Gas Distribution Networks

Cost and Performance Report for GD14

An assessment of costs and performance for firmus energy and PNGL

4 July 2018



About the Utility Regulator

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

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

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

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

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

Our Values

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

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

We regulate the revenue the gas distribution companies, firmus energy (FE), Phoenix Natural Gas Ltd (PNGL) and SGN NI Limited (SGN), receive through periodic price controls. This report reflects our assessment of FE and PNGL's performance during the GD14 period, covering the period from January 2014 to December 2016. Although SGN has not been distributing gas during the period, it will during the course of the subsequent price control GD17 and we report on areas which may be relevant for SGN in the future.

This report covers performance on key areas including: operational expenditure, capital expenditure, and outputs including domestic owner occupied connections.

Audience

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

Consumer impact

This assessment provides consumers with information on the performance of PNGL and FE from January 2014 to December 2016 in relation to our GD14 price control and looks ahead to future price controls and how we can make continual improvements. It reports on areas which will be relevant for SGN in GD17 and beyond.

Cost and Performance Report for GD14

Contents

1. Executive Summary

1.1 There are three Gas Distribution Network (GDN) operator companies in Northern Ireland: firmus energy (FE), Phoenix Natural Gas Limited (PNGL) and SGN NI Limited (collectively in this report the GDNs). FE own and operate the distribution network in the area called the 'ten towns'. PNGL own and operate the distribution network in the Greater Belfast, Larne and East Down. SGN was awarded a licence in February 2015 and have commenced building the distribution network in the area referred to as 'Gas to the West' (refer to Annex A for a map of respective areas).

1.2 This report covers the GD14 period of 1 January 2014 – 31 December 2016 for FE and PNGL. SGN has recently commenced operations and, although we do not report its costs and performance in this report, we will consider factors which will impact SGN going forward.

1.3 The Utility Regulator regulates the amount of revenue GDNs receive to ensure value for money for consumers. We scrutinise each company's revenue requirements through periodic price controls. We report GDN performance against our determined GD14 allowances, adjusted for differences between actual and allowed costs or outputs (such as connections or properties passed) provided to the GDNs as part of the price control determination. The current price control period (GD17) commenced on 1 January 2017 and the timetable for that reporting period is set out in section 6.

1.4 We consider that overall, in GD14, all GDNs have made a positive contribution to the ongoing development of the gas industry in Northern Ireland and performed well against price control targets, with approximately 41,000 new gas connections over GD14 and gas now more accessible to thousands more in Northern Ireland due to properties being passed by gas mains. We note that price control targets were met in many areas, with underperformance reported in selected areas and we would like to see these areas addressed going forward.

1.5 The GDNs have grown the gas network, in terms of km mains laid, by 12% i.e. from 4,145km cumulative mains laid at the end of 2013 to 4,654km in 2016. When measured by domestic connections, the GDNs have grown the network by 23% in the GD14 period i.e. from 177,297 cumulative connections at the end of 2013 to 217,482 in 2016, and in the same period Industrial and Commercial (I & C) connections have grown by 10%.

1.6 Increasing connections to the network results in a higher volume of gas consumed. Forecast volumes assume growth in customer connections and this is shown in Tables 17 & 18, in terms of forecast and actual volumes achieved. The volume of gas consumed is significant as increasing the number of customers connected spreads network costs over a larger customer group thereby benefiting both existing and future consumers. To achieve increasing connections the GDNs are focussed on increasing the number of domestic gas connections and GD17 builds on this.

1.7 Our key findings are summarised by GDN below. We note that GDNs bear the full

risk/ reward for any Opex/ Capex over or underspend.

FE

- Operational expenditure: FE's actual Opex in the GD14 period was £21.2m.
- Capital investment: FE have spent £36.7m on Capex over the period.
- FE achieved circa 12,000 new connections over GD14.
- FE passed over 33,000 new properties and laid 314km of gas pipe, increasing accessibility.
- The volume of gas burned over GD14 was 177m therms.

1.8 Overall, we are pleased that FE have performed well in achieving connections to gas and developing the gas network and improving accessibility. However, FE has overspent against its GD14 allowances in some areas and this is explained further in section 5.3.

PNGL

- Operational expenditure: Actual Opex in GD14 was £45.5m.
- Capital investment: PNGL spent £34.7m on Capex over the GD14 period.
- PNGL achieved circa 29,000 new connections over GD14.
- The actual volume of gas burned by PNGL over GD14 was 409m therms.
- 195km of new gas mains were laid and 17,000 additional properties were passed to make gas more accessible.

1.9 Overall, PNGL have performed positively over GD14 by largely achieving GD14 targets within set allowances. PNGL has achieved the outputs required, further developed the network and improved accessibility in its licensed areas.

SGN

1.10 SGN are currently building the distribution network in the 'Gas to the West' area. It covers Dungannon including: Coalisland; Cookstown including Magherafelt; Enniskillen including Derrylin; Omagh and Strabane. In our next cost and performance report we will be reporting on SGN's costs and performance in the GD17 period.

Outlook

1.11 Overall, we are pleased with the progress made by GDNs over GD14 and we will work in conjunction with companies to further develop the network to increase connections and improve accessibility. If the GDNs further develop the network as envisaged for GD17, around 60% of consumers in Northern Ireland, will have access to a gas connection. Going forward, we intend publishing regular cost and performance reports to monitor the progress of the GDNs, with the next report to cover the first two years of GD17 – 2017 and 2018.

2. Overview

Background

2.1 Our principal objective in carrying out our gas regulatory functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland (NI). As part of our role, we set overall limits on how much companies that own and operate the natural gas networks can charge for use of their pipelines, through a process called 'price controls.'

2.2 As part of our Forward work plan[1] for 2018-19, we indicated that we would wish to develop further annual reporting across all network companies, to monitor the costs and performance of GDNs, namely FE, PNGL and a recent addition- SGN. To that end we have produced a cost and performance report, for GDNs, in relation to the GD14 price control, which looks at the outputs compared to the final determination for a period of 3 years (i.e. 01 January 2014 – 31 December 2016). This is the first time that we have published a standalone report, on the performance of the GDNs and we intend to publish regular reports on the performance of the GDNs going forward. This will bring the reporting process for GDNs in line with the established process of our reporting on NI Water.

2.3 This review only looks at the main aspects of the overall performance and provides a brief assessment and commentary, where appropriate.

Gas Distribution Network (GDN) Operators

2.4 Northern Ireland has 3 GDNs, who are privately owned and operated and have been awarded licences in their respective geographical areas as follows.

- FE own and operate the distribution network in the area normally called the ten towns. The ten towns licenced area covers a greater geographical area including Ahoghill, Antrim, Armagh, Ballyclare, Ballymena, Ballymoney, Banbridge, Bessbrook, Broughshane, Bushmills, Coleraine, Craigavon, Cullybackey, Derry~Londonderry, Laurelvale, Limavady, Lurgan, Maghaberry, Magheralin, Moira, Newry, Portadown, Portstewart, Tandragee, Warrenpoint.
- PNGL own and operate the distribution network in the Greater Belfast, Larne and East Down areas.
- SGN are in the process of building the distribution network in the area typically referred to as 'Gas to the West' area. It covers Dungannon, including:

[1] https://www.uregni.gov.uk/sites/uregni/files/media-files/Final%20FWP%202018-19_0.pdf

Coalisland; Cookstown including Magherafelt; Enniskillen including Derrylin; Omagh and Strabane.

