonstrated by the submissions and the DD position supported by the UR for the other networks. In 2014, FeDLs IT allowance was £118k per annum (£2020) – this has now been proposed in the DD as £574k per annum, nearly a five-fold increase. Similarly, PNGL has a comparable allowance of £529k per annum (£2020) in the DD. In contrast the UR is determining SGN NG should receive on average only £33k per annum despite the similar nature of IT requirements across the 3 GDNs.

5.2.2 Group Management.

Costs within this area relate to support provided by SGN group under the Managed Service Agreement (MSA). Since the time of the bid application the level of support required from the SGN group has significantly evolved in many areas and as a result throughout GD17 the support provided has been much greater than envisaged. These include, but are not limited to:

- **Decarbonisation.** SGN NG has supported the UR and DfE in the development of the appropriate industry standards to enable biomethane entry onto the network. This has been achieved by utilising expertise in the GB markets and, in a similar manner, we have looked to support the transfer of

[83] In Northern Ireland the Department of Finance is the Competent Authority for electricity and gas, in the rest of GB Ofgem is the Competent Authority

knowledge surrounding hydrogen opportunities from GB innovation projects. There has been a significant level of support provided to SGN NG and the wider NI gas industry in this area. The industry in GB is much more advanced in this area and SGN group are a leading player - the need to rely on GB experience will only increase during GD23. For Business Separation reasons, this support is provided via the MSA and at a cost.

- **Levels of legal, procurement and regulatory support.** Levels of support have significantly exceeded that anticipated given the experience of the GB market. SGN NG has utilised this knowledge of the group to leverage better consumer outcomes than would have been the case than a smaller network employing only 33 FTEs in the final year of GD17.
- **Human Resources.** SGN NG do not employ any human resources personnel locally. The human resources services provided under the Managed Services Agreement (MSA).

The GD23 price control risks introducing a constraint on these broader customer benefits. This area is particularly concerning as while the UR recognise that price control activity is of a very similar nature for all GDNs[84] the same approach has not been applied to business-as-usual activity in this area, regardless of the size of the network.

5.2.3 Advertising Marketing and Development for the non-OO Market.

As we set out in section 4.1.2 there is a clear relationship between the expenditure on advertising and marketing and the number of connections realised. We also outlined in section 4.1.8 at the time when SGN submitted the bid, the previous price controls gave the impression that the customer market was more established than it actually was. The reality of GD17 has demonstrated that this assumption was misplaced and, if this is not rectified in GD23, it will risk causing enduring harm to the customers who have already connected. Without appropriate support to connect I&C customers to the network, our customer base will struggle to grow to a point where it would not be critically impacted by the withdrawal or reduction in demand of one of the large I&C ‘anchor’ loads.

In the business plan we demonstrated how incentivising the small and medium I&C customers by recovering the costs of connection over time would generate a net benefit for the network and its customers. Accordingly, we do not consider there to be any scenario where it is in customer interests to hold SGN NG to the bid position which has clearly been demonstrated to be erroneous. It is important that an underestimate in 2014 should not block the progress to improving the networks resilience and customer security.

These three areas represent a significant shortfall between the requested allowances and the DD proposed allowances. We have set out this out in the Figure below which shows a £4.7m gap in allowances as a result of the UR holding SGN NG to the 2014 bid position. Without a change in approach from the UR in these areas it will be impossible for SGN NG to continue to grow the network in an efficient way, whilst also undertaking the necessary work to support a decarbonised future for NI.

[84] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 2.79

Figure 5.2: Financial Impact of being held to 2014 bid.

GD23 Total £' 000 (£2020)	SGN NG GD23 BP	Draft Determination	Difference	% reduction from business plan
IT and Telecoms	838	201	637	76%
CEO Group Management (largely Managed Services Agreement)	2,750	602	2,148	78%
Advertising Marketing and Development for the non-OO Market	2,968	1,074	1,894	64%
Total Opex	**6,556**	**1,877**	**4,679**	**71%**

5.3 Employment – people and structure

SGN NG are extremely concerned with the URs proposal to use 2020 Full Time Employees (FTEs)[85] as a baseline for determining allowances for resources in GD23 as the FTEs in 2020 were distorted by COVID-19 and the choice of base year will have a disproportionate impact on SGN NG relative to the other networks due to the early stage of growth and rapid scaling up of the network.

The changes in the market created by COVID-19 created a lag in recruitment levels - a lag that was recovered in 2021 when recruitment recommenced. In 2020 COVID-19 constraints required SGN NG to suspend all mains laying and connections activity, undertake a complete change in marketing strategy and suspend recruitment activity due to the uncertainty presented at that time. The result of this was that staff numbers at the end of 2020 do not provide a true reflection of needs under business-as-usual activity.

In the DD the UR explains its methodology as having "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."[86] The GD23 business plan was written from the basis of business-as-usual operations rather than the 2020 COVID-19 pandemic baseline and, as such, this methodology will not reflect the lags in recruitment introduced as a result of COVID-19.

Specifically, our Business Plan outlined the requirement to recruit 2 sales representatives exclusively to grow the SME connections, as well as a dedicated Housing Executive sales representative and associated administration support, at the start of GD23. This increase in headcount is necessary to support higher customer volumes and greater connection volumes that were set out in the business plan.

The recruitment that we have undertaken to date, since the business plan submission, is in line with the recruitment profile included in our business plan, SGN NG's current headcount in April 2022 is 27 FTEs - clearly in line with the forecast presented in the business plan and already 95% of the future determined levels permitted in the DD by UR. As such UR's DD provides no scope for the growth of the network customer base.

Given the distortion of COVID-19 in 2020, we ask that the UR revise its methodology to use 2021 as the base year. The difference between the requested FTEs, the determined FTEs and the actual is shown in the figure below. The change between 2022 and 2023 is to provide for an NIHE rep, two SME sales reps, a decarbonisation and team manager.

[85] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.28, pg 107
[86] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.28, pg 107

Figure 5.3: Requested, Determined and actual FTE.

GD17 FTE		2018	2019	2020	2021	2022
SGN Requested		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 FTE	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
SGN Requested	33.0	33.0	36.0	37.0	38.0	38.0
UR Determined	27.8	27.8	28.0	28.0	28.2	28.2

We are also concerned that the UR has not recognised the continued growth in FTEs that will be required throughout the price control period. The UR has proposed that there an increase of just 0.4 FTEs during the GD23 period. This is inadequate to support the growth of the network and customer connections.

Figure 5.4: Requested, Determined and actual employee costs.

Net Staff after capitalisation £'000 (Ave £2014)		2018	2019	2020	2021	2022	Total GD17
GD17 Final Determination		£316	£341	£354	£362	£366	£1,739
Actual/Forecast		£612	£604	£814	£1,053	£1,099	£4,182
Difference		£296	£263	£460	£691	£733	£2,443
Net Staff after capitalisation £'000 (Ave £2020)	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Total GD23**
GD23 Draft Determination	£1,234	£1,209	£1,166	£1,154	£1,137	£1,106	£7,006
GD23 Business Plan Template	£1,352	£1,352	£1,412	£1,465	£1,511	£1,511	£8,603
Difference	£118	£143	£246	£311	£374	£405	£1,597
% Net Staff Determined	91%	89%	83%	79%	75%	73%	81%

Another area of concern is that the URs Annual Cost Reporting (ACR) categorise activities carried out by individuals within the business, they are not representative of the actual employee job roles, nor do they consider the additional hours which FTEs undertake. In a smaller organisation a larger proportion of staff will often need to work beyond standard hours in order to maintain effective operation and respond to the daily challenges which will not be accurately picked up by the ACR template. Similarly, in a smaller organisation the outcome is more sensitive to the way individuals are divided across roles where a role in isolation does not support a full FTE and may increase the level of inconsistency when comparing across networks.

As can be seen from the comparison between the DD and the SGN NG business plan proposal, the greatest discrepancies occur in select operational activities which would be expecting to see the fast growth during the early stage of the business growth cycle and were also most exposed to a recruitment pause during the COVID-19 lockdown period. By scale of reduction, these activities are 'Customer Management', 'System Control', 'Operations Management' and 'Audit, Finance and Regulation'.

Figure 5.5: GD23 FTEs – Business plan vs Draft Determination

GD23 Average FTEs (GD23 Averages)	SGN NG GD23 BP	Draft Determination	Difference	% reduction from business plan
Asset Management	1.16	1.08	0.08	7%
Operation Management	9.11	7.19	1.92	21%
Emergency Call Centre	1.46	1.44	0.02	1%
Customer Management	1.99	1.09	0.90	45%
System Control	1.44	0.94	0.50	35%
Emergency	0.26	0.26	0.00	0%
Metering	0.53	0.52	0.01	2%
PRE Repairs	0.20	0.20	0.00	0%
Maintenance	0.13	0.13	0.00	0%
Other Direct	0.30	0.35	-0.05	-17%
Total Direct Activities	**16.58**	**13.20**	**3.38**	**20%**
IT & Telecoms	0.22	0.20	0.02	9%
Property Management	0.18	0.18	0.00	0%
HR	0.19	0.19	0.00	0%
Audit, Finance and Regulation	5.62	5.00	0.62	11%
Insurance	0.04	0.04	0.00	0%
Procurement	0.10	0.10	0.00	0%
CEO & Group MSA				
Stores				
Total Business Support	**6.35**	**5.71**	**0.64**	**10%**
Advertising Marketing and Development - OO	6.77	3.77	3.00	44%
Advertising Marketing and Development - Non OO	6.15	5.34	0.81	13%
Total Marketing Support	**12.92**	**9.11**	**3.81**	**29%**
Total	**35.85**	**28.02**	**7.83**	**22%**

5.3.1 Employee costs and expenses

The UR has applied 2020 FTE values in assessing employee costs and expenses for the purposes of GD23. Whilst SGN NG agrees with the methodology applied, we disagree with the use of 2020 as a base year, as the staff costs incurred in this year were much lower than would be ordinarily incurred. This is because many of costs that are normally included under staff costs were significantly reduced in 2020 in comparison to a 'normal' year due the restrictions in place as a result of COVID-19. Costs such as travel, accommodation, private mileage expenses, training and staff development were dramatically and unexpectedly reduced.

The result is that while the number of FTEs correlates to the number requested in our GD23 Business Plan, the actual costs allowed are approximately 8% less than required in the area of Business Support. The level of disparity between FTEs and costs allowed varies depending on the business area as some activities require greater levels of business travel than others. We have provided a breakdown of the costs relating to Business Support in Figure 5.6 as an example.

Figure 5.6: Business Support FTEs and costs

Business Support	2023	2024	2025	2026	2027	2028	Total GD23
Draft Determination FTEs	5.69	5.69	5.69	5.69	5.73	5.73	
Draft Determination Allowance	£322,954	£322,954	£322,954	£322,954	£329,060	£329,060	£1,949,936
Business Plan Requested FTEs	5.69	5.69	5.69	6.49	7.24	7.24	
Business Plan Requested Allowance	£351,293	£351,223	£352,177	£382,894	£417,689	£417,689	£2,272,965
% Difference in allowances	8%	8%	8%	16%	21%	21%	14%

5.3.2 Employee costs – employer national insurance

The Chancellor of The Exchequer changed the percentage of Employers National Insurance in the Budget statement October 2021, from 13.80% to 15.05%, applicable April 2022. This increase was not factored into the Business Plan Template and due to its significant value, SGN NG request the Regulator to add £17k on average per annum to FTE costs to cover this new tax regulation.

Figure 5.7: National Insurance Rates

GD23 (£2020)	2023	2024	2025	2026	2027	2028	GD23
Employer National Insurance (BP) – 13.08 % NI	£177,505	£176,725	£187,255	£190,765	£194,015	£194,015	£1,120,280
Employer National Insurance (BP) – 15.05 % NI	£193,583	£192,733	£204,217	£208,044	£211,589	£211,589	£1,221,755
Additional Employer NI for GD23	£16,078	£16,008	£16,962	£17,279	£17,574	£17,574	£101,475

5.3.3 Capitalised FTEs

The UR agreed with our policy for capitalised FTEs in paragraph 2.18 of Annex D. SGN NG do not expect any change to be applied in this area for the FD. However, if the UR determines this is necessary SGN NG expect the UR to engage with us prior to publishing any decision.

5.4 Bottom-up cost assessment

The DD Annex D assessment of operating cost compared to the SGN NG BP submission is set out below. This shows that prior to the application of any efficiency the allowances determined by the UR in the DD are £16.2m which is a reduction of £12m (42%) from the assessment provided in our GD23 business plan. We outline the main points of difference in the assessment below.

Figure 5.8: Comparison of SGN NG BP and DD allowances for Opex (£'000s) - Average 2020 Prices

GD23 Operating costs £'000s (£2020)	SGN NG GD23 BP	Draft Determination	Difference	% reduction from business plan
Asset Management	277	186	91	33%
Operation Management	1,604	1,329	275	17%
Emergency Call Centre	697	625	n/a(*)	n/a
Customer Management	359	302	57	16%
System Control	333	208	125	38%
Emergency	1,126	1,104	22	2%
Metering	837	823	14	2%
PRE Repairs	91	89	n/a(*)	n/a
Maintenance	2,966	2,935	31	1%
Other Direct	36	42	-6	-17%
Total Direct Activities	**8,326**	**7,643**	**609**	**7%**
IT & Telecoms	838	201	637	76%
Property Management	2,392	1,946	446	18%
HR	70	66	4	6%
Audit Finance and Regulation	2,449	1,819	630	26%
Insurance	46	38	8	17%
Procurement	35	36	n/a(*)	n/a
CEO & Group MSA	2,750	602	2,148	78%
Stores	-	-	-	0%
Total Business Support	**8,580**	**4,708**	**3,872**	**55%**
Advertising Marketing and Development - OO	7,773	2,059	5,714	74%
Advertising Marketing and Development - Non OO	2,969	1,382[87]	1,587	53%
Total Marketing Support	**10,742**	**3,441**	**7,301**	**68%**
Trainees and Apprentices	-	-	-	0%
Non controllable opex	300	300	-	0%
Supplier of last resort	85	85	-	0%
Total (Pre Efficiency)	**28,033[88]**	**16,176**	**11,857**	**42%**

(*) n/a is where a difference has been introduced which SGN NG agree with due to a change identified as a part of the post submission Q&A process.

[87] Table 6.24 of Annex D component parts add up to £15,866 - £308 has been omitted from the Non-OO activity

[88] Table 3.9 of Annex D includes £2,367 for Property Management instead of £2,392 and total is £28,008 instead of £28,033 which were included in SGNNG Business Plan

5.4.1 Total Direct Activities

Asset Management.

Asset management costs have been reduced by a third by the UR compared to our GD23 business plan submission. This reduction is as a result of the URs decision to maintain number of FTEs at 2020 levels without any consideration of the impact of a pause on recruitment during 2020 as a result of COVID-19. This means that an average of 1.08 FTEs has been applied to the calculation rather than 1.16 average FTE which is a more accurate reflection of requirements in this area. This accounts for a 7% reduction overall and the exclusion of contractor costs which have not been incurred historically[89].

Contractor costs were not incurred historically in this area, which is requirement under the SGN NG Conveyance Licence[90], as the network was not sufficiently developed. We set out in the GD23 business plan[91] that SGN NG has contracted with Lloyds Register to carry out ISO 550001 Asset Management accreditation and surveillance visits. The accreditation phase of the project commenced in 2021 and evidence of these costs has been provided to the UR separately. The forecast costs include provision for a detail assessment in 2026 and has an average cost of £11.5k pa.

Operations Management.

Operations management costs have been reduced by 17% a reduction of £0.3m on the business plan submission. In our GD23 business plan we confirmed an average of 9.1 FTEs for Operations Management would be necessary. The UR state in paragraph 6.33 of Annex D that they have provided for 2 additional FTEs as this is consistent with increase in FTEs in the FeDL and PNGL network areas when they were in a similar stage of their network development. This approach does not consider differences in the allocation of roles under the activity Operations Management between the 3 GDNs. As a result, the UR have proposed that 7.19 FTEs should be allowed for during GD23.

This does not provide sufficient FTEs to allow for the increase operational management workload that will develop over GD23. As we progress through GD23 the costs to facilitate necessary meter inspections and governor inspections more than treble. These costs predominantly relate to routine maintenance activities that are easily identified and forecast. Our supporting appendix SGN NG GD23-029 Operations Management provides maintenance activities that we will be required to carry out for each equipment category has been set out giving a timeseries from 2017 through to 2028 along with an explanation of the procedures that are followed and references to the internal process documents that guides those procedures.

SGN NG provided detailed evidence in the GD23 business plan based on our bottom-up assessment needs. We do not agree with the URs approach to determining allowances in this area as the assessment does not consider differences in organisational structure and allocation of costs between the 3 GDNs. The result is that an unacceptable level of FTEs has been proposed which will mean that it would not be possible to support the level of maintenance activities required to ensure efficient operation of the network. It will be necessary for the UR to reconsider the network specific bottom-up analysis SGN NG provided as part of the GD23 business plan submission to ensure an appropriate level of FTEs is facilitated in this area.

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[89] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.30, pg 107
[90] https://www.uregni.gov.uk/files/uregni/media-files/SGN%20Licence%20-%20effective%2029%2001%202019.pdf condition 3.7
[91] SGN NG GD23-020 Detailed Business Plan Commentary, section 6.4.1, pg 125

Customer Management (Emergency call centre).

