

Sinn Féin response to the Consultation Paper by NIAER on The Proposed Acquisition of East Surrey Holdings plc by Kellen Acquisitions Limited – Implications for Phoenix Natural Gas Limited

1. Sinn Féin welcomes the opportunity to respond to the consultation paper by NIAER on the proposed acquisition of East Surrey Holdings plc by the private equity company, Terra Firma. This is an extremely important issue which deserves to be properly aired in public as it will affect the strategic direction of the gas industry in the north of Ireland for years to come.
2. Terra Firma's offer to acquire ESH raises renewed concerns around the super-profits being made by ESH and gives rise to a number of questions about issues related to the ongoing regulation of Phoenix. The Terra Firma offer suggests that the profits for Phoenix are unreasonably high. It is estimated that the shareholders of East Surrey Holdings will have accrued profits in the region of £100m in 18 months.
3. While Sinn Féin's preferred option is that public utilities remain in public control, along with the other political parties, both in the Assembly and outside the Assembly, we supported the creation and the expansion of the gas industry in the particular circumstances pertaining in the north at that time. This support was based on the need to open up the energy market to combat the very high energy costs resulting from the flawed privatisation of electricity and to effectively tackle the high levels of fuel poverty. Environmentally, gas is a cleaner alternative.
4. Thus gas is a subsidized industry in the north of Ireland which operates within very favourable market conditions at a higher than normal rate of return. Sinn Féin is not opposed to any company receiving a reasonable rate of return for its investment. It is Sinn Féin's view, however, that the Terra Firma offer represents an unreasonably high rate of return for ESH.
5. SF is concerned that the consumer is protected and that there is a commitment to a viable long term gas industry that can provide a relatively low cost energy supply to the north. The possible buy out of ESH by a private equity firm – which exists solely to make profits and sell on – is not good news for the consumer or for the long-term strategic interests of the gas industry.
6. When viewed in the longer term the sale of Phoenix Gas to Terra Firma will be seen to have had a significant negative impact upon the economic welfare of the north. It is our view that if the Assembly was operating it would not support this sale. Sinn Féin have sought an urgent meeting with minister Angela Smith to press her to block the proposed sale of Phoenix to Terra Firma pending all-party discussions on a comprehensive energy policy that will address the circumstances specific to here.
7. While it is anticipated that there will be an increased cost in gas for at least the next 12 – 18 months, it is Sinn Féin's concern that the proposed sale may, in the medium term, result in even higher prices for both domestic and industrial consumers of gas. Inevitably, such a price increase will slow the expansion in the

demand for gas within the north, further reducing the competitive position of the north within these islands.

8. The rationale for government's intervention within the energy sector is to ensure a competitive environment. This can only be achieved if consumers are free to choose with all available information. If price stability is not foreseeable in the long term then, especially with the sunk costs associated with a monopoly provider of gas, consumers will fail to invest in gas.
9. While a premia or indeed a guaranteed rate of return might have seemed acceptable in an immature market this is no longer the case and the justification for such a position is much less. Evidence to support such an argument is contained within the bid by Terra Firma where such a capital investment is only justified if the rate of return supports such an investment.
10. Essentially the excessive producer surplus maximised through the guaranteed rate of return is being capitalised by the bidder.
11. The cash premium inherent in the £450 million offer by Terra Firma strongly indicates that the negotiations that took place regarding the 8.5% agreed rate of return are now much too generous. Indeed they signal it is probable that many of the key assumptions made by the Regulator were based upon information which, in retrospect, appears to have been inaccurate. In essence the bid by Terra Firma has provided a 'revealed price' of the real worth of the enterprise.
12. There is concern that if Terra Firma pays such a premia that the incidence of such a fee will be passed through to consumers by way of increased prices or reduced services. The first impact of such a policy may be that the rate of investment by Terra Firma declines. Any of these scenarios would have serious consequences especially for those suffering from fuel poverty.
13. The party is concerned that the debt burden imposed upon the new company will seriously affect its ability to invest sufficiently to ensure continuing expansion of the consumer base. Such investment if it proved unavoidable could only be achieved through price rises or financed through borrowing. Both responses would have adverse effects upon the consumer interest in the longer term.
14. If the minister or the department is not minded to stop this sale then before any approval of the sale the Energy Regulator and DETI must be clear about what the commitments of Terra Firma are and about the long term consequences for the gas market.
15. Indeed, whether Terra Firma or some other firm acquires Phoenix, or whether it remains with ESH, Sinn Féin agrees with NIAER's contention that the regulatory framework for Phoenix needs to be revisited particularly around the two key

aspects of the size of the Regulatory Asset Base and the allowed rate of return of 8.5%.

16. Given that the discussions between NIAER and Phoenix on the proposed regulatory agreement have not been finalized and are currently non-binding it is reasonable, given the new information which the Terra Firma buy out suggests, that NIAER re-evaluates the rate of return and the adequacy of the licence agreement with Phoenix.
17. The guaranteed rate of return of 8.5% should be reduced significantly to take account of the new pricing information that the proposed bid provides for the Authority.
18. While Sinn Féin understands that there was an acceptance in principle on a move to a 40 year capital recovery period Sinn Féin would urge NIAER to revisit this in the context of private equity firms moving in as these generally operate on a greatly reduced time-frame.
19. Sinn Féin is in broad agreement with the proposals which NIAER has put forward in section 5 of the consultation paper entitled 'Review of the Licence Conditions'. They are eminently sensible proposals around ring-fencing Phoenix's business and financial activities to act solely in the interest of the gas business and independently of the parent company and to conduct its business in a transparent and open manner and in full co-operation with the Regulatory Authority (NIAER).
20. Given that the favourable environment in which Phoenix has been operating has led to unreasonably high profits in such a short space of time Sinn Féin is of the view that ESH should be pressed to return some of these bumper profits for the benefit of the gas consumer in the north of Ireland.
21. Sinn Féin are also concerned that neither ESH or Terra Firma met with or sought meetings with NIAER regarding the sale of Phoenix and only did so when requested by NIAER. While we understand that Terra Firma's offer to acquire ESH does not require the consent of NIAER it would have been both prudent and courteous for both companies to have liased closely with the Regulatory Authority for gas in the north.