Price Control for Northern Ireland's Gas Distribution Networks GD17

Discussion Document on our Overall Approach

19 December 2014



About the Utility Regulator

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

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

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

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

Our Mission	Value and sustainability in energy and water.
Our Vision	We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

We are publishing our discussion paper on approach for GD17, the price control for the gas distribution companies Phoenix Natural Gas Ltd (PNGL) and firmus energy (FE) for the years from 2017 onwards. Depending on the timing for the licence awards for the Gas to the West area, this price control may also be applicable to the Gas to the West low pressure licence holder.

Our proposed approach sets out a package of measures to continue the efficient growth of the gas industry in NI through building more pipelines and increased connections.

The price control will set out the amount the gas distribution companies will have to run their businesses and invest in the gas network. The key decisions for the companies will be on operating and capital expenditure allowances, targets for new gas pipelines and connections, proposed rate of return and the duration of the price control.

Audience

Industry, consumers & statutory bodies.

Consumer Impact

The price control will set out the allowed distribution charges for the gas distribution companies. Distribution charges make up around 35% of the total domestic customer bill. The price control approach detailed in this document will set out the basis on which we propose to determine the allowed distribution charges.

As part of our approach for the GD17 price control, we propose a range of measures designed to increase the number of consumers that can connect to the natural gas network, improve customer service and improve the environmental sustainability of the natural gas network.

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ACRONYMS AND GLOSSARY

BSI	British Standards Institution
Capex	Capital expenditure
CAPM	Capital Asset Pricing Model. A model that describes the relationship between risk and expected return.
CCNI	Consumer Council for Northern Ireland
ceteris paribus	Other factors remaining constant
Competition Commission	The statutory body to deal with rejections of price controls and makes a new determination and decision after listening to the evidence from all related parties. (From 1 April 2014, this organisation has changed its name to the Competition and Market Authority (CMA).)
Domestic New Build	Domestic Premises which have never previously been owned or occupied by any person (that is they are, or are to be, newly built premises) and in respect of which the connection to the Network shall be made prior to the premises first being occupied, but excluding any such premises which fall within the definition of NIHE.
e.g.	For example
etc.	Et cetera (and so forth)
European Gas Directive	Directive 2009/73/EC of the European Parliament of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC
FCO	First Call Operative
firmus	firmus energy (Distribution) Ltd
FOIA	Freedom of Information Act
G2W	Gas to the West. This is the name of the project aiming to extend the Natural Gas Network, to other areas of the province, namely Dungannon, Cookstown, Maghreafelt, Enniskillen, Omagh and Strabrane
GB	Great Britain
GD14	This is the name given to the price control for PNGL and firmus. It covers the period 2014 – 2016 (calendar years).

GD17	This is the name given to the next price control for the NI GDNs. It is proposed to cover the period 2017 – 2022 (calendar years).
GD23	This is the name given to the next price control for the NI GDNs. It is proposed to cover the period for the calendar years 2023 and beyond.
GDN	Gas distribution network company - firmus and PNGL At the time of writing, the final decision on the GDN for the Gas to the West area is still pending; this could be one of the existing GDNs or another business.
I&C	Industrial and commercial
i.e.	that is
MEAV	Modern Equivalent Asset Valuation
NI	Northern Ireland
NIE	Northern Ireland Electricity
NIEH	Northern Ireland Energy Holdings
NIHE	Domestic Premises which are (or will be when built) owned by: (a) the Northern Ireland Housing Executive; or (b) a housing association in Northern Ireland.
Ofgem	Office of Gas and Electricity Markets. Regulates the electricity and gas markets in Great Britain.
OO (Owner Occupied)	Domestic Premises which do not fall into the definition of: • Domestic New Build; or • NIHE.
Opex	Operating expenditure
PAS55	The British Standards Institution's (BSI) "Publicly Available Specification" for the optimised management of physical assets
Pi model	Model used for the calculation of conveyance charges for the GDNs.
PMICR	Post-Maintenance Interest Coverage Ratio
PNGL	Phoenix Natural Gas Limited
PNGL12	This is the name given to the price control for PNGL, covering calendar years 2012 and 2013.
PRE	Public Reported Escapes
PRS	Pressure Reduction Station. A pressure reduction equipment having an inlet pressure greater than 7 barg.

RAB	Regulatory Asset Base
Re	Regarding
RIGS	Regulatory Instructions and Guidance
RIIO-ED1	This is the first electricity distribution price control by Ofgem under the new RIIO (Revenue = Incentives + Innovation + Outputs) model. The price control is set for an eight-year period from 1 April 2015 to 31 March 2023.
RIIO-GD1	This is the first gas distribution price control by Ofgem under the new RIIO (Revenue = Incentives + Innovation + Outputs) model. The price control is set for an eight-year period from 1 April 2013 to 31 March 2021.
RIIO-GD2	This is the second gas distribution price control by Ofgem under the new RIIO (Revenue = Incentives + Innovation + Outputs) model. The price control is set to take effect on 1 April 2022.
RP5	This is the name given to the price control for NIE, covering the period from 1 April 2012 to 30 September 2017.
RPI	Retail Price Index
SGN	Scotia Gas Networks Limited
Shrinkage	Difference between the amount of gas that was recorded to have entered the distribution system and to have exited it. Includes: • gas loss through theft; • gas loss through leaks/emergencies; • own use.
SOC Code	Standard Occupational Classification Code
TMA	Traffic Management Act. The objective of the TMA is to tackle congestion and disruption on the road network. The TMA places a duty on local traffic authorities to ensure the expeditious movement of traffic on their road network and those networks of surrounding authorities. This has yet to come into force in Northern Ireland, at time of writing.
Totex	Total expenditure, i.e. the sum of capex and opex.
TRV	Total Regulatory Value: the Depreciated Asset Value plus any incentive adjustments including the profile adjustment.

1 Introduction

Purpose of Document

1.1 The purpose of this document is to set out for discussion our initial views on the high level approach in relation to the next price control for the two gas distribution networks in Northern Ireland, firmus energy (Distribution) Ltd ("firmus") and Phoenix Natural Gas Ltd ("PNGL"). This price control is referred to as GD17.

1.2 Depending on the timing for the licence awards for the Gas to the West area, the GD17 price control may also be applicable to the Gas to the West low pressure licence holder.[1]

1.3 This document sets out our proposed approach to GD17 as follows:

- Chapter 1 outlines the background to this price control and outlines our role in line with our statutory duties;
- Chapter 2 provides context, covering the economic regulation of gas distribution networks and price controls;
- Chapter 3 provides an overview of the previous price controls for GDNs (gas distribution network companies) and sets out the case for GD17;
- Chapter 4 sets out our proposed approach to some key areas which must be addressed as we develop and deliver GD17;
- Chapter 5 discusses the impact on consumers and the environment as well as how we will engage with stakeholders throughout the price control process;
- Chapter 6 considers the timetable and key milestones for GD17 and discusses proposals on other future areas for consideration;
- Appendices 1 and 2 to this document show the maps of the licensed areas;
- Appendix 3 to this document references the draft GD17 business plan template.

[1] The Gas to the West project is an initiative to extend the Northern Ireland natural gas network to the following towns: Dungannon (including Coalisland), Cookstown (including Magherafelt), Enniskillen (including Derrylin), Omagh and Strabane. As part of this initiative, two licences will be granted: one licence relating to the high pressure assets needed for the distribution of gas to the designated towns, and the other licence relating to low pressure assets in the designated towns that are required for the distribution of gas to individually connected supply points. We have published, on 18 November 2014, our decision on the preferred applicants for these licences (for further details see: Utility Regulator: Gas to the West Licence Applications, Final Decisions, 18 November 2014): Northern Ireland Energy Holdings (NIEH) for the high pressure network and Scotia Gas Networks Limited (SGN) for the low pressure network. As detailed in that document, we expect to consult on the conditions of the licences in December 2014.

Background

1.4 Our principal objective in carrying out our gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so consistently with our fulfilment of the objectives set out in the European Gas Directive[2], and by having regard to a number of matters, as set out more fully in the Energy (Northern Ireland) Order 2003.

1.5 In summary, taken in the round, we interpret our duties, in the context of carrying out price controls, as a broad mandate to secure the most cost efficient outcome – for the protection of consumers and the promotion of the gas industry in Northern Ireland – that also secures that the company can continue to finance the activities which are the subject of obligations placed on it, and that has due regard to all relevant factors.

1.6 We are a non-ministerial government department, accountable to the NI Assembly.

1.7 We set overall limits on how network prices can rise, or are required to fall, through a process called price controls.

1.8 The price control process must therefore start with the business plans (including actual data for previous years), as submitted by license holders, setting out their proposals for costs going forward. The information submitted will be scrutinised by us. In doing so, we seek to ensure that gas distribution license holders deliver best value for money for all consumers.

1.9 In making decisions during the GD17 price control, we will ensure the revenues and resulting tariffs are:

- sustainable;
- stable;
- transparent;
- predictable; and
- cost-reflective.

1.10 Our approach is based on best practice regulation of natural monopolies. Our task essentially consists of creating a framework within which, in return for providing monopoly services to an acceptable quality, the company receives a reasonable assurance of a revenue stream in future years that will cover its costs and ensure fairness for the consumer.

1.11 Northern Ireland currently has two gas distribution networks.

[2] Directive 2009/73/EC of the European Parliament and the Council of 13 July concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC

- Phoenix Natural Gas Limited (PNGL) own and operate the distribution network in the Greater Belfast and Larne areas; a map outlining the PNGL distribution licence area is shown Appendix 1: Map of the PNGL Greater Belfast and Larne Licensed Area.
- firmus energy (Distribution) Limited (firmus) own and operate the distribution network, normally called the ten towns. The ten towns licence area covers a greater geographical area including Ahoghill, Antrim, Armagh, Ballyclare, Ballymena, Ballymoney, Banbridge, Bessbrook, Broughshane, Bushmills, Coleraine, Craigavon, Cullybackey, Derry~Londonderry, Laurelvale, Limavady, Lurgan, Maghaberry, Magheralin, Moira, Newry, Portadown, Portstewart, Tandragee, Warrenpoint. A map of the ten towns licence area is shown in Appendix 2: Map of the firmus Ten Towns Licensed Area.

1.12 PNGL was awarded its conveyance licence in September 1996. Presently it has over 171,000 customers connected within the Greater Belfast and Larne licence area.

1.13 firmus was awarded its conveyance licence in March 2005 and have over 20,000 customers connected within the ten towns licence area.

1.14 At the time of writing, work is ongoing as part of the Gas to the West initiative to establish within Northern Ireland a third gas distribution network to the following towns: Dungannon (including Coalisland), Cookstown (including Magherafelt), Enniskillen (including Derrylin), Omagh and Strabane.[1]

2 Context

Economic Regulation of Gas Distribution Networks

2.1 Where a monopoly exists, consumers are not able to change their network operator in order to receive better prices or service levels. In the absence of such competitive pressures, natural monopolies may act against consumer interests by:

- becoming or remaining inefficient, passing higher costs on to consumers than would otherwise be necessary;
- delivering poor levels of service rather than seeking innovative or challenging ways to improve performance while reducing costs.

2.2 By subjecting monopoly service providers to external benchmarking and challenge, independent economic regulation helps ensure that they continue to act in the consumer interest.

2.3 Economic regulators also impose budgetary constraints on the regulated company or companies (while at the same time making sure that they are adequately financed). These constraints are based on direct challenge of the company's proposals, supported by external benchmarking of cost and service to establish the company's relative efficiency and performance.