The UR have set out their approach to determining the costs in this area based on a bottom-up approach which considers the number of connections to the network[92]. As shown in our analysis provided alongside the GD23 business plan, which is directly linked to the stage of network development and the relatively low penetration rates, it is more appropriate to link this analysis to the number of properties passed. When determining a best fit the correlation between properties passed and emergency calls shows a much stronger correlation that the relationship between connected customers and emergency calls. This is because SGN NG are required to respond to all emergency calls within the network area regardless of whether there is a connected customer in the area. We therefore consider that during GD23 the link between properties passed and emergency calls should be maintained. As the number of connections to the network grows, it may be more appropriate to consider linking this to connection numbers in future price controls. However, at present and where suitable information is available, it is important the UR ensure that decisions relating to the SGN NG network are specific to the circumstances experienced in the licence area, rather than linking to experiences of other GDNs.

As set out in the DD we acknowledge the error in the submission in the final couple of years of GD23 and agree with this adjustment.

Customer Management (Non-Emergency call centre).

In the DD the UR state that they have halved the proposed uplift to increase the number FTEs associated with the customer management from 2 FTEs set out in the business plan to 1 FTE on the basis that it is consistent with PNGL at an equivalent stage of their development[93]. We do not believe that there is a direct comparison that can be made between PNGL and SGN NG at their relative stages of development. It is our view that to operate with this FTE will reduce the quality of service that our customers receive.

System control

The requirements set out in our business plan for the area of system control are directly linked to the size of the network and the level of network activity. SGN NG therefore requested an increase of 0.5 FTEs across the GD23 period. The UR have proposed that FTEs in this area should be maintained at 2020 levels, without providing any explanation of the rationale for this decision. It is therefore difficult to understand how the UR consider this to be more appropriate than the results of the bottom-up analysis carried out by SGN NG which determined the additional workload that will be required in this area as the network continues to develop.

Emergency & PRE-Repairs

In the DD the UR set out a clear methodology for both Emergency[94] and Publicly Reported Escape (PRE) Repairs[95] on the process through which they used the SGN emergency model to assess the number of emergency jobs based on the number of calls received during GD17 to date and the average time and cost of each job. There was one correction identified in the model and a couple of slight changes in assumptions. SGN NG accept these changes and appreciate the clarity provided. We do not expect any further changes to be included within the FD for this area. If the UR determine this is necessary SGN NG expect that suitable engagement would be facilitated.

[92] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para6.35 page 108
[93] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.41, pg 109
[94] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.48, pg 110
[95] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.68, pg 113

Metering

In the DD the UR[96] carried out a detailed assessment of SGN NGs proposed meter inspection regime. The UR have determined that the five-year inspection maintenance regime has been applied a year earlier than necessary as they have adopted PNGL's assessment of the updated British Standard whereby the new standard does not apply to meters fitted before 1st January 2019. On this basis any meters fitted in 2017 and 2018 will not be subject to the new standard until 5 years from the date of the new standard rather than 5 years from the date of installation as assumed by SGN NG in the GD23 Business Plan. On this basis GD23 supports one rather than two inspections with the first inspection in 2024.

We have a different interpretation, and believe it is necessary to seek clarification from both BSI and HSENI before any assumption in relation to the updated standard is applied to allowances. We also note that it will be necessary to maintain allowances to support this requirement into GD29 and beyond for all networks.

Maintenance

In the DD the UR[97] undertook a detailed assessment and identified two reductions (a £1.5k/year minor error and a £3.8k/year error in submission). Following engagement with the UR we agree with both of these changes.

We note that in the DD the UR[98] have identified that they may carry out a further review of individual expenditure items and review of allowances against forecast lengths. If this review is carried out and results in a material change in the allowances awarded, then it is essential that there is sufficient and appropriate dialogue on this prior to the publication of the GD23 FD.

Other Direct Activities

The UR[99] have adjusted the allowances for other direct activities by constraining the FTE equivalent to their 2020 FTEs. As we have set out above, we disagree with 2020 being a relevant base year given the impact of COVID-19 and the barriers that this presented to recruitment during that period.

5.4.2 Total Business Support.

IT & Telecoms

As set out in section 5.2.1, SGN NG disagree with the conclusions the UR have reached. We note that in their explanation the UR set out:

> *"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."*[100]

[96] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.60, pg 112
[97] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.64, pg 114
[98] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.76, pg 114
[99] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.64, pg 114
[100] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.87 pg 116

In section 5.2.1 we identify that these additional investments are not due to increased customer numbers but are in response to external changes and recognition of gaps in the bid. SGN NG invested in a new CRM System in 2016 that was not included within the original bid - at the time of the bid it was envisaged that the existing SGN GB system could be utilised for NI. Following the grant of the licence it was possible to carry out a more detailed cost benefit analysis on system requirements for NI and it was determined that it would be more cost effective to develop a bespoke system specific to NI given the considerable differences between GB and NI market structure. It was not feasible to carry out this level of analysis in advance of the bid submission, therefore reasonable assumptions were applied at the time of the bid. The CRM system is essential for asset management, network code requirements and to support customer service.

This area also includes Geographic Information System (GIS) mapping software costs specific to NI which are essential for the safe and efficient operation of the network. These include the cost of licences for the use of software and fees relating to the provision of maps. SGN made the assumption at the time of the bid that costs relating to maps required for GIS would be available free of charge as is the case in GB. However, the maps for NI must be licensed from OSNI and therefore this cost was not included in the bid submission. We note the UR state 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[101].

We disagree with the UR's proposal to continue to link these costs to the bid, despite our explanation of the reason for the difference and the evidence of actual costs provided to the UR. These costs are necessary to support the safe and effective operation of the business and are reasonable when compared with costs proposed to be allowed for FeDL and PNGL, therefore the UR needs to reconsider their position in this area.

Property Management

The UR has 'rolled medium term historic average costs into the GD23 period costs'. SGN NG do not agree with this historic average cost approach as costs were lower than normal in 2020 and should not be utilised as a basis for setting targets in GD23. In addition to this, SGN NG moved office location in 2018 from Belfast to Lurgan. Costs experienced in 2018 are no longer appropriate as they relate to the office space in Belfast. It is therefore important that they are removed from the calculation when determining the costs relating to the new office space in Lurgan. Instead SGN NG would expect that actual costs relating to the rent and building rates would form the basis of forecasting costs going forward.

Furthermore, since the Business Plan Template was finalised, SGN NG has experienced gas heating rate increases of 249%, as well as electricity rate increases of 50%. These costs should be considered within the UR assessment, and we request the UR allow greater flexibility for these costs for the GD23 period. These incremental costs would mean property costs increase from £95k per annum to £103k per annum.

A significant portion of property management costs relate to network rates. We note that at the end of GD23 that there will be a true up between actual network rates and the allowed networks rates within the Uncertainty Mechanism. SGN NG agree with this approach however, we request further clarity on what would be considered as taking 'appropriate actions to minimise valuations'[102]and how this will be applied in practice.

[101] SGN NG GD23-020 Detailed Business Plan Commentary
[102] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.90 pg 116

HR and non-operational training

The UR accepted the SGN NG projections for costs in this area within the DD. We do not expect that this position will change in the FD. If the UR believe it is necessary to revisit this area, we expect than suitable engagement would be facilitated in advance of any decision being published.

Audit Finance and Regulation

We disagree with the conclusion that have been reached by the UR's review of the FTEs requirements and rates allowed. The UR have determined the need for FTEs going forward based on the FTEs employed during 2020. As mentioned throughout this response SGN NG do not agree that 2020 provides an appropriate base year for FTE assessment as we faced a recruitment freeze as a result of the COVID-19 pandemic. Therefore 2020 FTEs should first be adjusted to reflect this before determining a suitable forecast for the GD23 period.

We further note the UR suggests that some aspects of the work that SGN NG undertake under this cost category may be similar to that undertaken by the other GDNs and that they have more FTEs, however the UR has assumed that some of the work in this area will fall under the MSA. It is also worth noting that while some of the work undertaken in this area is similar, in a smaller business such as SGN NG, there are also additional workstreams carried out in this area that are carried out elsewhere for other GDNs. The UR do not appear to have taken the breadth of the roles within this area for SGN NG into consideration when determining an appropriate level of FTEs.

In our business plan we also set out the need for £40 k/year[103] for Legal Fees, Stationary, Recruitment Fees and Audit Fees separated by line item, as well as £20k per annum for Consultancy resources. The UR has proposed to allow £7,844 per annum in the DD across these range of services, however, the UR have not provided any information in relation to how this determination is to be allocated. The application of 'medium term historical actuals' underrepresents the costs that will be incurred. SGN NG limited the amount of expenditure in its formative years (2018, 2019 and 2020) but recognises it needs these support services going forward into GD23. SGN NG requests that the UR review this determination from a bottom-up perspective.

SGN NG does not agree with the URs determined allowance for Price Control preparation support of £ 210k. We requested £ 400k to meet the onerous needs of a price control across many subject matters. As SGN NG is a much smaller business than the other GDNs in NI and as the UR has also recognised in paragraph 6.98 of Annex D, that other GDNs have more FTEs in this cost category, there is much less flexibility to undertake significant projects such as price controls. Therefore, the need for additional support is much greater where there is a smaller team to facilitate business-as-usual requirements alongside additional projects. SGN NG are mindful of the need for flexibility in this area given the experience of GD23 to date where there have been unexpected changes to timelines and additional publications which resulted in the need for additional resource and therefore costs at short notice. SGN NG provided detailed information to the UR to support its cost request for GD29 alongside this response.

Insurance

We are surprised the UR have concluded that insurance should be rolled forward from 2020 with direct building insurance and staff cost[104] rather than permitting a modest increase in insurance costs that would be anticipated with a developing network and growing company.

[103] SGN NG GD23-020 Detailed Business Plan Commentary, section 6.5.4, pg 128
[104] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.101 pg 119

This is inconsistent with the approach to procurement requirements where the UR have accepted the marginal increase in forecast. A reference to a single point of time estimate for a network that should be on a rapid growth trajectory at this stage of the business cycle will inevitably lead to insufficient allowance. We therefore ask that the UR review this DD to ensure that it appropriately accommodates the growth of the network, customer base and associated increases in staff and services

Procurement

In the DD the UR accept the position put forward within the SGN NG business plan. We do not expect that this position will change in the FD. If the UR believe it is necessary to revisit this area, we expect that suitable engagement would be facilitated in advance of any decision being published.

CEO and group management

As set out in section 5.2.2 SGN NG disagree with the conclusions that the UR have reached. In paragraph 6.111 of Annex D, the UR quote the GTTW applicant information pack which stated that *'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'.* The changes required in this cost category are not as a result of changes in structure or cost allocation from our parent company, instead they are as a result of external factors.

We note the UR has assessed the MSA on the basis that it includes the following support:

- Human resources
- Gas control and operational control centre
- Legal and compliance
- Finance
- Stakeholder Management
- Information Technology

While the UR specifically mentions the additional cost requirements requested under regulation for price control activity, it appears based on this assessment the UR did not review the costs associated with the additional areas also included under the MSA which include governance support in the areas of specialist procurement support, Board and non-executive support and costs relating to facilities and insurance. It will be necessary for the UR to consider these additional activities when reviewing this cost category for the FD.

We note the UR did not allow any support under the MSA for group regulation support in relation to Price Control activity as cost were also requested for consultancy support in the Audit, Finance and Regulation category. The additional costs under the MSA relate to strategic and governance activity that is necessary to support the price control process. We do not agree with the UR's approach that these costs are not necessary.

The areas of the MSA which have been subject to change since the time of the bid application in 2014 relate to IT where there has been a fundamental shift in concerns over and the protection required for cyber security, to protect against ransomware attacks and to comply with the Network and Infrastructure Systems (NIS) Regulations[105]. The high growth in cyber risk, the increasing sophistication of the actors and the social and political consequence of high-profile cyber events could not be anticipated at the time of the bid submission.

[105] In Northern Ireland the Department of Finance is the Competent Authority for electricity and gas, in the rest of GB Ofgem is the Competent Authority

SGN NG benefits significantly from the specialist support of the SGN group in this area, which could not be facilitated locally.

Similarly, the critical move to cloud-based operations and supporting our team to work from home full time could not have been anticipated at the time of the bid but was critical to maintain operations during COVID-19 lockdowns. The costs relating to COVID-19 and home working could not have been anticipated at the time of the bid and benefit from economies of scale through the MSA. The support of the SGN group meant that unlike many organisations, SGN NG were able to immediately adjust to the need to work remotely in March 2020.

In addition, we have experienced increased costs in relation of various regulatory projects such as the move towards decarbonisation, the future metering project, and the Consumer Protection Programme. The magnitude of these projects require significant engagement for SGN NG and were not foreseeable at the time of the bid application and were not referenced by the UR in the GTTW Applicant Information Pack. The multifaceted nature of these projects mean that additional support is required across almost all cost categories under the MSA.

Stores and logistics

SGN NG did not request allowances under this cost category.

5.4.3 Total Marketing Support

Advertising and Marketing Development (Owner Occupier)

Of the £7.8m requested in the business plan the UR is proposing an allowance of £2m. This represents a 74% reduction in allowances requested by SGN NG. This level of allowance is unacceptable and does not support SGN NG appropriately to promote and develop the network to build the customer base.

In the DD the UR set out the process that they went through[106] in reaching the decision to move to a cost to serve model. In this the UR identify that they have used a £150k allowance that was 'suggested' by PNGL[107]. There is no explanation about context of this 'suggestion' and it is our understanding following discussion that the assumptions on the appropriateness of this level of allowance have been taken out of context.

The UR then propose that a fixed amount of £125k is appropriate for SGN NG due to 'its size and scale'[108] however no analysis has been provided to support this conclusion. SGN NG do not agree with this assessment as while a correlation can be drawn between the size and scale of the SGN NG network and marketing and advertising activity required, the UR have reached the opposite conclusion to that which the evidence[109] we submitted suggests. We provided detailed information and customer evidence collected and interpreted by industry experts in our Consumer Engagement submission[110] which identified that 62% of the customer base did not know the name of the company responsible for delivering natural gas to their town. This evidence shows that it is necessary to focus spend in this area to raise the brand profile and increase consumer awareness of both the company and natural gas as a product.

[106] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.118 pg 122
[107] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.136 pg 125
[108] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.137 pg 126
[109] SGN NG GD23 – 028 Sales & Marketing paper
[110] SGN NG GD23-021 Consumer Engagement Paper, part 3, pg 10

We have provided further information in Part 4 to explain why the UR's proposal on Advertising and Marketing and the premature move to a 'Cost to Serve' Model is both unacceptable for SGN NG and does not represent the needs of consumers in the west of NI. Failure to address these concerns within the FD will severely impede our ability to grow the customer base in the OO sector of the market.

Advertising and Marketing Development (Non-owner Occupier)

SGN NG requested allowances of 6.15 FTEs in this area and an average of £217k to support the provision of incentive payments for small I&C customers.

The UR note that SGN's bid application did not include provision for incentive payments for small I&C customers. Instead, 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&Cs would avail of this offer. Our experience during GD17 has shown that this level of support for small I&C customers has been wholly inadequate to encourage these connections to the network. Recognising URs statutory duty to *'promote the development and maintenance of an economic and coordinated natural gas industry'* and the significant wider economic benefit that connecting small I&Cs as early as possible during the licence period brings to all customers on the network, SGN NG believe it is absolutely necessary to include an incentive regime to encourage connections in this area.

In annex D to the DD, the UR state:

> '*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.'*[111]

The UR also 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'*[112].

SGN NG have not forecast spending in this area as we have in as far as reasonably practical maintained allowances granted under GD17. GD17 allowances also included unrealistic and unachievable volumes as a result of the FMA study under a price cap regime, therefore there is no opportunity for SGN NG to achieve a return on an investment in this area.

SGN NG fundamentally disagree with the URs proposals in the DD. The UR should not risk the long-term sustainability of the network and the financial impact of the customer that have already connected based on an assumption made in 2014 that is clearly and demonstrably incorrect. Evidence of the impact of incentives on the I&C customer base is demonstrated in Part 4 – Volumes and Connections.

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111 https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.151 pg 128
112 https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-d-opex-detail.pdf para 6.152 pg 128

PART 6: CAPITAL INVESTMENT

Summary of response

- **The Basket of Works (BoW) approach, as proposed in the DD, is not appropriate for determining Capex rates for SGN NG.**
- **The layout / density of SGN NG towns is demonstrably different from those of other GDNs.**
- **Road categories, traffic sensitivity and public realm enhanced reinstatement are excluded from the BoW.**
- **Detailed spatial analysis has been carried out to determine the appropriate service lengths – the UR is incorrect in the assertion that SGN NG service lengths 'will fall back into line with the other GDNs as its development of the network continues'.**

The focus of GD17 is to build the network and to build the number of properties that had a commissioned gas network in their street so that they can connect. This will be successfully delivered, as set out in the GD17 plan with 327.1 kms of distribution gas mains to be successfully constructed by the end of this price control in December 2022.

In GD23 we propose to finish the main construction work in the 8 towns of the SGN NG licence with a further 153.6km of distribution network to be constructed.

In addition to this core delivery, however, we have also identified 9 towns and villages where the IP network either passes through or very close to. These are 'readily accessible' towns that would make gas available to a further 4,242 potential customers over 62km of network at a cost of £6.8m. We also identified and evaluated a further 5 towns and concluded they were not a priority to progress at this time.

