



Price Control for Northern Ireland's Gas Transmission Networks GT22

Annex 2 – Operational Expenditure
May 2022



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, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.



Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.



Our vision

To ensure value and sustainability in energy and water.



Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.



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Acronyms and Glossary

ACRT	Annual/Cost Reporting Template
AGI	Above Ground Installation
ARR	Actual Required Revenue
ATEX	Equipment for explosive atmospheres
BGTL	Belfast Gas Transmission Limited
BGTP	Belfast Gas Transmission Pipeline
C&I Panel	Control & Instrumentation Panel
Capex	Capital expenditure
CBA	Cost Benefit Analysis
CIPS	Close Interval Protection Survey
CP	Cathodic Protection
CPI	Consumer Price Index
DD	Draft Determination
DSEAR	Dangerous Substances and Explosive Atmospheres Regulations
e.g.	for example
FD	Final Determination
GMO NI or GMO	Gas Market Operator for Northern Ireland, the Contractual Joint Venture to deliver a single system operator
GNI	Gas Networks Ireland (parent company of GNI (UK))
GNI (UK)	Gas TSO operating in Northern Ireland
GT17	This is the name given to the price control period from October 2017 to September 2022
GT22	This is the name given to the price control from October 2022 to September 2027
ILI	In-Line Inspections
ISO	International Organisation for Standardisation
IT	Information Technology



m	Million
MEL	Mutual Energy Limited
NI	Northern Ireland
NIS Directive	Network & Information Systems Directive
NWP	North-West Pipeline
Opex	Operating Expenditure
p.a.	Per annum (per year)
PLC	Programmable Logic Controllers
PTL	Premier Transmission Limited
Repex	Replacement Expenditure
RIGs	Regulatory Instructions and Guidance
RPEs	Real Price Effects
RPI	Retail Price Index
SCADA	Supervisory Control and Data Acquisition
SNIP	Scotland to Northern Ireland Pipeline
SNP	South-North Pipeline
SONI	System Operator Northern Ireland (electricity network)
TR	Transformer Rectifier
TSO	GNI (UK), PTL, BGTL and WTL. WTL is not a TSO (Transmission System Operator) as defined by the European Commission but it is referred to as a TSO in this document for simplicity.
UK	United Kingdom
UPS	Universal Power Supply
UR	Utility Regulator
WTL	West Transmission Limited
WTPS	West Transmission Pipeline System



1. Introduction

Purpose of this Document

- 1.1 This annex details the final considerations of the Utility Regulator (UR) in relation to controllable operational expenditure (opex) for GT22.
- 1.2 In conjunction with our consultants, we reviewed the TSOs and GMO business plan requests for GT22. Within the draft determination (DD), we made various adjustments to proposed opex allowances based on concerns regarding cost forecasts or missing justification.
- 1.3 The rationale for these adjustments was set out in the draft determination and in an independent report produced by our consultants. This report was provided separately to the companies.

Detailed Approach

- 1.4 In making assessments, our consultants advised as to both the need and reasonableness of costs. In order to reach a final determination (FD), we have considered their views alongside:
 - a) TSO representations;
 - b) Experience from other utilities; and
 - c) Benchmarking (where possible).
- 1.5 For context, we have provided detail of the draft determination for each disputed cost area. This includes the cost request, our issues with the business plan request and draft recommendation.
- 1.6 As part of their consultation responses, MEL, GNI (UK) and GMO provided data to address the opex information gaps or cost justification. In this annex, we summarise these responses and set out our views regarding the issues. This includes a final allowance position. The focus of this annex is on costs that were disputed at the draft stage.
- 1.7 All figures in this annex are given in March 2021 prices and in pre-efficiency amounts, unless otherwise stated.



2. GNI (UK) Opex

Background

2.1 UR analysis of the GNI (UK) disputed opex is set out in the tables below.

Table 1 – Intra-Company Recharges

Cost Area	Intra-Company Recharges
Amount Requested in GT22	£1.55m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> Intra-company recharges relate to general operating costs incurred by the parent company on behalf of the TSO. These costs are recharged to GNI (UK) in accordance with a service agreement. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> The business plan request represented a 4% uplift from forecast GT17 costs. However, these forecasts were over 20% above the GT17 allowance. GNI (UK) explained that the overspend related to legal expenses and revised facility cost allocations. CEPA recommended that the GT17 allowance be rolled forward until justification was provided for the uplift of costs. 	
DD Recommendation	Partial Disallowance (£1.24m)
<p>TSO Consultation Response</p> <p>Within their response, GNI (UK) made the following points:</p> <ol style="list-style-type: none"> These costs should be considered alongside <i>Other Overheads</i>, which also reflect parent company expenses recharged to GNI (UK). Taken together, the DD allowance is below both the GT17 determination and the expected actual costs. Uplift in GT22 reflects a more appropriate allocation for facility and IT costs. Benchmarked against MEL, the level of overheads and recharges is lower and more efficient for GNI (UK) on a cost per kilometre of pipeline basis. UR approach does not meet the consistency principle of regulatory best practice. 	
<p>UR Final Views</p> <ul style="list-style-type: none"> We are inclined to amend our position in line with GNI (UK)'s request. Focus at the draft stage was more on recharges rather than other overheads. TSO is correct to point out that costs are related and the combined DD allowance was below the GT17 position. This is not fair given actual spend in the period. GNI (UK)'s methodology for increased cost allocation is not unreasonable. We are not totally convinced of the benchmarking, as pipeline length does not seem the natural predictor of recharged costs. However, it does provide broad assurance that the GT22 request is reasonable. As such, the final determination is to reinstate the full allowance. 	
FD Recommendation	Approve in full (£1.55m)



