GD23 - Gas Distribution Price Control 2023-2028

Final Determination Annex D
Operational Expenditure
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 annex forms part of the Final Determination for the GD23 Gas Distribution Price Control. It details the approach, the GDN business plan requests, and the UR's (Utility Regulator) assessment of these requests, as well as the resulting UR proposals with respect to operational expenditure.

Audience

Industry, consumers and statutory bodies.

Consumer impact

The full implications of the effect on the consumer are covered in the GD23 Final Determination document that covers all aspects of the GD23 price control.

Contents

Executive Summary

This document forms part of the final determination for the GD23 price control for the three gas distribution network operators (GDNs) in Northern Ireland (NI). It reviews their business plans and sets out our initial conclusions on reasonable levels of operational expenditure for GD23.

Operational expenditure covers the costs of 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 24 cost categories which form the basis for the presentation of costs in this chapter and the structure of our detailed assessments. The structure is similar to the OFGEM RIGS. 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.

The table 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 and consultation responses received.

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.

To supplement this analysis, a breakdown of the opex cost categories requested by each GDN and allowed at final determination is provided. A brief explanation is provided after each table for the changes made to the major cost categories with the largest adjustments. A more detailed explanation of the adjustments is included in the remainder of this document.

FE Opex Summary (Pre-Efficiency)

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.

- 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.

- 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 (Pre-Efficiency)

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.

- 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).

- 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.

- 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.

- 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.

- 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. These reasons are that: 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 (Pre-Efficiency)

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	0.2
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.

- 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.

- 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.

- 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 area will unlikely to be given at the time of the next price control. This incentive will not apply to New Build sites.

1. Introduction

Purpose of this document

1.1 This document forms part of the final determination for the GD23 price control. This is the price control for the three gas distribution network operators (GDNs) in Northern Ireland (NI):

- Firmus Energy (Distribution) Limited (FE)
- Phoenix Natural Gas Limited (PNGL)
- Scotia Gas Networks Northern Ireland Ltd. (SGN)

The price control covers the 6-year period from 1 January 2023 onwards.

1.2 As an annex to the main GD23 final determination document, this document details the approach, business plan requests, and the UR's (Utility Regulator) assessment of these requests, as well as the resulting decisions in the Draft Determination. It also considers the consultation responses from respondents, in conjunction with further information requests and discusses the changes for the Final Determination, with respect to operational expenditure (opex).

Changes from Draft Determination to Final Determination

1.3 In Chapters 4 -6, a paragraph is included, that gives consideration to all consultation responses and briefly summarizes the key changes from the draft to the final determination

Structure of this document

1.4 This document is structured in a number of chapters as follows:

a) Chapter 1, Introduction, provides an overview of the purpose and structure of the document, as well as outlining the changes made from the draft determination to the final determination.

b) Chapter 2, Detailed Approach to Opex - UR Decisions, sets out the approach we have taken in assessing the opex-related requests made by the GDNs in their business plan submissions for GD23.

c) Chapter 3, Price Control Submissions - Opex, provides an overview of the context for the GDNs' opex requests. It also summarises, for each of the three GDNs, the opex allowance requests and related key points for GD23 as set out in the respective business plan submissions.

d) Chapter 4, Firmus Energy - UR Decisions, sets out our assessment of the opex allowances requested by FE as well as the decisions on allowances for the GD23 price control period.

e) Chapter 5, Phoenix Natural Gas - UR Decisions, sets out our assessment of the opex allowances requested by PNGL as well as the decisions on allowances for the GD23 price control period.

f) Chapter 6, SGN Natural Gas - UR Decisions, sets out our assessment of the opex allowances requested by SGN as well as the decisions on allowances for the GD23 price control period.

2. Detailed Approach to Opex - UR Decisions

Overview

2.1 This chapter complements the chapter on approach in the main GD23 final determination document. The approach set out in that main document, including in particular the application of our price control principles, is also relevant for our assessment of opex requests.

2.2 In addition, some aspects of our approach to the GD23 price control relate specifically to our opex assessment. These are detailed in this chapter.

2.3 Our detailed approach to the opex assessment is based on our Final Approach to GD23 price control[1].

2.4 Similar to our approach in the GD17 price control, we have undertaken a bottom-up assessment of the opex requests submitted by the GDNs, supported by targeted benchmarking of GDN costs in selected areas.

2.5 We have then adjusted the proposed pre-efficiency allowances for real price effects, and efficiencies to derive our final determination opex profiles, net of frontier shift.

2.6 We have furthermore considered the appropriateness of having an uncertainty mechanism, similar to that in the GD17 price control, and to include in this a new mechanism for dealing with the outcome of the Energy Strategy for Northern Ireland and the ongoing review into meter reading activities and other identified areas. The uncertainty mechanism is further detailed in the main GD23 final determination document and may lead to a retrospective adjustment of determined opex allowances. Further details on the energy strategy and metering specifically can be found in annex G and in Chapter 2 of the Main Document, with other areas identified in the appropriate areas.

2.7 We re-examined in depth our previous approach to GD17 benchmarking, alongside the issues raised at that time by the GDNs and the CMA, and considered the implications for GD23 benchmarking. To assist in this endeavour, we appointed CEPA consultants who were tasked with conducting some preliminary econometric top-down benchmarking of the GDNs for GD23.

[1] Utility Regulator: Gas Distribution Networks GD23 Price Control, Our Approach to GD23, November 2020.

2.8 We re-convened the GD17 CAWG, this time including SGN (NI) as our 3rdlocal comparator, and CEPA led discussion with a preliminary analysis on relative efficiency of local GDNs to GB counterparts.

2.9 On 3rd June 2020 the CAWG met with GDN representatives to hear and discuss CEPA's preliminary analysis and findings.

2.10 Despite CEPA and ourselves incorporating a great many data adjustments into our modelling dataset for FE and PNGL (to try to support as 'like for like' comparison of relatively young as well as smaller network GDNs locally with their more mature, larger comparators in GB), CEPA were unable to draw robust and meaningful conclusions from their opex top-down benchmarking with GB GDNs:

- Given the wide efficiency gap range (circa +/- 30%), it was too difficult for CEPA to conclude with any confidence whether PNGL and FE were either efficient or inefficient.
- CEPA's analysis highlighted the challenges of benchmarking Northern Ireland GDNs with GB GDNs.
- CEPA concluded benchmarking SGN (NI) to GB GDNs would not be appropriate for GD23, given their current scale and operating model.

2.11 For GD23 we found the lack of preliminary evidence to set any reliable catch-up efficiencies relative to the GB GDNs' recent performance as grounds for abandoning further top-down econometric benchmarking on this occasion.

2.12 This does not infer nor support the contention there are no further opportunities for local GDNs to release efficiencies for the consumer. Rather the complexity of relative efficiency comparison of our local GDNs is such that their dissimilarity at an aggregate, network level is such as to make this type of relative efficiency comparison unreliable at the present time.

2.13 We also considered the appropriateness of reallocating a portion of the operational expenditure allowances to be recovered by the GDNs through the connection incentive, similar to GD17 and GD14. For the GD23 final determination we have not reallocated any portion of operational expenditure allowances to be recovered under a connection incentive. The impact of this is to reduce risk on the GDNs.

Bottom-up assessment.

Overview

2.14 We have based our bottom-up opex assessment for GD23 on the same opex cost categories as those used in the GD17 price control and subsequent annual reporting. These are:

- Work Management
    - ♦ Asset Management;
    - ♦ Operations Management;
    - ♦ Emergency Call Centre (Customer Management);
    - ♦ Customer Management (Including Non-Emergency Call Centre) & Network Support (Including System Mapping); and
    - ♦ System Control.
- Work Execution
    - ♦ Emergency;
    - ♦ Metering;
    - ♦ Public Reported Escape (PRE) Reports;
    - ♦ Maintenance; and
    - ♦ Other Direct Activities.
- Business Support

- ♦ Information Technology (IT) & Telecoms;
- ♦ Property Management;
- ♦ Human Resources (HR) & Non-operational Training;
- ♦ Audit, Finance & Regulation;
- ♦ Insurance;
- ♦ Procurement;
- ♦ Chief Executive Officer (CEO) & Group Management; and
- ♦ Stores & Logistics.

- Other Opex Categories
  - ♦ Advertising & Market Development Owner Occupied (OO);
  - ♦ Advertising & Market Development (Non - OO);
  - ♦ Trainees & Apprentices; and
  - ♦ Non-Controllable Opex.

2.15 We have also carried out analysis on specific expenditure types, namely:

- Staff Costs and Agency Costs; and
- Network Rates.

2.16 In addition, we have considered the capitalisation policies provided by the GDNs as part of their business plan submissions and accepted these for the final determination.

2.17 We have also assessed and discussed the Supplier of Last Resort and Shrinkage.

2.18 Our approach to the bottom-up assessment of these individual cost categories, expenditure types and of the capitalisation polices is set out in the remainder of this section.

2.19 We note that in general, where applicable, we have reviewed any internal recharges and benchmarked them against prior years and against deemed efficient third party costs for any goods/services provided. In all cases, a 'value for money' approach has been adopted, to ensure consumers gain a fair deal in not having such goods/services outsourced on a third party arm's length transaction basis.

2.20 In completing our assessment for routine and non-routine metering, maintenance and emergency activities, we have considered how the expenditure projections submitted by the GDNs compare to historic activities and costs, after the increase in the customer asset base is taken into account.

2.21 We have paid particular attention to costs and activities that are not reflective of past experience and where material cost increases are evident. This includes new work items introduced by GDNs, for example, due to safety concerns, which have been considered on an individual basis.

2.22 For routine maintenance activity we have also considered how projections align with the age of assets and the required frequency of activity, based on industry guidance or best practice.

2.23 Comparative costs between GDNs have been considered in our analysis and costs have been adjusted to reflect our assessment of future connection numbers where appropriate.

2.24 Some of the work carried out in response to consumer requests or as a result of damage is off-set by contributions from consumers or third parties. In the individual cost category sections detailing our assessments for each GDN below, Business Plan costs and final determination allowances are reported net of contributions and capitalisation.

2.25 Where necessary, allowances for contributions and staff costs, including any associated capitalisation, have been amended to reflect the cost adjustments applied.

Asset Management

2.26 Asset Management covers the activity of managing the network's assets. The costs collated under asset management include costs incurred in the following areas:

- Network Planning;
- Network Integrity (including gas quality monitoring);
- Network Capacity;
- Network/engineering policy/procedures (covering all policies of the network e.g. records transfer and brought in services & materials);
- Network development/analysis; and
- Management of redundant sites & remediation programmes.

2.27 The GDN's asset management costs are in the main driven by its associated staff costs incurred in managing the network's assets. Our approach to determining staff costs is discussed for each GDN in the section referred to as Manpower in Chapters 4, 5 and 6.

Operations Management

2.28 Operations management includes the day to day planning and supervision of the operatives and contractors working within the work execution processes as follows:

- First Line Managers;
- Depot Managers;
- Safety, Health and Environmental; and
- Operations support.

2.29 The GDN's costs for these activities are driven by staff costs. Our approach to determining staff costs is discussed in section 2.107.

Customer Management (Emergency Call Centre)

2.30 The Emergency Call Centre cost category covers the activity associated with receiving and processing calls from the public, where the member of the public believes this relates to an emergency. Due to the potential safety implications, GDNs encourage the public to call the emergency hotline if they are in any doubt as to whether an emergency situation exists.

2.31 As the definition of an emergency is broad and subject to the perception of the caller, there are many instances where the relevant GDN discovers that no emergency exists once the reason for the call has been investigated.

2.32 The processing and reporting of emergency calls is broadly the same for each GDN, but there are some slight differences for calls that are not received on the emergency number.

2.33 All of the GDNs use Cadent as an emergency call handling service and use a common emergency contact number which goes straight to Cadent's call handling centre in England. This is intended to be the primary contact number for emergencies. Having received the call, Cadent logs it, processes it and, if necessary, arranges for an emergency response.

2.34 Each of the companies has a contract with Cadent. Charges are based on combination of fixed and variable costs. The fixed costs for FE and PNGL are based on a monthly call threshold which varies throughout the year on

the basis of the numbers of calls received in the past. For SGN this threshold is fixed at 50 calls per month. If call numbers remain below this threshold then there is no additional cost over and above the fixed monthly charge. If call numbers go above the threshold then they are charged at the variable rates specified in the contract for each type of call.

2.35 The service provided by Cadent is shared across the Northern Ireland GDNs from a resource perspective. Cadent then splits the overall associated management fee on the basis of the amount of work it estimates it will be undertaking for each GDN and reflects this in their individual contractual arrangements. This means that, while there are individual call thresholds and charges for each GDN, Cadent assesses its resourcing needs on the basis of the combined number of calls received on behalf of all the Northern Ireland GDNs. This is important as it means the driver for Cadent rebasing its resources, and the associated management fee charged to the GDNs, will be whether the cumulative GDN call threshold is being regularly exceeded, rather than the threshold for a particular GDN.

2.36 The GDNs also have direct lines on which they can be contacted for non-emergency matters. Inevitably some emergency calls come through on these business numbers. In most cases they are then simply transferred to Cadent for recording and processing. However, in some cases the GDN will record the details and arrange the response themselves.

2.37 The Cadent emergency call centre operates around the clock, whereas the GDN customer services and business numbers have specific operating hours. General calls taken on the customer services and business numbers outside normal operating hours must be re-routed to another call handling system. Some of the GDNs use services provided by a third party, whereas others route the out-of-hours calls straight to Cadent. These contrasting strategies make direct comparisons between the GDNs more difficult.

2.38 The key driver of costs in this expenditure category is the volume of calls, which is in turn driven by the number of connections.

2.39 In previous price controls we used a combined model to forecast the volume of emergency calls that would be received based on projected connection numbers. We revisited this model for GD23 to see if it could be used again, but found it to be unsuitable due to the need to incorporate SGN into the model, the different levels of maturity of each GDN and the variations in the call handling practices used by each company. We have therefore adopted company specific approaches to estimate call numbers in GD23. The approaches adopted for each GDN are explained in the company specific Emergency Call Centre sections below. The number of connections remains

the key driver for call volumes combined with consideration of historic rates of activity.

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

2.40 Customer Services (including non-emergency call centre) covers non-emergency calls and which also handle enquires and complaints. The non-emergency Customer Services also includes costs of the commercial/ contract department that manages all types of contracts for the whole of the business.

2.41 The GDN's costs for customer service and management activities are mainly driven by staff costs. Our approach to determining staff costs is discussed in section 2.107.

System Control

2.42 System control covers the costs associated with the activity of ensuring the safe flow of gas through the network, ensuring the supply is sufficient to meet the demand of gas on a daily basis. The related costs should represent the cost of running the control room (e.g. staff costs of resources working within the control room). Our approach to determining staff costs is discussed in section 2.107.

Emergency

2.43 The Emergency cost category covers the activity associated with the GDN's initial response to emergency calls received through the 'Customer Management (Emergency Call Centre)' cost category.

2.44 This activity often includes a more detailed phone discussion between the caller and a qualified member of staff who can ascertain the nature of issue and whether it is an emergency that requires further investigation. In most cases a first responder will be sent out to investigate the emergency, categorise it, and if possible, resolve it.

2.45 In some cases the initial responder will be able to rectify the issue and close the job at a relatively low cost. If this is not possible it will be scheduled for repair taking into account the urgency of the job and any mandatory response timescales. The highest priority jobs are those that involve a gas leak. They have the shortest mandatory response times and are dealt with under the 'Publically Reported gas Escape' (PRE) Repair cost category.

2.46 The contractors used to undertake emergency jobs are often redirected from the other work activities that they also undertake for the companies to deal with these more urgent issues.

2.47 There are legal obligations regarding the response time for Emergency Jobs and first responders. These apply to all the GDNs regardless of the number of customers served, or the size and layout of their operational area. Consequently the GDNs need to ensure that they have sufficient resources, situated in suitable locations and supported by appropriate operational practices to allow them to meet their mandatory obligations.

2.48 The key driver of costs in this expenditure category is the number and type of jobs, which is in turn driven by number of emergency calls received by the company. Our assessment applies historic rates for emergency jobs to projected emergency call numbers to estimate the volume of work.

2.49 In undertaking our analysis for GD23, we noted that the percentage of calls that become emergency jobs is very different across the GDNs. This difference was investigated and found to be due to internal processing and logging methods rather than representing a real difference in customer behaviour.

Metering

2.50 Metering covers the direct maintenance activity necessary to keep the meter asset base, including ancillaries such as regulators, in good working order.

2.51 It includes a broad range of planned and reactive work, including jobs carried out in response to consumer requests. Some of the customer requested work will be off-set by contributions from consumers.

2.52 The metering cost category incorporates activities such as planned inspection of pressure regulators, battery replacement on PAYG meters, repair/replacement of meter boxes and changing the type of meter installed as a consequence of consumer requests.

2.53 It excludes other network maintenance and emergency response work which is assessed and allowed for separately under different cost categories within the final determination.

2.54 Our assessment for routine and non-routine activities considered how the expenditure projections submitted compare to historic activities and costs, after the increase in the customer asset base is taken into account.

2.55 We have paid particular attention to costs and activities that are not reflective of past experience and where material cost increases are evident. This includes how routine maintenance projections align with the age of assets and the required frequency of activity based on industry guidance or best practice.

2.56 During GD23 the impact of an update to BS 6400 legislation, which moves the inspection timetable for medium pressure B6 regulators from 10 years to 5 years, will come into effect. These are the regulators used in domestic meters and because of the large numbers involved, this change will have a material impact on GDN activity levels and associated costs.

2.57 As part of our assessment we considered how the GDNs had interpreted and applied this requirement. As the update came into effect on 31 December 2018, we consider that it applies from 1 January 2019 in practice. On this basis, our view is that the first 5 years inspections would be required in 2024 (i.e. 5 years later) and so we excluded any related costs submitted by any GDN for 2023. One GDN challenged our approach in its response to the draft determination and so we took external advice on whether our interpretation was correct. This confirmed it was appropriate and so we have continued to exclude these costs in the final determination.

2.58 All of the GDNs have extended the 'principle' of the introduction of 5 year regulator inspections to medium pressure U16, U25 and U40 meter installations even though the new guidance only specifically applies to U6 meter installations. We have accepted this on the basis that it follows the practice adopted previously for 10yr inspections.

2.59 In our GD23 approach document we noted that we are proposing the transfer of meter reading responsibility from Suppliers to GDNs. This work is being progressed in parallel to the GD23 process and does not form part of the submissions made by the GDNs or our final determination. Further details on this work stream and ongoing work to implement a common solution for domestic pre-payment meters can be found in Chapter 2 of the final determination main document. This section of the main document also explains how any associated changes and costs might be dealt with.

PRE Repairs

2.60 The 'Publically Reported gas Escape' (PRE) Repair cost category covers the activity associated with the repair of mains and/or services where there is an escape of gas. These jobs arise when the initial first responder identifies that the emergency involves a gas leak and sends a crew to isolate the leak and effect the repair.

2.61 The contractors used to undertake the repairs are often redirected from the other work activities that they also undertake for the companies to attend these more urgent jobs.

2.62 As with Emergency Jobs, there are legal requirements regarding the response time that a company must meet when undertaking PRE Repairs and similar considerations with regard to the ability to meet these mandatory

timescales apply. These requirements apply to all the GDNs, regardless of the number of customers served, or the size and layout of their operational area.

2.63 Due to the safety implications associated with the escape of gas, PRE Repairs are considered the most urgent emergency jobs and have the shortest mandatory response times.

2.64 The key driver of costs in this expenditure category is the number of emergency jobs. Our assessment estimates the volume of work by applying historic rates for the number of PRE jobs to projected figures for the total number of jobs.

2.65 There are four categories of PRE Repairs. These are distinguished by the cause of the gas escape (third party damage or otherwise) and the type of asset (mains or services).

2.66 Third party damage is generally accidental damage caused when a third party is working in the vicinity of gas mains or services. In this circumstance the cost of the repair can be either be partially or fully recovered from the party at fault. Within the price control process, allowances are reported net of third party contributions.

Maintenance

2.67 Maintenance covers the direct activity necessary to keep the gas network in safe working order.

2.68 It includes a broad range of planned and reactive work on a range of network assets such as gas mains, pressure reduction stations, valves, telemetry installations and customer connections. This includes jobs carried out in response to customer requests, some of which will be off-set by contributions from consumers.

2.69 It excludes meter maintenance and emergency response work which is assessed and allowed for separately under different cost categories within the final determination.

2.70 Our assessment for routine and non-routine activities, considered how the expenditure projections submitted compare to historic activities and costs, after the increase in the customer asset base is taken into account.

2.71 We have paid particular attention to costs and activities that are not reflective of past experience and where material cost increases are evident. This includes any new work items introduced by GDNs, for example due to safety concerns, which have been considered on an individual basis.

Other Direct Activities

2.72 We assessed any costs for other direct activities on a case-by-case basis. The GDN's costs for other direct activities are mainly driven by staff costs. Our approach to determining staff costs is discussed in section 2.107.

IT & Telecoms

2.73 The IT & Telecoms cost category covers the provision of IT services for day to day service delivery and includes e.g. costs for Graphical Information Systems (GIS).

2.74 We have reviewed actual costs incurred and assessed the requested allowances against these in most circumstances. We have also benchmarked IT and Telecoms cost between the GDNs and reviewed the forecast split between opex and capex costs, where appropriate.

Property Management

2.75 The Property Management cost category covers the activity of managing, providing and maintaining non-operational premises. This includes costs such as: rent, rates (business), utilities costs including electricity, gas and water, maintenance/repair costs of premises and the provision of the facilities/property services such as: reception, security, access, catering, mailroom, cleaning and booking conferences.

2.76 A significant element of property management costs relates to network rates. Our approach to this specific expenditure type is covered below from paragraph 2.115.

2.77 For other expenditure types under this cost category, we have reviewed actual costs incurred and assessed the requested allowances against these.

HR & Non-operational Training

2.78 This cost category covers provisions of the HR function i.e. the full range of professional activity for an individual's career path from recruitment to retirement and post retirement where applicable, e.g. management and administration of pension payments and from related professional advice to directly resolving grievances for staff.

2.79 We have reviewed actual costs incurred and assessed the requested allowances against these.

Audit, Finance & Regulation

2.80 This cost category covers performing the statutory, regulatory and internal management cost and (business support activity) performance reporting

requirements as well as the customary financial and regulatory compliance activities for the network.

2.81 We have reviewed actual costs incurred and assessed the requested allowances against these. We have also benchmarked the costs associated with undertaking price controls between the GDNs, given that the work undertaken for price controls is of a very similar nature for all of the GDNs.

Insurance

2.82 This cost category covers support and expertise to develop the business risk profile, managing the claims process as well as provision of information and understanding to the business in relation to insurable and uninsurable risks.

2.83 We have undertaken a detailed review of the cost make-up of the insurance sub categories. This involved assessing requested allowances against actual costs occurred, as well as reviewing GDN's insurance costs over the medium term.

Procurement

2.84 This cost category covers the procurement of goods and services in the support of the business operations, through the management of procurement contracts with suppliers.

2.85 We have reviewed actual costs incurred and assessed the requested allowances against these.

CEO & Group Management

2.86 This cost category covers costs related to communications, group strategy, legal department, corporate responsibility and investor relations, board members, incremental ring fence compliance and credit reference agencies.

2.87 We have reviewed actual costs incurred and assessed the requested allowances and benchmarked where appropriate. For SGN CEO & Group Management costs relate to Managed Service Agreements (MSA) with other group companies. Our approach to SGN Group Management costs is outlined in section 6.140.

Stores & Logistics

2.88 This cost category covers the activity of managing and operating stores.

2.89 We have reviewed actual costs incurred and assessed the requested allowances against these.

Advertising & Market Development

2.90 This cost category covers costs related to advertising, marketing and PR, incentives as well as sales-related staff and shared corporate overheads.

2.91 The costs for Advertising & Market Development are classified into the following two categories:

- Advertising & Market Development - Owner Occupied (OO) properties; and
- Advertising & Market development (Non-OO) properties.

2.92 OO properties are those domestic premises which do not fall into the definition of:

- Domestic New Build; or
- NIHE or Housing Association.

In line with this definition, OO properties can also include private rented properties. Non-OO properties comprise all other domestic/domestic and I&C (Industrial and Commercial) properties.

2.93 Our approach to Advertising & Market Development for owner occupied properties has been informed by our review of the connection incentive.

2.94 Our approach to Advertising & Market Development for non-owner occupied properties was to review actual costs incurred and to assess the requested allowances against them, taking account of projected growth in non-owner occupied connections in the price control period.

2.95 We have given consideration to the apportionment of staff between the owner occupied and non-owner occupied categories. In doing so, we have considered both actual costs incurred and projected growth in connections for both categories.

Trainees & Apprentices

2.96 This cost category covers (i) the costs of any operational training and (ii) the cost of training any employees engaged on approved formal training or apprentice programmes (either operational or non-operational).

2.97 We have reviewed actual costs incurred and assessed the requested allowances against these.

Non-Controllable Opex

2.98 This cost category covers costs that are deemed as not being within the direct control of the GDN. In the GD17 price control, the only non-controllable cost allowed was licence fees.

2.99 For the GD23 price control, we have reviewed all items suggested to be non-controllable by the GDNs on a case-by-case basis to assess the appropriateness of this classification. For the GD23 final determination we have taken a similar approach as for GD17 and allowed licence fees as non-controllable costs.

Supplier of Last Resort (SOLR)

2.100 This area refers to circumstances where we revoke a gas supplier's licence (the defaulting supplier) and then subsequently give a direction[2] to another gas supply company (the SoLR supplier) to supply gas to the customers of the defaulting supplier. In a SoLR event, our intention is to direct a supplier within each distribution network area to be the SoLR supplier.

Shrinkage

2.101 The Shrinkage Factor is used to attribute shrinkage to gas flows and related suppliers, and is ultimately passed through to supplier tariffs, paid for by customers.

2.102 In December 2017, the GDNs provided the Northern Ireland Shrinkage Methodology. The methodology was developed jointly by the three GDNs. It sets out what shrinkage is and how the Shrinkage Factor is to be determined.

2.103 In line with the Northern Ireland Shrinkage Methodology, the Shrinkage Factor is calculated in the following way:

2.104 $$Shrinkage\ Factor = \frac{Gas\ Leakage + Own\ Use\ Gas + Theft\ of\ Gas}{Volume\ of\ Gas}$$

2.105 Where:

- Gas Leakage = Leakage from MP and LP Systems + Leakage from Pressure Reduction Installations + Leakage because of Interference Damage.
- Theft of Gas = Theft of Gas factor x Volume of Gas.

[2] Gas (Supplier of Last Resort) Regulations (Northern Ireland) 2009: http://www.legislation.gov.uk/nisr/2009/412/made/data.pdf

- Own Use Gas = Own use Gas factor x Volume of Gas.

2.106 It is noted that whilst the methodology and formula for calculating the shrinkage factor is consistent across the three GDNs, the actual shrinkage factor, and the relative importance of the different shrinkage components, can differ due to specifics of the networks.

Staff Costs and Agency Costs

2.107 Staff Costs include any form of payment, consideration or other benefit, paid or due to or in respect of employees. This also covers all staff-related additional costs that can be calculated using the presented drivers (for example, commission, entertainment, allowances, travel and subsistence, car allowance and fleet costs). Agency Costs cover costs for persons who are not under a direct contract of employment with the GDN or an affiliate of the GDN, but are hired through a third party or employment agency.

2.108 Staff Costs and Agency Costs form part of most of the cost categories within the Business Plan and Annual Cost Reporting Templates; however, they are not a cost category in themselves.

2.109 For this reason, we have not set an individual allowance for Staff Costs and Agency Costs as part of the GD17 price control, and we have applied a similar approach for the GD23 price control.

2.110 Our methodology for assessing the appropriate FTE levels for the engineering cost categories (covering Emergency Call Centre, Emergency, Metering, PRE Repairs and Maintenance) has changed for the final determination. In the draft determination we had adjusted the requested annual FTE levels in proportion to the annual adjustments we had made to activity costs. This resulted in FTE levels falling in some years where the GDNs had not proposed a year on year decrease, even though activity costs had continued to rise. To address this problem in the final determination, we considered the requested FTE allowance for each cost category individually and based our allowances on the following criteria:

- Historic GD17 FTE levels, relative to activity and expenditure.
- Submitted GD23 FTE levels, relative to activity and expenditure.
- Step changes in activity and expenditure levels, with larger step changes resulting in more material changes in FTEs.

2.111 Our final determination methodology for assessing FTEs for the engineering cost categories has resulted in an increase from draft determination levels for all three GDNs.

2.112 Furthermore, we have sought to standardise the method used to estimate the FTE cost allowance for the engineering cost categories with the approach adopted for the other Opex cost categories. We have therefore used a single base year unit cost to estimate the annual salary allowances for the determined number of FTEs throughout the GD23 period.

2.113 For the other non-engineering cost categories we have continued to review actual costs incurred and assessed the requested allowances against these, taking into consideration any evidence provided by the GDNs as to why the projected Full-Time Equivalents (FTE) and associated costs should differ from the base year and medium term historic actuals.

2.114 In addition, we have assessed assumptions around all inputs/driver data for Staff Costs and Agency Costs for reasonableness through benchmarking and actual outputs from previous years, where deemed appropriate.

Network Rates

2.115 This cost category covers the prescribed rates levied on distribution network assets.

2.116 For determining network rates allowances, we have retained the formula-based calculation in relation to network rates in line with our approach for the GD17 price control. However, we have considered whether the multiplier assumptions applied to revenue and the agreed rateable values as advised by the Land & Property Services (LPS) should be adjusted. For the final determination we have profiled a 'flat rate in the pound' for all years in GD23 for all the GDNs and this is a consistent approach to network rates for both FE and SGN in GD17.

2.117 We expect GDNs to be able to demonstrate that they have taken all steps to minimise their rates valuations and have considered any related evidence presented.

Capitalisation

2.118 We have assessed the capitalisation policies and resulting proposed capitalisation rates with specific focus on any differences compared to those used in previous years.

Real price effects, productivity and frontier shift

2.119 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

2.120 The price of a company's inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad

changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH).

2.121 However, not all types of cost changes experienced by a network business will be reflected in the basket of prices used to calculate the general inflation measure.

2.122 To account for this it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

2.123 Their calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs). Inclusion of the projected rate of productivity growth gives the frontier shift. The sum of these components can be a positive or a negative difference.

2.124 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

2.125 We have adopted the methodology similar to that which we first introduced at PC13 for NI Water. This aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

2.126 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are presented in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	6.9	7.8	4.5	2.7	2.8	3.1	3.1	3.1
CPIH	(2.5)	(8.0)	(5.6)	(2.3)	(1.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift (annual)	CPIH +3.2	CPIH -1.2	CPIH -2.0	CPIH -0.6	CPIH +0.6	CPIH -0.1	CPIH -0.1	CPIH -0.1
Cumulative frontier shift	3.2	2.0	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2

Table 2.1: GD23 Opex frontier shift calculations

2.127 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

2.128 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

3. Price Control Submissions - Opex

Overview

3.1 This chapter is complemented by the introduction and price control submissions chapters in the main GD23 final determination document.

3.2 The introduction chapter in the main GD23 final determination document provides a high-level overview of the GDNs' networks and the strategic context within which the price control is undertaken.

3.3 When assessing the appropriateness of the assumptions made and allowances requested by the GDNs as part of their business plan submissions, it is important to do this with consideration of the stage of network development at which each GDN is and of the strategic background against which the GDNs are operating.