Despite SGN NGs assessment to ensure the connection of the additional 9 towns would be cost effective, UR's provisional determination within the DD was that the completion of the additional towns was not in the consumers interests. This is disappointing for consumers in these areas given the gas main is already located in the area and they have already endured much of the inconvenience of traffic disruption to allow the mains to pass through their area. We consider that the URs economic appraisal is no longer appropriate as it does not take an appropriate view of future benefits and does not support the decarbonisation targets for NI.

6.1 Capex Rates

SGN NG has reviewed the proposals presented in the DD and appreciates the engagement meetings with the UR pre and post the publication of the DD.

6.1.1 Basket of Works vs Bottom-up approach

The UR notes that the GDNs developed their costs on the basis of a bottom-up approach, while the UR is proposing to continue with a Basket of Works (BoW) approach. The BoW approach combines areas of expenditure into a basket of work; however, this approach does not provide for a fair determination for SGN NG in GD23. The reason why the BoW approach is not appropriate is because the 'basket' does not take into account the important difference in work mixes and work environments – either their historical occurrence or future expectations. As such the BoW approach only has validity as a broad point of comparison across companies, unless appropriately calibrated to account for the differences between companies/work types/geography etc.

A clear example of the errors that arise as a result of a poorly comprised basket of works is the experience of SGN NG in GD17. Figure 6.1 shows the under/overspends up to the end of 2020 and that by the end of 2020 the cumulative overspend is £2.2m.

Figure 6.1 – BoW Under/(Over) spend 2017 to 2020

Under / (Over) Spend - Actual Spend v BoW Allowance*	2017	2018	2019	2020	2017 to 2020
Mains	(302,887)	153,662	(1,561,520)	448,751	(1,261,994)
Services	(86,610)	28,144	(248,677)	(63,073)	(370,217)
Meters	(48,905)	(14,317)	(549,984)	65,536	(547,670)
Total	(438,403)	167,490	(2,360,181)	451,214	(2,179,881)

*Impacts of UM/MT letter 28th April 2022 excluded

Over the course of 2021 and 2022, this trend is expected to continue. A theoretical BoW that generates such a significant loss over such a short period of time should call into question whether the BoW is working as intended and is an equitable basis on which efficient costs can be determined. It is SGN NG's position that the BoW is flawed in this respect and that it does not provide an equitable basis of comparison.

The prime reasons for the Under/Overspend are:

- Contract Rates – the rates in the BoW are based on averages across the GDNs. It does not take into account that each GDN has entered into specific contracts for their respective towns/builds/circumstances
- Road Categories – the category of the road has a major impact on the rates for installing mains and services
- Traffic Sensitivity – Traffic sensitive roads have working time restrictions applied
- Special Engineering Difficulties (SPEDs) – SPEDs are where the installation of the main presents special difficulties, outside the scope of normal, standard designs. Examples include river and culvert crossings.

Each of the factors that undermine the BoW will be examined further in the following sections. In the GD23 DD, the UR proceeds to make a number of requests from the GDN's[113]:

- Comment on any errors in the data used or proposals made in the allocation of costs and activities.
- Identify any further disaggregation of the basket of works which would improve the analysis and explain the rationale for this, providing any additional data necessary to support additional disaggregation.

[113] Annex F paragraph 3.76, pg 32

- Identify and explain any improvements in the ratios between the rates which would better reflect actual cost rates, recognising that in one rate will prompt a balancing change in other rates.
- Identify and quantify any company specific factors which should be considered in the application of the rates and, where appropriate, explain how these special factors were included in the historical capital investment used to develop the basket of works.
- Identify any areas where historical costs or activities might not adequately reflect future costs and activities and quantify the impact this would have on the company's estimated future costs.

These are addressed below where possible, however we note the UR advised[114] that sharing additional supporting information on the calculation of the unit rates would be provided, subject to GDN's agreement to share data. While SGN NG has agreed to this sharing of the rates, we understand that permission to share has not been received from the other GDN's. This lack of transparency makes it very difficult to make complete and detailed assessments on all of these points (although we accept that the UR is therefore not in a position to share the full supporting calculations).

6.1.2 Errors in the data used or the allocation of costs and activities.

"Comment on any errors in the data used or proposals made in the allocation of costs and activities."

As we have not had visibility on the way in which the basket of works has been compiled (as set out above this has not been shared across networks due to confidentiality issues) it is very difficult for us to determine whether or not there are specific errors in the data used or in the allocation of costs.

However, reviewing the basket of costs the following observations are apparent:

- We understand from our engagement with the UR that SPEDs have been included in the BoW. However, as the SPEDs incurred over the period 2017-2020 were for 315mm pipe, we believe that only the 315mm rate has been increased. SGN NG would like to engage further with the UR to incorporate SPEDs of different diameters installed in 2021 or to be installed in 2022.
- For mains, SGN NG will incur a loss on BoW rates for all diameters.
- For Small, Medium to Large I&C Services SGN NG will largely break even with the BoW rates.
- For Very Small I&C Services (U6) SGN NG will incur a loss on BoW rates
- For Domestic Services SGN NG will incur a loss on BoW rates

In summary, SGN NG will incur a loss of £2.0m for mains and £2.6m on services over the course of GD23 using the DD BoW individual rates. These are set out in figure 6.2 for mains expenditure which compares the DD allowance as set by the DD average band rate with the expenditure submitted with the BP. This gives a total variance of £2m, however the variance by diameter band varies by between 8% and 35% of the submitted allowance according to the work undertaken.

[114] Annex F paragraph 3.76, pg 32

Figure 6.2 – Projected BoW (Over) spend for GD23 mains

BoW vs Submission Mains Costs	Diameter	Metres	DD BoW Rate (£)	DD Average Band Rate (£)	GD23 Submitted Rate* (£)	DD Allowance (£)	Equivalent at Submitted Rate* (£)	Variance (£)
Mains	63mm	102,767	72.46	76.33	82.68	7,844,205	8,497,172	(652,967)
	90mm	26,795	78.68	76.33	100.78	2,045,262	2,700,458	(655,195)
	125mm	14,427	89.35	102.03	114.83	1,471,987	1,656,667	(184,681)
	180mm	7,961	111.65	102.03	156.03	812,261	1,242,171	(429,910)
	250mm	1,635	149.71	182.81	251.91	298,894	411,866	(112,972)
*Adjusted for rebasing of capitalised O/H		153,585				12,472,609	14,508,334	(2,035,725)

A similar comparison can be undertaken for Services in GD23, figure 6.3, and shows a £2.6 variance where SGN NG will be underfunded to do the work in GD23. The only positive variance is large I&C services that are typically bespoke (and as such less reliable) and have been delivered in GD17, therefore do not form a significant part of the GD23 plan.

Figure 6.3 – Projected BoW Under / (Over) spend for GD23 Services

BoW vs Submission Services Costs	Tenure	Quantity	DD BoW Rate (£)	GD23 Submitted Rate* (£)	DD Allowance (£)	Equivalent at Submitted Rate* (£)	Variance (£)
Services	OO	3,566	956.81	1,424	3,411,972	5,077,671	(1,665,699)
	NB	817	456.29	1,424	372,792	1,163,336	(790,544)
	SME P1	198	1,449.72	2,366	287,308	468,941	(181,633)
	SME P2	302	2,281.58	2,366	689,962	715,556	(25,594)
	Medium I&C	49	4,507.96	4,560	220,027	222,580	(2,553)
	Large I&C	7	8,950.13	4,560	59,118	30,122	28,996
		4,939			5,041,179	7,678,207	(2,637,027)

6.1.3 Disaggregation of the basket of works

"Identify any further disaggregation of the basket of works which would improve the analysis and explain the rationale for this, providing any additional data necessary to support additional disaggregation."

It should be noted that the BoW approach, focusses on averaging out road categories, traffic sensitivity and public realms elements across the GDNs - this despite there being clear differences between the proposed works to be carried out by each GDN.

Not taking into account these regional differences will unfairly discriminate against networks that have unavoidable costs due to the nature of the road space that they operate in.

It is our view that the basket of works needs to be further disaggregated by region according to the type of street that is being considered that are relevant to the area that the work is being delivered in. In our business plan we separated mains and services according to the distinctions that we see in the cost of delivery. These distinctions include:

- Road Categories – there are specific costs associated with working in different road categories. In our business plan submission, we categorised roads by NIRAUC categorisation with additional categories included for working in the footpath and unmade ground. Figure 6.4 below sets out the categories and the cost variance for one given diameter of pipe. Equivalent differences exist across all pipe categories and form the basis of our business plan submission. In our business plan we provided the full costed approach to defining these costs. If the UR are going to apply the BoW approach it is important to recognise these cost differences and the proportional cost variation created by each road type.

Figure 6.4 showing the road categories used to classify the mains and services that will be installed.

Road Categories	Source	Traffic Volume	Description	Cost £/m for 63mm pipe
Type 0	NIRAUC	Over 70,000 vpd	Generally, Motorways	n/a
Type 1	NIRAUC	Over 20,000 to 70,000 vpd	Very busy A Class and dual carriageways	82.03
Type 2	NIRAUC	Over 5,000 to 20,000 vpd	Busy A class / B class roads	82.03
Type 3	NIRAUC	Over 2,000 to 5,000 vpd	A Class and B Class roads	62.31
Type 4	NIRAUC	Up to 2,000 vpd	Quiet Residential Streets	62.31
Type 5	SGN NG	n/a	Footways	95.01
Type 6	SGN NG	n/a	Unmade Ground e.g. grass	51.42
Type 7	SGN NG	n/a	Open Trench	20.99
Type 8	SGN NG	n/a	Specialised Surface	n/a

For comparison purposes, Figure 6.5 shows the proportional changes in each rate for the different road categories – with Category 4 Roads acting as the relative starting point.

Figure 6.5 Percentage Variance of Mains Rates as charge by the contractor against Cat 4 by Mains Diameter

Low / Medium Pressure - Contract Rates						
Road Category	63	90	125	180	250	315
2	32%	31%	32%	32%	27%	22%
3	0%	0%	0%	0%	0%	0%
4	0%	0%	0%	0%	0%	0%
5	52%	51%	34%	28%	14%	10%
6	-17%	-18%	-24%	-27%	-23%	-25%
7	-66%	-66%	-65%	-62%	-49%	-49%
8	32%	31%	32%	32%	27%	22%

- Traffic Sensitivity – Our experience of operating in GD17 shows that there is typically an increase in the costs of delivering capital projects in traffic sensitive areas. These costs are incurred due to more regular mobilisation and demobilisation costs necessary to avoid sensitive travel times, and an increased cost associated with out-of-hours working. Analysis of the costs incurred in GD17, which was presented in the business plan[115] demonstrates a 20% increase in costs associated with carrying out works in traffic sensitive roads. In the BoW meeting[116] the UR requested visibility of this analysis, which is presented in Figure 6.6 below.

Figure 6.6 Cost breakdown for traffic sensitive roads

Project ID	Description	Standard Contract Cost (£)	Premium Payment for Sunday/BH Work or Night Works (£)	Assessed TS Uplift
G1701S01	Derry Road, Strabane	100,334	18,056	18.0%
G1805S01	Townview Avenue (1), Omagh	40,649	12,024	29.6%
G1805S01	Townview Avenue (2), Omagh	28,684	16,148	56.3%
G1904S02	Irvinestown Road, Enniskillen	75,694	8,749	11.6%
TOTAL		245,361	54,977	22.4%

- Public Realm – These are works that are completed in 'public realm' areas, where significant expenditure has been undertaken to improve the public appearance of an area and high-quality finishing and street furniture has been installed. This increases cost of both carrying out the project and remediating to the same high quality at the end of the project. In GD17 SGN NG has not directly interacted with these areas due to the advance planning work we were able to undertake. In GD23 we will need to work in these areas and our engineering judgement indicates that the costs will be 50% higher than a standard project. SGN NG understands the UR will have evidence gained from the other GDNs, who have carried out works in Public Realm areas, and would welcome engagement with the UR on this.

6.1.4 Ratios of rates

"Identify and explain any improvements in the ratios between the rates which would better reflect actual cost rates, recognising that in one rate will prompt a balancing change in other rates."

Our understanding of this statement is that the UR is suggesting that a change to any of the rates will result in a rebalancing of other rates to compensate. If one of the main laying rates is improved to ensure that SGN NG is benefiting, other rates will be rebalanced to reflect this. In other words, if SGN NG is projected to lose £2m on mains, rebalancing of the ratios will ensure that we continue to lose £2m.

On this basis, the issue with the BoW is not about rebalancing the costs between different categories, rather the overall costs do not reflect the expected outturn for SGN NG.

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115 SGN NG GD23-011 Detailed Business Plan Commentary
116 26 April 2022, Basket of Works meeting, SGN and UR

From the discussions with the UR regarding the use the BoW, the UR confirmed the use of averages across the three GDNs. From the outturns for SGN NG against the GD17 BoW rates, it appears that SGN NG rates are the most expensive of the three GDNs. There are many factors that have resulted in the rates for SGN NG being higher than for other GDNs, including but not limited to:

Scale of Works

By the end of GD17 SGN NG will have constructed circa 327km of mains and connected over 3,000 services. While this is a significant quantity of work it should be seen in the context that over the same period PNGL and FeDL will have completed circa 1,450km of main and 75,000 services.

Scale of works matter when securing a contractor as it permits the contractor to price risk accordingly – a large body of work provides headroom to permit the contractor to share its risk across a large turnover. The converse applies, when the body of work to be carried out is small, the quantity of work to share the burden of risk is smaller and will be priced accordingly. It is important to remember that the contractor will always price risk into a job – particularly on a contract where the Terms and Conditions are legally robust and the scope for additional Compensation Events is low.

The scale of works becomes a greater issue as we progress into GD23. The SGN NG Business Plan included 216km of mains, made up of 154km in the Core Towns and 62km in the Readily Accessible Towns, to be constructed. The DD has, by excluding the Readily Accessible towns, reduced this to the 154km. This represents a reduction of 53% in mainlaying activity from GD17 and will represent a reduction in turnover for the contractor. Despite this reduction of mainlaying turnover, the contractor will still need to retain the current management workforce levels in order to deliver the contract is a safe and efficient manner. This increased level of management costs will be priced into the next contract when SGN NG tender in 2023 and therefore this needs to be taken into consideration by the UR in the BoW rates.

Geographic Location

SGN NG has the largest geographical licensed area of the three GDNs, accounting for 42% of the NI area. However, it is the inverse relationship for both properties passed, and properties connected, as shown in figure 6.7 These combine to give by far the lowest density of properties. This low density of customers and properties passed will increase the contractor's rates as they will incur additional costs associated with greater travel times and distances to reach each customer location. SGN NG is unique in that it has four networks that each are geographically distant from each other - as a result this undermines any direct comparability between networks for a BoW approach without adjustments.

Figure 6.7: GDN areas

GDN	Area (km2)[117]	% of NI Area	Number of properties passed[118]	% of NI Area	Number of properties connected
SGN Natural Gas	5982	42%	15,583	3%	1,327
FeDL	5624	40%	158,516	30%	54,590
PNGL	1810	13%	350,711	67%	235,170
Non-Assigned	714	5%			-
Total	14130		**524,810**		**291,087**

[117] Areas derived from GIS datasets of GDN Licences and ONS Data for Northern Ireland
[118] Properties-passed and Connection numbers from the GD23 DD

The entire SGN NG has just circa 37km of motorway/high-quality dual carriageway. The remainder of the main roads are A and B class roads, so travel between towns/networks is slow and, arguably, arduous. With the exception of Omagh - which has a 'through-pass' - and Magherafelt - which has a very recently completed by-pass - none of the other towns in the SGN NG licence have been by-passed – there are no ring roads and traffic congestion is a significant issue.

While this poses some issues for the contractor in terms of mainlaying, it causes the biggest problems with service-laying. While mainlaying is carried out by self-contained gangs – JCBs, Grab Lorries, Welfare Units etc. – who are based in a given area for a sustained period of time, service-laying is driven by customer demand. The ideal methodology for services is to group services by geographic area to minimise travel, both for the teams carrying out the works and the support teams. By way of example, every service requires a grab lorry to assist with the backfill and reinstatement. A grab-lorry typically delivers fuel economy of just four miles per gallon, which adds significantly to service costs.

The relatively low numbers of connections that are available for SGN NG (fewer properties passed, delays to the availability of the HP/IP pipelines, COVID-19 etc.) severely limits the ability of the contractor to group services for construction and will ultimately be reflected in market rates.

SGN NG Contract Experience

It is also important to remember that SGN NG has been to the market twice for the distribution contract – the initial limited contract for Strabane (2017-2018) and the more comprehensive contract for the 8 towns (2019 to present). In both instances, the contract was award on the basis of the Most Economically Advantageous Tender (MEAT) and in both instances the current contractor was successful, providing rates that were lower than those from rival tenders.

SGN NG developed detailed bottom-up analysis for the projected works in GD23 and these formed the GD23 business plan submission. This was described in detail in ***SGN NG GD23-005 Infill Paper*** and ***SGN NG GD23-007 Mains Construction Contract*** provided as part of the supporting documentation for the business plan submission. The approach taken by SGN NG in developing the proposed costs for the business plan were further demonstrated during a BoW meeting held with the UR (26/04/2022).

In the DD response the UR identifies that "*The bottom up approach adopted by the GDN's could provide a reasonable estimate of costs, if it fully reflected the decision made and the opportunities available in delivery"*[119]*.* The UR then continues to note risks that this might pose to consumers in that the bottom-up analysis may not reflect truly efficient design and may not adequately reflect its specific costs or management costs.

