

# **Price Control for Phoenix Natural Gas Ltd and firmus energy Distribution Ltd ("GD14")**

Friday 6 September 2013

# Outline of presentation

- Overview of gas & background to PNGL & FE
- What is a price control?
- How price controls affect consumer bills
- Impact on consumer bills
- Price control process
- Utility Regulator proposals:
  - PNGL Capex & Opex
  - FE Capex & Opex
- Connections incentive mechanism
- Infill mains allowance
- TRV
- WACC
- PNGL Domestic Meter Exchanges
- Questions

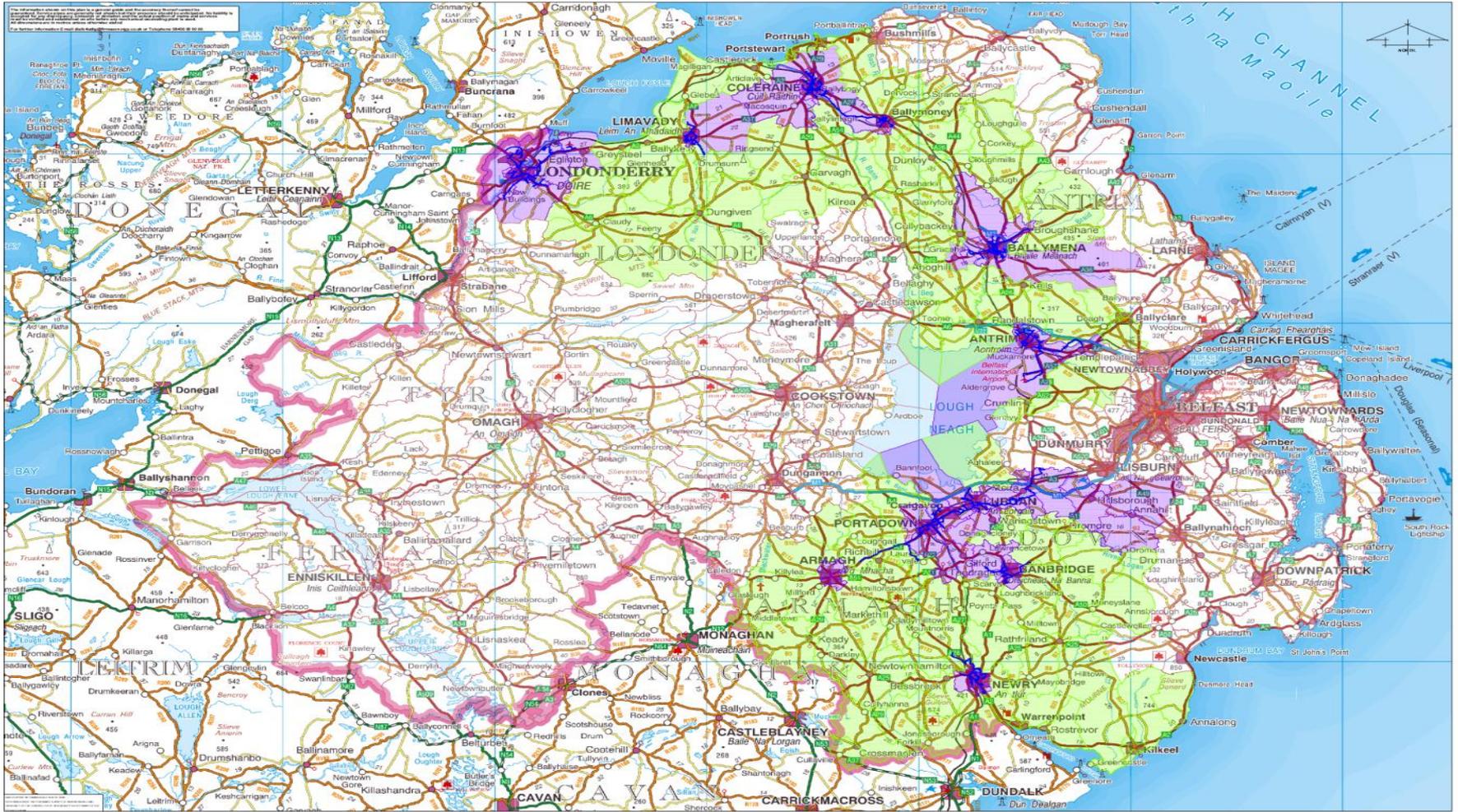
# Overview of Gas

- Principal objective of UR is to promote the development and maintenance of an Efficient, Economic, and Co-ordinated Gas Industry, in Northern Ireland
