

**14<sup>th</sup> January 2013**

Paul Harland  
Gas Distribution  
Utility Regulator  
Queens House  
14 Queen Street  
BELFAST  
BT1 6ER

Dear Paul

**Re: Consultation into Overall Approach for Price Controls of NI's Gas Distribution Networks**

Thank-you for providing firmus energy with this opportunity to respond to the above consultation.

Since 2005, firmus energy has brought the benefits of natural gas to over 17,000 homes and businesses in its network area, and in doing so we are;

- Currently providing consumers with the lowest gas price in the United Kingdom;
- Maintaining the highest level of customer service of any regulated energy company in Northern Ireland<sup>1</sup>;
- Developing a safe and robust gas distribution network; and
- Maximising the development of our network, whilst seeking additional regulatory permission to extend our network to areas and customers that were not included within our original business plan assumptions

Since our licence was awarded, we have:

- Invested over £70 million building our network in Northern Ireland, and we continue to invest around £10m per annum locally on network development and circa £5m per annum into the local Northern Ireland economy through our business operations ;

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<sup>1</sup> Enquires and Complaints Report 2011-12, July 2012, Consumer Council.

- Looked to increase the number of consumers who can benefit from natural gas. Our business model projected that we would be undertaking 2,000 connections per year, however, currently we are at a run rate of circa 4,000 connections per year;
- Grown our business in an economically viable and responsible manner by initially targeting large industrial and commercial loads, new housing estates and public housing where refurbishment was planned;
- Maintained competitive pricing to encourage conversion to natural gas – rather than increasing our costs to ensure we receive payback on our investment;
- Looked to extend the benefits of natural gas to as many consumers as possible. In addition to our original licence area we have negotiated with the Utility Regulator seven additional extensions (Portstewart, Ballyclare, Warrenpoint, Craigadoo, Coleraine Quarries, Bushmills, and Bessbrook ) over and above our original “Ten Towns” business plan; and
- Undertaken our network development against a backdrop of falling house prices and reduced economic confidence.

firmus energy is committed to working with the Utility Regulator, DETI, the Consumer Council and other stakeholders throughout the GD14 process in order to maximise the benefits of natural gas to consumers and the local economy in Northern Ireland, in a socially responsible and consumer focused manner. To that end, we welcome the opportunity to respond to this consultation.

firmus energy operates its bundled distribution and supply businesses pursuant to an established regulatory framework, made up of the terms of the licences granted in March 2005, further to which there have been three price controls to date, and the legislative regime set down, inter alia, in the Gas (Northern Ireland) Order 1996 (as amended).

We set out our comments below, tracking (for your ease of reference) the numbering used in your consultation.

### **Overview of our price controls**

We are content that there is a value with the timing of the price controls for both gas distribution companies to be aligned so that the Utility Regulator can take a co-ordinated approach. We agree with the Utility Regulator’s proposal that at the GDN price control should set price limits for the next five year period, as it is essential that there is a stable and predictable policy and regulatory regime within Northern Ireland. This will help to provide the certainty that is needed to encourage investment and

enhance the competitiveness of the Northern Ireland economy and brings confidence and benefits to consumers.

However, we also note your comment, with which we agree, that there are key differences between how the PNGL and firmus licences operate, including the fact that PNGL operates under a revenue control whereas firmus operates under a volume incentive control.

It is also noted that while PNGL has been in business, and licensed to convey and supply gas, since 1996, the firmus business is naturally less mature, being only seven years into our agreed thirty years licence period and therefore firmus energy is an immature business when compared to other gas distribution companies in the UK or indeed Northern Ireland.

firmus energy supports the Utility Regulator's overall stated aims within the consultation for the GD14 process of:

- Providing a strong foundation for the long term funding of gas, delivering long term improvement in the service to consumers;
- Challenging the GDN's to improve their efficiency and performance at an achievable and sustainable rate; and
- Promoting long term planning of the Business Plan which will secure continuity of investment between years and between price control periods.

### **Our Approach to Key Areas**

We note the comment that you are mindful of the need to keep the regulatory burden to a minimum "*while addressing the information asymmetry that exists between us and the companies*".

In our case, as agreed with the Utility Regulator, we have submitted our Price Control Submission for the GD14 period on the 17<sup>th</sup> December 2012. In addition, in the interests of improved regulatory transparency, firmus energy has worked with and provided the Utility Regulator with detailed annual cost reports to help provide enhanced transparency and regulatory understanding of our business. This has been in addition to our licence requirements to provide standards of performance, an annual development plan and to respond to reasonable ad hoc information requests. Therefore, in the case of firmus energy, no such "*information asymmetry*" exists.

Within GD14 we are keen to maximise the benefits of natural gas to as many customers as possible and our parent company (Bord Gáis Éireann) is committed to investing in the firmus energy network over this price control period in order to bring the benefits of natural gas to even more business and domestic customers than was

initially envisaged when our licence was awarded in 2005. In order to achieve this extra growth in terms of connections and volumes, we will need support from the Utility Regulator in terms of receiving a sensible rate of return and a fair level of operating expenditure, in each case in accordance (at a minimum) with the terms agreed in that regard in our licences.

Given that the natural gas has only been available for customers in the firmus energy licence area for the last seven years, and with many towns only receiving natural gas in the last few years (Armagh, Portstewart, Ballyclare and Warrenpoint), or in the coming year (Bushmills, Beesbrook, Coleraine and Ballymena Quarries), there still remains huge opportunities to bring the benefits natural gas brings (lower costs and increasing business competitiveness; a cleaner fuel which produces less CO<sub>2</sub> than oil or coal; greater consumer choice and convenience; and greater security of supply) to more areas and consumers.

firmus energy has invested over £70m building our distribution gas network, laid over 750km of mains pipes across Northern Ireland and has connected over 17,000 domestic and commercial customers including hundreds of Northern Ireland's largest manufacturers, private housing, Housing Executive properties, schools, hospitals and small businesses.