Table 2 – Routine Maintenance

Cost Area	Routine Maintenance
Amount Requested in GT22	£12.35m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • Routine maintenance includes pipeline, AGI and other normal repair costs. • In the business plan, GNI (UK) requested a 43% uplift from forecast costs in GT17. • There are a variety of reasons for this increase including: <ul style="list-style-type: none"> a) Material in-line inspection costs; b) New cyber security expenses; c) Asset information improvement initiative; and d) The re-tender of the MERC contract. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> • The draft determination made provision for most maintenance expenditure. • We did however make reductions (-£0.3m) for unknown cyber expenses, which GNI (UK) confirmed would be subject to a separate procurement. • We also reduced the last two years of the MERC contract for retender uplift costs. • GNI (UK) had forecast 10% uplifts but CEPA indicated that 5% might be more appropriate based on benefits achievable from competitive procurement. 	
DD Recommendation	Partial Disallowance (£11.62m)
<p>TSO Consultation Response</p> <p>Within their response, GNI (UK) made the following points:</p> <ol style="list-style-type: none"> 1) Reduction to 5% should have reduced the allowance request by £0.23m. However, UR has applied a reduction of £0.43m in its allowance calculations. 2) Understand the rationale for a cyber security holding allowance. 3) Propose that the balance of the cyber request be designated as a relevant item with the TSO to revert to the UR when costs and scope are certain. 	
<p>UR Final Views</p> <ul style="list-style-type: none"> • We are recommending a relevant item for the cyber security repex project. Given these opex costs will be linked to that work, a relevant item for the disallowed amount seems reasonable. • For MERC costs, we have made a minor adjustment. • Within the DD, we focused cuts on the AGI maintenance line (-10% in last two years) but allowed other MERC cost lines (e.g. pipeline maintenance, inspections and emergency costs) to rise by the full amount requested. • We focused on cuts rather than restricting percentage increases, as the different cost lines do not grow in a uniform fashion. • The impact across these combined MERC lines (emergency response, pipeline / AGI maintenance and inspections) was a reduction of approximately 7%, which is slightly higher than the CEPA recommended restriction of 5% in the last two years. • Consequently, we have adjusted the AGI maintenance allowance to ensure that the combined reduction (-£0.29m; -5%) is in line with CEPA recommendations, to 	



which GNI (UK) had raised no objections.	
FD Recommendation	Partial Disallowance (£11.76m)

Table 3 – Engineering Staff

Cost Area	Engineering Staff
Amount Requested in GT22	£2.54m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> Engineering staff costs comprise direct staff costs (i.e. salaries, bonus payment and pension costs), indirect staff costs (i.e. training and other indirect costs) as well as agency staff. These staff expenses make up almost 13.5% of GNI (UK)'s planned maintenance request. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> The business plan requested that engineering staff be increased to 6.1 FTEs. This represented a 0.9 FTE uplift against GT17 forecast actuals. GNI (UK) is also forecast to overspend on its GT17 engineering staff allowance by £0.36m due to the requirement to deploy more resources. The draft determination proposed to maintain the GT17 staff numbers until overspend and uplifts could be fully explained. 	
DD Recommendation	Partial Disallowance (£2.25m)
<p>TSO Consultation Response</p> <p>Within their response, GNI (UK) made the following points:</p> <ol style="list-style-type: none"> 1) Engineering staff numbers are based on an updated allocation methodology. This is more cost reflective based on resources used and assets being maintained. 2) The increase is the approximate equivalent of one additional FTE for the last year of the GT17 period, which will continue into GT22. 3) Allowance is significantly below that proposed for MEL, both in absolute terms and as a proportion of the repex/maintenance programmes. 4) Disparity in the DD between the two network operators is inconsistent with UR's approach document, which references using comparisons between licence holders. 	



UR Final Views

- Whilst we consider it appropriate to benchmark comparable salary costs, it is difficult to make a case for the comparisons as set out by the GNI (UK) response.
- MEL's network is both older and more complex by virtue of the underwater pipelines. There is also the difficulty of work allocation between what is done by internal staff and what is contracted out. This makes comparison of TSO staff numbers somewhat problematic.
- However, GNI (UK)'s explanation of its cost allocation changes are generally related to the proportion of NI assets, which seems sensible.
- The revised allocations are expected to impact on the last year of GT17 (2021-22) and continue into GT22.
- In the context of overall staff numbers, the request is not unreasonable. We have therefore provided the full allowance in the final reckoning.

