GD23 - Gas Distribution Price Control 2023-2028

Final Determination - Main Report
October 2022

About the Utility Regulator

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.

Abstract

This is the final determination for the Gas Distribution price control (called GD23), for the three gas distribution networks operators (GDNs) in Northern Ireland – Firmus Energy, Phoenix Natural Gas Limited and Scotia Gas Networks Northern Ireland Ltd. It covers the six-year period from 2023 to 2028.

The price control review comprised an assessment of business plans submitted by the GDNs, analysis of a wide range of information, and a public consultation on price control proposals.

Our determination includes our assessment of efficient levels of operational expenditure, capital expenditure, and the costs of financing the long term development of gas distribution networks.

Audience

Regulated utilities, regulatory community, consumers, their representatives and representative and statutory bodies.

Consumer impact

GD23 will deliver £185.5 million of efficient capital investment in the natural gas network and still keep a free gas connection for the majority of customers. The investments and costs necessary to run the network, will lead to a small increase in network charges per annum (before inflation) for domestic consumers of around £38 in the Firmus Energy area, £20 in the Phoenix Natural Gas area and £13 in the Scotia Gas Networks area compared to the business plan submissions made by the companies. However, it should be noted that currently network charges only account for around 15% of current tariffs.

The global economy has changed since we published the draft determination and this has affected our decisions in relation to GD23. The price control process adapted to meet the challenges of the global economic crisis to ensure that cost increases were minimized to protect consumers.

Contents

Annex	Title
A	Map of Licenced Areas
B	GD17 CPR- 2017 -2020
C	Connections and Volumes
D	Opex Detail
E	Frontier Shift
F	Capital Investment Detail
G	Energy Strategy
H	Incentives and Innovations
I	Cost of Capital
J	Pi Models - FE (Distribution) Ltd
K	Pi Models - PNGL
L	Pi Models - SGN
M	BPA FE
N	BPA PNGL
O	BPA SGN
P	Glossary
Q	Promoting Connections
R	Consultation Responses
S	Consultation Responses Report
T	Rate of Return Adjustment
U	GD23 Uncertainty Mechanism - FE
V	GD23 Uncertainty Mechanism - PNGL
W	GD23 Uncertainty Mechanism - SGN

Executive Summary

GD23 Price Control

This determination for the GD23 price control sets out our decisions on the financing of, and outputs for, the three gas distribution network operators (GDNs) in Northern Ireland for the six year period from 2023 to 2028. The three GDNs - Firmus Energy (FE), Phoenix Natural Gas Limited (PNGL) and Scotia Gas Networks Natural Gas Northern Ireland Ltd (SGN) distribute gas to consumers in defined areas under licences granted by the Utility Regulator (UR). Each GDN is subject to our economic regulation under the conditions of their respective licences.

In this price control we set values and parameters which will be used to calculate future gas distribution tariffs during the GD23 price control period. These values and parameters take account of the future development of the network, capital and operating expenditure, rate of return on capital and other financial issues. The impact of these decisions on consumers is also a key aspect of our assessment, particularly the expected impact on distribution charges and consumer bills.

The development of the Natural Gas network in Northern Ireland

The development of the current gas distribution networks commenced in 1996. PNGL developed the network in the greater Belfast Area first; then FE began serving the Ten Towns area, ranging from Newry to Derry/Londonderry, from 2005; and, most recently, SGN began serving consumers in the west from 2017 through the Gas to the West project. By the end of 2021, the distribution network had extended to make gas accessible to over half a million gas consumers, with over half of these already connected.

In December 2021, the Department for the Economy (DfE) published its new Energy Strategy “A path to net zero energy.” The strategy highlights the intention to utilise our modern gas infrastructure and the potential to generate and import zero carbon gases as a means of decarbonisation. While work is already underway to facilitate the injection of biomethane into the network, the route to fully decarbonised gas is uncertain and a further consultation has been identified within the Northern Ireland Energy Strategy on decarbonising heat. In the meantime, as natural gas has lower emissions than oil, the Northern Ireland Energy Strategy continues to support connections to the gas network, while recognising that it is not economic or viable to extend the network to all homes.

In the previous price control (GD17) we included plans to complete the infill of gas mains in most of the main cities, towns and larger villages already served by the GDNs. Our determination for GD23 allows for this infill to be continued and completed.

In our Approach to GD23, we set out how we assess the economics of further extensions of the gas network on a case by case basis. The key principle we apply, is that the gas mains should only be laid where there is a reasonable prospect that the initial outlay cost will be paid back over the useful economic period at current tariff levels. This ensures that tariffs for existing customers do not increase to subsidise future extensions.

Neither FE, nor PNGL, proposed any additional network extensions in their plans for GD23. SGN proposed to extend the gas network to cover a further 4,200 properties in nine areas which are close to existing gas mains. We have not included these extensions in our determination because they proved to be uneconomic as a package.

Our assessment suggests that we are at, or close to, the limit of the economic extension of the gas network, when assessed against our current economic test. During GD23, we will undertake a review of the economic test used to assess future extensions of the network taking account of wider objectives of the Northern Ireland Energy Strategy 'Path to Net Zero Energy'. This determination allows for future decision on extensions to be made in advance of the next price control if they are found to be in line with our duties in law.

Supporting gas network connections

While 308,000 properties have connected to the gas network at the end of 2021, there will still be around 247,000 properties close to a gas main which will not have connected. The GD23 price control continues to support connections to the gas network by providing for a free connection when the connection is made, with the cost of the connection paid for by all consumers over a period of time.

For the GD23 final determination we have retained many of the changes to the structure of the funding mechanism for funding OO connections proposed in the draft determination. An element of the allowed funding is in the form of a fixed sum with the remainder funded as a variable amount per connection. The funding levels have been reviewed, in light of the current economic circumstances and the desire to support and encourage consumers to become connected to the gas network, with a view to assisting the transition to Net Zero sooner.

Funding to promote OO connection will become progressively more challenging as the number properties available to connect gradually reduces. Unless the costs of advertising, marketing and development reduces through new, more efficient approaches, future costs would become progressively more and more uneconomic. In that context, a different model of funding for incentivising connections would be needed, and we would expect to move to the actual costs-to-serve approach for GD29.

Current economic climate

We are publishing our final determination at a time when a combination of factors have increased both short term volatility and medium term uncertainty in the wider economy. Local and global supply side constraints have increased costs, with clear evidence that construction costs for the gas industry have increased by more than general inflation. The cost shock of increased gas prices has affected consumers and industry alike and has contributed to high levels of inflation in 2022 and a reduction in amounts of gas consumed. The introduction of support mechanisms to mitigate gas price increases may affect future levels of consumption and inflation, adding to the short- term uncertainty. More recently, interest rates for new debt have increased and the cost of debt remains volatile.

In these circumstances we have taken account of current changes and future uncertainty in the wider economy in our final determination. Estimates of gas consumption in the GD23 price control have been reduced to take account of recent reductions in consumption. An allowance has been made for increased costs of capital works in excess of inflation which have occurred in 2022. The cost of capital has been determined using current spot estimates of risk free rates and, cost of debt at the end of September 2022. The allowance for corporation tax was adjusted to 19% in line with the Chancellor of the Exchequer's Ministerial Statement of 23 September 2022. We recognise that Government has subsequently announced its intention to apply 25% corporation tax rate. Future inflation rates have been profiled to account for current forecasts which suggest that high levels of inflation in 2022 will continue into 2023, before returning to more normal levels. Because of the increased uncertainty in estimating these key parameters over the GD23 period, the Rate of Return Adjustment mechanism has been amended to include adjustment for inflation and risk free rate as well as cost of debt and corporation tax rates.

We are aware that some of the figures from government and other independent sources used within our final determination will change prior to the final decision on the proposed licence modifications. It is our intention to consider any new relevant information of this nature along with the responses to the licence modification consultation. Where appropriate, we will take account of material changes when we make our decision on GD23 licence modifications at the end of February 2023. These changes might result in either increases or reductions in determined tariffs for GD23.

Financial aspects

We have actively challenged the activities and costs proposed by the GDNs to develop, maintain and operate the gas distribution networks.

We undertook a detailed assessment of capital expenditure (capex) challenging both the need for investment and the future costs of investment. Following this assessment, we have not included the following: investment in further extensions to the network; and, work proposed on network resilience. We plan to undertake further work during the GD23 price control to review the need for network extensions and investment in resilience. We have used a basket of works, similar to our approach to GD17, to determine future cost of investment based on recent costs. We have also allowed for increases in capital costs in excess of inflation experienced in 2022. The total investment for GD23 is £185.5m compared to £226.5m initially proposed by the GDNs, a reduction of 18%. Approximately, one third of this challenge relates to unit rates, with the rest linked to a reduction in work to be undertaken.

We initially considered benchmarking operational expenditure (opex) with GDNs in GB, but concluded that differences in scale and stage of development meant we could not rely on this type of comparison. Instead, we undertook a detailed bottom up assessment of opex, taking account of the recent levels of expenditure. We have allowed additional costs, where outputs or requirements have changed or the GDNs have provided good asset maintenance reasons for additional activities. In the case of SGN, we have continued to rely on limited costs submitted by the company when it applied for the licence for Gas to the West. For other areas of SGN costs we have determined costs based on bottom up estimates taking account of changes in circumstance. Our estimate of overall operational expenditure for all GDNs within GD23 is £188.8m, compared to £213.7m initially proposed by the GDNs, a reduction of 12%.

Our price control determinations and the subsequent annual assessments of tariffs takes account of a general measure of inflation. In the past RPI has been used, but for GD23 we have adopted CPIH as the general measure of inflation. This change reflects concerns expressed by the UK Statistics Authority (UKSA) over the robustness of RPI. As a result, the UKSA has urged Government and others to cease using RPI. The move to CPIH reflects changes the UKSA plan to make in 2030. We also consider that moving to CPIH provides a more equitable distribution of cost between today’s and future consumers, and it helps maintain financeability of the GDNs in GD23.

We have assessed an appropriate return on capital for each GDN using the Capital Asset Price Model (CAPM). In doing so we have taken account of regulatory precedents including the recent decisions by Ofgem for RIIO-GD2, which were also considered by the CMA in its role as a statutory appeals body. We also tested the ability of the GDNs to finance their regulated businesses through a combination of debt and equity using some of the key financial indicators used by credit rating agencies. The real rates of return determined for GD23 are shown below in Table 1.

	2023	2024	2025	2026	2027	2028
PNGL - Pre-tax	1.06%	4.02%	5.96%	5.39%	5.39%	5.39%
Firmus - Pre-tax	1.57%	3.29%	4.97%	5.44%	5.44%	5.44%
SGN - Vanilla	1.46%	3.37%	4.22%	3.85%	4.04%	4.23%

Table 1 - Rate of Return

We have calculated an appropriate return on capital at a gearing of 55% and tested financeability against ratios commonly used by credit rating agencies at gearings of 55% and 45%. Our view is that all GDNs are capable of financing their activities during the GD23 period via a prudent choice of capital structure. Our role is to ensure that the companies have an adequate return of equity and debt to manage their finances over the long run and to leave the detailed management of those finances to the companies. In the event that the revenues fall short of providing sufficient cash flows it is for the companies to make any adjustments they consider appropriate.

We continue to take account of the long term development of the networks when determining revenues and tariffs for GD23, with tariffs smoothed to the end of a 'recovery period' (2045 for FE, 2046 for PNGL and 2057 for SGN). This approach allowed those who connected in the early stages of development to pay a reasonable price for network services, with the investment made by GDNs recovered over the longer term as more consumers connect. The profiling of revenues is captured in a Total Regulatory Value (TRV) which also includes the depreciated asset value. The revenues and tariffs raised in each price control include a return on capital on the TRV and contribute to the cost of paying down the TRV over time. The profile of the combined TRV for all GDNs to 2045 is shown in Figure 1. The TRV is at its peak of £925m at the start of GD23 and reduces to £383m by 2045, when the aggregated depreciated asset value (DAV) is £368m.

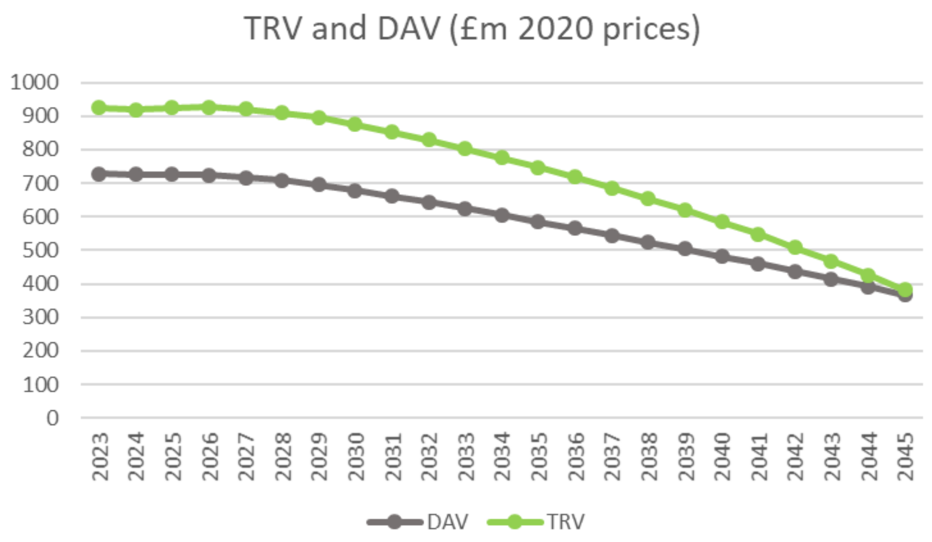

Figure 1: Total regulatory value (TRV) all GDNs to 2045.

The combined impact of our final determination is that consumers will pay more in GD23 than the GDNs initially proposed. However, it should be noted that network charges only account for around 15% of the current tariff.

2020 Prices	GD17 FD P1 tariff ppt	GD23 BPS P1 tariff ppt	GD23 FD P1 tariff ppt
FE	49.63	44.50	54.01
PNGL	45.14	43.51	48.50
SGN	33.01	43.72	47.01

"P1 tariff ppt" - the tariff for domestic and the smallest I&C consumers in pence per therm. FD - final determination; BPS - business plan submission by the GDNs. The additional cost is calculated based on 380 therms per annum.

Table 2: Impact on domestic tariffs and charges

Our determination takes account of the available information and makes projections for other key parameters such as inflation and the corporation tax rates. The price control includes mechanisms to adjust these parameters in the future. Tariffs will be adjusted for actual inflation and the cost of capital will be adjusted for key inputs such as inflation, interest rate benchmarks and corporation tax. FE and PNGL operate under a revenue cap regime with tariffs adjusted relative to actual volumes to deliver determined revenues while SGN are exposed to volume risk up to 15% of the determined values.

We acknowledge the changing policy environment as we are consulting on the proposed licence modifications to implement these decisions and note a further opportunity remains to consider figures sourced from government and other independent sources used within our final determination. The regulatory regime, which provides a high degree of protection to regulated companies, ensures that the essential service GDNs provide can continue to be financed, operated and extended during a period of economic challenge The price control has been adapted to meet the challenges of the global economic crisis to ensure that cost increase were minimised to protect consumers. Prices have therefore been set fairly in the current climate of increasing costs and all costs have been scrutinized to ensure that consumers get the best deal possible for the service they receive.

Final determination summary

A summary of the determination for each GDN is provided in the tables below. These summaries compare the GDNs' business plan submissions with our final determination of operational expenditure (opex), capital expenditure (capex), (all post efficiency) revenue, additional properties passed and connections in the GD23 period.

Capex £m in Av 2020 prices	2023	2024	2025	2026	2027	2028	Total
FE submission	18.9	13.2	12.3	10.8	10.8	10.9	76.9
GD23 final determination	12.7	9.8	9.7	9.9	9.5	9.5	61.1

Opex £m in Av 2020 prices	2023	2024	2025	2026	2027	2028	Total
FE submission	10.0	9.8	9.9	10.2	10.7	10.6	61.2
GD23 final determination	8.5	9.0	9.5	9.9	9.9	10.0	56.7

Revenues £m in Av 2020 prices	2023	2024	2025	2026	2027	2028	Total
FE submission	24.7	26.1	27.0	27.9	28.6	29.3	163.5
GD23 final determination	25.3	27.2	29.1	30.9	32.1	33.2	177.9

Properties passed	2023	2024	2025	2026	2027	2028	Total
FE submission	3,514	1,643	1,584	1,514	1,507	1,500	11,262
GD23 final determination	3,106	1,250	1,250	1,250	1,250	1,250	9,356

Connections	2023	2024	2025	2026	2027	2028	Total
FE submission total	6,500	6,335	6,171	6,016	5,866	5,724	36,612
- Owner occupied	3,852	3,685	3,524	3,371	3,224	3,084	20,740
- New Build	1,500	1,500	1,500	1,500	1,500	1,500	9,000
- NIHE	1,000	1,000	1,000	1,000	1,000	1,000	6,000
- Small and medium I&C	148	150	147	145	142	140	872
- Large and Contract I&C	0	0	0	0	0	0	0
GD23 final determination	4,363	5,150	5,921	5,766	5,616	5,474	32,290
- Owner occupied	2,000	2,750	3,524	3,371	3,224	3,084	17,953
- New Build	1,250	1,250	1,250	1,250	1,250	1,250	7,500
- NIHE	1,000	1,000	1,000	1,000	1,000	1,000	6,000
- Small and medium I&C	113	150	147	145	142	140	837
- Large and Contract I&C	0	0	0	0	0	0	0

Table 3: FE final determination summary

Capex £m in Sep 2020 prices	2023	2024	2025	2026	2027	2028	Total
PNGL submission	20.3	19.6	20.1	20.5	17.1	15.7	113.2
GD23 final determination	18.8	17.8	18.0	17.0	13.5	13.3	98.4

Opex £m in Sep 2020 prices	2023	2024	2025	2026	2027	2028	Total
PNGL submission	20.4	20.7	20.6	20.6	20.7	21.4	124.5
GD23 final determination	18.3	18.2	18.3	18.5	18.3	18.4	110.0

Revenues £m in Sep 2020 prices	2023	2024	2025	2026	2027	2028	Total
PNGL submission	66.0	66.8	67.5	68.1	68.7	69.2	406.3
GD23 final determination	67.0	70.1	73.4	75.4	76.6	77.9	440.4

Properties passed	2023	2024	2025	2026	2027	2028	Total
PNGL submission	5,579	3,265	3,365	3,465	3,564	3,564	22,802
GD23 final determination	5,129	2,715	2,715	2,715	2,714	2,714	18,702

Connections	2023	2024	2025	2026	2027	2028	Total
PNGL submission total	7,322	7,059	6,727	6,637	6,627	6,521	40,893
- Owner occupied	4,522	4,159	3,727	3,612	3,502	3,396	22,918
- New Build	2,300	2,400	2,500	2,600	2,700	2,700	15,200
- NIHE	350	350	350	300	300	300	1,950
- Small and medium I&C	148	148	148	123	123	123	813
- Large and Contract I&C	2	2	2	2	2	2	12
GD23 final determination	5,472	5,900	6,227	6,037	5,927	5,821	35,384
- Owner occupied	3,000	3,400	3,727	3,612	3,502	3,396	20,637
- New Build	2,000	2,000	2,000	2,000	2,000	2,000	12,000
- NIHE	350	350	350	300	300	300	1,950
- Small and medium I&C	120	148	148	123	123	123	785
- Large and Contract I&C	2	2	2	2	2	2	12

Table 4: PNGL final determination summary

Capex £m in Av 2020 prices	2023	2024	2025	2026	2027	2028	Total
SGN submission	6.3	6.0	5.7	8.3	5.5	4.5	36.3
GD23 final determination	4.2	3.8	4.7	5.6	3.6	4.2	26.0

Opex £m in Av 2020 prices	2023	2024	2025	2026	2027	2028	Total
SGN submission	4.2	4.3	4.4	4.7	5.4	5.0	28.0
GD23 final determination	3.1	3.4	3.6	3.9	4.0	4.2	22.1

Revenues £m in Av 2020 prices	2023	2024	2025	2026	2027	2028	Total
SGN submission	6.7	7.0	7.4	7.8	8.2	8.6	45.6
GD23 final determination	6.2	6.4	6.8	7.3	7.7	8.0	42.3

Properties passed	2023	2024	2025	2026	2027	2028	Total
SGN submission	2,944	2,873	3,181	4,414	1,794	1,736	16,942
GD23 final determination	2,108	1,926	2,979	3,619	1,106	1,779	13,517

Connections	2023	2024	2025	2026	2027	2028	Total
SGN submission total	972	934	984	1,122	977	1,017	6,005
- Owner occupied	623	593	599	652	643	640	3,750
- New Build	200	203	182	108	81	43	817
- NIHE	89	53	92	180	88	184	686
- Small and medium I&C	57	82	109	180	162	150	739
- Large and Contract I&C	3	3	2	2	3	0	13
GD23 final determination	456	624	873	939	802	919	4,614
- Owner occupied	200	364	529	565	544	562	2,765
- New Build	200	203	182	108	81	43	817
- NIHE	25	0	70	111	37	184	427
- Small and medium I&C	27	55	82	151	137	130	582
- Large and Contract I&C	4	2	10	4	3	0	23

Table 5: SGN final determination summary

1. Introduction

Purpose of this Document

1.1 This document sets out the Utility Regulator's (UR) final determination for the GD23 price control.

1.2 GD23 is the name given to the price control for the six-year-period from 1 January 2023 for the three gas distribution network operators (GDNs) in Northern Ireland:

a) Firmus Energy (Distribution) Limited (FE).

b) Phoenix Natural Gas Limited (PNGL).

c) Scotia Gas Networks Natural Gas Northern Ireland Ltd (SGN).

1.3 The price control sets out the amount the GDNs have to run their business and invest in the gas network. Key decisions for the companies are the operational and capital expenditure allowances, proposed rate of return, forecast connections and volumes and the mechanisms which would allow the determination to adjust for inflation, changes in outputs or to address new issues which emerge.

1.4 The determination of revenues and tariffs in the GD23 period takes account of forecasts of costs and gas consumption beyond GD23. Forecasts are considered up to the end of the revenue recovery period for each GDN, which ranges from 2045-2057. This approach allows reasonable tariffs to be set in any one price control period, with early network development costs recovered over the longer term.