2.4 The provision of gas distribution services tends to be a natural monopoly, and in the case of NI is delivered by firmus and PNGL, in their respective geographic areas.

2.5 As firmus and PNGL, in their respective geographical areas, are the only monopoly gas distribution service providers, a regulatory framework has been put in place to protect the consumers who use their services. In our role as economic regulator, we take action if we consider that either of the companies is performing less well or operates less efficiently than its peers and we set targets for improvement.

2.6 To ensure that a strong regulatory framework is in place between us and the GDNs, we also establish a clearly defined set of outputs[3] that the GDNs must deliver and put in place cost and performance reporting systems that allow monitoring of actual versus determined target outputs. When selecting these outputs we aim to strike a balance between outputs that are clearly defined while allowing the GDNs the flexibility they need to deliver them in the most effective way.

2.7 In addition to the pre-defined outputs, there are other outcomes a price control will have[4]. These will include for example (but are not necessarily limited to) the impact of

[3] See paragraphs 4.140 to 4.151 for further details on outputs for the GD17 price control.
[4] See chapter 5 for a description of some outcomes of the GD17 price control.

the price control on distribution costs and consumer tariffs, on the environment and greenhouse gas emissions and on customer service as well as the opportunity for an increasing number of consumers to enjoy the benefits of being connected to the natural gas network.

Overview of the Price Control Process

2.8 Within a regulatory regime, the determination of a constrained budget to deliver a defined set of outcomes over a set period is achieved through the price control process.

2.9 The principal aims of the price control are to ensure that:

- prices are set at the lowest level that is consistent with delivering outputs;
- GDNs day-to-day running costs are kept as low as possible; and
- GDNs invest efficiently and effectively and so deliver the desired effect of the development of the gas industry, at value for money prices.

2.10 We also challenge the GDNs to improve their efficiency and performance relative to the gas distribution companies in Great Britain.

2.11 The wide-ranging price control process includes a number of distinct stages:

- GDNs prepare a business plan (including actual data for previous years), that sets out their assessment of the funding necessary to deliver these outcomes.
- We will consider the business plan and benchmark efficiency and performance in order to set appropriate allowances that we consider are necessary to allow the GDNs to operate in an efficient manner.
- We issue a draft determination for public consultation. We encourage stakeholders to provide their views by commenting on the draft proposals.
- We then assess the business plan and carefully consider all responses received from the draft determination consultation to arrive at a final determination of a challenging and achievable level of funding. This process ensures the final determination is fair, balanced and proportionate for the GDNs.
- We consult on any licence modifications required as a result of the final determination. Such licence modifications will comprise modifications to designated parameters and determination values.
- We then assess the responses received to the consultation on licence modifications and carefully consider all responses received before publishing our licence modifications decision.

3 Overview of our Price Controls

Existing Price Controls: GD14 of PNGL & Firmus (2014-2016 Calendar Years)

3.1 In late 2012 we began scoping and planning the work necessary to develop the GD14 price control.

3.2 The draft determination of GD14[5] was published in July 2013, with the consultation closing at the end of September 2013.

3.3 A final determination document[6] was published on the 20 December 2013.

3.4 This was accepted by both PNGL and firmus.

3.5 firmus and PNGL have certain similarities in the main component parts of the price control, such as operating expenditure (opex), capital expenditure (capex), volumes of gas and rate of return. These components are the basis of allowed revenues or conveyance charges, which are set over various customer categories (mainly domestic and large industrial and commercial customers) which the GDNs charge to enable the recovery of operating costs, capital expenditure and allowed rate of return.

3.6 However, there are also some differences between how the firmus and PNGL licences operate. The main difference is that PNGL operate under a revenue control, whereas firmus operate under a volume incentive control.

Lessons Learnt from GD14

3.7 As a regulator we constantly strive to re-evaluate our processes and thinking to ensure that we deliver price controls in a focused and timely manner.

3.8 After GD14 had been published, we thought it would be appropriate to consider views from the main contributors, to engage on their thoughts about the GD14 process in general and consider what could be done differently for the next price control, referred to as GD17.

3.9 A few broad themes were identified, which can be summarised under two topics:

- alignment of the price controls and GDNs;
- timelines and duration of the price control process.

[5] http://www.uregni.gov.uk/uploads/publications/GD14_Final.pdf.
[6] http://www.uregni.gov.uk/uploads/publications/2013-12-20_GD14_Price_Control_for_NI_GDNs_2014-2016_Final_Determination.pdf.

3.10 GD14 was the first opportunity to align the price controls for both GDNs. This highlighted differences and similarities in the working practices of the respective organisations. It presented challenges in attempting to present information on a consistent basis across the price control, including the fact that the respective licences required costs to be presented in different cost bases, in relation to RPI.

3.11 The planning and approach of GD14 was constrained from its commencement, due to the rejection of PNGL12, which was referred to the then called Competition Commission, which reached its decision in December 2012. This had a knock on effect throughout, with limited clarity on the business plan submissions, which created more work during the process.

3.12 We have taken these lessons into account in designing the process for GD17. We have already put more detailed cost reporting arrangements in place with the GDNs and this paper provides a much longer program for GD17 than previous price controls to allow for higher levels of engagement and more advance notice of all aspects of the price control.

Gas Distribution Price Control 17 (GD17 2017-2022)

3.13 There is a growing need for a more holistic, more strategic approach to the management of all aspects of the gas industry. This will facilitate a consistent approach to gas distribution across the whole of Northern Ireland and will ensure benchmarking between the companies is implemented to ensure downward pressure on costs.

3.14 The optimum duration of a price control is a matter of judgement that needs to balance the advantage of allowing as much time as possible to plan and deliver the service with the constraints and external drivers that inform the overall level of charging that is possible.

3.15 Whilst GD14 was for a period of three years, we indicated in our final determination for that price control our intention for GD17 to be for a longer period such as five years.[7] We propose to also consider, as an alternative, a duration for GD17 of six years.

3.16 We believe that a 6 years duration offers certain benefits as follows:

- Allows UR to have sufficient internal resources available to mange other price controls which promotes a more consistent approach and reduces reliance on external consultants to the same degree.

[7] See Utility Regulator: GD14 Price Control for Northern Ireland's Gas Distribution Networks for 2014-2016, Final Determination, 20 December 2013 (http://www.uregni.gov.uk/uploads/publications/GD14_Final.pdf), paragraph 3.19.

- Considers the movement in other regulatory regimes of extending price controls and the increased certainty this affords all stakeholders. By way of an example, Ofgem RIIO-GD1 was for a duration of 8 years.
- This timeline would fall behind the next major price control in Great Britain, namely Ofgem RIIO-GD2 which is scheduled to come into effect from the 1 April 2021. This would facilitate an appreciation of and potential adoption of GB benchmarking data and allow us to keep abreast of any innovations that occur within a similar regulatory environment.
- Provides a more stable framework and certainty for all parities, considering the short term duration of PNGL12 (2 years) and GD14 (3 Years).

3.17 The 5 year duration is also worthy of consideration, as it reduces the risk of potential re-openers.

3.18 We would welcome views on all stakeholders on this issue of optimum duration.

3.19 The next price control, if a six year duration was adopted, would then be referred to as GD23 and would come into effect from 1 January 2023.

3.20 The duration of GD23, would be consulted on nearer to the time when this would come into effect.

4 Our Approach to Key Areas

Aims for GD17

4.1 It is important to set out clearly the overriding aim of the price control. For GD17 our principal aim is to continue the growth and development of an economic gas network. This will mean a strong focus on ensuring the GDNs have appropriate incentives to grow their networks to allow new customers the opportunity to connect to natural gas. In addition it will mean an emphasis on having the right mechanisms in place so that GDNs remain committed to connecting those customers with access to natural gas.

4.2 Our other aims are that the GD17 process will:

- commence from the solid foundation of GD14 and build on the long term funding of gas, delivering long term improvement in the service to consumers;
- challenge the GDNs to improve their efficiency and performance at an achievable and sustainable rate; and
- promote long term planning of the business which will secure continuity of investment across years and between price control periods.

4.3 At a more operational level we plan the following:

- set out a clear timetable with key deliverables and sufficient time to allow proper consideration of all comments;
- build on the RIGs for annual/cost reporting to monitor actual outputs of current performance and establish a recognised and consistent format;
- set out a template based on the RIGs for annual/cost reporting for population that will be used in the business plan submission for GD17;
- set out clear levels of engagement for all stakeholders, from the submission of the business plans, incorporating consumer engagement, to issuing of the final determination.

4.4 We would welcome views on what other aims we should focus on.

General Overview

Introduction

4.5 We propose that at the GDN price control we will set revenue limits. We will do so in a way that ensures that the company's operational and investment costs can be met and

objectives delivered effectively and efficiently, providing best value for money to consumers.

4.6 All aspects of the GDNs' businesses will be considered and the objectives to be delivered will be tailored to take account of the needs of the developing gas industry in Northern Ireland and associated cost. While we propose to focus on the price control period, we will also consider the planning work necessary to support the effective and efficient delivery of service in the longer term.

4.7 We will also carefully consider the impact of any price control decisions on consumers.

4.8 We note that the provision of relevant and robust information in a timely manner by the GDNs to us is a pre-requisite for a successful price control. We therefore envisage to clearly set out our information requirements and liaise with the GDNs on an ongoing basis as appropriate We may also consider licence modifications, where relevant and appropriate, to ensure relevant information will be provided to us in the timescales, format and quality required.

4.9 As indicated in our GD14 final determination, RIGs for annual/cost reporting were rolled out during 2014. As part of the roll-out, we held joint workshops with the GDNs and issued a template for population along with guidance notes to them. In doing so, we followed-up on the requirement of the GD14 price control to establish a base line of actual spends incurred, on a consistent basis.

4.10 We have also published, in July 2014, the Conveyance Revenue Models[8] used to set prices for the GD14 price control, which covered the determination values, but also the forecasts anticipated from 2017 onwards, based on the respective licence conditions of the GDNs. We believe this will allow all stakeholders better transparency of how a price control operates, along with the financial fundamentals necessary to operate and build a programme over the long term.

4.11 As part of the GD14 price control we aligned the price control process for the two GDNs then existing in Northern Ireland, PNGL and firmus. In this context, we have also considered aligning the price control process for the NI GDNs with the one for other GDNs in GB, where reasonable and possible, to facilitate better benchmarking and create a basis for a more holistic, strategic approach to the management of all aspects of the gas industry. As outlined in this document, we intend to continue and improve the alignment of the price control processes for PNGL and firmus, and for them and the GB GDNs, as part of the GD17 price control process with a view of adopting leading edge regulatory practice where it can be adopted locally and modifying it where appropriate for local circumstances. We also envisage that the price control process for the Gas to the West GDN should be aligned with the ones for the other GDNs. Depending on the

[8] http://www.uregni.gov.uk/publications/phoenix_natural_gas_limited_and_firmus_energy_distribution_limited_models_a.

timing for the granting of that licence, the first price control for the Gas to the West GDN may be done:

- as part of the GD17 price control process; or
- separately, with the first joint price control for all three NI GDNs being the one following GD17.

4.12 In either case, we propose that the price control process for the Gas to the West GDN should follow, where reasonable and possible, the GD17 approach, taking into consideration the lack of historic data, the different degree of network maturity of the Gas to the West network, the details submitted by that GDN in their business plan as part of the licence application process as well as the development plan which forms part of the Gas to the West low pressure licence. Therefore, references to the GDNs in this chapter 4 of this document should be understood to include the Gas to the West GDN as well, unless specifically stated otherwise, but subject to a further review of appropriateness of the approach outlined in this document. This review can only be completed once the details of the Gas to the West low pressure licence are known.