SGN NG acknowledged and appreciated this concern at the time of the business plan submission. We also recognised that our costs would not be directly comparable with either other networks in NI or networks in GB because of the unique position that SGN NG are in as a developing network installing a new asset base.

Accordingly, our business plan gave a particularly high level of granularity about the proposed projects, their designs and their costs. This level of granularity should give the UR the confidence that the risks set out above and referred to in the DD have been suitably mitigated.

[119] para 3.20

6.1.5 Company specific factors

"Identify and quantify any company specific factors which should be considered in the application of the rates and, where appropriate, explain how these special factors were included in the historical capital investment used to develop the basket of works."

To demonstrate the difference between key towns and cities in each of the different licence areas SGN NG has carried out a detailed spatial analysis of the key towns and cities in each network that was presented to the UR[120]. This spatial analysis demonstrated the differences in property densities across each of the towns and between the different GDNs.

The overall property density in the SGN NG towns is 46% less than for PNGL towns and 35% less than FeDL towns (see figure 6.8). Property density is important as it has a direct impact on the length of mains per property passed and on service lengths – while on average the properties may be the same size, they are on larger sites which require more mains to pass and longer services to connect.

In Figure 6.8 below, we have set out the spatial analysis of 28 largest on-grid towns in NI and ranked them according to the property density (measured as properties per km^2). This analysis clearly demonstrates that the SGN NG towns are all at the bottom end of the range with regards to property densities. The one exception is Strabane which sits in the middle of the table.

Figure 6.8 showing the ranking of the SGN NG towns vs the other GDN towns

Town	Properties	Area (km^2)	Density (properties / km^2)	Density Ranking
Derry	32933	10.2	3226	1
Belfast	213313	95.3	2239	2
………				
Banbridge	7639	5.7	1332	16
Strabane	5611	4.2	1325	17
………				
Omagh	7870	6.8	1161	22
Coalisland	2371	2.1	1139	23
Magherafelt	3870	3.5	1091	24
Enniskillen	6153	5.7	1084	25
Holywood	6146	5.9	1033	26
Cookstown	5516	5.6	982	27
Dungannon	6241	7.1	883	28

As the BoW approach assumes an average number of services per length of mains, it will introduce a systematic bias in favour of networks with a higher population density and systematic bias against networks

[120] 26 April 2022, Basket of Works meeting, SGN and UR

with a lower population density. This clear difference undermines the value of the BoW approach, which penalises SGN NG disproportionately.

A point to note is that in the questions received after submission, the UR questioned why the mains were installed further from properties[121]. As explained in the response, and for the avoidance of doubt, the differences in distances of properties from the gas mains has in no way influenced the SGN NG using 2 bar mains rather than the other GDN's 4 bar mains and is entirely a function of the lower property density within the SGN NG towns.

6.1.6 Representativeness of historical costs or activities

"Identify any areas where historical costs or activities might not adequately reflect future costs and activities and quantify the impact this would have on the company's estimated future costs."

In the GD23 DD[122] the UR suggest that there is no evidence of a cost increase and therefore that they determined rates on the basis of actual investment cost between 2017 and 2020 and that it is reasonable to assume that any cost increases will be picked up by inflation and RPEs.

In our business plan we set out how we had agreed a fixed rate of costs with the contractor to protect ourselves, as far as reasonably practicable, from escalating costs over the GD17 period. This contract is coming to an end and the contractor will need to rebase their contracts according to today's market values. SGN NG has discussed the recent, unprecedented price increases being experienced by the contractor and the implications that these will have for rates with the UR and has secured permission from the contractor to share these commercially sensitive details with the UR.

To assume that these costs are fully covered by general inflation and RPEs is to attribute a level of accuracy to those indexes that does not exist in practice. Market costs for specific projects and workloads may diverge from those indexes and as such it is important to reset those indicators according to market evidence.

If this is not done, then there will be a compounding impact of inaccurate inflation and RPE forecasts over time that will establish either a significant shortfall (if they are underestimated) or gain (if they are over estimated). The current market evidence suggest that they will create a significant shortfall.

As identified in Part 12 – Frontier Shift, the inclusion of RPEs is one part of the setting of the GD23 allowances, however we strongly believe the current proposed indices are not adequately addressing the recent step change in the markets. To enable these step changes to be incorporated in the final allowance setting, the UR must update the indices to include the latest available data. The 2021 RPE should align to that of the actual RPEs experienced during the period with this information now being known. By updating the proposed RPEs for with the latest available data, this will enable 2021 to be reflective of the actual RPE experienced by the market. This should also feed into the revised long-term forecast enabling the recent step changes in the market to be partially reflected in the long term RPEs.

The upward trend in market prices has continued into the start of 2022, we therefore believe the UR should also consider the inclusion of the available 2022 indices, as there is a significant risk that the step changes being incurred in the market in 2022 will not be adequately addressed in the allowance setting nor were these step changes known at the time of the GD23 submission.

[121] SQ SGN-DD037
[122] Draft determination main document para 6.15 and Annex F Capital investment, pg 8

To adequately address the risks associated with the impact of RPEs to both SGN NG and the consumer, it is important that the UR consider the inclusion of an RPE true up mechanism to enable the outturn RPEs to be adequately reflected in the overall allowances received by SGN NG over the course of the GD23 price control. If such a mechanism is not introduced, aiming up in the forecasting of RPEs is required to align to current market expectations.

Within ***Annex-f-capital-investment***, the UR have identified that they deem the appropriate starting point for the determination of unit costs for GD23 is to revert back to the GD17 determination[123], the current methodology applied is to convert the GD17 unit cost by taking the movement between the December 2014 RPI indexation and the average indexation for 2020. We believe there is inconsistency in this approach and the UR should have instead used a consistent index state, being either the assessment of movement between a fixed month for both 2014 and 2020 or the average indexation in each respective year.

Taking the RPI indexation as presented in the Business Plan Data Templates, this inconsistent approach resulted in the lowest uplift against the other potential alternatives, including the alternative approach the UR identified within annex f[124], of which was disregarded without clear justification or reasoning. It is more appropriate to use the annual average index of 14.49% or to run between two comparable months (such as the December index of 14.72%)

Figure 6.9: Alternative indexation approaches

Year	2014	2015	2016	2017	2018	2019	2020	2014-2020	Nature of assessment
Average Index (SGN, FE)	256.0	258.5	263.1	272.5	281.6	288.8	293.1	**14.49%**	Mvt of index
January Index	252.6	255.4	258.8	265.5	276.0	283.0	290.6	**15.04%**	Mvt of index
September Index (PNGL)	257.6	259.6	264.9	275.1	284.1	291.0	294.3	**14.25%**	Mvt of index
December Index	257.5	260.6	267.1	278.1	285.6	291.9	295.4	**14.72%**	Mvt of index
Alternative approach identified in Annex f								**14.29%**	Dec '14 vs Sept '20
UR adopted approach								**13.83%**	Dec '14 vs average '20

The approach is also inconsistent to that which was suggested by the UR at the meeting held with SGN NG on the 6th May 2022, whereby it was implied that the UR would look to inflate the 2014 costs to a 2023 position using RPI inflation, being the end of GD17 and convert back to the appropriate base period using CPIH, being the relevant indexation to be used for the GD23 price control.

The current approach penalises the GDNs by not adequately adjusting for the movements between the two time periods. The UR must revisit this approach to ensure the GD23 cost basis is consistently adjusted for inflation and the cost basis set addresses the growing market pressures faced.

123 Annex-f-capital-investment.pdf paragraph 4.19
124 Annex-f-capital-investment.pdf paragraph 4.19

6.2 Approach to capital expenditure

The basis of the business plan submission has been to detail the works to be carried out and to cost these as accurately as possible. The costs have necessarily been based on tendered rates and the provisions within the current contract. The analysis and processes undertaken by SGN NG in developing the business plan submission mitigate, as far as reasonably practicable, the risks identified by the UR in paragraph 3.71[125].

6.2.1 Efficient design choices, cost allocations or opportunities for cost saving in delivery

The design of the network that SGN NG is proposing is in line with company (SGN) procedures, underpinned by IGEM Recommendations and in accordance with the relevant legislation. The pipe diameters are based upon hydraulic models with the routes determined by a combination of geography, access, other utilities etc.

Costs are built up on the basis of pipe length, pressure tier, pipe diameter, road category, traffic sensitivity and public realm reinstatement. These individual elements have significant impacts on costs and are detailed in the SGNNG-GD23-005 Infill Paper.

6.2.2 Site specifics such as disruption and standing time, difficult ground conditions or restrictions on access, traffic management and the need for weekend working.

SGN NG has produced detailed designs as part of the business plan submission (as outlined in SGNNG-GD23-005 Infill Paper). These designs incorporate the latest road categories for reinstatement, the latest traffic sensitivity designations from the Department for Infrastructure and the areas where public realm enhanced reinstatement has been carried out. Each individual piece of pipe to be built in GD23 has been tagged with the corresponding road category, traffic sensitivity and public realm statuses. These workings have been shared with the UR and the unit costs of the work, when disaggregated to this level, should have a level of comparability across different network areas. The volume of works allocated to each category will vary according to region.

The GIS models that the company has developed for the mains and services, which incorporate the as-built pipe information and the proposed new pipe data, were used to assign key tags to each property that will be passed over the course of both GD17 and GD23.

These tags included road category, traffic sensitivity and public realm reinstatement status and were loaded into the corporate asset register. This data was then used to generate weighted averages for connections, incorporating the costs associated with each type of tag. This ensures that the key risk identified by the UR of Site Specifics associated with traffic management etc. is mitigated.

This granular level of designs demonstrate that the extent of each element has been identified and can be fully audited and appraised. This approach should be applied to both mains and services, as is the case in the SGN business plan.

[125] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-f-capital-investment.pdf

Figure 6.10 Sample map with road categories

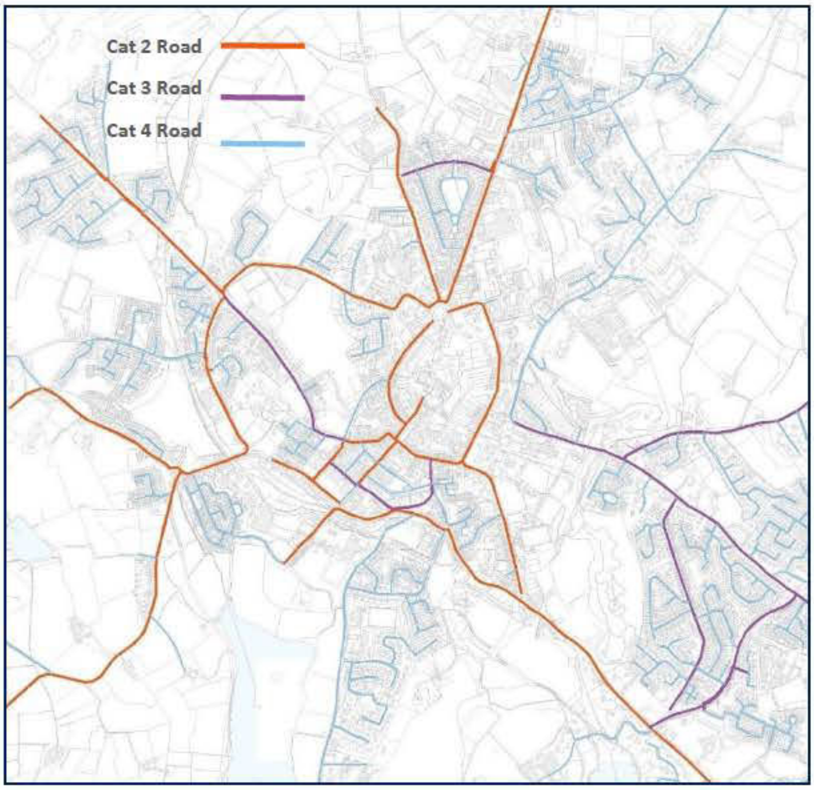


Figure 6.11 Sample map showing traffic sensitive streets

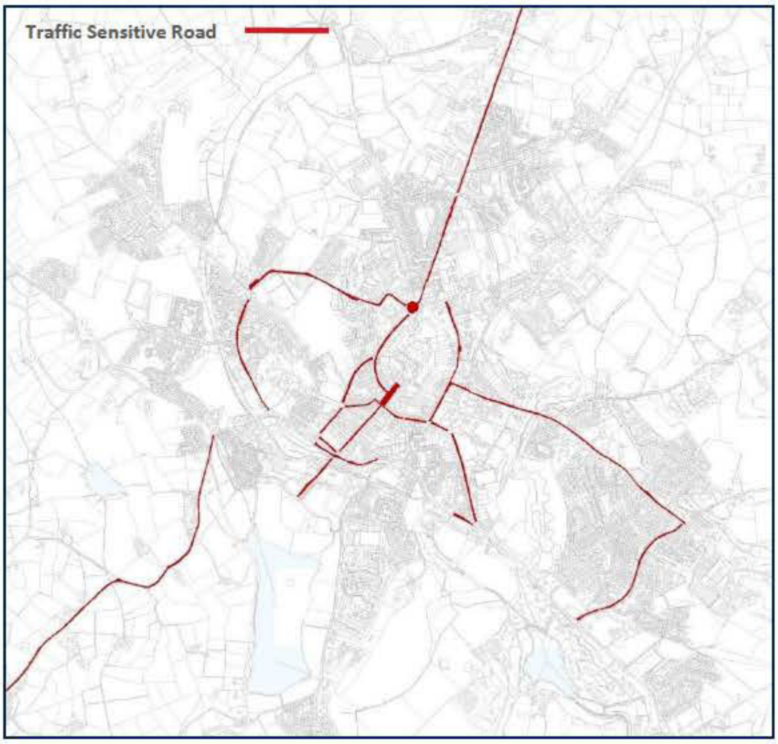


Figure 6.12 Sample map showing road categories and associated properties

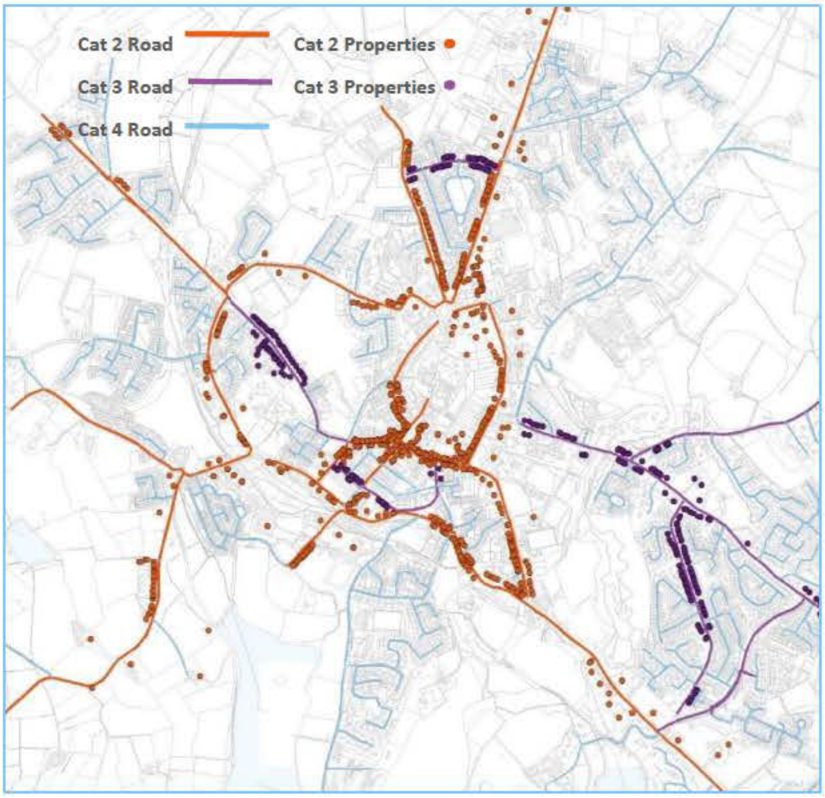
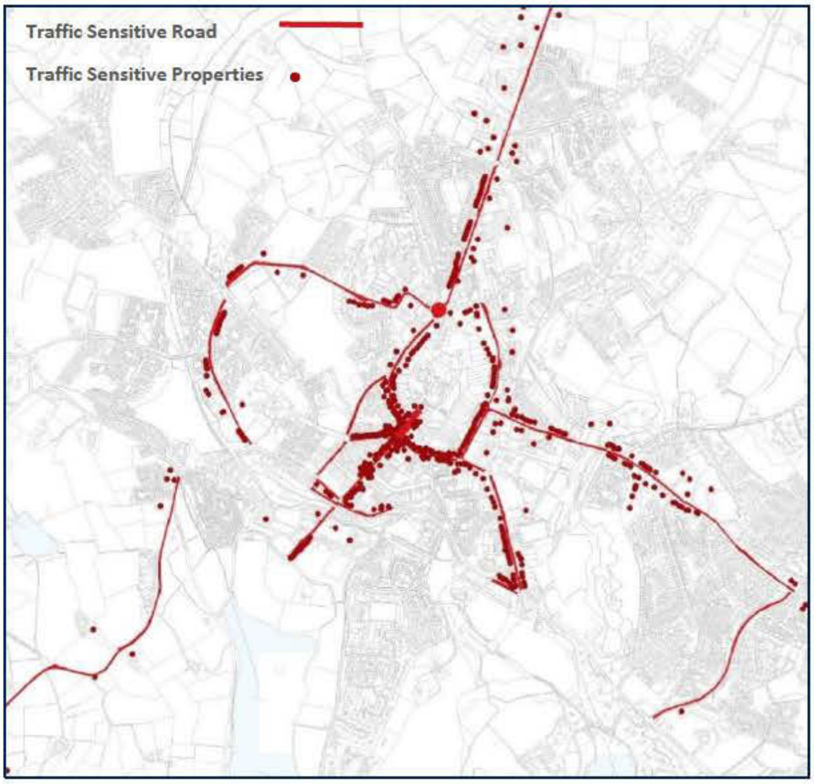


Figure 6.13 Sample map showing traffic sensitive streets and associated properties



6.2.3 Reflection of general items such as management costs

SGN NG understands this to mean the capitalised management costs, both contractor and company, that are capitalised. The style of contract that SGN NG operates incorporates management costs within the individual rates. The current management resource in operation with SGN NG's contractor is extremely efficient. The minimum level of management resource is maintained regardless of workload, which additional resource brought into the contract as and when the individual projects require it. For example, the Lough Erne Crossings carried out in 2021 required an additional, dedicated supervisor who was brought in for the specific crossings and moved out when the work was completed.