2.5 Annex A contains a map of the GDN's geographical location.

SGN Background

2.6 SGN was awarded its licence in February 2015 as part of a competitive tender process. This process set a large proportion of costs in relation to the mobilisation phase of the network. As this was outside the scope of GD14, SGN's performance is not analysed in this report. Reporting of SGN, will occur for the next price control, referred to as GD17, which commenced for SGN from January 2018.

Current Network Development

2.7 FE were awarded their conveyance licence in March 2005 and had 32,207 customers connected within the ten towns licensed area at the end of 2016.

2.8 PNGL were awarded their conveyance licence in September 1996. They had 200,423 customers connected within the Greater Belfast, Larne and East Down licensed areas at the end of 2016.

2.9 SGN were awarded their conveyance licence in February 2015 and are currently in the design and development phase of the network, with its first gas customer connected in early 2017 in the Strabane area. The other areas are envisaged to have gas available from late 2018 onwards, in a phased development programme to the major towns in its licenced area.

Cost and Performance Reports

2.10 A price control process considers the costs necessary to run an efficient business for the development and maintenance of the pipeline network, including financing costs and allowed revenues.

2.11 On 20 December 2013, we published the final determination for the GD14 price control period.[2] This was the price control for FE and PNGL covering the period from 1 January 2014 to 31 December 2016, a period of 3 years.

2.12 The GD14 price control process was the first time that price controls for FE and PNGL were aligned, i.e. they were conducted in parallel and for the same price control periods.

2.13 We included a number of mechanisms within the GD14 final determination to reduce the risk to GDNs or to incentivise them to deliver outputs consistently with

[2] Utility Regulator: GD14 Price Control for Northern Ireland's Gas Distribution Networks 2014-2016, Final Determination, 20 December 2013.

our statutory duties. The mechanisms were broken down into 3 categories and are explained further in paragraph 4.2.

2.14 Within the price control period, other developments can arise, which are outside the normal scope of a price control. These can, for example, be **Additional Development Areas**, where a GDN sees an opportunity to develop the network further and make an application in terms of a business case, in a request for additional funding. We consider these requests on a case by case basis and once satisfied that it would be economically viable, we go through the normal process of consultation and decision. Two large projects that were submitted during GD14 were as follows:

- Gas to Moy and Benburb by FE[3] which was approved on the 30 July 2015.
- Gas to East Down by PNGL[4] which was approved on the 10 December 2015.

2.15 Subsequently, they were approved during the course of GD14, with the appropriate funding approval made and reflected in tariffs for the next price control, GD17, which runs from the 1 January 2017 to the 31 December 2022, a duration of 6 years.

2.16 This report considers the performance of the GDNs, but as outlined above, a few steps are necessary to consider their true performance:

- The GDNs submitted business plans on the cost and outputs for the GD14 period. We considered these plans and subsequently made a final determination for GD14, including Outputs.
- Subsequently, changes in outputs, based on the Uncertainty Mechanism and any subsequent additions which are approved (e.g. Additional Development Areas), are used to reset Determination Values and Outputs
- These revised Determination Values and Outputs are then compared to actual performance to analyse how the GDNs have performed in the GD14 period.

2.17 This forms the basis of how we assess performance, of the respective GDNs, along with appropriate commentary.

2.18 The data that is used in this report was provided by the GDNs.

2.19 We consider that a costs and performance report will be published on a regular basis going forward.

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[3] https://www.uregni.gov.uk/news-centre/decision-gas-extension-licenced-area-firmus-energy-distribution-ltd-moy-benburb-wards

[4] https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/2015-12-10_Decision_Paper_-_Extension_to_the_Licence_Area_and_Modify_Licence_of_PNGL_-_East_Down_-_Final.pdf

Price Base

2.20 As GD14 covers a period of 3 years, from 1 January 2014 – 31 December 2016, it is important that numbers used are on a consistent basis, and therefore unless stated otherwise, all figures in this document are in real December 2016 prices.

Document Structure

2.21 This GD14 Cost and Performance report is structured as follows:

Section 2 covers the overview and background.

Section 3 covers the GD14 final determination compared to GDN business plan submissions.

Section 4 deals with Post GD14 final determination adjustments.

Section 5 deals with GDNs Opex, Capex and performance as compared to GD14 price control allowances and targets.

Section 6 outlines our future price control areas for consideration and reporting going forward.

3. Development of the GD14 FD from Business Plan Submissions

Overview

3.1 The GD14 final determination was published on the 20 December 2013. This document set the level of pricing that could be charged to customers for the use of the gas network.

3.2 The GDNs, namely PNGL and FE submitted business plans and based on our analysis of these business plans we set efficient allowances. We set allowances for Capex and Opex, which are subject to the efficiency challenges and variables based on certain pre-defined outputs that are contained within the Uncertainty Mechanism[5] for GD14.

3.3 Tables 1 & 2 in this section compare the GDN's GD14 business plan submissions for Opex and Capex allowances to our GD14 final determination. Tables 3 & 4 compare the GDN's proposed GD14 business plan key outputs, based on their requested allowances, to our GD14 final determination.

3.4 The key outputs in the GD14 period were:

- **Properties passed**, which incentivises the network operator to lay pipe in the most densely populated areas to maximise the potential number of connections in the future.
- **Connections- with particular focus on connection numbers for domestic consumers**. These are important, in terms of developing the network, where gas is readily available, to maximise the uptake of making a connection to gas.

3.5 Tables 5 & 6 in this section compare the GDN's forecast of volumes for the GD14 period (in therms) contained in their GD14 business plan submissions to the volumes forecast in our GD14 final determination.

Opex and Capex

3.6 In setting GD14 Opex allowances for FE and PNGL, we undertook a detailed assessment and review of the larger cost items, taking into account the current level of expenditure, the impact as a result of changes in outputs and, where appropriate, benchmarking against comparable organisations.

3.7 For both FE and PNGL we also set appropriate efficiency targets and made some adjustments for Real Price Effects. For GD14 the efficiency targets were applied to

[5] Refer to page 175 of the GD14 final determination for additional details on the Uncertainty Mechanism.

controllable Opex and consequently were not applied to uncontrollable Opex which for GD14 was determined as being licence fees and costs in obtaining owner occupied connections which were subject to the GD14 connections incentive. Our FD allowances for FE and PNGL were as shown in and Table 1 & Table 2 respectively.

3.8 In setting GD14 Capex allowances for both FE and PNGL we undertook a detailed assessment of capital expenditure. We set an efficient level of expenditure and applied the relevant compound Real Price Effect and ongoing productivity increase factors for each year, to set appropriate post-efficiency Capex allowances.

3.9 For GD14 we considered all Capex to be controllable and therefore the value for uncontrollable Capex was zero, as the GDNs had control on the development of the network. Our FD allowances were as shown in Table 1 for FE and in Table 2 for PNGL. (N*ote: some figures in tables may not add up due to rounding*).

Opex and Capex

FE (real, 2016 Prices), £m, post efficiency	FE submission (revised)				Final Determination				Difference to FE submission	
	2014	2015	2016	Total	2014	2015	2016	Total	Total	%
Opex	9.1	9.4	9.8	28.3	5.8	6.1	6.3	18.2	-10.1	-36%
Capex	16.6	14.2	12.3	43.1	12.2	10.2	9.1	31.6	-11.6	-27%
Total	25.8	23.6	22.1	71.4	18.0	16.3	15.4	49.7	-21.7	-30%
The above allowances were fed into our regulatory model, which calculate a revenue requirement to ensure the company recovers the value of the future as well as past investments, plus a return on this investment.										
Allowed Revenues	23.8	25.2	26.0	74.9	19.6	20.2	20.7	60.5	-14.4	-19%

Table 1. FE GD14 FD price control Opex and Capex allowances compared to FE GD14 submission.