4.13 In section 6 of this paper we provide a timeline of the key milestones which will be followed throughout the price control process.

A Proportionate Approach

4.14 In addressing the key areas of this price control, we are mindful of the need to keep the regulatory burden to a minimum while addressing the information asymmetry that exists between us and the companies.

4.15 We will consider adopting and applying a number of principles to ensure that our approach is proportionate. These principles are:

- GDN business plan templates referred to in Appendix 3: Business Plan Template will be populated and submitted by the GDNs to ensure a consistent and correct format is used at all times.
- Any atypical costs and special factors will be identified separately in GDN submissions.
- Areas of high expenditure will receive substantially more scrutiny and analysis than low value items, along with new additional opex and capex where we shall expect to have presented the net impacts from such increases and any decrements.
- Benchmarking will be used where possible and a triangulated approach adopted to ensure that allowances are efficient and that efficiency targets are reasonable but challenging.
- Where possible, any allowances set shall be closely aligned to clearly defined outputs and relevant drivers.

- Costs related to external factors which may or may not happen and about which there are no obvious firm estimates form part of the so called “uncertainty mechanism” which is described in more detail in paragraphs 4.125 to 4.131.
- If insufficient information is available to make an informed determination, either on grounds of whether the costs will or won’t materialise or an absence of any firm estimate if they do materialise, some areas may be subject to re-openers.
- The price control will be based on a standard RPI-X framework, which will incentivise the GDN to control its costs through the setting of efficiency targets and subsequent adjustments of opex and capex at subsequent price controls.
- Allowances will not be given for costs that the GDNs can recover through other channels, such as (but not necessarily limited to) third parties causing damages to the network, customers or suppliers.
- Allowances will not be given for profit margins for any related parties performing services for the GDNs, where relevant.

4.16 We will adopt a light touch approach if:

- there is evidence to show that the company is comparatively efficient;
- past costs are a strong indicator of future costs;
- there is insufficient data to support a more robust approach.

4.17 We will adopt a more detailed approach if:

- the company is comparatively inefficient;
- past costs are a weak indicator of future costs;
- data is available for econometrics, serviceability measures, outputs and so on.

4.18 We would expect GDNs to develop the data necessary to support a robust assessment of expenditure and outputs. Where it is necessary to adopt a light touch approach because there is insufficient data, we would adopt an approach to funding which is prudent but conservative until the company can develop a robust approach based on sound data.

4.19 We also propose to consider as part of our price control, where relevant and appropriate, best practice relating to other price controls and findings from our project to make network price controls more consistent, by adopting cross-utility approaches, principles and standards of regulation.

Information Requirements

4.20 We will continue to ensure that the information we require from the GDNs is proportionate but sufficient to:

- allow the GDN to communicate its business plan to us in a clear and effective manner; and
- ensure that we can submit the plan to effective and focused scrutiny.

4.21 For GD17 we will:

- continue to use and build on the information requirements that we developed for annual/cost reporting, maintaining the key objectives of continuity and simplicity;
- require the GDNs to submit their business plans in the format as provided, with sufficient historic information included and with an explanation, that can be understood by the customers, of the impact and cost of these business plans;
- ask each GDN to provide a plan of potential connections for the development of its gas distribution network which explains how it has assessed the potential for extending the network to pass and connect additional properties,
- add additional information requirements where necessary, for example to support efficiency assessments and capture information on current issues;
- build on the common working together that is already present within the gas industry and seek further alignment between price control submissions and other processes;
- consider whether further amendments to the format of our price control determination or other regulatory submissions such as e.g. regulatory accounts are necessary to ensure clarity and reconciliation between them;
- use appropriate methods to check and verify key information, as requested (in particular with respect to but not necessarily limited to information re: pipes laid and connections);
- use today's prices as a price basis, with actual or assumed RPI indices to enable switching to other price bases, if necessary;
- reserve the right to appoint, where appropriate, an examiner to examine the recording of relevant information by the GDNs;
- reserve the right to request, where appropriate, an audit of specified information relating to the GD17 price control, including specification of the terms on which an auditor is to be appointed by the GDNs for that purpose and of the nature of the audit to be carried out by that person.

4.22 In support of the drive for provision of high quality robust submissions, we expect the GDNs to:

- demonstrate that the GDN Boards take responsibility for and sign-off the assurance of the data and plans submitted for the GD17 price control;

- provide reliable, consistent driver-based information with appropriate explanations of any changes in numbers or circumstances;
- provide any information as requested in the timelines as specified;
- be able to demonstrate that all costs are necessary to run an efficient well managed business;
- demonstrate the basis of apportionment of costs shared between group and related parties.

Indexation and Efficiency Target

Overview

4.23 When setting an efficiency target, two effects need to be considered: catch-up to frontier performance and continued movement of the frontier over time.

4.24 The move of the frontier – or frontier shift – describes the efficiency gains resulting from companies becoming more efficient over time, e.g. through technological progress. The frontier shift in real terms can be calculated as follows:

Frontier shift in real terms	=	input price increase	minus
		forecast RPI (measured inflation)	minus
		productivity increase	

4.25 The move towards the frontier describes the efficiency gains a company can achieve through catching-up with the economic frontier.

4.26 In order to account for the two effects when determining opex and capex allowances as part of the GD17 price control, we will consider proceeding in stages:

- Use a bottom-up approach to opex and capex analysis to analyse, for each of the main opex and capex cost categories (and broken down into further sub-categories if and as appropriate) the data submitted by the GDNs with a view to assessing what we consider to be an efficient allowance for each category. In doing so, we will consider any atypical expenditure and special factors, as relevant and appropriate and we may use a variety of techniques as further detailed in paragraphs 4.49 to 4.84 for opex and 4.85 to 4.111 for capex.
- Use a top-down approach to opex and capex analysis, as described in paragraphs 4.28 to 4.39, to analyse, for the GDN as a whole, the efficiency gap against a company operating at the frontier and to determine, based on the results using a common base year, the catch-up target we expect the GDN to meet during the course of the price control. We will then consider applying this catch-up target to the base year forecast for each of the main opex and capex categories. Our base year

costs will be adjusted for consideration of any atypical expenditure and special factors[9] that may be relevant. We are minded to set out materiality thresholds as part of our special factors process, structured around our timetable for efficiency modelling.

- Determine the opex and capex allowances with consideration of the results of both, top-down and bottom-up analysis. For consistency with the GD14 price control, we propose to refer to these allowances as pre-efficiency allowances as they do not yet reflect the frontier shift efficiency gains the GDNs can be expected to achieve over time (even if these allowances already reflect the efficiency gains we expect the GDNs to have achieved as a result of catching-up with the economic frontier since our last price control).
- Establish frontier shift in real terms and apply it to the pre-efficiency allowances to establish the post-efficiency allowances, including any catch-up efficiencies, as described in paragraphs 4.41 to 4.48.

4.27 Thus, when setting our opex and capex determinations for the GDNs, we will apply efficiency targets to reflect our analysis of the appropriate speed of catch-up to frontier performance (as part of the bottom-up and top-down analysis), where relevant (i.e. where our analysis indicates that a GDN is not yet operating at the economic frontier) as well as efficiency targets to reflect movement in the frontier. The real frontier shift target may be variously positive or negative, reflecting whether productivity increases are expected to outweigh the anticipated real price effects (weighted average of nominal cost increases/decreases i.e. forecast costs minus general or RPI inflation) faced by an efficient company.

Catch-up with the Frontier

4.28 In order to establish the efficiency gains a company can achieve by moving closer to the economic frontier, it is necessary to establish the gap that exists between the performance of the company and the frontier. The quality of any such analysis will depend on the availability and quality of comparator data, as well as on consideration of any special factors and atypical events that might be relevant.

4.29 It is important to note that at this stage, we cannot fetter our discretion regarding the approach for setting frontier catch-up targets. This means that related methodologies or decisions cannot be finalised until the receipt of the GDNs' GD17 submissions and our determination. To do so could result in adopting a suboptimal approach and in turn have a harmful effect on consumers and/or the GDNs.

[9] A variety of efficiency modelling approaches are being considered for GD17; including those where special factors are submitted at time of the business plan or where special factors are deemed to require pre-modelling adjustment prior to being added back into a company's allowance once its frontier allowance has been calculated.

4.30 Although no final decisions are made in this approach document, we set out below some key considerations which we will consider incorporating in our models for assessing catch-up efficiency potentials. Like with most econometric modelling, there are a variety of techniques available. There is also an element of judgement, estimation and uncertainty.

4.31 As indicated in paragraph 4.26, we will consider using a combined top-down and bottom-up approach for the assessment of the efficiency gains a company can achieve through catching-up with the economic frontier. No one method can provide a single estimate of the required efficiencies with absolute accuracy, we prefer to combine a variety of approaches and therefore estimates as part of a triangulated approach. We then compare our proposed efficiency targets with experience of efficiency delivery from similar industries and arrive at our determination decisions by taking our efficiency view and targets 'in the round'. This means, any additional cost pressures which a company faces must also be counterbalanced against any efficiency gap to the frontier, the size of such a gap and how long we determine is reasonable to eradicate some or all of that gap during the price control period.

4.32 With a view to enhancing the options for and quality of benchmarking, we will consider aligning our top-down catch-up efficiency models with similar models used by Ofgem as part of the RIIO-GD1 price control, where reasonable and possible. In doing so, we propose to also consider atypical events and special regional or company-specific factors for the NI GDNs, where relevant and appropriate. We note that we expect the GDNs, as part of their business plan submissions, to indicate any atypical events and special factors they consider relevant. We also note that we may apply materiality thresholds for consideration of special factors. Any atypical expenditure submission around the base year(s) used for efficiency modelling will likely reduce a company's base year expenditure going forward, whilst allowing for a smaller estimate of any inefficiency compared to frontier performance ceteris paribus. Further detailed guidance and timescales around submission of both special factors and atypical expenditures will be issued as part of our business plan information requirements to GDNs.

4.33 Whilst, as part of the benchmarking, we intend to compare the data of the NI GDNs against comparable data of the GB GDNs, where reasonable and possible, we do not propose to recalculate the GB benchmarking data with consideration of data for the NI GDNs. Query processes in the immediate periods post (i) our sending out of business plan information requirements to GDNs, (ii) the GDNs submitting their business plans, (iii) our draft and final determinations and, finally (iv) any company submissions in response to our draft determination, will provide the opportunity to fine tune any local GDN data which is deemed materially different to GB GDN comparator datasets due to differences in cost treatment rather than (in)efficiency.

4.34 Like Ofgem, we propose to consider as part of our top-down analysis a number of different modelling approaches[10], including:

- totex (total expenditure) models to account for opex-capex trade-offs in our comparative efficiency assessment and identify the companies that have minimised total costs;
- activity level analysis to take into account a greater number of potential factors that explain costs;
- models based on historic data that have the benefit of being anchored in actual (as opposed to forecast data); and
- models using forecast data to take into account GDNs' views on how costs will change over the price control period.

4.35 To ensure a like-for-like comparison of local GDNs to their GB counterparts we shall consider which non-controllable or controllable costs we might exclude from top-down efficiency models, including whether such analyses inform a sensitivity analysis of modelling results.

