

Consultation on Gas Network Extensions in Northern Ireland

Executive Summary

- PNGL fully supports UR's aim of achieving the optimal outcome for consumers in the new licensed area in respect of each of transmission and distribution. To achieve this, UR will want to:
 - secure the maximum number of applications from qualified potential bidders;
 - facilitate fair competition on as many aspects of the application as possible; and
 - ensure meaningful comparisons can be made between applications, taking account of all relevant factors (including cost and risk of delivery).
- The application process and timetable, the criteria, and UR's approach to selecting the winner(s) should all be designed in a manner best calculated to achieve the optimal outcome for consumers.
- PNGL has made a number of observations in this response to assist UR in achieving its aim.

Introduction

Phoenix Natural Gas Ltd ("**PNGL**") welcomes the opportunity to respond to the Utility Regulator ("**UR**") consultation on gas network extensions in Northern Ireland.

The economic, social, health and environmental benefits emanating from the growth of the natural gas industry in Northern Ireland ("**NI**") are significant – as has been recognised by UR¹ and the NI Executive²; and PNGL fully supports efforts to make gas available to as much of the NI population as is feasible and economic.

The take-up and availability of natural gas in NI is largely centred on Greater Belfast; from a zero base in 1996, natural gas is now available to c.90% of the properties within PNGL's existing Licensed Area³. In addition, firmus energy has connected c.15,000 customers in its 10 towns/cities licensed

¹ See, for example, http://www.uregni.gov.uk/uploads/publications/Guide_for_Applicants_-_Business_Analyst_Gas_Supply.pdf (at page 4)

² See, for example, http://www.competition-commission.org.uk/assets/competitioncommission/docs/2012/phoenix-natural-gas-limited/deti_response_to_pd.pdf.

³ As defined in PNGL's licence.

area, focusing on connecting key gas loads, and has extended the network to additional urban areas. This capital investment will be paid for by existing and future natural gas consumers under the terms of existing licences.

PNGL fully supports the NI Executive's commitment to increase the number of homes and businesses with access to natural gas and its target of making natural gas available to 70% of properties in NI; this will need to be achieved both through extension of the natural gas network to new areas and by maximising potential further development within existing licensed areas.

While some significant milestones in establishing and developing the natural gas industry in NI have been met to date, there is still much to be done before oil will be displaced as the "fuel of choice" in NI. For example natural gas has been available to most geographical areas across PNGL's Licensed Area for only around 10 years. Whilst some of these areas have reached over 60% penetration (largely those areas where natural gas was first made available), other areas have lower than 18% penetration (largely those areas where natural gas has recently been made available). The early adopters who were persuaded by PNGL to convert to natural gas have already connected, and in many cases those who are still to convert – c.50% within PNGL's Licensed Area - have not yet been convinced of the benefits and require significantly more time, effort and investment in market development to persuade them to make the switch. Likewise in the firmus licensed area many potential consumers are still to be persuaded to convert to natural gas.

Securing a 'road map' for investors which provides the economic, political and regulatory conditions to expand upon the progress that natural gas has already made, will see the social, environmental and enterprise fundamentals extended to a relatively large proportion of the population of NI and in so doing, deliver the policy decisions of the NI Executive.

PNGL welcomes the decision of UR to consult on the key elements that should be explored when considering how best to extend the natural gas network in NI. PNGL has tried to provide a detailed response, but is conscious that further debate and discussion may add additional value to the process and as such, would be very willing to enter into further discussion with UR, if UR were to consider this helpful.

PNGL also welcomes UR's commitment to run any application process pursuant to its current principal statutory objective to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland⁴ and applicable EU law⁵ and in line with best regulatory practice, which will include ensuring the process satisfies the principles of transparency, non-discrimination and equal treatment.

⁴ Article 14(1) Energy (NI) Order 2003

⁵ Notably Article 40 of Directive 2009/73/EC concerning common rules for the internal market in natural gas (the "Third Gas Directive")

Response to consultation questions

Chapter 1

Q.1 Is the respondent actively considering making an application for either or both the necessary licence(s)?

PNGL is considering making an application or applications for both the transmission and distribution licences.