The scale of works has an impact on management costs. This applies to both the contractor and SGN NG direct staff. As described in 6.1.4, the reduction in mainlaying in the move from GD17 to GD23 will not result in a reduction in the management costs for the contractor. The reduction in the work levels proposed in the DD, through the exclusion of the Readily Accessible towns, will result in a proportional increase in the management element of the mainlaying rates when the contract goes out to tender and also increase the Capitalised Overheads element of the SGN NG rates. This will also need to be reflected in the BoW rates.

6.2.4 Reflection of performance against commercial terms such as pain-gain payments.

The SGN NG contract was established to deliver the main GD17 construction project. It was agreed at fixed unit rates that would minimise the risk of price escalation and overspending the allowances. As such it does not contain commercial terms such as pain-gain payment and therefore the risk of additional costs during that period are not borne by the consumer and neither are the additional overhead costs of managing the variations through a complex and often contestable pain-gain mechanism.

It should also be noted that the award of contract within SGN NG is carried out following strict procurement guidelines. The current contract was award on the basis of the Most Economically Advantageous Tender (MEAT), ensuring the correct balance between quality / safety and cost. It is important to remember that the contractor is constructing a network for the purpose of carrying a fuel and that quality and safety must remain the paramount consideration over short-term economic wins.

6.3 Properties Passed

We disagree with the proposed properties-passed target set out in the draft determination[126]. This appears to be calculated on the basis of the average number of properties passed rather than the actual number of properties passed.

As set out in section 6.1, the actual properties passed in the west of NI is significantly lower than other regions of NI and to therefore use an average rather than actuals (which have been calculated and the calculation shared with the UR) will impose a direct penalty on SGN NG. In the DD the UR propose a penalty for a property that is not passed of £50 per property[127]. With a properties-passed target that is 800 properties higher than actual properties passed that will impose an unjustified cost of £40k on SGN NG.

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[126] para 3.20)
[127] Para 3.21

6.3.1 Economic project mechanism

We recognise that this may provide an appropriate mechanism through which we may bring back the 9 'Readily Accessible Towns' to UR for reassessment and the further five towns that we previously determined were not at an appropriate stage of development to progress through the GD23 price control at that point in time. We will work with UR along the process set out in para 3.26 to submit these projects.

6.4 General Approach by investment categories

6.4.1 Resilience Mains

SGN have not made a submission for 7 bar, 4bar or 2 bar mains. As such we have no comments to make on the points raised in this section regarding costs. Within the draft determination, however, the UR identify the notification that we provided regarding two resilience projects that we may submit in 2029 and suggested that consideration needs to be given in laying out the network regarding IGEM standards[128]. Local resilience is designed into the network in line with the guidance provided, and referred to by the UR, by IGEM. This is standard practice for SGN NG, and one assumes for the other GDN's.

In the business plan submission, SGN NG identified a number of areas within the network where resilience could be improved. These projects would be significant in terms of construction and, based on the current phase of the SGN NG network development, not required in the short or medium term.

We recognise and agree with these IGEM standards which state that "consideration should be given" - one of the considerations is the cost and the risk mitigated as a result of that expenditure. This calculation can be improved with greater information and with an understanding of other benefits that could be delivered. As such, a design that may not be appropriate to commit to at the outset of the project, due to information uncertainty, may become appropriate as information quality improves.

To set out to do all the work at the outset, without confidence in the underlying benefits case, could lead to the accusation of 'gold plating', something that the UR has clearly been keen to avoid in the past.

We accept the position the UR has set out in the DD - the reason this was identified in the business plan as we consider there may be a point of re-evaluation during GD23 in anticipation of GD29 which we may want to discuss with UR. We would be looking to keep that opportunity for discussion open and SGN NG welcomes the suggestion of setting up a Resilience Working Group whose membership should extend beyond that of the economic regulator and include stakeholders such as the Department for the Economy and other stakeholders.

6.4.2 Infill mains

In the DD UR has decide to apply the same approach to SGN NG as Phoenix requested – to roll forward the GD17 previous decision – and to roll forward the GD17 BoW rates to the GD23 period. The UR are of the view that this will give SGN NG the flexibility to prioritise without putting SGN NG at a disadvantage[129].

[128] Para 4.4 and para 4.3 page 36.
[129] Para 4.21, pg 39

This methodology uplifts the 2014 GD17 average rates by 13.8% to reflect the move to 2020 base year prices. The same rate of uplift as applied to the other networks. As set out in section 6.1.6 the correct adjustment should be 14.49%.

While in theory this corrected uplift would be acceptable, it assumes that the rates that were applied in GD17 were correctly calibrated. This was not the case. Rather for the reasons we have set out in section 6.1 (the lower density of properties, the different street types etc) these 2017 rates are not accurate and do not reflect the costs of actual work undertaken in GD17.

We do not understand how this conclusion is arrived at – we would welcome engagement with the UR to further clarify this point.

Length of main per property passed

In the DD, the UR have proposed a length of main per property passed of 11.5m / property. Over the course of GD17 the average rate per property will outturn at 12.06m / property. The designs for GD23 indicate that this will increase slightly to 12.09m / property. As discussed in 6.1, the towns within the SGN NG licence have a lower property density than those of the other GDNs. The designs prepared by SGN NG are efficient and in line with the appropriate IGEM guidance. The length of distance between properties is fixed by reality and is not something that is within SGN NG's ability to influence and, accordingly, the length of main per property passed should be adjusted to 12.09m / property.

6.4.3 Infills at readily accessible towns

As a part of our business plan SGN NG identified nine readily accessible towns. Our assessments suggested that these would be cost effective, and we continue to support their delivery.

As previously stated, we presented a package of 9 'Readily Accessible Towns' to the UR as part of our Business Plan Submission. These Towns were rejected on the basis of a re-assessed economics evaluation once further Opex, at the request of UR, was added.

It should be noted that this economic assessment is incomplete and only captures the direct economic costs and savings associated with the proposed extension. A complete economic assessment would include the direct and the indirect costs and benefits associated with a public expenditure project. If the guidance as set out by HMRC[130] is followed in an appropriate manner, then the long-term economic benefit of reduced carbon dioxide emission should be considered as an integral part of the assessment process[131].

By not including the appropriate cost of carbon[132] UR risk creating a distortion between the basis on which a policy is assessed and justified (which includes the cost of carbon) and basis on which the delivery of that policy is then implement through the regulatory structures that govern investment (which doesn't consider the cost of carbon). This in turn risks undermining public policy appraisal and introducing inefficient investment options.

We have reassessed the resubmitted[133] economic test with the inclusion of the impact/savings that would be achieved by converting consumers from oil fired boilers to natural gas fired boilers[134]. The saving in carbon as a

[130] https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent/the-green-book-2020
[131] https://www.gov.uk/government/publications/valuing-greenhouse-gas-emissions-in-policy-appraisal/valuation-of-greenhouse-gas-emissions-for-policy-appraisal-and-evaluation#annex-1-carbon-values-in-2020-prices-per-tonne-of-co2
[132] The cost of carbon and other economic and health benefits are fully considered within the Ofgem CBA process.
[133] Submitted as part of the response to SGN-003A as part of the Business Plan Submission query process
[134] How Northern Ireland is progressing to net zero - Energy Saving Trust

cash equivalent value was then added to the analysis as a positive cashflow prior to discounting for net present value purposes. This results in the following summary:

Figure 6.14 NPV Assessment of Readily Accessible Towns

Readily Accessible Towns - Net Present Value Assessment	
NPV to 2057 Business Plan Submitted £ (Revised)	(592,617)
NPV to 2057 £ (including Estimated Carbon Savings)	25,580,871

Clearly and appropriately, the consideration of carbon in assessing the economics accounts for the significant environmental benefits that can be achieved through conversion to a natural gas fuel source.

In this instance, the calculations were performed using the central rate value of the HMRC[135] published carbon rates of £240 / tCO2e and our analysis shows that a flat rate less than £10/tCO2e is required to 'breakeven' in the 9 'Readily Accessible Towns'. It is worth noting that even at the low-rate value published, the minimum value placed per Tonne of carbon, in any given year, is £126/tCO2e (£2020).

We look forward to engaging with UR in the area over the coming weeks to ensure consumers in NI receive the appropriately appraised investment proposals.

6.4.4 New build mains

As discussed in section 6.4.3, the use of 9.5m / property for mains is restrictive and not reflective of the overall mainlaying achieved in GD17 or projected for GD23 (12.06m / property and 12.09m / property respectively). As set out in 6.1, this is a function of the property density of each of our towns and it is not appropriate that SGN NG is targeted with improving on something that it cannot influence e.g., the size of properties, the property density etc.

6.4.5 Pressure Reduction

We understand the UR's logic in this area. For the avoidance of doubt, it was not the intention of SGN NG to claim a second time for this work.

Nevertheless, SGN NG acknowledges the UR's proposal to allow the continued use of the capex roller mechanism through GD23 for these installations.

[135] Annex 1 - Valuation of greenhouse gas emissions: for policy appraisal and evaluation - GOV.UK (www.gov.uk)

6.4.6 Domestic Services

In the DD[136] the UR note:

'…the rate for existing property services in the business plan submissions is materially higher than the outturn unit rate'.

While SGN NG is not in a position to comment for the other GDN's, in our case there are a number of factors that are instrumental in increasing the rates:

- Incorporation of traffic sensitivity / road categories / public realm reinstatement
- Expected Contractor Rate Increases
- Service lengths

SGN NG would welcome further engagement with the UR to determine appropriate rates for GD23 in light of these factors.

6.4.7 Meters

Overall, we see that all meters are broadly covering the costs of instalment and accept the values set out in the DD.

6.4.8 Other Capex

SGN NG submitted plans to invest £300k over GD23 in the following areas:

- Switching and siteworks system
- Upgrade Microsoft Dynamics CRM
- SGN NG Website

SGN NG acknowledges that the UR has awarded these costs in the DD and would request engagement with the UR if there are any changes proposed for the FD.

6.5 Expected Contractor Rate Increases

SGN NG highlighted in the business plan submission that we will be retendering the current contract early in GD23. We highlighted some of the cost pressures that will impact on both mains and service rates, including elements for reduced turnover and allocation of overhead, training costs, red diesel tax relief, fuel cost and increased number of other services in footpaths.

We note in the DD[137] that the UR acknowledges the SGN NG red diesel tax relief and '..have not accounted for this in the draft determination as it is equivalent to a 0.08% increase for PNGL which we consider to be below the resolution of the calculations we used to set the basket of works unit rates.' We have two observations at this point:

- We fail to see the relevance of PNGL rates to SGN NG in this instance and request that the SGN NG submission is assessed on its own merits.

[136] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 3.39
[137] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 3.46

- As a general point, while some rates may seem small in isolation, when aggregated over the full capex request, they can have material impacts. Disallowing isolated 'small' amounts on an individual basis may have little impact in isolation, when aggregated they can have the impact of 'death by a thousand cuts'.

We note as well that much focus in the DD was on the red diesel tax relief, minimal consideration appears to have been given to the other elements, including labour pressures, that SGN NG highlighted as impacting on expected contractor rates.

It should also be noted that subsequent to the submission of the business plan in June 2021, significant geopolitical upheaval has occurred. At the time of writing CPI is running at 9%[138], with additional market specific forces greatly affecting our contractor. As discussed with the UR over the last months, the contractor is experiencing significant cost increases above the CPI level. These have included the red diesel issue already discussed, materials costs and labour costs. In order to maintain construction, SGN NG is in contractual discussions with the contractor regarding an above CPI increase in rates.

This will mean that the costs in the business plan have radically altered. SGN NG has significant concerns that this will lead to rates being determined that will, in effect, result in a cut from the current rates when GD23 beings. SGN NG would welcome further engagement with the UR to identify appropriate mechanisms for managing these unprecedented price rises / cost pressures.

[138] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/april2022

PART 7: ENERGY STRATEGY, INNOVATION AND INCENTIVES

Summary of response

1. **The GD23 DD misses the opportunity to support customers in the west of NI move away from more carbon intensive fuels and to open up the opportunity to deliver net zero through the newest network in NI.**
2. **The mechanism being proposed to support the delivery of biomethane risk being cumbersome and discouraging investment in new sources of green gas. The process needs to be tightly defined in terms of the approval process prior to investment.**
3. **The fact that no network has looked to utilise the innovation structure implement in GD17 would point to a question about whether the regulatory structure implemented is the barrier to projects progressing. We do not see why it is more likely to be used in GD23, and this represents a missed opportunity for GD23 and the consumers of NI**

7.1 Energy Strategy

Our GD23 Business Plan proposal set out an ambitious plan to support customers in the west of Northern Ireland (NI) to immediately move away from more carbon intensive fuels, such as heating oil, and support their transition to green gases such as biomethane or hydrogen in the longer term. SGN NG welcome the opportunities that the Energy Strategy will bring for decarbonisation in NI and recognise the fast pace at which GDNs must operate in order to find the necessary practical solutions to achieve net zero carbon.

We operate the most recently built network in NI. Our network was designed and constructed in a manner that makes SGN NG uniquely placed to transition our customers from natural gas to hydrogen or biogas. Our business plan set out how we proposed to facilitate this transition by supporting the development of these two net-zero fuels. We are disappointed that in the DD, the early initial steps towards this, which were set out in our GD23 business plan have been significantly scaled back by the UR. It is our view that this decision is out of step with the broader policy environment and a missed opportunity to promote a leading low carbon economy in the west of NI.

The UR note in the DD that the NI Energy Strategy highlights the intention to utilise modern gas infrastructure and the potential to generate and import zero carbon gases as a means of decarbonisation. This conflicts with the UR 'Cost to Serve' proposals, which by the URs admission will result in fewer connections to the gas networks.

Specifically, with regards to the energy strategy, the provision of allowances for 1 FTE with salary that does not reflect the specialist nature of this role and a ringfenced Uncertainty Mechanism that requires prior approval of each project[139] falls short of supporting this ambition.

[139] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-g-energy-strategy.pdf para 5.8 pg15

Ringfenced Uncertainty Mechanism

During GD17, SGN NG was able to have a material impact in supporting the policy development surrounding the connection of biomethane by utilising specific people in the GB market with specific knowledge and experience of biomethane who were able to apply it to the NI market. As the NI biomethane capacity builds and potential for biomethane injection into the NI gas networks is realised, it is important that there are skilled representatives available locally to work with NI customers, ensuring that local solutions for delivering biomethane are implemented. This technical stakeholder need cannot be delivered effectively from the GB market in an unfunded manner.

The UR note that GDNs are key stakeholders and contributors in facilitating development of decarbonisation solutions and that work is currently underway to facilitate the injection of Biomethane. This needs to be appropriately funded if biomethane injection is going to deliver to its potential, and the DD does not provide appropriate allowances. The UR's proposal is that

> *"The GD23 draft determination does not make any allowance for future costs to support the decarbonisation other than the additional staff described above. We will consider the annual submissions the GDNs make in respect of additional costs relating to the implementation the Energy Strategy and the decarbonisation of gas and make provision for costs we determine to be necessary and efficient through the GD23 Uncertainty Mechanism."*[140]

It is therefore our understanding from the DD and supporting Annex that it will be necessary to seek prior approval for each project under this mechanism and where approval is granted it will be subject to further scrutiny as part of the annual cost reporting process. This raises a number of concerns.

Firstly, given the nature of these projects and the pace at which they must evolve, the length of time which it has historically taken the UR to review will add a significant delay and risk to the project delivery. This will make the difference between projects going ahead and investors taking the decision to undertake them elsewhere. For this reason, we suggest it is absolutely necessary that a clear commitment is made in which projects will be reviewed is put in place for GD23 and that this should be as streamlined as possible to avoid being a barrier to investment.

Secondly, the review of costs relating to projects already delivered should only be undertaken where there is a material difference in those which were agreed in advance of the project. Detailed reviews of costs which do not substantially differ from those agreed in advance will result in an unnecessary duplication of workload for both the UR and GDNs and there is a cost associated with this.

Thirdly, we consider the proposal for a ring-fenced Uncertainty Mechanism as set out in the DD to be too vague to support additional expenditure on implementing the energy strategy. It is important that the UR provide much greater clarity on the costs that will be considered and the process in which the costs will be considered necessary and efficient. SGN NG's recent experience of presenting valid requests for additional costs to the UR under the GD17 Uncertainty Mechanism has shown that the Uncertainty Mechanism process as currently operated by the UR cannot be relied upon and that the UR are not willing to consider the evidence presented.