PNGL (real, dec 2016 Prices), £m, post efficiency	PNGL submission				Final Determination				Difference to PNGL submission	
	2014	2015	2016	Total	2014	2015	2016	Total	Total	%
Opex	18.0	18.6	18.4	55.0	14.9	15.1	15.2	45.2	-9.8	-18%
Capex	14.9	15.0	14.8	44.6	13.2	13.5	13.3	40.0	-4.6	-10%
Total	32.9	33.6	33.1	99.6	28.1	28.5	28.5	85.2	-14.4	-14%
The above allowances were fed into our regulatory model, which calculate a revenue requirement to ensure the company recovers the value of the future as well as past investments, plus a return on this investment.										
Allowed Revenues	63.5	65.6	67.6	196.8	48.8	50.6	52.5	151.9	-44.8	-23%

Table 2. PNGL GD14 FD price control Opex and Capex allowances compared to PNGL GD14 submission

Key Outputs

3.10 Table 3 shows the determined key outputs in GD14 for FE compared to FE's

business plan submission. It can be observed from Table 3 that we accepted the outputs proposed by FE.

Key GD14 Outputs	FE submission				Final Determination			
	2014	2015	2016	Total	2014	2015	2016	Total
Connections								
Domestic - New Build	800	800	800	2,400	800	800	800	2,400
Domestic - Owner Occupied	2,000	2,000	1,800	5,800	2,000	2,000	2,000	6,000
Domestic - NIHE	1,200	1,200	1,200	3,600	1,200	1,200	1,000	3,400
I & C	152	102	52	306	152	102	52	306
Connections Total	4,152	4,102	3,852	12,106	4,152	4,102	3,852	12,106
KM mains laid								
New Build	14.5	14.5	14.5	43.5	14.5	14.5	14.5	43.5
Other than new build	72.5	56.5	48.7	177.7	72.5	56.5	48.7	177.7
Total KM mains laid	87.0	71.0	63.2	221.2	87.0	71.0	63.2	221.2
Properties Passed*								
New Build	***800**	***800**	***800**	2400	800	800	800	2,400
Other than new build	***6526**	***6526**	***6526**	19,578	6,526	6,526	6,526	19,578
Total Properties Passed	7,326	7,326	7,326	21,978	7,326	7,326	7,326	21,978

** FE did not make a specific submission for properties passed rather property passed numbers are calculated from km mains laid with an assumption of no of property passed per metre of mains laid*

Table 3. FE GD14 FD key price control outputs compared to FE proposed outputs

3.11 Table 4 shows the determined key outputs in GD14 for PNGL compared to PNGL's business plan submission. It can be observed from Table 4 that we accepted the majority of the outputs proposed by PNGL. The exceptions to this were for domestic owner occupied connections and km mains laid. The reason why the GD14 FD figures differed from the PNGL business plan submission was that, in relation to owner occupied connections, we considered that PNGL could achieve more connections in the GD14 period in line with actual connections it had achieved during 2011 and 2012. In relation to km laid, this was changed to reflect the type of allowance given during GD14, which incentivised PNGL to lay gas pipes in the most densely populated areas.

Key GD14 Outputs	PNGL submission				Final Determination			
	2014	2015	2016	Total	2014	2015	2016	Total
Connections								
Domestic - New Build	2,300	2,550	2,750	7,600	2,300	2,550	2,750	7,600
Domestic - Owner Occupied	5,100	4,700	4,300	14,100	6,500	6,500	6,500	19,500
Domestic - NIHE	1,000	1,000	1,000	3,000	1,000	1,000	1,000	3,000
I & C	378	378	378	1,134	378	378	378	1,134
Connections Total	8,778	8,628	8,428	25,834	10,178	10,428	10,628	31,234
KM mains laid								
New Build	25.2	28.1	30.3	83.6	13.6	15.0	16.2	44.8
Other than new build	42.0	42.4	42.5	126.9	26.2	26.2	26.2	78.6
Total KM mains laid	67.2	70.5	72.8	210.5	39.8	41.2	42.4	123.4
Properties Passed								
New Build	2,300	2,550	2,750	7,600	2,300	2,550	2,750	7,600
Other than new build	3,403	3,403	3,403	10,209	3,403	3,403	3,403	10,209
Total Properties Passed	5,703	5,953	6,153	17,809	5,703	5,953	6,153	17,809

Table 4. PNGL GD14 FD key price control outputs compared to PNGL proposed outputs

Volumes

3.12 Volumes of gas (therms) are important for a GDN, in terms of the recovery method for paying and running the network. The more customers that are added to the network, the more likely that there will be stability in the conveyance charges for consumers.

3.13 FE licence operated within a Price Cap mechanism in the GD14 period and was therefore incentivised to outperform the gas volume targets set.

3.14 Table 5 shows the determined volumes in GD14 for FE compared to FE's business plan submission.

GD14 Volumes (in therms, 000's)	FE submission				Final Determination			
	2014	2015	2016	Total	2014	2015	2016	Total
Domestic's (incl small I & C)	8,161	9,824	11,392	29,377	8,230	9,806	11,344	29,380
Industrial and Commercial	47,282	46,675	45,985	139,941	50,348	51,111	51,618	153,077
Overall Total	**55,443**	**56,499**	**57,377**	**169,318**	**58,578**	**60,917**	**62,962**	**182,457**

Table 5. FE GD14 FD key price control volumes compared to FE proposed volumes.

3.15 PNGL's licence operates within a Revenue cap, which is more relevant in an established network business, given that gas demand cannot be as easily influenced by the operator's actions. Future growth is mainly by domestic customers.

3.16 Table 6 shows the determined volumes in GD14 for PNGL compared to PNGL's business plan submission. As the number of domestic connections was changed in the FD, this resulted in the associated change in volumes.

GD14 Volumes (in therms, 000's)	PNGL submission				Final Determination			
	2014	2015	2016	Total	2014	2015	2016	Total
Domestic's	59,720	62,879	65,973	188,572	60,007	63,822	67,736	191,565
Industrial and Commercial	75,313	75,988	76,735	228,036	75,313	75,988	76,734	228,035
Overall Total	**135,033**	**138,867**	**142,708**	**416,608**	**135,320**	**139,809**	**144,471**	**419,600**

Table 6. PNGL GD14 FD key price control volumes compared to PNGL proposed volumes.

4. Post GD14 Final Determination Adjustments

4.1 In order to report on performance for GD14, we need to know how the GDNs performed against our determined GD14 allowances, adjusted for differences between actual and allowed costs or outputs (such as connections or properties passed) provided to the GDNs as part of the price control determination. These adjusted allowances are dealt with by the 'Uncertainty Mechanism.'

4.2 The adjustments were broken down into 3 categories, which were identified in GD14 as follows:

- Output based – we determine a unit price (Capex) or unit allowance (Opex). The value included in the cost base is the determined unit price/unit allowance x the forecast driver for that item e.g. connections/properties passed (Opex) or m per connection (Capex).[6] Any difference in outputs (e.g. higher connections) between the determination and outturn will result in a retrospective adjustment at future price controls (i.e. determined unit rate/unit allowance x actual driver output less determined unit rate/unit allowance x forecast driver output).