PNGL believes that the best solution for NI's consumers (as well as fairness of the competition) will be achieved if UR settles upfront the key parameters of the future regulatory regime. In particular, UR must be clear on the terms of the licence when inviting licence applications. To ensure fair and effective competition, the application process cannot be based on one regulatory framework, while the award is based on another. If UR were to determine that its duties require it to adopt a different regulatory model to that on which applications have been submitted, UR must re-run the process and give all original applicants an equal opportunity to reconsider the content of their applications.

In terms of certainty, PNGL requests that UR clarifies the changes to the legislative framework that it is discussing with the NI Executive (referred to in paragraph 1.2 of the consultation paper).

Chapter 2

Q.2 Do respondents require any additional information on possible Northern Ireland Executive Subvention in order to construct any potential licence application effectively?

UR may wish to consider whether it would be more appropriate for it to commence the licence application process after the NI Executive has secured any state aid consents that are required, providing potential investors in the new transmission assets with important certainty about the level of subvention and the basis on which it is granted (see further PNGL's response to Q20 below).

PNGL notes that (i) the subvention of up to £32.5m is towards the cost of the new transmission pipeline only and (ii) the transmission pipeline must be laid before the distribution network can be commissioned. PNGL shares UR's concern about the risk of consumers having to fund stranded assets. Of particular concern is that having laid the transmission pipeline, its capacity is not utilised. PNGL would ask UR to consider whether the need to protect consumers against the risk of having to fund stranded assets is better addressed at transmission level, rather than revising the connection policies at distribution level. This would be consistent with the example provided in section 2.19 for the transmission network between BGE(NI) and ESB/ESBI in relation to the Coolkeeragh power station connection.

Distribution operators already undertake the 'economic test' through (i) their connection policies and (ii) their price controls. Furthermore UR is proposing a 'price cap' regulatory model at distribution level with the measure of demand being consumption. Distribution operators would therefore be exposed to the volume risk of companies making a connection to the network and not

utilising the asset. The transmission pipeline will cost c.50% of the total network extension and will have to be constructed and commissioned in advance of any consumers connecting to the distribution network. However, UR seems to be proposing that the transmission operator makes no 'contribution' to protect consumers against the risk of having to fund stranded assets. This would be inconsistent with the development of the natural gas industry to date. UR should therefore, in PNGL's view, determine an appropriate balance between the potential benefits of some form of financial guarantee and the potential barrier to connection for consumers.

PNGL would also urge UR to exercise caution when making comparisons against existing practice in GB. As noted in the introduction above, the network in GB is significantly more mature than in NI. UR should be mindful that the existing arrangements in GB were designed to meet a very different natural gas market than in NI and that any policy change in NI should not undermine the NI Executive's commitment to increase the number of homes and businesses with access to natural gas. In PNGL's experience, increasing the cost of connection would make the task of converting customers to natural gas significantly harder.

Chapter 3

PNGL notes the applicable regulatory and legislative framework set out at Chapter 3 of the consultation paper. PNGL further notes UR's intention to "apply" the principles set out in the May 2012 discussion paper on gas network extensions to the current application process. Those principles are not set out in the current consultation paper, but are:

1. Efficient

The regulatory model should result in efficient network operation which is most cost effective.

2. Economic

The arrangements should deliver the extension in a manner which takes account of all relevant costs and benefits.

3. Result in a coordinated gas industry

The extension should not lead to unwarranted fragmentation in system operation. The arrangements should also allow scope for innovation and consider possible developments in the gas industry in the future such that any network built is future proofed to the degree possible.

4. Promote the development of the gas industry

The extension should be carried out in such a way that maximises the potential scale of the gas industry by connecting as many customers as possible within the area of the extension and across Northern Ireland subject to the constraint that this should be done in an efficient and economic manner.

5. Protect the interests of gas consumers (present and future)

This principle overlaps with the others to some degree but in particular means that there must be an appropriate balance of risk and reward between customers and companies.

6. In line with any applicable EU legislative requirements

The arrangements should be consistent with applicable EU Directives and Regulations.⁶

Whilst acknowledging that these principles do not stand in place of the UR's statutory, public and EU law obligations, PNGL welcomes this statement of the range of considerations, which PNGL will factor into its decision-making process.

Chapter 4

Q.3. What are respondents views on the options presented on linking applications and price control allowances?