3.4 In particular, on an overall level, the FE and PNGL networks are now well established and largely developed. As such, and subject to the new Energy Strategy for NI, further network development is anticipated to be limited going forward compared to previous price control periods. It is anticipated that the numbers of properties passed from 2024 onwards will be mainly driven by new build developments. Whilst increasing connections to maximise the use of and benefit from the network remains important, maintenance requirements can also be expected to increase as the network ages.

3.5 The SGN network is comparatively newer, and its development will continue into the GD23 price control period. Whilst SGN notes itself that it will be transitioning from a construction and infrastructure delivery company to a customer service company during the GD23 price control period, the construction of further mains, the increase in numbers of properties passed as well the increase of connections will remain important.

3.6 Whilst the price control submissions chapter in the main GD23 final determination document provides an overview of the overall GDN performance during the GD17 price control period this chapter focuses specifically on the GDNs' opex requests.

3.7 Since the draft determination, the GDNs have provided draft summary 2021 information (submitted at the end of June 2022) of its 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 this information, 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. We made such an exception in relation to the number of FTEs employed during 2021 as we considered most of the information submitted in this area for 2021 was reasonable and appropriate detail had been provided. Therefore, a review has been made in some areas, with some cost increases allowed, as detailed below.

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 performance was similar to 2020 in its total expenditure

3.9 More specifically, this chapter provides, for each GDN, an overview over the requested opex allowances, associated key targets as well as opex-related key points highlighted by the GDNs in their submissions. We note that it does not cover our view with respect to the submissions; this is detailed in chapters 4, 5 and 6 of this document.

Firmus Energy GD23 opex requests

3.10 Table 3.1 provides an overview of the opex allowances requested by FE in its business plan submission.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	112	113	114	114	115	116	684
Operations Management	309	312	314	321	324	326	1,906
Emergency Call Centre	293	306	319	331	344	356	1,949
Customer Management	354	357	361	364	367	371	2,174
System Control	302	304	305	310	311	313	1,845
Emergency	916	985	1,054	1,124	1,194	1,265	6,538
Metering	971	1,021	1,054	1,200	1,273	1,302	6,821
Publically Reported gas Escape (PRE) Repairs	119	127	135	164	174	183	902
Maintenance	769	775	833	878	927	950	5132
Other Direct Activities	0.3	0.3	0.3	0.3	0.3	0.3	1.8
IT & Telecoms	783	711	701	724	726	729	4,374
Property Management	1,104	1,155	1,191	1,229	1,256	1,281	7,216
HR & Non-operational Training	138	139	139	140	140	141	837
Audit, Finance & Regulation	831	838	844	850	1,156	863	5,382
Insurance	326	326	326	326	326	326	1,956
Procurement	19	19	20	20	20	20	118
CEO & Group Management	226	228	229	231	232	234	1,380
Stores & Logistics	18	18	20	20	20	20	116
Advertising & Market Development - Owner Occupied (OO)	1,692	1,618	1,536	1,454	1,378	1,306	8,984
Advertising & Market Development (Non-OO)	224	226	227	229	230	232	1,368
Trainees & Apprentices	158	73	73	73	74	74	525
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	175						175
Total	9,889	9,701	9,845	10,152	10,637	10,458	60,684

Note 1. Figures may not sum due to rounding.

Table 3.1: FE opex requests as per business plan submission, £k (Average 2020 prices)

3.11 From Table 3.2 we can observe that FE is seeking higher allowances in GD23 when compared to actual opex in 2020. On average, FE is seeking £2.9 million more allowance per year of GD23 than it spent in 2020, which is a real increase of 40%.

3.12 FE expects to deliver more connections on average in GD23 than it delivered in 2020. This reflects the FE plan for developing its network in the GD23

period. The projected connections are significantly higher than those achieved in 2020 (2,604), but marginally less than those which FE expects to connect in 2021 (3,695) and 2022 (3,961).

Cost Items	2017	2018	2019	2020	2021	2022	Average GD17
	Actual	Actual	Actual	Actual	Forecast		
Opex, £m	6.9	7.1	7.0	7.2	8.7	8.7	7.6
OO Connections	2,224	2,395	3,115	2,604	3,695	3,961	2,999
Cost Items	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Average GD23 Submission**
	FE GD23 submission						
Opex, £m	9.9	9.7	9.8	10.2	10.6	10.5	10.1
OO Connections	3,852	3,685	3,524	3,371	3,224	3,084	3,457

Note 1. Figures may not sum due to rounding. Note 2. Figures for 2017 to 2020 exclude HA.

Table 3.2: FE GD23 Submission, £m

3.13 In addition to requested opex allowances, FE has also set out in its business plan submission its targets for additional properties passed, connections and volumes as shown in Table 3.3.

	2023	2024	2025	2026	2027	2028	GD23 Total
Properties Passed	3,514	1,643	1,584	1,514	1,507	1,500	11,262
Connections	6,500	6,335	6,171	6,016	5,866	5,724	36,612
Volume (million therms)	2.9	3.9	2.2	2.1	1.6	1.4	14.1

Note 1. Figures may not sum due to rounding.

Table 3.3: FE additional properties passed, connections and volumes as per business plan submission

3.14 Table 3.4 shows FE's forecast of the total properties passed numbers, connection numbers and volumes for each year in the GD23 price control period.

	2023	2024	2025	2026	2027	2028
Properties Passed (in thousands)	195.6	197.3	198.9	200.4	201.9	203.4
Connections (in thousands)	73.0	79.3	85.5	91.5	97.4	103.1
Volume (million therms)	75.5	79.4	81.6	83.7	85.3	86.7

Note 1. Figures may not sum due to rounding.

Table 3.4: FE total properties passed, connections and volumes as per business plan submission

3.15 FE has highlighted in its business plan submission the following key points:

- Enhanced focus on maintenance related activities associated with growth, maturity and safety of the network and to comply with changing requirements (e.g. increase in frequency of inspection of medium pressure regulators).
- Growing customer base leading to increased cost for gas emergency calls and responses.
- Increase in staff levels by circa 3.5 FTEs compared to current levels, of which three FTEs are to reflect the uplift in maintenance activities and half an FTE to cover additional regulatory reporting and stakeholder engagement (including with respect to consumer protection).
- Requested increase in connection incentive allowance for OO connections to reflect increased advertising and marketing requirements.
- Anticipated increase in network rates payable to LPS, calculated as a function of FE's conveyance revenue.
- Increase in professional and legal fees by circa £300k in the years leading up to the next price control period to reflect consultancy advice required.
- Projected increase in IT Cost with forecasts reflective of incremental customer and staffing requirements, current managed service contract for IT and projected costs for the licencing and use of a new IT platform, forecast to be purchased in 2022.
- Sustained higher level of insurance costs following significant increase in 2021 driven by the COVID-19 pandemic and Brexit.

Phoenix Natural Gas GD23 opex requests

3.16 Table 3.5 provides an overview of the opex allowances requested by PNGL in its business plan submission.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	282	282	282	282	282	283	1,693
Operations Management	563	564	552	553	554	555	3,341
Emergency Call Centre	461	461	461	461	461	461	2,766
Customer Management	884	870	859	861	861	861	5,196
System Control	146	146	146	146	146	146	876
Emergency	1,443	1,471	1,488	1,518	1,548	1,578	9,046
Metering	1,541	2,414	2,453	2,682	2,591	2,685	14,366
Publically Reported gas Escape (PRE) Repairs	934	946	956	968	981	995	5,780
Maintenance	3,277	2,901	2,588	2,276	2,253	2,221	15,516
Other Direct Activities	0	0	0	0	0	0	0
IT & Telecoms	535	535	581	575	578	575	3,379
Property Management	3,681	3,790	3,855	3,994	4,061	4,594	23,976
HR & Non-operational Training	272	273	273	273	273	273	1,637
Audit, Finance & Regulation	1,069	1,066	1,067	1,068	1,168	1,170	6,608
Insurance	1,054	1,063	1,066	1,071	1,080	1,089	6,423
Procurement	78	78	78	78	78	78	468
CEO & Group Management	1,785	1,785	1,785	1,786	1,786	1,786	10,713
Stores & Logistics	32	32	32	32	32	32	192
Advertising & Market Development - Owner Occupied (OO)	1,323	1,321	1,318	1,278	1,277	1,277	7,794
Advertising & Market Development (Non-OO)	542	545	548	542	544	545	3,266
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	158	158	158	158	158	158	948
Supplier of Last Resort	343						343
Total	20,403	20,701	20,546	20,602	20,712	21,362	124,328

Note 1. Figures may not sum due to rounding.

Table 3.5: PNGL opex requests as per business plan submission, £k (September 2020 prices)

3.17 From Table 3.6 we can observe that PNGL is seeking higher allowances in GD23 when compared to actual opex in 2020. On average, PNGL is seeking £4.8 million more allowance per year of GD23 than it spent in 2020, which is a real increase of 30%.

3.18 PNGL expects to deliver less connections on average in GD23 than it delivered in 2020. This reflects the PNGL plan for developing its network in

the GD23 period. The projected connections are significantly lower than those achieved in 2020 (5,311), and less than those which PNGL expects to connect in 2021 (5,000) and 2022 (4,700).

Cost Items	2017	2018	2019	2020	2021	2022	Average GD17
	Actual	Actual	Actual	Actual	Forecast		
Opex, £m	15.4	15.2	15.7	15.9	17.5	18.4	16.4
OO Connections	5,350	5,970	6,334	5,311	5,000	4,700	5,444
Cost Items	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Average GD23 Submission**
	PNGL GD23 submission						
Opex, £m	20.4	20.7	20.6	20.6	20.7	21.4	20.7
OO Connections	4,522	4,159	3,727	3,612	3,502	3,396	3,820

Note 1. Figures may not sum due to rounding.

Table 3.6: PNGL GD23 Submission, £m

3.19 In addition to requested opex allowances, PNGL has also set out in its business plan submission its targets for additional properties passed, connections and volumes as shown in Table 3.7.

	2023	2024	2025	2026	2027	2028	GD23 Total
Properties Passed	5,579	3,265	3,365	3,465	3,564	3,564	22,802
Connections	7,322	7,059	6,727	6,637	6,627	6,521	40,893
Volume (million therms)	1.9	1.7	1.5	1.3	1.2	1.1	8.6

Note 1. Figures may not sum due to rounding.

Table 3.7: PNGL additional properties passed, connections and volumes as per business plan submission

3.20 Table 3.8 shows PNGL's forecast of the total properties passed numbers, connection numbers and volumes for each year in the GD23 price control period.

	2023	2024	2025	2026	2027	2028
Properties Passed (in thousands)	368.7	371.9	375.3	378.8	382.3	385.9
Connections (in thousands)	258.0	265.0	271.7	278.4	285	291.5
Volume (million therms)	167.3	169	170.5	171.8	172.9	174

Note 1. Figures may not sum due to rounding.

Table 3.8: PNGL total properties passed, connections and volumes as per business plan submission

3.21 PNGL has highlighted in its business plan submission the following key points:

- Increasing maintenance and inspection programme to ensure PNGL's network continues to deliver a safe and reliable supply of gas to consumers as well as meeting changing legislative requirements (e.g. increase in frequency of inspection of medium pressure regulators).
- Anticipated increase in network rates payable to LPS.
- Sustained higher level of insurance costs following significant increase in 2021, driven by a hardening of the market in respect of Business Interruption insurance and Directors and Officers insurance and the anticipation of crime and cybersecurity attacks on companies to be becoming increasingly prevalent.
- Growing customer base leading to increased cost for provision of emergency service.
- Growing customer base and reduction of infill activities leading to increased cost for PRE Repairs.
- Changes to staff levels (both for the last two years of GD17 into the new price control period and for the new price control period itself) to support increasing maintenance programme and reinforcement, reflect reduction in domestic sales based on forecast connection activity and account for additional operational regulatory requirements (relating e.g. to NI's energy transition, consumer engagement, consumer protection and vulnerability as well as to the ongoing review of metering solutions and meter reading responsibility).
- Proposed continuation of connection incentive, with costs allocated to this mechanism expected to be similar to GD17 in the first half of GD23 and to then slightly reduce with reduction in sales force as the forecast level of connection reduces.
- Anticipated change in the profile of some IT costs from capex to opex, as a result of IT suppliers moving to annual product licensing rather than perpetual licences.
- Increase in annual costs of audit, finance and regulation in the last two years of the GD23 price control period due to workload implications and need for specialist support during times of price control.

SGN Natural Gas GD23 opex requests

3.22 Table 3.9 provides an overview of the opex allowances requested by SGN in its business plan submission.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	40	40	43	60	47	47	277
Operations Management	247	247	269	279	281	281	1,604
Emergency Call Centre	105	105	105	106	138	138	697
Customer Management	48	48	64	65	67	67	359
System Control	53	53	55	56	58	58	333
Emergency	176	180	184	198	193	195	1,126
Metering	80	84	132	151	185	205	837
Publically Reported gas Escape (PRE) Repairs	13	13	15	16	17	17	91
Maintenance	449	575	468	463	513	498	2,966
Other Direct Activities	6	6	6	6	6	6	36
IT & Telecoms	136	136	136	138	145	145	836
Property Management	319	381	394	408	424	441	2,367
HR & Non-operational Training	11	11	11	11	12	12	68
Audit, Finance & Regulation	322	322	322	353	714	414	2,447
Insurance	8	8	8	8	8	8	48
Procurement	6	6	6	6	7	7	38
CEO & Group Management	400	400	400	400	650	500	2,750
Stores & Logistics	0	0	0	0	0	0	0
Advertising & Market Development - Owner Occupied (OO)	1,286	1,246	1,263	1,334	1,324	1,320	7,773
Advertising & Market Development (Non-OO)	376	419	474	591	564	545	2,969
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	85						85
Total	4,216	4,329	4,404	4,702	5,403	4,955	28,008

Note 1. Figures may not sum due to rounding.

Table 3.9: SGN opex requests as per business plan submission, £k (Average 2020 prices)

3.23 From Table 3.10 we can observe that SGN is seeking higher allowances in GD23 when compared to actual opex in 2020. On average, SGN is seeking

£2.1 million more allowance per year of GD23 than it spent in 2020, which is a real increase of 81%.

3.24 SGN expects to deliver a similar number of connections on average in GD23 than it delivered in 2020. This reflects the SGN plan for developing its network in the GD23 period. The projected connections are broadly in line with those achieved in 2020 (593), and less than those which SGN expects to connect in 2021 (752) and 2022 (811).

Cost Items	2018	2019	2020	2021	2022	Average GD17
	Actual	Actual	Actual	Forecast		
Opex, £m	1.1	1.5	2.6	3.7	3.4	2.5
OO Connections	127	82	593	752	811	473
Cost Items	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**Average GD23 Submission**
	SGN GD23 submission						
Opex, £m	4.2	4.3	4.4	4.7	5.4	5.0	4.7
OO Connections	623	593	599	652	643	640	625

Note 1. Figures may not sum due to rounding.

Table 3.10: SGN GD23 Submission, £m

3.25 In addition to requested opex allowances, SGN has also set out in its business plan submission its targets for additional properties passed, connections and volumes as shown in Table 3.11.

	2023	2024	2025	2026	2027	2028	GD23 Total
Properties Passed	2,944	2,873	3,181	4,414	1,794	1,736	16,942
Connections	972	933	984	1,122	977	1,017	6,005
Volume (million therms)	1	1	1	1	1	1	5.2

Note 1. Figures may not sum due to rounding.

Table 3.11: SGN additional properties passed, connections and volumes as per business plan submission

3.26 Table 3.12 shows SGN's forecast of the total properties passed numbers, connection numbers and volumes for each year in the GD23 price control period.

	2023	2024	2025	2026	2027	2028
Properties Passed (in thousands)	30.0	32.9	36.1	40.5	42.3	44.0
Connections (in thousands)	4.4	5.3	6.3	7.4	8.4	9.4
Volume (million therms)	30.6	31.4	32.3	33.1	34.1	35.0

Note 1. Figures may not sum due to rounding.

Table 3.12: SGN total properties passed, connections and volumes as per business plan submission

3.27 SGN has highlighted in their business plan submission the following key points:

- Increased cost for inspection and maintenance as network grows and ages.
- Anticipated increase in retainer for emergency call centre provision from 2027 onwards.
- Growing network leading to increased number of PREs that require attendance and associated cost.
- Increase in IT costs in line with projected number of connections.
- Anticipated increase in network rates payable to LPS.
- Consultancy support annually with focus on regulatory modelling in addition to support preparation of the next price control.
- Increased cost for business support under a managed service agreement with the SGN group, reflective of the expanded service requirements as the business grows as well as additional group regulation support in preparation of the next price control.
- Anticipated increase in staff levels by circa 12.4 FTEs at the start of the price control period and 17.4 FTEs by the end of the price control period compared to 2020 levels, in line with the growth of the network and additional connections.

4. Firmus Energy - UR Decisions

Summary of Key Changes from Draft Determination to Final Determination

4.1 The final determination is made after carefully considering all the consultation responses, along with any further information supplied by the GDN's and engagement with the companies. The key changes are as follows:

- We have increased the allowance per new customers connected in AMD (OO) to maximise the number of connections possible.
- We have provided funding of 1% of Totex to enable backing of projects related to the Energy Strategy.
- We have provided potential additional funding in IT and Telecoms that is subject to the uncertainty mechanism and ring fenced, due to the uncertainty of timing of a specific material piece of work.
- We have moved in some areas from using the 2020 year where persuasive evidence has been provided, to ensure there is a more appropriate funding level for the GD23 period.
- Emergency Call Centre: We have rebased the Cadent management fee and increased call thresholds twice during the GD23 period which has resulted in an increased allowance. This adjustment is based on an estimation of when Cadent will need to increase its resources as a consequence of the combined call volume exceeding the capacity of its allocated resource.
- Emergency: The final determination changes in the emergency cost category were minor and related to our updated forecasts for connection numbers and FTE levels. All other draft determination adjustments and principles remain unchanged.
- Metering: The cost deduction for large I&C meters is no longer being applied and an allowance has been provided for an increase in battery costs. These additions have largely been balanced by cost reductions associated with the adjustment of the medium pressure percentages applied to U6 domestic regulators and the impact of lower connection number estimates. The non-routine maintenance deduction noted as an omission in the draft determination has now been applied.

- PRE Repairs: The final determination changes in the PRE Repairs cost category were minor and related to our updated forecasts for connection numbers and FTE levels. All other draft determination adjustments and principles remain unchanged.

- Maintenance: The valve cover replacement cost deduction is no longer being applied and the Daily Metered Site reduction has halved as a result of further information provided. Governor maintenance costs have been reassessed using updated data and an allowance has been provided for removing below ground governors being replaced by above ground District units. The leak survey allowance has been reduced in line with a revised proposal submitted by FE.

4.2 The full detail is contained within the appropriate sections below

Overview

4.3 As set out in chapter 2, we have used bottom-up analysis as the basis for our assessment of opex business plan requests and the consultation responses received from the draft determination.

4.4 We note that, in line with our detailed approach set out in chapter 2, we have assessed the requested opex allowances for the different cost categories. We have also undertaken additional analyses for selected expenditure types and proposed capitalisation policies. The bottom-up part of this chapter is structured accordingly.

4.5 We note furthermore that, in line with our detailed approach set out in chapter 2, we have generally used the most up to date detailed actuals[3] as part of our assessment of business plan requests, i.e. data relating to 2020 and considering the summary 2021 where it is available, which has not been fully scrutinized at this point. We consider that this provides a sound basis to inform a benchmark where appropriate. In some circumstances, however, there were good reasons for deviating from this approach, and a further explanation is given in the relevant areas.

4.6 As was the case for the GD17 price control, greater scrutiny has been exercised over those cost categories that represent the greatest cost or where a material cost change is evident. We have also considered the extent to which some cost items must be separately examined because of the particular way they are treated (e.g. pass-through), or due to other

[3] See Section 3.7

specific circumstances they warrant individual treatment, irrespective of their magnitude.

4.7 The FE Supply business is undergoing a price control (SPC 23) in 2022, which is due to take effect from the 1 January 2023. We are reviewing this work area alongside GD23 to examine any connected issues/areas as appropriate, including costs classified as either capex or opex and the split of FTEs and costs between the two businesses. We have updated the GD23 final determination to take account of this workstream.

4.8 In its GD23 submission FE advised that it had applied a cost pressure uplift of 5% to the unit rates for work due to be completed by its period contractor in GD23. Other GDNs have applied similar uplifts to capex but FE is the only GDN that has extended the application to its opex cost categories (e.g. maintenance and emergency activities). Consistent with our approach for capex, we have removed this uplift from contactor cost allowances when undertaking our opex assessments. Any other cost challenges applied have been calculated net of the 5% uplift to ensure there is no double counting.

Operating leases

4.9 FE informed us in its GD23 business plan submission that 'during 2019, the Company applied IFRS16 Leases resulting in recognition of lease assets, particularly building rental and motor vehicle leases, on the balance sheet with amortisation of those assets reflected through the Income Statement. While this is still a real cost to FE, this change effectively moved the lease costs from operating costs to an amortisation cost' and 'to aid comparison to the GD17 Determination and to ensure these cost allowances are not overlooked, building rental and motor vehicle leases have been treated as operating costs in our GD23 submission'.

4.10 We note however that these costs were excluded by FE when it compared its 2020 costs to GD17 final determination allowances although FE did discuss these leases, for example, the FE 2020 annual cost and reporting template commentary states 'costs for building rental and vehicle leasing (circa £100k) are no longer reported in our operating costs and this is part of the reason why operating costs are lower than determined allowances.' While we have taken account of these leases for the GD23 final determination we have also modified FE opex analysis of opex performance against GD17 determination allowances to take account of these leases.

4.11 Our approach to determining the value of operating leases into the GD23 period has been to roll forward actual costs of operating leases from the 2020 year. The value of these leases was circa £38k for vehicles and circa £60k for buildings.

Bottom-up assessment

Manpower

4.12 Given that manpower is such an integral part of the price control, we consider the number of FTE necessary to run an efficient business; it is therefore appropriate to determine the cost allowance at the overall manpower level.

4.13 In common with GD17, we have not set explicit FTE allowances for the individual cost categories, since manpower forms part of most of the cost categories within the Annual Cost Reporting Template, rather than being an individual cost category. We consider that it is the choice of the GDN to decide where to allocate its resources, as business needs develop.

	GD17					
	2017	2018	2019	2020	2021	2022
FE Requested Allowances	67.2	67.2	67.2	67.2	67.2	67.2
UR Determination	58.3	58.3	58.3	58.3	58.3	58.3
FE Actual	58.1	63.7	66.6	70.3	70.5	71.7
	GD23					
	2023	2024	2025	2026	2027	2028
FE Requested Allowances	71.8	71.8	72.8	73.8	73.8	73.8
UR Determination	70.2	70.2	71..0	71.9	71.9	71.9

Note 1. Figures may not sum due to rounding. Note 2. The year 2022 is forecast.

Table 4.1: FE FTEs Requested, Actuals and GD23 Determined

4.14 Table 4.1 sets out the FE requested allowances for FTEs for both GD17 and GD23. It can be observed that FE actual number of FTEs for 2020 was above our GD17 allowances by 20%. It can also be observed that FE's FTEs have also increased by 20% since 2017. Over the same period FE customer numbers have grown by 22,443. This contrasts to PNGL who over the same period reduced FTEs by 2.5% while its customer numbers grew by 34,747.

4.15 FE has requested further increases in FTEs in the GD23 period across a range of cost areas, such as: asset management, system control and audit, finance and regulation.

4.16 However, we do not agree that the level of resources requested by FE is appropriate. We have therefore based the level of FTEs on the 2020 level in general. We note that the 2021 FTE's is very similar to 2020 levels. Any additional extra FTE's is discussed further in the relevant sections below.

4.17 An area that is connected to Manpower and has subsequently happened since the submission of the Business Plan is the 'Health and Social Care Levy,' further details and implications are contained in section 4.170.

Asset Management

4.18 FE Asset Management costs are in the main driven by its associated manpower costs. In the 2020 year, FE had Asset Management costs of £121k and had 1.9 FTEs. FE proposed an additional 1.29 FTEs in each of the GD23 years when compared to 2020. FE also incurred £36k in professional and legal fees in 2020.

4.19 For the draft determination we allowed for 1.9 FTEs, which is in line with our allowance for GD17 as well as FE's long run historic actuals. In GD17 we noted that in GD14 we had previously allowed FE sufficient manpower resources to undertake their plans to develop and implement an asset management system for network maintenance. We understand that FE has now achieved its Asset Management ISO55001 accreditation and therefore has implemented its asset management system. Consequently, we did not accept the proposed increase in FTEs versus 2020 actuals.

4.20 We accepted FE's projections for professional and legal fees of £19k given they are in line with medium term recent historical average costs.

4.21 In response to the draft determination FE stated that 'the Utility Regulator has not compared the total activity costs but has based its determination on individual line items and selected figures from either actuals or submission to determine an allowance that is much lower than the 2020 actuals or firmus energy's submission.' FE also stated that 'whilst GD17 historical actual costs and FTEs for 2017, 2018, 2019 and 2020 were provided to the Utility Regulator as part of Annual Cost Reporting, only the 2020 actuals were used to derive GD23 allowances.'

4.22 We do not agree with these arguments, as in relation to staff costs we brought forward FE 2020 staff costs which are higher than forecast staff cost and simply applied the FE submitted capitalisation rate. In relation to professional and legal fees we took account of medium-term historical actuals, consequently our final determination allowances are unchanged from the draft determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	112	113	114	114	115	116
UR Final Determination	88	88	88	88	88	88
Variance	(24)	(25)	(26)	(26)	(27)	(28)

Note 1. Figures may not sum due to rounding.

Table 4.2: Asset Management Costs, Requested and Allowed, £k

Operations Management

4.23 FE's Operations Management costs are in the main driven by its associated manpower costs. In the 2020 year FE had Operations Management costs of £225k and had 13.0 FTEs employed within the Operations Management cost category. Within the £225k actual costs there was a £29.5k bad debt charge.

4.24 FE has proposed a marginal increase in FTEs in the GD23 period of 0.19 FTEs on average. We have accepted this for the final determination as we previously provided for an increase in FTEs in this area in GD17 i.e. to 13.77 FTEs and the requested amount of FTEs from FE is lower than this level.

4.25 FE has requested £4.7k p.a. for professional and legal fees. We have accepted this for the final determination as it in line with medium term average historical actuals. FE also requested £29.5k p.a. for bad debt. We have not accepted this for the final determination as it is inconsistent with FE's medium term historical average actual. We also note that no other GDN has projected this type of cost and we consider that it is for FE to recover any bad debt.

	2023	2024	2025	2026	2027	2028
FE requested allowances	309	312	314	321	324	326
UR Final Determination	271	271	271	278	278	278
Variance	(38)	(41)	(43)	(43)	(46)	(48)

Note 1. Figures may not sum due to rounding.

Table 4.3: Operations Management Costs, Requested and Allowed, £k

Customer Management (Emergency Call Centre)

4.26 An explanation of the Customer management (Emergency Call Centre) cost category and GDN arrangements for dealing with emergency calls is provided in the 'bottom-up assessment' section of this annex, starting at 2.30 above. This also explains why we were unable to use the combined modelling technique applied in previous price controls to project call volumes for the GDNs and therefore moved to company specific assessments for GD23.

4.27 The key driver of costs in this expenditure category is the volume of calls, which is in turn driven by number of connections.

4.28 As in the draft determination, our Emergency Call Centre assessment for FE applies individual call volume figures per 10,000 customers to existing and new customers respectively. These figures were provided to us by the company through the query process and remain unchanged for the final determination. We have estimated call volumes for the final determination by multiplying these figures by the customer numbers we have forecast for GD23. These connection forecasts have fallen slightly from the draft determination and therefore fewer calls are forecasted in GD23 overall.

4.29 Our forecast for the number of connections in GD23 is about 4% lower than the company's, which has led to a reduction of around 6,000 calls over the period.

4.30 FE uses two call handling services. Cadent is the emergency call centre that deals with calls received on the emergency contact number. Message Pad provides an out of hour's service that deals with calls received on other numbers and an overflow service during normal working hours. The out of hours calls received by Message Pad would normally be dealt with by FE staff during normal working hours. Both call centres can receive, triage, action and report on emergency calls, although Cadent receives the majority of emergency calls.

4.31 When determining a suitable cost allocation for FE's Emergency Costs we used the company's submitted rates for both Cadent and Message Pad.

4.32 Section 2.34 of this document explains that the emergency call handling agreement with Cadent includes a monthly threshold for the number of calls covered by a fixed fee. In their business plan submission, FE applied a reduction of around 31% to the number of calls covered by the contractual fixed cost threshold when estimating its costs. FE advised it had made this adjustment to account for seasonal call variance and the fact that the monthly threshold can be exceeded, without the annual total being exceeded.

4.33 This approach resulted in FE allowing for a higher number of calls charged at contractual variable rates. In our draft determination we estimated variable cost allowances on the basis of exceedance of the annual call threshold total. This follows the approach we adopted in GD17 and we have continued to use this approach in the final determination. This is on the basis that predicting exceedances in any month is not possible and that the fixed cost threshold profile agreed with Cadent should reflect seasonal variances.

4.34 When estimating the proportion of calls taken by each call service provider, FE assumed that Cadent's percentage of the overall number of calls received during the price control period would increase. This resulted in an increasing cost forecast over the period as Cadent's costs per call are higher.

4.35 Our determination assumes that the relative proportions will not change. We have therefore calculated the average percentage of the total number of calls taken by each service provider in the first four years of GD17 and applied this throughout the GD23 period.

4.36 In its draft determination response, FE raised a number of queries on our assessment of Emergency Call Centre activities and costs. These related to the fee paid to Cadent for their call handling services. FE asserted that, because the overall number of calls from Northern Ireland to Cadent is consistently rising in GD23, it would increase its charges to the Northern Ireland GDNs at some point to reflect the costs associated with the additional workload. FE therefore requested an additional allowance to cover the extra cost that it expected Cadent to charge. FE also asked us to allow for a change in the percentage share of the Cadent management as a consequence of the changing proportions of calls it would be handling for each GDN.

4.37 These issues had not been addressed in either the original business plan submission or the draft determination and so we have considered them as part of our assessment for the final determination. Our analysis of total call volumes for Northern Ireland indicates that the Cadent fee will probably increase twice in the GD23 period, once in 2026 and once in 2028. We have therefore provided an additional allowance for all the GDNs as a result of the queries raised by FE. This results in an increase of around £92k for FE when compared to the draft determination allowance.

4.38 In our draft determination we stated that the connection numbers would be rebased for the final determination. The outcome of this activity is that the number of cumulative connections forecasted for FE in GD23 is now lower than in the draft determination. This is primarily because the actual connections achieved, or expected to be achieved, in the latter stages of GD17 has fallen. This rebasing has resulted in a decrease in forecasted call volumes and a decrease in associated costs.

4.39 The cost impact of the decrease in connection numbers has had less of an effect than the cost increase associated with the points raised in FE's consultation response. Our final determination allowance has therefore increased when compared to the draft determination. However in overall

terms, we are still reducing the original business plan submission by around £456K.

4.40 The outcome of our final determination assessment for the emergency call centre is detailed in the table below.

	2023	2024	2025	2026	2027	2028
FE requested allowances	293	306	319	331	344	356
UR Final Determination	221	225	232	257	263	296
Variance	(72)	(81)	(87)	(75)	(81)	(60)

Note 1. Figures may not sum due to rounding.