4.36 Based on our assessment, for each GDN, of the efficiency gap to the frontier, we propose to set, as part of the GD17 price control process, catch-up targets for each GDN.

4.37 When setting catch-up efficiency targets, we will consider the following aspects:

- rate of catch-up; and
- applicability of targets.

4.38 Aspects we propose to consider when determining the rate of catch-up include (but are not necessarily limited to) the following:

- size of remaining efficiency gap;
- GDNs' business plans;
- regulatory precedent for catch-up rates;
- what other utilities have achieved at similar stages of development; and
- what efficiency we believe is achievable overall.

4.39 We will consider applying catch-up efficiency targets to some or all of the controllable and uncontrollable cost items. We propose that our decision will be informed by considerations including (but not necessarily limited to) the:

[10] For further details see e.g. Ofgem: RIIO-GD1: Initial Proposals, 27 July 2012, pp. 26-29 and Ofgem: RIIO-GD1: Final Proposals – Supporting document – Cost efficiency, 17 December 2012, p. 8.

- key areas from which the efficiency gap originates; and
- regulatory precedent for frontier catch-up targets.

4.40 As outlined in paragraph 4.26, we propose to consider the catch-up efficiency targets thus established, together with the findings from the bottom-up opex and capex analysis, when determining the allowances.

Frontier Shift

4.41 As part of the frontier shift calculation, the impact of input price inflation needs to be established. As the nominal prices for different types of inputs can develop in different ways, it is good practice to distinguish between different cost categories. As part of the GD14 price control, we have differentiated between the cost categories shown in Table 1 below. For GD17, we propose to consider the following:

- maintain as a minimum the cost categories already identified as part of GD14;
- review – with consideration of the data provided by the GDNs as part of their submissions and of best practice applied as part of other price controls – if a further differentiation of the cost category "Other"[11] is appropriate;
- maintain the differentiation between opex and capex with respect to the assessment of the impact of input price inflation for the different cost categories;
- review – with consideration of the data provided by the GDNs, of the approach used by Ofgem for other GDNs in GB and of best practice applied as part of other price controls – if the percentage split for opex and capex between the different cost categories is still appropriate; this will include a review of whether and under what particular circumstances company-specific weightings can be used, as done by the Competition Commission in their determination on the NIE RP5 price control, rather than using weightings for a notional or frontier company.

[B]By this we mean that further cost categories, which during the GD14 price control have been subsumed under "Other", would be identified for which the impact of input price inflation should be assessed separately; we would expect, however, that an "Other" cost category will remain for which such individual assessment of the impact of input price inflation does not make sense.

Table 1: Cost Categories and Weightings for Efficiency Analysis as part of GD14 Price Control

Cost Category	Opex	Capex
Labour (direct and contracted)	52%	56%
Materials	6%	19%
Equipment/ Plant	1%	4%
Other	41%	21%

4.42 In line with the approach taken as part of the GD14 price control, we will consider, where reasonably possible, basing our assumptions for RPI and nominal input cost price increases across a variety of different cost categories and their forecast increases using either our own extrapolation of trends in indices/nominal time series or publically available forecasts.

4.43 In line with the approach taken as part of the GD14 price control, we will consider determining the opex and capex nominal input price increase forecast for each year of the price control period by calculating the weighted average of the input price increases for the different cost categories. We will consider determining the opex and capex real input price increase forecast for each year of the price control period by subtracting the RPI forecast from the nominal input price increase forecast.

4.44 In line with the approach taken as part of the GD14 price control, we will consider assuming an average annual productivity increase for both opex and capex based on analyses from a number of sources. In doing so we will also consider best regulatory practice applied as part of other price controls.

4.45 As in GD14, we will consider establishing the base year for opex and the one for capex with consideration of the years on which the input data for the GD17 price control process was based. In line with the approach taken as part of the GD14 price control, we will consider applying opex/capex real price effects and productivity increases for each year, starting from the year following the base year to the end of the price control period. In doing so, we will, for any years prior to the start of the GD17 price control period, use the same approach as described in paragraphs 4.42 to 4.44 for the years of the price control period, and will consider whether to apply actuals or long run averages depending upon availability.

4.46 We will consider applying the relevant compound real price effect and ongoing productivity increase factors (calculated as detailed in paragraph 4.45) to the controllable pre-efficiency opex/capex allowances in order to determine the controllable post-efficiency opex/capex allowances for each year of the price control. Whilst as part of the GD14 final determination we have published the controllable post-efficiency opex/capex allowances for each year of the price control period and for the price control period as a whole as an aggregate and not broken down into the different controllable cost items, we

will consider for GD17 – in order to facilitate improved monitoring of performance against price control targets – publishing the controllable post-efficiency opex/capex allowances for each year of the price control period and for the price control period as a whole, both broken down into cost item level and as a total across all controllable cost items.

4.47 In line with the approach taken as part of the GD14 price control, we will consider determining the overall post-efficiency opex/capex allowance for each year of the price control period and for the price control period as a whole by adding the allowances for the uncontrollable opex/capex cost items to the total controllable post-efficiency opex/capex allowances.

4.48 We propose to consider in more detail, during the course of the price control, two options regarding the retrospective adjustment of real price effects during the price control period:

- No retrospective adjustment, i.e. real price effects used as part of the GD17 determination will be based on ex-ante forecasts.
- Retrospective adjustment as part of the uncertainty mechanism based on the actual RPI and index data used in the calculation of the real price effects. Under this scenario, we may also consider the use of materiality thresholds, i.e. retrospective adjustment would take place only in cases where the deviation between the forecast real price effect and the actual real price effect established in hindsight is considered to be material. Should an index used in the real price effect calculation be materially changed or discontinued during the period of the price control, we would consider using best estimates as part of the uncertainty mechanism instead of actuals for that index.

As part of our considerations of the two options, we propose to have regard to consistency between the actual development of real price effects for past years and our forecast for the price control period, to the consultation by Ofgem on the treatment of real price effects for the RIIO-ED1 price control[12] as well as to regulatory best practice applied as part of other price controls.

We note that the proposed consideration of options for retrospective adjustment under the uncertainty mechanism relates to real price effects only; we do not propose to conduct a retrospective adjustment for the average annual opex and capex productivity increases.

Operational Expenditure

Overview

[12] Ofgem: Consultation on the treatment of real price effects for RIIO-ED1 slow-track electricity distribution network operators, 28 August 2014.

4.49 The approach set out in paragraphs 4.50 to 4.84 provides a broad view of how we might assess particular elements of operational expenditure based on our previous experience and best regulatory practice. It is important to note that at this stage we cannot fetter our discretion regarding our approach to setting pre-efficient allowances. To do so could result in adopting a suboptimal approach and in turn have a harmful effect on consumers and/or the GDNs.

4.50 In line with the Regulatory Instructions and Guidance for annual/cost reporting issued to the GDNs in July 2014, we will consider distinguishing, as part of the GD17 price control, between the following main opex cost categories:

- Work Management
  - Asset Management
  - Operations Management
  - Customer Management (Emergency Call Centre)
  - Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping)
  - System Control
- Work Execution
  - Emergency
  - Metering
  - PRE Reports
  - Maintenance
  - Other Direct Activities
- Business Support
  - IT & Telecoms
  - Property Management
  - HR & Non-operational Training
  - Audit, Finance & Regulation
  - Insurance
  - Procurement
  - CEO & Group Management
  - Stores & Logistics
- Other Opex

- Advertising & Market Development (owner-occupied[13] and non-owner-occupied properties)
- Trainees & Apprentices
- Non-Controllable Opex

4.51 In the Regulatory Instructions and Guidance for annual/cost reporting issued to the GDNs in July 2014, costs relating to the following expenditure types were classified as uncontrollable:

- Shrinkage;
- Licence Fees;
- Bad Debt[14].

We would highlight this was not an indication of any decision as part of the GD17 price control on which costs are uncontrolled. We will review what costs should be considered uncontrollable as part of the price control.

4.52 The costs within each of the main opex categories may be comprised of different expenditure types. For the GD17 price control, we will consider distinguishing the same expenditure types as in the Regulatory Instructions and Guidance for annual/cost reporting issued to the GDNs in July 2014.

4.53 Where applicable, internal recharges will be reviewed and benchmarked against prior years and against deemed efficient 3rd party costs for any goods/services provided. In all cases, a 'value for money' approach will be adopted, to ensure consumers gain a fair deal in not having such goods/services outsourced on a 3rd party arms length transaction basis.

4.54 As set out in paragraph 4.26, we will consider using, as part of the GD17 price control, a combined top-down and bottom-up approach as a basis for our opex analysis. When determining the opex allowances, we will consider the results of both, top-down and bottom-up analysis. Paragraphs 4.28 to 4.39 detail our proposed approach for the top-down analysis, paragraphs 4.49 to 4.84 our proposed approach for the bottom-up analysis. In particular, paragraphs 4.59 to 4.84 include examples of what we mean by bottom-up benchmarking. As bottom-up benchmarking can be prone to be affected by atypical effects, we will consider validating it against some very high top-down catch-up efficiency targets, where material to the determination.

[13] It should be noted that the term owner occupied properties, as used in this document and defined in Acronyms and Glossary, comprises privately rented properties.
[14] As indicated in the Regulatory Instructions and Guidance for annual/ cost reporting issued to the GDNs in July 2014, we understand "Bad Debt" to be the amounts owed by third parties that are unlikely to be paid due. This includes, but is not limited to, debts from long-term disputes re: network damages.

4.55 We propose to consider, as part of our bottom-up analysis of the different cost categories, costs relating to all expenditure types. Where appropriate, we may also conduct a separate, more detailed analysis for selected expenditure types, including, but not necessarily limited to, manpower and network rates.

4.56 We will consider using benchmarking using both a top-down and bottom-up approach. It should be noted that as part of the top-down approach, benchmarking will include focus on assessing the efficiency of the GDN as a whole against other GDNs. As part of the bottom-up approach, benchmarking will include focus on assessing the performance of a GDN in a specific area against that of other companies in the same area.

4.57 Where relevant and appropriate, we may also consider as part of our opex analysis additional information such as for example (but not necessarily limited to) the views of industry and subject matter experts outside our own organisation.

4.58 In light of the ongoing uncertainty regarding the implementation of the TMA (Traffic Management Act) and its effect on operating costs, we propose to consider, should a decision on the timing and details of the TMA not have been taken by the time of our determination, including, where relevant and appropriate, an estimate of TMA costs in the opex allowances, subject to retrospective adjustment as part of the uncertainty mechanism at the time of the next price control. This would be in line with our approach as part of the GD14 price control and protect both, the GDNs (in the event that actual costs turn out to be higher than the estimate) and consumers (in the event that implementation is delayed or that the impact is less than the estimate). Should a decision on timing and details of the TMA have been taken before our determination, we will consider basing our determination on this decision; rates for TMA allowances would then not be included in the uncertainty mechanism, but there would still be a retrospective adjustment for the TMA cost drivers.

Work Management

Asset Management

4.59 We plan to review the existing asset management system in place and ensure that it is fit for purpose.

4.60 We will consider the findings of this review as part of our determination.

Operations Management

4.61 We will consider the following areas in relation to the day to day planning and supervision of the operative and contractors working within the work execution processes as follows:

- First Line Managers;
- Depot Managers;

- Safety, Health and Environmental; and
- Operations support.

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

4.62 We will review this area covering the following categories:

- Call centres (including central emergency call centre charge for emergency service);
- Customer services and commercial/contract management departments that handle enquiries/complaints, monitor standards, manage contracts etc.