PNGL considers that for the application process to be meaningful and effective, the successful application - which should be based on an established regulatory model and development plan - should form the basis of the first price control allowances. This will ensure that applications do not contain unrealistic costs which cannot be delivered and require renegotiation at the next stage of the process. There would however have to be some contingency should the parameters set by UR and upon which the applications rest prove to be inaccurate. See also PNGL's response to Q9 below.

Q.4. What are respondents views on having a structured competition in which applicants are asked to construct their applications on the basis of an established regulatory model and development plan?

PNGL recognises the merits of the hybrid approach, and supports its use in this application process. However PNGL considers that UR could maximise the benefits of competition under this approach still further. Notably, UR's current proposal precludes parties from competing on the most significant cost lines i.e. most elements of capex.

PNGL accepts that a detailed tender would place a greater demand on resources from applicants and would potentially lengthen the licence application process. PNGL would suggest that UR allows

⁶ Discussion Paper on Gas Network Extensions in Northern Ireland, p.12 (16 May 2012).

parties to compete on the overall design split between transmission and distribution to secure the optimal outcome for consumers in the new licensed area. PNGL considers that the current design uses an excessive length of transmission network and that, in some instances distribution network could be used instead. UR could ask parties to detail within their application any cost savings (compared to the Fingleton McAdam design and costs for transmission) they believe they could deliver by substituting lengths of transmission network with lengths of distribution network. This could be evaluated by scoring parties on the savings achieved by the revised designs i.e. a party receives 100 points for every £1m saving their design delivers compared to the Fingleton McAdam design and costs for transmission.

PNGL considers that to ensure that the construction costs in applications are as accurate and as meaningful as possible, they should form the basis of the first price control allowances, with some contingency in case the parameters set by UR and upon which the applications rest prove to be inaccurate. See also PNGL's response to Q9 below.

Q.5. What are respondents views on whether the transmission and distribution competitions should be constructed to allow applicants to apply for each licence separately or jointly?

PNGL fully supports UR's aim of finding the best solution to provide a transmission and distribution network in the network extension area. Achieving the optimal solution for each of transmission and distribution involves assessing each separately and awarding the winner in each case separately. There is no justification for selecting on the basis of aggregate scores, which implies a less satisfactory solution for consumers on one measure. If an applicant thinks it can score higher through cross-subsidy, it can always flex its application to reflect this.

UR has explained that it will first establish whether the applicant is technically competent and that it will only after this step is complete evaluate those applicants judged technically competent, on their operational ability and their commercial proposal. PNGL supports this two step approach, which at each step will require an assessment factually of the applicant's position based on a proportionate and objective review by UR of the material submitted to it, and in conformity with its statutory duties and objectives (as discussed in Chapter 3 of the consultation paper).

Chapter 5

Q.6. We would welcome views on whether three months is sufficient to prepare a licence application.

Although there is a considerable amount of work required to meet the licence application process outlined by UR, PNGL considers that three standard months would be sufficient to prepare a licence application provided that consideration is given to holiday periods, e.g. it would be extremely challenging to ask parties to deliver an application within three months if this spans the summer period. Therefore UR's proposed timeline may need to be amended to take into consideration the impact of holidays during July and August if the licence application 'bid' period were to span these months.

PNGL would also suggest that no limit is placed on the size of the submission. Imposing a limit risks applicants excluding information that may prove beneficial to UR's assessment, and ultimately, the network extension. Furthermore parties who are real contenders for the award of the licence(s) should have enough experience to determine what level of information is required to provide an appropriate application for evaluation by UR.

Q.7. We would welcome views on our proposal to merge the pre-qualification and invitation to tender stages of the evaluation into a single evaluation stage.

PNGL broadly supports UR's proposal to merge the pre-qualification and invitation to tender stages. It seems a pragmatic approach to deliver an effective solution while at the same time streamlining the licence application process, so as to enable the benefits of natural gas to be made available to consumers in the network extension area as soon as practicable. It may also help to maximise competitive pressure, as applicants will not know how many parties are still being considered by UR at the time they develop their costings.

PNGL notes, however, that UR's proposal does not currently appear to envisage a negotiation stage prior to award of the licence. Such a negotiation stage would be highly beneficial, allowing UR to enter into dialogue with the technically competent parties (as determined following UR's evaluation of applications) and ensuring that the process delivers the best overall solution for both transmission and distribution.

Q.8. We would welcome views on the proposed timeline for the licence application process.