FD Recommendation

Approve in full (**£2.54m**)

Table 4 – Fault Repairs

Cost Area	Fault Repairs
Amount Requested in GT22	£1.58m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • Fault repairs form part of unplanned maintenance. • Within their business plan, GNI (UK) forecast average costs of £315k per annum. • This represents an increase of 12.7% above the GT17 run-rate. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> • The business plan justification was largely based on an older network and remediation works from planned inspections. • GNI (UK) also argued that Covid-19 restrictions had suppressed costs. However, it was not clear why this might be the case. • Our opinion was that the increases were not well-justified and provided allowances in line with the GT17 position. 	
DD Recommendation	Partial Disallowance (£1.17m)
<p>TSO Consultation Response</p> <p>Within their response, GNI (UK) made the following points:</p> <ol style="list-style-type: none"> 1) The DD allowance is lower than the actual run-rate for GT17, which has been impacted by the pandemic. 2) Actual costs in 2020-21 was £0.34m and more expenses will be expected in this area given ageing assets. 3) Clear evidence was given of real price effects affecting maintenance. 4) Maintaining this allowance will constrain GNI (UK)'s ability to remediate issues as they arise. 	



<p>UR Final Views</p> <ul style="list-style-type: none"> • It is not obvious that unplanned fault repair costs should automatically increase, particularly given higher maintenance and replex provisions. • MEL's forecast for unplanned maintenance (excluding drainage) is not subject to material change, despite having an older network. • We do however accept that the allowance may need to be updated to reflect actual run-rate costs. • We are still of the opinion that increases above this are not well justified. However, GNI (UK) has estimated some additional costs in the other unplanned maintenance line due to projected work following surveys, inspections and pressure reviews. • We have provided full fault repair cost request to cover the run-rate and the additional costs associated with these remedial works following inspections and surveys. 	
FD Recommendation	Approve in full (£1.58m)

Table 5 – Other Unplanned Maintenance

Cost Area	Unplanned Maintenance
Amount Requested in GT22	£0.36m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • GNI (UK) included costs for work to be undertaken following ILI inspections and close interval protection surveys (CIPS). • They also forecast costs for the impact of maximum operating pressure reviews and for a large unplanned incident (Query 39a). 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> • Our view at draft determination was that the costs were not well justified. It was unclear how the amounts had been built up or estimated. • We further felt that the expense should be covered by the planned maintenance budget. 	
DD Recommendation	No allowance (£0.00m)
<p>TSO Consultation Response</p> <p>Within their response, GNI (UK) made the following points:</p> <ol style="list-style-type: none"> 1) Appropriate allowance should be provided in either this line or the planned maintenance allowance. 2) It is unacceptable that GNI (UK) should incur losses because of co-operating with other TSO's in maintenance activities. 3) It is not realistic to expect no costs following large inspection programmes. 	



UR Final Views

- Following the consultation response, we still do not consider that the basis of the majority of costs are well explained or justified.
- However, we would agree with some of the points raised by the TSO. In particular, we agree that GNI (UK) should not suffer loss for another TSOs activity.
- We also accept that some costs are likely to come out of the inspections.
- Consequently, we have provided a full allowance to the fault repairs line which covers the GT17 run-rate plus an uplift to cover these activities.
- No allowance has however been provided in this other unplanned cost line.
- The combined allowance of **£1.58m** for fault repairs and other unplanned maintenance represents funding in GT22 in line with the GT17 expected costs of **£1.56m** across these activities.

FD Recommendation	No allowance (£0.00m)
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Table 6 – SCADA and Communications

Cost Area	SCADA and Comms
Amount Requested in GT22	£0.98m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • Within their business plan, GNI (UK) were predicting a material uplift to these costs (from £0.36m to c. £1m). • The TSO explained that this was due to a service provider ending their communications support. • Whilst an emergency service had been negotiated, this has been at materially higher costs. • GNI (UK) also plans to move to satellite communications which would provide cyber security and compliance benefits. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> • At draft stage, it was not clear to us why the issue had not been addressed earlier. • It was also not clear what the basis of the new costs were or indeed if the proposed benefits would be commensurate with the spend uplift. • We proposed an allowance in line with GT17 until a more detailed explanation could be provided. 	
DD Recommendation	Material Disallowance (£0.30m)



TSO Consultation Response

Within their response, GNI (UK) made the following points:

- 1) Available technology has changed substantially.
- 2) Safety case requires that dual communication links be maintained.
- 3) After external service provider notified intention to withdraw service, GNI (UK) undertook a tender on the open market. This established that a satellite service was the most practical and offered the best value.
- 4) Will provide various benefits in terms of cyber security and NIS compliance.
- 5) Implementation of the system is captured in the repex request with this opex cost line covering ongoing rental and support costs.
- 6) Satellite system will cover all AGI's, whereas the emergency system is only being used for most critical sites.
- 7) Costs are also increasing in later years due to phased rollout of the system.
- 8) Also changing the cost allocation methodology in the last year of GT17 based on number of assets managed rather than user headcount.
- 9) UR proposals do not reflect actual costs or the changing market realities.