1.5 This determination details our decisions with respect to the GD23 price control period on allowances, incentive mechanisms and outputs. We have determined a weighted average cost of capital, and assessed the financeability of the GDNs to secure their ability to finance their regulatory activities. The final determination also considers the expected impact of these decisions on consumers, in particular the expected impact on distribution charges and consumer bills.

1.6 The decisions detailed in this document were made following responses and further information we received from GDNs, from consumers and from stakeholders during the consultation period on the draft determination.

Our Statutory Duties and Regulatory Principles

1.7 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, to do so consistently with our fulfilment of the objectives set out in the European Gas Directive, and by having regard to a number of matters, as set out more fully in the Energy (Northern Ireland) Order 2003[1].

1.8 Gas distribution networks are natural monopolies, with each GDN providing the distribution network in separate defined areas. While the GDNs' licences set some limits on exclusivity of areas served in principle, in practice there is no opportunity for consumers to change their distribution network provider. In these circumstances, economic regulation serves as a surrogate for competition, to challenge the GDNs to operate efficiently and maintain and improve the level of service received by consumers.

1.9 An important part of this regulatory framework is periodic price controls. A price control is a method of setting the total allowed revenues a GDN is allowed to recover from consumers through a cap on revenues, or the maximum tariffs a GDN is allowed to charge through a price cap. In the GD23 price control, PNGL and FE are subject to revenue caps and SGN is subject to a price cap, continuing the approach applied in GD17.

1.10 Through price controls, economic regulators 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.

1.11 As part of a price control, we also establish a clearly defined set of outputs that each GDN must deliver. When selecting these outputs, we aim to strike a balance between the clear definition and quantification of outputs while allowing GDNs the flexibility they need to deliver them in the most effective way.

1.12 We interpret our duties as a requirement to:

a) Secure the most cost efficient outcome for the protection of consumers and the promotion of the gas industry in Northern Ireland;

[1] The Utility Regulator's principal objective is set out in [Article 14 of the Energy (Northern Ireland) Order 2003]

b) Ensure the gas distribution network operators can continue to finance the activities which are the subject of obligations placed on them; and

c) Have due regard to all relevant factors.

1.13 It is our aim to do this by:

a) Providing a strong foundation for the continued and long-term economic development of gas distribution networks, delivering service improvements to consumers;

b) Challenging the GDNs to improve their efficiency and performance at an achievable and sustainable rate;

c) Promoting long term planning by the GDNs and securing the continuity of necessary and efficient investment; and

d) Ensuring that revenues and prices are set at the minimum levels that are consistent with efficient operation.

Development of the gas industry to date

1.14 Northern Ireland currently has three gas distribution networks:

a) Firmus Energy (Distribution) Limited own and operate the distribution network, normally called the ten towns area.

b) Phoenix Natural Gas Limited (PNGL) own and operate the distribution network in the Greater Belfast and Larne areas and East Down.

c) Scotia Gas Networks Ltd (SGN) own and operate the network of distribution mains in the west laid as part of the 'Gas to the West' project.

1.15 The operating areas of these three companies are shown in Annex A - Map of licenced areas.

1.16 The current development of the network is summarised in Table 1.1. It shows the number of properties passed, and the number of properties connected to the end of 2021 for each GDN.

1.17 In this context, a 'properties passed' or property passed is one which is typically located within 50m of a gas main, subject to certain practical limitations, and is referred to as 'readily connectable'.

1.18 The number of connections covers all property types including domestic and industrial / commercial. At the end of 2021, 55% of properties passed were connected. A total of over 247,000 properties which could connect remained to be connected. There is significant potential to connect further properties to the existing network.

GDN	Licence Awarded	Properties passed	Properties connected	Potential connections
PNGL	September 1996	358,713	244,495	114,218
FE	March 2005	174,322	61,148	113,174
SGN	February 2015	22,008	2,395	19,613
Total		555,043	308,038	247,005

Figures are correct up to the 31 December 2021

Table 1.1: Development of the gas network

1.19 Once GDNs complete the network development in GD17, and that already identified in the GD17 Price Control for completion in GD23, approximately 65% of properties in Northern Ireland will have access to natural gas, should they choose to connect to the network.

Overall Approach and Timelines for GD23

1.20 The GD23 process began in late 2019, when meetings were held individually and collectively with all the GDNs, identifying the key issues and challenges that they faced for GD23.

1.21 In addition to the engagement with the GDNs, we also engaged with other key stakeholders, including representatives from the Consumer Council of NI (CCNI) and the Department for the Economy (DfE).

1.22 From this initial feedback we issued an Approach document[2] for GD23 for consultation in GD23. We received five responses to this. Having considered these responses, we published our Final Approach document[3] for GD23 in November 2020.

1.23 At the same time, we engaged with the GDNs to develop the Business Plan Submission Templates and Commentary documents, including some supplemental papers. The Business Plan Submission Templates built on the GD17 Business Plan Templates and the Regulatory Information Guidance Templates used for annual cost and performance reporting. The Business Plans guidance and commentary, along with the supplemental papers were

[2] GD23 Approach 01.00 - Consultation published 2020-06-01.pdf (uregni.gov.uk)
[3] 2020-11-6 GD23 Final Approach- Final.pdf (uregni.gov.uk)

finalised and submitted to the GDNs on the 29 January 2021, and published[4] shortly thereafter.

1.24 At the end of June 2021, the GDNs submitted their business plan templates, and commentary with supplemental papers. A requirement of the submission was to produce a public facing document that was published on each GDN website[5], to enable open dialogue with other stakeholders on the key issues.

1.25 The GD23 business plan submission was followed by a phase of analysis, and an exchange of information requests and responses between ourselves and the GDNs to clarify any issues and queries arising. We considered the responses received from the GDNs in arriving at our draft determination.

1.26 We reviewed our proposals for GD23 in light of the responses received to our consultation to the draft determination.

1.27 Following the publication of the draft determination in March 2022, we entered into a further phase of bilateral engagement between ourselves and the GDNs, as well as engagement with other key stakeholders between June and September 2022.

1.28 The consultation on the GD23 draft determination closed on 26 May 2022, and we received nine responses in return. These responses were received from each of the three GDNs, the Energy Saving Trust, Kier Integrated Services, the Consumer Council for Northern Ireland (CCNI), Northern Ireland Electricity Networks (NIEN), Mutual, and National Energy Action NI (NEA NI). We subsequently analysed and considered all responses received as part of the preparation of this GD23 final determination.

1.29 The publication of the GD23 final determination in October 2022 will be accompanied by a consultation on related licence modifications, with the consultation period scheduled to end on 25 November 2022.

1.30 Following due consideration of the responses received to this consultation on licence modifications and consideration of other relevant factors, we expect to publish our related decision in February 2023. The effective date of the licence modifications will be at least 56 days after the publication of the licence modification decision, in line with the requirements of Article 14(10) of the Gas (Northern Ireland) Order 1996. This period provides an opportunity for the licence holder which is subject to the price control, any other licence holder materially affected by the decision, a qualifying body or

[4] 2021-01-29 GD23 Business Plan Commentary and Guidance- Final.pdf (uregni.gov.uk)
[5] GD23_Business_Plan_2021.pdf (firmusenergy.co.uk), 300721-FINAL-GD23-Report.pdf (phoenixnaturalgas.com), https://sgnnaturalgas.co.uk/publication/67

association representing one of those licence holders, and/or the CCNI to appeal the decision on the proposed licence modifications to the CMA.

1.31 A decision was made to follow the normal governance processes in terms of timelines for board approval. The result will be that the Licence Modifications decision will not be published until around 22 February 2023. This means there will be a short delay between the date when the decision is made and the new price control taking effect, in accordance with the statutory rule that licence modifications may come into force no earlier than 56 days after the date of the decision to make them. The anticipated date for the modifications to come into effect is therefore 19 April 2023 (56 days after the licence modification decision notice is expected to be published). However, once the licence modifications come into effect, they will apply in respect of the whole of the first year of the new control period (i.e. on and from 1 January 2023). In practical terms, therefore, the timing of the licence modifications coming into legal effect is designed to ensure that all of the licence formalities are fully satisfied, but the application of the new price control once the modifications are in effect will be such as to ensure that the GD23 allowances and outputs will apply from the 1 January 2023.

1.32 The key milestones of the GD23 price control are summarised in Table 1.2 below.

GD23 Key Milestones	Revised timeline
GD23 Approach Document Consultation	1 June 2020
GD23 Approach Document Consultation Ends	7 August 2020
GD23 Approach Document published	6 November 2020
Business Plan information requirements published	31 January 2021
GDNs submit BPs for GD23	30 June 2021
UR publishes DD consultation for GD23	9 March 2022
DD consultation period ends	26 May 2022
GD23 FD and licence consultation published	28 October 2022
GD23 GDN licence modifications consultation closed	25 November 2022
GD23 GDN licence modifications decision published	22 February 2023

Table 1.2: Price Control Process Key Milestones of GD23.

Summary of Key Changes from the Draft Determination

1.33 We have changed aspects of the price control since the publication of the DD. These changes have been made after: considering the responses to our consultation, further discussions, and undertaking analysis and consideration of evidence provided. For ease of reading, at the beginning of each chapter we have highlighted the main changes that we have made in that area.

1.34 We received 9 responses to the draft determination in total, and they are available in Annex R. Responses were received from:

- GDNs (these are redacted versions provided to us by the GDNs):
  - ♦ FE Draft Determination Consultation Response;
  - ♦ PNGL Response to GD23 Draft Determination; and
  - ♦ SGN Draft Determination Response.
- Other Parties
  - ♦ CCNI - GD23 DD Response;
  - ♦ Energy Saving Trust - Final Submission;
  - ♦ Kier Integrated Services Consultation Response to GD23 DD;
  - ♦ Mutual Energy - GD23 Consultation Response;
  - ♦ NEA NI Response to GD23 - Gas Distribution Consultation; and
  - ♦ NIE Networks Response to GD23 DD.

Structure of this Document

1.35 This document is structured in a number of chapters as follows, each addressing different aspects of the price control:

a) The Executive Summary provides an overview over the key findings and key decisions of this price control process.

b) Chapter 1, Introduction, provides an overview of: the purpose of this GD23 final determination; our statutory duties and regulatory principles; and the development of the gas industry to date.

c) Chapter 2, Common Issues, provides an overview of the price control process and key aspects of same.

d) Chapter 3, Price Control Submissions and Current Performance, provides an overview of requests made by FE, PNGL and SGN and a discussion of GD17 performance to date.

e) Chapter 4, Volume & Connections, sets out estimates for consumption volumes and connection numbers that contribute to the determination of costs and the determination of revenues and tariffs.

f) Chapter 5, Operational Expenditure, summarizes the operating expenditure (opex) allowances requested by each GDN, our assessment of these costs and our allowances for the GD23 price control period.

g) Chapter 6, Capital Investment, summarizes the capital expenditure (capex) allowances requested by each GDN, our assessment of the activities and costs proposed and our allowances for the GD23 price control period.

h) Chapter 7, Energy Strategy, Innovation & Incentives, is our view with respect to funding of innovation initiatives both in general as well as with respect to specific innovations proposed by the GDNs including any appropriate incentives and how we propose to deal with the implications of the Energy Strategy.

i) Chapter 8, Stakeholder and Customer/Consumer Engagement, deals with approaches to engagement after consideration of the proposals and direction of travel.

j) Chapter 9, Uncertainty Mechanism, details our review of the uncertainty mechanism with respect to the GD14 and GD17 outturns as well as our decisions for the GD23 uncertainty mechanism.

k) Chapter 10, Financial Aspects, discusses different aspects relating to the finance implications of the price control, including rate of return, depreciation, tax, profile adjustments and financeability.

l) Chapter 11, Outputs, Outcomes & Allowances, summarises key aspects of the price control determination such as designated parameters and determination values.

m) Chapter 12 reviews the Business Plan Assessments of each GDN and provides a summary, with a more detailed assessment contained in the Annexes.

n) Chapter 13, Next steps for and Further Issues, provides an overview of the proposed next steps and summarises consequential changes as well as further issues we propose to address pursuant to the price control determination.

1.36 The main chapters in this final determination provide a summary of our analysis and decisions with the detail of our assessment provided in supporting Annexes.

2. Common Issues

Summary of Key Changes from Draft Determination

2.1 This section addresses the following issues:

a) The duration of the GD23 Price Control.

b) The price base for GD23.

c) The form of the Price Control.

d) Adjusting for inflation.

e) Future of the domestic owner occupied connection incentive.

f) Future issues not covered in the GD23 determination.

2.2 The following changes have been made in these areas for the final determination:

a) Funding for the domestic owner occupied connection has been increased for all GDNs and the structure of the connection incentive has been allow GDNs to maintain engagement when connection numbers might continue to be supressed by high gas prices.

b) An allowance has been included for future costs to support the decarbonisation of gas. This fund is 1% of annual Totex. It is ring fenced via the uncertainty mechanism and is subject to a business case before any approvals would be granted.

Duration of the GD23 Price Control

2.3 The optimum duration of a price control is a matter of judgement which needs to balance a number of factors:

a) The advantage of giving planning security to the GDNs and providing them with the flexibility to plan their business and to deliver these plans within the framework and constraints set by each price control; and,

b) The need to account for changes in external environment and external drivers which inform the overall level of charging that is possible, and which become less predictable as the planning horizon lengthens.

2.4 GD17 covered the six year period 2017 to 2022 for FE and PNGL, and a five year period 2018 to 2022 for SGN. When we consulted on our approach to GD23 we proposed a six year duration for the price control. This proposal was supported by all GDNs. We concluded that a that a six year duration provides a reasonable balance between the risk to consumers and GDNs of material changes in circumstances over the price control while providing a framework which promotes stable long term delivery.

2.5 We have decided on a six year duration for the GD23 price control, which will run from the 1 January 2023 to the 31 December 2028.

2.6 As a result, the next price control after GD23 will be GD29, which is expected to come into effect on 1 January 2029. This timeline will enable the material used in Ofgem's RIIO GD3 to be considered in our determinations for GD29, where appropriate. This has not changed from our draft determination.

Price Base

2.7 Our financial decisions are presented in a defined price base and are subject to inflation and other adjustments as necessary as set out in the determination and the GDN licence. There are slight differences in the price base used in the GDNs licences as two GDNs use average year prices and one GDN uses September prices. We have decided to follow the price base used in each GDN's licence throughout this final determination as follows, unless indicated otherwise:

a) FE - Average 2020 prices.

b) PNGL - September 2020 prices.

c) SGN - Average 2020 prices.

2.8 This is consistent with the licences and respective Total Regulatory Value (TRV), used to calculate the conveyance charges.

2.9 While this means that costs and unit rates presented in this determination for PNGL, are not strictly comparable with those presented for FE and SGN, any differences are minor. This has not changed from our draft determination.

Form of the price control

2.10 FE and PNGL currently operate under revenue cap price control regimes, which have been in place since 2016 and 2006 respectively. Before that the companies operated under price cap regimes for a period of approximately

10 years from the initial grant of licence. Under a revenue cap regime the company is permitted to recover up to the maximum revenue determined through the price control. Annual tariffs are adjusted to reflect actual volumes of gas consumed and the company benefits if gas consumption is higher than estimated and does not carry any material risk if gas consumption is lower than expected. A revenue cap regime is appropriate for mature networks.

2.11 SGN currently operates under a price cap price control regime. Under a price cap regime we determine the tariffs the company is able to charge. This provides a strong incentive for companies to identify and connect new consumers during the initial stages of network development. SGN connected its first consumers in 2017, and continues to develop its network and build its consumer base.

2.12 Taking account of the responses to the public consultation on our Approach to GD23 on the form of the GD23 price control we have decided to:

a) Continue with a revenue cap price control regime for FE and PNGL; and

b) Continue with a price cap price control regime for SGN.

Adjusting for inflation

2.13 Our final determination for the GD23 price control is presented in a defined price base for each GDN as described at Paragraph 2.7.

2.14 As the price control is implemented, the determination of revenues and tariffs are adjusted for inflation. The TRV is also adjusted for inflation to establish an opening value for subsequent price controls.

2.15 The general measure of inflation applied in GD17 and previous price controls was the Retail Prices Index (RPI), as published by the Office of National Statistics (ONS) each month in respect of all items.

2.16 We are changing the general measure of inflation applied in the GD23 price control to the Consumer Prices Index including owner occupiers' housing costs (CPIH), as published by the ONS. Key decisions in the final determinations for GD23 reflect this decision, including:

a) The determination of a real weighted average cost of capital on a CPIH stripped basis.

b) The determination of a frontier shift on a CPIH stripped basis.

c) The calculation of the opening TRV for GD23 to ensure that the way in which CPIH is applied to future revenues and tariffs determined in 2020 prices reflects the inflation of the TRV to the end of the GD17 period using RPI.

2.17 RPI is no longer considered a robust measure of general inflation by those responsible for publishing it. It has been assessed against the Code of Practice for Official Statistics and found not to meet the required standard for designation as a National Statistic. The UK Statistics Authority (UKSA) has noted that: "We have been clear that the RPI is not a good measure, at times significantly overestimating inflation and at other times underestimating it, and have consistently urged all – in Government and the private sector – to stop using it."

2.18 In our approach to GD23, we noted proposals by the chair of UKSA to eventually cease the publication of RPI and, in the meantime, to incrementally adjust RPI to align with CPIH. In response to the UKSA's proposals, the Chancellor of the Exchequer ruled out any alignment beginning until at least 2025, but agreed with further consultations on this subject, before coming to a final decision.

2.19 However, following the UKSA's consultation, which closed in November 2020:

- The Chancellor of the Exchequer concluded that he would be unable to offer his consent to the implementation of a proposal (such that the UKSA intends to make) before the maturity of the final specific index-linked gilt in 2030.

- In light of the clarification provided by the Bank of England, and given the UKSA's position to address the shortcomings in the RPI in full at the earliest practical time, the UKSA's Chair replied to the Chancellor informing him that the UKSA would be able to legally and practically implement its proposal to the RPI in February 2030.

2.20 It is now clear that RPI will continue to be calculated, and published in its current form until 2030. It is likely that the UKSA will bring the methods and data sources of the Consumer Prices Index, including owner-occupiers' housing costs (CPIH) into RPI shortly thereafter. However, the pace at which this will happen is not yet clear. The decision made to delay any changes to RPI until 2030, means that it is no longer possible to begin a transition to CPIH in GD23 to align RPI with CPIH. As a result, we have concluded that we should now move to CPIH, as our general measure of inflation for GD23.

2.21 A change to CPIH ensures that the GD23 price control is based on a method of assessing general inflation, which is considered robust by the relevant competent statistical authorities. However, this does result in a re-profiling of revenues. Inflation, as measured by CPIH, is generally lower than inflation measured by RPI. As a result, revenues and tariffs will increase in the short term as the real weighted average cost of capital increases to reflect lower levels of general inflation. Over the longer term, the level of inflation applied to revenues and tariffs is lower and the TRV will subject to a lower level of general inflation. As a result revenues, and tariffs in the future should be lower.

2.22 A key consideration in our decision to adopt CPIH as a general measure of inflation in GD23, has been its impact on key measures of financeability as the weighted average cost of capital reduces. One GDN raised concerns about its ability to finance its Business Plan at the rates of return proposed in its Business Plan and that this issue would become more pronounced at the lower returns on capital proposed in this final determination. This GDN suggested either:

a) An enhancement to revenue in GD23, through an enhanced rate of return, with the additional revenue returned to consumers at the end of GD23 through the debt adjustment mechanism; or,

b) A change from RPI to CPIH as the general measure of inflation, which would increase revenues in GD23, but reduce the level of inflation applied to the TRV.

2.23 Of these options we prefer a change to CPIH, as this does not require more complex mechanisms to maintain financeability by enhancing revenues for the GD23 period, only to deduct these additional revenues from the opening TRV at the start of GD29.

2.24 A move to CPIH has additional advantages:

a) Consumer Prices Index (CPI) has become the commonly reported measure of consumer inflation used widely in society for both inflation targets and adjusting various payments by government.

b) Consumer Prices Index including Housing (CPIH) is becoming increasingly common in regulation, for example: Ofwat and Ofgem have moved, or shortly will move, from RPI to CPIH.

c) The application of a robust measure of inflation in our price controls improves the alignment of payments with the way network services are consumed, improving intergenerational equity.

2.25 In December 2021, we informed the GDNs that we were considering moving to CPIH as our measure of general inflation in GD23. We highlighted the adjustments we planned to make to the price control, to protect both the interest of consumers and the interest of the GDNs if this change was made. We asked the GDNs to provide general feedback on our approach and on any other changes which might be necessary to protect the interests of consumers and GDNs. In response, PNGL noted that the Utility Regulator's description of what is required regarding the RPI /CPIH move is appropriate. FE and SGN noted the need for consideration of a number of issues regarding NPV neutrality, and the assessment of return on capital.

Future of Domestic Owner Occupied Connection Incentive

2.26 For the GD23 draft determination we proposed a minimal cost-to-serve model for funding work undertaken by GDNs to promote and secure OO connections with separate funding for marketing. For the GD23 final determination we have:

- Reviewed additional information provided by the GDNs and acknowledged the value of increased advertising marketing and development compared to the allowance provided within the draft determination.
- Reviewed the economic test for funding OO connections to take account of revised parameters (such as the rate of return). We removed the contribution towards the cost of mains from this assessment as these are now considered a sunk cost.
- Maintained the general structure of funding for OO connections set out in the draft determination including removing non-additionality and general overheads from the allowances and providing fixed and variable elements for the allowance.
- Discontinued the cap and collar mechanism which formed part of the GD17 mechanism.
- Included Non-OO incentives for SGN to secure small and medium industrial and commercial connections.

2.27 We have retained many of the changes to the structure of the funding mechanism for funding OO connections proposed in the draft determination. An element of the allowed funding is in the form of a fixed sum with the remainder funded as a variable amount per connection.

2.28 Our review of the proposed funding levels are in light of the current economic circumstances and the desire to support and encourage consumers to become connected to the gas network, with a view to assisting the transition to Net Zero sooner. More detail on our proposals for connections can be found in Annex Q.

Future issues not covered in the GD23 determination

NI Executive Energy Strategy

2.29 In December 2021, the DfE published its new Energy Strategy "A path to net zero energy." The strategy highlights the intention to utilise our modern gas infrastructure and the potential to generate and import zero carbon gases as a means of decarbonisation. While we are currently working with the gas industry to facilitate the injection of biomethane into the network, the route to fully decarbonised gas is uncertain, and a further consultation is planned by DfE on Decarbonising Heat.