Given the considerable benefits associated with making gas available to a larger proportion of the population of NI, PNGL understands UR's desire to complete the application process as quickly as practicable. However, UR should allow itself sufficient time to fully review and digest the responses of consultees. PNGL is concerned that UR's timeline currently proposes publication of its decision paper within two weeks of the consultation period closing. This appears ambitious given the complexity and magnitude of this project and the variety and importance of the issues that UR has asked stakeholders to consider in this consultation. UR may also wish to consider a further round of consultation / discussion with stakeholders prior to launching the application process, and may wish to build this into its timetable. PNGL is aware that other UK regulators (such as Ofgem and Ofwat) have allowed themselves more time than UR has proposed before finalising licensing policy after consultation. To launch the competition prematurely risks wasted expenditure on the part of UR and potential applicants in the event subsequent refinements to the application process are found to be necessary.

Chapter 6

Q.9. We would welcome views on our proposed criteria and weightings for each criterion.

PNGL considers that the qualification criteria set by UR must ensure genuinely and objectively sound technical ability and sound relevant experience. The criteria (and the weight to be accorded to particular criterion) should not be applied so as to exclude anyone who meets these tests as this

may produce less than optimal results, in the context of UR's stated duties and objectives (as outlined in Chapter 3 of the consultation paper). Accordingly, PNGL does not expect that the criteria would be applied so as to exclude any applicant that has the requisite technical ability and experience to contribute to an efficient, economic and co-ordinated gas industry in NI.

For example:

- a potential new entrant in NI should not be excluded merely for lack of NI-specific experience, lack of directly relevant experience or inability to evidence five years of debt financing. What is relevant is an objective assessment of their capabilities to operate in this environment. PNGL notes that Ofgem awarded a number of licences to IGTs who had no previous experience of building or operating networks. In that case, the technical criteria were set high enough to ensure technical capability, but low enough to encourage qualified new entrants;
- conversely, the mere experience of owning and operating a transmission or distribution network is not sufficient alone to meet the tests outlined above. Given the nature and scope of this project, the criteria should ensure that applicants demonstrate that they are able to deliver a greenfield infrastructure project and to run small and remote networks; and
- any criteria that are arbitrary, rather than a full, objective and non-discriminatory test of competence and capabilities, should be avoided. For example, the proposed 5 year cut-off risks excluding potential substantively qualified applicants (including – arguably – PNGL) which it would be in the interests of UR and the achievement of its public objectives to consider. UR should not for administrative convenience adopt an inflexible criterion that obliges it to close its mind to relevant material regarding the expertise of potential applicants where a proportionate, substantive assessment of such material is possible. Such an approach is particularly inappropriate in view of the potentially small pool of applicants that might compete for licences).

In addition, PNGL considers that it would be beneficial if UR were to clarify:

- Why a list of advisors is needed in the applicant identification section of the questionnaire?
- Why the organisation structure section of the questionnaire does not refer simply to particulars of any gas or electricity licence(s) held or applied for in the EU (not least to respect the EU fundamental freedom of establishment)?
- What information is being sought in the innovation and technology transfer section of the questionnaire?

As discussed in PNGL's response to Q4 above, UR's proposal currently precludes parties from competing on the most significant cost lines i.e. most elements of capex. If this remains the case, the 70% weighting on Applicant Determined Costs seems excessive as it is an applicant's ability to operate and manage a network that has an impact on its costs. PNGL would suggest that a more appropriate weighting for transmission could be:

- Applicant Determined Costs (60% of available marks)
- Operational Business Plan (30% of available marks)
- Innovation and Technology Transfer (10% of available marks)

Similarly for distribution, UR's proposal currently precludes parties from competing on the most significant cost lines i.e. most elements of capex. If this remains the case, the 60% weighting on Applicant Determined Cost seems excessive given the additional requirement on applicants to maximise connections. As maximising connections is a key component of a "fat" distribution model, the proposed 10% weighting for "Maximising connections" and the proposed 20% weighting for "Operational Business Plan" seems moderate given the applicant's ability to deliver the necessary connections will directly impact upon the costs ultimately borne by consumers. PNGL would suggest a more appropriate weighting for distribution is:

- Applicant Determined Cost (40% of available marks)
- Operational Business Plan (25% of available marks)
- Maximising connections (25% of available marks)
- Innovation and Technology Transfer (10% of available marks)

Furthermore, there is little discussion in the consultation paper on the development plan upon which the competition will be judged. A mandatory development plan, which was a key feature of PNGL's original licence, has ensured that natural gas has been made available to the majority of households and businesses in PNGL's Licensed Area. PNGL would suggest that UR considers including a mandatory development plan within the new distribution licence. This will focus the award of the licence on the applicant that can demonstrate their ability to deliver the 'fat' distribution business model and provide consumers within the new licensed area with a clear expectation of when natural gas will be made available to them.