Table 4.4: Customer Management Costs (Emergency Call Centre), Requested and Allowed, £k

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

4.41 FE actual 2020 customer management costs were driven by its associated manpower costs. In the 2020 year FE had customer management costs of £334k and had 11.4 FTEs employed within the Customer Management cost category. FE has proposed a marginal decline in FTEs for Customer Management in the GD23 period i.e. from 11.4 FTEs in 2020 to 10.1 FTEs in the GD23 period.

4.42 For the final determination we have accepted the projections by FE for FTEs and rolled this forward with 2020 actual staff costs.

4.43 FE noted in its response to the draft determination that costs associated with call handling should have been split between the Emergency Call Centre cost and category and Non-Emergency Call Centre cost category as a portion of calls it receives relate to non-emergency calls. We have reflected the costs associated with non-emergency calls for the final determination. This provides for an increase in costs of £204k versus the draft determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	354	357	361	364	367	371
UR DD before re-allocation	324	326	328	330	331	333
Variance	(30)	(31)	(33)	(34)	(36)	(38)

Note 1. Figures may not sum due to rounding.

Table 4.5: Customer Management Costs (Including Non-Emergency Call Centre) & Network Support (Including System Mapping), Requested and Allowed, £k

System Control

4.44 FE's system control costs are in the main driven by its associated manpower costs. In the 2020 year FE had manpower costs of £160.5k and had 3.55 FTEs employed within the System Control cost category. FE has proposed an additional 0.6 FTEs for System Control in the GD23 period.

4.45 For the draft determination we rolled forward the 2020 FTEs and staff costs and therefore not allowed the proposed increase in FTEs. For GD17 we allowed FE an increase of 1.4 FTEs in system control to a total of 4.45 FTEs in the GD17 period, due to the envisaged impact of customer switching, when other suppliers entered the market place. However, we noted that no supplier for domestic customers has subsequently entered the market. We will keep the levels as set in GD17, to ensure that switching capacity is available, based on the Network code requirements.

4.46 In the 2020 year FE also incurred professional and legal costs of £92k and we have rolled this forward for the GD23 period as this is in line with medium term historical actuals.

4.47 FE noted in its response to the draft determination that it submitted costs of £40k per annum, required to support professional and legal fees for the costs associated with operating and maintaining a Supervisory Control and Data Acquisition (SCADA) system and the principle driver for implementing SCADA is to facilitate and monitor gas injection (biomethane or hydrogen) at specific sites.

4.48 FE however acknowledged that the socialisation of costs associated with facilitating biomethane injection connections to the distribution network is being considered within a separate Regulatory (Biomethane) workstream. Consequently, our final determination allowances are unchanged from the draft determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	302	304	305	310	311	313
UR Final Determination	242	242	242	243	243	243
Variance	(60)	(62)	(63)	(67)	(68)	(70)

Note 1. Figures may not sum due to rounding.

Table 4.6: System Control Costs, Requested and Allowed, £k

Emergency

4.49 The Emergency cost category covers the costs and activities associated with the initial callout and response to an emergency call from the public that requires further investigation.

4.50 Dispatch can either come from the emergency call centre or the company's own customer contact centre, and Kier Group undertake the emergency response.

4.51 In some cases the emergency call is closed without a visit as it is possible to resolve the issue over the phone. In most cases however, a trained first responder is sent to the location in question to determine the nature and severity of the incident. Further details on this cost category and company approaches to managing this type of work can be found in the 'bottom-up assessment' section of this annex, starting at 2.43 above.

4.52 The key cost driver in this expenditure category is the number and type of jobs, which is in turn driven by number of emergency calls received by the company. Our assessment applies historic rates of jobs to projected emergency call numbers to estimate the volume of work in GD23.

4.53 The number of emergency calls used in our assessment was taken from our 'Emergency Call Centre' analysis. This estimated a total number of calls which was around 6,000 less than that submitted by FE. Further details on this analysis can be found in the Customer Management (Emergency Call Centre) section of this document, starting at 4.26 above.

4.54 We then calculated the proportion of calls that became emergency jobs in the first four years of GD17 and applied this to our projected call numbers to estimate job numbers in GD23. We used a flat percentage throughout GD23 as opposed to the company's analysis which showed an increasing percentage of calls resulting in jobs over the period. Our assessment estimated a number of emergency jobs that was around 5,400 lower than the company's and a projected profile more reflective of the historic trend.

4.55 We have accepted the submitted costs for; materials, legal and professional fees, and the cost for additional responders requested by the company in both our draft and final determinations. We used the GD17 costs for the contractor's management fee and GD17 unit rates to estimate costs for emergency jobs requiring a callout and those closed without a visit. Because we used historic rates we did not need to adjust for the 5% uplift that FE applied to its period contractor rates for GD23.

4.56 Our final determination methodology for assessing appropriate staff FTE levels and associated costs is described in sections 2.110 to 2.114. FTE levels have increased slightly in the final determination as a consequence of the application of this methodology.

4.57 In our draft determination we stated that the forecasted number of connections for each of the GDNs would be revisited for the final

determination. Following this reforecasting the total volume of connections fell in GD23. However the re-profiling of the connection numbers resulted in a higher number of in year connections forecasted in the latter years of the price control. For this reason, while the overall connection numbers have fallen, the costs in some of the individual years has increased when compared to the draft determination.

4.58 The outcome of our final determination assessment for emergency costs is detailed in the table below.

	2023	2024	2025	2026	2027	2028
FE requested allowances	916	985	1054	1124	1194	1265
UR Final Determination	791	847	896	940	982	1024
Variance	(125)	(138)	(158)	(184)	(212)	(241)

Note 1. Figures may not sum due to rounding.

Table 4.7: Emergency costs allowed in the final determination for FE

Metering

4.59 FE requested around £6.8m for meter maintenance in the GD23 period, with routine maintenance on meters and governors accounting for 85% of the submitted costs.

4.60 The expenditure split for maintenance/inspections within the meter and governor routine maintenance cost category is roughly 57% on domestic, 28% on I&C and 15% on battery replacement.

4.61 FE provided connection data to support its proposed maintenance activity for domestic and small I&C meters (up to U40) along with information on how they had derived their numbers. We were able to validate the numbers submitted using annual cost report and business plan template data apart from the percentages FE had used to derive the number of medium pressure connections in each year.

4.62 In the draft determination, routine meter maintenance costs for domestic and small I&C meters (up to U40) were allowed apart from a minor adjustment of around £20k to reflect our slightly lower projected connection numbers for 2023 and a more material adjustment of around £350k resulting from the exclusion of 5 and 15 year inspection costs for 2023. The 2023 inspection costs were disallowed because we believed the revised guidance from the updated British Standard had been applied one year too early by FE (as explained further in section 2.57). In its response to our draft determination FE accepted our decision to exclude the 5 year inspection costs for 2023

and so the same £350k reduction has been carried forward to the final determination. However, as a consequence of our review of connection numbers for the final determination, the combined figures for 2021 to 2023 are now lower than in the draft determination. These connection numbers have a direct impact on the 5 year inspections required in the period 2026 to 2028 and as a result the associated cost deduction has increased from around £20k in the draft determination to around £115k in the final determination.

4.63 In the draft determination we had applied FE's low pressure/medium pressure split when estimating the routine meter maintenance costs for domestic and small I&C meters. However we advised FE that we would ask it to demonstrate that this was reflective of the actual split of historic connections for the final determination. In response to this request, FE provided information for the period 2017-2022. This showed that the medium pressure percentage had been increasing since 2017 as a result of the roll out of FE's infill programme. However, the higher percentage figure that FE had applied to domestic connections from 2017 onwards was only reached in the year 2022 and so we have adjusted allowances accordingly in the final determination. We believe we have taken a conservative approach by applying the higher percentage for both 2021 and 2022 despite the 'actual' percentage in 2021 being lower. This is on the basis that the difference between the allowed figure and the 'actual' 2021 figure would balance any further increase that might occur in 2023. Due to the 5 year lag until the first regulator inspection is required, 2023 is the last year that impacts numbers for the GD23 period and so the potential for further changes beyond 2023 did not need to be considered. For 2017 to 2020 we applied the lower percentage that FE had used for years up to 2017 as the data submitted showed that this was appropriate. This adjustment to the medium pressure domestic connections in 2017 to 2020 has resulted in a further reduction of circa £115k to FE's allowance in the final determination.

4.64 FE provided source data from its maintenance database to support the routine maintenance activities and costs requested for large I&C meters (i.e. U65 and above). When providing this information FE advised that it had identified some errors in the information submitted in the business plan, including some doubling counting. It did not submit any corrected figures. As a consequence, we used the source data provided to derive revised figures for large I&C routine maintenance for the draft determination and corrected any data issues notified by FE while doing so. This reassessment resulted in cost reductions of around £220k. In our analysis we allowed costs for work on Rotary Positive Displacement meter outlet valves that FE wanted to undertake when the meter is being replaced, but advised that we would seek additional clarification of why this cost was justified and not

covered by the Capex end of life replacement allowance for the final determination.

4.65 During our engagement with FE on its response to the draft determination, we were able to establish that replacing the meter outlet valve at the same time as the Rotary Positive Displacement meter made sense due to the marginal cost difference and the risk of damage to the newly installed meter if this was done afterwards. FE also provided evidence which indicates the Capex and Opex costs are mutually exclusive. So we have continued to allow for this work in the final determination.

4.66 In its response to the draft determination advised that it had not submitted any large I&C connections in the GD23 period in the absence of any firm commitments to connect, but expected there to be 11 large I&C connections per annum based on past experience. This aligns with the 4 year average for 2017 to 2020 and so the proposed annual increase has been accepted on this basis and allocated on the basis of the historic size distribution.

4.67 In addition, FE were able to demonstrate that inspections on its older meters had been undertaken earlier than the 10 years assumed in our analysis. This meant that the number of inspections required on large I&C meters had been underestimated in the draft determination and so we have adjusted our final determination figures to account for this. We have also allowed for 20 year inspections which had previously been excluded on the assumption that the regulator would be replaced with the meter at the end of its life. FE has however now advised that this will not be the case as it intends to extend the regulator life beyond 20 years. We consider our approach to be conservative as an element of the meter end of life replacement cost would be linked to the regulator replacement.

4.68 Having made these adjustments, our large I&C inspection figures and costs closely align with those submitted by FE and so the draft determination reduction of around £220k is no longer being applied.

4.69 To assess FE's non-routine maintenance allowance we considered how its total cost per connection for all expenditure areas was developing over time. This was found to be increasing disproportionate to connection numbers. This was not the case for PNGL or SGN, whose profiles were either stable or reducing and we would have expected this to be the same for FE. Adjusting FE's allowance to reflect a stable cost per connection profile from 2021 onwards results in a cost reduction of around £155k over the GD23 period. This was omitted from the draft determination modelling in error. However, we advised FE that this would be rectified in the final determination and so this cost reduction has now been applied.

4.70 During engagement following the draft determination, FE advised that its battery supplier was applying an immediate and material increase to the cost of batteries which was not reflected in the submission. This has resulted from global market pressures in terms of logistics and material prices, which have meant that current prices have become unsustainable. The increase has been allowed and a unit rate increase equivalent to that requested by PNGL for the same issue has been applied in the final determination. This has resulted in an additional allowance of around £46k.

4.71 In line with the approach outlined in section 4.8, we have removed the 5% uplift that FE has applied to its period contractor rates. This follows the approach adopted in the draft determination and results in a reduction of around £236k in the overall metering allowance.

4.72 Our method of assessing an appropriate level of FTEs has changed for the final determination and this has resulted in a minor increase in the number of FTEs allocated for metering compared to the draft determination. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

4.73 The outcome of our final determination assessment for metering is detailed in the table below.

	2023	2024	2025	2026	2027	2028
FE requested allowances	971	1,021	1,054	1,200	1,273	1,302
UR Final Determination	624	950	981	1,237	1,097	1,134
Variance	(347)	(72)	(73)	38	(176)	(168)

Note 1. Figures may not sum due to rounding.

Table 4.8: Metering Costs, Requested and Allowed, £k

PRE-Repairs

4.74 The 'Publically Reported Escape' (PRE) Repair cost category covers the activity associated with the isolation and repair of mains and/or services where an escape of gas is involved. It follows an initial assessment undertaken by the first responder.

4.75 Due to the safety implications, these are considered the most urgent emergency jobs and have the shortest mandatory response times. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.60 above.

4.76 The key driver of costs in this expenditure category is the number of emergency jobs. Our assessment estimates the volume of work by applying

historic rates for the number of PRE jobs to projected figures for the total number of jobs.

4.77 The number of emergency jobs used in our assessment was taken from our 'Emergency Response' analysis. This estimated a total number of emergency jobs which was around 5,400 less than that submitted by FE. Further details on this analysis can be found in the Emergency section of this document, starting at 4.26 above.

4.78 We then calculated the proportion of emergency jobs that became PRE jobs in the first four years of GD17 and applied this to our overall projected job numbers to estimate PRE figures for GD23. We used a flat 4.2% throughout GD23, in contrast to the company who applied a percentage that increased from 4.89% in 2023 to 5.26% in 2028.

4.79 When calculating our percentage we used a revised number of PRE Repair jobs undertaken in 2017 and 2018 that was provided by FE. This represented an increase of nearly 80% compared to the company's annual information returns, with the total number of PRE jobs rising from 133 to 238. We are satisfied that this increase is justified and so have allowed for it in our calculations.

4.80 Our analysis estimated a total number of PRE jobs that was 548 less than the company's. This is 10 fewer jobs than we allowed for in the draft determination and is attributable to the reduction in the number of connections forecast for the GD23 period in the final determination.

4.81 To determine the split between the different types of PRE job, we used the average proportions seen over the first four years of GD17. FE took a different approach. It decreased the proportion of 3rd party repair jobs, which are offset by contributions and increased the proportion of gas escape jobs which are not.

4.82 The GD17 blended contractor's rate stated in FE's business plan has been used to forecast the PRE Repair allowances for GD23. This blended rate was calculated by the company from the contractual rates and the proportion of jobs done in the first four years of GD17. As we have used the GD17 rates provided by FE, we did not need to adjust for the 5% uplift that FE applied to its period contractor rates for GD23.

4.83 The outcome of our final determination assessment for PRE Repairs is detailed in the table below.

	2023	2024	2025	2026	2027	2028
FE requested allowances	119	127	135	164	174	183
UR Final Determination	110	115	119	124	128	131
Variance	(9)	(12)	(16)	(40)	(46)	(52)

Note 1. Figures may not sum due to rounding.

Table 4.9: PRE-Repair Costs, Requested and Allowed, £k

Maintenance

4.84 FE requested just over £5.1m for maintenance in the GD23 period. Distribution Mains (43%) and Governor Maintenance (26%) account for the majority of the costs.

4.85 Valve maintenance represents almost 90% of the Distribution Mains costs and almost 40% of FE's proposed maintenance expenditure overall. The rest of the Distribution Mains expenditure is allocated to work associated with the mains themselves.

4.86 The majority of the cost items related to mains are low in value. They have been allowed on the basis of this and the fact that the projected costs remain broadly stable relative to historic expenditure.

4.87 There is, however, a step change in expenditure on mains commencing in 2021. This is a result of FE's proposal to undertake a leak survey of the network using a hand held device with a GPS tracker. The aim is to identify and locate leaks so that they can be addressed proactively. FE has advised that the last time they undertook a similar comprehensive survey was in 2010, pointing out that significant lengths of mains have been laid since.

4.88 The costs for the leak survey were allowed in the draft determination. However we noted we were unsure of the benefits this would deliver over and above FE's previous targeted approach, which focused on valves and purge points. We also indicated we were unclear how FE had accounted for the cost savings that would be delivered by the move away from the previous targeted approach and the impact that the proactive activity would have on reactive Public Reported Escape repairs. We advised we would check this for the final determination and, if necessary, adjust allowances accordingly.

4.89 FE submitted further information in support of its leak survey proposals as part of its draft determination response. It noted that its network length was now 4 times longer than at the time of the last survey and that it now had around 13 times as many customers. It reiterated the potential benefits that a handheld survey undertaken directly over the main might have in terms of identifying small low level leaks that might not normally be found. It

highlighted potential issues at welded joints and service connections on pipes between the mechanical joints that the existing approach focuses on. It advised that there would only be a marginal cost benefit initially and that the real benefit would materialise in the longer term. As part of its response FE reviewed its investment proposals and standardised its inspection interval at 12 years (i.e. roughly every other price control) as opposed to the range of 8 to 14 years included in its submission. This revised proposal has reduced the requested cost by around £62k, or 37%. Whilst the extent of the additional issues that the survey will find remains uncertain, we have decided to include the Leak survey allowance at this reduced cost in the final determination. This will allow FE to assess the benefits of this new approach compared to the traditional approach at a relatively low annual cost. We would expect FE to use the information gathered to inform the need to continue with wholesale handheld leak surveys in GD29 and also the potential for introducing more targeted maintenance regimes in the future. We would also expect FE to consider opportunities to prioritise the surveys based on existing operational knowledge to maximum any benefits as quickly as possible. We will also consider the need for it to submit interim reports on progress and findings through its annual cost reports to show whether the work is progressing as planned and whether the perceived benefits are being delivered.

4.90 The costs FE have allocated for valve maintenance also show some stepped increases within the GD23 period. These are primarily driven by proposals to undertake external and internal inspections at the company's most critical valves; to undertake planned inspections at a significant proportion of its other valves and purge points; and, to allow for increased reactive maintenance costs associated with the replacement of higher numbers of valve chamber covers than in the past.

4.91 PNGL has also included a critical valve inspection programme within its submission for GD23 and FE's proposal to inspect around one third of critical valves on a prioritised basis during GD23 does not appear unreasonable, as it appears to account for the comparative age of its assets. However FE's unit cost is high compared to PNGL's. This seems to be mainly driven by the allowance of 2 days' work for the team undertaking the inspections. For the draft determination we allowed all the activity proposed, but adjusted the duration of the inspection team to one and half days on average, which we considered reasonable. This represented a 25% reduction in the allowance for the inspection team, with all other associated costs remaining unchanged. This reduced FE's total allowance by around £150k and brought its unit cost closer to that submitted by PNGL. This deduction has been retained in the final determination.

4.92 FE's investment proposal for its other valves (in-line, service and riser) and purge points is based on it undertaking planned inspections at around 25% of these remaining assets during GD23 (or around 30% over the 8 year period commencing 2021). Costs have been allowed based on the numbers and unit costs submitted.

4.93 FE's submission for valve cover replacement represents a significant increase when compared to historic activity and cost. FE had based this on an assumption that the number will increase based on the age and extent of the network. We did not find evidence of this within recent historic data when undertaking our analysis for the draft determination. When we adjusted the number of jobs for 2017 and 2018 using the number of covers per job quoted for 2020, it suggested a year on year reduction from 2017 to 2019. The company also suggested that the higher than expected figures in 2021 provided evidence of year on year increases. However FE also indicated that activity in 2021 included some carryover from 2020, which it advised was atypical due to a widespread valve and pressure point cover inspection programme carried out during lockdown in spring 2020. We therefore did not consider this compelling evidence.

4.94 For our draft determination assessment we used the ratio of lids per defect from 2020 to estimate the number of lids replaced in 2017 and 2018. This was necessary because FE had reported the number of defects prior to 2019 rather than the number of lids replaced. We then used the 2017-2020 four-year average for the number of lids replaced to generate a revised starting position for our forward projections. We adopted this approach due to the atypical nature of the 2020 figures as noted in FE's submission. We considered this to be conservative as our four- year average included the unusually high figure from 2020.

4.95 We projected numbers for 2021 onwards from this revised base figure proportionally, using the annual increase in the length of the network allowed for in our Capex assessment for the draft determination. This approach assumed that the number of covers, and therefore the amount of potential work, would be related to the size of the network in some way. FE had assumed much higher annual increases (5% per annum for Transport Northern Ireland numbers and 10% per annum for internal inspections), which did not appear to be supported by any of the 'typical' data submitted.

4.96 To derive the valve cover replacement allowance we applied the 2019 unit rate due to the similar the level of activity in that year. This was the same unit rate used by FE. The outcome of our assessment for the draft determination was a cost reduction of around £129k. However, we noted that we would seek to update our assessment for the final determination in areas where assumptions had been applied using actual historic data if this

was available. We also indicated we would see if FE could provide any additional evidence to support its higher level of projected activity.

4.97 FE provided additional evidence in its draft determination response which showed that the average age of replacement for defective lids was 12 years. It then used two approaches based on the historic annual percentage increase in the number of lids installed to project potential activity levels for GD23 to try to show that the original submission was not unreasonable. In an attempt to validate the company's figures for the final determination, we tried to use historic data for the period 2017 to 2021 to extrapolate future activity based on the relationship between the number of lids replaced and the cumulative number of installations. Although this produced a slightly lower overall cost than FE requested we are conscious that some of the data on lid numbers is estimated and that there is a degree of variation around the line of best fit that we applied. Taking this and the materiality of the remaining variance into account, we have accepted the case made by FE and allowed costs in the final determination based on the original submission. The draft determination deduction of £129k is therefore no longer being applied.

4.98 In our Capex assessment for the draft determination we used the average level of activity from 2017 to 2020 to estimate the number of District Governors and Governor Bins that would be installed annually during GD23. When assessing the historic data we found a misalignment between the cost of the additions and how FE had allocated numbers between each asset type. We therefore reallocated the historic figures based on cost.

4.99 For consistency we carried this reallocation forward to our opex governor maintenance assessment in the draft determination and recalculated the total number of sites in each category for 2017 to 2020, using the 2017 starting figures quoted in the ACRT. We then used the annual additions derived through our Capex assessment to project revised totals for each governor category for each year of GD23. This resulted in a lower number of sites than FE had projected.

4.100 Using historic activity and cost data for 2017 to 2020 which FE had provided, we were able to calculate the average percentage of reactive jobs per site and the average historic unit cost for each cost category. We applied these to our revised projections for the total number of sites to determine the annual allowance for governor reactive maintenance. This resulted in a total reduction of around £275k over the GD23 period in the draft determination.

4.101 In the draft determination we noted that we had been unable to reconcile the number of historic sites quoted by FE in its query response to the numbers quoted in the annual cost report. We advised we would ask FE to provide a

reconciliation for the final determination to address any ongoing uncertainty in the numbers and also to clarify the historic allocation by governor category which did not appear to align with installation costs.

4.102 In response to the draft determination, FE confirmed that the historic data was incorrect and provided updated figures which more accurately reflected the number of district governors and governor bins previously installed. It also provided further details on the numbers of each type of governor that are due to be installed in each year of GD23, along with the reason for installation. We have accepted these figures and used them for our final determination Capex assessment. However, for maintenance, we have had to make a further adjustment to the cumulative number of governor bins due to the installation of R465 'upsize' replacement units due to growth. The information submitted by FE indicates that on average these installations will allow circa 1.5 below ground H160 units to be removed. We therefore adjusted the cumulative number of governor bins to take account of this ongoing rationalisation when assessing future maintenance costs. The average historic percentage of reactive jobs per site and the average historic unit cost for each cost category was applied to determine the reactive maintenance allowance for the final determination. Allowances were also made for District governor corrosion, governor bin valve replacement and the removal of the seven extra governor bins delivered through the R465 'upsize' rationalisation process. The updated assessment using the correct governor numbers results in a final determination reduction of £273k, which is almost identical to that in the draft determination. FE however also made the case that without appropriate funding it would not be able to install the above ground R465 units and deliver the associated rationalisation and long term maintenance benefits. We would not want this to be the case and so we have allowed funding under maintenance for the removal of the 15 governor bins that the R465 'upsize' units are directly replacing in addition to the two K1000 units. This provided FE with additional funding of around £111k and reduced governor cost reduction in the final determination to around £162k.

4.103 FE's submission for installing telemetry equipment at Daily Metered Sites with an annual quantity greater than 75,000 therms assumed an annual increase in the total number of sites of 7 from 2021 onwards. The reason for this sustained level of increase throughout the GD23 period was not clear and the addition of another 49 sites with annual quantity >75,000 therms between 2021 and 2028 (i.e. an increase of 53%) did not seem reasonable or reflective of other elements of FE's submission.

4.104 Our assumption for the draft determination was that the addition of 40 Daily Metered Sites in 2020 following the change in the Network Code and the addition of a further 7 sites in 2021 would have addressed any backlog. This

appeared to be reinforced by the data submitted by FE in table 2.0g of its business plan template which showed a static number of >75,000 therm sites throughout the period. This number was broadly consistent with the figure quoted in the submission for the end of 2021. We therefore based our draft determination assessment on the number of sites quoted in table 2.0g and applied the average unit cost for 2017-20 rather than the higher unit cost for 2020 used by FE. Our analysis resulted in a cost reduction of around £70k for these telemetry installations.

4.105 In its response to the draft determination advised that it had not submitted any large I&C connections in the GD23 period in the absence of any firm commitments to connect, but expected there to be 3 sites per annum falling above the threshold based on past experience. This aligns with the 4 year average for 2017 to 2020 and so the proposed annual increase has been accepted on this basis. FE also provided additional information in support of a higher unit cost and we have accepted the majority of their arguments for the final determination. These adjustments have been applied in the final determination and have halved the cost reduction for Daily Metered Site telemetry to around £36k.

4.106 In the draft determination we allowed the pressure logging maintenance costs submitted by FE but advised we would explore the linkage to the projected number of governors and the high level of non-routine jobs further for the final determination. We have aligned our figures to the revised governor numbers and tested the impact of a change in the percentage of non-routine jobs using data from 2017 to 2021 provided by FE. As a result of some uncertainty over the completeness of FE's historic data and the fact that our adjustments did not have a material cost impact, we have continued to allow the submitted costs in the final determination.

4.107 In line with the approach outlined in section 4.8, we have removed the 5% uplift that FE has applied to its period contractor rates. This follows the approach adopted in the draft determination and results in a reduction of around £172k in the allowance.

4.108 Our method of assessing an appropriate level of FTEs has changed for the final determination and this has resulted in a minor increase in the number of FTEs allocated for maintenance compared to the draft determination. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

4.109 The outcome of our final determination assessment for maintenance is detailed in the table below. The total allocation represents a material increase when compared to actual and projected costs for GD17. The annual average allowance is over 75% higher than the annual average

expenditure in the period 2017 to 2020 and around 60% higher if FE's projected expenditure for 2021 and 2022 is included. These increases align closely to those for PNGL. Therefore we consider that in overall terms it represents a reasonable allocation for delivering the necessary maintenance activities when considered as a package.

	2023	2024	2025	2026	2027	2028
FE requested allowances	769	775	833	878	927	950
UR Final Determination	736	711	744	777	812	818
Variance	(33)	(64)	(90)	(101)	(115)	(133)

Note 1. Figures may not sum due to rounding.

Table 4.10: Maintenance Costs, Requested and Allowed, £k

Other Direct Activities

4.110 FE's other direct activities costs are driven by manpower costs. In the 2020 year FE had actual manpower costs of £992 and 0.04 FTEs. FE has requested other direct activity costs on average of £335 in GD23. We have rolled forward actual 2020 FTEs and staff costs and this provides for allowances of £530 in each year for GD23. The allowances are lower than 2020 actuals as the projected capitalisation rate is higher in GD23 than for the 2020 year.

IT & Telecoms

4.111 FE IT & Telecoms costs are in the main driven by its associated manpower costs and costs for professional and legal fees as well as nominal expenditure on stationery, communications and billing. In the 2020 year, FE had IT & Telecoms costs of £574k.

4.112 FE had 1.17 FTEs employed within the IT and Telecoms cost category in 2020 and has proposed a marginal increase in FTEs for the GD23 period as well as a 27% increase on average in professional and legal fees and stationary, communications and billing costs (combined) in the GD23 period when compared to 2020 actuals. FE has explained that this is based on 'forecast IT opex costs primarily reflecting incremental customer and staffing requirements and have been modelled based on our current managed services contract for IT and projected costs for the licencing and use of a new IT platform, forecast to be purchased in 2022.'

4.113 In relation to FE's rationale for its projected increases in IT and Telecoms, we note that, both FE 2020 actuals for 2020 IT and Telecoms are higher than for PNGL by 13% and its average projected GD23 IT and Telecoms costs are 30% higher. We also note that PNGL, who use a similar GIS system to FE and have 60% more FTEs and over 4 times more customers

than FE in the 2020 year, while having lower overall opex expenditure than FE on IT and Telecoms. For the final determination we have rolled forward FE actual 2020 FTEs together with 2020 staff costs as well as 2020 professional and legal fees and stationery, communications and billing costs.

4.114 We observe that FE in GD17 was granted approval of £460k Capex in 2017 to replace its IUS/IT Transformation, but note that this development has still not occurred and is still pending in 2022, in which a separate request is also made in the GD23 business plan of £100kpa for 'New IUS Distribution Replacement licensing,' which is based on estimates from its connected supply business.

4.115 Following the draft determination, we consulted with FE on the status of the planned IUS/IT system. It appears that the system is unlikely to be replaced before 2024 and it is still uncertain what costs will be necessary to fund this system. Based on this uncertainty, we have decided to provide an allowance of £100k pa from 2024 - 2028, that is subject to the uncertainty mechanism, and is ring fenced, with a business case approval before expenditure is incurred. This strikes a balance of providing an allowance for the business that is subject to further scrutiny before approval, but equally if the project does not go ahead, it can be removed at the time of the next price control.

	2023	2024	2025	2026	2027	2028
FE requested allowances	783	711	701	724	726	729
UR Final Determination	574	674	674	674	674	674
Variance	(209)	(37)	(27)	(50)	(52)	(55)

Note 1. Figures may not sum due to rounding.

Table 4.11: IT & Telecoms Costs, Requested and Allowed, £k

Property Management

4.116 The most significant cost item under FE property management costs are in relation to network rates. We have in the past set network rates using a formula which links the allowance to FE revenues.

4.117 We are comfortable with the approach of using a formula linked to revenue in order to set the network rates allowance for FE. We have used this approach historically both in GD14 and GD17. The network rates allowances have therefore been calculated accordingly.

4.118 For the final determination we are of the view for the GD23 period that uncertainty mechanism should be updated to reflect network rates, consistent with the formula used that sets and links to revenue. We will

require a submission from FE demonstrating comprehensively how it has taken appropriate actions to minimise valuations. We will expect FE (as well as the other GDNs) to provide a copy of its actual network rates bill and accompanying verification of payments to the Utility Regulator alongside its annual uncertainty mechanism submission which is usually submitted with the Annual Cost Reporting Template. It should be noted that, as the Network rates are based on revenue which has now increased to cover the costs of the price control, this has resulted in a bigger allowance than requested in the business plan submission.

4.119 FE also has rent and rates costs in relation to its offices, including leases and we have rolled these costs forward from 2020 actual costs which in total are in line with FE projected costs or 2021 and 2022.

FE had 1 FTE under the Property Management cost category in 2020 and has not proposed any increase for the GD23 period and consequently we have allowed for 1 FTE in the GD23 period and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
FE requested allowances	1,104	1,155	1,191	1,229	1,256	1,281
UR Final Determination	1,118	1,188	1,262	1,329	1,373	1,415
Variance	14	34	71	101	117	133

Note 1. Figures may not sum due to rounding.

Table 4.12: Property Management Costs, Requested and Allowed, £k

HR & Non-operational Training

4.120 FE HR and non-operational training costs are in the main driven by staff costs and professional and legal fees.

4.121 In the 2020 year FE had HR and non-operational training costs of £119.2k. FE had 1.3 FTEs employed within the HR and Non-operational training cost category in 2020 and projected a 0.1FTE deduction in FTEs in this area for the GD23 period.