UR Final Views

- We accept the need for dual communication links to be maintained.
- We further acknowledge the uplift in costs already being experienced in GT17.
- As part of the repex allowance, we are proposing to support the GNI (UK) claim for installation of the satellite system. It therefore makes sense to provide the corresponding rental and support costs.
- What is unclear is why the costs are being materially uplifted in the last two years of GT22 when the expensive emergency service has been fully removed.
- In their response to Query 59, the TSO provided a breakdown of the satellite installation costs, which included the first year of rental costs. This cost split would not support the level of funding requested.
- We have therefore provided allowances of **£175k p.a.** for the last two years of the price control. This will make full provision for the new system as well as the cost allocation change, which affects earlier years.

FD Recommendation

Partial Disallowance (£0.79m)



GNI (UK) Opex Conclusions

- 2.2 The pre-efficiency controllable opex request and allowances are set out below. These figures exclude the GMO expenditure and repex.

Table 7 – Controllable Opex Request vs Allowance (Pre-Efficiency)

	GNI (UK) Request (£m)	UR DD Allowance (£m)	UR FD Allowance (£m)	% Allowance
Administration	5.06	4.75	5.06	100.0%
Planned Maintenance	18.86	17.84	18.27	96.9%
Unplanned Maintenance	3.03	2.26	2.66	88.0%
System Operation (TSO)	2.86	2.18	2.68	93.5%
Grand Total	29.81	27.03	28.67	96.2%

- 2.3 The final determination makes provision for around 96% of the pre-efficiency controllable opex request. We are also proposing a relevant item for disallowed cyber security costs in line with the repex position.



3. MEL Opex

Background

3.1 UR analysis of the MEL disputed opex is set out in the tables below.

Table 8 – Engineering Staff

Cost Area	Engineering Staff
Amount Requested in GT22	£6.14m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • Engineering staff costs comprise direct staff costs (i.e. salaries, bonus payment and pension costs), indirect staff costs (i.e. training and other indirect costs) as well as agency staff. • These staff expenses make up around 25% of MEL's planned maintenance business plan request. • MEL's average allowed engineering staff headcount was 5.8 people in GT17. However, in this period, it is using an average of 9.3 FTEs. • The business plan requested further average increases with MEL seeking a total allowance of 12 FTEs. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> • At draft stage, we provided for two additional staff above GT17 but this still resulted in a material disallowance. • We were concerned by the lacking justification, the scale of the increase in staff numbers and the value associated with such costs. • We also reduced direct and indirect staff costs by around 8% based on salary benchmarking undertaken against GNI (UK). 	
DD Recommendation	Material Disallowance (£3.75m)
<p>TSO Consultation Response</p> <p>Within their response, MEL provided more detail on the staff, their roles and the scope of work to be undertaken. They made the following points:</p> <ol style="list-style-type: none"> 1) Additional staff in GT17 is made up of: <ol style="list-style-type: none"> a) Group engineer – remit to review key processes and projects and undertake in-house management. b) Records officers – responsible for landowner engagement with WTL. c) IT and Operations manager – with responsibility for SCADA, control room and cyber security etc. 2) Bringing this work in-house has resulted in savings of c.1.7m, which are embedded in the GT22 submission. 3) Expect more substantial network planning savings due to scope of works including connection of gas turbines, bio-methane injection and reverse flow modelling. 4) Have requested two energy transition staff who's objectives include: <ol style="list-style-type: none"> a) Developing and implementing MEL's energy transition strategy. b) Contributing to the development of energy policy. 	



- c) Developing a programme with GNO's to decarbonise gas by 2050.
- d) Identifying and progressing external energy projects for energy transition.
- e) Accessing research and engaging other relevant work streams.

UR Final Views

- MEL did not make a response to the reduction in engineering salary costs based on staff benchmarking. We are therefore inclined to maintain this reduction.
- In terms of staff numbers, it is reasonable to expect some level of growth given addition of WTL assets and increased scope of works.
- However, the level of the increase is open to some debate.
- For the IT manager, MEL state that at GT17, *“there was no clarity on the ongoing structure of the GMO... As such the end allowance assumed the Mutual gas businesses would have no IT function.”* This was not the case as TSOs made it clear that the control room was out of initial scope. MEL also requested separate funds to update SCADA systems during the period. There was also no reduction to engineering staff numbers (i.e. no assumption GMO would take on this responsibility). Therefore, the need to employ an additional manager seems open to question as much of the same IT responsibilities existed both pre and post GMO implementation.
- In terms of energy transition, it seems questionable that two additional FTEs are required at this stage given the listed outputs. We would also have an expectation that a material element of the transition work should be undertaken by existing staff.
- The £1.7m savings listed are difficult to confirm as they are based on counterfactual costs, which may or may not have occurred. For instance, the £600k savings for the *Responsive Project* are credited to in-house staff but may just represent the difference between efficient procurement and a single quote.
- Given these concerns, we do not consider the full complement of the request to be fully justified, either for GT17 uplifts or for GT22 projections.
- We have therefore made provision for **10 FTEs** for engineering staff. This decision is based on the 5.8 staff at GT17 plus 4.2 FTEs to account for WTL assets, energy transition, connections and increased work scope.