- Natural Gas Established in Northern Ireland in 1996
- End 2012 - Nearly 180,000 Customers connected
- Just Under 4,000km of pipes laid

# Background to PNGL



# Background to firmus energy

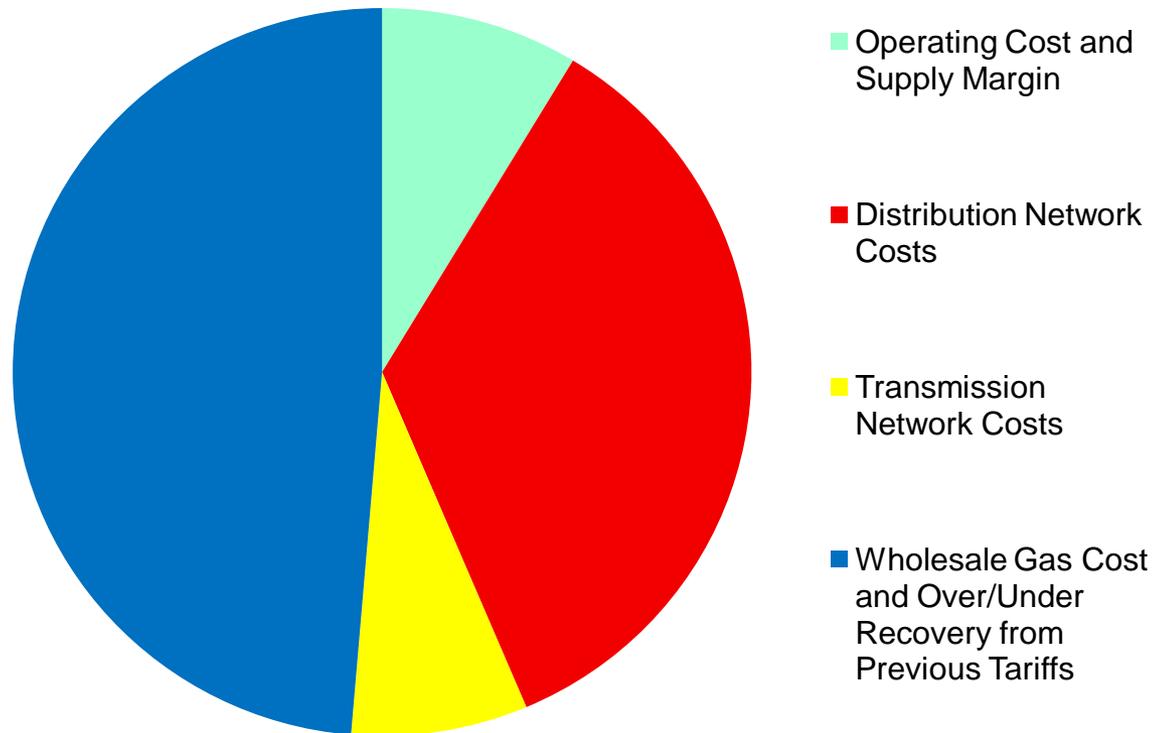


# What is a price control?

- NI Gas Distribution Networks are a monopoly
  - the Utility Regulator sets a ‘price control’
- A price control reviews the following:
  - Capital expenditure
  - Operating expenditure
  - Rate of return
  - Volumes of gas
  - Incentive mechanisms
- Forms a Regulatory Asset Base
- This results in setting a charge for use of the pipes by consumers
- GD14 is proposed to cover 3 years (2014 – 2016)