4.63 We will consider using call centre cost benchmarking, both between the NI GDNs and with other GDNs, where reasonable and possible. In doing so, we will consider specifics of the NI natural gas network which may impact on the number of calls, such as relatively high prepaid meter basis, new gas connections, any adverse weather conditions and any other pertinent factors.

System Control

4.64 We plan to review the existing arrangements for monitoring the safe flow of gas through the network and the associated costs incurred.

Work Execution

Emergency

4.65 We propose to consider the call centre model when setting our allowances on emergency costs.

4.66 We will consider, where reasonable and possible, additional information such as relevant benchmarking data and material NI- or GDN-specific special factors.

Metering

4.67 We propose to consider an analysis of historic and forecast GDN data when assessing metering costs. We may also consider, where reasonable and possible, additional information such as relevant benchmarking data and material NI- or GDN-specific special factors.

4.68 Furthermore, we will also consider, where relevant and appropriate, the implications of any changes to metering policies in Northern Ireland, such as the introduction of smart metering, should it occur during the GD17 price control period. We expect that the GDNs will set out their views on future metering strategy as part of their business plans.

PRE Repairs

4.69 We propose to consider an appropriate metric on GDN repair cost forecasts, based on the size of the network, and whether a driver such as e.g. MEAV[15] (Modern Equivalent Asset Valuation) should be used.

Maintenance

4.70 Maintenance activities are those direct activities required for the examination and repair of plant and equipment within the network. These activities can be split into three types:

- routine maintenance (i.e. maintenance activities that recur at least annually);
- non-routine maintenance (i.e. maintenance activities that recur regularly, but in intervals larger than one year); and
- exceptional items maintenance (any maintenance activities that are neither routine nor non-routine maintenance).

4.71 We plan to benchmark at a detailed activity level if we consider that we have sufficient robust benchmark maintenance activities.

4.72 We will consider exploring, as part of the GD17 price control process, the possibility of using (MEAV)[16] as a driver when assessing maintenance cost requests. Following the approach used in GB, this will require companies to undertake an inventory of their network assets and their replacement values. It is expected that the primary driver would be above ground assets, as this is understood to drive most of the maintenance cost. We may consider customer numbers as an alternative primary driver for costs relating to non-exceptional maintenance activities.

Other Direct Activities

4.73 We will consider assessing any costs for other direct activities on a case-by-case basis. We note that we expect the GDNs to provide sufficient detail on the nature of these activities as well as justification for the associated costs to inform our analysis.

Business Support Costs

In General

4.74 We will consider reviewing actual costs incurred and benchmark these areas where appropriate.

Insurance

[15] See paragraph 4.72 for further details on MEAV.
[16] MEAV is employed by Ofgem as a means of creating an equivalent new network which can be used as a scale driver for various cost activities. MEAV can recognise the size, asset base and complexity of a network, and represents the cost of creating an equivalent new network.

4.75 We will consider reviewing in detail the cost make up of the insurance sub categories as well as performing benchmarking against peers and actual outputs from prior years, where appropriate.

Other Opex

Advertising & Market Development (owner-occupied[13] and non-owner occupied properties)

4.76 We will consider retaining and developing the existing Connection Incentive Mechanism, through reviewing any assumption considered necessary and assessing its appropriateness for the future (whilst ensuring points 6 of paragraphs 5.52 & 6.44 of the GD14 final determination are given due consideration[17]).

4.77 We will consider looking into the possibility of targeted allowances within the current Connection Incentive Mechanism, for Fuel-Poor consumers, to help drive connections to this customer type.

Trainees & Apprentices

4.78 We will consider reviewing actual costs incurred and benchmark where appropriate.

Non-Controllable Opex

4.79 We will consider reviewing all items proposed to be non-controllable on a case-by-case basis to ascertain that this classification remains appropriate.

Expenditure Types

Manpower

4.80 We propose to present a submission template for GDN use to build up the manpower costs from a bottom-up approach, allowing clearly defined drivers, such as staff numbers by activity and grade to be applied in the aggregation and summation of salary and related requests for each activity and grade, as well as standard pre-populated drivers (for example, National Insurance etc). We may also use breakdown of manpower data by SOC (Standard Occupational Classification) Code for benchmarking purposes.

4.81 Included under the manpower opex will be all manpower-related additional costs that can be calculated using the presented drivers (for example, commission, entertainment, allowances, travel & subsistence, car allowance and fleet costs).

4.82 We will consider assessing assumptions around all inputs/driver data for reasonableness through benchmarking and actual outputs from previous years, where deemed appropriate.

Network Rates

[17] Paragraphs 5.52 & 6.44 – Point 6 state that we expect to reduce the full per connection allowance by 50% from 2017 onwards, but that this will be subject to review and possible modification, dependent on the outcome of consultation as part of GD17.

4.83 For the granting of allowances, we will consider retaining the formula based calculation in relation to network rates. However, we will consider reviewing and, where appropriate, updating the multiplier assumptions applied to revenue and the agreed rateable values as advised by the Land & Property Services (LPS).

4.84 We expect GDNs to be able to demonstrate that they have taken all steps to minimise their valuations.

Capital Expenditure

Overview

4.85 The approach set out in paragraphs 4.86 to 4.111 provides a broad view of how we might assess particular elements of captial expenditure based on our previous experience and best regulatory practice. It is important to note that at this stage we cannot fetter our discretion regarding our approach to setting pre-efficient allowances. To do so could result in adopting a suboptimal approach and in turn have a harmful effect on consumers and/or the GDNs.

4.86 In line with the Regulatory Instructions and Guidance for annual/cost reporting issued to the GDNs in July 2014, we will consider distinguishing, as part of the GD17 price control, between the following main capex categories:

- Growth
    - Mains
    - District Governors and Pressure Reduction Stations
    - Connections
- Replacement
    - District Governors and Pressure Reduction Stations
    - Service Governors
    - Meters
- Other Capex

We may, for all or some of these main categories, differentiate between further sub-categories if and as appropriate.

4.87 We recognise that the GDNs have manpower resources that are used in designing and constructing assets. As this manpower is normally classed as opex, we will consider an appropriate amount that will be reclassified to capex.

4.88 As set out in paragraph 4.26, we will consider using, as part of the GD17 price control, a combined top-down and bottom-up approach as a basis for our capex analysis. When determining the capex allowances, we will consider the results of both, top-down and bottom-up analysis. Paragraphs 4.28 to 4.39 detail our proposed approach for the top-down analysis, paragraphs 4.85 to 4.111 our proposed approach for the bottom-up analysis.

4.89 In line with the approach taken as part of the GD14 price control, we will consider using, as part of the benchmarking for the bottom-up approach, an analysis technique which combines the areas of expenditure into a basket of work. The basket of work can then be analysed and compared between benchmarks according to the volume of each work category. The key steps in the process are:

- identify the items of work contained within the basket;
- assess to which extent cost elements are fixed, i.e. not dependent on the level of workload carried out;
- select a standard set of unit rates to be used for each of the items within the basket;
- identify the workloads and associated costs submitted by the companies for these items;
- calculate the product of the company workload and the standard unit rate for each work item;
- rescale these for each work item so that the total work item cost equals the company's submission;
- establish an efficient level of performance for the basket of items in the base year;
- calculate the efficient level of performance for each of the work items in that year, without and with consideration of fixed costs;
- roll this performance forward to the years of the price control period, using the forecast workloads.

4.90 In light of the ongoing uncertainty regarding the implementation of the TMA (Traffic Management Act) and its effect on operating costs, we propose to consider, should a decision on the timing and details of the TMA not have been taken by the time of our determination, including an estimate of TMA costs in the allowances subject to retrospective adjustment as part of the uncertainty mechanism at the time of the next price control.

4.91 In line with the approach taken as part of the GD14 price control, we will consider classifying all capex cost items as controllable.

Growth

Mains

4.92 Mains to grow the network can be laid for a number of reasons, including:

- connecting individual large I&C (industrial and commercial) customers;
- passing a number of additional (domestic, small and/or medium I&C) properties;
- reinforcing the network; and
- increasing security of supply.

4.93 As continued growth of the Network is still a priority, we believe that any further growth opportunities must be completed on an economic basis in a co-ordinated manner.

4.94 Where this principle is not appropriate (reinforcing the network and security of supply) a sound business case must be justified before any approvals can be granted.

4.95 Related allowances will be subject to review and adjustment as part of the uncertainty mechanism.

4.96 With respect to mains required to pass a number of additional domestic, small and/or medium I&C properties, we will give careful consideration to the appropriateness of the economic assessment and its underlying assumptions, having regard to aspects including (but not necessarily limited to) costs, rate of return, conveyance tariffs, average consumption, properties passed and connection rates for same per customer category.

4.97 In order to provide further incentives to the GDNs to develop the network, we propose to consider, in line with our approach taken as part of the GD14 price control, a penalty/reward mechanism whereby the GDNs will have to pay penalties if they fail to meet the targeted number of properties passed and get rewards if they exceed these targets.

District Governors and Pressure Reduction Stations

4.98 In line with our approach as part of the GD14 price control, we will consider assessing costs for district governors and pressure reduction stations required to grow the network based on an analysis of historic and forecast GDN data. We may also consider the basket of works analysis, where relevant and appropriate.

4.99 We will consider retrospectively adjusting, as part of the uncertainty mechanism, the allowances for new district governors and pressure reduction stations based on the numbers actually installed.

Connections

4.100 Connections can comprise a number of elements, including:

- meters and meter governors;
- services and service governors;

- risers and laterals.

4.101 As part of the bottom-up approach to capex analysis, we will consider, in line with our approach as part of the GD14 price control, assessing costs for connections based on an analysis of historic and forecast GDN data. We propose to also consider the basket of works analysis, where relevant and appropriate.

4.102 Furthermore, we will also consider, where relevant and appropriate, the implications of any changes to metering policies in Northern Ireland, such as the introduction of smart metering, should it occur during the GD17 price control period. We expect the GDNs to include, as part of their business plan submissions:

- details on their metering policies with specific focus on arrangements re: the use of smart meters;
- an assessment of the expected impact of a policy decision for roll-out of smart meters in NI and/ or other jurisdictions, including (but not limited to) meter costs, meter availability, cost of operations and maintenance.

4.103 We will consider retrospectively adjusting, as part of the uncertainty mechanism, the allowances for connections based on the number of connections actually made.

4.104 The GDNs in NI have historically operated a limited approach to user commitment. This has meant that users have largely had to pay nothing for economic gas connections. This situation has been part of a package to promote the growth of the industry and increase connections. However this approach is different to that applied in GB and Ireland and indeed in electricity in NI where users are expected to contribute to connection costs. The current gas policy of limited user commitment does bring some risk whereby a GDN could pay for a connection and the user subsequently shuts down leaving the cost of the connection stranded and paid for by other users.

4.105 As part of our work on G2W we highlighted that we would consider whether it was still appropriate to continue with the current policy. The alternatives could include a range of approaches to user commitment including establishing a formal financial security policy or requiring a contribution to connection costs.

4.106 After considering the various options our initial view is that the current approach has been largely successful and may be the best approach to continue the growth of the industry. This is particularly important in light of the need to ensure strong growth in the G2W area. We would be keen to discuss this issue with stakeholders and consumer groups in particular.

Replacement

4.107 Replacement of district governors, pressure reduction stations, service governors and meters may be required due to such equipment reaching the end of its normal operating life or for other reasons (e.g. due to technical failures).