SGN NG therefore request that the UR provide greater clarity on this process to formally document what the UR classifies as business as usual and what activities would actually be awarded under the proposed ring-fenced Uncertainty Mechanism, the process through which the assessment will take place, and the process

[140] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.34, pg 14

through which any disagreement will be appropriately considered. Greater clarity in this area would help to restore trust in this process and is necessary to ensure that the required level of support is provided.

SGN NG simply cannot commit to undertaking projects during GD23 where there is uncertainty from the UR on the allowances under the Uncertainty Mechanism and face similar losses to those imposed by the UR during GD17.

Decarbonisation Analyst

The UR have provided allowance for one Decarbonisation Analyst. Based on the amount allowed under this allowance it is evident that the UR have not considered the information SGN NG submitted in relation to this role in August 21. It is also clear that the UR have not fully understood the complexity and the specialist nature of this role as the suggested allowance is not in keeping with the salary expectations for similar roles in the market including the Analyst roles recently recruited by the UR to support decarbonisation[141]. We estimate that the allowance for the decarbonisation analyst role proposed within the DD is 11% less than the lowest point of the UR published salary for a similar role (following adjustment for NI contributions, pension etc).

We consider it necessary for the UR to address this issue in the GD23 FD and provide a realistic allowance for the Decarbonisation Analyst, which is reflective of the requirements of the role and market rates for similar roles. Without this support it will not be possible for SGN NG to react to changes in policy at the pace which is required to achieve the overall targets for NI.

7.2 Innovation

We note the UR's view that innovation should be incentivised through the price control framework to reduce costs and improve outputs. As a new network we have clearly looked to build in efficiency and innovation into the model from the outset in order to meet the extremely challenging operational allowances that we were awarded in GD17.

As an organisation we embrace opportunities to deliver innovation and recognise the importance of continually improving what we do to provide value to our customers. We also recognise that the energy industry is changing fast as we prepare to transition to net zero and it is crucial SGN NG is supported with suitable innovation funding to overcome the challenges we'll face and to deliver great benefits for our customers and the wider NI economy.

Within the supporting annex to the DD, the UR state that during GD23 the approach to innovation will follow the innovation principles outlined in GD17 and that they *'welcome innovation initiatives from the GDNs, where reasonable and economically efficient.'*[142]. The UR further acknowledge that to date they have not received any submissions from any GDNs during the GD17 period.

It is evident from the DD that each GDN is keen to contribute to the area of innovation, therefore it raises the question as to why the UR have not received any requests for funding to date. SGN NG would welcome further engagement in this area to understand the factors which are influencing the use of this funding mechanism, which appears to have been ineffectual during GD17. Maintaining the status quo in relation to innovation funding during GD23 is likely to yield the same results as GD17 and it will be important to address this within the FD.

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[141] https://www.uregni.gov.uk/regulation-analysts-x-6
[142] https://www.uregni.gov.uk/files/uregni/documents/2022-03/annex-h-incentives-and-innovation.pdf para 2.6 pg4

7.3 Incentives

Connection Incentive

The impact of removing the connections incentive and its replacement with the 'cost to serve' approach has been discussed extensively in Part 4 – Volume and Connections.

Properties Passed Mechanism

The properties passed mechanism is intended to incentivise GDNs to continue to extend the network. The UR has proposed to retain the properties passed mechanism which is being applied for GD17 in GD23. This mechanism includes a target number of properties passed and failure to achieve the target results in a penalty of £50 for every property below the target. Passing a larger number of properties than the target would result in a reward of £20 per additional property over the target.

Further to this the properties passed mechanism is applied on an annual basis subject to the condition that an annual penalty will not be applied where cumulative performance is ahead of target in that year and an annual reward will not be applied where cumulative performance is behind target in that year. The reason for this is to ensure the mechanism targets sustained delivery.

During GD17 the application properties passed mechanism disadvantaged SGN NG due to circumstances which were beyond our control. The delay of the HP and IP pipelines lead to SGN NG not being able to meet cumulative properties passed targets during the year 2017 to 2020. The asymmetric nature of the properties passed mechanism during GD17 unfairly penalised SGN NG as a result. While we support the inclusion of the properties passed, we believe the penalty should be symmetrical with the reward.

Price Cap

As set out in the DD SGN NG currently operates under a price cap price control regime and this is proposed to continue into GD23 on the basis that it provides a strong incentive to connect new customers at the early stages of the network[143]. This is the position that SGN NG supported in its business plan on the basis of the connections incentives and marketing strategy proposed within that plan. Under the connection volumes proposed in the DD the price cap will be set on an inflated estimate of the volumes of connections and hence the volume of gas we are likely to transport. If those connections, and therefore volumes, cannot be delivered, then we will not secure the revenues necessary to enable us to undertake the activities set out in GD23. Due to these flawed inputs, we do not have confidence that a price cap regime would provide a valid regulatory structure for the operation of a distribution network. It is essential this issue is resolved.

[143] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 2.9, pg 9

PART 8: STAKEHOLDER AND CONSUMER ENGAGEMENT

Summary of response

- **At SGN NG, stakeholder involvement guides, supports, and enables everything we do. It helps us ensure our plans meet customers' needs and expectations and drives improvements through efficiency, innovation, excellence in customer service, while working in partnership with local communities and suppliers. We believe effective engagement comes from working directly and collaboratively with all our stakeholders.**
- **We recognise the importance of developing arrangements to ensure that consumer needs in this area can be appropriately met and that suitable monitoring arrangements are also developed. We are keen to ensure that any requirements that are put in place are proportionate to the company and network size, that consideration to the stage of development is included in decision making and that there is flexibility in the arrangements to ensure that they can evolve as consumers needs do.**
- **As an organisation we are committed to ensuring the needs of all our consumers are met and we proactively develop a culture which ensures that our people are empowered to make decisions. This means we provide the training and resources to ensure that our people have the tools they need to develop in this area.**

8.1 Stakeholder and Consumer Engagement in GD23

At SGN NG, stakeholder involvement guides, supports, and enables everything we do. It helps us ensure our plans meet customers' needs and expectations and drives improvements through efficiency, innovation, excellence in customer service, while working in partnership with local communities and suppliers. We believe effective engagement comes from working directly and collaboratively with all our stakeholders.

In the creation of our business plan, we have engaged with all the groups below as well as with stakeholders that represent the interests of specific groups of customers.

During the GD23 period we will continue to engage with these groups of customers that we directly affect and will also regularly review this list to assess whether there are additional customer segments not sufficiently represented in the categories below.

- Future customers;
- Domestic customers;
- Small and medium businesses;
- Large gas users, industrial and commercial;
- Customers in vulnerable circumstances;
- Hard to reach customers;
- Members of the public;

Figure 8.1 Customer group and insight gathering

Customer Group	Insight gathering
Future Customers – Domestic	Contact centre interactions Satisfaction surveys Quantitative and qualitative research Monitoring of enquiries and complaints Bi-lateral discussions (face to face and remote)
Future Customers - Commercial	Contact centre interactions In depth bi-lateral engagement (face to face and remote) Engagement with representative groups
Customers in vulnerable circumstances	Contact centre interactions Satisfaction surveys Quantitative and qualitative research Monitoring of enquiries and complaints Bi-lateral discussions (face to face and remote) Engagement with representative groups
Hard to reach customers	Quantitative and qualitative research Engagement with representative groups
Connected customers	Contact centre interactions Satisfaction surveys Quantitative and qualitative research Monitoring of enquiries and complaints Bi-lateral discussions Engagement with representative groups

To continue to evolve our research methods and make best use of all available insight, we will develop our research and analysis expertise with an in-house team and consult with external experts to gain additional insight and challenge. We will also continue to engage with our direct customers who have experienced our works to gauge their input for potential improvements and expectations through annual independent customer focus sessions.

We note that the UR has set out their intention to increase focus on consumer metrics and to develop metrics for the monitoring of GDN performance. We are fully supportive of this approach and are keen to engage with the UR to understand the requirements in more detail, but also to ensure that any proposals are proportionate to the individual GDNs and that there is recognition of the stage of development on each network. Much like our tailored approach to dealing with customers in vulnerable circumstances, we do not believe a 'one size fits all' approach is appropriate. Instead, we will work with the UR to develop metrics that are right for SGN NG consumers at present and have the flexibility to evolve as our consumer needs change.

8.2 Consumer Protection

Since the submission of the GD23 Business Plan, the UR have also published the Best Practice Framework Approach[144]. In this document the UR have set out further expectations in relation to the treatment of consumers and specifically those in vulnerable circumstances.

[144] https://www.uregni.gov.uk/news-centre/launch-consultation-approach-delivering-best-practice-framework-programme

We welcome the publication of this document and are extremely keen to work with the UR, stakeholders and other utilities in NI to develop the most appropriate principles and meaningful measures to identify, support and protect consumers in vulnerable circumstances.

We note the URs intention to reflect best practice exemplars seen in Great Britain (GB) and we would encourage the UR to consider the level of support in terms of funding and provision of resource specifically dedicated to this in GB. We believe that any requirements placed on utilities in NI should be appropriate and proportionate given the size and scale of the NI market and commensurate with the level of financial support provided to the companies. While the timing of the GD23 process and the Best Practice Framework Approach publication did not align, we believe it is extremely important for the UR to engage with GDNs to ensure that requirements that are being put in place are appropriate to meet consumer needs and achievable based on a suitable level of support being provided to NI GDNs. We have included further detail in relation to this area in our response to the Best Practice Framework Approach.

PART 9: UNCERTAINTY MECHANISM

Summary of response

- **While SGN NG and the UR have engaged on the issue of Uncertainty Mechanism and Materiality Threshold there remain gaps in information, with the UR only supplying written logic on acceptance/rejection of allowances applied for under the Materiality Threshold within the GD17 allowances in their letter dated 28th April 2022, some four weeks prior to the DD response deadline.**
- **SGN NG were keen to have an agreed upon OAV/GD23 Opening TRV with the UR to avoid any further confusion or issues going into the Final Determination (FD). The Draft Determination (DD) as it currently stands is incorrect and creates a negative view in the public domain.**
- **All of the engagement was welcomed, however, there has been a significant change in modelling logic applied by the UR at the DD stage which has not been transparent in application. This has been extremely disappointing and frustrating for SGN NG.**

In this chapter we cover each area of Uncertainty Mechanism adjustments necessary in compiling the GD17 OAV and GD23 opening TRV used for modelling and price setting purposes.

We outline where transparency is lacking on the part of the UR and our disappointment in being at the DD stage with so many fundamental differences existing, the lateness of the UR's letter containing details on acceptance/rejection logic puts SGN NG at a severe disadvantage in responding to the inaccurate information contained in the DD in view of the public.

9.1 OAV Assessment

The GD17 OAV of £1.9m[145] (Average £2014), is not recognised by SGN NG. While there has been some engagement surrounding the adjustments within the Uncertainty Mechanism, as at the point of GD23 DD publication, there were still significant gaps in knowledge regarding the rationale and logic which lead the UR to this conclusion. The letter received from the UR on 28th April 2022 also highlighted other issues which SGN NG were only being made aware of for the first time, this represents a lack of transparency given the materiality of the decisions being taken.

In August 2021 we submitted papers on the Materiality Threshold and the Uncertainty Mechanism adjustments to encourage discussion prior to the GD23 DD publication to ensure agreement could be reached. This would have aided out understanding of the URs position to allow SGN NG to present a coherent response. Unfortunately, despite the extension timelines by 3 months being granted to the UR in publishing the DD, this additional engagement was not facilitated.

The OAV highlighted in the updated[146] Uncertainty Mechanism spreadsheet received from the UR following the publication of the DD, indicated a value of circa £2.4m (average £2014). This meant that SGN NG could not review or discuss the proposed values included in the model and which had been previously included in the

[145] GD23 – Gas Distribution Price Control 2023-2028, Draft Determination – Main document, March 2022, para 9.14 pg 57
[146] Per email from UR to SGN NG dated 11th November 2021.

published DD[147] until the DD query process had been initiated. It was at this time that SGN NG uncovered a fundamental change to the Capex Risk Sharing mechanism, which was not transparently discussed with SGN NG prior to, nor has this change been captured in the GD23 DD publication.

As discussed in Part 3, we believe the change applied to the risk sharing within the model represents a fundamental error by the UR. The risk sharing calculation should be return to that which was agreed between SGN NG and the UR in 2017 after the GD17 FD. Since 2017, SGN NG has operated on the basis that a 25:75 sharing factor would apply and took this into account when making operation and management decisions regarding how best to develop the network in the long term interests of gas consumers. This change is a significant common issue throughout the Uncertainty Mechanism adjustments discussed below.

9.2 GD17 Capex Adjustment (including RoR)

The GD17 quoted downward Capex Adjustment (including Rate of Return (RoR)) in the published DD of £10.9m (Average £2014), reflects the reduced rate of Capex Risk Sharing discussed above and if this alone was corrected the downward total would stand at c£9.8m (Average £2014).

SGN NG also do not agree with the SPED allowances included in the published DD, on the basis that there are significant crossings etc in excess of £100k individually that have not been included. Again, it is extremely disappointing that the justification for these being rejected under the mechanism was not received until the receipt of the letter from the UR dated 28th April 2022 without meaningful engagement, some four weeks prior to the DD response deadline.

The allowance granted for Encirc withing the model was difficult to reconcile in the absence of the UR letter and was not fully understood until it was received on 28th April. The letter confirmed that the allowance for the meter was granted and but not the allowance for the service. The same rule was applied to the allowances for the other significant services which meet the Materiality Threshold criterion. The rationale to this decision appears illogical.

While we welcome the inclusion of the allowances for large meters, we firmly believe that the large service variances are legitimate and should be included in the Uncertainty Mechanism .

These differences impact the Depreciated Asset Value (DAV) and depreciation adjustment significantly, therefore, the Opening TRV for GD23 is not accurate, and therefore the prices quoted under the SGN NG ‘price cap’ are also inaccurate.

9.3 GD17 Opex Adjustment (including RoR)

The engagement to date relating to Opex adjustments allowed for minor alterations to network rates and licence fees to be agreed between SGN NG and the UR in advance of the GD23 DD publication. However, despite positive engagement in this area, there remains significant differences in opinion on the logic employed by the UR, in their letter dated 28th April 2022 and the reality of the circumstances faced by SGN NG.

SGN NG presented a Materiality Threshold paper on Opex adjustments in early August 2021 in excess of the £100k threshold set by the UR, resulting in a downward Opex adjustment (including RoR) of c£1.9m (Average £2014). The query we raised for the DD version of the Uncertainty Mechanism, allows us to conclude that the

[147] See DD Response Query SGN-DD001 and subsequent response.

downward value in the published DD in respect of Opex adjustment (including RoR) is closer to c£3.0m (Average £2014).

This difference is a result of all of the additional allowances requested of c£1.1m (Average £2014) including RoR, being removed. This is extremely concerning SGN NG given the trust that is required in making expenditures to be recovered under the Materiality Threshold mechanism. The mechanism exists to ensure there is autonomy of spending in areas that require immediate attention and in circumstances where allowances have not been previously awarded, to ensure GDNs are not left out of pocket (subject to a set threshold).

All the Opex requests presented meet the criterion required for Opex adjustments under the mechanism due to the change in pressure of network building at a very late stage of the bid process (to the benefit of consumers), acceleration of decarbonisation activities and a global pandemic during GD17. We therefore disagree with the URs decision in this area.

9.4 GD17 Depreciation Adjustment

The depreciation adjustment concept is documented into our licence and we are fully aware of the purpose of this adjustment. This aligns the Uncertainty Mechanism adjusted DAV depreciation into the TRV based on actual performance as opposed to determined value.

Firstly, the proposed downward adjustment of c£1.3m in the published DD does not match the c£1.4m highlighted in the model received as part of the query process, this is concerning but we assume the model is correct. Secondly, the calculation of such an adjustment is fully influenced by the issues discussed above in respect of Capex adjustments and will be subject to change when the UR correct for our concerns.

As the detailed written information, the UR provided to SGN NG by way of their letter was provided so late in the process, and was not part of the DD publication, we are in the position where we are still left with large voids in a fundamental area of the price setting calculations in the licence (i.e., the opening GD23 TRV, actuals to 2020 and best available in respect of 2021 and 2022).

9.5 GD23 Uncertainty Mechanism Capex Proposals

SGN NG have considered each of the proposed Uncertainty Mechanism Capex proposals for the GD23 period and comment on each with our views in the figure below:

Figure 9.1 Capex Proposals

Capex Item	Uncertainty Mechanism applicable in GD23	Our View on UR Proposals
7 Bar Mains	There are no outputs for SGN in GD23.	Not applicable.
Feeder and infill mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 11.50m and determined unit rate will apply. Additional incentive (£20/property) and penalties (£50/property) will apply for every property above or below the target respectively (with cumulative performance considered).	This does not appear to be the same mechanism that was in operation for GD17, where cumulative annual averaging was used. This needs to be fully clarified (with modelling) for the FD. The 11.5m is restrictive to the SGN NG mainlaying activities, please refer to Section 6 for further detail regarding property densities in SGN NG towns. The risk/reward mechanism does not allow any leeway for similar circumstances faced by SGN NG in GD17, where penalties were applied on the basis of cumulative pp inappropriately, due to build delays and a global pandemic not being taken into account.
New build mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 9.50m and determined unit rate.	This does not appear to be the same mechanism that was in operation for GD17, where cumulative annual averaging was used. This needs to be fully clarified (with modelling) for the FD. The 9.5m is restrictive to the SGN NG mainlaying activities, please refer to Section 6 for further detail regarding property densities in SGN NG towns.
Individually funded	There are no outputs for SGN NG in GD23.	Not applicable.
Pressure reduction	Not applicable in GD23.	We understand the UR's logic in this area and subject to us having access to a 75% retention of overspends in the GD17 period, have no issue.
Domestic and I&C services	Output based on connections and determined unit rates.	Agree with approach.
Domestic and I&C meters	Output based on connections and determined unit rates.	Agree with approach.
Domestic and I&C meters end-of-life replacement	Not applicable in GD23.	Not applicable.
Other capex	Not applicable in GD23.	Fixed allowance granted annually in GD23.