FD Recommendation

Partial Disallowance (**£4.76m**)

Table 9 – Drainage

Cost Area	Drainage
Amount Requested in GT22	£2.09m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • Forecast drainage costs (£2.1m) in the MEL business plan were around double that expected in GT17 (£1.0m). • MEL indicated that this was mostly related to adoption of the WTL assets but also with activity related to the Kilroot spur. • MEL stated that external costs were based on the following justification; <i>“We’ve included costs for 1 full-time person for the first year, 75% costs of a full-time person for the second year and then 50% of a full-time person for the remainder of the price control period.”</i> 	



DD Issues / Summary	
<ul style="list-style-type: none"> At draft stage, we were unclear how much responsibility for land remediation would fall to the pipeline contractor before MEL took accountability. We were also concerned that the increases to the WTL budget seemed in excess of a staff member equivalent. Whilst an uplift on GT17 costs was provided, this represented 70% of the total request. 	
DD Recommendation	Partial Disallowance (£1.46m)
TSO Consultation Response	
<p>Within their response, MEL made the following points:</p> <ol style="list-style-type: none"> Contractor warranty ends in June 2022, after which WTL will have responsibility. Drainage issues can take time to materialise. Difficulties encountered with wet ground make substantial claims from landowners almost inevitable. MEL will be required to determine if claims are valid, agreeing the remediation and supervision costs for work to be carried out. This will require significant landowner engagement. Costs are based on a fully accredited supervisor based on tendered MERC rates. 	
UR Final Views	
<ul style="list-style-type: none"> We appreciate the clarification detail provided by the TSO. We further agree that additional costs will be inevitable, hence, the c. 50% uplift from GT17 spend at the draft stage. However, the daily rate of the accredited supervisor is in excess of what we might otherwise expect to see. MEL has also explained that a records officer has been employed during GT17 to assist in landowner liaison. It is our view that the internal staff and the uplift to external drainage costs should provide sufficient funding. We are not minded to amend the DD position. 	
FD Recommendation	Partial Disallowance (£1.46m)

Table 10 – SNIP Agent

Cost Area	SNIP Agent
Amount Requested in GT22	£4.21m
Cost Synopsis	
<ul style="list-style-type: none"> The SNIP Agent contract is the key vehicle used by MEL to procure grid control services. The contract covers various areas including: <ol style="list-style-type: none"> 24/7 operational service of the control room and MERC liaison. Technical monitoring service of the system via SCADA, Leakfinder, telemetry and communication systems. Contract management for business continuity and resilience. 	



DD Issues / Summary

- At draft stage, we provided the full amount requested.
- However, it was understood that MEL was procuring this contract in GT17 and costs could change.
- It was also expected that re-platforming of the SCADA system would be required and additional scope might be expected due to cyber security compliance.

DD Recommendation	Full allowance (£4.21m)
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TSO Consultation Response

Within their response, MEL made the following points:

- 1) Contract was competitively procured with SGN being appointed in January 2022.
- 2) An assumption was made that the tenderer submission would be for a dedicated hardware solution with the hardware being replaced within 5/7 years.
- 3) SCADA and Leakfinder will be moved to a cloud-based solution.
- 4) The transition to a cloud based service would result in higher year 1 costs for the migration with the future costs declining.
- 5) MEL spent £2.7m on the previous refresh of all equipment and integrated systems. Mobilisation and transfer to the cloud costs £3m but will negate the need for future hardware refresh and re-platforming.
- 6) Additional cyber security services will be employed covering technical security, incident and change management.
- 7) Consequently, the grid control cost line request should be uplifted from **£842k** p.a. to **£1.41m** per year (**£7.03m**).
- 8) Increase can be attributed to:
 - a) Increased resource costs to deliver the operational services.
 - b) Increased technical running costs due to additional requirements e.g. new telemetry links, additional gas control infrastructure etc.
 - c) Increased contractor support costs.
 - d) Changed scope of cyber security works.
- 9) MEL also undertook a benchmark against historical costs with the inclusion of additional services. They found that the new contract uplifted costs by **4.8%**.

UR Final Views

- MEL has provided considerable cost detail and explanation around the contract.
- The scope of work in terms of cyber security monitoring and telemetry / communications upgrades is similar to that requested by GNI (UK).
- MEL's grid control costs are significantly in excess of GNI (UK)'s, though this is not totally comparable, as they have captured cyber security in different cost lines.
- It may also be expected to some extent given that GNI (UK) can benefit in this particular area from scale economies, due to being part of larger a network.
- It is difficult to be definitive on cost efficiency given the scale (**+67%**) of the uplift from business plan forecasts, though we recognise the wider scope of work.
- However, the activities in terms of cyber security, communications upgrades, incident monitoring etc. are similar across the TSOs.
- We also have assurance that the contract has been through an open procurement and savings have been delivered following of the BAFO¹ process.
- MEL also provided further assurance via the query log in terms of the procurement process and why SGN had been selected.

¹ BAFO = Best and Final Offer.