2.30 Further work will be required to achieve full decarbonisation of the gas network, including the development policy, regulation and practical solutions for the decarbonisation of gas networks including the potential injection of biomethane and hydrogen. The GDNs are key stakeholders and contributors in facilitating this development. At this stage, it is not possible to anticipate what future costs will be necessary to allow the network to adapt to the use of zero carbon gases or fund activities by the GDNs to support decarbonisation.

2.31 Our final determination for GD23 makes provision for two additional full-time equivalents in each GDN to work on the impacts of the Energy Strategy. We expect the GDNs to continue to work together on these issues, optimising the use of resources and collaborating on innovation projects and studies to maximise benefits for consumers. This would include developing a plan of activities a year ahead for additional work necessary to support decarbonisation of gas. This plan should take account of opportunities for external sources of funding for innovation and development work.

2.32 The GD23 final determination makes an allowance for future costs to support the decarbonisation of gas. This fund is 1% of annual Totex, is ring fenced via the uncertainty mechanism and is subject to a business case before any approvals would be granted.

Future metering solutions

2.33 In our draft determination we did not take account of two potential changes to gas metering.

- In our GD23 Approach Document we advised that we were minded to transfer responsibility for meter reading from supply companies to the GDNs and add greater clarity on roles and responsibilities. We indicated that we would make provision for future allowances for meter reading if the timeline for this work did not align with the Price Control process.

- The GDNs are currently working together to procure a new domestic pre-payment meter to a common specification including some enhanced functionality. Our final determination is based on historical metering costs, and therefore does not take account of any future metering solution.

2.34 The GDNs acknowledged our proposals in respect of meter reading in their business plan submissions. They expressed the view that further consideration, engagement and time would be required to allow proposals for the transfer of these obligations to be fully considered, timelines for implementation to be agreed and for support systems to be put into place. The need to align this work with future metering solutions being considered through the Gas Metering Solutions Group, was also noted.

2.35 On the basis that the consideration of the future provision of services was ongoing, none of the GDNs made any allowances for associated costs in GD23, and based their price control submissions on current Licence provisions and meter reading arrangements.

2.36 We will continue to progress this workstream separately to the GD23 determination. As part of this work we plan to engage with the GDNs in relation to the additional costs and the timetable for delivery, with a view to ensuring the provision of efficient and effective meter reading and inspections. Submissions from the GDNs with respect to future licence conditions related to this issue will then be sought outside the GD23 process. The GDNs were therefore not expected to respond on these proposals as part of the final determination consultation process.

2.37 Changes required in the future as a consequence of the outcome of this work and any associated transfer of responsibility will be considered through the GD23 Economic Project Mechanism which covers work not included in the determination subsequently found to be either economic, or necessary. This might include as appropriate: approval of additional allowances to cover efficient additional costs of meter reading or a variation to the unit cost of meter installation embedded in the GD23 uncertainty mechanism.

2.38 We are not proposing any change to our draft determination position within this final determination.

FE distribution / supply separation

2.39 Condition 1.16 of FE's licence requires it to achieve full managerial and operational independence of the Authorised Business from any Associated Business once it has 100,000 consumers connected to its gas conveyance network. It is possible that this will occur towards the end of the GD23 period.

2.40 In its Business Plan Submission, FE stated that, at the time of writing, the nature of its business separation remains uncertain, and as such, presents challenges for both FE and the Utility Regulator in assessing appropriate and efficient costs associated with undertaking this licence obligation. The company did not include an estimate of the costs of business separation within its business plan and proposed that cost estimates should be submitted at a later date and considered under the materiality threshold mechanism within the GD23 uncertainty mechanism. The company anticipated that this submission would be made in late 2026 / early 2027 (on current projections of connections), allowing time for any changes necessary to be implemented in advance of the 100,000 connections threshold being reached.

2.41 The GD23 final determination does not make any allowance for future one-off or enduring costs of business separation. We will consider any submission the company makes in respect of business separation and make provision for costs we determine to be necessary and efficient through the GD23 uncertainty mechanism. There is no change in this decision from our draft determination.

3. Price Control Submissions and Current Performance

Summary of Key Changes from Draft Determination

3.1 There are no changes to this section from the draft determination. The GDNs in late June 2022, did provide a summary update of its 2021 information, but due to its timing and detail, it has not been possible to update the Cost and Performance Report.

3.2 In particular, the review of GD17 Cost and Performance covers the four year period 2017 to 2020 and has not been updated for summary information for 2021.

Overview

3.3 On the 30th June 2021, the GDNs submitted the Business Plan Submission templates and also commentary detailing the resources that they need to run their business for the next 6 years, along with some forecasting beyond this period.

3.4 The documents provided were based on the requirements as published[6] by the Utility Regulator on the 29 January 2021, in consultation with the GDNs in advance, and were similar to the GD17 requirements. A public facing version was also required to be published, for transparency and for the purposes of informing the wider stakeholder group. These documents may be accessed at the links below:

a) FE - GD23 Business Plan 2023 - 2028

b) PNGL - Our GD23 Business Plan (2023 - 2028)

c) SGN - SGN Natural Gas GD23 Business Plan

3.5 This section provides an overview of the key focus areas as proposed by each GDN for GD23 as per its Business Plan submission. For a comparison, we have included the final GD17 final determination numbers, (For FE this was the GD17 CMA remitted matters) that exclude any additions/adjustments that may have been added at a later stage, during the course of GD17.

[6] GD23 Regulatory Instructions and Guidance for Business Plan Submission | Utility Regulator (uregni.gov.uk)

FE

Price Control period	Rate of Return Pre Tax	Total Capital Investment - 6 Years (Avg 2020 prices)	Total Operating Expenditure - 6 Years (Avg 2020 prices)	New Connection-All	Revenue for 6 Years (Avg 2020 prices)
GD23	3.16%	£75.8M	£60.7M	36,600	£163.5M
GD17 FD	4.32%	£102.4M	£46.0M	19,400	£133.1M

Table 3.1: FE - GD23 Business Plan Submission & GD17 Final Determination

PNGL

Price Control period	Rate of Return Pre Tax	Total Capital Investment - 6 Years (Sept 2020 prices)	Total Operating Expenditure - 6 Years (Sept 2020 prices)	New Connection-All	Revenue for 6 Years (Sept 2020 prices)
GD23	3.33%	£114.3M	£124.5M	40,893	£406.2M
GD17 FD	4.26%	£100.8M	£98.5M	49,886	£380.5M

Table 3.2: PNGL - GD23 Business Plan Submission & GD17 Final Determination

SGN

Price Control period	Rate of Return Post Tax	Total Capital Investment - 5/6 Years (Avg 2020 prices)	Total Operating Expenditure -5/6 Years (Avg 2020 prices)	New Connection-All	Revenue for 5/6 Years (Avg 2020 prices)
GD23 (6 Years)	3.44%	£36.3M	£28.0M	6,000	£45.6M
GD17 FD (5 Years)	5.30%	£47.9M	£9.9M	8,692	£22.2M

Table 3.3: SGN - GD23 Business Plan Submission & GD17 Final Determination

GD17 Cost and Performance Review

Overview

3.6 When assessing the GD23 business plans submitted by the GDNs and the appropriateness of the assumptions made and allowances requested, it is important to do this with consideration of the actual performance against the previous price control (GD17). This is an important part of the scrutiny process of the price control, to review and allow consideration whether the requests are reasonable and justified. This does not review the forecasts of 2021, and 2022, made by the GDNs.

3.7 Since the draft determination, the GDNs have provided a draft summary of 2021 information (submitted at the end of June 2022) showing their actual performance. However, this is not a complete submission due to the demands of work and resources needed on the current price control. A full submission is scheduled for November 2022, with formal verification and sign off by the GDNs. Whilst this information at a high level is useful, it has not been possible, due to its incompleteness and timing, to perform a full assessment using it and therefore it has not been relied upon. Instead we have used the last year of actuals in which a full assessment was made which in this case was the year 2020. The only exception to this approach, is where the GDNs have provided persuasive evidence and made valid points that the 2020 year is not appropriate and, where this is the case, we have clearly documented any deviation from the use of the 2020 year.

3.8 In their consultation responses, across various Opex and Capex categories, the GDNs argued that the 2020 year is not appropriate, due to the effects of COVID-19 that impacted that year. We observe that for FE and PNGL the Capex and Opex costs are broadly in line with 2020 compared to 2021 at the summary level, and therefore consider that the use of the 2020 year is appropriate, unless persuasive evidence has been provided. SGN's performance was similar to 2020 in relation to its total expenditure.

3.9 Annex B provides further details of the actual performance, adjusted for the uncertainty mechanism where appropriate and any additions that have been included/approved to provide a better assessment of true performance against the price control targets set. Previously, we have published a similar report for the last price control, which is referred to as the "Cost and Performance Report for GD14"[7] that was published in July 2018, which covered the full duration of that price control period, which was for 3 years.

3.10 Below, we provide a summary of how each GDN has performed in GD17.

3.11 Some of the cost allowances and targets included in the GD17 Final Determination (FD) are adjusted through an uncertainty mechanism to account for actual delivery (for example, connections made and properties passed). The uncertainty mechanism also takes account of other adjustments to the GD17 price control such as additional network extensions, which were approved after the final determination.

3.12 For both FE and PNGL, this will be a total of 4 years from 2017 to 2020 and for SGN as their price control started in 2018, this will be a total of 3 years from 2018 to 2020.

[7] 2018-07-04 GD14 Cost and Performance report - Final.pdf (uregni.gov.uk)

FE

3.13 Table 3.4 provides a comparison of FE's actual costs and outputs (Actual Totals) against the adjusted costs allowances and targets (GD17 FD Totals) for the first four years of GD17.

3.14 FE has out-performed the GD17 determination to date. The company laid more mains and passed more properties than planned, bringing forward work originally scheduled for GD23 into the GD17 period. This helped FE deliver more connections than anticipated. The company out-performed its capital allowances by 11% and opex allowances by 3%, showing improved efficiency in delivery. The volume of gas consumed in the FE area was marginally less than forecast, due to large Industrial and Commercial (I&C) customers closing down in the early stages of GD17.

FE (2020 prices)	KM Mains Laid	Properties Passed	Connections	Capex (£m)	Opex (£m)	Therms of gas (M)
GD17 FD Updated Totals	474.2	47,579	18,811	75.9	29.2	249.5
Actual Totals	604.4	57,951	22,443	67.3	28.3	245.0

Table 3.4: Summary of totals for each key area from 2017-2020

PNGL

3.15 Table 3.5 provides a comparison of PNGL's actual costs and outputs (Actual Totals), against the adjusted cost allowances and targets (GD17 FD Totals) for the first four years of GD17. PNGL has out-performed the GD17 determination to date.

3.16 The company has laid more mains and passed more properties in GD17 than planned, and this has contributed to an out performance on connections. The company out-performed its capital allowances by 4% and opex allowances by 7% showing improved efficiency in delivery. The volumes of gas consumed in the PNGL area was slightly greater than expected, as a result of additional connections and higher than expected average consumption.

PNGL (2020 prices)	KM Mains Laid	Properties Passed	Connections	Capex (£m)	Opex (£m)	Therms of gas (M)
GD17 FD Updated Totals	250.6	23,190	33,292	70.8	66.6	617.5
Actual Totals	330.2	31,556	34,747	68.8	62.2	619.0

Table 3.5: Summary of totals for each key area from 2017-2020

SGN

3.17 Table 3.6 provides a comparison of SGN’s actual costs and outputs (Actual Totals) against the costs allowances and targets (GD17 FD Totals) for the first three years of its GD17 price control (2018 to 2020).

3.18 This was SGN's first price control since the award of a licence in February 2015. The price control allowances, including rate of return were set largely by the competitive competition for the award of the licence. The company has not performed as initially expected in the first three years of GD17.

3.19 Capital expenditure was in line with expectations, with the company spending 1% more than the adjusted capital allowances. However, SGN underperformed in respect of operational expenditure in these 3 years, spending £2.1 million (68%) more than the final determination allowances. Connections, properties passed and volumes were all below the targets and projections of the GD17 determination. Delays to the completion of the Gas to the West High Pressure (HP) and Intermediate Pressure (IP) feeder mains under the High Pressure licence and lower than expected rates of connections of industrial and commercial properties contributed to this under performance. SGN was successful in connecting the larger energy consumers in its area, and gas consumption at the end of 2020 was 84% of GD17 projections.

3.20 Connections, properties passed and volumes were all below the allowances set at GD17, which was mainly due to delays to the commissioning of the High Pressure (HP) mains, which supplies the Intermediate Pressure (IP) feeder mains and the knock on effect of not having gas available.

SGN (2020 prices)	KM Mains Laid	Properties Passed	Connections	Capex (£m)	Opex (£m)	Therms of gas (M)
GD17 FD Updated Totals	166.7	15,690	4,940	22.1	3.1	55.2
Actual Totals	185.4	15,218	1,320	22.4	5.2	38.0

Table 3.6: Summary of totals for each key area from 2018-2020

4. Volume & Connections

Summary of Key Changes from Draft Determination

4.1 Since the draft determination we have:

a) Reviewed connection numbers and average consumptions to take account of information for the year 2021.

b) Adjusted future volumes for the early years of GD23 to take account of the latest estimates for consumption in 2022 and 2023 provided by firmus energy and PNGL as part of tariff setting process for 2023. These showed a general reduction in consumption linked to increased gas prices.

c) Reduced projected connection numbers for domestic Owner Occupied properties in the early years of GD23 to take account of a reduction in connection activity reported by GDNs for 2022.

d) Taken account of updated information from SGN on future connections and consumption for larger I&C consumers.

e) Reduced the long term energy efficiency adjustment applied to estimated volumes post GD23 to account for the reductions made to volumes in GD23 to reflect reduced volumes revealed when setting tariffs for 2023.

Introduction

4.2 Our determinations of tariffs for GD23 are based on a reasonable estimate of connections and the volumes of gas consumed in each network area. In making our determination we take account of the future development of the network and smooth tariffs to the end of the recovery period for each GDN (2045, 2046 and 2057 for FE, PNGL and SGN respectively).

4.3 The detail of our assessment is included as Annex C. In this Chapter we provide an overview of the main adjustments made and provide information on connections and consumption in the GD23 period for each GDN.

4.4 Our estimates of gas consumption were initially based on current consumptions per property for various types of properties. For the final determination these have been adjusted to take account of the reductions in connections and consumption which GDNs have experienced.

4.5 We have applied an energy efficiency adjustment period beyond 2028 to take account of the possibility that energy consumption is likely to reduce in the future as the energy efficiency of appliances and buildings improve.

Overview of the main adjustments to connections and consumption

4.6 For the GD23 draft determination we proposed a minimal cost-to-serve model for funding work undertaken by GDNs to promote and secure OO connections with separate funding for marketing, resulting in substantially reduced connection rates compared to the GDNs submissions. For the GD23 final determination we reviewed the additional information provided and acknowledge the value of increased advertising and marketing compared to the allowance provided within the DD. This additional money has been linked to the number of connections (similar to the model used in GD17, but with material changes in the structure of the mechanism). In light of this change, we have accepted the GDN's estimates of OO connections for the years 2025 to 2028. For 2023, we have taken account of a reduction in connections in 2022 which has been attributed to the high price of gas. We have assumed that connections in 2023 will be similar to the likely outcome for 2022, with a partial recovery in 2024 and full recovery to normal connection rates from 2025 onwards.

4.7 We have reduced the number of new build connections in GD23, taking a more cautious approach than the GDNs, due to current economic uncertainty. We have accepted the numbers of NIHE connections proposed by the GDNs.

4.8 We have adjusted SGN connection numbers to reflect the exclusion of additional network extensions proposed by the GDN for GD23.

4.9 For the years 2024 to 2028 we have generally accepted the numbers of I&C connections proposed by FE and PNGL. We have reduced the rate of connections they proposed in 2023 in recognition of the impact that current economic conditions might have on rates of connection in the short term. Both companies operate under a revenue cap price control which means that they are not exposed to volume risk and do not lose or gain revenue if volumes of gas consumed is higher or lower than anticipated.

4.10 We have not included additional volumes for major I&C connections identified by FE as they are not yet confirmed.

4.11 We set SGN's I&C connections targets for GD17 from the Gas to the West licence application process. The company has under-performed against its targets for GD17. Based on this experience it has estimated connections for the end of GD23 which are lower than those originally expected for the end of GD17. Because the company is subject to price cap regulation, its revenue is dependent on the connections achieved and the volume of gas consumed. This provides a strong incentive for the company to secure new connections. As a result of under-performing against connection targets in GD17, the company has recovered less revenue than expected in the GD17 period.

4.12 For GD23, we consider it appropriate to determine I&C connection targets for SGN on the company's estimates for GD23. These estimates reflect both the company's experience in GD17 and its engagement with the industrial and commercial sector to date. In the draft determination we reduced the number small and medium I&C connections to provide an opportunity for the company to invest in securing new connections. For the final determination, we have allowed a direct financial incentive to secure new connections and, as a result, we have not reduced the number of connections to provide a further incentive, aside from 2023 in recognition of the impact that current economic conditions might have on rates of connection in the short term.

Determined connections and volumes

FE – determined connections and volumes

4.13 Determined connections and volumes for FE are shown in Table 4.1.

Connections	2023	2024	2025	2026	2027	2028	Total
Domestic owner occupied	2,000	2,750	3,524	3,371	3,224	3,084	17,953
Domestic new build	1,250	1,250	1,250	1,250	1,250	1,250	7,500
Domestic NIHE	1,000	1,000	1,000	1,000	1,000	1,000	6,000
Industrial and commercial	113	150	147	145	142	140	837
Total	4,363	5,150	5,921	5,766	5,616	5,474	32,290

Volumes('000 therms)	2023	2024	2025	2026	2027	2028	Total
Domestic owner occupied	10,168	11,283	12,895	14,441	15,765	17,030	81,583
Domestic new build	4,569	5,022	5,560	6,008	6,386	6,764	34,310
Domestic NIHE	5,971	6,379	6,885	7,274	7,575	7,877	41,961
Industrial and commercial							
P1 Very small I&C	1,419	1,553	1,727	1,872	1,992	2,111	10,673
P2 Small I&C	7,004	7,276	7,466	7,911	7,911	7,911	45,47
P3 Medium I&C	5,743	6,039	6,162	6,236	6,236	6,236	36,650
P4 Large CHP	1,865	1,865	1,865	1,865	1,865	1,865	11,189
P5 Large firm I&C	12,456	12,872	13,045	13,148	13,148	13,148	77,818
P6 Interruptible I&C	14,787	16,155	17,038	17,759	17,835	17,835	101,410
Total	63,984	68,443	72,642	76,513	78,713	80,776	441,071

Note 1. Figures may not sum due to rounding.

Table 4.1: GD23 determined connections and volumes - FE

PNGL – determined connections and volumes

4.14 Determined connections and volumes for PNGL are shown in Table 4.2.

Connections	2023	2024	2025	2026	2027	2028	Total
Domestic owner occupied	3,000	3,400	3,727	3,612	3,502	3,396	20,637
Domestic new build	2,000	2,000	2,000	2,000	2,000	2,000	12,000
Domestic NIHE	350	350	350	300	300	300	1,950
Industrial and commercial	122	150	150	125	125	125	797
Total	5,472	5,900	6,227	6,037	5,927	5,821	35,384

Volumes('000 therms)	2023	2024	2025	2026	2027	2028	Total
Domestic owner occupied	51,831	54,189	57,480	59,793	61,330	62,820	347,443
Domestic new build	19,525	20,614	22,008	23,016	23,746	24,475	133,384
Domestic NIHE	15,255	15,661	16,277	16,582	16,673	16,763	97,211
Industrial and commercial							
P1 Very Small I&C	4,913	5,071	5,304	5,433	5,487	5,542	31,749
P2 Small I&C	17,757	19,241	20,150	20,415	20,540	20,664	118,768
P3 Firm I&C & CHP	30,088	30,770	31,058	31,117	31,180	31,243	185,455
P4 Interruptible I&C	12,256	13,121	13,611	13,697	13,697	13,697	80,080
Total	151,624	158,666	165,889	170,053	172,652	175,204	994,089

Note 1. Figures may not sum due to rounding.

Table 4.2: GD23 determined connections and volumes - PNGL

SGN – determined connections and volumes

4.15 Determined connections and volumes for SGN are shown in Table 4.3.

Connections	2023	2024	2025	2026	2027	2028	Total
Domestic owner occupied	200	364	529	565	544	562	2,765
Domestic new build	200	203	182	108	81	43	817
Domestic NIHE	25	0	70	111	37	184	427
Industrial and commercial	31	57	92	155	140	130	605
Total	456	624	873	939	802	919	4,614

Volumes('000 therms)	2023	2024	2025	2026	2027	2028	Total
Domestic owner occupied	698	810	998	1,210	1,412	1,614	6,741
Domestic new build	105	167	231	278	307	326	1,414
Domestic NIHE	232	240	258	289	311	343	1,674
Industrial and commercial							
Small I&C	36	56	90	148	219	284	832
Medium I&C	138	234	389	642	942	1,228	3,573
Large I&C	725	844	912	1,016	1,140	1,165	5,802
Contract I&C	23,280	23,438	24,236	24,746	24,746	24,783	145,230
Total	25,214	25,790	27,113	28,328	29,077	29,743	165,266

Note 1. Figures may not sum due to rounding.

Table 4.3: GD23 determined connections and volumes - SGN

Energy efficiency adjustment

4.16 In GD17 we estimated future consumption volumes based on reasonable estimates of current consumptions per property, or specific information on some larger users where this was available.

4.17 We recognised the possibility that energy consumption was likely to reduce in the future as the energy efficiency of appliances and buildings improved. In GD17 we applied an energy efficiency adjustment to future gas volumes of 20% beginning in the first year of the next price control (GD23).

4.18 The GDNs applied similar energy efficiency adjustments to estimates of future gas consumptions in their Business Plans as outlined below:

a) FE applied an energy efficiency adjustment of 25% starting in 2023 profiled to the end of the revenue recovery period in 2045;

b) PNGL applied an energy efficiency adjustment of 20% starting in 2023 profiled to the end of the revenue recovery period in 2046; and

c) SGN applied an energy efficiency adjustment of 30% starting in 2029 profiled to the end of the revenue recovery period in 2057.