4.122 We have accepted this projection in FTEs and consequently provided for 1.2 FTEs in the GD23 period. This consistent with our approach for the GD17 price control, which also provided for 1.2 FTEs. For the draft determination we also rolled forward 2020 staff costs and 2020 professional and legal fees.

4.123 FE noted in its response to the draft determination, that its submission for professional and legal fees under the activity of HR & non-ops training was based on the average of the GD17 historical actuals (2017 to 2020), allowing for an adjusted cost for pension advice as there were no such costs in 2020.

However, as a result of COVID-19 and the inability for its service provider to attend on-site meetings to offer advice to our employees, the Utility Regulator has relied solely upon our actual costs for 2020 (£63,128) to determine allowances for GD23.

4.124 For the final determination we used the medium term average (2017-20) to determine professional and legal fees and this provides for an increase in costs of £75k versus the draft determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	138	139	139	140	140	141
UR Final Determination	127	127	127	127	127	127
Variance	(11)	(12)	(12)	(13)	(13)	(14)

Note 1. Figures may not sum due to rounding.

Table 4.13: HR & Non-Operational Costs, Requested and Allowed, £k

Audit, Finance & Regulation

4.125 FE Audit, Finance and Regulation costs are in the main driven by staff costs and professional and legal fees.

4.126 In the 2020 year FE had audit, finance and regulation costs of £477k. FE had 8.2 FTEs employed within the Audit, Finance and Regulation cost category in 2020 and has proposed an increase of 1.5 FTEs in this area for the GD23 period.

4.127 For the draft determination we noted that FE have only provided an explanation for an increase of 0.5 FTEs. FE's explanation for this increase is in relation to workstreams to support the Utility Regulator in delivering projects currently identified within its Corporate Work plan, such as our Consumer Protection Programme.

4.128 We also noted however that FE has already employed an additional 0.8 FTE above that provided for in the GD17 final determination at 8.2 FTEs versus 7.4 FTEs. We considered that the additional 0.8 FTEs already employed by FE should be sufficient to deal with the workstreams described by FE.

4.129 FE has projected professional and legal fees which contain uplifts of £300k in 2021 and 2027 'to reflect the necessary consultancy advice associated with price control reviews.'

4.130 For the draft determination we noted that the £300k uplift in relation to price control costs projected by FE are significantly above those projected by another GDN which operates under the same price control process as FE. Consequently, we did not allow this scale of uplift for the draft determination.

However, we included an allowance for price control costs at an efficient level for the 2027 and 2028 years.

4.131 For all other years we accepted FE projected professional and legal fees as they are in line with medium term historic average actuals.

4.132 In its response to the draft determination FE noted PNGL has been allowed an additional £200k per annum more than firmus energy under this operational activity and hence has more resources to draw upon for their Price Control reviews. FE argued that it is therefore reasonable to conclude that firmus energy will incur additional consultancy costs, when compared to PNGL, to sufficiently and appropriately resource its Price Control activities, and that despite the differences between firmus energy and PNGL with respect to length of network, operations and customers connected, the nature of each company's regulatory activities, obligations and reporting (including Price Control review) is equal.

4.133 We do not agree with the points put forward by FE. We note that the allowances related to price control work we provided for FE in the draft determination are significantly above those in GD17 while there has been little change in the price control process. It is up to FE to decide between its mix of staff and consultancy support to undertake price controls, but note that we have provided for increased FTEs in this area for the GD23 period. We also note that our professional and legal fee allowances for years unrelated to price control reviews are significantly above those provided for in GD17.

4.134 For the final determination we have provided for a further additional FTE for energy transition which is consistent with our approach for the other GDNs. For the draft determination we had previously allocated 1 FTE for energy transition under the AMPR (non-OO) category. Therefore, we have reallocated that FTE to the audit, finance and regulation category. The allowance for 2028 is higher that requested as we provided an allowance for the price control across 2 years i.e. 2027 and 2028 to support the GD29 price control review, which is based on previous expenditure experience, rather than in a single year as projected in the FE GD23 business plan.

	2023	2024	2025	2026	2027	2028
FE requested allowances	831	838	844	850	1,156	863
UR Final Determination	828	828	828	828	947	947
Variance	(3)	(10)	(16)	(22)	(209)	84

Note 1. Figures may not sum due to rounding.

Table 4.14: Audit Finance & Regulation Costs, Requested and Allowed, £k

Insurance

4.135 The main element of FE insurance costs is business insurance, which in turn is dominated by Public Liability cover as well as Employee Protection.

4.136 The total insurance costs requested by FE represent a significant increase on 2020 actuals. The increase between 2020 actuals and the request for GD23 from 2023 is around 36%. In advance of our draft determination we queried FE about these increases and FE provided substantial documentation on their insurance premiums together with an industry benchmarking report. However, the response from FE noted that the expected increase in their insurance costs for the 2021 year were less than set out in their GD23 business plan submissions.

4.137 For the draft determination we rolled forward FE actual 2020. Insurance costs, including costs which relate to office and car insurance. However, we noted that we would take further analysis of insurance costs in advance of the GD23 final determination.

4.138 In its response to the draft determination FE provided further material (including its 2021 and 2022 actual insurance costs) to show how insurance costs were increasing, albeit by a lesser amount projected in its GD23 business plan. We have therefore based our GD23 allowance on FE 2022 actual costs and this provided for an increase of £254k versus the draft determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	326	326	326	326	326	326
UR Final Determination	286	286	286	286	286	286
Variance	(40)	(40)	(40)	(40)	(40)	(40)

Note 1. Figures may not sum due to rounding.

Table 4.15: Insurance Costs, Requested and Allowed, £k

Procurement

4.139 FE procurement costs are driven by staff costs. In the 2020 year FE had procurement costs of £13k. FE had 0.35 FTEs employed within the Procurement cost category in 2020.

4.140 For the final determination we have rolled forward 2020 actual FTEs and staff costs and accepted FE projected professional and legal fees as they are in line with medium term historic average actual costs. The final determination allowances are marginally above FE business plan requests as 2020 staff costs are marginally higher than projected staff costs for this cost category.

	2023	2024	2025	2026	2027	2028
FE requested allowances	19	19	20	20	20	20
UR Final Determination	22	22	22	22	22	22
Variance	3	3	2	2	2	2

Note 1. Figures may not sum due to rounding.

Table 4.16: Procurement Costs, Requested and Allowed, £k

CEO & Group Management

4.141 FE CEO & Group Management costs are driven by associated staff costs as well as professional and legal fees. FE CEO & Group Management costs were £233k in 2020, made of £156k in staff costs and £76k in professional and legal fees. FE employed 1.2 FTEs in the CEO and Group Management cost category in 2020. FE proposed a flat profile of 1.2 FTEs for the GD23 period, which is the same as 2020 actuals, together with a reduction in professional and legal fees.

4.142 For the GD23 final determination we have rolled forward 2020 actual FTEs and staff costs and accepted FE projections on professional and legal fees as they are similar to our GD17 allowances.

4.143 We have also analysed information from FE on how they allocate FTEs between their supply and distribution businesses (including for FTEs and associated costs with the CEO and Group Management cost category)

4.144 On review of the SPC23 supply price control final determination, published in September 2022[4] , we note that the changes are minimal (In terms of overall FTEs) and have not made any changes for the final determination.

[4] Price Control for firmus energy (Supply) Ltd Final Determination.pdf (uregni.gov.uk)

	2023	2024	2025	2026	2027	2028
FE requested allowances	226	228	229	231	232	234
UR Final Determination	219	219	219	219	219	219
Variance	(7)	(9)	(10)	(12)	(13)	(15)

Note 1. Figures may not sum due to rounding.

Table 4.17: CEO and Group Management Costs, Requested and Allowed, £k

Stores & Logistics

4.145 FE has proposed allowances for staff costs for stores and logistics in the GD23 period based on an average of 0.63 FTEs in the GD23 period. In 2020 FE had no actual costs in relation to stores and logistics.

4.146 FE rationale for the requested average 0.63 FTEs in GD23 is that it currently lacks a dedicated resource to manage stock, especially as its 20- year replacement program of works is reached in 2026. FE further advised that its external auditor has highlighted that an area of improvement is required in stock management.

4.147 We note that PNGL (which has been in existence longer than FE) and which also has asset management accreditation does not employ FTEs for this area. We also note that FE has had a significant increase in FTEs since 2014 to 2020 i.e. circa 30% and therefore should have sufficient staff resources to manage this area.

4.148 In its response to the draft determination FE argued that the Utility Regulator is inconsistent in its treatment of firmus energy and PNGL. Whilst PNGL do not attribute FTEs to this area, they do however incur other costs in relation to managing the activity of stores & logistics. firmus energy has not been granted any costs under this activity heading and that the draft determination includes a capex allowance for the expansion of firmus energy's stores, workshops and recycling areas (to reflect the step change in stock activity levels) which is inconsistent with the absence of opex allowances under this activity.

4.149 We reviewed the argument put forward by FE and we note that the capex allowance cited by FE is only from the 2025 year. We have therefore provided for an opex allowance based on 0.5 FTE from the 2025 year. This provides an increase of £61k versus the draft determination.

	2023	2024	2025	2026	2027	2028
FE requested allowances	18	18	20	20	20	20
UR Final Determination	0	0	15	15	15	16
Variance	(18)	(18)	(5)	(5)	(5)	(4)

Note 1. Figures may not sum due to rounding.

Table 4.18: Stores and Logistics Costs, Requested and Allowed, £k

Advertising & Market Development (Owner Occupied)

4.150 The history and context of this section has been reviewed in Annex Q, Promoting connections, so all information in relation to any changes or consultation responses and considerations, is contained within that Annex.

4.151 The overall figures used for the final determination and simple calculations are below. They are subject to the uncertainty mechanism and actual outputs.

4.152 It should be noted that all connections allowances claimed by GDNs must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

4.153 Table 4.19 provides the annual average allowance per determined connection, which includes the fixed (£588k pa) and variable allowance as discussed in Annex Q. Table 4.20 compares the final determination owner occupied (OO) connection numbers, used for the purposes of this calculation, against the FE GD23 submission.

FE	2023	2024	2025	2026	2027	2028
Average allowance per connection	589	509	462	469	477	486

Note 1. Figures may not sum due to rounding.

Table 4.19: OO Connection Allowance, £

4.154 The allowances set out in Table 4.19 translates to an average allowance over the 6 years of GD23 for FE of £492 per determined connection, subject to the fixed and variable allowance as described in Annex Q.

	2023	2024	2025	2026	2027	2028
FE submission	3,852	3,685	3,524	3,371	3,224	3,084
UR Final Determination	2,000	2,750	3,524	3,371	3,224	3,084

Note 1. Figures may not sum due to rounding.

Table 4.20: OO Connection Numbers

4.155 Table 4.21 shows the comparison of the final determination allowances against the FE GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
FE requested allowances	1,692	1,618	1,536	1,454	1,378	1,306
UR Final Determination	1,178	1,399	1,628	1,582	1,539	1,498
Variance	(514)	(219)	92	128	161	192

Note 1. Figures may not sum due to rounding.

Table 4.21: Advertising & Market Development (Owner Occupied) Costs, Requested and Allowed, £k

Advertising & Market Development (Non - Owner Occupied)

4.156 The Advertising and Market Development (non-OO) cost category covers advertising and market development expenditure in relation to NIHE, New Build and I&C properties.

4.157 FE Advertising and Market development costs are driven by staff costs and market development costs and a small amount for stationery, communications and billing. In the 2020 year FE had advertising and market development (non-OO) costs of £214k.

4.158 FE had 5.7 FTEs employed within the advertising and market development (non-OO) category in 2020 and is proposing to reduce the level of FTEs to 4.85 in GD23. We note that the 2020 actual number of FTEs for advertising and marketing (non-OO) is significantly more than that planned by FE in the GD17 period which was 3.4 FTEs.

4.159 We consider that the FE proposed reduction in FTEs for advertising and marketing on non-OO reflects FE's focus in the GD23 period on the owner occupied sector. We have rolled forward our allowance for FTEs i.e. 5.85 FTEs using 2020 staff costs. We have also carried forward 2020 costs for Market Development Review allowance and stationery, communication and billing costs.

	2023	2024	2025	2026	2027	2028
FE requested allowances	224	226	227	229	230	232
UR Final Determination	204	204	204	204	204	204
Variance	(20)	(22)	(23)	(25)	(26)	(28)

Note 1. Figures may not sum due to rounding.

Table 4.22: Advertising & Market Development (Non-Owner Occupied) Costs, Requested and Allowed, £k

Trainees & Apprentices

4.160 FE's trainees and apprentices' costs are driven mainly by professional and legal fees as well as staff costs. FE has requested trainees and apprentices' allowances of £158k in 2023 and £73k for each of the subsequent years in GD23. FE actually spent £41k on trainees and apprentices in 2020. The requested increase in allowances is driven from an increase in professional and legal fees of circa 129% on average across the GD23 period.

4.161 For the GD23 draft determination we based our allowances on 2020 FTEs and staff costs, as well as 2020 professional and legal fees.

4.162 In its response to the draft determination, FE argued that the 2020 year did not represent the necessary costs to support its GD23 activities for trainees and apprentices as, for example, many training activities were cancelled or postponed. For the final determination we have based professional and legal fees on medium term historical actuals and this provides for an increase in allowances for the final determination of £28k.

4.163 FE also highlighted that for the 2023 year it requested an allowance for costs associated with putting Governor Technicians (x3) through an NVQ accredited course. After receiving further information and the course outline, we have decided to grant this approval.

4.164 The allowances for the final determination appear higher than 2020 actual costs as FE have shown 0% capitalisation of staff costs for GD23 when compared to 35% in 2020.

	2023	2024	2025	2026	2027	2028
FE requested allowances	158	73	73	73	74	74
UR Final Determination	139	54	54	54	54	54
Variance	(19)	(19)	(19)	(19)	(20)	(20)

Note 1. Figures may not sum due to rounding.

Table 4.23: Trainees & Apprentices Costs, Requested and Allowed, £k

Non-Controllable Opex

4.165 The only costs under non-controllable opex are FE licence fees. We have accepted FE's forecast costs for licence fees of £50k per annum for the final determination, but further work will continue in this area to ensure allowances are sufficient going forward. Any difference between forecast licence fees and actual licence fees will be taken account of by the uncertainty mechanism in GD29.

Supplier of Last Resort

4.166 With regard to the Supplier of Last Resort (SOLR), we believe that there is merit in including an allowance to cover any unforeseen costs that may occur, if an event were to happen. This amount is ring fenced and will be removed at the time of the next price control, if an incident fails to materialise. For the GD23 final determination we have accepted the proposal made by FE and allowed £175k for these costs in 2023 only to cover the duration of the price control.

Other Issues - Shrinkage

4.167 The shrinkage forecast from FE across the GD23 price control period are forecast to be stable at 0.26% across the price control period. There is a slight increase from 0.23% for 2020 however it is consistent with the shrinkage forecast for the final 2 years of GD17. Given the network extension in the final 2 years of the price control, we do not consider this increase unusual.

4.168 We have not made any shrinkage-related changes to existing regulatory arrangements and/or the introduction of a shrinkage-related incentive mechanism at this stage.

4.169 However, we consider that FE should continue to establish the annual shrinkage factor in line with the common Northern Ireland Shrinkage Methodology which was developed, and should be maintained and amended as may be appropriate from time to time, jointly by all three GDNs. We furthermore consider that shrinkage should continue to be monitored as part of the annual cost and performance arrangements.

Health and Social Care Levy

4.170 An area that has arisen since the submission of the Business Plan is the 'Health and Social Care Levy,' which was introduced by HM Revenue and Customs (HMRC) and has a similar charging structure to National Insurance Contributions. It was introduced in April 2022 and will be treated as a separate new tax of 1.25%, from April 2023.

4.171 The Chancellor announced on the 23 September 2022, regarding its Growth Plan[5] statement and reconfirmed that the April 2022's National Insurance rise and April 2023's Health and Social Care Levy will be cancelled. Following this announcement, legislation was introduced to the House of Commons, to bring this into effect.

[5] The Growth Plan: Factsheet on cancellation of National Insurance rise and Health and Social Care Levy - GOV.UK (www.gov.uk)

4.172 FE provided further information on this area and the likely effect on costs for each FTE. Based on this recent update, no allowance for the Health and Social Care levy has been provided for the duration of GD23.

Energy Strategy Funding Levy

4.173 As indicated in Annex G, Energy Strategy, a funding levy of 1% of Totex (i.e. All Capex and Opex allowances over the FD period) has been introduced. This funding is to enable projects that will achieve the aims of the Energy Strategy. This area is ring fenced and subject to the uncertainty mechanism. Projects will need prior approval in advance before any expenditure is approved in most cases, and must be accompanied with a business case, in which it is envisaged that all GDNs will submit a shared proposal detailing the level of work/role envisaged for each operator.

Capitalisation

For the GD23 final determination we have accepted FE's capitalisation rates. Real price effects, productivity and frontier shift

4.174 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

4.175 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH).

4.176 However, not all types of cost changes experienced by a network business will be reflected in the basket of prices used to calculate the general inflation measure.

4.177 To account for this it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

4.178 This calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs). Inclusion of the projected rate of productivity growth gives the frontier shift. The sum of these components can be a positive or a negative difference.

4.179 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

4.180 We have adopted the methodology similar to that which we first introduced at PC13 for NI Water. This aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

4.181 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	6.9	7.8	4.5	2.7	2.8	3.1	3.1	3.1
CPIH	(2.5)	(8.0)	(5.6)	(2.3)	(1.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift (annual)	CPIH +3.2	CPIH -1.2	CPIH -2.0	CPIH -0.6	CPIH +0.6	CPIH -0.1	CPIH -0.1	CPIH -0.1
Cumulative frontier shift	3.2	2.0	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2

Table 4.24: GD23 Opex frontier shift calculations

4.182 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

4.183 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

Summary of bottom-up assessment findings

4.184 Table 4.25 shows the opex allowances for FE in the GD23 period. The total pre-efficiency opex allowances (excluding allowances associated with AMD-OO) for FE in GD23 on average are 31% higher than 2020 actuals.

FE Categories	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	88	88	88	88	88	88	528
Operations Management	271	271	271	278	278	278	1,648
Emergency Call Centre	221	225	232	257	263	296	1493
Customer Management	324	326	328	330	331	333	1,972
System Control	242	242	242	243	243	243	1,455
Emergency	791	847	896	940	982	1,024	5,481
Metering	624	950	981	1,237	1,097	1,134	6,022
PRE-Repairs	110	115	119	124	128	131	728
Maintenance	736	711	744	777	812	818	4,598
Other Direct Activities	0.5	0.5	0.5	0.5	0.5	0.5	3
IT & Telecoms	574	674	674	674	674	674	3,943
Property Management	1,118	1,188	1,262	1,329	1,373	1,415	7,686
HR & Non-operational Training	127	127	127	127	127	127	765
Audit, Finance & Regulation	828	828	828	828	947	947	5,207
Insurance	286	286	286	286	286	286	1,716
Procurement	22	22	22	22	22	22	132
CEO & Group Management	219	219	219	219	219	219	1,314
Stores & Logistics	0	0	15	15	15	16	62
Advertising & Market Development - Owner Occupied (OO)	1,178	1,399	1,628	1,582	1,539	1,498	8,825
Advertising & Market Development (Non OO)	204	204	204	204	204	204	1,224
Trainees & Apprentices	139	54	54	54	54	54	407
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	175						175
Energy Strategy Funding Levy	211	186	189	196	192	193	1,166
Total: Pre-Efficiency	8,542	9,016	9,460	9,862	9,926	10,050	56,856
Frontier Shift %	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2	
Total: Post Efficiency	8,535	8,954	9,455	9,851	9,910	10,029	56,734

Note 1. Figures may not sum due to rounding.

Table 4.25: FE GD23 Opex Final Determination Pre and Post Efficiency, (£k)

5. Phoenix Natural Gas - UR Decisions

Summary of Key Changes from Draft Determination to Final Determination

5.1 The final determination is made after carefully considering all the consultation responses, along with any further information supplied by the GDNs and engagement with the companies. The key changes are as follows:

- We have increased the allowance per new customers connected in AMD (OO) to maximise the number of connections possible.
- We have provided funding of 1% of Totex to enable backing of projects related to the Energy Strategy.
- 2 Extra FTEs have been provided in total, with 1 to deal with the impact of the Energy Strategy and the other for business support.
- We have allowed more insurance costs, but with a challenge to reduce them over GD23 to the long-term average.
- We have moved in some areas from using the 2020 year, where persuasive evidence has been provided, to ensure there is a more appropriate funding level for the GD23 period.
- Emergency Call Centre: We have rebased the Cadent management fee and increased call thresholds twice during the GD23 period which has resulted in an increased allowance. This adjustment is based on an estimation of when Cadent will need to increase its resources as a consequence of the combined call volume exceeding the capacity of its allocated resource.
- Emergency: The final determination changes in the emergency cost category were minor and related to our updated forecasts for connection numbers and FTE levels. All other draft determination adjustments and principles remain unchanged.
- Metering: An additional allowance has been provided to account for an increase in battery costs, based on information submitted by PNGL. All other draft determination adjustments remain unchanged, apart from allowing for the impact of the lower connection estimates used in the final determination.

- PRE Repairs: The draft determination calculated unit rates for any PRE Repair jobs performed by PNGL's framework delivery partner using an all-in rate that encompassed all contractor costs. The final determination calculations have been based on the fixed and variable costs in the delivery partner's contract. This has resulted in an increase in the allowances for this cost category.

- Maintenance: Cost deductions for steel plate inspections and installation of telemetry at governor bins are no longer being applied in full. The steel plate allowance is based on higher priority sites identified by PNGL and the governor bin funding is based on fault history. Both of these allowances provide the opportunity to assess and validate the benefits of the investment to inform future investment needs. Reductions have been applied to account for an estimate of time that an additional emergency team funded through PRE Repairs could spend undertaking maintenance duties and PNGL's reassessment of the budget required for purge point maintenance

5.2 The full detail is contained within the appropriate sections below.

Overview

5.3 As set out in chapter 2, we have used bottom-up analysis as basis for our assessment of opex business plan requests.

5.4 We note that, in line with our detailed approach set out in chapter 2, we have assessed the requested opex allowances for the different cost categories. We have also undertaken additional analysis for selected expenditure types and on the proposed capitalisation policies. The bottom-up part of this chapter is structured accordingly.

5.5 We note furthermore that, in line with our detailed approach set out in chapter 2, we have generally used the most up to date detailed actuals[6] as part of our assessment of business plan requests, i.e. data relating to 2020 and considering the summary 2021 where it is available, which has not been fully scrutinized at this point. We consider that this provides a sound basis to set-up a benchmark where appropriate. In some circumstances, however, there were good reasons for deviating from this approach, and a further explanation is given in the relevant areas.

5.6 As was the case for the GD17 price control, greater scrutiny has been exercised over those cost categories that represent the greater cost. We have also considered the extent to which some cost items must be

[6] See Section 3.7

separately examined because of the particular way they are treated (e.g. pass-through), or due to other specific circumstances calling for individual treatment, irrespective of their magnitude.

5.7 Significant elements of PNGL's network maintenance work is carried out by a related company, Phoenix Energy Services (PES). In previous price controls we established and adopted the policy of disallowing profit margins of any related party. We have maintained this approach in our GD23 assessments and removed the profit element from the costs for any emergency, maintenance and metering work that PNGL has advised will be undertaken by PES within price control period.

5.8 In GD17, PNGL estimated the PES profit element as 9.85% based on its accounts for 2012 to 2014. To establish an appropriate percentage to apply for GD23, we asked PNGL to provide updated figures. The revised percentage based on PNGL's accounts for 2017 to 2020 was 7.9% and this has been applied to calculate the costs to be disallowed. We consider that the use of a four- year average is more appropriate than the use of a figure for a single year. This is because the information submitted by PNGL shows that the margin can go up as well as down, with a higher percentage in 2018 balancing a lower one in 2020.

5.9 In its draft determination consultation response, PNGL questioned the principle of the UR applying a profit margin adjustment to work undertaken by PES. It noted that this has resulted in a difference between the charges levied by PES to PNGL and price control allowances, even though margins are low and aligned to best practice and normal transfer pricing between group companies. Reference is made to a small single year cost increase for SGN which relates to work due to be undertaken by a related company. PNGL also stated that our policy should be supported by targeted benchmarking of the three GDNs' costs across each such area to ensure that the GDNs, and indeed consumers, are not unjustly disadvantaged as a result of each GDN's choice of how they meet their emergency, maintenance and metering obligations during GD23. It quotes the example, that it would seem unjust that the UR would not allow PES to earn any profit on works undertaken on PNGL's behalf, if PNGL pays PES at market rates. It suggests that if PNGL were to employ an independent third party to carry out this work then the third-party provider would charge enough to earn a profit on works undertaken and concludes that it is therefore unreasonable for the UR to maintain a position whereby PES does not achieve a market level of return on its work.

5.10 We have considered PNGL's comments and our response on this issue is as follows:

- Our approach of not allowing for third party profit margins parties has been consistently applied and accepted since our PC03 (2007-2011) price control.

- Our GD23 Approach consultation document which was published on 1st June 2020, listed the principles that we were considering adopting and applying for the GD23 price control. The principle that "allowances will not be given for profit margins for any third parties," was included. PNGL had the opportunity of challenging this in its consultation response, but did not do so. It therefore formed part of the final list of principles that would be adopted and applied in GD23, as published in our Final Approach document on 6th November 2020.

- PNGL's reference to the allocation for SGN does not appear relevant, as this cost allocation also excludes the profit margin and so has been allowed on the same basis as the costs for PES.

- We considered benchmarking across all GDNs but determined that at present due to the differences in the scale of the organisations, the results of the benchmarking in this specific area would not be sufficiently reliable to change our approach.

- PES rates have not been tested in the open market. The only way of properly testing their comparability to market rates is by doing so or by PNGL disclosing further financial information from their accounts.

5.11 We believe that our approach remains appropriate for the reasons outlined above and so we have continued to apply an adjustment for the PES profit margin in the final determination. As in the draft determination, this has been applied following completion of our staffing salary assessment for a particular area. This was avoids a reduction in salary costs being applied as a result of the profit margin being disallowed.

Bottom-up assessment

Manpower

5.12 Given that manpower is such an integral part of the price control, we consider the number of FTEs necessary to run an efficient business; it is therefore appropriate to determine the cost allowance at the overall manpower level.

5.13 In common with GD17, we have not set an explicit FTE allowance for the individual cost categories, since manpower forms part of most of the cost categories within the Annual Cost Reporting Template, rather than being an

individual cost category. We consider that it is the choice of the GDN to decide where to allocate its resources, as business needs develop.

5.14 We also note that following receipt of each GDN's response to the draft determination we asked all the GDNs to provide a breakdown of staff employed in the 2021 year broken down by cost category. While FE and SGN provided this information PNGL explained that they had not yet completed the process to allocate actual 2021 FTEs across the categories included in the annual cost reporting template.

	GD17					
	2017	2018	2019	2020	2021	2022
PNGL Requested Allowances	127.8	128.2	128.7	129.1	129.6	130.0
UR Determined	121.8	121.8	121.8	121.8	121.8	121.8
PNGL Actual	115.9	117.4	119.1	113.1	113.2	123.9
	GD23					
	2023	2024	2025	2026	2027	2028
PNGL Requested Allowances	126.9	126.3	123.9	122.9	122.9	122.9
UR Determined	120.3	120.3	119.7	118.8	118.8	118.8

Note 1. Figures may not sum due to rounding. Note 2. The year 2022 is forecast.

Table 5.1: PNGL FTEs Requested, Actuals and GD23 Determined

5.15 Table 5.1 sets out the PNGL requested allowances for FTEs for both GD17 and GD23. It can be observed that PNGL's actual number of FTEs for 2020 was below our GD17 allowances by 7% and below the PNGL GD17 business plan submission by 12%. It can be also observed that PNGL's FTEs have marginally decreased from 2017. PNGL have explained that part of the reason for this decrease was in relation to a reduction in workstreams for a period of the 2020 year brought about by COVID-19 restrictions. We note that the 2021 total FTEs was 113.2, which is very similar to 2020.

5.16 PNGL has requested increases in FTEs in the GD23 period across a range of cost areas such as operations management, customer management and audit finance and regulation.

5.17 An area that is connected to Manpower and has subsequently happened since the submission of the Business Plan is the 'Health and Social Care Levy.' Further details and implications is contained in section 5.178 below.

Asset Management

5.18 PNGL Asset Management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had Asset Management costs of £263k and had 3.7 FTEs. PNGL has requested a marginal increase in FTEs in the GD23 period to 3.8 FTEs. PNGL also incurred £99k in professional and legal fees in 2020 as well as £6k in materials costs.

5.19 For the final determination we have rolled forward 2020 actuals of 3.7 FTEs as well as 2020 staff costs. This is line with PNGL medium term historical actual FTEs. We have also rolled forward PNGL 2020 actual costs for professional and legal fees and materials costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	282	282	282	282	282	283
UR Final Determination	267	267	267	267	267	267
Variance	(15)	(15)	(15)	(15)	(15)	(16)

Note 1. Figures may not sum due to rounding.

Table 5.2: Asset Management Costs, Requested and Allowed, £k

Operations Management

5.20 PNGL's Operations Management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had Operations Management costs of £411k and had 17.3 FTEs employed within the Operations Management cost category. PNGL have proposed that there should be on average 20.1 FTEs for Operations Management in the GD23 period.

5.21 PNGL explained within their GD23 business plan that part of the reason for the proposed increase in FTEs in the GD23 period is to recruit and train technicians for additional workload in the GD23 period due to ageing assets.

5.22 For the draft determination we provided for an additional FTE as this is consistent with medium term historical actual averages which is higher than 2020 actuals and rolled this forward with 2020 actual staff costs.

5.23 In its response to the draft determination. PNGL argued that it had requested an additional FTE to take account, of this area, which was in place since 2021, to design, raise and manage the delivery of the critical remedial workstream derived from asset condition assessment checks performed. We note that PNGL allocated this FTE across several cost categories and that for the draft determination and we have already allowed for an additional FTE versus 2020 actuals; and as such, we consider that this provides sufficient headroom for the FTE requested by PNGL.

5.24 PNGL also in response to the draft determination requested allowances to recruit and train two in-house apprentice technicians to replace technicians due to retire in the GD23 period and noted that in its GD23 submission it had allocated these requested FTEs between 3 cost categories i.e. Operations Management, Maintenance and Emergencies. We note that we have provided for additional FTEs across these cost categories in the final determination and we are not prescriptive on how PNGL utilises these allowances. We also consider that PNGL should have some cost savings from the retirement of the existing technicians in the GD23 period.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	563	564	552	553	554	555
UR Final Determination	497	497	491	491	491	491
Variance	(66)	(67)	(61)	(62)	(63)	(64)

Note 1. Figures may not sum due to rounding.

Table 5.3: Operations Management Costs, Requested and Allowed, £k

Customer Management (Emergency Call Centre)

5.25 An explanation of the Customer management (Emergency Call Centre) cost category and GDN arrangements for dealing with emergency calls is provided in the 'bottom-up' assessment section of this annex, starting at 2.30 above. This also explains why we were unable to use the combined modelling technique applied in previous price controls to project call volumes for the GDNs and therefore moved to company- specific assessments for GD23.

5.26 The key driver of costs in this expenditure category is the volume of calls, which is in turn driven by number of connections. For PNGL our assessment applies historic rates of calls to projected connection numbers to estimate call volumes in GD23.

5.27 Our final determination connection numbers for GD23 are around 17k lower than those submitted by PNGL in its business plan. As this is the main driver for the number of calls received, this reduction has had a direct impact on projected call volumes.