# How price controls affect consumer bills

- PNGL and FE charge suppliers (e.g. Airtricity and firmus Supply) for use of the network
- Suppliers pass-through this charge to consumers in their bills – c.35% of a tariff customer's final bill is distribution charges
- The Utility Regulator regulates this charge to protect consumers



# Impact on consumer bills

- Price control proposals would result in reduction to PNGL & FE distribution tariffs.

| <b>Distribution Tariff: Domestic</b> |                                  |                                |
|--------------------------------------|----------------------------------|--------------------------------|
|                                      | <b>PNGL</b><br>(pence per therm) | <b>FE</b><br>(pence per therm) |
| Previously determined tariff         | 43.37                            | 51.33                          |
| GD14 minded to tariff                | 37.18                            | 38.91                          |
| Difference                           | - 6.19                           | - 12.42                        |

- Annual savings for a domestic customer (based on average consumption of 410 therms/annum):
  - PNGL: annual savings of £25/annum
  - FE: annual savings of £51/annum
- Difference will be greater for I&C customers, in particular large burning industrial customers
- Refer to consultation, chapter 13.

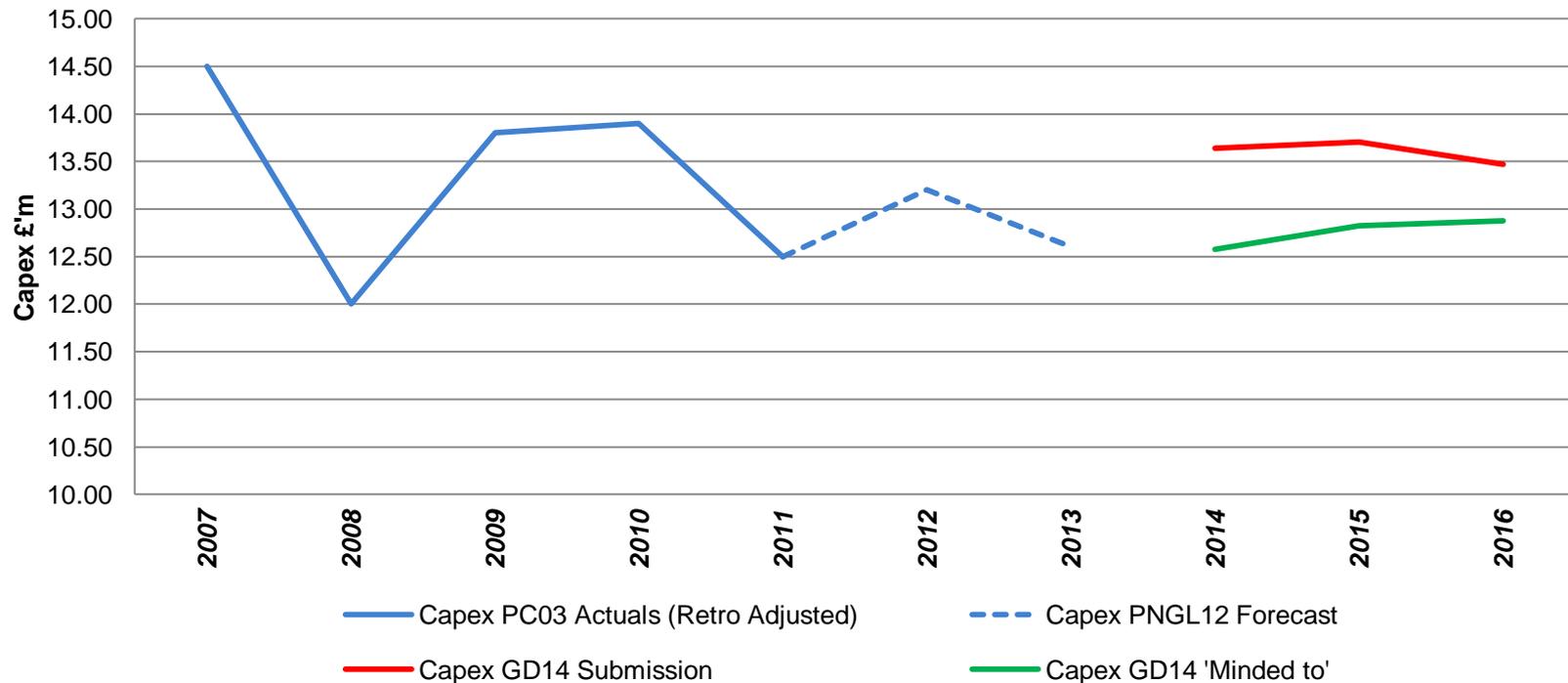
# Price Control Process

- UR consults on Approach to price control
- PNGL & FE Submit a Business Plan including request for costs.
- UR Consider and Review
- Benchmark where appropriate
- Make a Draft Determination For Consultation
- Review Consultation Responses
- Make a Final Determination

# Utility Regulator Proposals for PNGL Capex

| PNGL  | PNGL Requested (2014-2016) | Utility Regulator proposals (2014-2016) | Total Difference | % Difference |
|-------|----------------------------|---|------------------|--------------|
| Capex | £40.8 million              | £38.3 million                           | - £2.5 million   | - 6%         |

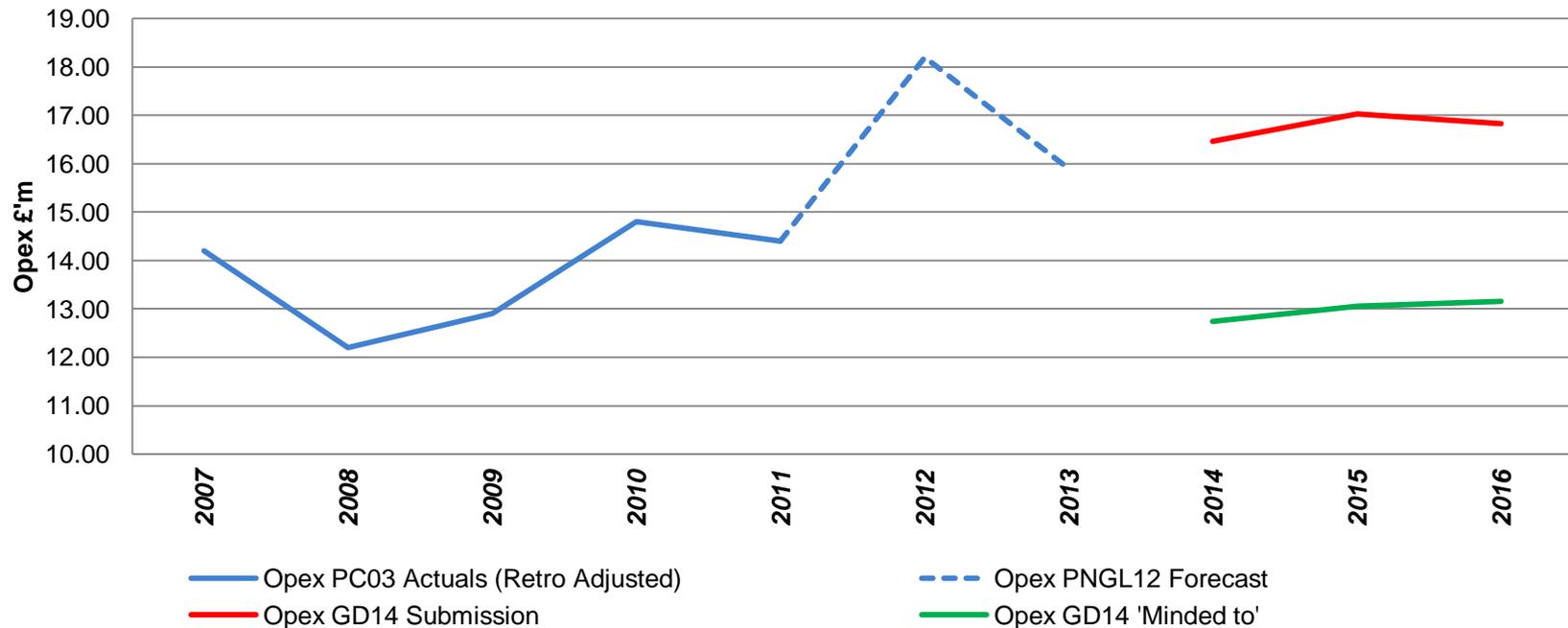
**PNGL Capex Trending (£2012)**



# Utility Regulator Proposals for PNGL Opex

| PNGL | PNGL Requested (2014-2016) | Utility Regulator proposals (2014-2016) | Total Difference | % Difference |
|------|----------------------------|---|------------------|--------------|
| Opex | £50.3 million              | £39.0 million                           | - £11.3 million  | - 22%        |