4.19 We have based consumption in GD23 and beyond on current levels of consumption per property type, adjusted to take account of reductions in consumption identified for 2022 and 2023 through the 2023 tariff process. This adjustment includes an assumption that current gas prices will prompt consumers to bring forward energy efficiency measures which will reduce medium term consumption in GD23. In GD23, conversion from oil to gas will make a contribution to overall energy efficiency, but this is already factored into current average gas consumptions. We do not consider it appropriate to apply a further energy efficiency adjustment to estimated consumption for the GD23.

4.20 Our final determination makes an allowance for future energy efficiency measures beyond GD23. These have been amended for the final determination to take account of the adjustments made to volumes in GD23 which reflect the current impact of higher gas prices. The energy efficiency adjustments applied in the final determination are:

a) For FE – a further energy efficiency adjustment of 20% (reduced from 25% in the draft determination) was applied starting in 2029 profiled to the end of the revenue recovery period in 2045;

b) For PNGL - an energy efficiency adjustment of 20% (reduced from 25% in the draft determination) was applied starting in 2029 profiled to the end of the revenue recovery period in 2046; and

c) For SGN - an energy efficiency adjustment of 25% (reduced from 30% in the draft determination) was applied starting in 2029 profiled to the end of the revenue recovery period in 2057.

5. Operational Expenditure

Summary of Key Changes from Draft Determination

5.1 We have moved in some areas, based on the consultation responses, which are applicable to all GDNs. These are as follows:

- The Advertising & Market Development (Owner Occupied) levels have been increased, with a higher level allowance for each connection and a higher fixed marketing budget, with the aim of maximising the number of potential connections available, that is presently around 250k connections; and

- Energy Strategy Fund. We have introduced an allowance for future costs of work to deliver the energy strategy. This has been set at 1% of Totex Funding and we encourage all GDNs to work together when submitting a business case. Approval will be required from the Utility Regulator for the work within this area and evidence will also need to be provided by the GDNs that they have considered alternative funding methods. We have also provided additional resources to assist in the delivery of the Northern Ireland Energy Strategy.

5.2 Further details for the key change made for each GDN are contained below.

Overview

5.3 This chapter summarises the operational expenditure (Opex) proposed by the three GDNs in their business plans and sets out our initial conclusions on reasonable levels of operational expenditure for GD23. It provides a high level summary of a more detailed assessment which is set out in Annex D to this final determination.

5.4 Operational expenditure covers the costs the day-to-day activities carried out by the GDNs to operate and maintain their assets, manage their businesses and interact with consumers. To provide structure to our assessment, we collect and analyse opex under twenty three cost categories, which form the basis for the presentation of costs in this chapter and the structure of the detailed assessments in Annex D. Under each of these cost categories we consider a further breakdown by activities such as staff, materials, professional and legal fees, etc. to inform our decisions.

5.5 Table 5.1 below provides a comparison of the total operating expenditure requested by each GDN for GD23, and the allowances included in the final determination, following our assessment of the company submissions.

GDN (£m 2020 prices)	GD23 Opex request	GD23 Opex Final Determination Pre-Efficiency	Opex adjustment	Opex adjustment %
FE	60.6	56.9	(3.8)	6%
PNGL	124.3	110.2	(14.1)	11%
SGN	28.0	22.1	(5.9)	21%

Note 1. Figures may not sum due to rounding.

Table 5.1: Summary of totals for each key area from 2017-2020

5.6 In the remainder of this chapter we provided a breakdown of the opex requested by each GDN and the allowances included in the final determination by cost category. This analysis is presented in the following tables:

- Table 5.2 - FE
- Table 5.3 - PNGL
- Table 5.4 - SGN

5.7 A brief explanation is provided after each table for the changes made for the five cost categories with the largest adjustments. A detailed explanation of the adjustments is included in Annex D.

FE Opex Summary

FE Categories (£m)	GD23 Submission	Final Determination	Difference
Asset Management	0.7	0.5	0.2
Operations Management	1.9	1.6	0.3
Emergency Call Centre	1.9	1.5	0.5
Customer Management	2.2	2.0	0.2
System Control	1.8	1.5	0.4
Emergency	6.5	5.5	1.1
Metering	6.8	6.0	0.8
Publically Reported gas Escape (PRE) Repairs	0.9	0.7	0.2
Maintenance	5.1	4.6	0.5
Other Direct Activities	0.0	0.0	0.0
IT & Telecoms	4.4	3.9	0.4
Property Management	7.2	7.7	-0.5
HR & Non-operational Training	0.8	0.8	0.1
Audit, Finance & Regulation	5.4	5.2	0.2
Insurance	2.0	1.7	0.2
Procurement	0.1	0.1	0.0
CEO & Group Management	1.3	1.3	0.0
Stores & Logistics	0.1	0.1	0.1
Advertising & Market Development - Owner Occupied (OO)	9.0	8.8	0.2
Advertising & Market Development (Non-OO)	1.4	1.2	0.1
Trainees & Apprentices	0.5	0.4	0.1
Non-Controllable Opex	0.3	0.3	0.0
Supplier of Last Resort	0.2	0.2	0.0
Energy Strategy Funding	0.0	1.2	-1.2
Total	60.6	56.9	3.8

Note 1. Figures may not sum due to rounding.

Table 5.2: FE Summary of Opex for GD23 FD

5.8 A brief explanation is provided below for the changes to FE's opex for the key cost categories with the largest adjustments from the business plan submission compared to the final determination:

a) Emergency Jobs – The cost deduction in the final determination is approximately the same as in the draft determination and the factors contributing to the reduction remain unchanged. It primarily results from the difference between the job numbers allowed in our final determination and those submitted in the business plan. Our figures are less than FE's for two reasons. Firstly, our projected number of connections is lower and this translates into a lower estimate for the volume of calls that will result in an emergency job. Secondly, we have projected activity levels and costs on the basis of the historic proportion of customer calls that become emergency jobs, whereas FE increased this proportion. The remainder of the cost reduction results from the removal of a 5% uplift that FE had applied to its period contractor rates from 2023 onwards. This follows the approach adopted in our draft determination.

b) Metering – The final determination deduction from the FE Business Plan submission is circa £125k higher than that in the draft determination. This movement is mainly a consequence of the removal of £155k of non-routine maintenance costs which were found to be disproportional to connection numbers and the costs submitted by the other GDNs. This adjustment also corrects an omission that FE was notified about in the draft determination. The final determination also includes some material cost additions. The deduction for large I&C meters is no longer being applied and an additional allowance has been provided to account for an increase in battery costs. However, these additions have largely been balanced by further cost reductions for B6 regulator inspections associated with the alignment of the medium pressure percentages applied to domestic connections with historic actuals and the impact of lower connection number estimates used in the final determination. The majority of the rest of the cost reduction results from the removal of 5 year inspection costs for 2023, as a result of FE applying the updated British Standard guidance one year too early, and the removal of the 5% uplift that FE applied to its period contractor rates. Both of these adjustments have been carried forward from the draft determination.

PNGL Opex Summary

PNGL Categories (£m)	GD23 Submission	Final Determination	Difference
Asset Management	1.7	1.6	0.1
Operations Management	3.3	3.0	0.4
Emergency Call Centre	2.8	2.9	-0.1
Customer Management	5.2	4.7	0.5
System Control	0.9	0.7	0.1
Emergency	9.0	8.2	0.9
Metering	14.4	13.0	1.4
Publically Reported gas Escape (PRE) Repairs	5.8	5.4	0.4
Maintenance	15.5	13.9	1.6
Other Direct Activities	0.0	0.0	0.0
IT & Telecoms	3.4	3.3	0.0
Property Management	24.0	18.9	5.0
HR & Non-operational Training	1.6	1.5	0.2
Audit, Finance & Regulation	6.6	6.5	0.1
Insurance	6.4	4.9	1.5
Procurement	0.5	0.5	0.0
CEO & Group Management	10.7	8.4	2.3
Stores & Logistics	0.2	0.2	0.0
Advertising & Market Development - Owner Occupied (OO)	7.8	6.6	1.2
Advertising & Market Development (Non-OO)	3.3	2.8	0.5
Trainees & Apprentices	0.0	0.0	0.0
Non-Controllable Opex	1.3	0.9	0.3
Supplier of Last Resort	0.0	0.3	-0.3
Energy Strategy Funding	0.0	2.1	-2.1
Total	124.3	110.2	14.1

Note 1. Figures may not sum due to rounding.

Table 5.3: PNGL Summary of Opex for GD23 FD

5.9 A brief explanation is provided below for the changes to PNGL's opex for the key cost categories with the largest adjustments from the business plan submission compared to the final determination:

a) Property Management (Mainly Network Rates) – PNGL made a submission error in which they over estimated their requested allowance. Therefore, we have not changed the approach used from the draft to the final determination, apart from updating for current revenue values. This area uses an existing formula approach, as used in GD17 (and used for all GDNs) to set the allowances and is linked to a fixed % of actual revenue in the year. This in turn sets a rateable value and calculation of rates, based on an assessment of regional rates. This is subject to GDNs demonstrating they have taken all appropriate steps to minimize the valuations from the Land and Property Service (LPS).

b) CEO and Group Management (Mainly Senior Management Team Remuneration) – For the draft determination and consistent with GD17, we have used Benchmarked rates for senior positions. In response to the draft determination PNGL argued that its remuneration packages should be benchmarked against a wider UK sector specific marketplace. While we note this area is a matter for PNGL, the comparison with the UK sector is not appropriate, as the PNGL licence area covers only part of Northern Ireland. We consider that the allowances provided to PNGL for its management team are within Northern Ireland market rates and therefore our allowances are unchanged for the final determination.

c) Maintenance – The deduction in the final determination is around £415k lower than in the draft determination. This movement mainly results from the partial reinstatement of funding requested for the inspection of steel plates above strategic mains and for the provision of telemetry at governor bins. All of this investment had been excluded in the draft determination and the decision to partially reinstate it results from additional clarification and information provided by PNGL. These additional allowances will allow PNGL to undertake work at priority sites and to assess the benefits delivered and the need for future investment. For the final determination we applied a further reduction to account for an estimate of time that an additional emergency team funded through PRE Repairs could spend undertaking maintenance duties and a reduction to reflect PNGL's reassessment of the budget required for purge point maintenance. We also corrected an error notified by PNGL in advance of the draft determination, adjusted staff costs and made a small PES profit margin adjustment, which accounts for the remainder of the reduction. These adjustments were carried forward from the draft determination.

d) Insurance – We have not allowed the projected increases over the GD23 period, as other GDNs did not expect to experience the same level of increases. We have used increases set by other GDNs to roll forward an appropriate rate, that coincides with the long term average of PNGL, as insurance costs vary based on other factors, apart from Car Insurance (Large company car fleet), where benchmark data was used.

e) Metering – The deduction in the final determination is approximately the same as in the draft determination, as the majority of the adjustments remain unchanged. A large proportion of the reduction results from the removal of the PES profit margin in line with previously- established policy. Material deductions have also been made to allowances for 5 year inspections on B6 to U40 medium pressure regulators. Our figures for these inspections are less than PNGL's for several reasons. Our total connection numbers are lower than in the company submission, the percentage of historic medium pressure connections has been reduced based on an asset inventory assessment, a correction to the submitted figures acknowledged by PNGL following its submission has been applied and our assessment of the number of B6 to U40 inspections required based on the company's asset inventory is lower than in the company's submission. For the final determination, the cost reduction associated with connection numbers has increased due to our lower final estimates of connection numbers for 2021 to 2023. Our overall cost reductions have been mitigated by the provision of additional allowances to account for PNGL underestimating the number of battery replacements required in its submission and for increased battery costs. The former was allowed in the draft determination and the latter has been added for the final determination.

SGN Opex Summary

SGN Categories (£m)	GD23 Submission	Final Determination	Difference
Asset Management	0.3	0.3	0.0
Operations Management	1.6	1.3	0.3
Emergency Call Centre	0.7	0.6	0.1
Customer Management	0.4	0.4	0.1
System Control	0.3	0.2	0.1
Emergency	1.1	1.1	0.0
Metering	0.8	0.8	0.0
Publically Reported gas Escape (PRE) Repairs	0.1	0.1	0.0
Maintenance	3.0	2.9	0.0
Other Direct Activities	0.0	0.0	0.0
IT & Telecoms	0.8	0.8	0.0
Property Management	2.4	2.2	0.1
HR & Non-operational Training	0.1	0.1	0.0
Audit, Finance & Regulation	2.4	2.6	-0.1
Insurance	0.0	0.0	0.0
Procurement	0.0	0.0	0.0
CEO & Group Management	2.8	0.7	2.0
Stores & Logistics	0.0	0.0	0.0
Advertising & Market Development - Owner Occupied (OO)	7.8	4.6	3.1
Advertising & Market Development (Non-OO)	3.0	2.4	0.6
Trainees & Apprentices	0.0	0.0	0.0
Non-Controllable Opex	0.3	0.3	0.0
Supplier of Last Resort	0.1	0.1	0.0
Energy Strategy Funding	0.0	0.5	-0.5
Total	28.0	22.1	5.9

Note 1. Figures may not sum due to rounding.

Table 5.4: SGN summary of Opex for GD23 FD

5.10 A brief explanation is provided below for the changes to SGN's opex for the key cost categories with the largest adjustments from the business plan submission compared to the final determination:

a) Advertising & Market Development - Owner Occupied (OO) – For GD23 we have updated the 'Cost to Serve' allowance, which is to cover the GDN's reasonable costs of responding to customer contacts and supporting them through the connection process, including the cost of Energy Advisers, with comments made from the consultation responses. A refresh of the Economic Mechanism assumptions has been made, to be more reflective of current costs. We have also examined the level of fixed marketing and increased this to provide a more stable platform for the promotion of connections, especially for SGN, due to that it is currently in the development stage of building its network. The connection levels for 2023-2024 have been reduced to reflect the current market conditions/expectations.

b) CEO and Group Management (Mainly Managed Service Agreement) – This service is provided by the SGN Group, which encompasses Head Office support for various activities. We have used the G2W Bid numbers, as the Application pack specifically indicated that beyond GD17 we were to "not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies." However, we have considered moving away from this position, to signal to SGN that we would drop the linkage to the bid/competition allowances. Therefore, we have set the year 2028 at more normal levels, based on current 2020 costs, with a clear direction given of reviewing this area for the next price control.

c) Advertising & Market Development (non-OO) – SGN requested incentive payments to small and medium I&C consumers to encourage connections. This was not requested at the time of the Gas to the West Application process. We have reconsidered this position, after considering the information supplied on the economic benefits and considering how other GDNs have benefited from this in the past and have decided to provide allowances, that will be linked to the uncertainty mechanism based on actual connections, but with clear direction that this cost will be very unlikely to be given at the time of the next price control. This incentive will not apply to New Build sites.

6. Capital Investment

Summary of Key Changes from Draft Determination

6.1 In coming to our final determination we have considered the consultation responses received, any additional information supplied by the GDNs and the outcome of our engagement with the GDNs. The key changes made since the draft determination as a consequence of this are as follows:

- We have estimated 'above inflation' cost pressures and have made an allowance for these in our frontier shift assessment.

- We have removed the properties passed mechanism for PNGL for the whole of GD23, and after 2023 for FE, based on the fact that the infill within their control will have been completed by this time.

- We have added an item to FE's uncertainty mechanism to account for work that might be required on 'Private Streets' following the completion of its general infill in 2023.

- We have advised the GDNs that we will work with them to establish a collaborative working group to develop a rational basis for identifying investment requirements for resilience projects which can be applied consistently across all GDNs. We have also added an item into the uncertainty mechanism for each GDN to account for 'necessary' resilience projects that might be required during GD23 as a consequence of the outworking's of this group.

- We have adjusted the unit rates applied to PNGL's 7 bar main reinforcement proposals to account for the differences in productivity that might be expected between work undertaken in rural and urban environments.

- We have adjusted the unit rates for domestic services to account for the longer service lengths allowed for in the final determination.

- We have adjusted the unit rates for domestic services for FE and PNGL and the blended main laying rates for SGN to account for the reallocation of overheads required as a consequence of the reduction in main laying activities.

- We have adjusted our customer contributions calculation to account for the cost of diversionary works.

Overview

6.2 This chapter of the GD23 final determination summarises the capital expenditure (capex) proposed by the three GDNs in their business plans, and sets out our initial conclusions on reasonable levels of capital expenditure for GD23. It provides a high level summary of a more detailed assessment which is set out in Annex F to this final determination.

6.3 Capital expenditure covers the investment used by the GDNs to build the networks of gas mains and other assets that distribute natural gas to domestic and industrial & commercial properties, install services and meters at properties wishing to connect and replace their assets over time. To provide structure to our assessment, we collect and analyse capex data under ten investment categories. These categories form the basis for the presentation of costs in this annex and the layout of our detailed assessments.

6.4 The overall investment proposed by the GDNs for GD23 is presented in Table 6.1 below. In total, the GDNs requested investment of £226.5m.

Investment category	Capital investment for GD23 (£m)			
	FE (Av 2020)	PNGL (Sept 2020)	SGN (Av 2020)	Total (Various)
7 bar mains	0.000	13.731	0.000	13.731
LP, 2 bar and 4 bar mains	16.001	12.631	19.869	48.500
Individually funded	0.000	5.855	0.000	5.855
Pressure reduction	1.095	2.941	2.806	6.843
Domestic services	37.994	38.154	7.544	83.691
Domestic meters	8.627	26.209	0.990	35.827
I&C services	2.321	1.721	2.430	6.473
I&C meters	2.688	4.407	0.893	7.988
Other capex	1.466	2.077	0.300	3.842
TMA	5.632	6.624	1.492	13.747
Totals	75.823	114.349	36.324	226.497

Note 1. Figures may not sum due to rounding.

Table 6.1: Capital investment proposed by the GDNs for GD23

6.5 The outcome of our final determination for each GDN is shown in Table 6.2 below against the same investment categories. The total gross capital investment allowance for GD23 is £174.5m before the application of a frontier shift and the deduction of customer contributions. The net capital investment allowance after these adjustments are made is £185.6m.

Investment category (£m)	Capital investment for GD23 (£m)			
	FE (Av 2020)	PNGL (Sept 2020)	SGN (Av 2020)	Total (Various)
7 bar mains	0.000	9.453	0.000	9.453
LP, 2 bar and 4 bar mains	6.800	5.319	13.873	25.992
Individually funded	0.000	5.853	0.000	5.853
Pressure reduction	0.645	1.701	0.000	2.346
Domestic services	32.469	33.536	4.468	70.473
Domestic meters	8.487	24.275	0.879	33.641
I&C services	1.815	1.652	1.414	4.881
I&C meters	1.992	3.766	1.114	6.872
Other capex	1.207	1.766	0.300	3.273
TMA	4.108	5.581	1.976	11.665
Totals	57.523	92.901	24.024	174.449
Frontier shift	4.790	7.727	2.003	14.520
Customer contributions	-1.193	-2.213	-0.006	-3.412
Totals net of FS and contributions	61.120	98.416	26.021	185.556

Note 1. Figures may not sum due to rounding.

Table 6.2: Capital investment included in the GD23 final determination

Business Plan assessment approach

6.6 In assessing the Business Plan submissions we:

- Accounted for some supplementary information provided by the GDNs. This increased the total investment requested from £226m to £231m.
- Excluded items from the determination where we disagreed with the need for the investment. The majority of the exclusions relate to resilience mains; network extensions to towns that are currently not served by natural gas networks; and, reductions in the number of services and meters that we expect the GDNs to install in the GD23 price control period. These items amount to a total reduction in investment of around £41m. In making these deductions, we recognise that some of the excluded work might eventually be carried out in GD23 through the uncertainty mechanism if the need for the investment is confirmed.

- Challenged some of the increases in the cost of delivery proposed by the GDNs. In doing so we relied on historic unit costs from 2017 to 2020 to determine an appropriate level of investment for GD23. This resulted in a total cost reduction of around £14m over the price control period.

6.7 This resulted in a gross capital investment allowance for GD23 of £174.5m. The impact of each of these steps and the associated challenges applied to the overall investment plan can be seen in Figure 6.1 below.

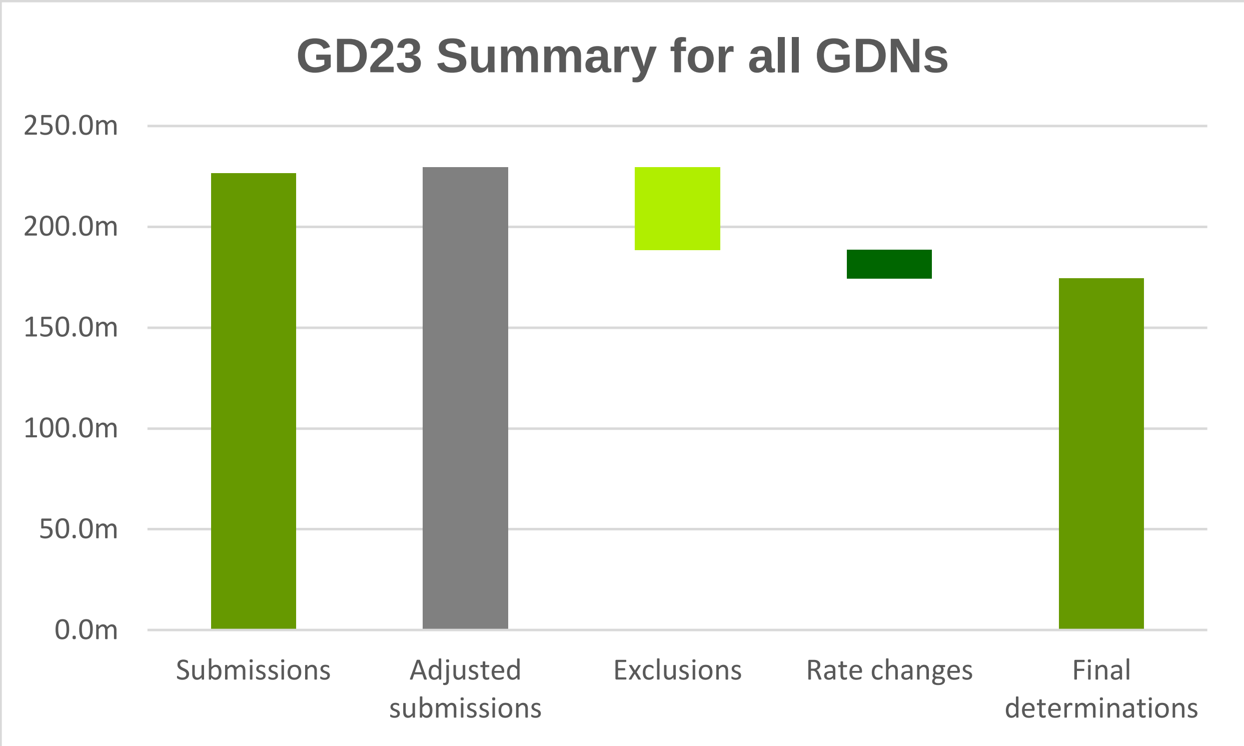

Figure 6.1: GD23 final determination summary for all GDNs (£m)

6.8 We then applied the following adjustments:

- Updated our frontier shift calculation for the final determination to try to reflect the 'above inflation' cost pressures which are currently being experienced. This resulted in a net cost addition of around £15m.