4.108 As part of the bottom-up approach to capex analysis, we will consider assessing replacement costs based on an analysis of historic and forecast GDN data. We may also consider the basket of works analysis, where relevant and appropriate.

4.109 We will consider retrospectively adjusting, as part of the uncertainty mechanism, the replacement allowances based on the numbers of pieces of equipment actually replaced.

Other Capex

4.110 In line with the Regulatory Instructions and Guidance for annual/cost reporting issued to the GDNs in July 2014, we will consider the cost category "other capex" to include the following:

- System Operations;
- IT and related Telecoms;
- Commercial Gas Trading IT;
- Plant, tools & equipment;
- Land, buildings, furniture and fittings;
- Security;
- Vehicles and wheeled plant;
- Other.

4.111 We will consider assessing the other capex based on justification provided by the GDNs for such cost as well as on historic and forecast GDN data. We may also consider, where reasonable and possible, additional information such as relevant benchmarking data and material NI- or GDN-specific special factors.

Asset Maintenance

4.112 We expect the monopoly service providers we regulate to demonstrate effective long term stewardship of the asset base which has been and continues to be funded by consumers. For GD17, we require GDNs to set out the steps they have taken and plant to take to achieve excellence in asset maintenance planning and to demonstrate how this gives confidence in the company's ability to assess the optimum range of medium term interventions and level of investment required to maintain serviceability and to target future investment effectively.

4.113 To demonstrate that robust asset management processes are in place to inform robust business decisions, we will require GDNs to:

- provide a self assessment of their asset management capability against a recognised asset management methodology and identifying any further work required to achieve excellence in asset management planning.
- provide an assessment of the data they currently use to prioritise current interventions to estimate future level of capital and operational investment in the medium to long term.
- prepare a plan to improve their asset management capability which sets out how the company will address any weaknesses in its current methodologies and data necessary to improve asset maintenance planning, and timescale over which this will be achieved.
- show how a range of top-down and bottom up techniques have been applied during the preparation of their business plans to assess the optimum level of asset interventions and investment over the GD17 period.

4.114 We will develop our approach to asset maintenance planning as we complete our information requirements for GD17.

Volumes

4.115 The level of scrutiny in this area is based on the type of price control that is in effect.

4.116 PNGL are subject to a revenue cap, reflective of its network age and it being in a more mature state.

4.117 The firmus network is still growing and is currently subject to a price cap, this provides strong incentives to outperform on volumes. We will be consulting on whether to change this to a revenue cap as part of GD17.

4.118 In relation to volumes of gas and connections, we consider it appropriate to use a bottom up approach similar to that of GD14, where we:

- review the targeted number of connections by customer category and associated average burn volume assumptions (for domestic and tariff customer categories) and monthly volume usages (for contract customer categories);
- review the assumptions around customer additions and losses by month over the period of GD17 in relation to all customer categories (with contract being on an individual named customer basis);
- benchmark against actual output data from previous years, where applicable.

Incentives & Innovations

Overview

4.119 Having reviewed a range of incentive mechanisms used as part of the GD14 price control, but also as part of other price controls such as RIIO-GD1, we will consider including the following incentive mechanisms as part of GD17:

- Connection Incentive;
- Properties Passed Incentive.

4.120 As outlined in paragraph 35.18, we will consider reviewing, during the GD17 price control period, the measures in place to ensure ongoing focus of the GDNs on consumer interests and needs. This will, over time, facilitate a better monitoring of GDN performance in this area and may form the basis for the introduction of additional incentive mechanisms such as specific customer service incentives as part of future price controls. Hence, we will consider undertaking a further review of incentive mechanisms as part of the price control following GD17.

Connection Incentive

4.121 We propose to consider the appropriateness of the existing connection incentive mechanism, through reviewing any assumption considered necessary and assess its appropriateness for the future (whilst ensuring points 6 of paragraphs 5.52 & 6.44 of the GD14 final determination are given due consideration)[17].

4.122 We will consider looking into the possibility of separate allowances and targeted connections within the current Connection Incentive Mechanism, for fuel-poor consumers, to help drive connections to this customer type.

Properties Passed Incentive

4.123 In order to incentivise the GDNs to develop the network, we will consider having as part of GD17 a properties passed incentive in form of a penalty/reward mechanism. For further details see paragraph 4.97.

Other Incentives & Innovations

4.124 While we have been prescriptive on some incentives mechanisms, we encourage any of the GDNs to provide any further ideas or innovations as part of their GD17 business plan submissions that could make their business more efficient or offer an enhanced service for customers. This will be considered, if a robust and appropriate business case has been submitted which sets out clearly the detailed costs and benefits as well as how risks will be allocated.

Uncertainty Mechanism

Retrospective Adjustments

4.125 The uncertainty mechanism addresses uncertainties and reduces the related risks to consumers and GDNs by retrospectively adjusting price control allowances based on differences between actual and allowed costs or outputs. For GD17, we propose to consider three categories of retrospective adjustments:

- Output-based cost: For this cost, forecast outputs and related allowances will be reconciled with actual outputs and related allowances;
- Ring-fenced cost: This cost, based on its nature, is not known with certainty at the time of the determination. Submission of a fully justified business case will be required by the GDN for this cost to be approved;
- Pass through cost: A cost that is entirely outside of the control of the GDN to manage. Cost categories in these areas will be limited.

4.126 We will consider refining the current uncertainty mechanism models, as part of the GD17 price control, to ensure they reflect the settlement of allowances which are based on outputs, ring-fenced or pass through costs.

4.127 It is our intention to publish the GD17 uncertainty mechanism models, to ensure a fair and equal level of transparency to all.

Reopeners

4.128 In light of the ongoing development of the natural gas market in Northern Ireland and the proposed duration of the GD17 price control period[18], developments may happen during the GD17 price control which have a significant impact on the GDNs' cost base but for which impact and/or timing cannot be foreseen with a sufficient level of detail and confidence to allow for consideration as part of the GD17 allowances. We propose to consider having appropriate re-openers for such developments, where relevant and material.

4.129 As indicated as part of our GD14 final determination, we will consider undertaking a meter reading review to establish if the responsibility for meter reading is more appropriate to continue to remain with the gas suppliers, as is currently the case, or if it should be transferred to the GDNs. There is a potential for this review and consultation to occur during the GD17 price control period. Based on the outcome of this consultation we reserve the right to re-open this area during the period when GD17 will be in force.

4.130 Should a smart metering programme be introduced in Northern Ireland during the GD17 price control period, we will consider undertaking a review of the associated implications

[18] See paragraphs 3.15 to 3.19 for further details.

for the GDNs. Based on the findings of that review, we may decide to re-open or not to re-open that area during the period when GD17 will be in force.

Materiality Thresholds

4.131 In line with our approach as part of GD14 price control, we will consider having a materiality threshold for material costs not foreseen at the price control determination but incurred as part of the GDN operations during the price control period. GDNs can request approval of such costs from us, provided they are above the materiality threshold and sufficiently justified with a robust business case. The materiality threshold is set at £100,000 per project for the duration of the GD14 price control period. However, we note that may revise this threshold as part of GD17 if deemed appropriate. In taking decisions on granting of additional allowances we will consider the balance between the material unforeseen costs and any unforeseen cost reductions or revenue gains achieved during the price control period.

Financial Issues

Rate of Return

4.132 In relation to rate of return, we will consider:

- using a standard CAPM (Capital Asset Pricing Model) methodology for assessing a suitable rate of return for the GDNs;
- using all available similar regulatory settlements to benchmark appropriate rates;
- how tax should be treated in rate of return.

4.133 We will also consider, as indicated in GD14, whether there is merit in exploring having different rates of return on certain components of the TRV (Total Regulatory Value), to reflect the associated levels of risk faced.

4.134 As identified in GD14, PNGL have a very unique build up of the TRV, which can be broadly divided into 2 areas as follows:

1) Conventional RAB (Regulatory Asset Base), i.e. capex, opex, working capital, etc.

2) RAB based on regulatory commitment, i.e. deferred capex and historical outperformance.

We will consider the implications of setting either a single or dual rate of return for certain components of the TRV.

4.135 As indicated in GD14, we will review the appropriateness of the rate of return associated with the under-recoveries built up by firmus and consult where applicable. Under-recoveries represent the value accumulated by under-charging on conveyance in the

early start up years, to help drive connections to the network and promote the use of gas.

Depreciation

4.136 As outlined in GD14, we will review and consult, if necessary, on the appropriateness and level of benefit gained in aligning the depreciation policies of all GDNs. Currently, firmus and PNGL have different policies in applying depreciation rates and useful economic lives.

Financeability

4.137 We propose to consider the financeability of the licence holders, using established financial metrics, such as gearing, debt to TRV ratio, PMICR (Post-Maintenance Interest Coverage Ratio), etc., which can be used to benchmark the GDNs with the levels of an efficient, well-managed, regulated company.

4.138 Sensitivity analysis will also form part of this assessment, to ensure that the business could cope under shock conditions likely to impact the key business inputs, such as costs, volumes of gas and connections.

Profile Adjustment

4.139 We will consider reviewing the need to retain a profile adjustment within the licences, or whether NI is ready to move to a more conventional GB regulatory type of practice.

Price Control Outputs

Form of Price Control

4.140 We will consider reviewing the appropriateness of using a price cap versus revenue cap form of price for each GDN; based on our review, we will decide whether a shift in control type is necessary in the best interests of consumers. We will consider the feasibility of taking a related decision before the timeline for submission of business plans by the GDNs.

Profiling of Revenues

4.141 We will consider engaging with GDNs in detail, to derive the most accurate profile of post GD17 allowances for modelling purposes.

4.142 Although allowances for a price control are determined at each review period, the phasing of allowances post price control is important in establishing allowed revenues and prices (dependent on the cap type the licensee is subject to).

4.143 The accuracy of these post price control allowances is therefore important to minimise adjustments at the next price control review to compensate for inaccuracies.

TRV

4.144 In reviewing the use of the Profile Adjustment, we will decide whether future Opex costs are to be treated as per GB standard regulatory model and no longer capitalised.

Pi-Model

4.145 We will consider maintaining Pi models similar to those published on our website on 7 July 2014[19]. This will ensure consistency for the GD17 price control, subject to any changes necessary to update such models.

4.146 The details contained within the price control submission will form the basis of the inputs for the Pi models.

Designated Parameters and Determination Values

4.147 We will consider reviewing all designated parameters as part of the GD17 price control, to allow update for current circumstances, should any require alteration.

4.148 Determination values will be based on all information presented to us for consideration throughout the review period; this will include consideration of any engagement and responses to our draft determination, where applicable.

4.149 Any changes to Designated Parameters and Determination Values will require licence modifications. These will be consulted on and implemented with consideration of the consultation responses received.

Firmus Under-Recoveries

4.150 In relation to firmus under-recoveries, we will consider continuing to review firmus' plan to eliminate such under-recoveries by a reasonable date in the future. We will also consider the implications of our review of the rate of return attached to such under-recoveries.

4.151 We will ensure appropriate inputs and opening values are used in the under-recovery spreadsheet maintained and agree the appropriate closing values with firmus at the point of the price control as far as actual data exists to ensure transparency and certainty around the cumulative values.

[19] http://www.uregni.gov.uk/publications/phoenix_natural_gas_limited_and_firmus_energy_distribution_limited_models_a

5 Stakeholder Engagement and Social Impact

Stakeholder Engagement

General Stakeholder Engagement

5.1 During the GD17 price control process, we will engage with the key stakeholders to ensure they fully understand the key components of the price control, allow us to take full account of stakeholders' views in making a final determination and secure a successful outcome of GD17.