5.28 To estimate the volume of calls received from PNGL's customers we calculated the average percentage of calls per customer in the first four years of GD17 (i.e. 2017 to 2020) and applied this to our revised cumulative connection numbers.

5.29 In previous price controls we treated existing and new customers differently when forecasting the number of emergency calls. This was based on the

assumption that new customers, who are unfamiliar with the gas network and their new equipment, are more likely to call with a perceived emergency than those who are familiar with using gas. For GD23 we have treated all customers the same, accepting the rationale that the differential impact for PNGL would be immaterial based on its large existing customer base and the low number of new connections planned.

5.30 Our analysis indicates that the average historic call rate was 10.75% and we have applied this as a flat rate over the GD23 period. PNGL adopted a similar approach but used percentages which increased from 10.86% in 2023, to 10.9% in 2028.

5.31 The lower connection number and call rates used in our analysis resulted in a total number of emergency calls for the GD23 period which was around 3,000 lower than submitted by PNGL in its business plan.

5.32 This did not impact the submitted cost for the Emergency Call Centre as both PNGL's and our figures were below the fixed cost threshold for the Cadent Contract. However, the lower call numbers do affect the cost allowances for Emergency and Public Reported Escape repair jobs, as both are directly related to the number of emergency calls received from customers.

5.33 As part of the consultation response to the draft determination, PNGL raised a number of queries relating to our assessment of emergency costs in general and also the Emergency Call Centre cost category specifically. Details of these can be found below.

5.34 PNGL asserted that we should not have used data from 2020 when calculating the average historic number of calls and jobs for our GD23 forecasts because this was atypical due to COVID-19. During our engagement with the company on this issue we clarified that, from a cost forecast perspective for PNGL, there were would be both positives and negatives associated with the exclusion of 2020 from our modelling. Furthermore, the determination uses a multiplier ratio of 10.78% to calculate call numbers from connections (based on 2017 to 2020 data) and PNGL's own calls to connections figures are broadly similar to ours. However when the 2020 figure is removed from our analysis the call multiplier increases to 11.52%. This is markedly higher than either our determination or PNGL's own business plan figures. As a result we decided to continue with our draft determination approach of including 2020 in our modelling for all emergency costs categories. This approach has been consistently applied throughout the emergency cost categories in the GD23 final determination for all GDNs.

5.35 The company noted that the winters in the years included in the modelling had been fairly mild and suggested that allowances did not sufficiently

provide for the greater than usual number of emergency calls that might arise if severe weather events occurred in GD23. PNGL did not suggest a methodology for calculating the appropriate costs for extreme weather events, nor did it include an allowance for such events in its own submitted information. For our final determination we have therefore continued to apply the approach taken in GD17 and in our GD23 draft determination and have not provided any additional allowances for extreme weather events within any of the emergency cost categories.

5.36 When compared to the draft determination, there has been a minor reduction in the cost allowance for FTEs. This amounts to around £13k and is the only cost reduction applied in the PNGL emergency call centre cost category. This is a result of the application of the 2020 FTE unit cost in the final determination. We have allowed the number of FTEs proposed by PNGL in its business plan submission. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

5.37 FE's consultation response noted the potential for Cadent to increase charges in GD23 as a consequence of the increase in the total number of GDN emergency calls during the period. As a consequence of our assessment of this issue, we have allowed for cost increases in 2026 and 2028. This has benefitted all three GDNs. For PNGL this has resulted in an additional cost allowance of around £125k in the final determination and an overall allowance that is above that requested in the original business plan submission. Sections 2.33 and 4.1 provide further details of our treatment of this issue.

5.38 The outcome of our final determination assessment for the emergency call centre is detailed in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	461	461	461	461	461	461
UR Final Determination	460	459	459	489	489	511
Variance	(2)	(2)	(2)	28	28	50

Note 1. Figures may not sum due to rounding.

Table 5.4: Customer Management Costs (Emergency Call Centre), Requested and Allowed, £k

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

5.39 PNGL's customer management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had customer management costs of £764k and had 32.2 FTEs employed within the

Customer Management cost category. PNGL have advised us that the 2020 FTEs were low as a result of reduced workstreams for a period of the year brought about by COVID-19 restrictions, coupled with a challenging environment for new recruitment'.

5.40 For the draft determination we considered the points made by PNGL and used 2019 actual FTEs at 34.8 FTEs is a reasonable allowance for the GD23 period as it is also in line with medium term historical actual average FTEs (excluding the 2020 year) and rolled this forward with 2020 staff costs.

5.41 PNGL also proposed that we develop an adjustment mechanism of the GD23 price control i.e. through the GD23 uncertainty mechanism to deal with any potential material increases in switching levels given their view that this could impact upon Customer Management resource levels. Currently, capacity of Customer Switching is set as per the Network code and we are not presently unaware of any capacity issues occurring over the present GD17 period, but recognise that if a new supplier did enter the market, some pressures may be experienced initially, but over the longer term would settle down. In light of this, we would not be persuaded to add this to the uncertainty mechanism.

5.42 In response to the GD23 draft determination PNGL argued that we should include an additional FTE, in place since 2021, to specially work on a critical GIS Positional Improvement Project to update PNGL's gas records following an update by the Land and Property Services to their maps. We note that for the draft determination we had already provided for an increase of 2.6 FTEs versus 2020 actuals and therefore consider we have provided sufficient headroom for the FTEs requested by PNGL. Consequently, our final determination allowances are unchanged from the draft determination.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	884	870	859	861	861	861
UR Final Determination	790	790	787	789	789	789
Variance	(94)	(80)	(71)	(72)	(72)	(72)

Note 1. Figures may not sum due to rounding.

Table 5.5: Customer Management Costs (Including Non-Emergency Call Centre) & Network Support (Including System Mapping), Requested and Allowed, £k

System Control

5.43 PNGL's system control costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had manpower costs of £118k and had 5.45 FTEs employed within the System Control cost category. PNGL

has proposed an additional 0.35 FTEs for System Control in the GD23 period.

5.44 For the final determination we have rolled forward the 2020 FTEs and staff costs. Our allowance for FTEs for system control is in line with PNGL medium term historical actuals and in line with our allowances in GD17.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	146	146	146	146	146	146
UR Final Determination	122	122	122	122	121	121
Variance	(24)	(24)	(24)	(24)	(25)	(25)

Note 1. Figures may not sum due to rounding.

Table 5.6: System Control Costs, Requested and Allowed, £k

Emergency

5.45 The Emergency cost category relates to the costs and activities associated with the initial callout and response to an emergency call from the public that requires further investigation.

5.46 Dispatch can either come from the emergency call centre or the company's own customer contact centre.

5.47 In some cases the emergency call is closed without a visit as it is possible to resolve the issue over the phone. In most cases however, a trained first responder is sent to the location in question to determine the nature and severity of the incident. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.43 above.

5.48 The key driver of costs in this expenditure category is the number and type of jobs, which is in turn driven by number of emergency calls received by the company. Our assessment applies historic rates of jobs to projected emergency call numbers to estimate the volume of work in GD23.

5.49 The number of emergency calls used in our assessment was taken from our 'Emergency Call Centre' analysis. This estimated a total number of calls which was around 3,000 less than that submitted by PNGL. Further details on this analysis can be found in the Customer Management (Emergency Call Centre) section of this document, starting at 5.25 above.

5.50 We then calculated the proportion of calls that became emergency jobs in the first four years of GD17 and applied this to our projected call numbers to estimate job numbers in GD23. We used a flat percentage throughout GD23 which was also the approach adopted by PNGL in its submission.

5.51 Our analysis indicated that 61.9% of emergency calls became emergency jobs in first four years of GD17. PNGL used a figure of 62.5%. Although the difference between these figures is small it has a material impact on the level of activity and total costs because it is being applied to a large number of calls over a 6-year period.

5.52 To forecast the number of jobs that could be closed without a first responder visit at a lower cost, we again applied the historic proportion from the first four years of GD17. The figure we calculated was very similar to the company's, with less than 1% variance.

5.53 The lower emergency call numbers and job percentages used in our analysis has resulted in a total number of emergency jobs for the GD23 period which is around 3,000 lower than that submitted by PNGL.

5.54 When assessing the unit rate that needed to be applied to the callout jobs, we initially planned to use the rates stated in the company's submission and intended only to reduce the variable element of the allowance based on the change in the volume of work.

5.55 However, following discussion with PNGL it became apparent that this was subject to a high degree of interpretation. Consequently, we assessed the contractor's rates at a high level and noted a slight overall improving trend over the price control period which compared well to historic expenditure rates. We therefore applied the annual high level rate submitted in the business plan to the volume of jobs for each year in GD23 to estimate costs. In the draft determination we stated that if the company wished to provide further information that allowed us to move away from the application of the higher level unit rate for their Emergency contractor costs we would consider it for the final determination. PNGL did not raise this as an issue or provide the any further information and so we have continued to use the higher level unit rates calculated from the business plan submission in the final determination.

5.56 The emergency job contract work is performed by Phoenix Energy Services (PES) which is a related Phoenix company. In the draft determination we removed the 7.9% profit margin from costs associated with the work undertaken by PES. This followed the approach adopted in previous price controls for work undertaken by related companies, as described in sections 5.7 and 5.8 of the PNGL overview section above. As part of their consultation response PNGL challenged this approach for a number of reasons which are fully detailed in section 5.9 of the overview. Following consideration of the case made by PNGL, we have decided to continue to apply the profit margin reduction in the final determination. The rationale for

our decision is explained in detail in sections 5.10 and 5.11 of the overview section.

5.57 When all contractor and staffing costs are included, the unit rates used in the final determination are very similar to those submitted by PNGL and the difference is largely attributable to the removal of the PES profit margin. The vast majority of the deductions are therefore due to the change in the volume of work. This results from the reduction in connection numbers (and therefore volume of calls) and the slightly lower percentages used to determine the number of calls that become emergency jobs. The forecast customer connections have been remodelled for the final determination, as noted in the draft determination. The connection forecast for GD23 is slightly lower in the final determination as a result of this reassessment and the number of emergency jobs has reduced accordingly.

5.58 Our assessment of the FTE allocation for emergency costs changed for the final determination, resulting in a minor increase in allocated FTEs. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

5.59 The outcome of our final determination assessment for emergency costs is detailed in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,443	1,471	1,488	1,518	1,548	1,578
UR Final Determination	1,303	1,328	1,350	1,372	1,394	1,415
Variance	(140)	(143)	(139)	(146)	(154)	(163)

Note 1. Figures may not sum due to rounding.

Table 5.7: Emergency costs, Requested and Allowed, £k

Metering

5.60 PNGL requested around £14.4m for meter maintenance in the GD23 period. Routine maintenance on meters and governors accounts for 84% of the submitted costs.

5.61 Domestic regulator inspections (70%) and battery replacement (21%) represent the vast majority of expenditure within the meter and governor cost category.

5.62 PNGL provided source data for its domestic and I&C meter stock which allowed us to check most of the activity data submitted either directly or indirectly. PNGL also provided explanations of how it had estimated its meter maintenance figures and advised that in some circumstances it had

used operational reports to derive its numbers, rather than the meter stock data.

5.63 When providing this source information, PNGL advised it had underestimated the number of domestic prepayment meter battery replacements that would be required during the GD23 period. Analysis of the detailed meter data provided confirmed that this was the case and so we allowed additional costs of around £410k in the draft determination. This remains the case in the final determination.

5.64 During engagement following the draft determination, PNGL also advised that its battery supplier was applying an immediate and material increase to the cost of batteries which was not reflected in the submission. This has resulted from global market pressures in terms of logistics and material prices, which have meant that current prices have become unsustainable. PNGL provided evidence to allow us to validate the cost increase being applied and due its materiality, and the volume of 'replacements' to which it applies, we have adjusted the unit rate accordingly. This has resulted in an additional allowance of around £80k in the final determination. Therefore, when combined with the amount allowed for the underestimation of quantities in the draft determination, the additional allowance for battery replacement in the final determination has increased to £490k.

5.65 PNGL also advised that the numbers relating to 'B6 10-year inspections completed 5 years previous' had been overstated for 2024 and 2025 in its submission. We were able to validate the revised figures provided by PNGL using its meter stock data and adjusted the draft determination allowance accordingly. This resulted in a 9% reduction in the number of inspections and a cost reduction of around £160k which has been carried forward to the final determination.

5.66 The majority of the remaining routine meter maintenance costs were allowed in the draft determination following validation using the information provided by PNGL. Any exceptions are detailed below.

5.67 PNGL advised that its figures for 5 year inspections on U6 meter regulators 'installed 5 years previously,' were based on the actual proportion of new connections that this type of installation represented in 2020. Our analysis of the meter stock data indicated this was around 70% and applying this percentage to submitted connection numbers gave a GD23 total which was within 1% of PNGL's figure. This confirmed the stated approach and that the meter stock data aligned with it.

5.68 Further analysis of the meter stock data showed that the percentages for this type of installation for the four-year period 2017 to 2020 was 67% on

average and that 2020 was an outlier. We therefore adjusted this element of the 5- year inspection allowance to reflect the 4- year average, rather than using the 2020 figure in isolation. This resulted in a 6% reduction in the number of jobs allowed in the draft determination, which translated into a cost reduction of just over £100k for GD23. This approach has been retained for the final determination. However due to further adjustments to connection numbers since the draft determination, the reduction in the number of jobs allowed has increased to 7% and the cost reduction for the GD23 period has increased slightly, to around £130k.

5.69 Our assessment of the U6 meter inspections required in 2024 for '20-year end of life replaced 5 years previous' based on meter stock data was 29% lower than PNGL's submitted figure. Extrapolation of 2020 meter stock data gave a figure which was 20% lower. Using the original service install date to estimate the number of inspections required 5 years after 20yr end of life replacement gave a GD23 total which was 27% lower than PNGL's, which broadly correlated with previous results.

5.70 Prior to the draft determination we queried the 2024 difference with PNGL who advised that their figure was higher because approximately 1,000 'regulator only' replacement jobs had been included in their submission. Through engagement it was established that this had resulted in the number of inspections being overstated and that basing the forecast on a more strategic methodology would be more appropriate. We therefore used the average of our 2019 and 2020 assessments to establish a proportional adjustment which was applied to PNGL's figures. This resulted in a 23% reduction in inspections which translates into a cost reduction of around £555k. In the draft determination we noted that further options for refining this adjustment would be considered for the final determination. However through engagement with PNGL it was established that further consideration of the approach adopted for assessing the number of B6 regulator inspections was not required. Therefore, no further changes have been made to the assessment and the same cost reduction has been applied in the final determination.

5.71 Like the other GDNs, PNGL extended the 'principle' of the introduction of 5-year regulator inspections to medium pressure U16, U25 and U40 meter installations even though the new guidance only specifically applies to U6 meter installations. We have accepted this on the basis that it follows the practice adopted previously for 10- year inspections.

5.72 However, PNGL incorporated inspections for the U16 to U40 meters with medium pressure regulators from 2021 onwards. This does not align with its approach to B6 regulator 5- year inspections which commence in 2024 (i.e. 5 years after the guidance comes into effect). PNGL indicated they planned to

commence these inspections earlier due to concerns over a specific type of regulator installed from 2014 onwards, which has a built-in safety device that is susceptible to 'sticking.' We excluded the 5- year costs for 2023 in our draft determination. This was on the basis that: the installation of suitable regulators is the company's responsibility; other GDNs had not asked for the U16 to U40 meter regulator inspections to commence earlier than the B6 inspections; the revised industry guidance does not specifically apply to these sizes of regulators and is only being extended by way of good practice; and, PNGL have previously operated on a 10yr inspection cycle for these sizes of regulator which would equate to 2024, based on the first year of installation for this type of regulator. Our position remains unchanged in the final determination and so costs for 2023 continue to be excluded.

5.73 The meter stock data submitted by PNGL was used to try to validate the inspection figures for the U16 to U40 regulator inspections. However, we arrived at different figures to those submitted by PNGL for the 1st cycle of inspections/tests (Installation date + 5 years), the 2nd cycle of inspections/tests (1st cycle + 5 years) and 20-year replacement jobs undertaken 5 years previously. We also did not identify any additional 'growth' requirement as we believe our 1st cycle inspection figures include any relevant new installations. We used our estimated figures for U16 to U40 inspections for the draft determination. These were around 27% lower than those submitted by PNGL, which equated to a cost reduction of around £70k. In the draft determination we indicated that we would seek further information from PNGL to try to clarify and reconcile any differences in the numbers for the final determination. In subsequent engagement with PNGL, we asked if it had any concerns about the method we had used to estimate our figures other than the period over which the costs were allowed. It indicated it understood the approach adopted by UR in reaching its draft determination and did not intend making any further representations. Therefore, no further changes have been made to the assessment and the same cost reduction has been applied in the final determination.

5.74 In the draft determination we also removed the 7.9% profit margin for any metering work that PNGL's related company, Phoenix Energy Services (PES), would be undertaking during GD23. This followed the approach adopted in previous price controls for work undertaken by related companies, as described in sections 5.7 and 5.8 of the PNGL overview section above. This resulted in a reduction in the allowance of just under £980k. In its draft determination response, PNGL questioned the principle of applying this profit margin adjustment for a number of reasons which are fully detailed in section 5.9 of the overview. Following consideration of the case made by PNGL we have decided to continue to apply the profit margin reduction in the final determination. The rationale for our decision is

explained in detail in sections 5.10 and 5.11 of the overview section. The associated deduction has increased very slightly in the final determination to just over £980k as a consequence of the various changes made to metering cost adjustments since the draft determination.

5.75 When reviewing non-routine meter maintenance for the draft determination we considered the projected profile of total cost per connection for all expenditure areas and found this to be stable or falling from 2021 onwards. The submitted costs were allowed on this basis. We checked this for the final determination using our final connection numbers and found this still to be the case. The conclusion reached in the draft determination therefore remains appropriate.

5.76 The outcome of our final determination assessment for metering is detailed in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,541	2,414	2,453	2,682	2,591	2,685
UR Final Determination	1,510	2,118	2,220	2,501	2,238	2,373
Variance	(31)	(296)	(233)	(181)	(353)	(312)

Note 1. Figures may not sum due to rounding.

Table 5.8: Metering Costs, Requested and Allowed, £k

PRE-Repairs

5.77 The 'Publically Reported Escape' (PRE) Repair cost category covers the activity associated with the isolation and repair of mains and/or services involving an escape of gas, following assessment by the first responder.

5.78 Due to the safety implications these are considered the most urgent emergency jobs and have the shortest mandatory response times. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.60 above.

5.79 The key driver of costs in this expenditure category is the number of emergency jobs. Our assessment estimates the volume of work by applying historic rates for the number of PRE jobs to projected figures for the total number of jobs.

5.80 The number of emergency jobs used in our assessment was taken from our 'Emergency Response' analysis. This estimated a total number of emergency jobs which was around 3,000 less than that submitted by PNGL. Further details on this analysis can be found in the Emergency section of this document, starting at 5.39 above.

5.81 We then calculated the proportion of emergency jobs that became PRE jobs in the first four years of GD17 and applied this to our overall projected job numbers to estimate PRE figures for GD23. We used a flat percentage throughout GD23 which was also the approach adopted by PNGL in its submission.

5.82 Our analysis indicated that 4.99% of emergency jobs became PRE Repair jobs in first four years of GD17. PNGL used a figure of 5.27%. This difference resulted in a reduction in the total number of jobs and therefore the allocated costs. Our number of PRE repair jobs in the final determination is 472 lower than the company's, which is similar to the reduction in the draft determination.

5.83 The forecast customer connections have been remodelled for the final determination, as noted in the draft determination. The connection forecast for GD23 is slightly lower in the final determination as a result of this reassessment and the number of PRE Repair jobs has reduced accordingly.

5.84 Initially our cost analysis was based on the assumption that PES attended 'gas escapes' jobs and Kier attended incidents caused by third parties. This was based on information in the business plan submission. In subsequent discussions with PNGL we were informed that this was not the case, so we instead analysed the GD17 costs incurred by PES and Kier against PRE Repair work in its entirety.

5.85 Our assessment of the high level unit cost of repair jobs for both contractors showed they were gradually decreasing over the period (due largely to the diminishing impact of the fixed management fee spread over an increasing number of jobs). We accepted these annual unit rates on this basis and applied them to the forecast number of jobs for GD23 to determine the draft determination allowance. However during our engagement with PNGL on its draft determination response the company challenged the approach we had applied, particularly for the Kier allowance. PNGL requested that the UR use the contracted annual fixed management fee and variable rates to derive an appropriate allowance. Following discussions outlining the implications for other cost categories, we agreed to follow the approach suggested by the company. This resulted in an increase in the PRE Repairs cost category of around £218K which has been applied in the final determination.

5.86 The costs of PRE Repair jobs undertaken as a result of third party damage are recoverable and any contributions received offset the costs incurred by the company. When we assessed the extent of recovery in PNGL's business plan we found it was less, as a percentage of the overall cost incurred, than in GD17 to date. We are unclear why this cost should be increasing relative to expenditure and so have maintained the historic

recovery levels for our final determination so that consumers are not disadvantaged.

5.87 Finally we assessed the amount of work that PNGL's related company. Phoenix Energy Services (PES) would be undertaking using the original proportions from the submission and removed the 7.9% profit margin. This followed the approach adopted in previous price controls for work undertaken by related companies, as described in sections 5.7 and 5.8 of the PNGL overview section above. As part of their consultation response PNGL challenged this approach for a number of reasons which are fully detailed in section 5.9 of the overview. Following consideration of the case made by PNGL we have decided to continue to apply the profit margin reduction in the final determination. The rationale for our decision is explained in detail in sections 5.10 and 5.11 of the overview section.

5.88 Our method of assessing an appropriate level of FTEs has changed for the final determination and this has resulted in a minor increase in the number of FTEs allocated for PRE Repairs. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

5.89 The outcome of our final determination assessment for PRE Repairs is detailed in the table below.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	934	946	956	968	981	995
UR Final Determination	887	893	894	899	905	910
Variance	(48)	(53)	(62)	(69)	(77)	(85)

Note 1. Figures may not sum due to rounding.

Table 5.9: PRE-Repairs Costs, Requested and Allowed, £k

Maintenance

5.90 PNGL requested just over £15.5m for maintenance in the GD23 period. Other maintenance costs (47%) and Miscellaneous (31%) account for the majority of the costs.

5.91 Purge point maintenance represents the majority of the expenditure on 'other maintenance' (71%) and around 22% of maintenance costs overall. Strategic Mains Inspection is also a material item in this cost category. Miscellaneous expenditure is split roughly 50:50 between Valve maintenance and Telemetry.

5.92 In overall terms the proposed maintenance expenditure has increased significantly compared to GD17. The step change is largely attributable to

three new projects (purge point maintenance, strategic valve inspections and strategic main inspections) and an increase in Telemetry costs. The costs for the majority of the remaining maintenance items and staff costs were found to be broadly stable. So for the draft determination we focused on the expenditure areas that had resulted in material cost increases.

5.93 At almost £3.5m, purge point maintenance is the largest maintenance expenditure item overall and the main driver of the significant increase in the 'other maintenance' cost category. PNGL advised that they identified the need for this new project through an ISO 55000 asset management audit in 2020-21, which highlighted the need for a condition assessment and remedial project to maintain purge points to an appropriate standard. They noted that the site inspections undertaken had identified corrosion to a point of material loss, thus weakening the integrity of the pressurised fitting, and highlighted the risk that failure could pose to members of public, operatives and network supply.

5.94 PNGL is aiming to inspect all purge points that are 20 years or older by the end of GD23. This includes addressing some backlog before moving to an annual 20 year inspection programme from 2029 onwards. The percentages used to determine the number of lower cost maintenance jobs and higher cost replacement jobs are based on the outcome of a survey covering all asset age ranges. Our draft determination assessment showed that these had been applied correctly to the total number of assets in each age bracket to generate the submitted activity levels and costs.

5.95 In the draft determination we allowed the purge point inspection allowance in full. However, we noted that PNGL did not commence a full inspection programme immediately after the audit and our intention to consider the stated urgency further for the final determination, including whether work should start earlier, or alternatively, whether the inspection profile could be smoothed over a longer period.

5.96 We also indicated we wanted to consider whether the issues identified could have been reasonably foreseen and mitigated at the time of original installation. This was to ensure that customers are not unnecessarily paying for work twice. We said we would also seek to assure ourselves that PNGL's proposals for ensuring its new installations mitigate against the issues identified to date are reasonable.

5.97 PNGL submitted an additional paper in its consultation response which sought to address these issues. It explained that there had not been an immediate transition to preventative purge point maintenance due to the scale of the programme and the need to spend time over the initial set up (for example process development, validation of appropriate technology,

review of associated operational practice, allocation of resources and provision of training). In doing so it noted the criticality of the initial set up to the smooth running and success of the project in the longer term. In its response, PNGL advised that it had extended its sample size and spread it more evenly across its network to achieve a more statistically robust estimate of the extent of work required. This larger sample consistently resulted in lower estimates of the amount of replacement work required and higher estimates of the number of repairs needed, across all historic installation contracts. PNGL noted that its cost estimate for this programme of work had reduced by £90k over the period as a result of this further assessment and this cost reduction has been accepted and applied in the final determination. PNGL maintains that purge points were always installed in accordance with the appropriate standards and recommendations for construction at the time. It quotes lab results which show that an aggressive environment (i.e. high moisture content) was the main cause of deterioration rather than galvanic corrosion and notes the potential for an unforeseen impact linked to the wrapping exacerbating the problem. It has advised that it plans to increase levels of cathodic protection for all newly constructed fittings and any fittings replaced or repaired under this programme of work to mitigate against similar deterioration in the future. On balance, based on the evidence and information provided, we have decided to allow PNGL to undertake the activity estimated through the extended sampling work it has undertaken. In doing so we expect PNGL to:

- Ensure that there is an established definition and understanding of what a standard installation entails for each case and the standards that need to be implemented, for example in terms of coating, wrapping, cathodic protection etc. Any corrosion protection provided from the main pipeline connection to the ground level access point should follow the latest industry best practice.

- Monitor cathodic protection, for example through recorded resistivity readings, to help assess the corrosiveness of the environment and provide early indicators of corrosion issues and further options for preventative maintenance.

- Capture relevant data from this programme and all other sources (for example: inspections reports, maintenance work reports, collated cathodic protection data, routine operation reports, non-routine operation reports, investigation reporting, and any other relevant documentation), to help identify risks to the system and inform future maintenance plans for installation components.

5.98 Some of the cost increase in 'other maintenance' also resulted from another new project for inspecting protective steel plates installed at critical points

over strategic mains. PNGL's submission included the cost required to inspect all steel plates that have been in place for at least 20 years, with the aim of assessing their condition and verifying they are still able to provide the protection required. The submission totalled just under £600k for inspecting around 3,400 steel plates.

5.99 We excluded all of the costs for the strategic mains project in the draft determination. This was because we did not consider that the risk, need and benefit for this level of activity and cost has been evidenced sufficiently, through investigation or through reference to known performance issues. However, we advised that we would consider the company's proposals further when it was in a position to present a well-evidenced business case to justify the expenditure.

5.100 In response to our draft determination, PNGL noted its disappointment that funding for the proposed steel plate inspections had been excluded. Although PNGL was still not in a position to present a well-evidenced business case to justify the expenditure, it submitted an alternative prioritised investment proposal linked to a risk assessment. PNGL's risk ranking was relatively straightforward and based on the age and diameter of the main on which the protective plates were installed. It suggested that the UR should provide allowances for PNGL to assess the condition of the steel plates at all sites assessed as being at 'high risk' (i.e. ≥250mm diameter and between 19 and 25 years old), as a minimum. PNGL noted this would provide UR and PNGL with evidence to inform any future decisions on the wider scope of this project as well flagging any urgent remedial work required at high-risk locations.

5.101 The cost of PNGL's alternative proposal is around £110k compared to an original submission of £600k. It would allow PNGL to inspect 624 (18%) of all sites ≥19 years of age and 4% of the overall number of sites that have steel plates installed. Whilst a smaller number of sites might be considered sufficient for a 'pilot' we have decided to include this allowance in the final determination. This will allow PNGL to undertake inspections at all sites that it deems to be at high risk and the decision has been taken on the basis that it only represents a marginal increase in cost from any alternative smaller pilot scheme. It will also ensure that no issues at high risk sites are missed as a consequence of the site selection required for a smaller sample size and will provide a broader basis (in terms of age, location and ground conditions) for assessing whether there is a need to extend the inspection programme to steel plates on smaller diameter mains in GD29. We expect PNGL to prioritise this work, based on age and criticality, and to record and report on its outcome as part of its GD29 submission. We will also consider the need for PNGL to submit interim reports on progress and findings

through its annual cost report to show whether the work is progressing as planned and the perceived benefits are being delivered.

5.102 Under Telemetry, PNGL submitted proposals to expand its pressure monitoring capability through the installation of monitors at 60 additional network monitoring points and the provision of monitoring at all of its 438 governor bin systems. In the draft determination we accepted the provision of the 60 additional pressure monitoring points on the basis that this would complement the monitoring already provided at District PRSs.

5.103 We did not allow the costs relating to the installation of pressure monitoring at the 438 governor bins as we were not convinced of the additional benefit of providing further monitoring within the network at this level, at significant additional cost to consumers. This resulted in a reduction of around £1m in the costs submitted for telemetry in the draft determination.

5.104 In response to our draft determination, PNGL noted its disappointment that funding for the proposed pressure monitoring at governor bins had been excluded. It referred to previous information presented in the business plan submission and through the subsequent information request process as evidence of the rationale and justification for this investment. It also submitted an additional alternative prioritised investment proposal linked to a risk assessment, based on a two-tier risk assessment approach.

5.105 The information submitted by PNGL also included historic fault data. This showed that in the 5 year period 2017 to 2021 there had been 178 faults identified through annual PSSR examinations which are intended to identify 'hidden' failures that otherwise would not be evident during day-to-day operations. The fault data submitted would equate to faults on 214 systems (or circa 50% of systems) on a pro-rata basis over 6 years. Water ingress and its subsequent effects were noted as the most prevalent cause of the issues experienced.

5.106 In its draft determination response, PNGL asked that the UR provide appropriate allowances to allow it to prioritise installation of pressure monitoring across 384 governor bin systems (i.e. those with ≥ Medium Risk from its risk assessment) during GD23. This equates to 88% of its total number of 438 governor bin systems and therefore 88% of the cost of the original submission (i.e. £897k compared to £1,023k). This chosen risk 'balance' appears high, particularly in the context of the fault numbers identified through the annual PSSR checks.

5.107 The categories included in PNGL's assessment would appear to provide a useful basis for prioritising investment. However, it does not necessarily provide a clear indication of the level of investment required or whether the

additional benefit delivered (for example over fault identification achieved through ongoing annual PSSR checks or through the pressure monitoring provided at District Governors and network control points) justifies the investment proposed. This is because the allocation of scores, categorisation of risk bands and decisions on the bands to include for investment in any such approach will, to some degree, be subjective choices, unless linked directly to the impact that historic performance issues have had on consumers.

5.108 Therefore, for the purposes of the final determination, we have used the historic fault data provided to derive an allowance for GD23 and have provided funding to install telemetry on 214 systems. This is the 6 year pro-rata equivalent of the number of systems that PNGL identified faults on between 2017 and 2021. This equates to an additional allowance of circa £500k compared to the draft determination and represents a reduction of £523k from PNGL's original submission of £1,023k.