- Removed customer contributions amounting to around £3m.

6.9 This produced our net capital investment allowance for GD23 of £185.6m.

Summary of the Capex adjustments applied to individual GDN submissions

6.10 The following tables provide a breakdown of the adjustments that have been applied to the capital investment submissions of each GDN in our final determination.

Investment category (£m) - FE	Sub	Adj sub	Excl	Rates change	Rates change	FD
7 Bar Mains	0.0	0.0	0.0	0.0	0%	0.0
LP, 2Bar or 4Bar Mains	16.0	15.3	-7.9	-0.7	-9%	6.8
Individually Funded	0.0	1.2	-1.2	0.0	0%	0.0
Pressure Reduction	1.1	0.8	0.0	-0.1	-16%	0.6
Domestic Services	38.0	38.0	-1.8	-3.8	-10%	32.5
Domestic Meters	8.6	8.6	-0.8	0.6	8%	8.5
I&C Services	2.3	2.3	-0.1	-0.4	-18%	1.8
I&C Meters	2.7	3.0	-0.7	-0.3	-14%	2.0
Other Capex	1.5	1.5	0.0	-0.3	-18%	1.2
TMA	5.6	5.6	-1.5	0.0	0%	4.1
Total	75.8	76.4	-13.9	-4.9	-8%	57.5
Total (post FS, net of contributions)						61.1

Note 1. Figures may not sum due to rounding. Gross figures, Average 2020 prices

Table 6.3: FE capital investment final determination summary

Investment category (£m) - PNGL	Sub	Adj sub	Excl	Rates change	Rates change	FD
7 Bar Mains	13.7	14.2	-2.7	-2.1	-18%	9.5
LP, 2Bar or 4Bar Mains	12.6	12.6	-5.7	-1.6	-23%	5.3
Individually Funded	5.9	5.9	0.0	0.0	0%	5.9
Pressure Reduction	2.9	2.9	-1.2	0.0	0%	1.7
Domestic Services	38.2	38.2	-2.8	-1.8	-5%	33.5
Domestic Meters	26.2	26.2	-1.1	-0.8	-3%	24.3
I&C Services	1.7	1.7	-0.1	0.0	-1%	1.7
I&C Meters	4.4	4.5	-0.6	-0.1	-4%	3.8
Other Capex	2.1	2.1	0.0	-0.3	-15%	1.8
TMA	6.6	6.6	-1.0	0.0	0%	5.6
Total	114.3	115.0	-15.4	-6.7	-7%	92.9
Total (post FS, net of contributions)						98.4

Note 1. Figures may not sum due to rounding. Gross figures, September 2020 prices

Table 6.4: PNGL capital investment final determination summary

Investment category (£m) - SGN	Sub	Adj sub	Excl	Rates change	Rates change	Final determ
7 Bar Mains	0.0	0.0	0.0	0.0	0%	0.0
LP, 2Bar or 4Bar Mains	19.9	20.3	-6.0	-0.4	-3%	13.9
Individually Funded	0.0	0.0	0.0	0.0	0%	0.0
Pressure Reduction	2.8	2.8	-2.8	0.0	0%	0.0
Domestic Services	7.5	7.5	-1.1	-2.0	-31%	4.5
Domestic Meters	1.0	1.0	-0.1	0.0	4%	0.9
I&C Services	2.4	2.4	-0.4	-0.6	-30%	1.4
I&C Meters	0.9	0.9	-0.2	0.4	50%	1.1
Other Capex	0.3	0.3	0.0	0.0	0%	0.3
TMA	1.5	3.0	-1.0	0.0	0%	2.0
Total	36.3	38.2	-11.7	-2.6	-10%	24.0
Total (post FS, net of contributions)						26.0

Note 1. Figures may not sum due to rounding. Gross figures, Average 2020 prices

Table 6.5: SGN capital investment final determination summary

Key capex decisions and themes

6.11 The following sections outline some of the key decisions and themes that underpin the material adjustments that have been made to the investment proposals submitted by the GDNs in our final determination.

Exclusions

6.12 The ‘resilience’ schemes proposed by FE and PNGL have been removed due to the absence of a common understanding and approach for identifying appropriate investment requirements. These schemes are intended to provide additional interconnectivity in already developed networks to reduce the risk of supply being lost due to a pipe burst. We recognise that there is a need to consider resilience requirements further and so will work with the GDNs to establish a working group to develop a rational basis for identifying investment which can be applied consistently across all the GDNs. We acknowledge that this might result in resilience schemes being brought forward for delivery during the GD23 period if considered necessary.

6.13 Most of FE’s reinforcement schemes have been removed. Many of these schemes were originally scheduled for the start of GD23, but the company has subsequently confirmed that most are not required until either the end of GD23 or the start of following price control period. Given the long lead in times and an element of uncertainty over the need for these schemes, we have moved the investment to 2029 (i.e. beyond GD23). However, if it is subsequently confirmed that any schemes need to be delivered earlier, the work can be accelerated under the economic project mechanism.

6.14 SGN's proposal to infill nine towns and villages outside their original development plan has not been allowed. This is because SGN’s economic appraisal of the investment needed to infill these towns does not meet our economic test (i.e. that the investment would not increase tariffs). SGN proposed including the cost of carbon within the economic test. However, as this is not currently included within economic appraisals this investment has been excluded from the final determination. We are however open to reconsidering this in the future if circumstances change.

6.15 SGN's pressure reduction proposals have been removed in their entirety. The pressure reduction requested for the nine additional towns is no longer required as a consequence of the infill investment being excluded. SGN also requested funding for additional governors for its eight core towns. This was removed as these governors were funded in GD17 and consumers should not be expected to pay twice for this investment. SGN has advised that this was not its intention. If SGN chooses not install these governors in the GD17 period, the Capex Risk Sharing mechanism will still allow it to install them in GD23.

6.16 The number of connections and meters for all the GDNs have been reduced in our determination to reflect our most recent estimates of activity and penetration. These numbers and the associated allowances will subsequently be corrected for actuals through the uncertainty mechanism.

Cost Rate Adjustments

6.17 We have continued to use the Basket of Works approach first adopted in GD14, and have generally determined the unit rates used in our determination from actual investment that was undertaken by the GDNs in the period 2017 to 2020.

6.18 PNGL's request for a significant amount of 7 bar reinforcement work in GD23 has been allowed. The rates that we have applied to determine an appropriate allowance are based on the outturn cost of reinforcement projects completed in GD17 and also the East Down extension. The historic outturn rates are from rural projects, whereas the work in GD23 is predominantly urban. The rates have therefore been adjusted to account for the differences in productivity that might be expected between a rural and urban environment.

6.19 In their business plan submissions the GDNs asked for large increases in the cost of installing services, suggesting that this work had been cross subsidised by mains construction work in the past. In a large part this resulted from the GDNs maintaining historic levels of capitalised cost against a declining volume of work, particularly in main laying, which increased the percentages allocated to services. This was not allowed in the draft determination, however following consideration of further evidence provided by the GDNs, we have reallocated some overheads from main laying activities to service laying activities for the final determination.

6.20 The GDNs had asked for a 4-6% uplift in their rates for current cost pressures related to COVID-19 recovery, Brexit and energy prices in their submissions. In our draft determination we assumed that these impacts would be either short term and/or reflected in general inflation. Through subsequent engagement and consideration of further information provided by the GDNs we have concluded that additional cost pressures above general inflation exist and that they are more material than previously thought. There is also the potential that they will extend beyond the short term. Based on the evidence provided by the GDNs we have estimated the additional cost pressure as 10.7% and so have applied this uplift across the capex programme for the final determination.

6.21 The determination includes an allowance for the future implementation of the Traffic Management Act (TMA). The figure we allow is 10% of the cost of mains and services. The reduction to the TMA allowance in the determination is therefore a function of the mains and services cost reductions that have been applied. The GD23 allowance will be deducted from the opening TRV for GD29 if the TMA is not implemented.

7. Energy Strategy, Innovation & Incentives

Summary of Key Changes from Draft Determination

7.1 We have updated these price control areas following on from the GD23 draft determination with due consideration of the responses received. Key changes made in this context include:

- The provision of funding for the Utility Regulator approved projects related to the Energy Strategy. The value of this fund will be 1% of determined annual total Capex and Opex (Totex) allowances.

- The allowance of one further full-time equivalent (FTE) for each GDN to further support the GDNs in meeting the requirements of the Northern Ireland Energy Strategy; this puts the level of resource in this area up to two FTEs for the duration of GD23.

- Clarification that the materiality threshold applies to funding applications for innovation projects that are not deemed to contribute to the Energy Strategy.

7.2 Any changes for the main incentives are detailed in their respective price control areas identified in Paragraph 7.17 of this document.

Overview

7.3 The sections below are the summary of our decisions for these areas. The full details of the representations made by the GDNs in their Business Plan submissions, key draft determination responses and any assessments made or discussion by us for any emerging topics are contained within the following Annexes:

a) Annex G - Energy Strategy.

b) Annex H - Incentives and Innovation.

7.4 We note that Innovations and the Energy Strategy, are closely linked, but we make a distinction between the projects which relate to:

a) The Energy Strategy (i.e. focus on a reduction in carbon emissions and a phasing out of fossil fuels).

b) Innovation (i.e. Projects or innovative activities not related to the Energy Strategy that may require investment in the business, over and above normal activities e.g. Metering Issues).

Energy strategy

7.5 The Energy Strategy was published by the Department for the Economy (DfE) in December 2021[8] and aims to ensure clean, secure, and affordable energy for current and future generations, though with regard to the gas networks, the practicalities of the Energy Strategy are not yet clear. It is a live document and the consequences and the costs associated with achieving its aims will only become clearer as the elements within it are further progressed. Our statutory duties may also be amended to help us assist in the delivery of the Strategy.

7.6 One further development is The Climate Change Act (Northern Ireland) 2022[9] that was enacted 6th June 2022. This put into law emissions targets and stipulated that the Department for the Economy must develop and publish sectoral plans for the energy sector that set out how the sector will contribute to the emissions targets. It is expected that the publication of these sectoral plans will give further direction for the natural gas networks.

7.7 It must be noted that the publication of the GD23 price control is during a period of global energy price shock that has seen an unprecedented rise in natural gas prices. As a result there have been impacts on the cost of living and concerns with energy supply security and power generation. Persistently high energy prices will ensure the energy market remains a focus of public, political and media attention, contributing to ongoing high social risks for the sector. What effect, if any, this energy crisis will have on the Energy Strategy's development is unknown, but governmental priorities and timelines may change, and we will be mindful of any changes that may arise.

7.8 It is difficult to give any further precision to events or direction of travel at this stage, but as a regulator we have a duty to protect both current and future consumers, as well as ensure financeability for the GDNs during price control periods. In line with this, we will use a ring-fenced uncertainty mechanism with a level of funding, initially set at 1% of determined total Capex and Opex (Totex) per annum, to enable flexibility and a degree of financeability for the GD23 price control Energy Strategy requirements.

7.9 Any GDN that requires access to this Energy Strategy funding for a project, will be required to submit a business case for approval and evidence that alternative funding methods have been considered. While assessing these projects we will take into account our statutory duties. Any proposed project should meet the core principles below:

[8] Energy Strategy - Path to Net Zero Energy | Department for the Economy (economy-ni.gov.uk)
[9] https://www.legislation.gov.uk/nia/2022/31/enacted

- Primarily, demonstrate how the project aligns with core aims detailed in the Energy Strategy - secure, affordable and clean energy for current and future generations.

- Demonstrate how the project will contribute to the achievement of net zero carbon.

- Illustrate how the proposal incorporates a reduction in fossil fuel usage.

7.10 We actively encourage joint submissions from all three GDNs, identifying the envisaged level of work/role for each operator. This will help utilise the synergies between all three companies, ensuring the best possible outcome for the consumers of Northern Ireland. This is in line with the effective joint working the GDNs have established in relation to the Energy Strategy work to date.

7.11 It should be noted that the materiality threshold does not apply to applications for Energy Strategy funding. However, we reserve the right to turn down certain submissions of low materiality if the resources required by us to analyse these submissions are unreasonably extensive for the value of the submission.

7.12 In light of the anticipated activity with the Energy Strategy and following further consideration, based on the responses received, particularly the GDN's existing resource commitment to this area, we have increased the staff allowance for the final determination to 2 FTEs for each GDN from the 1 FTE proposed at our draft determination.

Innovation

7.13 Innovation that would be considered to contribute to the Energy Strategy is discussed above and in Annex G. With "other" innovation in mind, we expect the GDNs to deliver innovation as a “Business as Usual” activity. The cost risk sharing mechanism, within the price control framework, allows a proportion of capital and opex cost savings to be retained by the GDNs. This provides a strong incentive for the GDNs to invest in innovation to deliver costs savings and improve outputs. Consumers will benefit in the long run from improved services and lower prices.

7.14 We consider that this approach should remain the principal mechanism for delivering innovation. It provides maximum flexibility to the GDNs to make innovation decisions, aligns the benefits for consumers and GDNs and avoids the risk of a regulator being asked to pick winners from a list of potential innovation projects.

7.15 We are conscious that in some cases funding of innovations through increased prices may be appropriate, and should a GDN identify this funding need, they must apply through the submission of a business case, before any funding will be approved. Applications are subject to the materiality threshold and should comply with the Innovation Funding Principles, detailed in Annex H, to ensure proper consideration is given to the risks and rewards, though valid explanations around any of the principles will be considered.

Incentives

7.16 Incentives are an important part of the regulatory framework to ensure that the GDNs continue to develop the network, in the most efficient manner possible. We are continuing with the key incentive that allows the GDNs to offer owner occupied consumers wishing to connect a free connection (subject to additional charges for reinstatement of high cost surfacing or particular requests in respect of location). This offers a strong incentive for customers to connect as in most cases these costs are in the region of £1,500 per new connection made.

7.17 Our review and final determination for a selection of the main existing incentives is detailed in the appropriate areas of the price control as follows:

a) The properties passed mechanism to incentivise the GDNs to continue to extend their networks. More detail on this is contained in Annex F – Capital Investment Detail.

b) The cost of debt mechanism, to secure the most cost effective financing possible. More information on cost of debt is contained within Chapter 10 of this document.

c) A price cap incentive for SGN, to offer incentive to outperform on gas volumes set, when network is still in a developing stage. More detail on this is contained in Annex C – Connections and Volumes.

d) The connection incentive mechanisms to support advertising, marketing and development for connections. Full detail published in Annex Q - Promoting Connections.

8. Stakeholder and Customer/Consumer Engagement

Summary of Key Changes from Draft Determination

8.1 There are no changes from the draft determination to the final determination in relation to Stakeholder and Customer/Consumer Engagement. Respondents were supportive of the approach and proposals for Stakeholder and Customer/Consumer Engagement and we welcome this.

8.2 We will continue our work and positive engagement with the GDNs on the development and implementation of the Best Practice Framework and the delivery of other future consumer engagement and protection projects. We will also work with GDNs to develop a timetable for GD23 new consumer focused metrics, KPIs and targets by the end of 2024.

8.3 A number of GDNs stated that there should be a mechanism in place for cost recovery for work undertaken by them to deliver future consumer protection measures, which could result in changes to processes and systems and therefore generate a cost. They sought assurances from the Utility Regulator on this. Some of this work is currently still in development, whilst other areas have yet to commence and therefore it is difficult to place a quantum on it. We want to reassure the companies that recovery of cost as a result of such work and projects which are accepted in advance as appropriate by the Utility Regulator and in line with the delivery of future consumer protection development, which are necessarily and efficiently undertaken (such as but not limited to the Best Practice Framework) will be permitted. This will, of course, be subject to normal regulatory scrutiny and approval. The mechanism for this recovery will be the through the 'uncertainty mechanism' for which there will be no de-minimis level (as is currently the case for this mechanism).

Background to Consumer Engagement and Consumer Protection

8.4 For us, a commitment to consumers is central to our work and it is essential that protecting and supporting consumers that may be at risk of detriment, as well as providing customers with high levels of service, are at the core of Northern Ireland gas distribution networks' delivery priorities. In our document "Approach to GD23"[10] we highlighted the importance of consumer engagement and protection regarding not only the development of the GD23 submissions, but also in relation to the ongoing work of the gas networks.

10 GD23 Final approach | Utility Regulator (uregni.gov.uk)

We looked to the GDNs to further develop existing engagement with consumers and stakeholders to ensure the consumer is at the heart of GD23 business plan submissions.

8.5 As part of our approach, we asked GDNs to consider how they will use existing and additional channels of consumer engagement to find out what consumers expect GDNs to deliver in GD23. We asked GDNs to demonstrate how they have taken account of the views of consumers and stakeholders in developing their plans, setting out what engagement was undertaken and how the engagement informed respective business plans. Specifically, we asked companies to prepare an inventory of their consumer contacts by type of communication channel and show how they currently use structured and unstructured consumer contact information and follow up surveys to monitor consumer satisfaction, identifying issues which they address to help improve consumer service. We asked GDNs to set out the steps they are currently taking to address our Consumer Protection Programme (CPP)[11] and Best Practice Framework[12], especially development of best practice engagement and day to day contacts with vulnerable consumers.

8.6 Each GDN provided substantive submissions setting out the wide range of consumer and stakeholder engagement undertaken as part of their day to day activities and in formulation of their business plans. We provide an overview of these submissions below.

8.7 All GDNs acknowledged the importance of the delivery of the Best Practice Framework under Utility Regulator's Consumer Protection Programme, including enhanced provision for vulnerable consumers. All GDNs committed to participating in its implementation once developed and finalised. We welcome the recognition by the GDNs of the importance of meaningful consumer engagement, in terms of dialogue with existing and future customers, and our encouragement of new consumer focused performance metrics and KPIs, to help shape future outcomes and drive continuous improvement.

8.8 We note that following the companies' submissions, each network operator presented their proposals in respect of vulnerable consumers to the Consumer Vulnerability Working Group.

[11] consumer-protection-plan-review.pdf (uregni.gov.uk)
[12] bpf-approach-paper.pdf (uregni.gov.uk)

Overview of the GDNs consumer and stakeholder engagement

FE - Overview of consumer and stakeholder engagement

8.9 In FE's GD23 submission, we note and welcome the acknowledgement of and the commitment to participate in the Consumer Protection Programme and the Best Practice Framework project. The FE Consumer and Stakeholder GD23 Supplementary Paper identified many areas where the company is already working to engage with and support a variety of stakeholders and customers via a wide range of communication channels both digital and non-digital.

8.10 We particularly welcome the statement that FE is committed to addressing vulnerability and that it is to remain a priority for the business during the GD23 price control period. Furthermore, the company's commitment to develop a Customer Vulnerability Strategy before the start of GD23 and attain BSI 18477 accreditation (Inclusive Service Provision) early in the GD23 price control period is a very positive step towards supporting consumers and is evidence of FE's engagement with the Consumer Protection Programme.

8.11 In the submission, FE provided information on their bespoke and ongoing research supporting the development of the GD23 business plan. We note the focus on consumer awareness, connecting to natural gas and customer satisfaction. We also note that FE has used the research to support the development of their GD23 submission under the themes of financeability and cost to connect, customer service and perceptions of natural gas and environmental issues. We can see from the submission that the company has considered the feedback from consumers, identified what they currently do to support consumers but importantly, and in keeping with our "Approach to GD23", identified what further action they are proposing to take to support consumers in areas of key concern. We welcome the proactive nature of this consumer engagement with the specific actions and outcomes.

8.12 FE has identified in the submission that as part of developing their Customer Vulnerability Strategy there will be further research and engagement with consumers in vulnerable circumstances and consumer representatives. In addition to this, FE has stated that it intends to look to work completed by GB GDNs in order to develop 'best practice' approaches locally.

8.13 We welcome that FE has identified that a "top-down" level of commitment and awareness of vulnerability amongst staff is required to deliver a standout level of service, and we note that the company is working to enhance this approach across the company, including listening to staff themselves who may have knowledge of or experience vulnerable situations. We note the existing vulnerability staff training undertaken which will be a good foundation for FE to build upon for the Best Practice Framework and principles on culture, ethos and training.

8.14 FE has completed a solid evidence gathering programme and has identified lessons learned from this engagement and activities to take forward to enhance service and experience across the customer base.

PNGL - Overview of consumer and stakeholder engagement

8.15 The PNGL GD23 Business Plan submission recognises the importance of delivering services in a manner that acknowledges the needs of all consumers and embraces them into business delivery that the company continues to develop in alignment with the objectives of our Consumer Protection Programme. We welcome PNGL's statement of intent towards outcome-based, consumer-focused delivery.

8.16 From the PNGL submission, it is clear that the inclusion of consumer engagement and protection are recognised at a strategic level in the organisation with the application of key principles of engagement via an engagement strategy reviewed at senior executive level twice yearly. This approach mirrors the principles around culture, ethos and training from our Best Practice Framework which has been recently published.

8.17 In the development of its GD23 submission, PNGL provided evidence of ongoing longitudinal research with connected and unconnected customers around experience of connection and service as well as propensity to switch to natural gas. The research also explores the ongoing experience consumers have with PNGL and its contractors. This research has been supplemented with bespoke research for GD23 focussing on the needs of consumers in vulnerable circumstances as well as senior stakeholder workshops. This demonstrates how PNGL have taken account of the views of consumers and stakeholders in developing their plan.

8.18 PNGL's submission also identified company engagement with local community groups to support marginalised and disadvantaged consumers alongside a programme of stakeholder engagement with a broad range of groups and organisations across a variety of platforms, digital and non-digital.