- Pass through – Any difference between the allowance in the determination and the actual costs incurred will result in an adjustment at future price controls.

- Ring fenced – Similar to pass through items; however, we will require a justification from the licence holder that the costs were necessarily and efficiently incurred, otherwise the full amount may not be allowed or may subsequently be removed if not used.

4.3 The adjustments will also include the impact of the allowed cost of capital from the date of the difference in expenditure to the date that the adjustment is made.

4.4 Also as mentioned above, the GDNs make requests for **Additional Development Areas,** which is considered on a case by case basis. In general, the UR assesses these projects by reviewing the business case submitted and makes a decision to approve or reject, based on the overall contribution that it may make to the network.

4.5 Some development areas require a change in the licenced area of the GDN, which requires a consultation process. The additional allowances approved is as per the current price control, unless the project is very unique, such as dealing with Special Engineering Difficulties (SPEDs).

[6] The symbol x refers to multiplication of values.

Uncertainty Mechanism

4.6 The table below sets out the components, in terms of Capex and Opex for each of the GDNs that were subject to change in GD14.

FE Uncertainty Mechanism

4.7 For FE Capex the following areas were considered under the Uncertainty Mechanism.

FE Capex

Capex Item	Determination Basis
Traffic Management Act	Ring fenced
Pressure Reduction Stations	Output based on actual numbers installed
All Mains (4 Bar Mains, Feeder Mains, Infill Mains & Security of Supply)	Ring Fenced. We will determine on this once sufficient information has been received and our determination will clarify any retrospective issues.
Domestic/ I & C Meters	Output based on connections and determined unit rates.
Domestic/ I & C Services	Output based on connections and determined unit rates.
Capex over and under spend	Additional Development Area (ADA) projects submitted by FE and approved by us will retrospectively be allowed into the cost base at the time of the next review as well as approved projects to deal with Energy Efficiency. Similarly any projects within the price control which do not go ahead will be removed from the cost base.
Volumes in relation to Additional Development Areas (ADAs)	Output based on additional volumes times the determined Pi rate. Volume determination updated to reflect actual burn of ADAs.
IT	Ring-fenced allowance for 2014.

4.8 For FE Opex, the items subject to retrospective adjustment are those shown in the table below.

FE Opex

Opex Item	Determination Basis
Rates	Pass through.
Licence Fees	Pass through.
Connections Incentive Mechanism (inclusive of sales/support staff and related overheads)	Output based on Owner Occupier connections (excluding assessed non-additional connections) and determined unit rates (as adjusted for over/under performance with respect to target owner occupier connections.

PNGL Uncertainty Mechanism

4.9 For PNGL Capex the following areas were considered under the Uncertainty Mechanism.

PNGL Capex

Capex Item	Determination Basis
Traffic Management Act	Ring fenced
Pressure Reduction Stations	Output based on actual numbers installed
7 bar, 4 bar & Feeder Mains	Output based – linked to approved projects (none have been requested in GD14)
Other Mains: Existing Domestic and I & C	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 7.7 metres and determined unit rate. Additional incentive and penalties will apply as outlined in the FD
Infill Mains: New Build Domestic	Output based on actual number of properties passed, annual average number of metres of infill laid per property passed up to a cap of 5.9 metres and determined unit rate.
Domestic/I & C Meters	Output based on connections and determined unit rates.
Domestic/I & C Services	Output based on connections and determined unit rates.
Capex over and under spend	We will retrospectively allow approved Capex into the cost base at the time of the next review e.g. as a result of Energy Efficiency improvements.

4.10 For PNGL Opex, the items subject to retrospective adjustment are those shown in the table below.

PNGL Opex

Opex Item	Determination Basis
Rates	Output based on turnover as set out in GD14 final determination
Licence Fees	Pass through
Connections Incentive Mechanism (inclusive of sales/support staff and related overheads)	Output based on Owner Occupier connections (excluding assessed non-additional connections) and determined unit rates (as adjusted for over/under performance with respect to target owner occupier connections. This is outlined in the GD14 final determination.

Post GD14 adjustments (FE)

Capex Adjustments

4.11 The Capex adjustments for GD14 were all fully controllable in that, in terms of the development of the network, this was at the discretion of the GDNs.

4.12 We now consider the steps that explain the changes from the starting position of the GD14 FD to the adjusted determination of GD14.

FE Capex (£k) (dec, 2016 prices)	2014	2015	2016	GD14 Total
GD 14 FD	12,176	10,215	9,182	31,573
GD14 Revisied Mains Allowances (Incl Foyle and Ulster Farm by Products)	-2,771	-1,416	1,355	-2,831
Loughgall,Moy,Charlemont,Richhill, Benburb and Blackwatertown	0	2,222	1,478	3,700
Traffic Mangement Act	-1,017	-860	-778	-2,654
IC Services and Meters	153	117	90	360
Other Capex Updated	-641	655	1,498	1,512
Adjusted Determination	**7,901**	**10,933**	**12,825**	**31,660**

Table 7. FE GD14 FD Capex allowances before and after retrospective adjustments.

4.13 The main reasons why the Capex has changed is as follows:

- The Revised Mains allowance was decided in January 2015, as at the time of the GD14 FD, we were unable to make a final decision until other information had been provided, to set an appropriate, property passed allowance and a few other projects were included, such as the Foyle River crossing in Derry/Londonderry.
- FE submitted a business case for an Additional Development Area, which fell outside its existing licenced area, which was approved and consulted on separately, but based on the allowances as decided in the GD14 FD.
- The Traffic Management Act (TMA) which was included in the FD, as

potential legislation did not come into force and was not needed.

- The IC Services and Meter costs were revised to reflect updated connections.

Opex Adjustments

4.14 The Opex adjustments for FE in GD14 included the following:

- Rates;
- Licence Fees; and
- Owner Occupied Connection Incentive.

4.15 We use these adjustments to calculate a retrospectively allowed GD14 Opex allowance to take account of costs which were uncertain at the time of the GD14 final determination.

4.16 For licence fees the forecast costs set in GD14 are adjusted for actual licence fees. The network rate costs, which are a significant component of the FE total rates costs for the GD14 final determination, were set with reference to forecast FE revenue over the GD14 period. This was adjusted for actual FE revenue over the GD14 period. The owner occupied connection costs are determined based on owner occupied connections (excluding assessed non additional connections) and determined unit rates (as adjusted for over / under performance) with respect to target owner occupier connections.

	2014	2015	2016
GD14 FD opex (post efficiency and pre adjustments) (£k)	5,860	6,036	6,266

FE GD14 rates adjustment (£k)	2014	2015	2016
GD14 FD allowance	988	1,122	1,150
revised allowance based on actual cost	899	1,016	1,092
adjustment	-88	-105	-59

FE licence fee adjustment (£k)	2014	2015	2016
GD14 FD allowance	53	53	53
revised allowance based on actual cost	82	47	22
adjustment	30	-6	-31

FE connections incentive adjustment (£k)	2014	2015	2016
GD14 FD allowance	781	781	781
revised allowance based on actual connections	352	821	967
adjustment	-429	40	186

Total adjustments (£k)	-488	-72	96

GD14 allowances after adjustments (post efficiency)	5,372	5,964	6,362

Table 8. FE GD14 FD Opex allowances before and after retrospective adjustments (Dec 2016 prices).