5.109 This funding will allow PNGL to install pressure monitoring on approximately 50% of its Governor Bin systems on a prioritised basis during GD23. It will provide a comprehensive basis for monitoring and assessing the benefits that this investment delivers, in line with the approach proposed for steel plates. It will also deliver a level of coverage broadly equivalent to that which will have been provided for Firmus by the end of the GD23 price control period. The funding has been allocated in line with PNGL's original proposals. This will allow PNGL to complete these installations in the first half of the price control period and use the evidence gathered to inform any investment proposals submitted for the rest of the network in GD29.

5.110 A further telemetry reduction of around £110k had also been made in the draft determination as a consequence of PNGL identifying an error in the submission. This was due to the annual costs of their new Gascore platform and the calibration of telemetry being allowed for twice. This correction has been carried forward to the final determination.

5.111 The majority of the remaining telemetry increases relate to the need to replace or update software, systems and hardware which are becoming obsolete. This includes the impact of PSTN copper wire phone lines reaching end of life in 2025 and, as in the draft determination, costs have been allowed on this basis.

5.112 The step change in the valve maintenance expenditure almost entirely results from a strategic valve inspection programme proposed by PNGL. PNGL identified this requirement through an ISO 55001 asset management audit in 2020, which found that PNGL's 'Critical Valves' asset group did not fully correspond with current standards. As a consequence PNGL upgraded

its original inspection list to include valves at a list of additional strategic locations. PNGL quoted examples of condition deterioration found through operational activities and of valve failures linked to corrosion. It also highlighted that these types of valves have been installed since 1996 and that some will have reached 25 years of age by the start of GD23.

5.113 PNGL provided data to support the numbers and unit costs included in its submission. In recognition of the age and criticality of these assets, we allowed the total cost of just over £1.1m for strategic valve inspections in the draft determination, and this remains the case in the final determination.

5.114 The scope of work in the service risers and laterals cost category has increased due to the inclusion of a proposal to inspect house entry tees, cellar entry fittings and hockey sticks from 2021 onwards. This has been proposed as a consequence of an industry safety alert. As PNGL are planning to carry out these inspections when undertaking meter end of life replacements, we tried to reproduce numbers using meter stock data provided by the company, but our figures were slightly lower than PNGL's. PNGL subsequently provided additional information to clarify its submission. We allowed these costs in full in the draft determination, and have allowed them again in the final determination, following further consideration of the remaining minor reconciliation differences.

5.115 In the final determination we have applied an additional reduction of around £245k to the maintenance budget. This is to account for an estimate of the time that an additional GD23 emergency response team will spend on maintenance activities when it is not employed on emergency work. This deduction has been made following engagement with PNGL, during which it requested that the full allocation for this new team and for the existing team be made under 'PRE Repairs'. It is evident that the existing emergency team spends a proportion of its time doing maintenance work when not engaged on emergencies and it is reasonable to assume that this will be the case for the new team. We have not adjusted for the existing team in our assessment as PNGL has clarified that all of its costs were allocated to 'PRE Repairs' historically and that none of its costs were allocated to maintenance. Therefore, maintenance allowances based on historic costs will account for PNGL's approach to cost allocation and the cost for this team will only be allowed for once. However, a similar rationale does not apply for the new team as it did not exist. We consider that giving unadjusted maintenance allowances, based on the projection of historic costs, will already have provided the required funding for activities, despite the fact that the new team (fully funded through PRE Repairs) will be able to undertake some of this maintenance work moving forward. Our adjustment has been based on PNGL's numbers of jobs per annum and an estimate of hours

spent on jobs. We have assumed the following: that 50% of out of hours jobs require an additional 4 hours work the following day, that jobs undertaken within the normal working day take 4 hours and that the new team has to assist the existing team on 25% of its jobs. This roughly equates to the new team spending 77% of its time on emergency work and 23% of its time on maintenance work. We believe that this represents a reasonable approach, particularly considering that the total number of jobs has not increased proportionally, even by the end of GD23. The natural extension of this point is that even the existing team would have additional time to spend on maintenance work during the period, if the two teams roughly share the projected number of jobs equally between them. We also believe that the significant increase in maintenance activities in GD23 provides PNGL with sufficient opportunities to make efficient use of this team on maintenance activities, when it is not undertaking emergency work.

5.116 In the draft determination we also removed the 7.9% profit margin for any metering work that PNGL's related company, Phoenix Energy Services (PES), would be undertaking during GD23. This followed the approach adopted in previous price controls for work undertaken by related companies, as described in sections 5.7 and 5.8. This resulted in a reduction in the allowance of around £11.7k. In its draft determination response, PNGL questioned the principle of applying this profit margin adjustment for a number of reasons, which are fully detailed in section 5.9 of the overview. Following consideration of the case made by PNGL, we have decided to continue to apply the profit margin reduction in the final determination. The rationale for our decision is explained in detail in sections 5.10 and 5.11 of the overview section. The associated deduction has increased very slightly to £12.2k in the final determination as a consequence of the various changes made to maintenance cost adjustments since the draft determination.

5.117 Our method of assessing an appropriate level of FTEs has changed for the final determination and this has resulted in an increase in the number of FTEs allocated for maintenance compared to the draft determination. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

5.118 The outcome of our final determination assessment for maintenance is detailed in the table below. The total allocation represents a material increase when compared to actual and projected costs for GD17. The annual average allowance is over 75% higher than the annual average expenditure in the period 2017 to 2020 and around 60% higher if PNGL's projected expenditure for 2021 and 2022 is included. These increases align closely to those for FE. Therefore we consider that in overall terms it

represents a reasonable allocation for delivering the necessary maintenance activities when considered as a package.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	3,277	2,901	2,588	2,276	2,253	2,221
UR Final Determination	2,915	2,547	2,241	2,099	2,079	2,048
Variance	(361)	(354)	(347)	(176)	(174)	(172)

Note 1. Figures may not sum due to rounding.

Table 5.10: Maintenance Costs, Requested and Allowed, £k

Other Direct Activities

5.119 PNGL has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and, therefore, we have not provided for any allowances for the GD23 period.

IT & Telecoms

5.120 PNGL IT & Telecoms costs are in the main driven by its associated manpower costs and costs for stationery, communications and billing. In the 2020 year, PNGL had IT & Telecoms costs of £507k.

5.121 PNGL had 3.15 FTEs employed within the IT and Telecoms cost category in 2020 and projected a flat profile in FTEs for the GD23 period as well as a 12% increase on average in stationery, communications and billing costs in the GD23 period when compared to 2020 actuals. PNGL has explained that it 'expected a switch of IT costs from capex to opex from 2025 onwards as a result of IT suppliers moving from annual product licensing (opex) rather than perpetual licences (capex)' and therefore requested that we consider the aggregated IT forecasts for opex and capex when setting PNGL's overall IT allowances for GD23.

5.122 For the final determination we have rolled forward PNGL actual 2020 FTEs together with 2020 staff costs. In relation to stationery, communications and billing costs we have accepted PNGL projections, as we recognise some of the increase in opex costs arise from a switch in capex to opex costs in the GD23 period.

5.123 PNGL did not raise any consultation responses for IT and we assume that all allowances provided are sufficient.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	535	535	581	575	578	575
UR Final Determination	529	529	575	569	572	569
Variance	(6)	(6)	(6)	(6)	(6)	(6)

Note 1. Figures may not sum due to rounding.

Table 5.11: IT & Telecoms Costs, Requested and Allowed, £k

Property Management

5.124 The most significant cost item under PNGL property management costs are in relation to network rates. We have in the past set network rates using a formula which links the allowance to PNGL revenues.

5.125 We are comfortable with the approach of using a formula linked to revenue in order to set the network rates allowance for PNGL. We have used this approach historically both in GD14 and GD17. The network rates allowances have therefore been calculated accordingly.

5.126 PNGL have acknowledged that the figures contained within their GD23 business plan submission for network rates contained an error. We accepted the PNGL resubmission on network rates with the exception that we have profiled a 'flat rate in the pound,' for all years in GD23 as this has a consistent approach of how we have set network rates for both FE and SGN.

5.127 PNGL also requested that we treat network rates in GD23 as a cost pass-through item as it considers that 'network rates is something that PNGL as an entity has limited/no control over and therefore one that should be pass-through regardless of the choice of methodology utilised by LPS'.

5.128 For the final determination we are of the view for the GD23 period that the uncertainty mechanism should be updated to reflect network rates, consistent with the formula used that links to revenue, subject to PNGL demonstrating that it has taken appropriate actions to minimise valuations. We will expect PNGL (as well as the other GDNs) to provide a copy of its actual network rates bill and appropriate payment verification to the Utility Regulator alongside its annual uncertainty mechanism submission which is usually submitted with the Annual Cost Reporting Template.

5.129 PNGL also has rent and rates costs in relation to its offices. We have reviewed these costs and, consistent with our approach in GD17 and the draft determination, made an adjustment to give PNGL an opportunity to sub-let part of its premises. This would have been a reduction of 1/6 of the rent if the premises was sublet. However, PNGL have highlighted that they

have been unable to sublet any part of the building for a significant period of time and consequently we have removed this 1/6 reduction in rent.

5.130 PNGL have indicated that a rent review was underway in 2021, which is still ongoing. We have decided to use 2020 actuals, but with no rent reduction made, to provide some headroom for any increase that may occur.

5.131 It should be noted that at the time of the next price control, we would plan to review this area (Rent for the Office Building) and use appropriate benchmarks, to set an efficient level of rent, based on the size necessary to run a business of this size and scale.

5.132 PNGL had 1.55 FTEs under the Property Management cost category in 2020 and proposed an increase for the GD23 period to 2.11 FTEs for the GD23 period. We have allowed this for the final determination given it is in line with average medium-term historic actuals and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	3,681	3,790	3,855	3,994	4,061	4,594
UR Final Determination	3,081	3,125	3,175	3,194	3,184	3,167
Variance	(600)	(665)	(680)	(800)	(877)	(1,427)

Note 1. Figures may not sum due to rounding.

Table 5.12: Property Management Costs, Requested and Allowed, £k

HR & Non-operational Training

5.133 PNGL HR and non-operational training costs are in the main driven by staff costs and professional and legal fees as well as some materials costs.

5.134 In the 2020 year PNGL had HR and non-operational training costs of £244k. PNGL had 3.1 FTEs employed within the HR and Non-operational training cost category in 2020 and projected a flat profile in FTEs in this area for the GD23 period.

5.135 We have accepted this projection in FTEs and consequently provided for 3.1 FTEs in the GD23 period and rolled this forward with 2020 staff costs. We have also rolled forward 2020 professional and legal fees and materials costs as when taken together they are broadly in line with medium term historical actuals.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	272	273	273	273	273	273
UR Final Determination	242	243	243	243	243	243
Variance	(30)	(30)	(30)	(30)	(30)	(30)

Note 1. Figures may not sum due to rounding.

Table 5.13: HR & Non-Operational Costs, Requested and Allowed, £k

Audit, Finance & Regulation

5.136 PNGL Audit, Finance and Regulation costs are in the main driven by staff costs and professional and legal fees as well as some costs for stationery, comms and billing.

5.137 In the 2020 year PNGL had audit, finance and regulation costs of £965k. PNGL had 12.2 FTEs employed within the Audit, Finance and Regulation cost category in 2020 and has proposed an increase of 1.2 FTEs in this area for the GD23 period.

5.138 PNGL explained in its GD23 business plan that given its 'operational and strategic resource is fully utilised, PNGL has determined that 1 additional senior business analyst is required to deliver upon the suite of additional regulatory requirements of the department'.

5.139 We noted for the draft determination that PNGL has actually reduced the number of FTEs employed within its Audit, Finance and Regulation department over the medium term i.e. from 12.7 FTEs in 2014 to 12.2 FTEs in 2020. We also noted that in GD17 PNGL stated that it required 13.5 FTEs but only actually employed 12.2 FTEs in 2020. Therefore for the draft determination we rolled forward 2020 FTEs together with 2020 staff costs, which are marginally higher than GD17 medium term historical averages (i.e. over the 2017 to 2020 period).

5.140 PNGL projected professional and legal fees which contain uplifts in the 2027 and 2028 years in relation to price control costs as they consider it is 'more cost effective to buy in specialist services from the market as required,' as 'its scale does not justify retention of core services based on the breadth of activities that such core resources would need to cover.'

5.141 We have compared PNGL's submission in this area to the submissions received from the other GDNs and we have also compared PNGL's professional and legal fees in previous years, e.g. 2015 and 2016, for the GD17 price control.

5.142 Overall, we found the PNGL submissions in this area reasonable. We took the average of medium- term (2017 to 2020) professional and legal fees

actual costs and have applied this to the GD23 period and provided an uplift in line with PNGL submission. For the final determination we also rolled forward PNGL 2020 actuals for stationery, comms and billing as they are in line with medium-term historical actuals.

5.143 In its response to the draft determination, PNGL argued that the allowance for stationary comms and billing did not take account of the requirement for PNGL to inspect metering apparatus every five years, which equates to circa 20k additional jobs per annum, and therefore additional costs are incurred in relation to administration required to support these increases in maintenance activities. We have accepted this for the final determination with the exception of the 2023 year as we understand that the requirement to inspect metering apparatus, is every five years, which takes effect from the 2024 year. This provides for an increase of £296k versus the draft determination.

5.144 For the final determination we have provided for a further additional FTE for energy transition, which is consistent with our approach for the other GDNs. For the draft determination we had previously allocated 1 FTE for energy transition under the AMPR (non-OO) category. Therefore, we have reallocated that FTE to the audit, finance and regulation category.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,069	1,066	1,067	1,068	1,168	1,170
UR Final Determination	997	1,051	1,054	1,056	1,164	1,166
Variance	(72)	(15)	(13)	(12)	(4)	(4)

Note 1. Figures may not sum due to rounding.

Table 5.14: Audit Finance & Regulation Costs, Requested and Allowed, £k

Insurance

5.145 The main element of PNGL insurance costs is business insurance, which in turn is dominated by Business Interruption and Public Liability cover as well as Directors & Officers, Crime Professional Indemnity.

5.146 The total insurance costs requested by PNGL represent a significant increase on 2020 actuals. The increase between 2020 actuals and the request for GD23 from 2023 is around 48%. We queried PNGL about these increases and PNGL provided substantial documentation on their insurance premiums including their 2021 actual costs.

5.147 PNGL also explained that 'there is no evidence to suggest that these increases i.e. circa 40% increase from 2020 to 2021, will only apply in the short term and therefore the increases costs experienced by PNGL in 2021

are reflected in its overall insurance forecast for the GD23 price control period.'

5.148 However, we have noted the evidence provided by FE in terms of a benchmarking report showed that envisaged increases for 2021/2022 were not as significant as previously assumed albeit the increases are still significant. We also note that the claimed increases by PNGL are significantly higher than that claimed by FE.

5.149 We note that PNGL historical insurance costs have both increased and decreased between individual years over the medium term and there has not been any historic sustained period of increased insurance costs.

5.150 For the GD23 final determination we have based our allowances on a circa 17% increase on 2020 actual insurance costs. This is in line with the increases that has been allowed to FE. We note that this allowance is significantly above PNGL average insurance costs both in the GD17 period to date and the GD14 period. This approach should provide an appropriate allowance to deal with premiums for the next 6 years, recognising that insurance costs are not directly linked to operational activity, but the wider market place and past history of previous premiums.

5.151 In relation to office insurance we have based our allowances on 2020 actual costs. In relation to car insurance we note that the projected insurance per car profiled by PNGL is significantly above that of both industry benchmark reports and other GDNs operating in Northern Ireland. Therefore, we reduced the projections by PNGL to those contained within average policy price referenced in a recent industry report.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,054	1,063	1,066	1,071	1,080	1,089
UR Final Determination	812	812	812	812	812	812
Variance	(242)	(251)	(254)	(259)	(268)	(277)

Note 1. Figures may not sum due to rounding.

Table 5.15: Insurance Costs, Requested and Allowed, £k

Procurement

5.152 PNGL procurement costs are driven by staff costs. In the 2020 year PNGL had procurement costs of £62k. PNGL had 1.55 FTEs employed within the Procurement cost category in 2020. PNGL has projected 2.11 FTEs for the GD23 period.

5.153 For the final determination we have accepted PNGL's projection of FTEs as it is line with medium term historic actual FTEs and rolled this forward, with a slight increase in FTEs, with 2020 actual staff costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	78	78	78	78	78	78
UR Final Determination	85	85	85	85	85	85
Variance	7	7	7	7	7	7

Note 1. Figures may not sum due to rounding.

Table 5.16: Procurement Costs, Requested and Allowed, £k

CEO & Group Management

5.154 PNGL CEO & Group Management costs are driven by the senior management team costs as well as professional and legal fees together with stationary, communications and billing costs. The number of FTEs PNGL has allocated for the GD23 period is similar to that for 2020 actuals at 3.9 FTEs.

5.155 For the draft determination allowances for CEO & Group Management were rolled forward from GD17. We also rolled forward 2020 actual costs for professional and legal fees as well as for stationery, communications and billing costs.

5.156 In response to the draft determination, PNGL argued that its remuneration packages are appropriately benchmarked throughout the organisation, not least at management team level and that resource at this level within the business are guided by shareholder oversight and, due to the nature of the position, will be benchmarked against a wider UK sector specific marketplace.

5.157 While we note that it is up to PNGL to select its remuneration policy/packages, for all employees, 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 from the draft determination.

5.158 We also note that the allowances provided in the past for this area, have been regularly exceeded, but consider that this is a matter for the company to decide the emoluments at Management level.

5.159 PNGL also argued in its response to the draft determination that in relation to stationery, communications and billing costs, that we should have used an average of 2017-19 costs and excluded 2020 costs, due to the impact of

COVID-19, in order to determine allowances to cover these costs for the GD23 period.

5.160 For the final determination, we have used an average of 2017-20 costs to set allowances for stationery, communications and billing for the GD23 period and note that this is line with PNGL actual costs for 2019, a period preceding COVID-19.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,785	1,785	1,785	1,786	1,786	1,786
UR Final Determination	1,403	1,403	1,403	1,403	1,403	1,403
Variance	(382)	(382)	(382)	(383)	(383)	(383)

Note 1. Figures may not sum due to rounding.

Table 5.17: CEO and Group Management Costs, Requested and Allowed, £k

Stores & Logistics

5.161 PNGL stores and logistics costs are driven by transport and plant costs. In 2020, PNGL actual costs were £28k, and PNGL have requested allowances of £32k in the GD23 period. For the final determination we have rolled forward 2020 actuals costs as they are in line with medium term average historic actual costs.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	32	32	32	32	32	32
UR Final Determination	28	28	28	28	28	28
Variance	(4)	(4)	(4)	(4)	(4)	(4)

Note 1. Figures may not sum due to rounding.

Table 5.18: Stores and Logistics Costs, Requested and Allowed, £k

Advertising & Market Development (Owner Occupied)

5.162 The history and context of this section has been reviewed in Annex Q, Promoting connections, so all information in relation to any changes or consultation responses, and considerations is contained within that Annex.

5.163 The overall figures used for the final determination and simple calculations are below. They are subject to the uncertainty mechanism and actual outputs.

5.164 It should be noted that all connections allowances claimed by GDNs must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

5.165 Table 5.19 provides the annual average allowance per determined connection, which includes the fixed (£438k pa) and variable allowance as discussed in Annex Q. Table 5.20 compares the final determination owner occupied (OO) connections, used for the purposes of this calculation, against the PNGL GD23 submission.

PNGL	2023	2024	2025	2026	2027	2028
Average allowance per connection	337	320	309	313	316	320

Note 1. Figures may not sum due to rounding.

Table 5.19: OO Connection Allowance, £

5.166 The allowances set out in Table 5.20 translate to an average allowance over the 6 years of GD23 for PNGL of £319 per determined connection, subject to the fixed and variable allowance as described in Annex Q.

	2023	2024	2025	2026	2027	2028
PNGL submission	4,522	4,159	3,727	3,612	3,402	3,396
UR Final Determination	3,000	3,400	3,727	3,612	3,502	3,396

Note 1. Figures may not sum due to rounding.

Table 5.20: OO Connection Numbers

5.167 Table 5.21 shows the comparison of the final determination allowances against the PNGL GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	1,323	1,321	1,318	1,278	1,277	1,277
UR Final Determination	1,012	1,089	1,151	1,129	1,108	1,088
Variance	(311)	(232)	(167)	(149)	(169)	(189)

Note 1. Figures may not sum due to rounding.

Table 5.21: Advertising & Market Development (Owner Occupied) Costs, Requested and Allowed, £k

Advertising & Market Development (Non - Owner Occupied)

5.168 The Advertising and Market development (non-OO) cost category covers advertising and market development expenditure in relation to NIHE, New Build and I&C properties.

5.169 PNGL Advertising and Market development costs are driven by staff costs and market development costs and a small amount for stationery, communications and billing and entertainment. In the 2020 year PNGL had advertising and market development (Non-OO) costs of £454k.

5.170 PNGL had 7.6 FTEs employed within the advertising and market development (non-OO) category in 2020 and is proposing to increase the level of FTEs to 8.7 FTEs in GD23. We queried PNGL on this proposed increase and PNGL informed us that it had allocated an envisaged 'Energy Transition Manager' role to this cost category and that it had recruited this role part way through 2021.

5.171 We noted for the draft determination that the 2020 actual number of FTEs for advertising and marketing (non-OO) is significantly more than that planned by PNGL in the GD17 period which was 7 FTEs. We also noted that other GDNs have profiled lower FTEs in this area for the GD23 period and that connection numbers for the AMD (Non-OO) for PNGL are expected to decline in the GD23 period.

5.172 For the draft determination we based the advertising and market development (Non-OO) cost allowance for GD23 on the PNGL 2020 actual FTEs, however, we provided for an additional FTE for energy transition which was consistent with our approach for the other GDNs. This meant we provided for 8.6 FTEs against the 8.7 FTEs requested by PNGL and have rolled forward 2020 staff costs. We also carried forward 2020 costs for stationery, communication, billing and stationery costs.

5.173 For the final determination we have reallocated the existing FTE for the energy transition to the audit, finance and regulation cost category. This is, in addition to the extra 1 FTE allocated for this area, which includes an allowance for 2 FTEs for the energy transition overall. Further details of this are provided in Annex G of the Energy Strategy.

5.174 In its response to the draft determination PNGL argued that we had mistakenly used 2020 actual costs for the stationery, communication and billing which covers entertainment costs. PNGL argued that its entertainment costs were artificially low in 2020 due to COVID-19. We do not agree with this argument as we note that in some previous years predating COVID -19 e.g. 2014, PNGL had similar levels of entertainment expenditure. However, for the final determination we have used an average of expenditure over the 2017-2020 period to set allowances for the GD23 period.

	2023	2024	2025	2026	2027	2028
PNGL requested allowances	542	545	548	542	544	545
UR Final Determination	460	460	460	460	460	460
Variance	(82)	(85)	(88)	(82)	(84)	(85)

Note 1. Figures may not sum due to rounding.

Table 5.22: Advertising & Market Development (Non-Owner Occupied) Costs,

Requested and Allowed, £k

Trainees & Apprentices

5.175 PNGL has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and therefore we have not provided for any allowances for the GD23 period.

Non-Controllable Opex

5.176 The only costs under non-controllable opex are PNGL licence fees. We accepted PNGL forecast costs of licence fees of £158k per annum for the draft determination, but have worked on the area further and updated it for the final determination. Any difference between forecast licence fees and actual licence fees will be taken account of by the uncertainty mechanism in GD29.

Supplier of Last Resort

5.177 With regard to the Supplier of Last Resort (SOLR), we believe that there is merit to including an allowance to cover any unforeseen costs that may occur, if an event were to happen. This amount is ring fenced and will be removed at the time of the next price control, if an incident fails to materialise. For the GD23 final determination we have accepted the proposal made by PNGL and allowed £343k for these costs in 2023 only to cover the duration of the price control.

Health and Social Care Levy

5.178 An area that has arisen since the submission of the Business Plan is the 'Health and Social Care 'Levy,' which was introduced by HM Revenue and Customs (HMRC) and has a similar charging structure to National Insurance Contributions. It was introduced in April 2022 and will be treated as a separate new tax of 1.25%, from April 2023.

5.179 The Chancellor announced on the 23 September 2022, regarding its Growth Plan[7] statement and reconfirmed that the April 2022's National Insurance rise and April 2023's Health and Social Care Levy will be cancelled. Following this announcement, legislation was introduced to the House of Commons, to bring this into effect.

[7] The Growth Plan: Factsheet on cancellation of National Insurance rise and Health and Social Care Levy - GOV.UK (www.gov.uk)

5.180 PNGL provided further information on this area and the likely effect on costs for each FTE. Based on this recent update, no allowance for the Health and Social Care levy has been provided for the duration of GD23.

Energy Strategy Funding Levy

5.181 As indicated in Annex G, Energy Strategy, a funding levy of 1% of Totex (i.e. all Capex and Opex allowances over the FD period), has been introduced. This funding is to enable projects that will achieve the aims of the Energy Strategy. This area is ring- fenced and subject to the uncertainty mechanism. Projects will need prior approval in advance, before any expenditure is approved in most cases, and must be accompanied with a business case, in which it is envisaged that all GDNs will submit a shared proposal, with the level of work/role envisaged for each operator.

Capitalisation

5.182 For the GD23 final determination we have accepted PNGL capitalisation rates.

Shrinkage

5.183 Having assessed the PNGL business plan submission with respect to shrinkage, we noted that the shrinkage factors are forecast to be stable at 0.22% across the GD23 price control period. They are also consistent with the shrinkage factor for 2019 and 2020 and those forecast for the last two years of the GD17 price control period.

5.184 We have not made any shrinkage-related changes to existing regulatory arrangements and/or the introduction of a shrinkage-related incentive mechanism at this stage.

5.185 However, we consider that PNGL should continue to establish the annual shrinkage factor, in line with the common Northern Ireland Shrinkage Methodology which was developed, and should be maintained and amended as may be appropriate from time to time, jointly by all three GDNs. We furthermore consider that shrinkage should continue to be monitored as part of the annual cost and performance arrangements.

Real price effects, productivity and frontier shift

5.186 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

5.187 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for

broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH).

5.188 However, not all types of cost changes experienced by a network business will be reflected in the basket of prices used to calculate the general inflation measure.

5.189 To account for this, it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

5.190 This calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs). The deduction of the projected rate of productivity growth, produces the frontier shift. The sum of these components can be a positive or a negative difference.

5.191 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

5.192 We have adopted the methodology we first introduced at PC13, PC15 and PC21 for NI Water, which aligns closely with the determination for Northern Ireland Electricity at RP5, RP6, and, more recently the Competition and Markets Authority (CMA) decisions.

5.193 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	6.9	7.8	4.5	2.7	2.8	3.1	3.1	3.1
CPIH	(2.5)	(8.0)	(5.6)	(2.3)	(1.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift	CPIH +3.2	CPIH -1.2	CPIH -2.0	CPIH -0.6	CPIH +0.6	CPIH -0.1	CPIH -0.1	CPIH -0.1
Cumulative frontier shift	3.2	2.0	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2

Table 5.23: GD23 Opex frontier shift calculations

5.194 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

5.195 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

Summary of bottom-up assessment findings

5.196 Table 5.24 shows the opex allowances for PNGL in the GD23 period. The total pre-efficiency opex allowances (excluding allowances associated with AMD-OO) for PNGL in GD23 on average are 10% higher than 2020 actuals.

PNGL Categories	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	267	267	267	267	267	267	1,600
Operations Management	497	497	491	491	491	491	2,958
Emergency Call Centre	460	459	459	489	489	511	2,868
Customer Management	790	790	788	789	789	789	4,735
System Control	122	122	122	122	121	121	730
Emergency	1,303	1,328	1,350	1,372	1,394	1,415	8,161
Metering	1,510	2,118	2,220	2,501	2,238	2,373	12,959
PRE-Repairs	887	893	894	899	905	910	5,387
Maintenance	2,915	2,547	2,241	2,099	2,079	2,048	13,929
Other Direct Activities	0	0	0	0	0	0	0
IT & Telecoms	529	529	575	569	572	569	3,345
Property Management	3,081	3,125	3,175	3,194	3,184	3,167	18,926
HR & Non-operational Training	242	243	243	243	243	243	1,457
Audit, Finance & Regulation	997	1,051	1,054	1,056	1,164	1,166	6,488
Insurance	812	812	812	812	812	812	4,872
Procurement	85	85	85	85	85	85	510
CEO & Group Management	1,403	1,403	1,403	1,403	1,403	1,403	8,417
Stores & Logistics	28	28	28	28	28	28	166
Advertising & Market Development - Owner Occupied (OO)	1,012	1,088	1,151	1,129	1,108	1,088	6,577
Advertising & Market Development (Non OO)	460	460	460	460	460	460	2,760
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	158	158	158	158	158	158	948
Supplier of Last Resort	343						343
Energy Strategy funding Levy	369	357	359	351	313	312	2,061
Total: Pre Efficiency	18,269	18,360	18,332	18,517	18,303	18,417	110,199
Frontier Shift %	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2	
Total: Post Efficiency	18,254	18,234	18,322	18,497	18,274	18,378	109,959

Note 1. Figures may not sum due to rounding.

Table 5.24: PNGL GD23 Opex Final Determination Pre and Post Efficiency, (£k)

6. SGN Natural Gas - UR Decisions

Summary of Key Changes from Draft Determination to Final Determination

6.1 The final determination is made after carefully considering all the consultation responses, along with any further information supplied by the GDN's and engagement with the companies. The key changes are as follows:

- We have increased the allowance per new customers connected in AMD (OO) to maximise the number of connections possible.
- We have provided allowances for SME (Small and Medium sized Enterprises) to drive connections in this area in AMD (NON OO)
- IT and Telecoms costs are now provided for on a normal operating basis and not connected to the G2W bid.
- We have changed the CEO Group Management (Managed Service Agreement) that will break the link to the G2W bid from 2028 onwards.
- We have provided funding of 1% of Totex to enable backing of projects related to the Energy Strategy.
- Around 6 Extra FTEs have been added in total, to deal with the impact of the Energy Strategy and the other for business support areas identified.
- We have moved in some areas from using the 2020 year where persuasive evidence has been provided, to ensure there is a more appropriate funding level for the GD23 period.
- Emergency Call Centre: We have rebased the Cadent management fee and increased call thresholds twice during the GD23 period which has resulted in an increased allowance. This adjustment is based on an estimation of when Cadent will need to increase its resources as a consequence of the combined call volume exceeding the capacity of its allocated resource.

- Emergency: The final determination changes in the emergency cost category were minor and related to our updated forecasts for connection numbers and FTE levels. All other draft determination adjustments and principles remain unchanged.

- Metering: The final determination changes in the emergency cost category were minor and related to our updated forecasts for connection numbers and FTE levels. All other draft determination adjustments and principles remain unchanged.

- PRE Repairs: The final determination changes in the PRE Repairs cost category were minor and related to our updated forecasts for connection numbers and FTE levels. All other draft determination adjustments and principles remain unchanged.

- Maintenance: The final determination changes in the maintenance cost category were minor and related to our updated forecasts for FTE levels. All other draft determination adjustments and principles remain unchanged.

6.2 The full detail is contained within the appropriate sections below.

Overview

6.3 As set out in chapter 2, we have used bottom-up analysis as basis for our assessment of opex business plan requests.

6.4 We note that, in line with our detailed approach set out in chapter 2, we have assessed the requested opex allowances for the different cost categories. We have also undertaken additional analysis for selected expenditure types and on the proposed capitalisation policies. The bottom-up part of this chapter is structured accordingly.