- We are therefore minded to accept the full revised request of **£7.0m** for grid control expenditure.
- However, the original business plan also contained a request for **£0.6m** in the *SCADA and comms* cost line for remedial arrangements and periodic upgrades of the SCADA software.
- We asked MEL if these costs had been subsumed into the SNIP Agent contract. Their response to Query 66 indicated that this was not the case as these expenses relate to various separate items such as penetration testing, communications support, RTU support etc.
- The query response did not seem satisfactory given that information in the DD response confirmed that:
 - a) SNIP Agent includes provision for regular SCADA upgrades, which was the original justification for these costs in the business plan.
 - b) SNIP Agent covers expenses related to communication links, telemetry, testing, support and component refresh.
- Given this detail, we can see no clear rationale for providing a separate *SCADA and comms* allowance, as to do so would appear to be double funding.
- We have made full provision for the **£7.0m** SNIP Agent expenses but rejected the original **£0.6m** request for SCADA costs.

FD Recommendation

Minor Disallowance (£7.03m)



MEL Opex Conclusions

- 3.2 MEL did not make any response regarding Board member cost reductions. We are therefore retaining the DD position with respect to these costs.
- 3.3 The pre-efficiency controllable opex request and allowances are set out below. These figures exclude the GMO expenditure and repex.

Table 11 – Controllable Opex Request vs Allowance (Pre-Efficiency)

	MEL Request ² (£m)	UR DD Allowance (£m)	UR FD Allowance (£m)	% Allowance
Administration	10.38	10.19	10.19	98.1%
Planned Maintenance	24.26	21.99	23.02	94.9%
Unplanned Maintenance	2.72	2.10	2.10	77.0%
System Operation (TSO)	8.48	5.67	7.89	93.0%
Grand Total	45.85	39.94	43.20	94.2%

- 3.4 The final determination has uplifted allowances by £3.3m, which represents 94% of the updated business plan request. This increase is mostly related to staff changes and the additional grid control costs associated with the new SNIP Agent contract.
- 3.5 The overall percentage allowance is similar to that of GNI (UK), albeit that the costs are materially different.

² Figures include the amended grid control expenditure.



4. GMO Opex

Background

4.1 The only area of GMO expenditure subject to reduction at draft determination was the IT system enhancement and server hosting costs, captured under the *contracts and licences* cost line. UR analysis of the GMO disputed opex is set out in the table below.

Table 12 – Contracts and Licences

Cost Area	Contracts and Licences
Amount Requested in GT22	£5.07m
<p>Cost Synopsis</p> <ul style="list-style-type: none"> • Contract and license costs largely cover the Delphi IT system. • Overall, GMO is seeking a 106% uplift on the GT17 spend for the GT22 period. • The additional spend is to be targeted at the Delphi system which is business critical and must have a very high level of availability. • Cost increases were principally focused on the IT hardware/software refresh and uplifts to server hosting/support costs. • There is also anticipated to be Delphi enhancements associated with market changes i.e. code modifications, short-term exit products etc. 	
<p>DD Issues / Summary</p> <ul style="list-style-type: none"> • At draft stage, we were concerned around the need for some of the work, and the justification for the cost forecasts. • We also had concerns around the material uplift to hosting costs. • As a result, we made a material reduction and requested further detail to be provided evidencing value for money. 	
DD Recommendation	Material Disallowance (£3.23m)
<p>GMO Consultation Response</p> <p>Within their response, GMO provided more detail on the cost breakdown alongside further explanation. They made the following points:</p> <ol style="list-style-type: none"> 1) Reductions would affect delivery and result in various non-compliance issues. 2) There is uncertainty around the enhancement scope and costs. Therefore, request that Tier 2 projects be treated as a relevant item. 3) Delphi IT system is critical and hardware/software updates are now overdue. 4) Not proposing a cloud-based system so spend is based on similar 2010 activity. 5) Gemserv assessed IT costs in 2016 at the establishment of the GMO and found that the costs were efficient. 6) Server hosting contains a mixture of security, subscriptions and support costs, many of which are not forecast to increase. Some are changing due to new obligations and activity. 	



UR Final Views

- We welcome the additional detail provided by the Market Operator.
- We accept many of the points raised and have restored a significant proportion of the request.
- In terms of disallowances, these can be summarised as follows:
 - a) For *Delphi Enhancements*, we have allowed **£0.57m** of the **£0.67m** requested. The disallowance relates to reduced run-rate for changes associated with legislation and codes based on lack of evidence for full provision from the GT17 experience.
 - b) For the *Application Upgrade*, we have made provision (**£1.0m** of the **£1.48m** request) for the major hardware/software changes in the first two years of the price control. We have disallowed the minor application refreshes and ongoing software costs, where the need is unclear particularly after a major upgrade.
 - c) With respect to *Server Hosting & IT Support*, we have accepted most of the additional cost requests. However, it is not clear why some new licencing and support costs are being allocated to GMO where previously no allocation was made. The split from Ervia might explain cost uplifts but not new allocations. We have not made full provision for these unjustified costs.
- Across all the contract and licence costs, we have made provision for **£4.29m** against a request of **£5.07m**. This represents **85%** of the request and a material uplift from expected GT17 spend of **£2.47m**.
- This allowance does however include the large-scale hardware/software upgrade, which accounts for approximately £1m of the uplift.
- The Tier 2 costs are uncertain and GMO was unable to provide a VROM (Very Rough Order of Magnitude) estimate of these. Without some view of materiality or probability of occurring, we are not able to say if a relevant item is appropriate.
- Given that many of the Tier 2 changes are linked to the energy transition, we think any activity can be addressed through this process rather than specifying a relevant items for GMO IT costs.