5.2 In line with the approach taken as part of the GD14 price control, we will consider conducting, as part of the GD17 price control process, a consultation on the draft determination[20].

5.3 We will also consider offering workshops and information sessions to interested parties at key stages of the price control process, to more fully engage on the issues that have been raised during the process. We envisage holding at least one stakeholder workshop on the proposed approach for the GD17 price control and at least one stakeholder workshop during the consultation period for the draft consultation. We will also consider arranging additional stakeholder workshops and information sessions as appropriate. This will allow all stakeholders an opportunity to be as fully informed as possible.

5.4 Furthermore, we will consider co-operating with Ofgem and the GDNs in NI and GB with a view to enhancing our benchmarking between the GDNs and facilitating exchange of benchmarking data between the NI and GB GDNs to enable further benchmarking across the industry.

5.5 We will also consider conducting consumer research on specific topics, where relevant and appropriate. More specifically, we will consider conducting:

- a large user focus group;
- a customer survey on customer willingness to contribute to specific service enhancements under the price control, where relevant;
- research into customer views on the expected GD17 impact on consumer bills in relation to the services to be delivered by the GDNs.

[20] See chapter 6 for timelines.

We will consider conducting this research in co-operation with the Consumer Council for Northern Ireland (CCNI) and our regulated companies, where relevant and appropriate, and to time it, where possible, so that the findings can inform the final determination.[20]

5.6 We will expect the GDNs to:

- include in their business plan submission details of any customer satisfaction surveys they have already undertaken;
- demonstrate how they have taken account of the views of stakeholders in developing their plan, setting out what engagement was undertaken and how the engagement informed the business plan;
- provide a public facing business plan which explains, in a way that can be understood by consumers, the impact and cost of their business plan.

Effective engagement is not a box ticking exercise or about the number of meetings or stakeholders addressed. Instead, it is about obtaining information about stakeholders' preferences and likely future needs and determining the deliverables and proposed approach in the plan reflecting these. Consumer engagement, as with any consumer research, must provide a company with the 'actionable data' with which it can respond to the consumers' voice and meet consumer need through better planning.

We will consider effective engagement with a range of stakeholders to be a pre-requisite to the submission of a well-justified business plan.

5.7 We will also consider taking on board the views of credit agencies and investors through ongoing liaison work.

Working with the Consumer Council

5.8 The CCNI will have a key role to play in the price control in line with its statutory position. We therefore propose to engage with the CCNI on key strategic issues throughout the price control process so that it has an opportunity to represent consumers throughout the decision making process.

5.9 We will also engage with CCNI as to whether we have any common work streams that would add value to the price control, e.g. specific consumer research into consumer priorities and the setting of new consumer and customer satisfaction measures. In so far as reasonably possible – in particular with respect to the timing of these work streams and of this price control process – we will consider the findings of any such work streams as part of the price control.

Working with the GDNs

5.10 We propose to engage with the GDNs on an ongoing basis throughout all phases of the PC process, especially those related to queries between parties.

5.11 This engagement will include, in addition to consideration of GDNs' price control submissions and price control consultation responses, requests for additional information or clarification, where required, as well as bi-lateral meetings with the GDNs. Where appropriate, joint meetings with all GDNs may also be arranged. The timing and frequency of the meetings may vary during the different phases of PC and will be agreed with the GDNs on an ongoing basis.

Consumer Impact

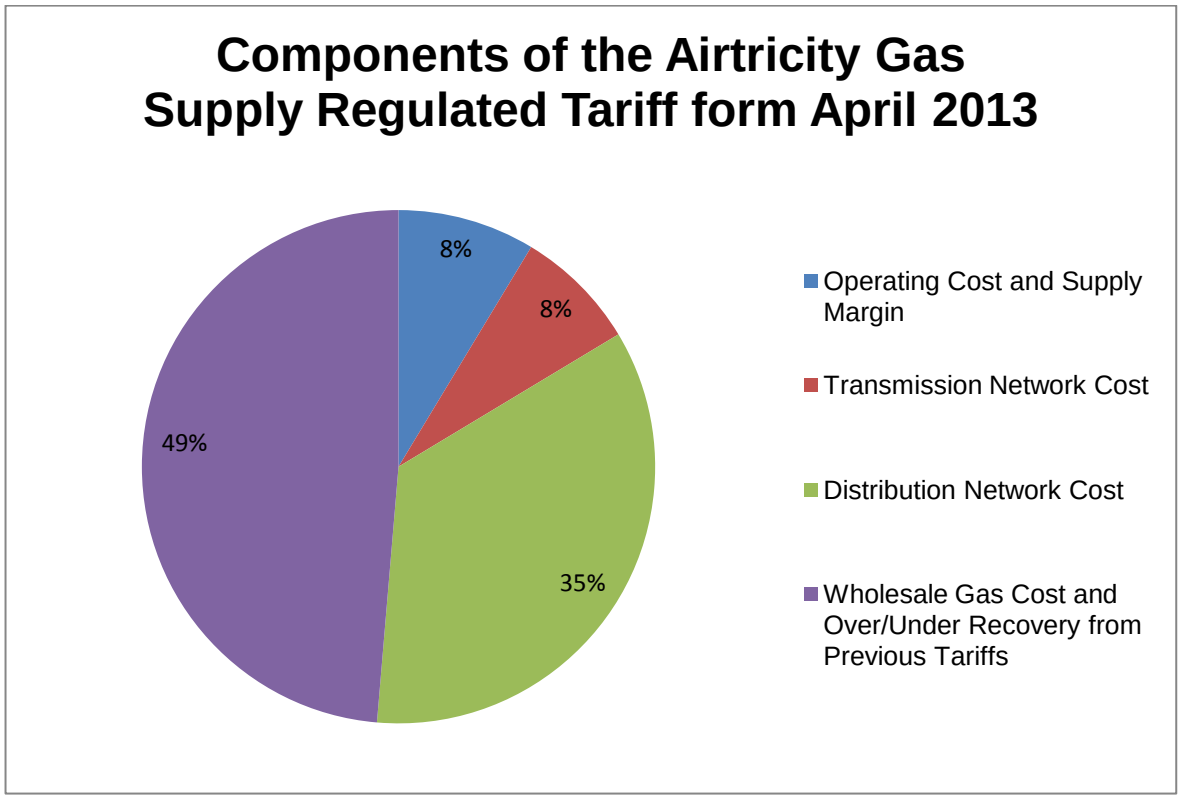
Impact of Distribution Costs on Consumer Tariffs

5.12 The regulated tariffs for gas customers are comprised of the following main elements:

- wholesale gas cost;
- operating cost of the supply business and supply margin;
- transmission network cost;
- distribution network cost.

5.13 The following graph shows how each of these elements make up the Airtricity Gas Supply (NI) Ltd (previously Phoenix Supply Ltd) regulated tariff that has been effective since April 2013.

Figure 1: Components of the Airtricity Gas Supply Regulated Tariff from April 2013



5.14 It is clear from this graph that, other than wholesale gas costs, the largest component of the Airtricity Gas Supply regulated gas tariff is the distribution network cost as it amounts to roughly 35% of the regulated tariff paid by consumers. The firmus energy regulated tariff is also comprised of the same components with similar percentage splits between each element.

5.15 It is important to note that the wholesale gas market can be volatile and there is no real control over the wholesale gas cost. The largest element of the tariff that is regulated is therefore the distribution network cost.

5.16 It is clear that distribution network cost, which will be determined as part of the price control process, has a significant impact on the final gas bill for consumers. Therefore, it is vital to have active consumer involvement during the price control process.

Customer Service

5.17 As indicated in paragraph 5.5, we will consider conducting, as part of the GD17 preparation, consumer research to ensure the price control, and the GDNs, deliver services in the ways in which consumers expect.

5.18 We will also consider revising during the GD17 price control period, the measures in place to ensure ongoing focus of the GDNs on consumer interests and needs. This may include the following:

- Increased focus on complaints data, especially complaints escalated to CCNI and ourselves and lessons learnt that can be derived from same.
- Review of the appropriateness and relevance of the Guaranteed and Overall Standards of Service already in place and implementation of a process of amendment where relevant and appropriate. This may require co-operation with other organisations such as CCNI and DETI.
- Review of serviceability metrics used in NI and GB and, where relevant and appropriate, standardisation of such metrics across NI. This may involve introduction of customer satisfaction surveys to be conducted by the GDNs on a regular basis. These surveys could be based on those in place in GB[21], they could be different surveys designed specifically for local utility consumers to support benchmarking across local utility providers, or they could be a combination of both.

This will, over time, facilitate a better monitoring of GDN performance in this area and may form the basis for the introduction of additional incentive mechanisms such as specific customer service incentives as part of future price controls.

Environmental Impact and Energy Efficiency

5.19 Directive 2012/27/EU on Energy Efficiency was introduced on 25 October 2012[22.] This Directive amends Directives 2009/125/EC and 2010/30/EU and repeals Directives 2004/8/EC and 2006/32/EC. It establishes a common framework of measures for the promotion of energy efficiency within the European Union in order to ensure the achievement of the 20% headline target on energy efficiency by 2020 and to pave the way for further energy efficiency improvements beyond that date. The Directive sets out, in article 15 (2), the obligation to ensure that, by 30 June 2015:

(a) "an assessment is undertaken of the energy efficiency potentials of the gas and electricity infrastructure, in particular regarding transmission, distribution, load management and interoperability, and connection to energy generating installations, including access possibilities for micro energy generators; and

[21] For further details, see e.g. Ofgem: RIIO-GD1 Gas Distribution Price Control – Regulatory Instructions and Guidance: Version 1.1, 30/05/2014.
[22] Directive 2012/27/EU: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:315:0001:0056:EN:PDF.

(b) concrete measures and investments are identified for the introduction of cost-effective energy efficiency improvements in the network infrastructure, with a timetable for their introduction."

5.20 In response to Directive 2012/27/EU, the Energy Efficiency Regulations (Northern Ireland) 2014 were made and came into operation on 25 July 2014. They set out, in article 5, the obligation of the Authority to deliver to the Department before 30 June 2015 an assessment of the gas infrastructure and a list identifying concrete measures and investments compliant with Directive 2012/27/EU as well as the obligation of the GDNs to provide related information, assistance or advice upon request.

5.21 As part of the price control process, we will consider any plans for the introduction of cost-effective energy efficiency improvements in the network infrastructure identified in line with Directive 2012/27/EU and to be implemented during the price control period.

5.22 One aspect of energy efficiency is the treatment of shrinkage gas. We envisage that this will be further reviewed as part of the assessment of energy efficiency potentials to be undertaken in line with Directive 2012/27/EU. As part of the price control process, we will take into consideration the findings of this review and we will consider setting shrinkage targets for the price control period.

5.23 As part of their operations, the GDNs connect customers to the natural gas network. This entails an increase in the burn of natural gas as well as a reduction in the burn of fuels these customers have been using up to their conversion to natural gas, i.e. in particular of oil and coal. The environmental impact of these changes can be measured as the related reduction of greenhouse gas emissions. In line with government guidance on the valuation of energy use and greenhouse gas emissions, the standard unit of account for greenhouse gas emissions is equivalent tonnes of carbon dioxide (tCO_2e), i.e. the equivalent amount of CO_2 that would have the same global warming potential as a given greenhouse gas emission. As part of the price control, we will consider publishing the expected environmental impact resulting from GDNs' operations during the price control period.