6.5 We note furthermore that, in line with our detailed approach set out in chapter 2, we have generally used the most up to date detailed actuals[8] as part of our assessment of business plan requests, i.e. data relating to 2020 and considered the summary 2021, where it is available,. We consider that this provides a sound basis to set-up a benchmark where appropriate.

Implications of the G2W Application Process

6.6 In some circumstances, however, we have good reasons for deviating from the normal approach in setting allowances.

[8] See Section 3.7

6.7 We believe the circumstances are warranted for some cost lines. The reason for the deviation, is that in the context of the award of the SGN licence, reference was made to certain areas that would last beyond the GD17 price control period. To that end we need to examine the SGN business plan submission in some areas, in tandem with the application process for the G2W licence, specifically:

a) IT and Telecoms costs;

b) CEO Group Management (Largely Managed Serves Agreement (MSA); and

c) Advertising and Market Development (non-OO) category.

6.8 In order to facilitate an analysis of the SGN GD23 business plan submission against the G2W bid we requested SGN to provide its G2W bid in a structure consistent with the GD23 business plan template. SGN responded to the Utility Regulator stating that 'this information is not readily available and can only be derived through a set of assumptions on how the original bid was compiled. Neither the original bid nor the underlying calculations contained this information and would require spurious assumptions to be made.'

6.9 SGN also stated 'SGN NG no longer consider the values within the bid to be an appropriate point of reference. The forecast figures were prepared in 2014 and were based on assumptions that we believed were appropriate at that time. Since then, many of these assumptions have been proved to be incorrect which therefore impacts the validity of these forecasts. The GttW project delivery has also been delayed since the bid submission, which has had significant impacts on many aspects of our original forecasts. We consider that our operating costs for the GD17 period are now the most appropriate point of reference, and therefore render the bid figures obsolete. Therefore, our GD23 submission is based around our GD17 actual expenditures that have been incurred efficiently over the price control. We feel that many bid assumptions (derived from the FMA study) have been shown to be unreliable when considering the actual outturns witnessed, therefore as this information is not part of our GD23 submission, we do not see the relevance of completing this spreadsheet for years 7 to 10.'

6.10 SGN also responded that the GD17 final determination stated: 'Thus in advance of GD17, it was clear that we intended to put significant weight on the figures used in the G2W licence competition. It was also clearly identified that adjustments would be considered to reflect changes to assumptions on customer numbers and volumes. However, otherwise there was a high bar to making changes from the AIP and this was particularly true for the first price control.'

6.11 On 6 February 2014, we published the G2W Applicant Information Pack (AIP).[9] In addition to details on the licence application process itself, this document also contained clarifications on links between the information revealed as part of the application process and subsequent price control processes. This was to incentivise applicants to submit realistic bids.

6.12 With respect to opex allowances we stated: "we believe that a direct link between the cost information revealed in the application and the allowances provided in subsequent price controls will act as a powerful incentive to ensure that applicants reveal realistic cost information and that some link should be maintained beyond the first price control period. In particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies. However, we will consider requests for different allowances where these are the result of unforeseen significant changes in the market since the application was submitted[10]." We also clarified that, "[as] set out [...] under capex, a number of items are adjusted under an 'uncertainty mechanism' and we intend this to be applied to the new licence."[11]

6.13 There was further guidance specifically in relation to incentivising Industrial and Commercial Customers (I&C customers, where Paragraph 4.36 of the AIP stated: '[no] incentive payments for non-owner occupier connections have been included in the workbook. However, if an applicant believes that in order for them to meet the target for industrial and commercial connections they will require funding for financial incentives they have an opportunity to include such costs in the Operating Expenditure worksheet. They should also explain in their operational business plan how such payments would facilitate connections by non-owner occupier supply points. Only if the successful applicant has included such incentives in their application will these be funded by price control allowances.'

6.14 The Applicant Information Pack also clarified that we intended to use the pattern of volumes and connections derived from the FMA study[12] to set the first and future price controls. However, we also clarified that, should significant changes in expected supply points/consumption patterns arise between the licence application process and the setting of the first price

[9] Utility Regulator: Gas Network Extensions in Northern Ireland, Gas to the West: Applicant Information Pack, 6 February 2014.
[10] Utility Regulator: Gas Network Extensions in Northern Ireland, Gas to the West: Applicant Information Pack, 6 February 2014, paragraph 3.44
[11] Utility Regulator: Gas Network Extensions in Northern Ireland, Gas to the West: Applicant Information Pack, 6 February 2014, paragraph 3.47
[12] A study by Fingleton McAdam (FMA) to determine the technical and economic feasibility of extending the natural gas network in Northern Ireland which was used by DETI in its assessment of G2W and the basis for the figures used in the Application Workbook.

control, we would consider if these needed to be reflected in the development plan and price control values.

6.15 In August 2014, the Preferred Applicants chosen were NIEH for the HP pipeline and SGN for the LP pipeline.

6.16 Thus, in advance of GD17 and GD23, it was clear that we intended to put significant weight on the figures used in the G2W licence competition. It was also clearly identified that adjustments would be considered to reflect changes to assumptions on customer numbers and volumes. However, otherwise there was a high bar to making changes from the AIP and this was particularly true for the first price control.

6.17 In its GD17 submission and in its GD23 submission, SGN proposed significant changes to opex figures compared to those it submitted in their G2W application. We have examined these carefully against the criteria we set out in designing the G2W licence application competition.

6.18 For GD17 we provided for increased costs only for those cost categories which were related to a change in customer numbers and volumes as the G2W AIP stated ''if there are significant changes in expected supply points/consumption patterns between the licence application process and the setting of the first price control we will consider if these need to be reflected in the development plan and the price control values.'

6.19 In GD17 it was clear that there had been a significant change in projected customer numbers and volumes since the licence application and this warranted an adjustment to the opex that was submitted by SGN in its licence. Consequently, in GD17 we provided for an uplift in opex costs, which we considered to be most impacted by increased customer numbers.

6.20 For GD23 we have reviewed actual customer numbers versus those projected in the GD17 final determination. We note that the actual number of customers is materially lower than that projected in GD17 for example actuals connections over the 2018 to 2020 period were 1,320 versus 4,940 connections projected over the same period in the GD17 final determination. This means that the scale of the SGN business is now smaller than what was actually delivered in GD17, up until 2020.

6.21 We note the SGN reference to paragraph 4.39 in the GD17 final determination, however we do not consider our approach to determining SGN opex allowances for GD23 to be inconsistent with the paragraph cited by SGN.

6.22 Finally, to check that our GD23 draft determination opex allowances for SGN (excluding costs associated with the connection incentive) for 2028 are

reasonable, we compared them to assumptions made in the G2W low pressure workbook. Specifically, paragraph 4.32 of the G2W applicant information pack stated: 'In subsequent years the pattern of operating expenditure in years 11 to 40 reflects experience from existing distribution networks in Northern Ireland. For year 11 the average operating expenditure for years 1 to 10 excluding mobilisation will be uplifted by 15%'. In relation to SGN, year 11 is equivalent to the 2028 year.

Update on the approach of the G2W Application Process areas

6.23 We believe our approach for the draft determination was valid, and provided adequate notice to SGN in how certain areas would operate beyond the 1st price control, in keeping with the need to maintain the integrity of the licence application and award process. However, we have further considered the responses made by SGN on these areas and the reasonableness of keeping to figures presented in 2014 in relation to the submission of the bid to run and operate its business.

6.24 Whilst the market has moved on in some areas since the submission of the application, the fundamentals of running a Gas Network Business have largely remained the same, and in relevant instances where change has occurred, we do not consider those changes to have been unforeseeable or indeed entirely "unforeseen". An experienced gas network operator would be aware of potential changes in these areas, and it is possible that the assumptions used in the submission of the bid did not have sufficient scrutiny in what was proposed.

6.25 As stated in 6.12, we are using our discretion, as identified in the following section, 'However, we will consider requests for different allowances where these are the result of unforeseen significant changes in the market since the application was submitted.' In terms of reviewing the following areas, we have come to the following view:

a) IT and Telecoms

SGN has suggested several issues were unforeseen. We outline these below. SGN considered that there was a shift in focus of cyber security, with increased concerns over the threats and the level of protection required. Another factor was the move to cloud-based operations and supporting staff to work from home fully and beyond. In addition, SGN noted the investment of a new CRM System in 2016 that was not within the original bid, as it was envisaged the existing SGN system could be utilised for NI. SGN, in the original bid, included the assumption that the corporate Geographical Information System (GIS) would be appropriate to support the mapping for the development of the network, but this was not the case.

We accept that some of these events could be considered 'Unforeseen,', and based on the IT requirements/costs for the other GDNs, we have been persuaded to grant allowances in line with current costs.

b) CEO Group Management (largely Managed Service Agreement (MSA)

SGN have suggested that, under the Managed Service Agreement (MSA), the level of support required from the SGN group has significantly evolved. This includes governance support in the areas of specialist procurement, HR, Gas Control, Legal and compliance, Finance, Stakeholder Mgt, IT Support, Board and non-executive support and costs relating to facilities, insurance, regulation support in relation to Price Control activity including strategic and governance activity.

Whilst we understand the issues raised, we feel that this area was clearly sign posted and not 'Unforeseen.'. As stated in paragraph 6.12 above: "In particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies."

However, we consider that this should last for a minimum of 10 years, as identified in paragraph 6.22, and believe that moving away from this position in the last year of the price control and setting allowances based on 2020 actuals, is a suitable comprise to clearly signal that we would be minded to change this position for the next price control. The extra allowance is discussed below.

c) Advertising and Market Development (non-OO) category

SGN have said the following in its consultation response to our proposal in this area:

(i) When SGN submitted the bid, the previous price controls gave the impression that the customer market was more established than it actually was.

(ii) Without appropriate support to connect I&C customers to the network, the customer base will struggle to grow to a point, where it would not be critically impacted by the withdrawal or reduction in demand of one of the large I&C 'anchor' loads.

(iii) Accordingly, we do not consider there to be any scenario where it is in customers' interests to hold SGN to the bid position which has clearly been demonstrated to be erroneous.

(iv) It is important that an underestimate in 2014 should not block the progress to improving the networks resilience and customer security.

(v) Directing towards previous regulatory decisions by UR, on providing allowances to other GDNs in this sector and the benefits that resulted from the momentum in establishing focus on this area.

(vi) Recognising UR's statutory duty to 'promote the development and maintenance of an economic and coordinated natural gas industry' and the significant wider economic benefit that connecting small I&Cs as early as possible during the licence period brings to all customers on the network, SGN believe it is absolutely necessary to include an incentive regime to encourage connections in this area.

(vii) SGN fundamentally disagree with the UR's proposals in the DD. It claims that the UR should not risk the long-term sustainability of the network and the financial impact of the customer that have already connected based on an assumption made in 2014 that is clearly and demonstrably incorrect.

Whilst the terms of the bid were clear, some of the comments made suggest a lack of due diligence and undertaking of research in the market place. However, a number of the points made do bear further consideration in the context of the requirement to promote the development of this sector, albeit for a limited time, and to establish this sector with the associated benefits and outcomes. Based on this evidence, we plan to provide the request in the allowances for this area. It will be based on actual outputs of connections, dependant on size of the connection (ie IC 1 & 2) and subject to the uncertainty mechanism and ring fenced. This allowance will not be repeated in GD29, as over 10 years will have passed since the 1st price control came into effect and it would be similar in duration to that of the last GDN who received a similar type of assistance. Further details are contained within the relevant section below.

Bottom-up assessment

Manpower

6.26 Given that manpower is such an integral part of the price control, we consider the number of FTEs necessary to run an efficient business; it is therefore appropriate to determine the cost allowance at the overall manpower level.

6.27 In GD17, this area was set as per the G2W bid, which had a range of 17-19 FTEs employed during this control.

6.28 For GD23, we have adopted the approach as used for FE and PNGL, which does not set explicit FTE allowance for the individual cost categories, since manpower forms part of most of the cost categories within the Annual Cost Reporting Template, rather than being an individual cost category. We consider that it is the choice of the GDN to decide where to allocate its resources, as business needs develop.

	GD17				
	2018	2019	2020	2021	2022
SGN Requested Allowances	13.7	19.8	21.0	20.0	20.0
UR Determined	19.0	19.0	19.0	17.0	17.0
SGN Actual	16.8	19.3	20.6	23.7	28.0
	GD23				
	2023	2024	2025	2026	2027	2028
SGN Requested Allowances	33.0	33.0	36.0	37.0	38.0	38.0
UR Determined	33.3	33.3	34.3	35.1	36.1	36.1

Note 1. Figures may not sum due to rounding. Note 2. The year 2022 is forecast.

Table 6.1: SGN FTEs Requested, Actuals and GD23 Determined

6.29 Table 6.1 sets out the SGN requested allowances for FTEs for both GD17 and GD23. It can be observed that SGN actual number of FTEs for 2020 was above our GD17 allowances by 8% but in line with the SGN GD17 business plan submission.

6.30 SGN has requested increases in FTEs in the GD23 period across most cost areas with the most significant increases requested in operations management, audit, finance and regulation and advertising and marketing for owner occupied and non-owner occupied properties.

6.31 However, we do not agree that the level of resources requested by SGN is appropriate. We have therefore in general based the level of FTEs on the 2020 level of FTEs and provided for additional FTEs, where we considered there was evidence to support the requested increase. We have also provided for an additional FTE for 'energy transition.'

6.32 An area that is connected to Manpower and has subsequently happened since the submission of the Business Plan is the 'Health and Social Care Levy,' further details and implications are contained in section 6.184

Asset Management

6.33 SGN Asset Management costs are in the main driven by its associated manpower costs. In the 2020 year, SGN had Asset Management costs of £34k and had 1.08 FTEs. PNGL has requested a marginal increase in FTEs in the GD23 period to 1.16 FTEs on average. SGN also requested contractor costs of £11.5k on average for the GD23 period.

6.34 For the draft determination we rolled forward 2020 actuals of 1.08 FTEs as well as 2020 staff costs. We did not accept SGN's projected contractor costs as we noted SGN has not incurred these costs in its historical actuals.

6.35 In its response to the draft determination SGN highlighted that it has contracted Lloyds Register to carry out ISO 550001 Asset Management accreditation and surveillance visits in the GD23 period, including a detailed assessment in 2026.

6.36 For the final determination we have provided the requested allowances for these contractor costs and the request for a marginal increase in FTEs. However, we expect SGN to have fully implemented their asset management system in GD23, given these allowances have been granted for the final determination and this allowance would be very unlikely to be repeated again.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	40	40	43	60	47	47
UR Final Determination	38	38	41	59	46	46
Variance	(2)	(2)	(2)	(1)	(1)	(1)

Note 1. Figures may not sum due to rounding.

Table 6.2: Asset Management Costs, Requested and Allowed, £k

Operations Management

6.37 SGN's Operations Management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had Operations Management costs of £157k and had 5.19 FTEs employed within the Operations Management cost category. SGN have proposed that there should be on average 9.1 FTEs for Operations Management in the GD23 period.

6.38 SGN have explained that the forecast increase in FTEs is required as: "with the construction workload reducing significantly over time, it believes this model (using a combination of direct-employed and out sourced resources) offers the greatest flexibility and we will move to having more direct employees as justified by the changing workload over time."

6.39 For the draft determination we have provided for an additional 2 FTEs as this is consistent with increase in FTEs in the FE and PNGL network areas when they were in a similar stage of their network development. We also rolled forward 2020 actual staff costs with the 7.19 FTEs allowed for.

6.40 In its response to the draft determination SGN argued that our draft determination allowances did not allow for the increase operational

management workload that will develop over the GD23 period and it did not agree with the UR's approach to determining allowances in this area as the assessment does not consider differences in organisational structure and allocation of costs between the three GDNs.

6.41 We do not agree with the points made by SGN as each of the GDNs are required to submit actual costs and business plan forecast costs using a common approach. We also note that SGN's actual number of FTEs in this area for 2021 only increased by 0.02 FTEs versus 2020. Consequently, our final determination allowances are unchanged from the draft determination.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	247	247	269	279	281	281
UR Final Determination	227	227	213	220	221	221
Variance	(20)	(20)	(56)	(59)	(60)	(60)

Note 1. Figures may not sum due to rounding.

Table 6.3: Operations Management Costs, Requested and Allowed, £k

Customer Management (Emergency Call Centre)

6.42 An explanation of the Customer management (Emergency Call Centre) cost category and GDN arrangements for dealing with emergency calls is provided in the bottom up assessment overview section, starting at 2.30 above. This also explains why we were unable to use the combined modelling technique, applied in previous price controls, to project call volumes for the GDNs and therefore moved to company specific assessments for GD23.

6.43 SGN based their call forecast on the number of properties passed. We are not convinced that this is an appropriate driver for emergency calls and so have used connection numbers for our forecasts. This follows the approach we have adopted in previous price control and for the other GDNs. As part of its consultation response, SGN reiterated their belief that properties passed is an appropriate metric for forecasting emergency calls. We have decided not to change our approach for the final determination and continued to use connections to develop our call forecasts. This is because we believe our initial conclusion remains valid.

6.44 We therefore calculated the annual percentage of calls per connection based on SGN's submission and applied this to our forecast connection numbers to generate a total number of calls for each year of GD23.

6.45 The forecast customer connections have been remodelled for the final determination and this has produced a slightly lower connection forecast

than the draft determination. The number of calls has therefore reduced in the final determination, as a result.

6.46 Our final determination connection numbers for GD23 are around 5,000 lower than those submitted by SGN in its business plan. We are therefore forecasting a reduction of 395 calls over the period, compared to the company submission.

6.47 The reduction in emergency calls in the final determination has not increased the cost reduction for the emergency call centre beyond that applied in the draft determination. This is because the threshold for Cadent's fixed management fee has not been exceeded. However the lower call numbers do affect the cost allowances for Emergency and Public Reported Escape repair jobs, as both are directly related to the number of emergency calls received from customers.

6.48 During the draft determination process SGN identified an error in the original submission related to the costs for the call handling service provided by Cadent. SGN advised that the increase from £63,000 in 2026 to £93,000 in 2027 was incorrect and this was removed from the draft determination. This correction has been carried forward to the final determination and accounts for the majority of the cost reduction in this category.

6.49 Section 2.34 of this document explains that the emergency call handling agreement with Cadent includes a monthly threshold for the number of calls covered by a fixed fee.

6.50 In its business plan submission SGN had included additional costs for calls exceeding the contractual monthly threshold in years when the cumulative annual threshold had not been reached. We have estimated variable cost allowances on the basis of exceedance of the annual call threshold total. This is on the basis that predicting exceedances in any month is not possible and that SGN could reasonably have agreed a fixed cost threshold profile with Cadent, based on their experience of other local GDNs, which might have better reflected seasonal variances.

6.51 FE's consultation response noted the potential for Cadent to increase charges in GD23 as a consequence of the increase in the total number of GDN emergency calls during the period. As a consequence of our assessment of this issue, we have allowed for cost increases in 2026 and 2028. This has benefitted all three GDNs. For SGN this has resulted in an additional cost allowance of around £3.7k in the final determination. Sections 2.35 and 4.1 provide further details of our treatment of this issue.

6.52 Our methodology for assessing the FTE allocation changed for the final determination, resulting in a minor decrease in the allocated FTEs for the emergency call centre for SGN. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

6.53 The outcome of our final determination assessment for the emergency call centre is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	105	105	105	106	138	138
UR Final Determination	103	103	103	105	106	107
Variance	(1)	(1)	(2)	(2)	(32)	(31)

Note 1. Figures may not sum due to rounding.

Table 6.4: Customer Management Costs (Emergency Call Centre), Requested and Allowed, £k

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

6.54 SGN's customer management costs are in the main driven by its associated manpower costs. In the 2020 year PNGL had customer management costs of £17k and had 0.55 FTEs employed within the Customer Management cost category. SGN have proposed an uplift of FTEs to 2 FTEs on average in the GD23 period.

6.55 For the draft determination we provided for an additional 0.54 FTEs i.e. doubled 2020 actuals, as this is consistent with increases in FTEs in the FE and PNGL network areas when they were in a similar stage of their network development. We have rolled forward 2020 staff costs with this profile of FTEs.

6.56 In its response to the draft determination, SGN argued that a direct comparison cannot be made between PNGL and SGN at their relative stages of development. We do not agree with this argument and note that the SGN network, even when fully developed, will have significantly fewer customers than either the FE or PNGL network areas. However, for the final determination we have provided for an uplift of 0.2 FTEs on average in the GD23 period.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	48	48	64	65	67	67
UR Final Determination	48	48	63	63	66	66
Variance	0	0	(1)	(2)	(1)	(1)

Note 1. Figures may not sum due to rounding.

Table 6.5: Customer Management Costs (Including Non-Emergency Call Centre) & Network Support (Including System Mapping), Requested and Allowed, £k

System Control

6.57 SGN system control costs are in the main driven by its associated manpower costs. In the 2020 year SGN had manpower costs of £37k and had 0.94 FTEs employed within the System Control cost category. SGN has proposed an additional 0.5 FTEs on average for System Control in the GD23 period.

6.58 For the draft determination we rolled forward the 2020 FTEs and staff costs and therefore did not allow the proposed increase in FTEs.

6.59 In its response to the draft determination SGN argued that the area of system control is directly linked to the size of the network and the level of network activity and that the UR should have used a bottom up analysis carried out by SGN which determined the additional workload that will be required in this area as the network continues to develop.

6.60 We do not agree with this argument as we note that the number of FTEs SGN employed in this area actually fell in 2021 when compared to 2020. We also note that the number of FTEs employed by PNGL and FE in this area has not materially increased over time and as their network has developed. Consequently, our allowances are unchanged for the final determination.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	53	53	55	56	58	58
UR Final Determination	35	35	34	34	35	35
Variance	(18)	(18)	(21)	(22)	(23)	(23)

Note 1. Figures may not sum due to rounding.

Table 6.6: System Control Costs, Requested and Allowed, £k

Emergency

6.61 The Emergency cost category relates to the costs and activities associated with the initial callout and response to an emergency call from the public that requires further investigation.

6.62 In some cases the emergency call is closed without a visit as it is possible to resolve the issue over the phone. In most cases, however, a trained first responder is sent to the location in question to determine the nature and severity of the incident. Further details on this cost category and the companies' approach to managing this work can be found in the bottom up assessment overview section, starting at 2.43 above.

6.63 A deduction was made to the emergency cost allowance in the draft determination, as a result of a mistake in the submission data. We corrected this which resulted in a reduction in contractors' costs of £1.8k per annum. This correction has been carried forward to the final determination.

6.64 To assess the appropriate level of expenditure and activity for emergency jobs in GD23, we used a model supplied by SGN through the query process. The model categorises emergency jobs based on the number of calls in each year of GD17 to date and the number of each type of emergency or PRE job that resulted from them. It then monetarises the jobs using the contractor rates and average hours allocated to each type of job.

6.65 The proportions of each job type and the costs submitted by the company in the model were accepted and used to forecast the Emergency and PRE Repair allowances in the draft determination.

6.66 We calculated the number of emergency jobs to be entered into the model using the company's submitted proportion of emergency calls that became emergency jobs. This was found to be 57.8% and was applied to the call numbers that we had estimated for GD23 as a flat rate throughout the period. As our connections and call numbers were slightly lower than SGN's, this resulted in a total number of jobs which was lower than the company's submission.

6.67 Our forecast for the number of emergency jobs in GD23 has reduced further in the final determination. This is because our remodelled connection numbers are lower than in the draft determination, which leads to lower call volume estimates. The number of jobs in our final determination is 229 fewer than in SGN's business plan, resulting in a lower cost allowance.

6.68 The variable cost outputs from the model were split between PRE Repairs and Emergency Jobs, according to the proportions identified by the company and added to the contractor fixed costs to determine the GD23 allowances.

6.69 From the company's submission, we calculated a drop in the ratio of calls to connections in 2028 which exceeded the number of additional connections. This is why our emergency allowance is slightly lower in 2028 than 2027.

6.70 The higher cost in 2026 is due to additional involvement of the SGN NG services contractor in that year. Although this is a related company, SGN have assured us that there is no profit margin associated with this work and so no further adjustment is required.

6.71 Our assessment of the FTE allocation for SGN's emergency cost category changed for the final determination, resulting in a minor increase in allocated FTEs and associated costs. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

6.72 SGN did not challenge any aspects of our draft determination for emergency jobs in its consultation response. Therefore, the only adjustments made in the final determination were those related to the change in connection numbers and our revised methodology for assessing the number of FTEs.

6.73 The outcome of our final determination assessment for emergency costs centre is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	176	180	184	198	193	195
UR Final Determination	170	173	177	190	184	186
Variance	(6)	(7)	(7)	(8)	(9)	(9)

Note 1. Figures may not sum due to rounding.

Table 6.7: Emergency costs allowed in the final determination for SGN

Metering

6.74 SGN submitted costs of around £840k for meter maintenance in the GD23 period. Routine maintenance on meters and governors accounted for 81% of the contractor costs.

6.75 SGN's meter stock is relatively young and low in number as meter installations only commenced in 2017. This means that some activities such as 10- year battery replacement and 10- year regulator inspections only start late in the period with low levels of activity and costs. Others such as 20- year end of life meter replacement will not occur until after GD23.

6.76 Annual Cost Report and Business Plan Template meter installation data was used to check the submitted activity data for annual inspections (U65+ meters); 10- year battery replacement (domestic prepayment); 5- year inspections (U6 to U40 MP meter regulators); 6- year inspections (U65+ meter regulators) and 10- year inspections (U6 to U40 MP meter regulators).

6.77 The submitted figures were found to be correct, assuming the low pressure/medium pressure percentage split applied by SGN for domestic meter installations is accurate. The split was found to be broadly reflective of figures quoted for 2018 and 2019 and has been accepted on this basis.

6.78 All of SGN's routine meter maintenance costs were allowed in the draft determination on the basis of the validation checks undertaken, apart from the following. The 5- year inspection costs for 2023 were excluded and a minor adjustment was made to the 5- year inspection costs for 2028, to account for our slightly higher projected connection numbers for 2023. These adjustments resulted in a small deduction of £16k.

6.79 The 2023 5- year inspections were disallowed because we believe the revised guidance from the updated British Standard had been applied one year too early by SGN (as explained further in section 2.57), unlike PNGL who we considered had interpreted the requirements correctly. The same exclusion was applied to FE at a more material level and FE accepted our interpretation and decision in its response to the draft determination. SGN however indicated it had a different interpretation and suggested we should seek further clarification before adjusting allowances. We therefore took external advice which confirmed our approach was appropriate and a £16k exclusion has continued to be applied in the final determination.

6.80 We also advised the GDNs that allowances would be adjusted to account for any changes to connection numbers in the final determination. For SGN the combined figures for 2021 to 2023 from our final determination modelling were lower than in the draft determination. As the numbers of connections in these years have a direct impact on the 5- year inspections required in the period 2026 to 2028, this has resulted in a net cost reduction of around £23k.

6.81 When reviewing non-routine meter maintenance for the draft determination we considered the projected profile of total cost per connection for all expenditure areas and found this to be stable or falling from 2021 onwards. The submitted costs were allowed on this basis. We checked this for the final determination, using our final connection numbers, and found this still to be the case. The conclusion reached in the draft determination therefore remains appropriate.

6.82 We note that SGN has a higher net cost per connection than PNGL and FE for non-routine meter maintenance. We assume this is due to the potential for its greater proportion of large I&C meters to generate higher maintenance costs and have included the requested allowances in the final determination on this basis.

6.83 Our method of assessing an appropriate level of FTEs has changed for the final determination and this has resulted in a minor increase in the number of FTEs allocated for metering compared to the draft determination. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

6.84 The outcome of our final determination assessment for metering is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	80	84	132	151	185	205
UR Final Determination	64	84	132	152	168	197
Variance	(16)	0	0	1	(18)	(8)

Note 1. Figures may not sum due to rounding.

Table 6.8: Metering Costs, Requested and Allowed, £k

PRE-Repairs

6.85 The 'Publically Reported Escape' (PRE) Repair cost category covers the activity associated with the isolation and repair of mains and/or services where an escape of gas is involved. It follows an initial assessment undertaken by the first responder.

6.86 Due to the safety implications these are considered the most urgent emergency jobs and have the shortest mandatory response times. Further details on this cost category and the companies' approach to managing this work can be found in the 'bottom-up assessment' section of this annex, starting at 2.60 above.

6.87 The key driver of costs in this expenditure category is the number of emergency jobs.

6.88 The PRE Repairs' cost allocation has been determined using the model supplied to us by SGN through the draft determination query process. This model was used to calculate the contractor's costs for the work volume forecast for the period. The SGN model and its origins are described in more detail above, starting in section 6.64.

6.89 For the draft determination we changed the model input values to reflect the reduced call numbers generated by our lower estimates of connection numbers for GD23 and PRE job numbers reduced as a result. The forecast customer connections have been remodelled for the final determination, as noted in the draft determination. These are slightly lower than in the draft determination and the number of jobs has reduced further as a result.

6.90 Our number of PRE jobs is 13 lower than the company's which has led to a reduction in the allowed contractor costs.

6.91 For our draft determination, we accepted the standby and callout rates provided to us by SGN, as well as the time allocated to each repair job.

6.92 In SGN's case we couldn't check the figures submitted for contributions received from third parties against past experience, due to the lack of historic data. We therefore compared SGN's figures to the levels recovered by the other GDNs and found its recovery forecast to be reasonable.

6.93 The company's submission indicated a drop in the calls to connections ratio in 2028, which is why our PRE Repairs allowance is slightly lower in 2028 than 2027.

6.94 Our assessment of the FTE allocation for PRE Repairs changed for the final determination, resulting in an increase in allocated FTEs and associated costs. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

6.95 SGN did not challenge any aspects of our draft determination for PRE Repairs in its consultation response. Therefore, the only adjustments made in the final determination were those related to the change in connection numbers and our revised methodology for assessing the number of FTEs.

6.96 The outcome of our final determination assessment for the PRE Repairs is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	13	13	15	16	17	17
UR Final Determination	12	12	15	16	16	17
Variance	(1)	(1)	(1)	(1)	(1)	(1)

Note 1. Figures may not sum due to rounding.

Table 6.9: PRE-Repairs Costs, Requested and Allowed, £k

Maintenance

6.97 SGN's maintenance submission for the GD23 period totals circa £2.9m. IP Mains (54%) and telemetry (23%) account for the majority of the costs. Plant protection represents almost 85% of the IP Mains costs and over 45% of the proposed maintenance expenditure overall.

6.98 SGN's maintenance submission was assessed both at a high level and through consideration of individual material expenditure items.

6.99 As indicated above, plant protection accounts for nearly half of SGN's proposed maintenance expenditure. This cost item covers activities designed to reduce the risk of the company's gas mains being damaged by third parties (e.g. driving the entire route of its feeder mains). We requested and reviewed information on the build-up of these costs and concluded they were not unreasonable. The high length of mains relative to the number of connected properties explains why this expenditure item represents such a significant proportion of SGN's cost. Costs were allowed apart from a minor reduction of around £1,500 per annum which results from us projecting a slightly lower length of mains than SGN over the price control. This reduction amounts to circa 0.5% of the total requested cost for this project.

6.100 An additional reduction of around £23,000 was made as a result of a mistake which was identified through the price control query process.

6.101 For the draft determination we focused on the material cost items and stated that we would consider whether a further review of other individual expenditure lines was necessary for the final determination. We also indicated we would review allowances against forecasted lengths of mains and connection numbers to determine whether any changes were necessary. Following further consideration of both these issues we have concluded that no further adjustments are required for the final determination.

6.102 The only change in the allowance for the final determination has resulted from a change in the methodology we have used to estimate FTEs. This has resulted in a minor increase in FTE levels when compared to the draft determination. Further information regarding our final determination FTE methodology can be found in section 2.110 to 2.114 of this document.