As discussed in PNGL's responses to Q3 and Q4, the successful application should form the basis of the first price control allowances to avoid unrealistic costs being submitted. The award, however, should balance the cost of delivery and risk of delivery. For example, as the mutual model is underwritten by consumers and therefore it is the consumer who picks up the bill when costs vary from forecast, there is no incentive on a mutual company to improve efficiency, reduce costs or in fact forecast accurately. This is contrary to the principles of incentive-based regulation, which is widely recognised as beneficial for consumers. PNGL would therefore suggest that the evaluation process includes an assessment of the level of risk borne by the consumer to provide a common basis on which all applications can be judged effectively against each other i.e. if a mutual company proposes a lower rate of return because the risk is underwritten by consumers, UR's proposed evaluation criteria should score the applicant high on its commercial proposal and must also score the applicant low on the level of risk borne by the consumer.

PNGL also suggests that, if the application should form the basis of the first price control allowances, that the Applicant Determined Cost weighting is separated with a greater weighting given to costs

incurred in the first price control period. This would mitigate the risk that applicants will deliberately understate long-term costs, relying on these being adjusted upwards in subsequent price controls.

Q.10. In relation to the criterion ‘Economic and Financial Standing’ do respondents agree that the appropriate capital value for the network extension against which applicants should be required to provide proof of net assets should equal the total costs of the network over 40 years?

PNGL agrees with UR that UR should undertake an appropriate evaluation to ensure that applicants have the necessary financial solvency and strength to deliver the network extension.

As stated in response to Q9 above, a potential new entrant in NI should not be excluded merely for lack of NI-specific experience, lack of directly relevant experience or inability to evidence five years of debt financing.

On the basis that ‘Economic and Financial Standing’ is being considered at the evaluation stage of the licence application process, PNGL believes that previous experience of being able to fund the capital value of the assets expected to be delivered by the applicant is an appropriate evaluation (referred to in the first bullet point in paragraph 6.13 of the consultation paper).

Most efficient businesses will only seek to raise capital when the investment is required. Given that most infrastructure investments are funded by debt finance, PNGL believes that the applicant’s ability to raise debt finance in proportion to the level of debt finance proposed would seem an adequate requirement (referred to in the second bullet point in paragraph 6.13 of the consultation paper).

If PNGL’s understanding of paragraph 6.13 of the consultation paper is not correct, PNGL would welcome clarification of this.

Q.11. Should there be an opportunity to rectify any omissions from the application?

PNGL believes that an appropriate balance needs to be struck. PNGL considers that there should be an opportunity to rectify any omissions from applications; but that only a short timeframe should be permitted for rectification. This avoids the risk of gaming, whereby parties attempt to increase the amount of time to prepare the application; and allows for genuine omissions to be promptly resolved.

Q.12 Do respondents consider that the proposed workbook is sufficient to capture the cost information necessary for the Utility Regulator to assess applicant determined costs effectively?

The proposal by Fingleton McAdam is detailed. Although PNGL has not yet undertaken a detailed review of the workbook and the workbook notes, it has not identified any significant omissions or areas of concern at this stage. In PNGL’s experience, however, it may only be when applicants come to populate the workbook that any issues will be identified and clarifications sought. PNGL welcomes the proposal that when clarifications are given by UR to one party, they will be given to all.

In respect of the assumptions used, one point did stand out: if UR is proposing that the allowance for financing costs will be reviewed at the end of the first price control period at which point it will be

set using the standard CAPM methodology, PNGL considers that it would be more appropriate for UR to determine an 'indicative' rate of return from the second price control period onwards to provide a common basis on which all applications can be judged effectively against each other.

Chapter 7

Q.13. We would welcome respondents' views on whether 40 years is the appropriate period over which operating cost data is to be provided.