8.19 A key area to note is PNGL's development and progress of a Consumer Vulnerability Strategy. PNGL has been proactive in this work area, stating an intention to develop a dedicated vulnerability strategy workstream for completion within the current GD17 price control period. We welcome that

PNGL has aligned development of their strategy to our ongoing Consumer Protection Programme and has embraced our definition of vulnerability. The establishment of vulnerability working groups, which include a cross section of PNGL senior managers, to challenge all consumer interaction with the aim to deliver high quality and best practice, sets the tone for the organisation's approach to supporting consumers. PNGL's vulnerability training module for all staff, to ensure the service provided meets specific consumer needs, training with expert organisations and the appointment of vulnerability champions across the organisation, is evidence PNGL is committed to a high level of consumer engagement which should result in enhanced customer service.

SGN - Overview of consumer and stakeholder engagement

8.20 In the submission, SGN highlighted their principles around consumer and stakeholder engagement including providing measurable benefits, inclusivity and diversity, responsiveness and ongoing improvement. There was evidence of engagement with a wide range of stakeholder organisations, including consumer representative bodies. The submission would have benefitted from more detail on the type and depth of engagement with these organisations and what the results of these interactions had on the development of its GD23 submission and the company's work in general.

8.21 We note the commitment to and success in customer service provision by the SGN parent company and welcome the "whole organisation" approach to consumer first, led by the Chief Executive. As company culture, ethos and training are key components of the Best Practice Framework it is noteworthy this is already a building block of SGN's approach to customer service and we look forward to seeing how this is built upon during the GD23 price control period. We welcome SGN's commitment to collaborate with us, consumer groups and other utility companies to develop strategies and support mechanisms to deliver Best Practice for Northern Ireland consumers. We also note SGN's acknowledgement of the wide range of potential vulnerable circumstances that consumers may experience and welcome SGN's approach to work collaboratively with organisations to identify, engage and communicate with these groups of consumers.

8.22 SGN's submission provided information on research that SGN commissioned to support the development of its GD23 business plan. We note the research focuses on brand awareness, propensity to switch to natural gas, customer satisfaction with a gas installation and some research on alternative fuel sources. We believe that SGN's future research should include more engagement directly with consumers in vulnerable circumstances as it expands its consumer base, so that this consumer group can be appropriately represented in future business planning. We welcome

SGN's commitment to vulnerable consumers in its plans for GD23 as this is a key component of our Best Practice Approach, currently out for consultation, and should be adopted in future consumer engagement and research planning.

Consumer and Stakeholder Engagement in GD23

8.23 In recent years, industry have sought greater clarity from the Utility Regulator on what they need to do to ensure the fair treatment of vulnerable consumers. Increased clarity and consistency across all utilities will be achieved through the implementation of our Best Practice Framework and the Consumer Protection Programme.

8.24 Our Best Practice Framework will impact GDN activities such as vulnerable consumer identification, assistance, staff training, care register delivery (including volume, reach, awareness and promotion), and monitoring and reporting. The Best Practice Framework will also extend into senior management leadership and company ethos around consumer vulnerability issues.

8.25 The GDN submissions for GD23 have highlighted some of the good work that network operators are already delivering or are proposing. We are mindful of the 'starting position' of many of our regulated companies when it comes to operationalising the concept of vulnerability and their ability to date to develop appropriate consumer interventions, and have considered and highlighted this in our Best Practice Framework document.

8.26 In GD23 we expect all GDNs to continue to work on their development and implementation of the Best Practice Framework for Consumer Protection as the approach to delivery, content, monitoring and reporting is developed.

8.27 During GD23 we will continue to use our preferred partnership approach with the GDNs and key stakeholders, to review GDNs delivery against local consumer needs and expectations. This may include the following:

- Increased focus on complaints data, especially those complaints escalated to CCNI and any lessons learned.
- Review of the consumer metrics used in Northern Ireland and GB and, where relevant and appropriate, standardisation of such metrics across our local GDNs and energy companies to enable cross sectoral comparison.

8.28 The above will, over time, facilitate better monitoring of GDN performance, better comparison between GDNs and local energy counterparts and may form the foundation for the introduction of additional consumer service incentive mechanisms in future price controls.

8.29 Agreeing on the timetable for GD23 new consumer focused metrics, KPIs and targets by the end of 2024 is a developmental objective for GD23. We shall work to develop this to ensure their introduction provides the actionable data GDNs will need to ensure they meet consumer needs and expectations throughout the GD23 price control period.

9. Uncertainty Mechanism

Summary of Key Changes from Draft Determination

9.1 We have updated this chapter following on from the GD23 draft determination, giving due consideration of the responses received during the consultation period. Key changes made in this context include:

a) The GD17 uncertainty mechanism adjustments for SGN have been updated to reflect the UR's decision on the Capex Risk Sharing Mechanism and its application throughout GD17. This update has resulted in an adjusted Opening Asset Value (OAV) for GD17 of £2.45m [£Av. 2014 RPI].

b) For GD23 we have added a number of categories to the uncertainty mechanism, which will allow the allocation of additional allowances to specific areas of work that fall outside of the scope of the existing mechanisms. The nature of these areas of work mean that the allowances required are not known at the time of final determination publishing and therefore additional allowances, if required, will be provided for within uncertainty mechanism. These include;

(i) Future Consumer Protection Development;

(ii) New Meter Specifications;

(iii) GDN Meter Inspection Costs;

(iv) GDN Meter Reading Costs;

(v) Business Separation (FE only); and

(vi) Advertising and Market Development - Non OO (SGN only).

Funding for these categories will require prior approval from the Utility Regulator and may require the completion of an economic appraisal. Please see the relevant annexes for further detail.

c) In GD23, we have included an allowance for the Energy Strategy Funding, which is 1% of the GDNs totex across the duration of GD23. This will apply to all GDNs.

d) For GD23, we have introduced an adjustment for IT and Telecoms, which will allocate £100k per annum (£2020, pre-efficiency) across 2024 – 2028 for FE only. Further information can be found in Annex D.

e) In GD23, we have introduced an adjustment for Advertising and Marketing Development – Non Owner Occupied for SGN only. Further information can be found in Annex D.

f) For GD23, we have updated the uncertainty mechanism to remove the Properties Passed mechanism entirely for PNGL. For FE the mechanism will apply in 2024 only. For SGN the mechanism will apply for the duration of the GD23 price control.

Detailed Approach – UR Decisions

9.2 We have included a number of mechanisms within this determination to reduce the risk to GDNs or to incentivise them to deliver outputs consistently with our statutory duties as described in Chapter 1, Section 2.

9.3 This chapter summarises these mechanisms and, where appropriate, references the sections of this document where the rationale and operation of the mechanisms are described in more detail.

9.4 The primary methodology that we use is termed the "uncertainty mechanism." This will be implemented at the time of the GD29 price control, by adjusting determined allowances for differences between actual and allowed costs or outputs (for example, connection activity).

9.5 Adjustments fall into one of eight categories as set out in our determination, namely:

- ***Output based*** – we determine a unit price (Capex) or unit allowance (Opex). The value included in the cost base is the determined unit price/unit allowance (e.g. cost of meter/connections incentive) multiplied by the forecast driver for that item (e.g. number of connections). Any difference in the driver (e.g. higher connections) between the determination and outturn will result in an adjustment at the time of GD29 (i.e. determined unit rate/unit allowance x actual driver output less determined unit rate/unit allowance x forecast driver output).

- ***Pass through*** – Any difference between the allowance in the determination and the actual costs incurred will result in a retrospective adjustment at the time of GD29.

- ***Ring fenced*** – This item has been included in the determination but will be removed through an adjustment in GD29 unless we determine that the costs (or adjusted costs) are necessary and efficient.

- ***Nominated output*** – an allowance included for the delivery of a specific project proposed by the GDN after undertaking a detailed technical assessment to identify a need and the optimum way of meeting that need. If the GDN subsequently decides that the work is not necessary or can be deferred to a later date, we will either remove the investment from the price control or re-profile the allowance to reflect actual delivery. If the company decides that an alternative solution will deliver the same output, we will review the proposal and determine whether the original allowance should be maintained or the allowance adjusted to reflect a change of output.

- ***Materiality Threshold*** – this covers additional projects which are not included within the final determination but are subsequently approved by us and cost above £120k. Further detail is provided from Paragraph 9.36 below.

- ***Capex Risk Sharing*** – to be applied at the last stage of the uncertainty mechanism once all other adjustments have been calculated. We have introduced a common 35:65 capex sharing mechanism for all GDNs as detailed further in Chapter 11.

- ***Economic Project Mechanism*** – allowances for major new projects not included in our determination, delivery of the Energy Strategy objectives or Innovative projects including new metering solutions and meter reading.

- ***Necessary Projects*** – allowances for new projects not included in our determination, which may be deemed non-economic through the Economic Project Mechanism, but which are necessary for the development, strength or reliability of the gas network, for example Resilience projects.

9.6 The methodology ensures adjustments also include the impact of the allowed cost of capital from the date of the difference in expenditure to the date that the adjustment is made. For example, the GD23 adjustments are grossed up for applicable return to the end of 2028, prior to inclusion into the opening TRV for GD29. The adjustments will follow methodology used to calculate the GD17 adjustments or as updated below.

9.7 The determined unit rates/unit allowances applied in the uncertainty mechanism will be post efficiency.

FE uncertainty mechanism adjustments for GD17

9.8 GD17 included an uncertainty mechanism for FE similar to the mechanism that has been used below for this GD23 price control period.

9.9 In respect of the FE GD17 uncertainty mechanism adjustments, the final adjustments are as follows:

FE Uncertainty Adjustments (RPI £Av-14) £000's	GD14	GD17
GD14 Actualised Adjustment	(185)	
GD17 Capex Adjustment		14,758
GD17 Capex Return Adjustment		1,221
GD17 Opex Adjustment		253
GD17 Debt Adjusted WACC Adjustment		(6,459)
GD17 Depreciation Adjustment		711

Note 1. Figures may not sum due to rounding.

Table 9.1: FE Final Uncertainty Mechanism Adjustments

9.10 All the above adjustments are added or removed from the closing TRV for 2022 appropriately, giving a final TRV at 1 January 2023 for FE of £252.5m [£av. 2020 CPIH].

PNGL uncertainty mechanism adjustments for GD17

9.11 GD17 included an uncertainty mechanism for PNGL similar to the mechanism that has been used below for this GD23 price control period.

9.12 In respect of the PNGL GD17 uncertainty mechanism adjustments, the final adjustments are as follows:

PNGL Uncertainty Adjustments (RPI £Sept-14) £000's	GD14	GD17
GD14 Actualised Adjustment	(248)	
GD17 Capex Adjustment		(1,351)
GD17 Capex Return Adjustment		594
GD17 Opex Adjustment		134
GD17 Q & CC Movement Adjustment		(335)
GD17 Debt Adjusted WACC Adjustment		(36,063)
GD17 Depreciation Adjustment		(274)
GD17 Capex Roller Adjustment		71
GD17 Greater Belfast Infill Adjustment		(85)
GD17 Housing Association Adjustment		297

Note 1. Figures may not sum due to rounding.

Table 9.2: PNGL Final Uncertainty Mechanism Adjustments

9.13 All the above adjustments are added or removed from the closing TRV for 2022 appropriately, giving a final TRV at 1st January 2023 for PNGL of £662.0m [£Sep 2020 CPIH].

SGN uncertainty mechanism adjustments for GD17

9.14 The SGN GD17 price control period started from 1st January 2018. At this time we calculated a pre price control allowance for 2016 & 2017 in order to form a 2018 Opening Asset Value for the GDN of £3.7m [£Av. 2014 RPI].

9.15 The GD23 draft determination calculated an Opening Asset Value (OAV) for GD17 of £1.9m [£Av. 2014 RPI], using actual outturn information.

9.16 Following publication of the GD23 draft determination and through consultation with SGN, UR has decided to apply the Capex Risk Sharing Mechanism as a 25/75 share with SGN assuming 25% of risk on any over/underspends and consumers assuming the remaining 75% risk.

9.17 Therefore, the OAV calculation for SGN has been updated for GD23, using actual outturn information and the amended Capex Risk Sharing position, resulting in an adjusted Opening Asset Value (OAV) for GD17 of £2.45m [£Av. 2014 RPI].

9.18 GD17 included an uncertainty mechanism for SGN similar to the mechanism that has been used below for this GD23 price control period.

9.19 In respect of the SGN GD17 uncertainty mechanism adjustments, the final adjustments are as follows:

SGN Uncertainty Adjustments (RPI £Av-14) £000'S	GD17
GD17 Capex Adjustment	(8,416)
GD17 Capex Return Adjustment	(1,337)
GD17 Opex Adjustment	(3,040)
GD17 Depreciation Adjustment	(1,215)

Note 1. Figures may not sum due to rounding.

Table 9.3: SGN Final Uncertainty Mechanism Adjustments

9.20 All the above adjustments are added or removed from the closing TRV for 2022 appropriately, giving a final TRV at 1st January 2023 for SGN of £32.2m [£av. 2020 CPIH].

GD23 Uncertainty Mechanism – UR Decisions

FE

9.21 In respect of GD23 FE capex allowances, the items subject to an uncertainty adjustment are those shown in Table 9.4 below:

Capex Item	Uncertainty Mechanism applicable in GD23
7 Bar Mains	There are no outputs for FE in GD23.
Feeder and infill mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 10.30m and determined unit rate until the completion of the infill projects identified in GD17 in 2023 and on a cumulative basis covering GD17 and 2023. From this point (2024-2028), the general infill cap of 5.16m and determined unit rate will apply. Additional incentive and penalties will apply to the year 2023 only outlined in Annex F.
New build mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 9.50m and determined unit rate.
Individually funded	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to cap of: Ten Towns Private Streets - 10.30m and determined unit rate. Applies from 2024 inclusive.
Pressure reduction	Not applicable in GD23.
Domestic and I&C services	Output based on connections and determined unit rates.
Domestic and I&C meters	Output based on connections and determined unit rates.
Domestic and I&C meters - other replacement	Output based on the actual number of meters replaced.
Domestic and I&C meters end-of-life replacement	Output based on the actual number of meters replaced which are 20 years older or more.
Other capex	Not applicable in GD23.
Traffic Management Act	Ring fenced.
Additional projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary or deemed to be innovative.
Materiality Threshold	Subject to future UR determinations.
Capex Risk Sharing	Applied as per Chapter 11.

Table 9.4: FE Capex Uncertainty Mechanism

9.22 The determined rates for the capex uncertainty mechanisms are:

- The basket of works unit rates set out in Annex F following the application of the frontier shift.
- Except for infill mains and new build mains where the blended basket of works unit rates set out in Annex F will apply.

9.23 In respect of GD23 FE opex allowances, the items subject to uncertainty adjustment are those shown in Table 9.5 below:

Opex Item	Uncertainty Mechanism applicable in GD23
Property Management	Network Rates based on turnover as set out in the Annex D - Opex Detail.
Licence Fees	Pass Through.
Advert. & Market Dev. (OO)	Actual Connections Output based on Owner Occupied connections (As set out in Annex D - Opex Detail).
Supplier of Last Resort	Ring-fenced – Annex D Opex Detail.
IT and Telecoms	Ring Fenced - Annex D Opex Detail
Energy Strategy Funding	Ring Fenced - Annex G Energy Strategy and Annex D Opex for funding
Materiality Threshold	Subject to future UR determinations.
Additional Projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary or deemed to be innovative.

Table 9.5: FE Opex Uncertainty Mechanism

9.24 Further detail and determined rates for the opex uncertainty mechanism in relation to:

- Network Rates, Licence Fees, Supplier of Last Resort, Advertising & Market Development (OO) and IT and Telecoms are set out in Annex D - Opex Detail.
- Energy Strategy is set out in Annex G and Annex D for funding.

9.25 It should be noted that the opex allowances, as set in Annex D, are set pre-efficiency. They will be updated to reflect the frontier shift as per Annex E.

PNGL

9.26 In respect of GD23 PNGL capex allowances, the items subject to uncertainty adjustment are those shown in Table 9.6 below:

Capex Item	Uncertainty Mechanism applicable in GD23
7 Bar Mains	Nominated outputs for defined projects as detailed in Annex F.
Feeder and infill mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 5.16m and determined unit rate will apply. Additional incentive and penalties will not apply in GD23 as outlined in Annex F.
New build mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 9.50m and determined unit rate.
Individually funded	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to caps of Greater Belfast - 14.30m and determined unit rate. Whitehead - 9.00m and determined unit rate. East Down - 11.52m and determined unit rate.
Pressure reduction	Not applicable in GD23.
Domestic and I&C services	Output based on connections and determined unit rates.
Domestic and I&C meters	Output based on connections and determined unit rates.
Domestic and I&C meters - other replacement	Output based on the actual number of meters replaced.
Domestic and I&C meters end-of-life replacement	Output based on the actual number of meters replaced which are 20 years older or more.
Other capex	Not applicable in GD23.
Traffic Management Act	Ring fenced.
Additional projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary or deemed to be innovative.
Materiality Threshold	Subject to future UR determinations.
Capex Risk Sharing	Applied as per Chapter 11.

Table 9.6: PNGL Capex Uncertainty Mechanism

9.27 The determined rates for the capex uncertainty mechanisms are:

- The basket of works unit rates set out in Annex F following the application of the frontier shift.
- Except for infill mains and new build mains where the blended basket of works unit rates as set out in Annex F will apply.

9.28 In respect of GD23 PNGL opex allowances, the items subject to uncertainty adjustment are those shown in Table 9.7 below:

Opex Item	Uncertainty Mechanism applicable in GD23
Property Management	Network Rates based on turnover as set out in the Annex D - Opex Detail.
Licence Fees	Pass Through.
Advert. & Market Dev. (OO)	Actual Connections Output based on Owner Occupied connections (As set out in Annex D - Opex Detail.
Supplier of Last Resort	Ring-fenced – Annex D Opex Detail.
Energy Strategy Funding	Ring-fenced - Annex G Energy Strategy and Annex D Opex for funding
Materiality Threshold	Subject to future UR determinations.
Additional projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary or deemed to be innovative.

Table 9.7: PNGL Opex Uncertainty Mechanism

9.29 Further detail and determined rates for the opex uncertainty mechanism in relation to:

- Network Rates, Licence Fees, Supplier of Last Resort, and Advertising & Market Development (OO) are set out in Annex D - Opex Detail.
- Energy Strategy is set out in Annex G and Annex D for funding.

9.30 It should be noted that the opex allowances, as set in Annex D are set pre-efficiency. They will be updated to reflect the frontier shift as per Annex E.

SGN

9.31 In respect of GD23 SGN capex allowances, the items subject to uncertainty adjustment are those shown in Table 9.8 below:

Capex Item	Uncertainty Mechanism applicable in GD23
7 Bar Mains	There are no outputs for SGN in GD23.
Feeder and infill mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 11.50m and determined unit rate will apply. Additional incentive and penalties will apply as outlined in Annex F.
New build mains	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 9.50m and determined unit rate.
Individually funded	There are no outputs for SGN in GD23.
Pressure reduction	Not applicable in GD23.
Domestic and I&C services	Output based on connections and determined unit rates.
Domestic and I&C meters	Output based on connections and determined unit rates.
Domestic and I&C meters - other replacement	Output based on the actual number of meters replaced.
Domestic and I&C meters end-of-life replacement	Not applicable in GD23.
Other capex	Not applicable in GD23.
Traffic Management Act	Ring fenced.
Additional projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary or deemed to be innovative. For avoidance of doubt this may include consequential changes to volumes.
Materiality Threshold	Subject to future UR determinations.
Capex Risk Sharing	Applied as per Chapter 11.

Table 9.8: SGN Capex Uncertainty Mechanism

9.32 The determined rates for the capex uncertainty mechanisms are:

- The basket of works unit set out in Annex F following the application of the frontier shift set.
- Except for infill mains and new build mains where the blended basket of works unit rates set out in Annex F will apply.

9.33 In respect of GD23 SGN Opex allowances, the items subject to uncertainty adjustment are those shown in Table 9.9 below:

Opex Item	Uncertainty Mechanism applicable in GD23
Property Management	Network Rates based on turnover as set out in the Annex D - Opex Detail.
Licence Fees	Pass Through.
Advert. & Market Dev. (OO)	Actual Connections Output based on Owner Occupied connections (As set out in Annex D - Opex Detail.
Advert. & Market Dev. (NON OO)	Actual Connections Output based on Non Domestic Owner Occupied connections, being IC1 (£600) or IC2 (£3,000) as set out in Annex D - Opex Detail.
Supplier of Last Resort	Ring-fenced – Annex D Opex Detail.
Energy Strategy Funding	Ring-fenced - Annex G Energy Strategy and Annex D Opex Detail for funding
Materiality Threshold	Subject to future UR determinations.
Additional projects	The economic project mechanism will apply to new projects which are shown to be either economic or necessary or deemed to be innovative.

Table 9.9: SGN Opex Uncertainty Mechanism

9.34 Further detail and determined rates for the opex uncertainty mechanism in relation to:

- Network Rates, Licence Fees, Supplier of Last Resort, Advertising & Market Development (OO) and Advertising & Market Development (NON OO), are set out in Annex D - Opex Detail.

- Energy Strategy are set out in Annex G and Annex D for funding.

9.35 It should be noted that the opex allowances, as set in Annex D, are set pre-efficiency. They will be updated to reflect the frontier shift as per Annex E.

Materiality Thresholds

9.36 In line with our approach as part of GD17 price control, GD23 includes a materiality threshold for 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. We would only expect to approve such costs where they are linked to new outputs, and not part of normal operational work.

9.37 Any costs must be submitted to the Utility Regulator with a business case, before any approval for additional allowances would be granted for this area. Any expenditure incurred in advance of approval would be very unlikely to be approved.

9.38 The materiality threshold is set at £120k (GD14 and GD17 was set at £100k and an increase has been made for inflation) per project for the duration of the GD23 price control period. This materiality threshold is the same for each of the three GDNs.

9.39 Consideration will also be made for any issues arising that could not reasonably have been foreseen, or for which realistic estimates with respect to the associated costs could not reasonably be made at the time of the price control determination and which are reasonably outside the control of the GDNs, such as European Directives or equivalent local legislation which the GDNs are required to implement. Whilst we will still require a robust business case for any projects, or initiatives to deal with such issues from the GDNs, we note that we may also consider them, as relevant and appropriate, if the materiality threshold is not met.