Capex Item	Uncertainty Mechanism applicable in GD23	Our View on UR Proposals
Traffic Management Act	Ring Fenced	The increase to 10% of our allowances might be better utilised for other projects as requested by SGN NG in our submission.
Additional projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary including work associated with delivery of the Energy Strategy or deemed to be innovative. For avoidance of doubt this may include consequential changes to volumes.	Understand the logic, however, we would welcome engagement on reassessment of extension towns (or other projects) at a stage in the future, utilising final allowances and not just draft allowances.
Materiality Threshold	Subject to future UR determinations.	DD states expectations of GDNs in having an allowance approved by the UR prior to the spend commencing. We believe this to be restrictive and may be detrimental. However, where UR feel that this preapproval is necessary, then it is important to ensure that timelines are placed on UR and included in the FD to ensure that such requests are facilitated in a timely manner. We have addressed our concerns on the Materiality Threshold within this response. We have assessed the inflated threshold from GD17 at £115k and are comfortable that this should remain in place for GD23.
Capex Risk Sharing	35:65 sharing where a 35% symmetrical reward or risk of all outperformance or underperformance on capex targets, applied at the end of the UM.	The wording in relation to capex risk sharing is confusing and SGN NG feel that examples of each be placed into the FD for the avoidance of doubt here. We read this to mean an under performance of £100 (i.e. an overspend) would result in £35 of this being lost and for an outperformance of £100 (i.e. an underspend) would result in £35 being retained. This would be a reduction in the % currently retained (to be corrected in the UM) on the GD17 period and would encourage UR to retain our 75% retention of efficient overspends, enabling SGN NG to build out the network in the most efficient manner.

9.6 GD23 Uncertainty Mechanism Opex Proposals

SGN NG have considered each of the proposed Uncertainty Mechanism Opex proposals for the GD23 period and comment on each with our views in the figure below:

Figure 9.2 Opex Proposals

Opex Item	Uncertainty Mechanism applicable in GD23	Our View on UR Proposals
Property Management	Network Rates based on turnover setting allowance, subject to actual evidenced adjustment.	Agree with approach.
Licence Fees	Pass Through.	Agree with approach.
Advert. & Market Dev. (OO)	Actual Connections Output based on Owner Occupied connections.	No issues with the adjustment mechanism, however, please see section 4 of this response for SGN NG's significant concerns around the overall allowance and allowance setting mechanism.
Supplier of Last Resort	Ring Fenced allowance of £85k in 2023 and subject to actual costs.	Agree with approach.
Materiality Threshold	Subject to future UR determinations.	DD states expectations of GDNs in having an allowance approved by the UR prior to the spend commencing. We believe this to be restrictive and may be detrimental. However, where UR feel that this preapproval is necessary, then it is important to ensure that timelines are placed on UR and included in the FD to ensure that such requests are facilitated in a timely manner. We have addressed our concerns on the Materiality Threshold within this response. We have assessed the inflated threshold from GD17 at £115k and are comfortable that this should remain in place for GD23.
Additional Projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary including work associated with delivery of the Energy Strategy or deemed to be innovative.	Understand the logic, however, we would welcome engagement on reassessment of extension towns (or other projects) at a stage in the future, utilising final allowances and not just draft allowances.

9.7 Materiality Thresholds

We note in para 9.34 of the published DD that *"Any costs must be submitted to UR with a business case, before any approval for additional allowances would be granted for this area."*. While this is now clearly set in the DD, this may be restrictive to GDNs should a circumstance arise where such expenditure is required immediately, particularly given the length of time it has historically taken the UR to review such requests.

The risk of any expenditure being incurred before a business case being approved lies with the GDN now, therefore, the UR have a responsibility to GDNs to clearly set out timelines detailing how long a decision will take from the point it is submitted.

In the absence of such transparency, this would put GDNs at a disadvantage and at risk the viability of some projects.

Finally, SGN NG have assessed the GD17 threshold for inflation and equates to £115k. We are comfortable with this level of threshold for the GD23 period.

9.8 Tax Allowance Adjustment

In accordance with the published DD Pi model, tax is not payable until 2034 and whilst this date may change depending on where the FD allowances land, it is highly unlikely that this date will be within the current Price Control period.

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PART 11: OUTPUTS, OUTCOMES AND ALLOWANCES

Summary of response

- The outlook created by the current DD package, negatively impacts the prices paid by consumers due to the lack of support to grow the customer base sufficiently and diversify against large customer losses over the medium to long term.
- The reduced connections of Net Present Value (NPV) positive customers means that the entire network and consumers in the west of NI suffer higher conveyance tariffs of c8.6% once targets are appropriately adjusted.
- In turn, this negativity is highly likely to lead to further customer losses in the Large I&C sector, the loss of one of our large P5 customers combined with these adjusted targets leads to a c17.4% increase in conveyance tariffs and high potential for the knock on effects to be further suffered by consumers in the west of NI.

11.1 Impact on Consumer Bills

The lack of support and generally negative outlook created by the published DD package on offer requires a rebasing of realistic targeted connections for the FD. The detailed rationale of which is discussed in Part 4 of this document.

When the OO and SME sectors are rebased to a realistic target of connections/volumes, driven by the lack of support package proposed by the UR, and current customer engagement for larger loads, our modelling highlights the impact that these factors will have on the consumers in the west of NI.

Below, Figure 11.1 shows the allowed revenue and the associated operating and capital expenditure for each year of the GD23 and the associated as they stand in the current DD proposed by the UR.

This shows that the total expenditure over GD23 will be £36.7m whilst the allowed revenue will only come to £34m creating a £2.6m shortfall over GD23 as we are unable to deliver the connections targets set out in the DD.

Figure 11.1 – Current DD allowances, targets & tariffs

DD KPIs	2023	2024	2025	2026	2027	2028	Total
Volumes (therms '000s)	30,483	31,133	31,804	32,379	33,004	33,478	192,281
Allowed Revenue (£'000)	5,205	5,394	5,589	5,773	5,972	6,124	34,057
Opex (£'000)	-2,601	-2,634	-2,549	-2,585	-2,760	-2,757	-15,885[181]
Capex (£'000)	-3,673	-3,372	-3,828	-4,293	-2,740	-2,906	-20,811
Total (£'000)	**-1,068**	**-611**	**-788**	**-1,105**	**473**	**461**	**-2,639**
			TARIFFS (ppt)				
P1	32.06	32.06	32.06	32.06	32.06	32.06	
P2	32.06	32.06	32.06	32.06	32.06	32.06	
P3	30.97	30.97	30.97	30.97	30.97	30.97	
P4	17.63	17.63	17.63	17.63	17.63	17.63	
P5	17.63	17.63	17.63	17.63	17.63	17.63	
P6	17.63	17.63	17.63	17.63	17.63	17.63	
P7	13.34	13.34	13.34	13.34	13.34	13.34	

[181] Post efficiency Opex value

Figure 11.2 reflects the realistic version of the connections that this DD package is offering out to our consumers and provides an adjusted connection forecast that aligns to the cost to serve proposal and current customer engagement for larger loads. This reduces total volumes by 10% to 174m therms and reduces total GD23 revenue from £34m to £32m however the costs are then reduced by £6m to £30.7m bringing the expenditure back into line with revenues. The average tariff for P1 customers though is c8.6% higher.

Figure 11.2 – Revised DD allowances, targets & tariffs to reflect insufficient support in DD

REVISED DD KPIs	2023	2024	2025	2026	2027	2028	Total
Volumes (therms '000s)	27,966	28,640	29,034	29,314	29,598	29,805	174,356
Allowed Revenue (£'000)	5,104	5,269	5,376	5,472	5,570	5,641	32,431
Opex (£'000)	-2,332	-2,375	-2,319	-2,381	-2,583	-2,566	-14,557
Capex (£'000)	-2,496	-2,556	-3,065	-3,522	-2,096	-2,377	-16,112
Total (£'000)	**275**	**338**	**-9**	**-432**	**891**	**698**	**1,762**
			TARIFFS (ppt)				
P1	34.81	34.81	34.81	34.81	34.81	34.81	
P2	34.81	34.81	34.81	34.81	34.81	34.81	
P3	33.62	33.62	33.62	33.62	33.62	33.62	
P4	19.14	19.14	19.14	19.14	19.14	19.14	
P5	19.14	19.14	19.14	19.14	19.14	19.14	
P6	19.14	19.14	19.14	19.14	19.14	19.14	
P7	14.49	14.49	14.49	14.49	14.49	14.49	
P1 Movement from DD				8.6%			

This lack of support manifests itself in higher distribution tariffs for all of the consumers in the west of the region of 8.6% per therm conveyed, leading to an annual increase of c£10/year for the average domestic consumer and significantly more for Large I&C customers (e.g. a 2,500,000 therm/year P5 customer will pay c£38k more per year , also an 8.6% increase).

As a result of the DD, our assessment shows that customers connected to our network will have to pay 8.6% more for network charges with fewer customers, leading to lower financial resilience.

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11.2 Designated Parameters and Determination Values

The Designated Parameters, as submitted by SGN NG as part of this response are discussed in Figure 11.5 below, with comparison to those contained in the UR's DD document:

Figure 11.5 Designated Parameters

Designated Parameter	Requested Value	Summary Detail	Comparison to DD
rt	0.0412	Refer to response document section 10 for detail, this is set on a CPIH real basis.	This is higher than the equivalent DD rate of 2.76%, please refer to response document part 10 for details.
n	2028	Representing the final year of GD23 (a 6 year period)	In agreement with the UR logic as published in the DD
m	2022	Representing the final year of GD17 and year prior to GD23 starting in 2023	In agreement with the UR logic as published in the DD
ft	0.5	Mid year cashflow averaging	In agreement with the UR logic as published in the DD
q	2057	Maintained value for end of revenue recovery period	Incorrectly stated as 2046 in the UR table published in the DD, we expect this to be corrected for the FD
CPIH	108.9	ONS Published Data dated August 2021	UR moved SGN NG from an RPI to CPIH basis. This equates to the average for calendar year 2020.
w	6	Savings to coincide with the length of the review period	Stated as a period of 5 years in the UR table published in the DD, we feel that this should reflect the period of price control length, therefore, expect this to be corrected for the FD
g	0	ORI to remain switched off in GD23	In agreement with the UR logic as published in the DD
h	0	CRI to remain switched off in GD23 as capex risk sharing mechanism still operating	In agreement with the UR logic as published in the DD
d	0	As CRI is requested to be 'switched off', the associated DI should also be	In agreement with the UR logic as published in the DD
I	33	No effect as ***d*** requested to be set at 0	In agreement with the UR logic as published in the DD
δt	0	Offsetting of under/over-recoveries across conveyance categories is not envisaged to be utilised in the GD23 period	In agreement with the UR logic as published in the DD
Xo,t	0	A full rate of return on under-recoveries is deemed disincentive enough to avoid over recovery of revenues	In agreement with the UR logic as published in the DD
Xu,t	0	Assuming the full rate of return awarded on under-recoveries - this adjustment is not required	Confirmation of the rate to be applied to 'Z' under-recoveries required to assess this parameter, full rate of return should be applicable, as per our request.
αt	0.4	To allow sufficient scope in recovering 'Z', should SGN NG decide to utilise the under-recovery option	In agreement with the UR logic as published in the DD

PART 12: FRONTIER SHIFT

Summary of response

- The datasets used in the determination of the indices must reflect the latest available data.
- The RPEs identified for 2021 must reflect the actual indices.
- The UR have failed to consider the restricted ability to drive efficiency in a business that is still in its early stages of development.

12.1 Frontier Shift

While SGN NG disagree with the current frontier shift presented by the UR, we welcome the inclusion of Real Price Effects (RPEs) as part of the price control setting and accept the requirement to apply an efficiency challenge to the business. However, we strongly believe that the current proposed indices are not adequately addressing the recent step change in the markets. The UR have failed to include the relevant data sets within the determination of the RPEs and strongly believe that applying a 1% efficiency challenge deemed relevant to established companies to a company in the early stages of its maturity is wrong. We are also of the view that the UR have failed to consider SGN NG's proposal of a true-up mechanism being introduced for RPEs. Our concerns with the URs approach are set out below.

12.2 RPEs

Real Price Effects (RPEs) is a term which describes increases in costs which are not in line with the traditional rate of inflation calculation. For GD23, the Consumer Price Index including Housing (CPIH) is to be used as a proxy for the external cost pressures. Is it recognised that, whilst the rate of inflation calculation will provide some security against rising costs over time, the costs which are subject to RPEs will inflate out of line with the normal inflation forecast. If the effect of RPEs is not considered and accounted for, the networks will be unable to recover the actual costs of their business activities. We, therefore, continue to stress the importance of RPEs being included in the GD23 FD to enable the significant cost pressures likely to be faced by SGN NG over GD23 to be adequately reflected in the final awarded allowances.

As set out in the GD23-027 Real Price Effects, the cost pressures are closely linked to:

- The macro economic impact in NI – including the impact of more recent events
- Availability of skilled Labour
- Demand for key materials

And as identified in the updated RPE appendix submitted in December 2021, there has been a 'significant and unanticipated increase in core business operating costs that will be reflected in the GD23 costs, but risk not being captured in the underlying allowances unless they are explicitly allowed for.'[182] Post the submission of the updated appendix there has been a further step change in the market driven by the war in Ukraine. And even using the most recent available indices we would highlight that we do not believe the indices are currently reflecting the impact of the heightened prices in the market nor the unprecedented rises in inflation.

[182] GD23-027 RPEs Update (Dec-21)

Due to the reporting lag that is generally found in any indices, the continued impact of such events is unlikely to be reflected until later in the year.

Considering the current information presented by the UR, although the current indices do not incorporate the more recent events due to a known lag in the index reporting, the UR have failed to utilise the latest available data in its determination. Therefore, failing to identify the step change in prices experienced during 2021 that were highlighted in the resubmitted RPE appendix. We are therefore concerned that the current proposed RPEs are inadequate and penalise the GDNs.

To enable the step changes in the market to be incorporated in the final allowance setting, the UR must update the indices to include the latest available data. With the 2021 indices now being published on the respective sites, the 2021 RPE should align to that of the actual RPEs experienced during that period. But further the long term forecast should be updated for the latest available data to ensure that consideration is given to this recent step change in the marketplace.

These upward pressures have continued into the start of 2022, and even through the inclusion of the actual 2021 indices, there is a significant risk that these step changes will still not be adequately addressed.

We therefore strongly believe, that due to the continued price movements and levels of uncertainty in the market, it is important the UR consider an annual true up provision, as has been adopted by Ofgem. This would ensure that the RPEs are monitored on a regular basis and can be accurately calculated with allowances being adjusted annually to reflect the prices experienced in the market as set out in the RPE appendix update[183]. This will assist in ensuring that SGN NG is not unfairly penalised but also that the consumers are not adversely affected through either higher than required bills or underfunded services. If such a mechanism is not introduced, aiming up in the forecasting of RPEs is required to align to current market expectations.

12.3 Labour

For the labour RPE the UR have identified the intent to use the OBR Average earnings date. At the time of publication, the latest available data was based on the October 2021 positioning as detailed below:

Figure 12.1: Extract of Table 2.4: OBR Economic and Fiscal Outlook, October 2021 – Labour Market summary, Table 2.7

Labour market	% change on year earlier, unless otherwise stated						
	Out turn	Forecast					
	2020	2021	2022	2023	2024	2025	2026
Average earnings	1.2	5.0	3.9	3.0	2.2	2.9	3.5

Subsequent to the release of the DD, the Economic and fiscal outlook - March 2022 OBR report has been published of which reflects an increased forecast in the average earnings anticipated to be incurred in 2021 and 2022 with the 2023 to 2026 forecast remaining at a broadly similar average over the period. The March 2022 report also reflects an updated 2020 outturn position reflecting a 50% increase.