PNGL notes in the proposal that total cost is calculated as the net present value of 40 years revenue. PNGL assumes that 40 years has been chosen so that costs are recovered over the expected useful economic lives of the assets concerned.

Both the assumptions that are made about asset lives for depreciation purposes and the profile adjustment impact on the speed and profile of investment recovery.

Although the regulatory asset life assumption may be set at 40 years, the technical life of the assets may be longer.⁷ It is not unusual that regulatory asset lives do not match technical asset lives. As Ofgem noted in its first consultation for the RIIO GD-1 price control review:

"There are a number of different ways of defining the life of a network asset. Each asset will have a design life, a technical life (the expected life of an asset from commission until it falls below minimum technical and/or safety performance levels); and an economic life (the life it is expected to be active on the network). Through good maintenance and management of an asset, its technical life will often exceed its design life. The economic life of an asset will be no longer than its technical life but may be shorter".⁸

Under the RIIO model, Ofgem decided that regulatory asset lives should reflect the average expected economic life of the related network assets, since this *"balances the interests of existing and future customers as it spreads the cost of network assets over the time they are in use"*.⁹ Economic asset lives are determined on the basis of expectations about the long-term demand for use of the network, including taking account of, among other things, the possibility that gas consumption falls in the long-term as a result of decarbonisation efforts.¹⁰

UR's approach – given the possibility that the technical life of mains may be longer than 40 years – may therefore be considered prudent.

⁷ The technical life of polyethylene pipes is not actually known as they have been in service for less than 40 years, but advanced ageing tests suggest that the technical lives may exceed 40 years.

⁸ Ofgem, "Consultation on strategy for the next transmission and gas distribution price controls", December 2010.

⁹ *Ibid.*

¹⁰ In GB, Ofgem derived scenarios for the move towards renewables to assess the scope for future use of the gas network. Ofgem concluded that, at present, it would be premature to reduce regulatory asset lives, and retained its assumption of 45 years for post-2002 gas distribution assets.

PNGL suggests that, in line with normal regulatory practice, all assets are depreciated in a way that reflects their economic life. If however, for the purposes of the competition, total cost is calculated as the net present value of 40 years revenue rather than assessing applications on the basis of a rolling 40 year recovery period, this could lead to applicants understating long-term costs.

PNGL assumes that operating cost data will need to be provided over the cost recovery period determined by UR. PNGL suggests that, if the application should form the basis of the first price control allowances, that the Applicant Determined Cost weighting is separated with a greater weighting given to costs incurred in the first price control period. This would mitigate the risk of applicants 'gaming' by understating long-term costs. Moreover, it is reasonable to assume that forecasts will, by their very nature, prove to be more inaccurate for the later years of the project, reinforcing the need for a greater weighting given to forecast costs for the early years of the project.

Q.14 Do respondents consider that the proposed controllable operating expenditure cost lines in the workbook are appropriate to capture this data effectively?

See PNGL's response to Q12 above.

Q.15 Do respondents consider that the proposed workbook notes are sufficiently detailed to allow applicants to complete the workbook effectively?

See PNGL's response to Q12 above.

Q.16 Do Respondents consider that the proposed definitions of Controllable Operating expenditure as set out in the notes accurately reflect the structure of costs and the cost divers a licence holder would expect to experience?

Licence fees and rates are correctly treated as pass-through costs in line with standard regulatory practice in the UK.

PNGL has not undertaken a detailed review of the proposed definitions of 'Controllable Opex', but it appears to be based on activity costing. While applicants will have the raw data upon which the application is to be based, it would be helpful for UR to facilitate a workshop with Fingleton McAdam to allow applicants the opportunity to discuss any queries on which cost category these should be allocated to. Benchmarking will be meaningful only if each applicant makes its submission on the same basis, i.e. each cost category includes the same costs for each applicant.

Given the geographical location, PNGL would highlight the need for applicants (and for UR when reviewing the applications) to give due consideration to the logistics of the network extension e.g. having to respond to uncontrolled gas escapes within one hour of being notified and to controlled gas escapes within two hours of being notified.

Q.17 Do respondents consider that the network design information as set out in the accompanying FMA documents is sufficient for applicants to develop a robust application?

The FMA documents are useful, and at this stage in the process, PNGL does not request any further network design information if UR were to proceed with the process as set out in the consultation paper.