Post GD14 Adjustments (PNGL)

Capex Adjustments

4.17 The Capex adjustments for GD14, were all fully controllable in that, in terms of the development of the network, this was at the discretion of the GDNs.

4.18 We now consider the steps that explain the changes from the starting position of the GD14 FD to the adjusted determination of GD14.

PNGL Capex (£k) (dec, 2016 prices)	2014	2015	2016	GD14 Total
GD 14 FD allowances	13,232	13,489	13,315	40,036
Main Changes				
Traffic Mgt Act (TMA)	-928	-941	-949	-2,818
IC Service and Meters	-326	-437	-429	-1,192
Other Capex (Including East down)	1,226	-313	-1,903	-990
Adjusted Determination	13,205	11,797	10,034	35,036

Table 9. PNGL GD14 FD Capex allowances before and after retrospective adjustments.

4.19 The main reasons why the Capex has changed is as follows:

- The Traffic Management Act (TMA) which was included in the FD, as potential legislation did not come into force and was not needed.
- The proposed level of IC connections as per the business plan which we accepted did not materialise and so was removed.
- In Other Capex, this was a combination of reduction in the New Build programme with associated connections, slight upside on Domestics and NIHE connections and the commencement of the East Down build programme in 2016.

Opex Adjustments

4.20 The Opex adjustments for PNGL in GD14 included the following:

- Rates;
- Licence Fees; and
- Owner Occupied Connection Incentive.

4.21 We use these adjustments to calculate a retrospectively allowed GD14 Opex allowance to take account of costs which are uncertain at the time of the GD14 final determination.

4.22 For licence fees, the forecast costs set in GD14 are adjusted for actual licence fees. The network rate costs, which are a significant component of the PNGL total rates costs for the GD14 final determination were set with reference with forecast PNGL revenue over the GD14 period. This is adjusted for actual PNGL revenue over the GD14 period. The owner occupied connection costs are determined based on owner occupied connections (excluding assessed non additional connections) and determined unit rates (as adjusted for over / under performance) with respect to target owner occupier connections.

	2014	2015	2016
GD14 FD opex (post efficiency and pre- adjustments)	14,924	15,148	15,211

PNGL GD14 rates adjustment (£k)	2014	2015	2016
GD14 FD allowance	1,482	1,654	1,731
revised allowance based on actual cost	934	1,676	1,947
adjustment	-548	22	216

PNGL licence fee adjustment (£k)	2014	2015	2016
GD14 FD allowance	126	125	125
revised allowance based on actual cost	109	96	95
adjustment	-16	-29	-31

PNGL connections incentive adjustment (£k)	2014	2015	2016
GD14 FD allowance	2,825	2,825	2,825
revised allowance based on actual connections	3,753	2,827	1,792
adjustment	928	2	-1,033

Total adjustments (£k)	364	-4	-847

GD14 allowances after adjustments (post efficiency)	15,288	15,144	14,364

Table 10. PNGL GD14 FD Opex allowances before and after retrospective adjustments (Dec 2016 prices).

5. Outturn Operational and Capital Costs Including Outputs

Background

5.1 As explained previously, we have made a decision in terms of setting a price control, adjusted it for the Uncertainty Mechanism components and have added in any allowed adjustments e.g. Additional Development Areas during the price control.

5.2 We now consider the performance of the GDNs against GD14 adjusted allowances.

FE

Outturn Operational Expenditure

5.3 The FE actual Opex in the GD14 period was significantly above our GD14 final determination (i.e. by 20%). A comparison of the actual FE Opex in in each year of GD14 versus the GD14 final determination adjusted allowances is shown in Table 11.

5.4 In relation to this 20% overspend compared to Opex adjusted allowances FE have stated that the main reasons for this variance were:

- Costs incurred to deliver owner occupied connections.
- Interim transitional service arrangement costs for IT transition away due to sale of the business, which occurred in June 2014.
- Additional legal and consultancy costs throughout the period, including costs in relation to the GD17 price control submission and costs incurred in 2016 in respect of FE's appeal to the CMA of the GD17 final determination (issued on 15 September 2016).

5.5 FE have stated that overspends in these areas were partially offset by underspend in Emergency first call costs.

5.6 We concur with the FE analysis for the reasons for the 20% overspend in the GD14 period and note that FE bears the full risk and reward for any Opex over and underspends.

FE Opex (£k) (dec, 2016 prices)	2014	2015	2016	GD14 Total
GD 14 allowances (after adjustments, post efficiency)	5,372	5,964	6,362	17,698
Actual Opex	6,352	7,219	7,647	21,218
Over (Under) Spend	980	1,255	1,285	3,520
Percentage variance (GD14 allowance v actual)	**18%**	**21%**	**20%**	**20%**

Table 11. FE actual Opex compared to GD14 allowances.

Outturn Capital Expenditure

5.7 A comparison of the actual FE Capex in GD14 versus the GD14 final determination adjusted allowances is shown in Table 12.

5.8 FE have overspent when compared the regulatory allowances as set in GD14, which have been updated for key outputs, for the following reasons:

- FE has laid more pipe in developing the network than the Properties Passed allowance.
- The meter and service costs were more than the allowances given.
- Due to the sale of the business to new ownership in June 2014, a major IT development programme was necessary, which resulted in expenditure over allowances granted.

5.9 FE began the Moy and Benburb project in 2015 and completed it at the end of 2016. In comparison to determined allowances, FE laid an additional 2.7km of mains and passed an additional 54 properties.

5.10 The actual costs on the Moy and Benburb project were lower than allowances granted due to cost savings from increased directional drilling than forecast.

5.11 FE also have a Capital Rolling Incentive[7] mechanism that incentivises efficient performance.

FE Capex (£k) (dec, 2016 prices)	2014	2015	2016	GD14 Total
GD 14 allowances (after adjustments)	7,902	10,933	12,825	31,660
Actual Capex	11,690	12,721	12,244	36,654
Over (Under) Spend	3,788	1,788	-582	4,994
Percentage variance (GD14 allowance v actual)	**48%**	**16%**	**-5%**	**16%**

Table 12. FE actual Capex compared to GD14 allowances.

[7] Refer to section 14.9 of GD14 final determination for additional details.

PNGL

Outturn Operational Expenditure

5.12 The PNGL actual Opex in the GD14 period was quite close to the GD14 final determination i.e. above by 2%. A comparison of the actual PNGL Opex in in each year of GD14 versus the GD14 final determination adjusted allowances is shown in Table 13.

5.13 In relation to the 2% overspend compared to opex allowances PNGL have stated that '*despite PNGL's owner-occupied connections during GD14 being higher than UR's target, the asymmetric nature of the connection incentive mechanism resulted in PNGL's overall GD14 retrospective opex allowance being c.£100k less (£2012 prices) than if it had met the target in line with UR's determined profile. Mainly as a consequence of this PNGL's GD14 opex performance shifted from being a £0.2k favourable variance in 2014 to a £0.7m adverse variance in 2016'*

5.14 We note that overspends in some areas were partly offset by underspends in other areas, for example, insurance costs. PNGL bears the full risk and reward for any Opex over and underspends.

