GNI (UK) Response to UR Proposed Overall Approach to GT17

19 August 2016

1 Introduction

GNI (UK) is pleased to have the opportunity to respond to Utility Regulator's (UR) consultation on the Proposed Overall Approach to GT17.

GNI (UK) owns and operates 295km of high pressure transmission pipelines and 18 above ground installations. To date, it has invested c. £179m in the gas transmission network for Northern Ireland. In operating and maintaining the network GNI (UK) is committed to providing a safe, sustainable and reliable service to its customers.

GNI (UK) operates under a "Revenue Cap" mechanism whereby it is granted an allowed revenue to carry out its duties under the licence and is exposed to the risk associated with deviations between allowances and actual costs. In 2012, UR published its determination of the allowances for GNI (UK) over the five year Price Control period to September 2017. These allowances were substantially below the level requested by GNI (UK) and have not been sufficient to fund the duties under the licence, requiring GNI (UK) to provide funding in addition to the regulated funding to ensure the network continues to operate in a safe and secure manner to fund the duties under the licence.

GNI (UK) acknowledges the approach as set out in the consultation document and is broadly supportive of the approach. However there are two issues that GNI (UK) wishes to highlight at this stage which are discussed further below;

> **Allocation of CJV Costs:** Although the TSOs are working to develop the projections for the CJV costs, it will not be possible to agree an allocation of costs in advance of the September submission. Staff costs will form a key part of the ongoing CJV costs and because CJV staff have not yet been recruited the relative contribution of GNI (UK) to the CJV costs is not available at this juncture.
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> **Repex:** The bespoke nature of asset replacement expenditure does not easily fit into the GNI (UK) revenue mechanism. To ensure necessary asset replacement can be undertaken, GNI (UK) ask UR to adopt a flexible approach and avail of the adjustment mechanisms in the licence to fund the expenditure if required.

2 Contractual Joint Venture

GNI (UK) supports UR's intention to have in place a single system operator for the Northern Ireland high pressure network by 1 October 2017. GNI (UK) is broadly supportive of the approach set out in the document towards the determination of allowances related to CJV.

The TSOs are currently finalising a mobilisation budget to capture the costs which will be incurred in advance of 1 October 2017, such as:

- Single IT System build (vendor) costs.
- Backfill costs to cover internal effort required to support the new system build and CJV organisation set-up.
- CJV staff costs where they will commence employment within the CJV in advance of October 2017.
- CJV office rent and associated fit-out costs.
- Other establishment costs such as website design and communications (letterhead & stationery, etc.)

This budget is to be agreed with UR within the NIED project and GNI (UK) does not envisage that the evaluation of these costs will form part of the GT17 process.

The TSOs are working together to prepare and agree the CJV related business plan cost template in accordance with Step 1, 2 and 4 of the Price Control process set out in the consultation. However, as there will not be full clarity on which TSO will undertake certain activities it will not be possible to agree the split of costs between TSOs (Step 3). UR will still be able to consider the joint CJV cost submission

and determine an appropriate allowance for CJV costs (Step 5). The TSOs will continue their work on the establishment of the CJV and work towards an agreed costs split as early as possible. A potential solution could be that the TSOs determine an ex-ante split of the agreed allowance for the CJV costs and that allowances will be reallocated between the TSOs based on a reconciliation process (as discussed and highlighted in the UR single system operator funding paper issued to the TSOs on 10 August 2016).

While the TSOs are currently working towards a go-live date of 1 October 2017 for the CJV, the financial impact on business is yet to be finalised. Pending detailed organisation design for the CJV, the GNI (UK) business plan forecasts will be on a 'business-as-usual' basis and we will engage with UR during the process to assess the impact of the CJV on our operating costs.

We also note that the UR proposal states that *"there are unlikely to be any unforeseen developments".* The level of market changes that may be required/take place for the CJV activities during the 5 year price control period is very uncertain. If there are no unforeseen developments, this will place greater certainty on the costs of running the CJV operation. If there are market changes required, the CJV General Manager will prepare specific project allowance requests to cover the costs involved (which would primarily be IT/code related).

3 Asset Replacement Expenditure

GNI (UK) agree with UR that the price control process in its licence does not set allowances for capital expenditure to increase the capacity of the network. GNI (UK) welcomes the indication that asset replacement expenditure may be allowed as Operating Expenditure, subject to justification and demonstration of customer benefits. In many cases GNI (UK) are required to spend money on such works as a responsible and prudent operator and also to ensure continued compliance with legislation, such as the Pipelines Safety Regulations (Northern Ireland) 1997. GNI (UK) will not seek allowances for capacity or related changes to the network (e.g. physical reconfiguration at Gormanstown to facilitate the flow of gas from the Corrib field to Northern Ireland) as part of GT17.

GNI (UK)'s transmission network is relatively young. The primary components of the network, the high pressure steel pipework, have a long design life (40 years). However, the ancillary components and subcomponents have considerably shorter design lives (as low as 10 years in the case of some electronic components). Some of these components have reached or are approaching their end of design life and will require refurbishment or replacement during GT17 to ensure they continue to operate in a safe and secure manner.

Asset replacement projects tend to be periodic bespoke projects. High level costs estimates can be made based on engineering judgement and knowledge of similar projects. GNI (UK) proposes that these high level estimates could be used for assessing the justification for the project and the benefit to the customers. However, functional specification and accurate costs, which UR have previously stated are required[1], can only be determined following investment in detailed design, including confirmation through tender process of material and construction costs. Detailed design can account for up to 20% of the overall costs of bespoke projects. GNI (UK) was not granted allowances for detailed design work during the current price control period.

UR proposes replacement expenditure is to be classified as Controllable Opex and that contingency will not be allowed. Therefore, the risk of over or underspend relative to allowance on any project will fall entirely on GNI (UK). Unless, both GNI (UK) and UR can have confidence in the accuracy of the cost estimates and allowances, this level risk is not appropriate to GNI (UK), or indeed UR.

To address the issues above GNI (UK) propose a two pronged approach to be considered in cases where GNI (UK) can justify a project, but detailed costs cannot yet be estimated. The key elements of this approach would be;

[1] See Section 4.21 of UR consultation document "BGE (NI) ltd Price Control 2012-2017 Initial Proposals for Consultation"

- Funding of Detailed Design: Development of the detailed design should be funded where a project can be justified;
- Use of adjustment mechanism: Once detailed design is complete and more accurate costs can be determined, the adjustment mechanisms within the GNI (UK) licence can be availed of to grant allowances.[2]

[2] Condition 2.2.4 (i) and (j)