Figure 12.2: Table 1.1 of the March 2022 OBR[184] presents updated values as follows:

Labour market	% change on year earlier, unless otherwise stated						
	Out turn	Forecast					
	2020	2021	2022	2023	2024	2025	2026

[183] GD23-027 RPEs Update (Dec-21) Paragraph 3.2
[184] https://obr.uk/docs/dlm_uploads/CCS0222366764-001_OBR-EFO-March-2022_Web-Accessible-2.pdf

Average earnings	1.8	6.2	5.3	2.8	2.6	2.9	3.2

For the later 4 years of the forecasted period, the expectation of average earnings is suggested to be around 2.9%. Although, there is a general view that inflation will return to around 2% in 2 to 3 years' time[185] it currently is continuing to rise and in the 12 months to March 2022 rose by 6.2%[186]. The March 2022 report identifies that *'...we expect domestic price pressures to continue to rise as labour market tightness and sharp increases in the cost of living lead to higher nominal wage growth.'*[187] With the Bank of England Monetary Report February 2022 further supporting this *'...underlying wage growth has picked up and is expected to strengthen over 2022, given the recent tightening in the labour market and some temporary upward pressure from higher price inflation'.*[188]

We are however still concerned, that if inflation continues to rise that there could be further movements in the forecasted average earnings presented in the March 2022, as detailed in Figure 12.2, and therefore the use of the current forecast will not adequately reflect the average earnings growth in future years as the gap between the cost of living and earnings attempts to close. As identified in the March 2022 report *'...although settlements data has thus far only shown a modest rise, recent surveys from the CIPD and Bank of England point to significant rises in employer expectations of pay settlements, well above what has been experienced in the past decade.'*[189]

As a minimum the UR should include the updated OBR average earnings in the FD for the GD23 price control, but consideration should be given to the potential impacts on the average earnings over the next few years as the cost-of-living issues are addressed. It is identified in the OBR report that the increase in inflation *'is driven primarily by higher gas prices feeding into sharp rises in domestic energy bills, alongside higher fuel prices and global good inflation. Excess demand in the domestic economy means we expect that much of these cost increases will be passed onto consumer prices and will be partly matched with higher nominal wage growth.'*[190]

This continued level of uncertainty, as emphasised throughout the March 2022 report, highlights the need for the UR to adopt a true-up mechanism as identified above.

12.4 Materials

[redacted]

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[185] https://www.bankofengland.co.uk/knowledgebank/will-inflation-in-the-uk-keep-rising#:~:text=We%20expect%20inflation%20to%20rise,the%20next%20couple%20of%20years.
[186] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/march2022
[187] Economic and fiscal outlook - March 2022 (obr.uk) paragraph 2.24
[188] https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2022/february/monetary-policy-report-february-2022.pdf section 1: The economic Outlook
[189] Economic and fiscal outlook - March 2022 (obr.uk) paragraph 2.46
[190] Economic and fiscal outlook - March 2022 (obr.uk) Paragraph 2.22
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12.6 Other

For the cost category identified as other, we believe it is relevant to assume prices increase at the same nominal rate as general inflation.

12.7 Weights

The UR have identified that they have decided not to adopt the approach of company specific weights for RPEs as this 'may be inconsistent with the principal objective of RPEs'[197]. Although we agree with the general principle, we are concerned that if the RPEs are insufficient to reflect the recent price increases, especially within the materials weighting of which has seen a significant step change, that SGN NG could be unfairly penalised. As can be seen in Figure 12.9 below, SGN NG proposed a material weighting of 25% for Capex activities as opposed to the URs current proposal of adopting the Ofgem weightings of which suggests 14% weighting of material indices.

Figure 12.9: Proposed RPE Weights versus SGN NG proposals

Cost Category	GD23 Proposal	SGN NG Opex proposal	SGN NG Capex proposal
Labour	70%	56%	38%
Materials	14%	2%	25%
Plant and Equipment	4%	1%	32%
Transport	2%		
Other	9%	41%	5%

[197] Annex E - Paragraph 2.17

As SGN NG is still in the early stages of development adequate capital funding is vital to enable the network to be progressed. This further supports the need for the UR to ensure that the most recent data and increased cost pressures in the market are accurately reflected in the RPEs set out for GD23.

12.8 Productivity

The UR have proposed a productivity improvement that aligns to that of the RIIO-GD2 CMA determination of 1% being deemed applicable to GB GDNs. As set out in appendix GD23-030 Figure 3, 1% has a regulatory precedence in previous price controls across the Great Britain (GB) utilities and aligns to the chosen productivity challenge applied in GD14 and GD17. We believe the UR have failed to address the proposals put forward within our business plan and disagree with this determination. The assumption that a level of productivity relevant to established companies can be deemed relevant to that of a company in the early stages of maturity and further that a productivity level deemed relevant to GB should be assumed to be applicable to NI is incorrect.

As detailed in section 2.3 of appendix GD23-030, submitted as part of the SGN NG Business Plan, we identified several key factors as to why a similar level of efficiency is not achievable:

- SGN NG is still in the early stages of a growth cycle with focus predominately on marketing and connecting customers to the network
- Higher proportion of fixed costs against a low level of output
- The direct activities are predominately undertaken by a contracting resource, as a result we continue to be more susceptible to the changes in the economic climate
- Difficulties in recruiting and retaining resources with relevant gas safety accreditation
- The current contracting structure in place in SGN NG

As SGN NG is still in the early stages of development, any such cost pressures experienced are attributable over a small level of output and therefore more pronounced with limited ability to offset against savings elsewhere within the business. Where possible we have already looked to minimise costs through utilisation of the management services through SGN as opposed to requiring SGN NG specific functions such as IT support, payroll and Human Resources all of which would create a significant cost burden if the management service was not available. Further we have looked to use a contracting resource for emergency activity of which operates across NI for all gas utilities, removing the need to recruit in house. The ability to resource in such a way has enabled us to keep the costs of activities such as emergency relatively low. Had we been required to directly employee for such roles this would drive significant levels of unproductive time into the business. Therefore, there are limited areas remaining in which we can drive efficiency within the business whilst it is still in the development phase.

In addition, it is incorrect for the UR to assume that the similar levels of productivity deemed relevant to Great Britain GDNs are achievable in NI. As identified in by Ulster University in a May 2019 report, 'productivity levels In NI are still more than 15 percent below the UK average.'[198] With the report concluding amongst other things that *'…despite productivity being the focus of a range of economic development policies it has lagged the rest of the UK regions for a number of years and is falling further behind.'*[199] And this is further supported by a report produced by Economic Observatory in April 2021 of which identifies that *'Northern Ireland produces less output per hour worked than most other regions in the UK.'*[200] There are a number of reasons cited within the report as potential drivers of lower productivity in NI including:

198 https://www.ulster.ac.uk/__data/assets/pdf_file/0005/414662/Understanding-Productivity-in-NI-May-2019.pdf paragraph 1.2
199 https://www.ulster.ac.uk/__data/assets/pdf_file/0008/118385/Understanding_productivity_in_Northern_Ireland_27_September_2016.pdf_Section 12. Conclusion
200 https://www.economicsobservatory.com/what-explains-northern-irelands-long-standing-problem-of-low-productivity

- Economic structure
- Geographical location
- Investment in capital
- A deficit in human capital

We fail to see where the UR has taken into account the SGN NG submission nor that they have considered that there are clear differences in the productivity levels of GB and NI.

We agree that a level of productivity should be applied within a price control to ensure the networks are driving efficiency where possible. However, we do not believe the UR have taken a balanced view of the data available to them. As identified in SGN NG GD23-030 we continue to believe, based on a balanced view of the available data, that a 'productivity growth assumption of 0.35%' continues to be a challenging but fair position when considering the current economic climate.

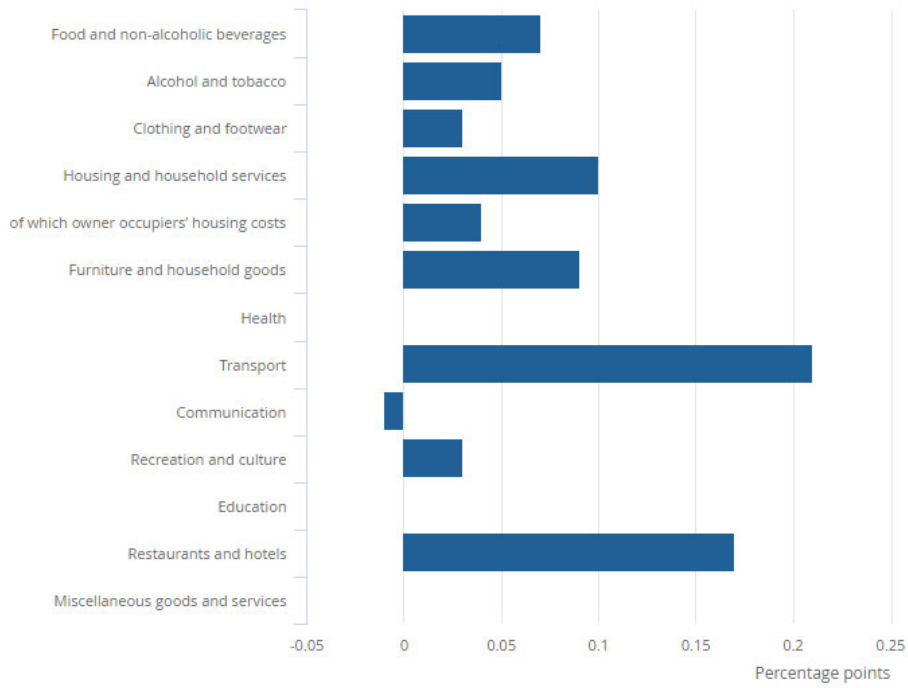
12.9 Consumer Prices Index Projections

Within Annex E, the UR identify that 'CPIH sits at 3.8% for the 12 months to October 2021'[201], this has however continued to rise and based on the March 2022 Consumer price inflation bulletin[202] CPIH 'rose by 6.2% in the 12 months to March 2022'. The report further states that the increase came from 'many categories' and there were 'no large offsetting downward contributions' as can be seen from Figure 12.10 below.

Figure 12.10: Extract of the upward contributions to CPIH over the 12-month period

Figure 3: 8 of the 12 divisions made upward contributions to the change in the CPIH annual inflation rate

Contributions to change in the CPIH 12-month inflation rate, UK, between February and March 2022

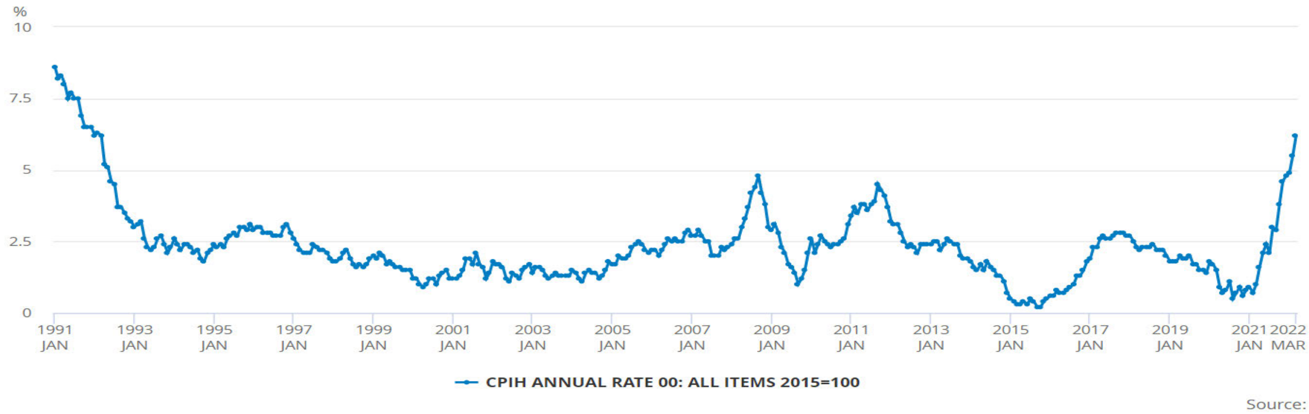


[201] Annex E – paragraph 2.48

[202] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/march2022

The current increases in inflation is beyond that which was experienced during the financial crisis in 2008, with such levels of inflation having not been seen since the early 1990's as reflected in Figure 12.11[203] below.

Figure 12.11: Historical CPIH



The Bank of England's (BoE) current expectation is that it will 'it's likely to reach around 10% this year'.'[204] With an expectation that it will be 'close to 2% in around two years' Therefore, higher than historic average inflation could continue through 2023 and 2024 with potential 2% levels not being seen until 2025 being the 3rd year of the GD23 price control.

Although there is a general view that this high level of inflation will stabilise in a couple of years, it is also believed that this will have resulted in an upward shift of prices of which are unlikely to revert back to the levels seen previous. This is emphasised by the BoE stating that 'even though the rate of inflation will slow down, the process of some things may stay at a high level compared with the past'.[205] It is therefore vital that the UR ensure that the relevant level of inflation is included within the determination of the price control and reflect the step change in the marketplace that has been experienced in recent months but also address the inflation that is set to continue to rise throughout 2022.

[203] https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l55o/mm23
[204] https://www.bankofengland.co.uk/knowledgebank/will-inflation-in-the-uk-keep-rising 5th May 2022 update
[205] https://www.bankofengland.co.uk/knowledgebank/will-inflation-in-the-uk-keep-rising

PART 13: BUSINESS PLAN ASSESSMENTS

Summary of response

- **Overall while SGN NG are please with a rating of good from the UR, the Business Plan Assessment appears inconsistent with discussions with the UR throughout the process and the level of engagement maintained.**
- **The UR has suggested SGN NG needed to provide further justification on additional opex and volume of new connections, however, there has been extremely limited engagement in this area from the UR. For SGN NG this also raises concerns that the UR may have incorporated decisions into the draft determination without suitable engagement or sufficient information to do so.**
- **Throughout the DD and in particular in the URs assessment of the SGN NG business plan there appears to be little attempt by the UR to understand the differences in size, scale or maturity of the SGN NG business in comparison to the other NI GDNs.**
- **The UR engagement in this area was extremely limited with little focus on discussion following the actual assessment. SGN NG would suggest that in future results of business plan assessments should be provided by the UR with suitable time to allow meaningful engagement from GDN's.**

13.1 UR Assessment

Overall, SGN NG are pleased with the rating of good, but there were a number of areas within the UR assessment which appeared to be inconsistent with the engagement with the UR throughout the Price Control Process. In particular SGN NG are concerned that the UR highlighted some areas where they believed the information provided was insufficient and therefore additional information could have improved the Business Plan. This was particularly concerning as the subsequent requests for information in these areas were not received from the UR through the supplementary information process which was in place between July 2021 and January 2022. It would therefore appear that the UR may have incorporated decisions into the GD23 DD without suitable engagement or sufficient information to do so.

In particular we note that the rating for question 1 seems inconsistent with the level of engagement SGN NG have had to date from the UR in terms of the information provided within the Business Plan and the subsequent supplementary question process. In recent meetings the UR have acknowledged that the areas where there has been limited engagement are representative of areas where sufficient information has been provided within the Business Plan and therefore there was no requirement to request further detail. However, the report suggests that *'SGN's request for additional opex versus the volume of new connections needs further justification'*. We therefore suggest the Business Plan assessment lacks transparency on this matter. It also raises concerns that the UR regarding the basis on which decisions specific to SGN NG were made within the GD23 DD.

The lack of transparency in this area also creates the perception that SGN NG are not providing value for money to consumers. We don't agree with this message, nor do we believe the current drafting provides an appropriate narrative to consumers given the current climate and unprecedented uncertainty in relation to gas prices.

We acknowledge that the UR provided advance sight of the assessment, however we believe that even with the extension to the UR timelines for the publication of the DD, this was carried out too late in the process.

While it allowed the GDN's an opportunity to provide feedback, the draft assessment document was circulated so close to the DD publication deadline, the UR did not take any of the feedback from SGN NG onboard. This limited any value in consulting with GDNs in advance of the publication and undermined the process. We would suggest that if this assessment is to be retained in future Price Control's that the UR should seek to provide the opportunity for more meaningful engagement with the GDN's by ensuring more suitable timeframes are provided for.

APPENDIX A - GLOSSARY OF TERMS

ACR - Annual Cost Reporting
CAPM- Capital Asset Pricing Model
CMA – Competition and Markets Authority
CMS- Constant Maturity Swaps
DAV- Depreciated Asset Value
DD – Draft Determination
DfE – Department for the Economy
FD – Final Determination
FeDL – firmus energy (Distribution) Limited
FMA – Fingleton McAdam
FTE – Full-Time Equivalent
GB – Great Britain
GDN – Gas Distribution Network
GHG – Greenhouse Gas
GIS – Geographic Information System
GttW – Gas to the West
HA – Housing Association
HP – High Pressure
I&C – Industrial and Commercial
IP – Intermediate Pressure
IT – Information Technology
KM – Kilometres
MDR – Market Development Review
MP – Medium Pressure
MSA – Managed Service Agreement
NB – New Build
NGN- Northern Gas Networks
NI – Northern Ireland
NIHE – Northern Ireland Housing Executive
NIRAUC – Northern Ireland Road Authority and Utility Committees
NPV – Net Present Value
OAV – Opening Asset Value
OO – Owner Occupier
PMICR – Post Maintenance Interest Coverage Ratio
PNGL – Phoenix Natural Gas Limited
PP – Properties Passed
RAV – Regulatory Asset Value
RCF- Revolving Credit Facility
RFR – Risk Free Rate
RoR- Rate of Return
RoRE – Return on Regulatory Equity
RPE – Real Price Effect
RPI – Retail Price Index
SGN – Scotia Gas Networks
SGN NG – SGN Natural Gas
SME – Small and Medium Sized Enterprise
SOLR – Supplier of Last Resort
SPED – Special Engineering Difficulty
TMA – Traffic Management Act 2004
TMR – Total Market Returns

TRV – Total Regulatory Value
UM – Uncertainty Mechanism
UR – Utility Regulator
WACC – Weighted Average Cost of Capital
WWU – Wales and West Utilities