5.15 It is important to note that the PNGL operational expenditure has only marginally increased in the GD14 period i.e. from £15,087k in 2014 to £15,159k in 2016. In the same period, PNGL has grown the gas network in terms of km mains laid by 5.9% i.e. from 3,313km cumulative mains laid at the end of 2013 to 3,508km in 2016. When measured by domestic connections, PNGL has grown its network by 18% in the GD14 period i.e. from 159,139 total cumulative connections at the end of 2013 to 187,688 in 2016, and in the same period I & C connections have grown by 7%.

PNGL Opex (£k) (dec, 2016 prices)	2014	2015	2016	GD14 Total
GD 14 allowances (after adjustments, post efficiency)	15,288	15,144	14,364	44,796
Actual Opex	15,087	15,284	15,159	45,530
Over (Under) Spend	-201	140	795	734
Percentage variance (GD14 allowance v actual)	**-1%**	**1%**	**6%**	**2%**

Table 13. PNGL actual Opex compared to GD14 allowances. [8]

Outturn Capital Expenditure

5.16 A comparison of the actual PNGL Capex in GD14 versus the GD14 final determination adjusted allowances is shown in Table 14.

5.17 PNGL has kept very close to the regulatory allowances set in GD14, and delivered

[8] For 2016 the GD14 FD Opex allowance was adjusted from £15,211k to £14,364k mainly due to a revised connection incentive allowance. See Table 10 for further details.

its key outputs.

5.18 PNGL's GD14 Capex performance benefitted from a release of historic accruals from earlier construction contracts thereby supporting the favourable variance against retrospective Capex allowances.

5.19 Under the Capex Sharing Mechanism, PNGL retains five years of financing costs (equivalent to 4 years' return and 5 years' depreciation) on Capex underspends and will forego five years of financing costs on approved overspends i.e. Capex overspends that have been efficiently incurred and approved by UR. Capex over and underspends are thus treated symmetrically under the mechanism.

PNGL Capex (£k) (dec, 2016 prices)	2014	2015	2016	GD14 Total
GD 14 allowances (after adjustments)	13,205	11,797	10,034	35,036
Actual Capex	13,379	10,932	10,425	34,736
Over (Under) Spend	174	-865	391	-300
Percentage variance (GD14 allowance v actual)	**1%**	**-7%**	**4%**	**-1%**

Table 14. PNGL actual Capex compared to GD14 allowances.

Performance Against Price Control Outputs

5.20 The key outputs which we use to assess the performance of the GDNs are in relation to connections, km mains laid and properties passed.

FE

5.21 Table 15 below shows the performance of FE on these key outputs against the GD17 final determination. It is important to note that the table below takes account of additional development areas.

Key GD14 Outputs	Final Determination (inc ADA's)				Actuals (inc ADA's)				Difference to GD14 FD	
	2014	2015	2016	Total	2014	2015	2016	Total	No	%
Connections										
Domestic - New Build	800	800	800	2,400	777	916	1,294	2,987	587	24%
Domestic - Owner Occupied	2,000	2,000	2,000	6,000	1,580	2,085	2,296	5,961	-39	-1%
Domestic - NIHE	1,200	1,200	1,000	3,400	1,402	693	593	2,688	-712	-21%
I & C	152	102	52	306	260	187	114	561	255	83%
Connections Total	4,152	4,102	3,852	12,106	4,019	3,881	4,297	12,197	91	1%
KM mains laid										
New Build	5.5	5.5	5.5	16.6	10.6	13.4	12.3	36.3	19.6	118%
Other than new build	45.2	70.6	84.2	200.0	62.5	97.8	117.2	277.5	77.5	39%
Total KM mains laid	50.7	76.1	89.7	216.6	73.1	111.2	129.5	313.8	97.1	45%
Properties Passed										
New Build	800	800	800	2,400	698	821	1,334	2,853	453	19%
Other than new build	6,526	7,911	8,010	22,447	6,211	9,791	13,664	29,666	7219	32%
Total Properties Passed	7,326	8,711	8,810	24,847	6,909	10,612	14,998	32,519	7,672	31%
** FE did not make a specific submission for properties passed rather property passed numbers are calculated from KM mains laid with an asumption of no of property passed per metre of mains laid*										

Table 15. FE actual outputs compared to GD14 FD (including 'Additional Development Areas').

Connections for New Build, NIHE and I & C

5.22 FE outperformed significantly on Domestic New Build and I & C as can be seen from Table 15. In regard to NIHE, there was a significant underperformance. FE have explained that this was due to fewer than anticipated NIHE conversion projects in the GD14 period.

5.23 FE have further explained that its emphasis in the years leading up to 2014 (i.e. prior to GD14), was in connecting larger I & C consumers, together with NIHE areas, but the focus shifted for the GD14 period to connecting domestic owner occupied consumers (including housing associations).

Owner Occupied Connections (OO)

5.24 On Domestic OO Connections, FE were under target by only 1% against the GD14 final determination. The underperformance was most pronounced in 2014, with this underperformance being offset by outperformance in 2015 and 2016. FE have explained that the price of oil, the predominant fuel in the Ten Towns area, reduced dramatically over the GD14 period especially when compared to natural gas prices and in their view this impacted on decisions to convert to natural gas.

Mains Laid (km)

5.25 FE have laid more pipe i.e. 313.7km in the GD14 period compared to the allowances of 216.6km. This was due to longer connections lengths that were laid.

Properties Passed

5.26 FE significantly outperformed in properties passed when compared to the GD14 final determination i.e. by 31%. The main reason for this was FE developed the network further and laid more pipe in the ground due to the distance between properties on the network.

PNGL

5.27 Table 16 below shows the performance of PNGL on these key outputs against the GD17 final determination. It is important to note that the table below takes account of the extension of the PNGL network into the East Down area.

Key GD14 Outputs	Final Determination (inc East Down)				Actuals (inc East Down)				Difference to GD14 FD	
	2014	2015	2016	Total	2014	2015	2016	Total	No	%
Connections										
Domestic - New Build	2,300	2,550	2,750	7,600	1,756	1,801	1,845	5,402	-2198	-29%
Domestic - Owner Occupied	6,500	6,500	6,500	19,500	7,751	6,504	5,529	19,784	284	1%
Domestic - NIHE	1,000	1,000	1,000	3,000	1,292	1,060	1,011	3,363	363	12%
I & C	378	378	378	1,134	295	303	256	854	-280	-25%
Connections Total	10,178	10,428	10,628	31,234	11,094	9,668	8,641	29,403	-1,831	-6%
KM mains laid										
New Build	13.6	15.0	16.2	44.8	12.7	16.0	17.4	46.2	1.4	3%
Other than new build	26.2	26.2	42.2	94.6	38.1	36.9	74.0	149.1	54.5	58%
Total KM mains laid	39.8	41.2	58.4	139.4	50.9	52.9	91.5	195.3	55.9	40%
Properties Passed										
New Build	2,300	2,550	2,750	7,600	1,599	1,860	2,151	5,610	-1990	-26%
Other than new build	3,403	3,403	4,042	10,848	4,030	3,982	3,638	11,650	802	7%
Total Properties Passed	5,703	5,953	6,792	18,448	5,629	5,842	5,789	17,260	-1,188	-6%

Table 16. PNGL actual outputs compared to GD14 FD (including East Down).

Connections

New Build Connections

5.28 There is a 29% lower level of new build connections than that proposed by PNGL and accepted by the UR for the GD14 FD. PNGL has explained that connections within the new build market continued to be subdued with new housing development remaining down over a sustained period, compared to historic levels, as the sector generally sought to recover following the financial crash.