FD Recommendation

Partial Disallowance (£4.29m)



GMO Opex Conclusions

4.2 The pre-efficiency opex request and allowances are set out below.

Table 13 – Controllable Opex Request vs Allowance (Pre-Efficiency)

	GMO Request (£m)	UR DD Allowance (£m)	UR FD Allowance (£m)	% Allowance
GMO Staff Costs	2.64	2.64	2.64	100.0%
GMO Administration	0.65	0.65	0.65	100.0%
Contracts and Licences	5.07	3.23	4.29	84.6%
Network Code Development	0.50	0.50	0.50	100.0%
Compliance & Engagement	0.20	0.20	0.20	100.0%
Total GMO Costs	9.06	7.22	8.28	91.4%

4.3 The final determination has uplifted allowances by around £1m, which represents 91% of the request. This increase is exclusively related to IT cost changes.

4.4 The £8.3m pre-efficiency allowance represents a material uplift from the forecast spend of £5.9m in GT17 but does include costs for a major hardware/software refresh in the period.



5. Opex Conclusions

Summary

- 5.1 The graphs below detail the controllable opex allowances against requests after accounting for efficiency. They also provide the context of GT17 actual and forecast spend. Figures for TSOs include their element of GMO spend.

Figure 1 – GNI (UK) Opex Request vs Allowance (Post Efficiency)

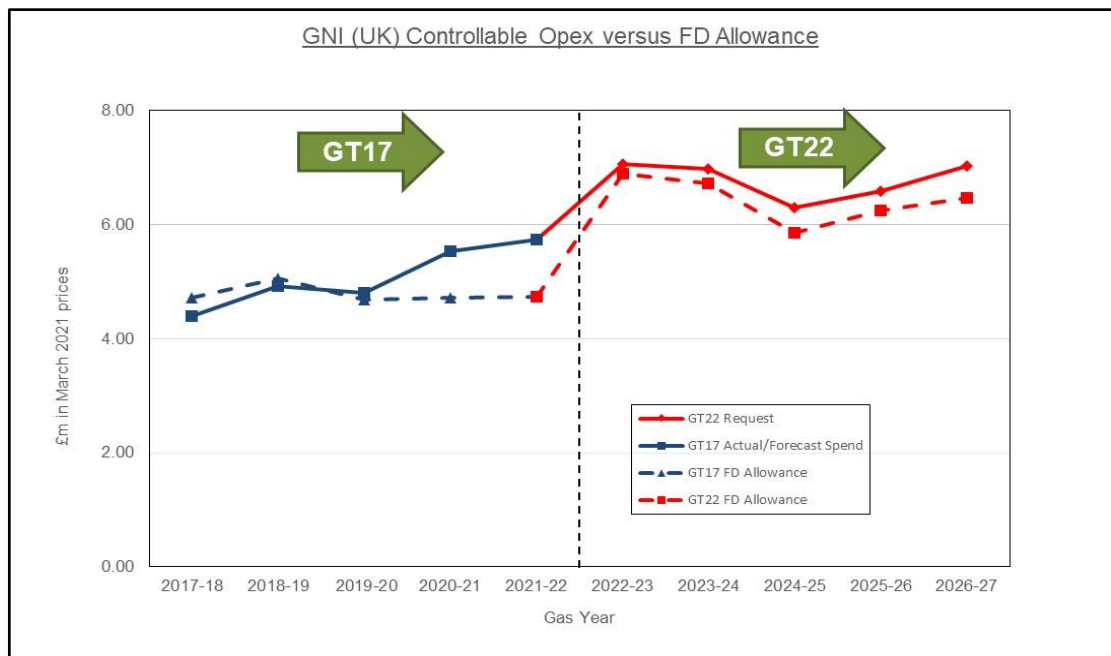


Figure 2 – MEL Opex Request vs Allowance (Post Efficiency)