As noted above, we are prepared to invest significantly more capital across our licence area over and above our original business plan, but in order to do this it is essential that there is a clear and stable regulatory regime which respects existing investors' interests.

### Benchmarking

From the consultation document we understand the Utility Regulator's wish to use benchmarking within the price control process. However we iterate our belief that it is important to recognise the differences between the firmus energy's network, and the other gas distribution network in Northern Ireland. firmus energy's network is more dispersed and provincial in nature; the North-West and South-North Pipeline in the firmus energy licence area covers a distance of 271 km between Derry and Warrenpoint, This compares to a distance of around 75 km from one end to the other end of the Greater Belfast licence area. In addition, the towns within firmus energy's network area have only had on average gas available to them for the last four years.

In addition, firmus energy's licence is very different in nature to other gas distribution network in Northern Ireland. Our licence is based on a volume driver, rather than a connections driver.

### Regulatory certainty

Regarding the proposed GD14 timetable firmus energy has worked with the Utility

Regulator, in providing detailed annual cost reports to help provide enhanced transparency and increase the regulatory understanding of our business. In addition, we have submitted our Price Control Submission as per the Utility Regulator's agreed deadline of 17<sup>th</sup> December 2012, which is in fact a little early of our original licence condition. In addition, we have submitted our Price Control Submission as per the Utility Regulator's agreed deadline, and therefore we are concerned that the consultation document states at this late stage that;

*"if sufficient information is available to make an informed determination, some areas may be subject to re openers";*

*"However, given the timeline for the Price Control and complexity of some areas to be considered, it may be necessary to make re-openers for some areas during the price control period. If this is necessary, this will be set out fully in the final determination";*

*"Given the timeline of the Price Control, it is likely that we will not have the time to fully address all issues. We thought it prudent to highlight areas that may be considered as either future re-openers or at the next PC";*

*"We would highlight that if a full price control is to take place, the time constraints will mean we will be focusing our efforts on capex, opex and volumes and this may lead to a number of re-openers being included in the price control."*

With such an immature market and with the potential to develop the gas network and market further in Northern Ireland, it is essential, as we have previously mentioned in this response, that there is a stable and predictable policy and regulatory regime for the gas industry within Northern Ireland. Regulatory certainty is essential in encouraging the necessary investment that is needed to further develop the gas network in Northern Ireland which in turn will enhance the competitiveness of the Northern Ireland economy and bring confidence and benefits to consumers. Therefore we are extremely concerned as to how and when "re-openers" will be used within this price control period, and their overall materiality to any price control determination, which in turn could increase the investment uncertainty relating to any future development and expansion of the gas network in Northern Ireland.

It is noted that neither our licence terms nor the legislative framework pursuant to which the licence is granted provides for such "re-openers". Accordingly, we are unclear as to the basis on which this methodology is proposed.

We would make a similar observation in relation to other aspects of the Regulator's proposed proportionate approach at section 4.4 and section 4.5. It is unclear how the retrospective mechanism described in Section 4.4 for costs related to external factors that may not happen interacts with the existing Rolling Incentive model in our licence,

and this would need further discussion. Equally, it is suggested that rules on how unforeseen costs and retrospective adjustments will operate will be clearly set out – again, we note that the impact of any such proposal on our existing licence and price control model would need to be considered. The same comment applies in relation to the use of a standard RPI-X framework suggestion. Lastly we note the suggestion that the Regulator will consider whether further amendments are necessary to ensure clarity and reconciliation between the price control determination and the statutory/regulatory accounts. Naturally, to the extent that any amendments are proposed to our licence in that regard, such would be dealt with in accordance with the usual modification process.

### **Main areas for Consideration**

In relation to Capex and the Utility Regulator's proposal to review the tendered contract rates of the construction company that is responsible for installing all gas services in relation to network activities, we would like to highlight we have a different contract methodology to the other GDN in Northern Ireland. firmus energy contract has an all inclusive unit rate, and therefore we would request that the Utility Regulator is mindful of this in any benchmark comparisons it makes.

The latest Utility Regulator report<sup>2</sup> shows firmus energy having the cheapest natural gas price in the United Kingdom (and EU countries). We have been able to achieve this through responsible and prudent cost management during PCR02.

In light of these efforts, the Regulator's comments regarding setting challenging efficiency targets for the GDNs are noted, as again are the provisions of our licence.

On section 4.15 and the proposal to consider the rate of return for firmus based on a standard CAPM methodology, we note Condition 4.10.4 of our licence provides, inter alia, that that the rate of return shall be 0.075 until the end of formula year 2016.

On section 4.16 (Retrospective Adjustments and Models) again we note that our licence contains a Rolling Incentive mechanism for both opex and capex which it would seem address the concern which is the focus of this proposal.

### **Areas of Future Work**

In regards to the remainder of the consultation, firmus energy agree that the Consumer Council (CCNI) may well have a role to play in this process, as per their statutory position, and we look forward to engaging with CCNI and indeed other stakeholders to enable them to understand and have confidence in the key components of GD14.

Please feel free to contact me direct on 028 9442 7835, should you wish to discuss

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<sup>2</sup> Utility Regulator, Quarterley Transparency Report, December 2012

further.

Yours sincerely

*John*

John French  
**Head of Regulation and Pricing**