Owner Occupied (OO) Connections

5.29 PNGL outperformed against its GD14 final determination OO connection targets by

circa 1%. (i.e. 284 properties) There were a number of issues which PNGL consider influenced the connection numbers in the GD14 and how this contrasted to earlier periods. This is shown graphically in Figure 1.

5.30 PNGL have previously stated to us that in relation to 2013 and 2014 that '2013 and 2014 produced the highest owner occupied connections levels since the peak in 2003. '*We believe these performance levels were the result of (i) a continuation of many of the market conditions experienced between 2011 and 2012; (ii) the impact of the introduction of the Northern Ireland Executive Boiler Replacement Allowance in September 2012; and (iii) the rapidly rising cost of home heating oil and the associated publicity.'*

5.31 In relation to the 2015 year, PNGL have indicated the boiler replacement scheme had a positive impact on connections; whereas the differential on oil versus gas prices had a negative impact on connections.

5.32 In relation to the 2016 year, PNGL have indicated that there were no specific market stimulants for owner occupied gas connections and the favourable market conditions in previous years meant that consumers who would otherwise have been naturally considering gas in 2016 had chosen to convert sooner.

5.33 We note PNGL's view on the factors which PNGL consider influenced the connection numbers in the GD14 period.

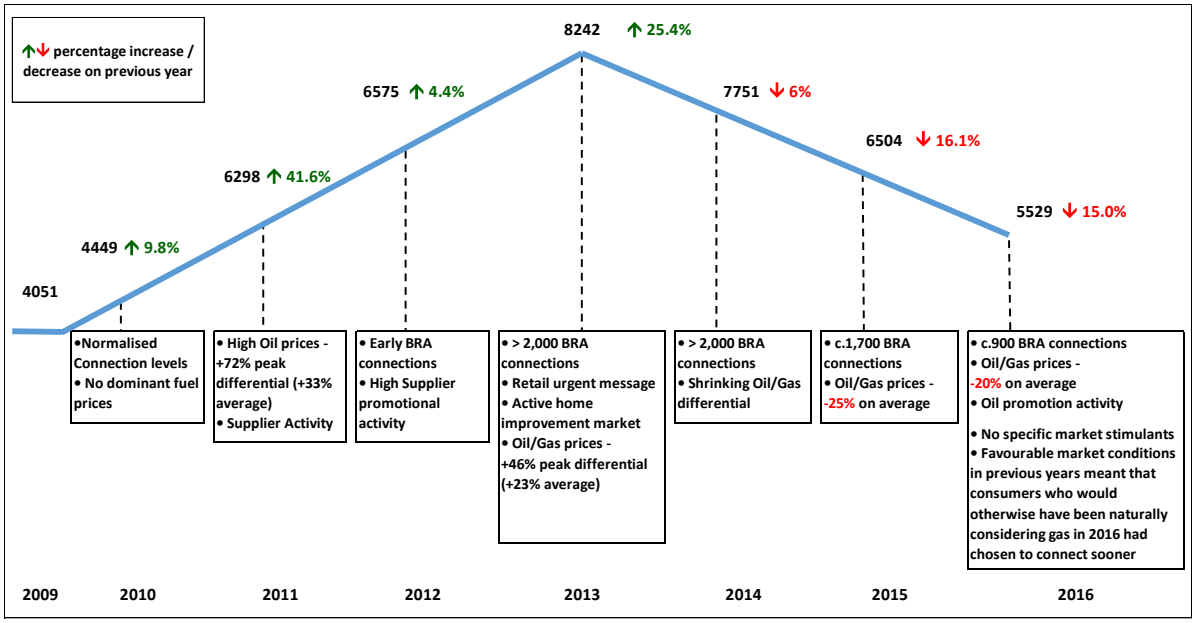


Figure 1. PNGL Graphical Representation of Issues Influencing Connection Numbers

5.34 PNGL has stated in relation to Owner Occupied connections that '*the owner-occupied sector represents PNGL's greatest opportunity for growth and UR recognised this potential in its GD14 Final Determination by including a connections incentive that rewarded PNGL for connecting owner-occupied customers*.' PNGL

has exceeded on outputs in the owner-occupied sector across GD14, connecting 19,784 homes to the network.

NIHE Connections

5.35 PNGL outperformed against its GD14 final determination NIHE targets by circa 12%. NIHE connections are driven by the availability of Government funding and NIHE's 15-year boiler replacement cycle.

I & C connections

5.36 PNGL underperformed against its GD14 final determination I & C connection targets by circa 25%.

Mains Laid (km)

5.37 The actual amount of mains laid (km) by PNGL relating to new build properties was 3% higher than that determined in the GD14 final determination. The actual amount of mains laid (km) by PNGL related to existing properties was 58% higher than that determined in the GD14 final determination. This difference is largely explained by the laying of large gas pipes to the East Down development area.

Volumes

5.38 A number of factors can affect the volume of gas flow, in terms of new connections and development of any network extensions, temperature related (degree days) and usage by I & C customers. We do consider that the volume of gas conveyed by a GDN is important, in terms of stability in tariffs and managing its business going forward.

FE

5.39 The actual volume of gas burned (therms) by FE in the GD14 period was 3% lower in total terms than that forecast in the GD14 final determination as shown in table 17.

5.40 FE have explained that the 3% underperformance was largely due to underperformance in domestic and interruptible contract volumes. FE is more dependent on large load volumes.

5.41 FE operated under a price cap in GD14 and was incentivised to outperform on the gas volume targets set. FE have explained that despite having targeted incentives to deliver volumes, the GD14 period saw the announcement and closure of some of FE's large I & C customers. At their peak these companies accounted for 8 million

therms per annum, representing 13% of FE's total volumes.

GD14 Volumes (in therms, 000's)	Final Determination (inc ADA's)				Actuals (inc ADA's)				Difference to GD14 FD	
	2014	2015	2016	Total	2014	2015	2016	Total	No	%
Domestic's (incl small I & C)	8,222	9,817	11,411	29,451	5,997	7,023	8,534	191,565	-7,897	-27%
Industrial and Commercial	50,348	51,248	52,241	153,837	49,118	54,453	52,005	155,576	1,739	1%
Overall Total	**58,570**	**61,065**	**63,652**	**183,288**	**55,115**	**61,476**	**60,539**	**177,130**	**-6,158**	**-3%**

Table 17. FE actual volumes compared to GD14 FD (including 'additional development areas')

PNGL

5.42 The actual volume of gas burned (therms) by PNGL in the GD14 period was quite close to our final determination being only 2% lower in total terms as shown in table 18.

5.43 PNGL operate under a revenue cap, so there is no incentive to outperform in achieving over and above the gas volumes set.

GD14 Volumes (in therms, 000's)	Final Determination				Actuals				Difference to GD14 FD	
	2014	2015	2016	Total	2014	2015	2016	Total	No	%
Domestic's	60,007	63,822	67,736	191,565	58,761	65,738	70,217	194,716	3,151	2%
Industrial and Commercial	75,313	75,988	76,734	228,035	69,781	73,142	71,733	214,656	-13,379	-6%
Overall Total	**135,320**	**139,809**	**144,471**	**419,600**	**128,542**	**138,880**	**141,950**	**409,372**	**-10,228**	**-2%**

Table 18. PNGL actual volumes compared to GD14 FD (including East Down).