6 Timelines

GD17 Timetable

6.1 Based on the comments received back from GD14, we plan to have a well laid out structure of the price control process that will allow sufficient time and interaction between all relevant stakeholders, before any key decisions are made.

6.2 To that aim, we consider setting a timeline, which is of a longer duration than was the case for previous gas distribution price controls in Northern Ireland. This would in theory require license changes, but based on the duration of notice, we believe that this will not be necessary.

6.3 More specifically, we propose to produce a full price control in 2015-16, to cover the GD17 price control period.

6.4 We have set out the key milestones to GD17 below. We note that the dates indicated are provisional dates which may be subject to change.

Table 2: Key Milestones of GD17

Key Milestones of GD17	
Key Points	**Proposed Date**
Circulation of GD17 approach to key stakeholders	19 December 2015
Workshop on GD17 approach	27 January 2015
Information requirements working-level meetings and approach to efficiencies workshop	January – March 2015
Publication of final approach document and spreadsheet for GD17 after consideration of feedback from key stakeholders	31 March 2015
Submission by the GDNs of business plans (including actual data for previous years)	30 June 2015
Stakeholder workshop on draft determination	January 2016
GD17 publication of draft price control determination for consultation	15 March 2016

Key Milestones of GD17	
Key Points	**Proposed Date**
Closure of draft price control consultation	15 June 2016
Publication of final determination of GD17 and consultation on related licence modifications	15 September 2016
Decision on licence modifications relating to GD17	1 November 2016
Start of GD17 price control period	1 January 2017

7 Discussion Document Feedback

7.1 This is an open discussion document on the GD17 approach. We have not posed any specific questions in this paper. Instead we invite stakeholders to express a view on any particular aspect of this paper and the draft business plan templates.

7.2 The Utility Regulator would like to invite all interested stakeholders to attend a workshop on the 27 January 2015 at 10am to discuss the overall approach to GD17. An agenda will be distributed nearer the time.

7.3 If you would like to attend, please email Karen.mcconnell@uregni.gov.uk by 22 January 2015.

7.4 If appropriate, we can have individual discussions, with interested parties. Please contact us if you consider this to be more suitable.

7.5 If you wish to submit a written response, this should be received **no later than the 10 February 2015** at 5pm and should be addressed to:

Paul Harland

Regulation Manager

Utility Regulator

Queens House

14 Queen Street

BELFAST

BT1 6ER

Tel: 028 9031 1575

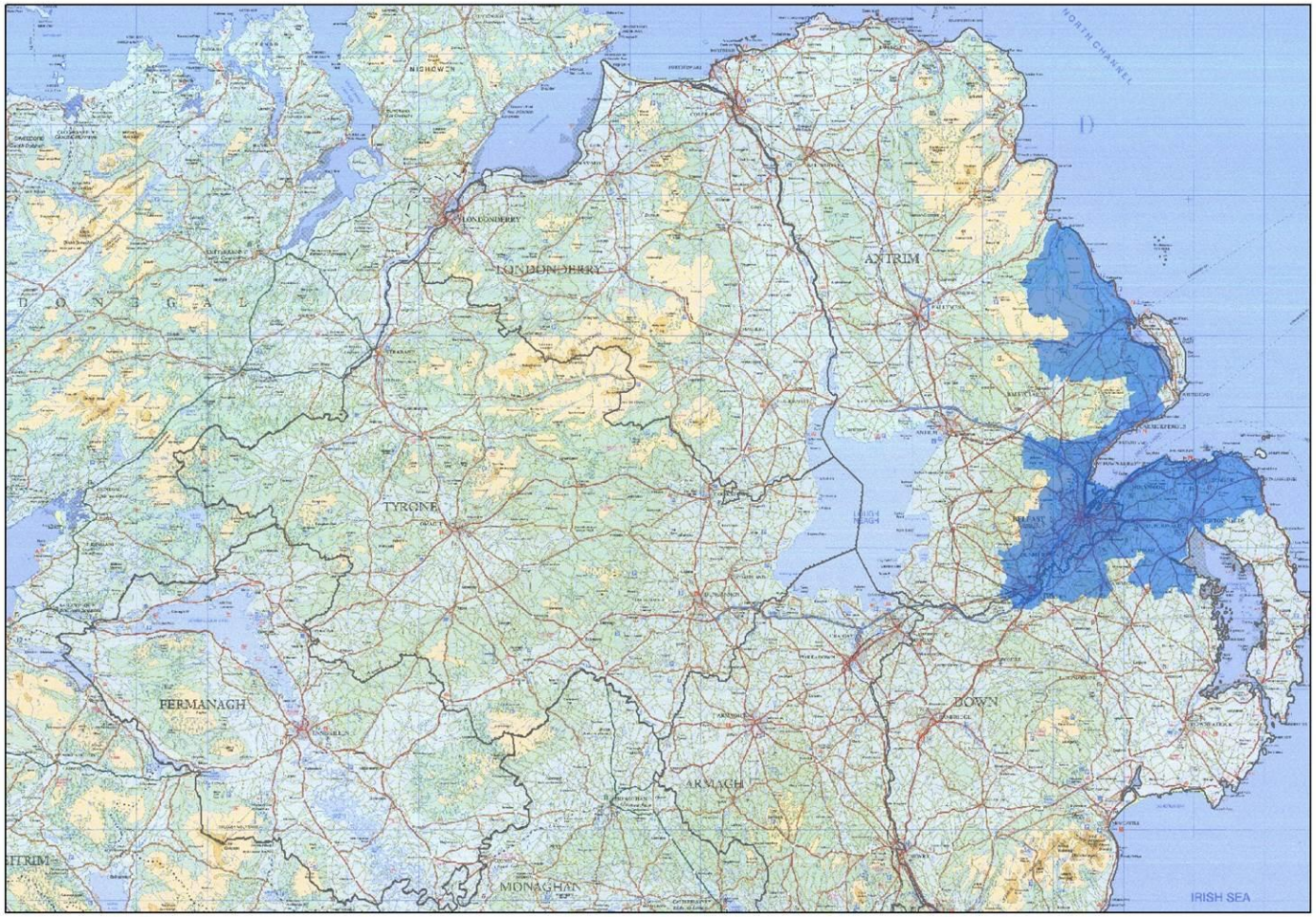
E-mail: paul.harland@uregni.gov.uk

7.6 Our preference would be for responses to be submitted by e-mail.

7.7 Individual respondents may ask for their responses in whole or in part, not to be published, or that their identity should be withheld from public disclosure. Where either of these is the case, we will ask respondents to also supply us with the redacted version of the response that can be disclosed. As a public body and non-ministerial Government department, we are bound by the Freedom of Information Act (FOIA) which came into full force and effect on 1 January 2005. According to the remit of FOIA, it is possible that certain recorded information contained in responses can be put into the public domain. Hence, it is now possible that all responses made will be discoverable under FOIA – even if respondents ask the Utility Regulator to treat responses as confidential. It is

therefore important that respondents note these developments and in particular, when marking responses as confidential or asking the Utility Regulator to treat responses as confidential, should specify why they consider the information in question to be confidential.

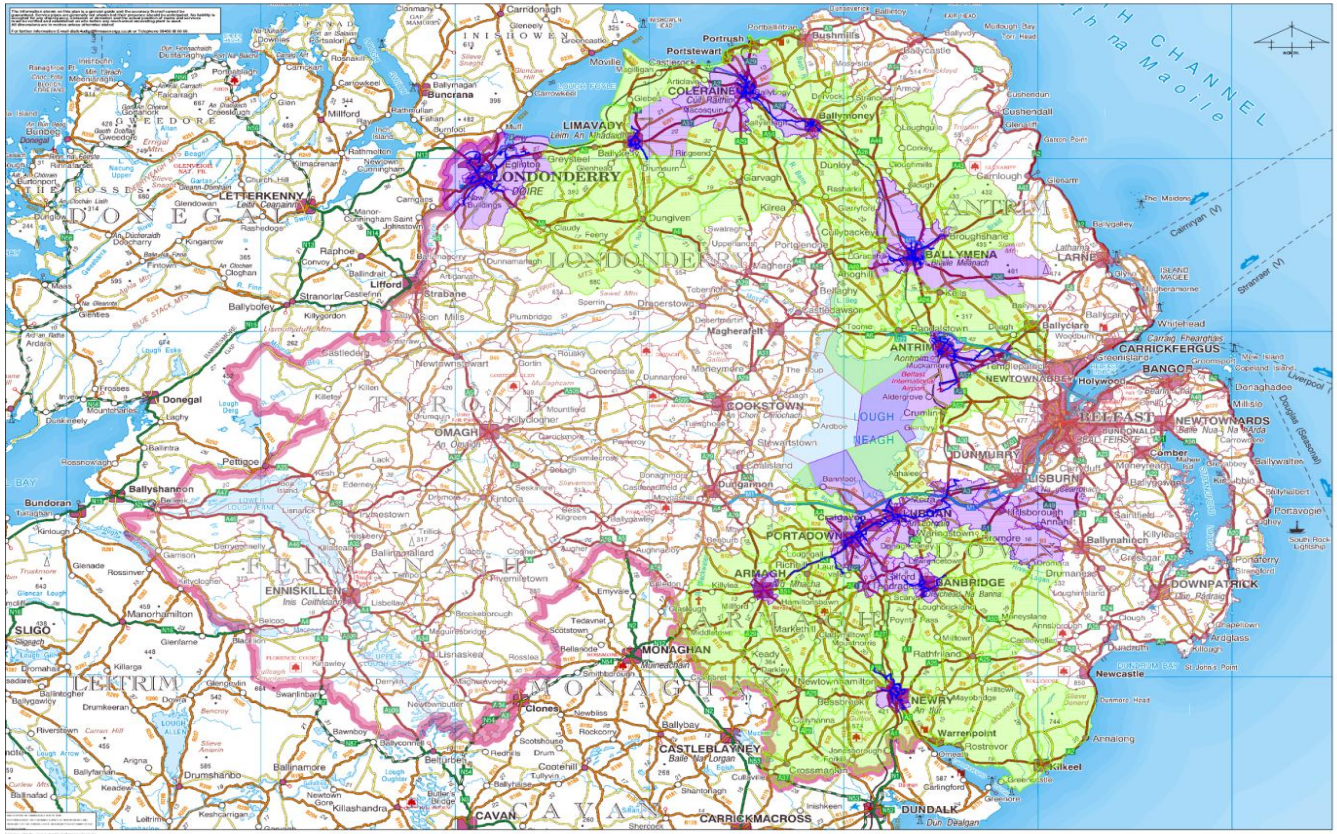
Appendix 1: Map of the PNGL Greater Belfast and Larne Licensed Area



Appendix 2: Map of the firmus Ten Towns Licensed Area[23]

A1.1 Figure 2 shows a map of the (coloured) firmus Ten Towns licensed area.

Figure 2: Map of the firmus Ten Towns Licensed Area



[23] Map to be updated to reflect recent changes to licensed area.

Appendix 3: Business Plan Template

A1.1 As part of this draft approach to the GD17 price control, we are also issuing the draft template for the GD17 business plan submission. The document can be found here:

Draft GD17 business plan template	http://www.uregni.gov.uk/publications/gd17_business_plan_template

A1.2 We note the draft business plan template may change dependent on the feedback we receive.

A1.3 We also plan to issue Regulatory Instructions and Guidance for the GD17 business plan template, together with the publication of the final approach document and business plan template for GD17, in March 2015.