9.40 We also note that some areas have now been identified in the price control that are not subject to the materiality threshold due to their unpredictability and/or scale of cost. Unless the area is clearly identified, all other areas will be subject to the materiality threshold.

9.41 In taking decisions on granting of additional allowances we will consider the balance between the unforeseen costs and any cost reductions or revenue gains achieved during the price control period, to ensure fairness for consumers.

Rate of Return Adjustment

9.42 As well as the adjustments that will be made with respect to opex and capex described above we will also make adjustments for rate of return.

9.43 Chapter 10 and Annex T contain further detail on this.

Tax Allowance Adjustment – SGN

9.44 As part of the SGN licence we are required to set an annual tax allowance for the business due to WACC being set on a vanilla basis. The GD23 allowance is determined at nil per annum and it is forecast to be 2035 when the first tax becomes payable. We will discuss this matter further with SGN but it is unlikely to require further consideration during GD23.

9.45 However, it is important to establish the principle of tax allowance adjustment as it may be required during the next price control - GD29.

10. Financial Aspects

Summary of Key Changes from Draft Determination

10.1 In coming to our final determination we have considered the consultation responses received, additional information available and the outcome of our engagement with the GDNs. The key changes made since the draft determination as a consequence of this are as follows:

- Data up to 28 September 2022 replaces the draft determination cut-off date of October 2021.
- We have moved asset beta to the mid-point of the ranges identified by our consultant.
- We have added inflation and risk free rate to the rate of return adjustment mechanism.

10.2 This chapter should be read in conjunction with, Annex I - Cost of Capital, Annex S - Consultation Responses Report and Annex T - Rate of Return Adjustment.

Detailed Approach – Utility Regulator Decisions

10.3 The Utility Regulator's regulatory model provides for the GDNs to earn a return on their allowed expenditures from customers, up until the point of recovery of those expenditures. The value of this return is calculated as a weighted average of the costs of the equity and debt finance that the companies have to pay to investors.

10.4 In calculating the allowed cost of equity, the Utility Regulator, like most economic regulators, uses the Capital Asset Pricing Model (CAPM) to determine the returns that shareholders require in exchange for their equity investments. CAPM estimates the required return to be a function of the risk-free rate (Rf), the expected return on the market portfolio (Rm) and a firm-specific measure of risk (beta of βe) as follows:

10.5 Return on equity = Rf + βe . (Rm – Rf)

10.6 In Paragraphs 10.10 to 10.43 we explain how we have put numbers to each of the parameters in this formula.

10.7 The interest that PNGL and FE pay on their debts is directly observable, and in the first instance we propose to align the allowed cost of debt for these companies to actual interest rates. Both companies will then need to refinance the entirety of their existing debts during the GD23 period, meaning that there is some uncertainty about the interest that PNGL and FE will pay from mid-2024 and mid-2025 respectively. In a continuation of the approach we first adopted in our GD17 decision, we therefore provide now for 'placeholder' values for the cost of new debt and for an adjustment mechanism that will update our allowances in line with prevailing market rates at the point when the companies raise new borrowing. The corporation tax rate was also adjusted via this mechanism in GD17 and for GD23 we intend to add adjustments for inflation and risk free rate. The calibration of this mechanism is outlined in Paragraphs 10.44 to 10.50 and Annex T.

10.8 SGN is in a slightly different position because it borrows from its parent company rather than directly from the financial markets. We set out our calculation of the 'transfer price' for this debt in Paragraphs 10.40 to 10.42. SGN will also be subject to the rate of return adjustment mechanism during GD23.

10.9 In carrying out its functions, the Utility Regulator is required to have regard to the need to secure that licence holders are able to finance their activities. This duty has underpinned our approach to the whole of our cost of capital assessment, and to the assembly of the GD23 price control more generally, but we also give a self-contained assessment of financeability in Paragraphs 10.51 to 10.64.

Rate of Return

10.10 The values that the Utility Regulator proposed for the GD23 allowed rate of return in its draft determination are set out in Table 10.1.

	PNGL	FE	SGN
Gearing	0.55	0.55	0.55
Cost of debt (%)	0.6	1.0	1.1
Risk-free rate (%)	-1.1	-1.1	-1.1
Market return (%)	6.5	6.5	6.5
Asset beta	0.33	0.33	0.39
Equity beta	0.64	0.64	0.78
Post-tax cost of equity (%)	3.78	3.78	4.79
Tax rate	24.75	24.75	24.75
Pre-tax cost of equity (%)	5.02	5.02	6.37
Pre-tax WACC (%)	2.59	2.81	3.47
Vanilla WACC (%)	2.03	2.25	2.76

Table 10.1 - Draft Determination Rate of Return

10.11 PNGL, FE and SGN all said in their responses to the draft determination that the above rates of return were too low. A detailed review of the arguments that they made is set out in Annex S - Consultation Responses Report. Key points made in submission included:

- risk-free rate and expected market return – PNGL, FE and SGN proposed alternative values for the market-wide CAPM parameters which were generally higher than the Utility Regulator's proposed values; and
- beta – PNGL and FE both argued that the Utility Regulator was wrong to position their betas, and hence the allowed cost of equity, below the values that Ofgem used in its RIIO-GD2 price control decision. SGN also considered that the UR had failed to make adequate allowance for its heightened exposure to risks;
- cost of debt – PNGL, FE and SGN each provided a series of comments on the component parts of the cost of debt calculation, and concluded that the Utility Regulator had significantly under-estimated required allowances.

10.12 All three GDNs also pointed out that market data had changed markedly since the October 2021 cut-off date that we used when compiling the draft determination, necessitating higher allowed return.

10.13 In reaching this final determination, we have paid careful attention to these representations and sought to address the points that have been made either in this chapter or in Annex S - Consultation Responses Report. We have also asked our expert consultant to update its previous analysis using data up to 28 September 2022. This report is published as Annex I.

10.14 Our final determination of allowed returns for the GD23 period is set out below.

Gearing

10.15 As a matter of economic and regulatory principle, the WACC should not be especially sensitive to the choice of gearing ratio. For the sake of computational simplicity, we therefore calculate the cost of capital for all three GDNs at the GD17 debt-to-TRV ratio of 55%.

10.16 We consider the appropriate notional gearing assumption for the GD23 period in more detail in the subsequent discussion of financeability below.

Risk-free rate and expected market return

10.17 Our approach to estimating the risk-free rate involves taking readings of the yields on 20-year index-linked gilts and on AAA non-government bonds of 10-15 and 10+ year maturities. The risk-free rate calculation provided to us by First Economics in its latest report uses yield data as 28 September 2022, to give an up-to-date snapshot of the risk-free rate of return following a period of significant market movement. Our proposed GD23 risk-free rate value aligns to First Economics' recommended value of 1.77% and will be subject to subject to adjustment via rate of return adjustment mechanism.

10.18 The expected market return has been considered at length in recent UK price reviews and we have considered this further with interest rates having moved up markedly. However our chosen value remains at 6.5%.

Beta

10.19 The betas of listed firms can be estimated empirically using stock market data. In this price review, however, we are concerned with three companies that do not have a stock market listing. We have therefore sought to understand the betas that regulators have factored into other companies' allowed rates of return and we have attempted to position PNGL's, FE's and SGN's logically against these comparators.

10.20 We have placed particular weight on the 0.35 asset beta value that Ofgem used in its RIIO-GD2 decision. There are, however, reasons why PNGL's, FE's and SGN's betas could differ from the GB GDNs' beta:

- PNGL and FE manage comparatively low amounts of ongoing expenditure in comparison to the capital that investors have put into the business. This should mean that any cost shocks, if they occur, have less of any impact on the percentage return that PNGL and FE are able to give investors, thus offering equity providers a more stable and more predictable return than is the case with other regulated utilities; and

- SGN has been operating for a relatively short period of time and has a slightly different regulatory framework from the other companies. In particular, SGN has a price cap rather than a revenue cap, which gives it a heightened exposure to demand risk.

10.21 In our GD17 decision, we said that we found it difficult to produce a robust and defensible quantification of the effect that a low totex-to-TRV ratio has on beta. This remains the case today. We are, however, clear that there is an effect, and can point to the recent commodity/construction price shock as one example of the way in which returns at different companies can be affected by systematic cost shocks to different degrees depending on the scale of the expenditure that a company is managing relative to the size of its regulatory asset base.

10.22 We consider it appropriate to weigh this differentiating factor alongside the possibility that differences in the Northern Ireland and GB regulatory frameworks could create a perception of slightly higher risks around PNGL's and FE's returns. Having examined this matter, we do not consider that this is a relevant factor given that the fundamentals underpinning long-term revenue entitlements and associated incentive arrangements are similar in Northern Ireland and GB. Indeed, we note that two of the GDNs, FE and SGN, did not place any emphasis on this matter in its submissions.

10.23 We therefore consider that there is a prima facie case for positioning PNGL's and FE's betas below Ofgem's RIIO-GD2 beta. The difficulties that we face in calculating an appropriate differential have, however, persuaded us that we should adopt a cautious approach. While we would not necessarily take the same position in future reviews, we have decided that in this review, in the presence of estimation uncertainties, we will set PNGL's and FE's asset beta at 0.35, in line with Ofgem's RIIO-GD2 estimate. We view this as a prudent decision which will help to ensure that both PNGL and FE are capable of building new equity capital, should they require it, during the GD23 period.

10.24 At gearing of 55%, and assuming a debt beta of 0.075, the calculated equity beta is 0.69. We note that this estimate is within the range put forward by FE in its business plan submission, after adjusting FE's gearing assumption, albeit at the bottom end.

10.25 In SGN's case, we are clear that SGN's beta should sit above the RIIO-GD2 beta to reflect SGN's greater exposure to systematic risks. Again, there is no incontrovertible way of determining what the appropriate beta differential should be. SGN made a number of submissions on this matter, but found it difficult to evidence most of the assumptions that it was required to make when calculating a precise beta value. Accordingly, we prefer to put weight on the estimates that SGN submitted as part of the competitive award process for its licence. This evidence points to a beta differential of 0.06 or an asset beta of 0.41.

10.26 At gearing of 55%, and assuming a debt beta of 0.075, the calculated equity beta is 0.81.

Tax

10.27 The rates of return for PNGL and FE are pre tax rates of return which combine remuneration for interest costs equity returns and a simple 1 / 1-t tax wedge adjustment into a single allowance. This reflects the UR's historical practice of setting pre-tax rates of return in all previous price control determinations.

10.28 For SGN we use an alternative approach and set a stand-alone allowance for tax.

10.29 We use a 19% tax rate in our calculations. We are aware of further political movement and proposals in this area and will consider further when making our final licence decisions.

Overall cost of equity

10.30 Table 10.2 brings our proposed figures for the risk-free rate, expected market return, beta and gearing into an overall calculation of the allowed cost of equity.

	PNGL	FE	SGN
Gearing	0.55	0.55	0.55
Risk-free rate (%)	1.77	1.77	1.77
Market return (%)	6.5	6.5	6.5
Asset beta	0.35	0.35	0.41
Equity beta	0.64	0.64	0.78
Post-tax cost of equity (%)	5.02	5.02	5.65
Tax rate	19.0	19.0	19.0
Pre-tax cost of equity (%)	6.19	6.19	6.97

Table 10.2 - Cost of Equity

Cost of debt

10.31 Our allowances of PNGL's and FE's cost of debt are built around our current best estimates of the interest rates that the businesses will pay over the GD23 period, plus an allowance for transaction costs.

10.32 The calculations start with the interest that PNGL and FE will pay on existing debts prior to their intended refinancing. The average rates are 1.9% for PNGL and 2.8% for FE. We add an annualised amount of the fees that the companies incurred when entering into their borrowing arrangements, giving an all-in embedded cost of debt of 2.2% and 3.2% respectively.

10.33 In making 'placeholder' estimates of the post-refinancing costs of debt, we assume that current market rates are the best available predictor of future market rates. This means that we allow for interest rates to remain elevated throughout the GD23 period in comparison to the rates that the GDNs faced when they arranged their existing borrowings.

10.34 There are a number of choices that we could make for the precise benchmark for the cost of debt. In the report it prepared ahead of our draft determination, our consultant focused on the yields on a 7-10 year maturity BBB bond index. The tenor and rating of this index broadly mirror the tenor and credit quality of PNGL's and FE's existing debt. In its response, PNGL noted that yields on short-tenor borrowing tend to be lower than the yields on long-tenor debt and argued that this approach could prevent the GDNs from issuing longer tenor debt at their next refinancing. PNGL's suggestion was that we should revert to a 10+ year maturity index, in line with our approach for the GD17 period.

10.35 The decision that we face on this matter is finely balanced. On the one hand, PNGL and FE have never previously borrowed at a tenor of more than ten years, and we would be concerned if PNGL were to argue for one type of benchmark now but again borrow at 7-10 year maturity two years from now. On the other hand, we do not consider that it is right to dictate a particular form of borrowing to the GDNs.

10.36 We therefore set our 'placeholder' for the cost of new debt in line with forecast yields on longer tenor bonds. Our calculation proceeds as follows:

- First, we observe that the yield on BBB rated 10+ year debt in secondary markets as at the 28 September 2022 was 6.60%;
- Second, we have examined data from the gilt market in order to ascertain what kind of allowance we should make for changes in interest rates ahead of the GDNs' planned refinancing. The data suggests that 20-year gilt yields will remain broadly flat, meaning that it is not necessary to make a forward rate adjustment within our calculations; and
- Finally, we allow for refinancing-related transaction costs in line with actual costs incurred in the companies' last debt-raising exercises.

10.37 There calculations exclude certain premia that the GDNs claimed for in their submissions (e.g. illiquidity premia, a gas network premium, and the so-called cost of carry) on the basis that the companies did not incur such expenses in past financing exercises and there is no evidence that the companies will need to incur such costs in the future.

10.38 We convert the nominal costs of debt into their real equivalents by adjusting for GD23 CPIH inflation assumptions as set out in Table 10.3. As stated earlier inflation forecasts are subject to the rate of return adjustment mechanism.

	2023	2024	2025	2026	2027	2028
Forecast Inflation	5.55%	2.28%	1.09%	2.09%	2.09%	2.09%

Table 10.3 - Forecast Inflation

10.39 Table 10.4 to Table 10.6 bring the calculations together into an overall baseline for the real cost of debt.

	2023	2024	2025	2026	2027	2028
Cost of embedded debt	1.90%	1.90%	-	-	-	-
Placeholder cost of new debt	-	6.60%	6.60%	6.60%	6.60%	6.60%
Weights	100:0	50:50	0:100	0:100	0:100	0:100
Fees etc.	0.33%	0.33%	0.33%	0.33%	0.33%	0.33%
Inflation	(5.55%)	(2.28%)	(1.09%)	(2.09%)	(2.09%)	(2.09%)
Real cost of debt	(3.15%)	2.25%	5.78%	4.74%	4.74%	4.74%

Table 10.4 - PNGL Cost of Debt

	2023	2024	2025	2026	2027	2028
Cost of embedded debt	2.80%	2.80%	2.80%	-	-	-
Placeholder cost of new debt	-	-	6.60%	6.60%	6.60%	6.60%
Weights	100:0	100:0	50:50	0:100	0:100	0:100
Fees etc.	0.41%	0.41%	0.41%	0.41%	0.41%	0.41%
Inflation	(5.55%)	(2.28%)	(1.09%)	(2.09%)	(2.09%)	(2.09%)
Real cost of debt	(2.22%)	0.91%	3.98%	4.82%	4.82%	4.82%

Table 10.5 - Firmus Cost of Debt

10.40 In SGN's case, we noted above that our task is to set a 'transfer price' for the interest paid on monies that SGN borrows from its parent company. SGN argued that we should approach this costing exercise by assuming that the licensee is a fully stand-alone business. However, we do not consider that it is appropriate to make allowance for entirely hypothetical costs that SGN has not had to pay and will not have to pay because it is able to make use of intra-group borrowing arranged by a significantly larger parent company.

10.41 We continue to calculate a 'transfer price' for SGN's cost of debt in line with the average yield on the iBoxx £ utilities 10+ year index. However, we adjust our allowance for transaction costs to 37 basis points so that the allowance that SGN receives is in line with the expenses identified by PNGL and FE.

10.42 Our cost of debt calculation for SGN is set out in Table 10.6 below.

	2023	2024	2025	2026	2027	2028
Cost of embedded debt	3.10%	3.10%	3.10%	3.10%	3.10%	3.10%
Placeholder cost of new debt	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%
Weights	0:100	10:90	20:80	30:70	40:60	50:50
Fees etc.	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%
Inflation	(5.55%)	(2.28%)	(1.09%)	(2.09%)	(2.09%)	(2.09%)
Real cost of debt	(1.97%)	1.51%	3.05%	2.38%	2.72%	3.07%

Table 10.6 - SGN Cost of Debt

Overall rate of return

10.43 Table 10.7 to Table 10.9 combine our calculations of the cost of equity and the cost of debt into overall rates of return for the GD23 period.

	2023	2024	2025	2026	2027	2028
Gearing	0.55	0.55	0.55	0.55	0.55	0.55
Pre-tax cost of equity (%)	6.19	6.19	6.19	6.19	6.19	6.19
Cost of Debt	-3.15	2.25	5.78	4.74	4.74	4.74
Pre-tax WACC (%)	1.06	4.02	5.96	5.39	5.39	5.39

Table 10.7 - PNGL Overall Rate of Return

	2023	2024	2025	2026	2027	2028
Gearing	0.55	0.55	0.55	0.55	0.55	0.55
Pre-tax cost of equity (%)	6.19	6.19	6.19	6.19	6.19	6.19
Cost of Debt	-2.22	0.91	3.98	4.82	4.82	4.82
Pre-tax WACC (%)	1.57	3.29	4.97	5.44	5.44	5.44

Table 10.8 - Firmus Overall Rate of Return

	2023	2024	2025	2026	2027	2028
Gearing	0.55	0.55	0.55	0.55	0.55	0.55
Post-tax cost of equity (%)	5.65	5.65	5.65	5.65	5.65	5.65
Cost of Debt	-1.97	1.51	3.05	2.38	2.72	3.07
Vanilla WACC (%)	1.46	3.37	4.22	3.85	4.04	4.23

Table 10.9 - SGN Overall Rate of Return

Rate of return adjustment

10.44 The GD17 final determination included a Rate of Return Adjustment Mechanism Capital correction mechanism which adjusted the determined cost of capital for changes in the iBoxx benchmark used to determine rates for debt and to adjust for corporation tax rates.

10.45 For GD23, we have updated the mechanism (Annex T) to work on an annual basis. In addition due to uncertainties over the trajectory of interest rates and inflation in the economy, we propose to put in place an additional adjustment mechanisms that will adjust the allowed return on equity for risk-free rate and the real cost of debt for inflation if they turn out to be higher or lower than our base case forecast.

10.46 Inflation replaces actual annual average inflation in place of the forecasts used throughout GD23.

10.47 Ofgem operates a risk free rate adjustment mechanism in its RIIO-2 framework for the GB energy networks and our understanding is that that the mechanism has been welcomed by both consumer representatives and by networks as a way of reducing exposures to exogenous changes in the cost of capital.

10.48 Our calculation of the risk-free rate uses three different input indices and requires forecasts of both RPI and CPIH inflation. Rather than strive to replicate this computation on a continual basis, we propose to focus the adjustment mechanism on change in the value of index on which we place most weight - i.e. the yield on 20-year index-linked gilts. We will track the value of this index, as published on the Bank of England's website, and adjust retrospectively the calculation of the risk-free rate in each year of the GD23 period by an amount that is equal to the difference between the annual average out-turn value of the index and the value of 28 September 2022 of 0.75%.

10.49 The Rate of Return Adjustment Mechanism for GD17 included a sharing of the cost of debt at the time of refinancing. This was calculated as 80% (to consumers) of a defined iBoxx benchmark at the time of refinancing compared to that assumed in the final determination. The use of a spot rate of the 28th September 2022 for the final determination exposes a weakness of this sharing mechanism. The GDNs and consumers carry a risk against a choice of a benchmark by the Utility Regulator for the final determination and a benchmark rate at the time of refinancing – neither of which they can influence. In view of this we propose that the sharing mechanism is removed (with consumers carrying 100% of the risk and reward) and the GDN's incentive is limited to out-performance against the iBoxx benchmark. However, we will review this sharing mechanism again during GD29.

10.50 The Rate of Return Adjustment Mechanism results in an adjustment to the opening TRV of the next Price Control providing a delayed and slow return of revenue to the company or consumers and we propose to retain this for GD23.

Financeability

10.51 Article 14 of the Energy (Northern Ireland) Order 2003 requires us to carry out our functions in the manner we consider is best calculated to further our principal objective, having regard to the need to secure that licence holders are able to finance the activities which are the subject of statutory and licence obligations.

10.52 This duty is framed similarly to the financing duties of other UK regulators and can broadly be taken in practice to mean that the price control ought to be set at a level which would allow an efficient network company to finance its licensed activities. It is therefore necessary for us to consider financeability as an integral part of a price review.

10.53 In assessing whether this draft determination leaves each GDN in a position where they will be able to finance all of their activities which are the subject of regulatory obligations during the GD23 period, we have considered the ability that the companies will have to utilise both equity and debt finance.

10.54 The key determinant of the companies' ability to access equity finance is the allowed return on equity. As noted in section above, we have built returns by considering the level of returns that investors are likely to be able to get from other equity investments and by positioning the return offered by PNGL, FE, and SGN logically against these alternative investments. Our proposed equity returns are slightly higher, on a like for-like basis, than the returns that Ofgem factored into its recent RIIO-GD2 price control calculations. Accordingly, we are satisfied that each GDN ought to be capable of securing equity finance on an ongoing basis throughout the next six years.

10.55 As far as borrowing is concerned, it will be important for the GDNs to maintain investment-grade credit quality. One determinant of the companies' credit worthiness in the eyes of lenders will be the level of cashflows that the networks generate under our price controls. A second key factor will be the amount of borrowing that the companies attempt to take on. We influence the first of these things, but the second is firmly in the hands of the GDNs' Boards.

10.56 In Table 10.10 to Table 10.12 we present the results of some modelling that we have produced to understand the projected level of key financial ratios at a gearing of 55%.