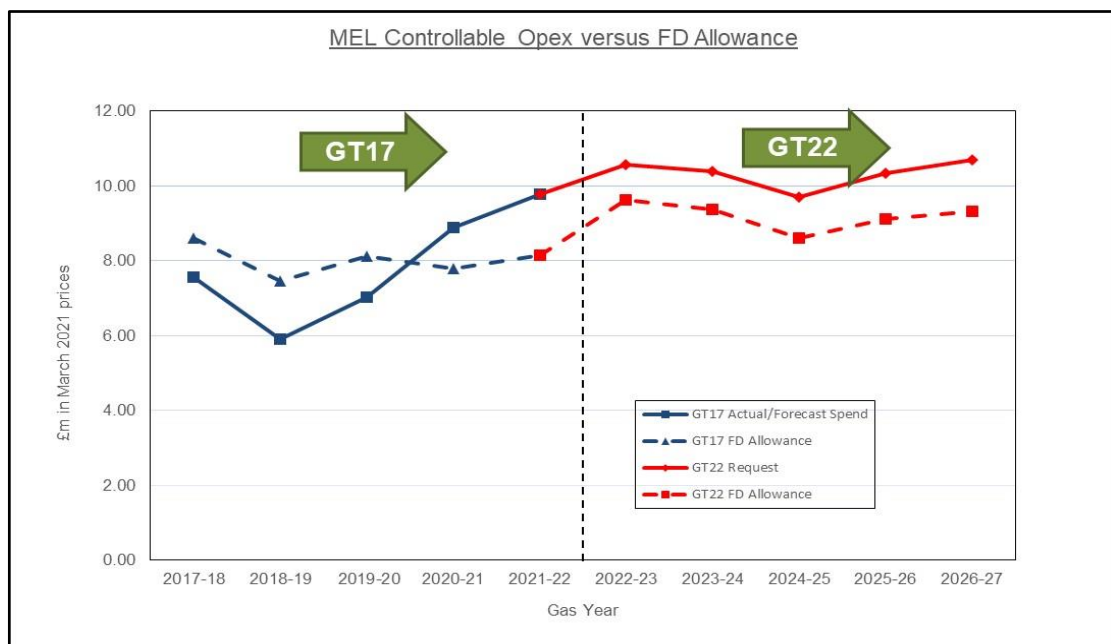
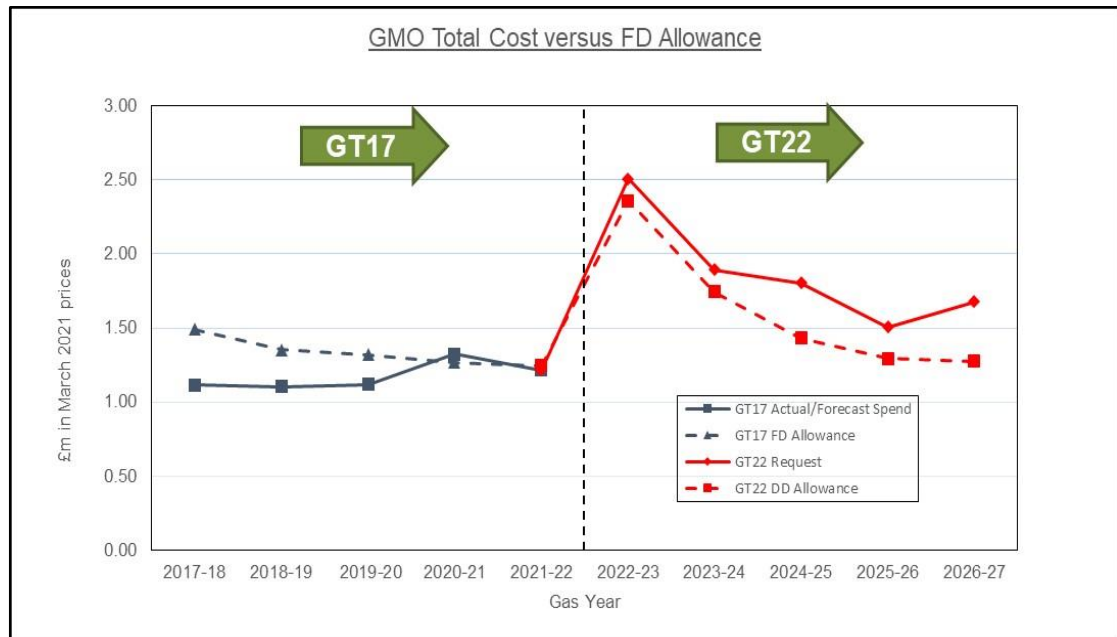




Figure 3 – GMO Opex Request vs Allowance (Post Efficiency)



5.2 For GNI (UK), the table below evidences the material uplifts in request from the GT17 controllable opex allowances (including GMO). Whilst the allowance has been uplifted, there is still some minor disallowance. However, the final decision still represents a 42% increase from the GT17 allowance for the controllable opex programme.

Table 14 – GNI (UK) Opex Allowances (Post Efficiency)

GT17 Forecast Spend	GT17 Allowance	GT22 Request	GT22 FD Allowance	% Change in Request from GT17 Allowance	GT22 % Allowance
£25.4m	£23.9m	£33.9m	£32.2m	41.9%	94.8%

5.3 For MEL, the table below evidences the material uplifts in request from the GT17 allowances and spend. The position has changed between draft and final determination, in major part due to engineering staff costs and the SNIP Agent contract.

Table 15 – MEL Opex Allowances (Post Efficiency)

GT17 Forecast Spend	GT17 Allowance	GT22 Request	GT22 FD Allowance	% Change in Request from GT17 Allowance	GT22 % Allowance
£39.2m	£40.1m	£51.7m	£46.1m	28.7%	89.1%



- 5.4 For the GMO, the table below indicates the step change from GT17. Allowances have been uplifted from the draft stage, which reflects changes to IT costs.

Table 16 – GMO Allowances (Post Efficiency)

GT17 Forecast Spend	GT17 Allowance	GT22 Request	GT22 FD Allowance	% Change in Request from GT17 Allowance	GT22 % Allowance
£5.9m	£6.7m	£9.4m	£8.1m	40.5%	86.3%

- 5.5 The step changes in costs does however include a major IT upgrade to the Delphi hardware/software, which was not part of GT17.