Chapter 8

Q.18 We welcome respondents views on our proposals for the key features of the regulatory model to be used in the transmission ‘competition’.

PNGL has provided its views on UR’s proposals for the transmission ‘competition’ throughout this response. In addition, PNGL notes that:

- the transmission revenue will be collected by means of the Northern Ireland transmission tariff, meaning that all gas consumers in Northern Ireland will be responsible for funding the transmission assets; and
- UR is proposing to determine the level of contingency that will be permitted for transmission. PNGL would expect that the level of contingency would cover costs highlighted in the application only. PNGL would expect that any costs not highlighted in the application would be permitted provided that it can be demonstrated that these costs (i) were efficiently incurred; (ii) are clearly in the interests of consumers; and (iii) could not have been foreseen at the time the application was submitted.

Q.19 We welcome respondents views on the incentive proposed to ensure the pipeline is operational as quickly as possible.

PNGL notes that interest paid on working capital will be capitalised at LIBOR + 0.5% and included in the opening asset value, as was the case in the construction of the BGE(UK) transmission network. PNGL assumes that this is because UR believes its effectiveness as an incentive has already been proven elsewhere in Northern Ireland.

Chapter 9

Q.20 We welcome respondents views on our proposals for the key features of the regulatory model to be used in the distribution ‘competition’.

PNGL has provided its views on UR’s proposals for the distribution ‘competition’ throughout this response.

In addition, PNGL notes UR’s proposal to use the price cap regulatory model for a period of c.10 years after which UR proposes to change the form of control. PNGL agrees that this will provide a strong incentive at the appropriate time in the evolution of the natural gas industry in the network extension area and will ensure the distribution network is operational and consumers are connected as quickly as possible.

It would be useful to understand the basis upon which the possible NI Executive Subvention is to be made. If a ‘fat’ distribution business model is assumed where as many businesses and existing domestic properties as is financially viable are connected, amendments or a different model being adopted by UR in finalising licence conditions would be inappropriate. Amending or moving to a different model may also impact on any assumed reduction in CO₂ emissions; again this should be

considered in light of the basis upon which the possible NI Executive Subvention is to be made. Similarly deferring consideration of what level of domestic connections would be financially viable until the first price control review would weaken the incentive under the price cap regulatory model. The full potential of the possible NI Executive Subvention must be realised.

The relative risk of each model must also be recognised. The 'skinny' distribution business model is more exposed to the industrial and commercial and the new housing markets, both of which are more sensitive to changes in the economy. These risks are mitigated in a 'fat' distribution business model.

PNGL notes that there will be no cross-subsidy from natural gas consumers in existing licensed areas; however, the consultation paper suggests that UR is minded that the licence will include an obligation to facilitate distribution Postalisation at some point in the future. It would therefore be useful to understand the prospective tariff in the network extension area and how this compares to the current tariffs in existing licensed areas.

PNGL also notes UR's proposal to (i) undertake a price control review every 5 years; (ii) include a profile adjustment over 40 years to facilitate a constant level of distribution tariff over the life of the project; (iii) include a five-year rolling incentive mechanism for capex only and (iv) base indexation on RPI.

PNGL notes UR's proposal to allow £300 per existing domestic connection made for the purposes of promoting the development of the network in the first 10 years. PNGL understands that this figure reflects the existing domestic connections incentive only. If this is not correct, PNGL would welcome clarification of this. In any event, PNGL considers that UR's allowance would also need to include associated costs of promotion such as advertising, marketing and public relations.

It would be useful if UR clarified the impact of the Energy Efficiency Obligation on transmission and distribution licence holders from 2014.

Additional general observations

PNGL welcomes UR's invitation to respondents that they may comment on any other issue they feel is relevant to the issues under consideration in the consultation. PNGL notes that this consultation focuses on delivery of the necessary conveyance licences. PNGL suggests that it would be useful for UR to set out its early thoughts on the appropriate supply licence as well, e.g. does UR intend to grant supply exclusivity for a period of time as has been the case with the licences awarded in the other licensed areas or does UR intend there to be a competitive market for supply from day one? This will provide a basis for applicants to propose an application i.e. will the distribution operator require systems to facilitate supply competition from day one or will systems need to be developed to facilitate supply competition at a later stage?