	2023	2024	2025	2026	2027	2028
FFO Interest Cover	5.60	3.00	2.16	2.23	2.30	2.38
PMICR	0.22	1.35	1.43	1.28	1.26	1.25
Nominal PMICR	4.70	2.25	1.71	1.82	1.81	1.80
FFO / Net Debt	10.3%	9.2%	8.0%	8.6%	9.0%	9.5%
Gearing	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%

Table 10.10 - PNGL ratios at 55% gearing

	2023	2024	2025	2026	2027	2028
FFO Interest Cover	3.69	3.90	2.66	2.10	2.17	2.25
PMICR	0.73	1.61	1.61	1.32	1.30	1.28
Nominal PMICR	3.79	2.88	2.00	1.86	1.83	1.81
FFO / Net Debt	8.6%	9.3%	8.5%	7.7%	8.2%	8.8%
Gearing	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%

Table 10.11- Firmus ratios at 55% gearing

	2023	2024	2025	2026	2027	2028
FFO Interest Cover	5.02	4.18	3.85	3.45	3.17	2.92
PMICR	0.78	1.59	1.81	1.53	1.49	1.46
Nominal PMICR	3.54	2.64	2.27	2.33	2.25	2.16
FFO / Net Debt	14.0%	12.1%	11.9%	11.1%	10.6%	10.0%
Gearing	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%

Table 10.12 - SGN ratios at 55% gearing

10.57 When assembling these projections, we have had to decide what a suitable opening level of gearing is as at 1 January 2023. In our GD17 final determination modelling, we assumed that PNGL and FE would begin the GD17 period modelling with gearing of 55% and that PNGL's gearing would decline slightly and FE's gearing would increase slightly over the six years to December 2022. Since that point in time there has been a significant inflation shock. This is relevant to our modelling of financial ratios because the GDNs' TRVs index in line with RPI inflation, while the value of the GDNs' debt is fixed in nominal terms i.e. all other things being held equal, higher inflation results in a lowering of the GDNs' debt-to-TRV ratios.

10.58 This presents us with two options:

- We could assume that the GDNs have been passive in the face of high inflation, and that their gearing has reduced in 2021 and 2022; or

- We could assume that the GDNs have responded to higher inflation by borrowing more money and paying that money out as dividends as part of a conscious decision to keep their gearing constant.

10.59 We think that the first of these two options is the more logical approach. In these circumstances, we do not think it would be appropriate for a GDN to deliberately borrow more and exacerbate a known financeability issue. Rather, we think it is more reasonable that a GDN would view a natural, inflation-driven de-gearing as beneficial in alleviating a forecast tightening of financial ratios.

10.60 We note that this approach is consistent with the approach that the Utility Regulator took to financeability in GD17 and with the statements that the CMA made in its determination of FE's GD27 appeal about the contribution that a lower debt-to-TRV ratio can take to improving a company's credit quality.

10.61 We therefore model the financial ratios that a GDN would exhibit if it begins the GD23 period with gearing of 45%. This figure assumes that the higher inflation that we have seen since mid-2021, and expect to continue to see through to December 2022, feeds 1-for-1 into a lower debt-to-TRV ratio.

	2023	2024	2025	2026	2027	2028
FFO Interest Cover	6.80	3.63	2.60	2.69	2.77	2.86
PMICR	0.22	1.61	1.70	1.52	1.50	1.48
Nominal PMICR	5.70	2.71	2.05	2.18	2.17	2.15
FFO / Net Debt	12.9%	12.0%	11.1%	11.7%	12.3%	12.9%
Gearing	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%

Table 10.13 - PNGL ratios at 45% gearing

	2023	2024	2025	2026	2027	2028
FFO Interest Cover	4.47	4.72	3.21	2.52	2.61	2.71
PMICR	0.85	1.92	1.93	1.57	1.55	1.52
Nominal PMICR	4.59	3.48	2.40	2.23	2.20	2.18
FFO / Net Debt	11.1%	11.9%	11.3%	10.7%	11.3%	12.0%
Gearing	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%

Table 10.14 - Firmus ratios at 45% gearing

	2023	2024	2025	2026	2027	2028
FFO Interest Cover	6.19	5.16	4.75	4.27	3.92	3.62
PMICR	0.95	1.95	2.21	1.88	1.83	1.78
Nominal PMICR	4.33	3.23	2.77	2.85	2.75	2.64
FFO / Net Debt	18.0%	15.9%	15.6%	14.8%	14.2%	13.7%
Gearing	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%

Table 10.15 - SGN ratios at 45% gearing

10.62 While we have also tested the ratios above for negative cost shocks we do not consider such sensitivity analysis provides additional relevant insights. If a GDN encounters shocks during the GD23 period, its financial ratios will inevitably become weaker and its credit quality may come under pressure. The URs position is that this may necessitate dividend forbearance and /or using equity to stabilise the businesses finances.

10.63 The evidence that we have seen in rating agency reports, as well as analysis conducted by other UK regulators, indicates that a GDN will normally need to maintain post-maintenance interest cover ratio (PMICR) of at least 1.4 times and gearing of no more than 70% in order to obtain a BBB credit rating.

10.64 Table 10.13 to Table 10.15 suggest that all three GDNs are capable of financing their activities during the GD23 period via a prudent choice of capital structure.

11. Outputs, Outcomes & Allowances

Summary of Key Changes from Draft Determination

11.1 We have updated this chapter following on from the GD23 draft determination to reflect the impact of changes made. Key changes made in this context include:

(i) Update to the Impact on Consumer Bills;

(ii) Update to the Designated Values and Designated Parameters; and

(iii) Further clarification provided on the Capex Risk Sharing Mechanism.

Risk Sharing Mechanism

11.2 At present each GDN is subject to a capex risk sharing mechanism. The mechanisms have developed in different ways and have been introduced into the process in different ways;

- A Capex Roller Incentive Mechanism is included in the FE licence and was switched on for GD14 and GD17.

- Currently PNGL are subject to a Capex Roller Incentive calculation similar to FE but outside the licence, as 'switched on' for the PC03 Price Control. A supplemental document forms part of the PNGL12 Final Determination to describe this in detail.

- A Capex Roller Incentive Mechanism is also included in the SGN licence, however the condition is switched-off and replaced with a simpler mechanism within the uncertainty mechanism, as introduced in GD17.

11.3 For GD23, in the interest of simplicity and consistency, we have decided to switch off the capex roller mechanisms for FE and PNGL and apply an approach similar to that used for SGN throughout GD17.

11.4 The Capex Roller Incentive for GD23 will be amended to be a simple 35% symmetrical sharing of outperformance for all companies applied as part of the uncertainty mechanism.

11.5 In practice, this means that the company would take 35% reward or risk of all outperformance or underperformance on capex targets. An example of this is shown in Table 11.1 below.

Overspend/(underspend)	Uncertainty Mechanism Adjustment	Explanation
£100,000	£65,000	The GDN has overspent by £100k. Through the Capex Risk Sharing Mechanism they are entitled to retain 65% of this overspend, with consumers assuming the remaining 35% risk. This results in a total adjustment of £65,000 via the uncertainty mechanism to determined expenditure.
(£100,000)	(£65,000)	The GDN has underspent by £100k. Through the Capex Risk Sharing Mechanism they are only entitled to recover 35% of this overspend, resulting in a total adjustment of (£65,000) via the uncertainty mechanism to determined expenditure.

Table 11.1: Capex Risk Sharing Mechanism – Worked Example

11.6 The mechanism will be applied through the uncertainty mechanism after all other capex adjustments have been calculated.

Impact on Consumer Bills

11.7 Table 11.2 below sets out a summary of the impact on customers. The percentage columns look at the impact of our final determination on the distribution tariff compared to the GDNs submission and compared to the current tariff.

11.8 The modelling we have applied in the final determination produces an increase of 21%, 11%, and 8% to domestic distribution tariffs compared to the FE, PNGL, and SGN submissions respectively.

11.9 If we convert the increase in tariffs into the impact on customers' overall bills, this results in domestic customers paying around £38, £20, and £13 more per annum when compared to the FE, PNGL, AND SGN submissions respectively. For I&C customers, the difference would be larger. However, it should be noted that network charges only accounts for around 15% of the current tariff.

GDN	GD23 P1 tariff (pence per therm)	GD23 distribution tariff v BP submission	GD23 V GD17 distribution tariff
FE (Av. £2020)	54.01	21%	9%
PNGL (Sep £2020)	48.50	11%	7%
SGN (Av. £2020)	47.01	8%	42%

Table 11.2: Impact on Domestic Customer Bills

Designated Parameters and Determination Values

FE

11.10 Table 11.3 and Table 11.4 show the designated parameters and determination values respectively for FE.

Designated Parameter	Value					
	t=2023	t=2024	t=2025	t=2026	t=2027	t=2028
r_t	0.0157	0.0329	0.0497	0.0544	0.0544	0.0544
n	2028					
m	2022					
q	2045					
CPIH (Shall be RPI up to and including Formula Year 2022 and CPIH commencing Formula Year 2023).	108.9					
f_t	0.5					
w	5					
g	0					
h	0					
d	1					
l	33					

Table 11.3: FE – Designated Parameters

All values in £(000's)	£av. 2020						
Description (For Conveyance Categories i and Formula Years t)	**Determination Values**	**t=2023**	**t=2024**	**t=2025**	**t=2026**	**t=2027**	**t=2028**
Volume (therms)	$V_{E,i,t}$ (I)	22128	24237	27067	29595	31718	33782
Volume (therms)	$V_{E,i,t}$ (II)	7004	7276	7466	7911	7911	7911
Volume (therms)	$V_{E,i,t}$ (III)	5743	6039	6162	6236	6236	6236
Volume (therms)	$V_{E,i,t}$ (IV)	1865	1865	1865	1865	1865	1865
Volume (therms)	$V_{E,i,t}$ (V)	12456	12872	13045	13148	13148	13148
Volume (therms)	$V_{E,i,t}$ (Vi)	14787	16155	17038	17759	17835	17835
Capital Expenditure	$C_{E,t}$	12736	9807	9667	9932	9491	9486
Operating Expenditure	$O_{E,t}$	8535	8954	9455	9851	9910	10029
Annual Depreciation	$D_{E,t}$	8382	8631	8873	9084	9279	9423
Cash Flow (calculated in accordance with Condition 4.6.6)	$F_{E,t}$	4046	8427	10019	11158	12709	13710
Revenue Per Unit	$P_{E,i,t}$ (I)	0.5401	0.5401	0.5401	0.5401	0.5401	0.5401
Revenue Per Unit	$P_{E,i,t}$ (II)	0.3794	0.3794	0.3794	0.3794	0.3794	0.3794
Revenue Per Unit	$P_{E,i,t}$ (III)	0.3401	0.3401	0.3401	0.3401	0.3401	0.3401
Revenue Per Unit	$P_{E,i,t}$ (IV)	0.2701	0.2701	0.2701	0.2701	0.2701	0.2701
Revenue Per Unit	$P_{E,i,t}$ (V)	0.3187	0.3187	0.3187	0.3187	0.3187	0.3187
Revenue Per Unit	$P_{E,i,t}$ (Vi)	0.2895	0.2895	0.2895	0.2895	0.2895	0.2895
Total Revenue	$R_{E,t}$	25317	27188	29141	30942	32111	33225

Depreciated Asset Value (calculated in accordance with Condition 4.6.7)	$DAV_{E,t}$	217426	218602	219397	220245	220457	220520
Total Regulatory Value (calculated in accordance with Condition 4.6.8)	$TRV_{E,m}$						257626
Profile Adjustment	$PA_{E,m}$						37106

Table 11.4: FE – Determination Values

PNGL

11.11 Table 11.5 and Table 11.6 show the designated parameters and determination values respectively for PNGL.

Designated Parameter	Value					
	t=2023	t=2024	t=2025	t=2026	t=2027	t=2028
r_t	0.0106	0.0402	0.0596	0.0539	0.0539	0.0539
n	2028					
m	2022					
q	2046					
CPIH (Shall be RPI up to and including Formula Year 2022 and CPIH commencing Formula Year 2023).	109.2					

Table 11.5: PNGL – Designated Parameters

All values in £(000's)	£Sept. 2020						
Description (For Conveyance Categories i and Formula Years t)	**Determination Values**	**t=2023**	**t=2024**	**t=2025**	**t=2026**	**t=2027**	**t=2028**
Volume (therms)	$V_{E,i,t}$ (I)	91524	95535	101070	104823	107235	109600
Volume (therms)	$V_{E,i,t}$ (II)	17757	19241	20150	20415	20540	20664
Volume (therms)	$V_{E,i,t}$ (III)	30088	30770	31058	31117	31180	31243
Volume (therms)	$V_{E,i,t}$ (IV)	12256	13121	13611	13697	13697	13697
Capital Expenditure	$C_{E,t}$	18842	17816	17986	17014	13466	13293
Capital Creditors	$CC_{E,t}$	-5661	-5490	-5519	-5356	-4765	-4736
Operating Expenditure	$O_{E,t}$	18254	18234	18322	18497	18274	18378
Annual Depreciation	$D_{E,t}$	21795	22468	23155	23813	24184	24495
Cash Flow (calculated in accordance with Condition 4.6.6)	$F_{E,t}$	30263	33416	36633	38604	42455	45982
Working Capital	$Q_{E,t}$	-5701	-5241	-4756	-4480	-4266	-4094
Revenue Per Unit	$P_{E,i,t}$ (I)	0.4850	0.4850	0.4850	0.4850	0.4850	0.4850
Revenue Per Unit	$P_{E,i,t}$ (II)	0.4365	0.4365	0.4365	0.4365	0.4365	0.4365
Revenue Per Unit	$P_{E,i,t}$ (III)	0.4112	0.4112	0.4112	0.4112	0.4112	0.4112
Revenue Per Unit	$P_{E,i,t}$ (IV)	0.2068	0.2068	0.2068	0.2068	0.2068	0.2068
Total Revenue	$R_{E,t}$	67045	70097	73398	75376	76626	77853
Depreciated Asset Value (calculated in accordance with Condition 4.6.7)	$DAV_{E,t}$	470416	465764	460595	454619	445527	434325
Total Regulatory Value (calculated in accordance with Condition 4.6.8)	$TRV_{E,m}$						606263

Profile Adjustment	$PA_{E,m}$						180769

Table 11.6: PNGL – Determination Values

SGN

11.12 Table 11.7 and Table 11.8 show the designated parameters and determination values respectively for SGN.

Designated Parameter	Value					
	t=2023	t=2024	t=2025	t=2026	t=2027	t=2028
r_t	0.0146	0.0337	0.0422	0.0385	0.0404	0.0423
n	2028					
m	2022					
q	2057					
CPIH (Shall be RPI up to and including Formula Year 2022 and CPIH commencing Formula Year 2023).	108.9					
f_t	0.5					
W	5					
g	0					
h	0					
d	0					
l	33					
δ_t	0					
$X_{O,t}$	0					
$X_{U,t}$	0					
α_t	0.4					

Table 11.7: SGN – Designated Parameters

All values in £(000's)	£Av. 2020						
Description (For Conveyance Categories i and Formula Years t)	**Determination Values**	**t=2023**	**t=2024**	**t=2025**	**t=2026**	**t=2027**	**t=2028**
Volume (therms)	$V_{E,i,t}$	1071	1274	1576	1924	2248	2567
Volume (therms)	$V_{E,i,t}$ (II)	138	234	389	642	942	1228
Volume (therms)	$V_{E,i,t}$ (III)	439	558	626	730	855	879
Volume (therms)	$V_{E,i,t}$ (IV)	286	286	286	286	286	286
Volume (therms)	$V_{E,i,t}$ (V)	12038	12196	12994	13504	13504	13541
Volume (therms)	$V_{E,i,t}$ (VI)	0	0	0	0	0	0
Volume (therms)	$V_{E,i,t}$ (VII)	11242	11242	11242	11242	11242	11242
Capital Expenditure	$C_{E,t}$	4218	3758	4677	5626	3572	4169
Operating Expenditure	$O_{E,t}$	3069	3367	3577	3855	4023	4203
Annual Depreciation	$D_{E,t}$	1616	1639	1687	1764	1789	1908
Tax	$T_{E,t}$	0	0	0	0	0	0
Cash Flow (calculated in accordance with Condition 4.6.6)	$F_{E,t}$	-1132	-736	-1412	-2178	59	-414
Revenue Per Unit	$P_{E,i,t}$ (I)	0.4701	0.4701	0.4701	0.4701	0.4701	0.4701
Revenue Per Unit	$P_{E,i,t}$ (II)	0.4701	0.4701	0.4701	0.4701	0.4701	0.4701
Revenue Per Unit	$P_{E,i,t}$ (III)	0.4541	0.4541	0.4541	0.4541	0.4541	0.4541
Revenue Per Unit	$P_{E,i,t}$ (IV)	0.2586	0.2586	0.2586	0.2586	0.2586	0.2586
Revenue Per Unit	$P_{E,i,t}$ (V)	0.2586	0.2586	0.2586	0.2586	0.2586	0.2586
Revenue Per Unit	$P_{E,i,t}$ (VI)	0.2586	0.2586	0.2586	0.2586	0.2586	0.2586

Revenue Per Unit	$P_{E,i,t}$ (VII)	0.1957	0.1957	0.1957	0.1957	0.1957	0.1957
Total Revenue	$R_{E,t}$	6154	6390	6842	7303	7654	7958
Depreciated Asset Value (calculated in accordance with Condition 4.6.7)	$DAV_{E,t}$	40327	42447	45437	49299	51082	53343
Total Regulatory Value (calculated in accordance with Condition 4.6.8)	$TRV_{E,m}$						46334
Profile Adjustment	$PA_{E,m}$						-7009

Table 11.8: SGN – Determination Values

12. Business Plan Assessments

Summary of Draft Determination Responses

12.1 There are no changes from the draft determination to the final determination in relation to Business Plan Assessments. The assessments were carried out on the business plans submitted prior to the draft determination. However we did receive a number of draft determination consultation responses for this area, which we have outlined and provided a response to where appropriate.

12.2 Generally there was a positive response to the business plan assessment element of the price control process, especially from stakeholders involved in consumer protection, but it was suggested it could be refined through further engagement.

12.3 The GDNs highlighted a perceived contradiction with Utility Regulator's positive assessment result for their business plan versus the negative movement of their business plan requested allowances in the Utility Regulator's draft determination. To clarify, the business plan assessment is based on the extent and quality of the evidence in the submitted business plans, rather than actual numbers that the Utility Regulator could have a different of perspective on.

12.4 SGN commented that there were issues with transparency and engagement as the Utility Regulator had not sought further justification prior to draft determination for its proposed tariff increase that the Utility Regulator assessed as "needs further justification." They also highlighted issues with the timeframe of the Business Plan Assessment process, referring to the draft assessment document being issued so close to the publication of the draft determination that the Utility Regulator were unable to act on any feedback.

12.5 CCNI recommended that the questions on quality of engagement asked in Area 4, include a recognition of the need to specifically engage with vulnerable customers and incorporate their needs into the company's ongoing activities. They also questioned the effectiveness of the current approach to the self-assessment element, as the GDNs all rated their own assessments as exceptional. They suggested a trade-off system may be more effective, where if the GDN rated an assessment area very highly, this would reduce their ability to rate other assessment areas as highly.

12.6 We have noted these comments and suggestions from the GDNs and other stakeholders and we will continue our work with them on the development and implementation of the Business Plan Assessments for future price controls.

Overview

12.7 One of our aims for GD23 is that GDNs should produce high quality, well evidenced business plans which can be accepted following limited scrutiny.

12.8 When we set out our approach to GD23, we signalled that we planned to carry out an assessment of the GD23 Business Plan submissions.

Utility Regulator Assessment

12.9 We have reviewed the GDNs business plans and have made our own assessment of the submissions provided to us as follows:

- Overall, the FE business plan received a rating of **Good**.
- Overall the PNGL business plan was rated as **Good** with one area identified as **Exceptional**.
- Overall, the SGN business plan received a rating of **Good** with one area Meeting Basic Expectations.

12.10 Included for each GDN is an Annex that provides a more thorough summary of the approach used for our assessments, and the full assessments based on that approach.

- Annex M - FE BPA.
- Annex N - PNGL BPA.
- Annex O - SGN BPA.

13. Next steps for and Further Issues

Summary of Key Changes from Draft Determination

13.1 We have updated this chapter following on from the GD23 draft determination, following due consideration of the responses received to same. Key changes made in this context include an update on the Further Issues with additional issues considered to be beyond the scope of the GD23 price control determination.

Key milestones and Next Steps

13.2 Table 13.1 provides an overview over the Key milestones and associated timelines for the GD23 price control process.

GD23 Key Milestones	Timeline
GD23 FD and licence consultation published	28 October 2022
GD23 Licence Consultation period ends	25 November 2022
GD23 GDN licence modifications decision published	22 February 2023

Table 13.1: Price Control Process Key Milestones after Publication of GD23 Final Determination.

Consequential Changes

13.3 We consider that a number of consequential changes will be required as a result of the GD23 final determination. These will include the following:

- Alignment of the Annual/Cost Reporting templates and associated regulatory instructions and guidance with the GD23 final determination, where relevant and appropriate.
- Review of the GDN connection policies to ensure alignment with the GD23 final determination, where relevant and appropriate.

13.4 We note that this list is not exhaustive and that the need for further consequential changes may arise.

Further Issues

13.5 As part of this GD23 final determination we have identified a number of issues that we consider to be beyond the scope of the GD23 price control determination. Broadly speaking, these issues can be categorised as follows:

- Further consultation on a possible change of the regulatory model for PNGL and FE to take place at the start of the next price control period, GD29.

- Metering solutions.

- Resilience Projects review.

- Energy Strategy Projects.

Change in Ownership Structure

13.6 It is possible that any GDN could end up under common ownership. Under the terms of their licences, any change of ownership must be approved by the Utility Regulator.

13.7 Our expectation, in particular if any GDN came under common ownership, is that there may be synergies and other cost savings that can be achieved.

13.8 As a consequence, it may be appropriate to re-open this price control for any change of ownership depending on the exact timing. If the businesses come under common ownership we would seek to ensure that the resulting synergy cost savings are shared between the GDNs and consumers.

Lessons Learnt

13.9 In line with good regulatory practice, we plan to conduct a lessons learnt process to take place within the 1st year of 2023, after the GD23 price control process has been completed.

13.10 As part of this lessons learnt process we intend to capture feedback from the GDNs, key stakeholders as well as internally from our colleagues on key aspects of the price control process.

13.11 We wish to use this information to implement improvements to the way in which we conduct price controls and apply them to future price control processes, where reasonable and possible.