6.103 The outcome of our final determination assessment for maintenance is detailed in the table below.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	449	575	468	463	513	498
UR Final Determination	445	570	463	458	507	492
Variance	(4)	(5)	(5)	(5)	(6)	(6)

Note 1. Figures may not sum due to rounding.

Table 6.10: Maintenance Costs, Requested and Allowed, £k

Other Direct Activities

6.104 SGN's Other Direct Activities costs are in the main driven by its associated manpower costs. In the 2020 year SGN had Other Direct Activities costs of

£9k and had 0.35 FTEs employed within the Other Direct Activities cost category. SGN have proposed a marginal reduction in FTEs for Other Direct Activities in the GD23 period.

6.105 For the final determination we have rolled forward 2020 actual staff costs with the 2020 actual FTEs, which results in a marginal increase.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	6	6	6	6	6	6
UR Final Determination	7	7	7	7	7	7
Variance	1	1	1	1	1	1

Note 1. Figures may not sum due to rounding.

Table 6.11: Other Direct Activities Costs, Requested and Allowed, £k

IT & Telecoms

6.106 SGN IT and Telecoms costs are driven mainly by the cost of annual licences and its GIS system as well as some staff costs. In 2020, SGN had IT & Telecoms costs of £105k. £95k of this was related to GIS and licence cost and £10k was related to staff costs. In 2020, SGN had 0.20 FTEs employed in the IT & Telecoms cost category.

6.107 SGN have projected a significant uplift in IT & Telecoms costs in the GD23 period i.e. to an average of £140k. SGN have explained that the reason for this projected increase is that it's 'asset management system requires user licences, which are renewed on an annual basis. In addition, the provision of a helpdesk support service is also included in these costs and the number of licences has increased to 30 as the scale of the business increased.'

6.108 SGN has also explained that 'another element included with the IT opex costs is the GIS data licence supplied by OSNI which is a non-negotiable fixed price and for GD23 we are forecasting further increases to £130k for our IT costs in line with the projected number of connections.' We note that the IT and Telecoms allowances sought by SGN for GD23 are more than 3 times that provided by SGN in its G2W bid.

6.109 We also note that SGN had similar arguments for projected increases in IT costs in GD17 which we did not accept[13] . As in GD17 we have considered the SGN request against the criteria which were set out in the overview as discussed in paragraph 6.6 above. We have not seen any strong reason to conclude that such costs were unforeseen.

[13] 2016-09-15_GD17_Final_Determination_-_final_0.pdf (uregni.gov.uk) Paragraph 6.516 - 6.518

6.110 For the draft determination we considered that it was SGN's responsibility to identify the full costs of any IT system it deemed necessary for G2W at the time of the licence application. The analysis that SGN has undertaken since being awarded the licence could have been undertaken when SGN formulated its licence application.

6.111 Furthermore, and as set out in the GD17 final determination, we would expect that investments in an IT system would provide robust long- term capability for the network and do not accept that increased customers would justify any significant changes in IT costs, which was our view in the draft determination.

6.112 However, as indicated in section 6.23, for the final determination, we have reconsidered this approach and granted allowances that are mainly based around 2021 actual costs, with some growth envisaged for this area. This would deviate from the normal approach of using 2020. This also represents a change from the draft determination. However, based on the low level of costs between 2017- 2020 and the requirements of other GDNs for the same/similar software packages, we have increased allowances for the final determination.

6.113 The staff costs are based on 2020 actuals rolled forward with a marginal increase in FTEs, which are in line with the SGN GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	136	136	136	138	145	145
UR Final Determination	126	126	126	126	128	128
Variance	(10)	(10)	(10)	(12)	(17)	(17)

Note 1. Figures may not sum due to rounding.

Table 6.12: IT & Telecoms Costs, Requested and Allowed, £k

Property Management

6.114 The most significant cost item under SGN's property management costs are in relation to network rates. For GD23 we are using a formula which links the allowance to SGN revenues.

6.115 We are comfortable with the approach of using a formula linked to revenue in order to set the network rates allowance for SGN. We have used this approach historically, both in GD14 and GD17, for FE and PNGL. The network rates allowances have therefore been calculated accordingly.

6.116 SGN, in a response to a query from us, updated their business plan assessment of projected network rates payable in the GD23 period. We have taken account of this for the final determination.

6.117 For the final determination, we are of the view for the GD23 period, that the uncertainty mechanism should be updated to reflect network rates, consistent with the set formula used that links to revenue, subject to SGN demonstrating that it has taken appropriate actions to minimise valuations. We will expect SGN (as well as the other GDNs) to provide a copy of its actual network rates bill along with appropriate evidence of bill payment to the Utility Regulator alongside its annual uncertainty mechanism submission which is usually submitted with the Annual Cost Reporting Template.

6.118 SGN also has rent and building rates costs in relation to its offices as well as some materials costs. For the draft determination we rolled forward medium term historic average costs for rent, building rates and materials (2018 - 2020) into the GD23 period. We also noted that some aspects of SGN facilities management e.g. site security, come under the Managed Services Agreement (MSA).

6.119 SGN had 0.1 FTEs under the Property Management cost category in 2020 and proposed an increase for the GD23 period to 0.18 FTEs on average for the GD23 period. We allowed for this for the draft determination and rolled this forward with 2020 staff costs.

6.120 In its response to the draft determination, SGN highlighted that it moved office location in 2018 from Belfast to Lurgan and therefore using medium term average costs were not appropriate for setting allowances for rent, building rates and material costs.

6.121 For the final determination we updated our approach and utilised 2020 rental costs and 2021 costs for rates and material related costs, and this provides for an increase in these allowances of circa £54k.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	319	381	394	408	424	441
UR Final Determination	316	352	362	380	400	414
Variance	(3)	(29)	(32)	(28)	(24)	(27)

Note 1. Figures may not sum due to rounding.

Table 6.13: Property Management Costs, Requested and Allowed, £k

HR & Non-operational Training

6.122 SGN's HR and non-operational training costs are driven by staff costs. In the 2020 year SGN had HR and non-operational training costs of £7k. SGN

had 0.13 FTEs employed within the HR and Non-operational training cost category in 2020 and proposed an average increase in FTEs in this area for the GD23 period to 0.19 FTEs. We note that some aspects of Human Resources, e.g. employee relations management, come under the Managed Services Agreement (MSA).

6.123 We have accepted this projection in FTEs and consequently provided for 0.19 FTEs in the GD23 period and we have rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	11	11	11	11	12	12
UR Final Determination	10	10	10	11	12	12
Variance	(1)	(1)	(1)	(0)	(0	(0)

Note 1. Figures may not sum due to rounding.

Table 6.14: HR & Non-Operational Costs, Requested and Allowed, £k

Audit, Finance & Regulation

6.124 SGN's Audit, Finance and Regulation costs are in the main driven by staff costs and professional and legal fees.

6.125 In the 2020 year, SGN had audit, finance and regulation costs of £147k made up of £3k for professional and legal fees and £144k for staff costs. SGN had 2.8 FTEs employed within the Audit, Finance and Regulation cost category in 2020 and has proposed an increase to 5.6 FTEs, on average, in this area for the GD23 period.

6.126 SGN has projected professional and legal fees which contain uplifts of £400k in 2027 and 2028 due to 'increased workload and specialist knowledge required for Price Control preparation.' For the remaining years in GD23, SGN has proposed professional and legal fees which are significantly higher than 2020 actual costs and, in addition, SGN has projected £5k of stationery, communication and billing costs.

6.127 For the draft determination we allowed for 5 FTEs (an uplift of 2.2 FTEs), compared to 2020 actuals, as we consider that some aspects of the work that SGN undertake under this cost category may be similar to that undertaken by the other GDNs who have more FTEs than SGN for this cost category. However, we note that some workstreams e.g. treasury support and audit management come under the Managed Services Agreement (MSA). We have rolled forward the 5 FTEs with 2020 actual staff costs.

6.128 We note that the £400k uplifts in relation to price control costs projected by SGN are significantly above those projected by the other GDNs which

operate under the same price control process as SGN. Consequently, we did not allow this scale of uplift for the GD23 draft determination. We however allowed an allowance for price control costs at an efficient level for the 2027 and 2028 years.

6.129 For all other years we based SGN's projected professional and legal fees on medium term historical actuals but not accepted the proposals for stationery, communications and billing costs for the draft determination.

6.130 In its response to the draft determination, SGN argued that the allowances for FTEs was insufficient as its 2020 levels of FTEs was affected by COVID-19. SGN also disagreed with allowances for professional and legal fees, including in relation to work undertaken for price controls.

6.131 For the final determination, we have provided a further uplift of 2.63 FTEs on average in the GD23 period. We included 1 extra FTE for the energy transition, which is consistent with our approach for the other GDNs. For the draft determination we had previously allocated 1 FTE for energy transition under the AMPR (non-OO) category. Therefore, we have reallocated that FTE to the audit, finance and regulation category. The extra FTEs has resulted in providing a bigger allowance than what was originally requested by SGN in this area.

6.132 We have not changed our allowances for professional and legal fees, including for work undertaken for price controls as we consider that it is up to SGN to decide between its mix of staff and consultancy support to undertake price controls, but note that we have provided for increased FTEs in this area for the GD23 period.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	322	322	322	354	714	414
UR Final Determination	370	370	370	415	556	556
Variance	48	48	48	61	(158)	142

Note 1. Figures may not sum due to rounding.

Table 6.15: Audit Finance & Regulation Costs, Requested and Allowed, £k

Insurance

6.133 SGN's Insurance costs are driven by staff costs and buildings insurance costs. Other aspects of SGN insurance, such as commercial and travel insurance, and insurance of the pipeline are covered under the Managed Services Agreement (MSA).

6.134 In the 2020 year SGN had buildings insurance costs of £4k and staff costs of £2.5k. SGN had 0.04 FTEs employed in the insurance cost category for

2020 and projected this this number of FTEs into the GD23 period. SGN has projected an increase in buildings insurance into the GD23 period to £5k.

6.135 For the draft determination we have rolled forward SGN 2020 FTEs and staff costs for insurance into the GD23 period, together with 2020 actual building insurance costs, as this is broadly consistent with medium term historical actuals.

6.136 In its response to the draft determination, SGN argued that the UR should have allowed for a modest increase in increase in insurance costs that would be anticipated with a developing and growing company.

6.137 We do not agree with this argument since the insurance relates to buildings insurance and we do not consider that this has a direct linkage to the growth of SGN. Consequently, our allowances are unchanged from the draft determination.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	8	8	8	8	8	8
UR Final Determination	6	6	6	6	6	6
Variance	(2)	(2)	(2)	(2)	(2)	(2)

Note 1. Figures may not sum due to rounding.

Table 6.16: Insurance Costs, Requested and Allowed, £k

Procurement

6.138 SGN's procurement costs are driven by staff costs. SGN's procurement staff costs were £4k in 2020 and SGN employed 0.07 FTEs under the Procurement cost category in 2020. We note that some aspects of SGN procurement activities, e.g. support for local managers in contract negotiations, come under the Managed Services Agreement (MSA).

6.139 SGN has projected a marginal increase in FTEs for the GD23 period to an average of 0.10 FTEs. We have accepted this projection into the GD23 period, and rolled this forward with 2020 staff costs.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	6	6	6	6	7	7
UR Final Determination	5	5	5	6	7	7
Variance	(1)	(1)	(1)	0	0	0

Note 1. Figures may not sum due to rounding.

Table 6.17: Procurement Costs, Requested and Allowed, £k

CEO & Group Management

6.140 SGN CEO and Group Management charges are driven by costs associated with its Managed Service Agreements (MSAs) with other group companies. In 2020 the actual costs of Managed Service Agreements were £250k, which was over 6 times that outlined in the SGN G2W bid at £39k.

6.141 SGN requested MSA allowances for the GD23 period that are on average 4.5 times that set out in the G2W bid and almost double that of 2020 actual costs. In its GD23 business plan submission, SGN have explained that MSA covers the following activities:

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

6.142 In relation to the requested allowances for GD23, SGN explained that: 'following the bid submission SGN provided the Utility Regulator with the business plan submission for GD17. In this document we set out necessary adjustments to the bid submission as a result of changes in external factors which meant that the bid submitted did not include sufficient cover, given the level of group support necessary has been significantly higher than originally anticipated.'

6.143 SGN further explained that: 'we further clarified the current position in the GD23 business plan which details how the MSA continues to offer value for money alongside the flexibility to adjust services in line with business needs, where it is economic to do so. The costs currently incurred via the MSA are reflective of required services to allow SGN to continue to operate as a reasonable and prudent operator and those presented in the GD23 business plan reflect the costs that will be necessary in future. The rebasing of allowances as part of the GD23 price control will allow for more realistic costs being considered as those cost presented within the bid submission are no longer reflective of actual requirements under the MSA.'

6.144 We do not agree with the arguments put forward by SGN. Costs associated with the MSA should have been well known to SGN when it formed its G2W bid, as mentioned in from paragraph 6.6 above. SGN was best placed to

provide a robust estimate of these costs in the G2W application. There has been no material change of circumstances or change in the scale of the business, which would explain the increase.

6.145 Furthermore, the G2W applicant information pack was very clear in relation to how the MSA charge would be treated in future price controls, for example, paragraph 3.44 states: 'as set out in the Conclusions paper we believe that a direct link between the cost information revealed in the application and the allowances provided in subsequent price controls will act as a powerful incentive to ensure that applicants reveal realistic cost information and that some link should be maintained beyond the first price control period. In particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies.'

6.146 Furthermore, we note that the costs outlined in the G2W bid for MSAs were constructed using a customer numbers ratio and we note that the actual customer numbers in the SGN area are less than envisaged by SGN in its GD17 business plan submission.

6.147 SGN requested MSA allowances for GD23 included requested allowances of £350k for costs associated with undertaking price controls. SGN explained that these costs 'relate to the time needed over and above 'normal business' activities as part of the MSA, from SGN Group staff (Regulatory team), at a point when our workload increases significantly due to Price Control Business Plan and modelling preparation.

6.148 We note that SGN also requested allowances for work associated with price controls under the Audit, Finance and Regulation cost category, and these requests were above those requested by the other GDNs.

6.149 We consider that we have provided SGN with sufficient allowances for work associated with price controls under the Audit, Finance and Regulation cost category and therefore have not provided an allowance under the CEO & Group Management (MSA) cost category.

6.150 For the draft determination, we kept to the allowances as clearly identified in relation to the G2W bid and followed the principles outlined in section 6.145.

6.151 In its response to the draft determination SGN argued that the changes required in this cost category are not as a result of changes in structure or cost allocation from our parent company, instead they are as a result of external factors.

6.152 Whilst we understand the issues raised, we feel that this area was clearly sign posted and not 'Unforeseen.' As stated in paragraph 6.12 above,' In

particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies.'

6.153 For the final determination, we have further considered both this position and the duration that the G2W bid cost would be applied for. It is clear that the G2W bid made reference to costs for a minimum of a 10-year period which was based on the original timeline (which lasted until 2027).

6.154 Based on this consideration, we have reviewed our position and have decided, for the final year of GD23 (2028 only), to base allowances on 2020 actual costs, as we recognise this year is beyond the initial bid period of 10 years. For the next price control we would not make any connection/linkage to the G2W bid for this area.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	400	400	400	400	650	500
UR Final Determination	75	85	95	105	116	250
Variance	(325)	(315)	(305)	(295)	(534)	(250)

Note 1. Figures may not sum due to rounding.

Table 6.18: CEO and Group Management Costs, Requested and Allowed, £k

Stores & Logistics

6.155 SGN has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and, therefore, we have not provided for any allowances for the GD23 period.

Advertising & Market Development (Owner Occupied)

6.156 The history and context of this section has been reviewed in Annex Q, Promoting Connections; all information relating to changes or consultation responses and considerations is contained within that Annex.

6.157 The overall figures used for the final determination and simple calculations are below. They are subject to the uncertainty mechanism and actual outputs.

6.158 It should be noted that all connections allowances claimed by GDNs must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

6.159 Table 6.19 provides the annual average allowance, per determined connection, which includes the fixed (£309k pa) and variable allowance as

discussed in Annex Q. Table 6.20 compares the final determination owner occupied (OO) connection, used for the purposes of this calculation, against the SGN GD23 submission.

SGN	2023	2024	2025	2026	2027	2028
Average allowance per connection	2,552	1,854	1,591	1,553	1,574	1,556

Note 1. Figures may not sum due to rounding.

Table 6.19: OO Connection Allowance, £

6.160 The allowances set out in Table 6.20 translate to an average allowance over the 6 years of GD23 for SGN of £1,677 per determined connection, subject to the fixed and variable allowance as described in Annex Q.

	2023	2024	2025	2026	2027	2028
SGN submission	623	593	599	652	643	640
UR Final Determination	200	364	529	565	544	562

Note 1. Figures may not sum due to rounding.

Table 6.20: OO Connection Numbers

6.161 Table 6.21 shows the comparison of the final determination allowances against the SGN GD23 business plan submission.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	1,286	1,246	1,263	1,334	1,324	1,320
UR Final Determination	510	676	841	878	857	875
Variance	(776)	(570)	(422)	(456)	(467)	(445)

Note 1. Figures may not sum due to rounding.

Table 6.21: Advertising & Market Development (Owner Occupied) Costs, Requested and Allowed, £k

Advertising & Market Development (Non Owner Occupied)

6.162 SGN's costs for Advertising and Marketing (non-OO) are driven by manpower costs and Market Development costs. In 2020, SGN's costs for Advertising and Marketing (non-OO) were £189k made up of manpower costs of £179k and advertising and marketing costs of £10k. SGN employed 4.3 FTEs for Marketing and Development (non-OO) in the 2020 year.

6.163 SGN has requested an additional 1.8 FTEs for the GD23 period, on average, as well as an average increase in Marketing and Development costs of 2000% against 2020 actuals to an average of £217k in the GD23 period. SGN has explained these increases are reasonable because the Utility

Regulator facilitated I&C incentive allowances for PNGL in the PNGL12 price control (2012-13) and for FE in the PCR02 price control (2009 to 2013).

6.164 SGN explained that a blended incentive rate of £1,762 in GD23 for non-OO potential customers compares well to the £2,161 afforded to FE in the PCR02 price control. SGN have explained that if the Utility Regulator granted this allowance, then SGN would gain an additional 425% in IC1 average annual connections against 2022 forecast connections and an additional 1,142% in average IC2 connections against 2022 forecasts and that: 'this represents value for money in ensuring the opportunity for the positive impact each connection brings is not foregone.'

6.165 We note that the PNGL12 (published January 2012) and PCR02 (published December 2008) price control documentation was publicly available information available to SGN at the time SGN formed its G2W bid (submitted May 2014). If it had wished, SGN could have put similar or indeed greater amounts in its G2W bid for I&C incentives as contained in these price controls. The fact SGN choose not to do so is a matter for SGN, and we note that other Applicants did submit a request for allowances in this area.

6.166 We note that the G2W Application Information Pack (AIP) paragraph 4.36 stated in relation to incentivising I and C customers states: '[no] incentive payments for non-owner occupier connections have been included in the workbook. However, if an applicant believes that in order for them to meet the target for industrial and commercial connections they will require funding for financial incentives they have an opportunity to include such costs in the Operating Expenditure worksheet. They should also explain in their operational business plan how such payments would facilitate connections by non-owner occupier supply points. Only if the successful applicant has included such incentives in their application will these be funded by price control allowances.'

6.167 The amounts in the SGN bid for G2W were to cover costs in relation to provision of a 0% finance offer (only available for 2 years) and assumed that 75% of small I&Cs would avail of this offer.

6.168 Furthermore, and again as repeated in the GD17 final determination, Annex 8 of the G2W information pack clarifies that Marketing Advertising & PR for Non-OO Connections comprises costs for the promotion of connections to non-OO customers (e.g. NIHE, Industrial and Commercial (I&C) customers, New Build developers), and covers such costs as:

- Market Research;
- Marketing;

- Advertising;
- Public Relations;
- Engagement with Key Stakeholders;
- Any other relevant costs deemed necessary by the applicant; and
- Incentives i.e. costs used in assisting non-OO in converting from existing fuel source to natural gas.

6.169 Consequently, the Utility Regulator is of the view that it will only allow opex for non-OO connections as set out by SGN in its G2W licence application for the GD23 period, with the exception of rolling forward actual 2020 FTEs and staff costs into the GD23 period.

6.170 As we also stated in the GD17 final determination and also in this determination, we would also note that a significant element of SGN's request to adjust the licence application figures relates to incentivising the industrial and commercial business. As set out in paragraph 4.36 above, the AIP was particularly clear on this point stating that "Only if the successful applicant has included such incentives in their application will these be funded by price control allowances". We do not consider it appropriate to change from a figure provided by SGN for incentives for non-owner occupied customers which was submitted as part of a competitive application. This is particularly true in the circumstances where the other applicants included substantially higher incentive costs than SGN.

6.171 Finally, we note that SGN, within its GD23 business plan submission, did not forecast spending any additional money in 2021 or 2022 beyond that spent in 2020 on advertising and marketing for I & C customers (at a level of £10k pa).

6.172 We consider that the form of price control for SGN i.e. price cap, provides a strong financial incentive for SGN to outperform against volume targets. To assist in outperforming these targets, SGN could have provided incentives, including, for example, financial assistance to non -OO customers, in order to encourage them to connect to gas, which SGN has not done so, to date, nor has any plans to do so in the GD17 period.

6.173 However, as noted in section 6.23, and in Annex Q, we have been persuaded to move from this position in the draft determination.

6.174 We believe that providing allowances based on outputs of actual connections will be beneficial to grow the customer numbers in the early years for the benefit of all consumers. The sector of Small/Medium sized enterprises

(SME), is an important area of the economy that may need some limited support to make the move for a new gas connections. This support is only available to SME that have an existing fuel/heating source and will NOT be available to New Build sites of any description, as a New Build will have an option/choice of what system it installs. The IC1 and IC 2 definitions are contained within the Annual RIGS, but should be "tariff only" based customers who consume no more than 25k therms per annum.

6.175 It should be noted that this type of allowance will "NOT" be available for the next price control. This is based on the most recent experience from the last GDN who was granted this type of allowance, who had it removed after about a decade of being granted this type of licence.

6.176 Further information on this area is contained within Annex Q, Promoting connections.

6.177 The following allowance, is available, based on actual connections that is subject to the uncertainty mechanism and is ring fenced, with the following amounts:

- IC1 £600 per connection; and
- IC2 £3,000 per connection.

6.178 It should be noted that all connections claimed, must relate to properties which have a supplier and are burning gas. We expect the GDNs to be able to demonstrate that all connections have a supplier agreement in place and burn a minimum quantity of gas.

6.179 The table below summarises the connections as set for the price control period that will be updated via the uncertainty mechanism, based on actual outputs.

	2023	2024	2025	2026	2027	2028
SGN Requested Connections IC1	34	48	64	109	97	89
SGN Requested Connections IC2	23	33	45	71	65	61
UR Final Determination IC1	16	32	48	92	82	77
UR Final Determination IC2	11	23	34	59	55	53
Variance (IC1 & IC2)	(30)	(26)	(27)	(29)	(25)	(20)

Note 1. Figures may not sum due to rounding.

Table 6.22: AMD (NON OO) IC1 and IC2 Connection Numbers

6.180 For the final determination we have reviewed the staff costs. The business plan requested an average of 6.15 FTEs and we have granted this proposal for the GD23 period. The purpose of this increase in FTEs, over the draft determination, is to ensure that sufficient resources are available to maximise the number of connections. We will review this area at the next price control and consider the relationship between the number of connections, in conjunction with the allowances and FTEs actually employed.

	2023	2024	2025	2026	2027	2028
SGN requested allowances	376	419	473	591	564	545
UR Final Determination	293	339	386	487	470	461
Variance	(83)	(80)	(87)	(104)	(94)	(84)

Note 1. Figures may not sum due to rounding.

Table 6.23: Advertising & Market Development (Non-Owner Occupied) Costs, Requested and Allowed, £k

Trainees & Apprentices

6.181 SGN has not requested any allowances for this cost category for GD23 and had no costs for this cost category in 2020 and therefore we have not provided for any allowances for the GD23 period.

Non-Controllable Opex

6.182 The only costs under non-controllable opex are SGN licence fees. We have accepted SGN forecast costs for licence fees of £50k per annum for the final determination. Any difference between forecast licence fees and actual licence fees will be taken into account by using the uncertainty mechanism in GD29.

Supplier of Last Resort

6.183 With regard to the Supplier of Last Resort (SoLR), we believe that there is merit to including an allowance to cover any unforeseen costs that may occur, if such an event were to happen. This amount is ring- fenced and will be removed at the time of the next price control, if an incident fails to materialise. For the GD23 final determination we have accepted the proposal made by SGN and allowed £85k for these costs in 2023 only, for the duration of the price control.

Health and Social Care Levy

6.184 An area that has arisen since the submission of the Business Plan is the: 'Health and Social Care Levy,' which was introduced by HM Revenue and

Customs (HMRC) and has a similar charging structure to National Insurance Contributions. It was introduced in April 2022 and will be treated as a separate new tax of 1.25%, from April 2023.

6.185 The Chancellor announced on the 23 September 2022, regarding its Growth Plan[14] statement and reconfirmed that the April 2022's National Insurance rise and April 2023's Health and Social Care Levy will be cancelled. Following this announcement, legislation was introduced to the House of Commons, to bring this into effect.

6.186 SGN provided further information on this area and the likely effect on costs for each FTE. Based on this recent update, no allowance for the Health and Social Care levy has been provided for the duration of GD23.

Energy Strategy Funding Levy

6.187 As indicated in Annex G, Energy Strategy, a funding levy of 1% of Totex (i.e. all Capex and Opex allowances over the FD period) has been introduced. This funding is to enable projects that will achieve the aims of the Energy Strategy. This area is ring- fenced and subject to the uncertainty mechanism. We note that projects will need prior approval in advance, before any expenditure is approved in most cases, and must be accompanied with a business case, in which it is envisaged that all GDNs will submit a shared proposal, with the level of work/role envisaged for each operator.

Capitalisation

For the GD23 final determination we have accepted SGN capitalisation rates Shrinkage

6.188 Having assessed the SGN business plan submission with respect to shrinkage, we noted that the shrinkage factors, as provided are recast to increase from: 0.15% (for 2023) to 0.16% (for 2024 and 2025) and 0.18% (from 2026 onwards).

6.189 This is a slight increase from the shrinkage factor of 0.14% for 2020 and also forecast for the last two years of the GD17 price control period. We do not consider this to be unusual, given the planned further development of the SGN network for GD23.

[14] The Growth Plan: Factsheet on cancellation of National Insurance rise and Health and Social Care Levy - GOV.UK (www.gov.uk)

6.190 We have not made any shrinkage-related changes to existing regulatory arrangements and/or the introduction of a shrinkage-related incentive mechanism at this stage.

6.191 However, we consider that SGN should continue to establish the annual shrinkage factor in line with the common Northern Ireland Shrinkage Methodology which was developed, and should be maintained and amended as may be appropriate from time to time, jointly by all three GDNs. Furthermore, we consider that shrinkage should continue to be monitored as part of the annual cost and performance arrangements.

Real price effects, productivity and frontier shift

6.192 We have assessed particular elements of cost, drawing on our previous experience and current regulatory practice.

6.193 The price of a company's various inputs may differ over time. Price controls have normally been indexed by the Retail Price Index (RPI) to account for broad changes in prices. For GD23, we have now moved to using the Consumer Price Index and Housing (CPIH).

6.194 However, not all types of cost changes experienced by a network business will be reflected in the basket of prices used to calculate the general inflation measure.

6.195 To account for this it is common practice to calculate and make adjustments for the difference, either positive or negative, between particular input price changes for a company or industry and whatever measure of inflation is adopted. These are described as real price effects (RPE).

6.196 This calculation is based on the projected rate of gas industry input costs compared to general inflation movements, as measured by CPIH (Consumer Prices Index, including owner occupiers housing costs). Inclusion of the projected rate of productivity growth gives the frontier shift. The sum of these components can be a positive or a negative difference.

6.197 Frontier shift in real terms = input price increase minus

forecast CPIH (measured inflation) minus

productivity increase

6.198 We have adopted the methodology similar to that which we first introduced at PC13 for NI Water. This aligns closely with the determination for Northern Ireland Electricity at RP5, RP6 and more recent Competition and Markets Authority (CMA) decisions.

6.199 The forecast for each of the components and the resulting frontier shift to be applied to GD23 opex are given in the tables below.

Figures in %	GD17		GD23					
	2021	2022	2023	2024	2025	2026	2027	2028
Weighted nominal input prices	6.9	7.8	4.5	2.7	2.8	3.1	3.1	3.1
CPIH	(2.5)	(8.0)	(5.6)	(2.3)	(1.1)	(2.1)	(2.1)	(2.1)
Productivity	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Frontier shift (annual)	CPIH +3.2	CPIH -1.2	CPIH -2.0	CPIH -0.6	CPIH +0.6	CPIH -0.1	CPIH -0.1	CPIH -0.1
Cumulative frontier shift	3.2	2.0	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2

Table 6.24: GD23 Opex frontier shift calculations

6.200 Further detail on the make-up of the frontier shift is contained in Annex E, Frontier Shift.

Net impact

6.201 We have applied the frontier shift to the pre-efficiency opex to derive our final determination opex profiles, net of frontier shift.

Summary of Bottom-up Assessment Findings

6.202 Table 6.25 shows the opex allowances for SGN in the GD23 period. The total pre-efficiency opex allowances (excluding allowances associated with AMD-OO) for SGN in GD23 on average are 38% higher than 2020 actuals.

	2023	2024	2025	2026	2027	2028	GD23 Total
Asset Management	38	38	41	59	46	46	268
Operations Management	227	227	213	220	221	221	1329
Emergency Call Centre	103	103	103	105	106	107	627
Customer Management	48	48	63	63	66	66	355
System Control	35	35	34	34	35	35	209
Emergency	170	173	177	190	184	186	1,079
Metering	64	84	132	152	168	197	798
PRE-Repairs	12	12	15	16	16	17	87
Maintenance	445	570	463	458	507	492	2,936
Other Direct Activities	7	7	7	7	7	7	41
IT & Telecoms	126	126	126	126	128	128	761
Property Management	316	352	362	380	400	414	2,224
HR & Non-operational Training	10	10	10	11	12	12	66
Audit, Finance & Regulation	370	370	370	415	556	556	2,639
Insurance	6	6	6	6	6	6	38
Procurement	5	5	5	6	7	7	36
CEO & Group Management	75	85	95	105	116	250	726
Stores & Logistics	0	0	0	0	0	0	0
Advertising & Market Development - Owner Occupied (OO)	510	676	841	878	857	875	4,637
Advertising & Market Development (Non OO)	293	339	386	487	470	461	2,436
Trainees & Apprentices	0	0	0	0	0	0	0
Non-Controllable Opex	50	50	50	50	50	50	300
Supplier of Last Resort	85	0	0	0	0	0	85
Energy Strategy funding Levy	73	71	82	94	75	83	479
Total: Pre Efficiency	3,071	3,391	3,583	3,864	4,034	4,217	22,160
Frontier Shift %	-0.1	-0.7	-0.1	-0.1	-0.2	-0.2	
Total: Post Efficiency	3,069	3,367	3,581	3,859	4,028	4,208	22,113

Note 1. Figures may not sum due to rounding.

Table 6.25: SGN GD23 Opex Final Determination Pre and Post Efficiency, (£k)