6. Future Price Controls and Reporting

Areas for Consideration

6.1 As part of the GD17 final determination we identified a number of issues that we consider lie beyond the scope of the GD17 price control determination.

6.2 The issues to be considered during the GD17 price control period are as follows:

- Connections Incentive review;
- Consumer engagement and customer satisfaction;
- Shrinkage review;
- Review of conveyance charges;
- Delivery of a common branding approach in relation to promoting natural gas in NI;
- Revision of Annual/Cost reporting templates and associated RIGs; and
- Asset maintenance excellence.

6.3 We have had initial engagement with the GDNs in relation to a number of these areas, for example, we have commenced discussions on the consumer engagement and customer satisfaction. We will provide an update on these areas in future cost and performance reports.

6.4 We do consider however that two work areas require more discussion, considering their importance in progression to the next price control. We discuss these areas below.

Connection Incentive Review

6.5 The connection incentive is unique to the gas industry in Northern Ireland. We highlighted in the GD17 final determination that we intend to review the rationale for the connection incentive as well as the performance of each of the GDNs in connecting owner occupied properties. We consider that a mid-point review, during GD17 would be an appropriate point to do this- i.e. in 2020. We consider that this review would assist in developing our approach for any connection incentive for the GD23 price control period. In considering next steps, we believe it could be useful to consider some of the following in any review:

- Current/historic performance and expenditure on connection incentive type activities;
- Justification- including the economic test for a connection Incentive allowance going forward;
- Need to differentiate any connection incentive in the respective licence areas;

- The components of any connection incentive;
- Alternatives to connection incentive including charging for connections;
- Cost and activities covered either in full or in part by the connection incentive;
- Factors that influence customer decision to convert to gas; and
- Inter-generational balance in terms of charges for present and future consumers.

6.6 We will discuss the scope of the review further with the GDNs.

Revision of Annual/Cost Reporting Templates and RIGs[9] for GD17

6.7 As stated in our 2018-19 forward work plan,[10] we will continue to publish reports which monitor the progress of GDNs, compared to price control determinations. We will continue to progress this further for GD17 and commence planning for GD23.

6.8 For GD17, the timetable for this work is set out below. We intend requiring GDNs to submit returns relating to the first two years of GD17 (2017 and 2018) together before the end of June 2019. This will allow us to make any revisions to RIGs necessary for GD17 and in particular to consider any relevant aspects from the reporting regime for RIIO in GB. Our next cost and performance report will therefore cover the 2017 and 2018 years and we expect to publish it by the end of 2019.

6.9 In developing the RIGs we will be working collaboratively with GDNs in the development of these RIGs and any amendments will be made using the process set out in the RIGs licence conditions.

6.10 We intend developing the reporting guidance and we will ensure that there is a consistent approach by each of the GDNs in reporting costs (e.g. overhead costs). Henceforth, we expect companies to submit annual returns in accordance with the RIGs template and guidance and we intend producing annual cost and Performance reports by end June of the year following the review year. This is similar to our approach for Northern Ireland Water.[11]

6.11 We would envisage a similar report next year for a GD17 cost and performance report, updated for any amendments or changes that the GD17 FD implemented. We will also consider mapping trends in expenditure and outputs over a longer time

[9] Regulatory Instructions and Guidance (RIGs).
[10] https://www.uregni.gov.uk/news-centre/forward-work-programme-2018-19-published

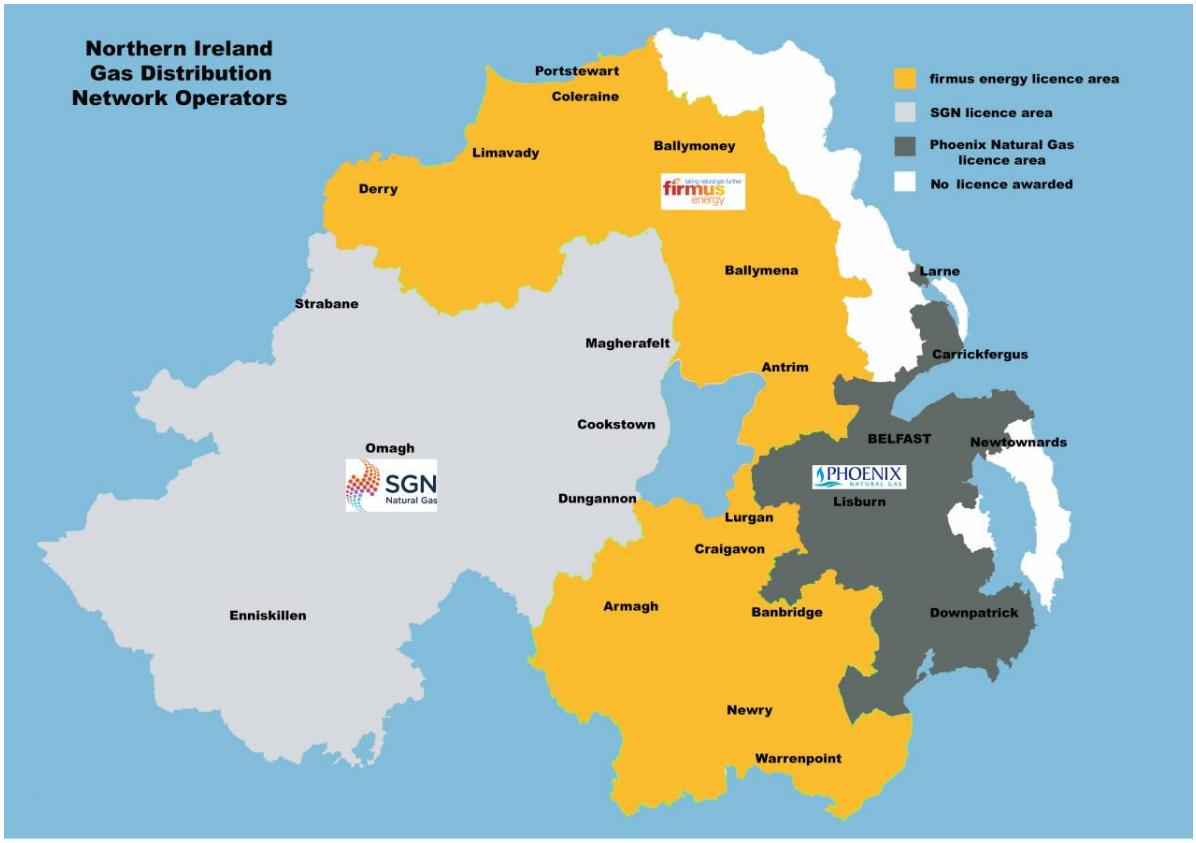
[11] https://www.uregni.gov.uk/sites/uregni/files/media-files/Final%20CPR%20for%202016-17_02.00%20-%20Published%202018-03-20.pdf

horizon to establish a baseline going forward. We envisage that the price base will be in the most up to date numbers possible.

6.12 The timings of our first GD17 cost and performance report covering the 2017 and 2018 years has been communicated and discussed with GDNs at bilateral meetings and expected timeframes are summarised below.

Provisional Milestone	**Expected Timelines**
Issue of revised RIGs guidance for GDNs	December 2018
RIGs submissions from GDNs covering 2017 and 2018	Before the end of June 2019
Publication of cost and performance report for 2017 and 2018 years of GD17	Before the end of 2019

Annex A- NI Gas Distribution Network Operators Map



(Please note for exact clarification of individual licenced areas, reference should be made to the relevant licences).