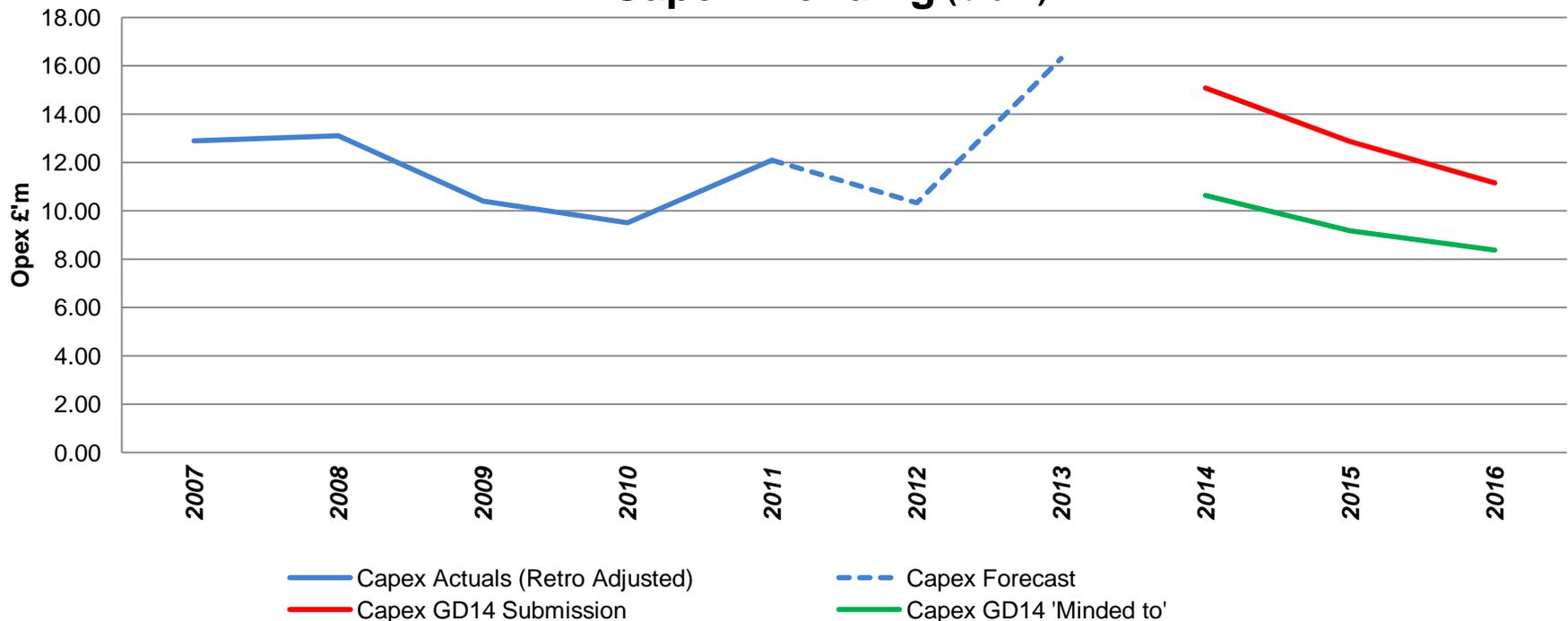
**PNGL Opex Trending (£2012)**



# Utility Regulator Proposals for FE Capex

| FE    | FE Requested (2014-2016) | Utility Regulator proposals (2014-2016) | Total Difference | % Difference |
|-------|--------------------------|---|------------------|--------------|
| Capex | £39.2million             | £28.2 million                           | - £11.0 million  | - 28%        |

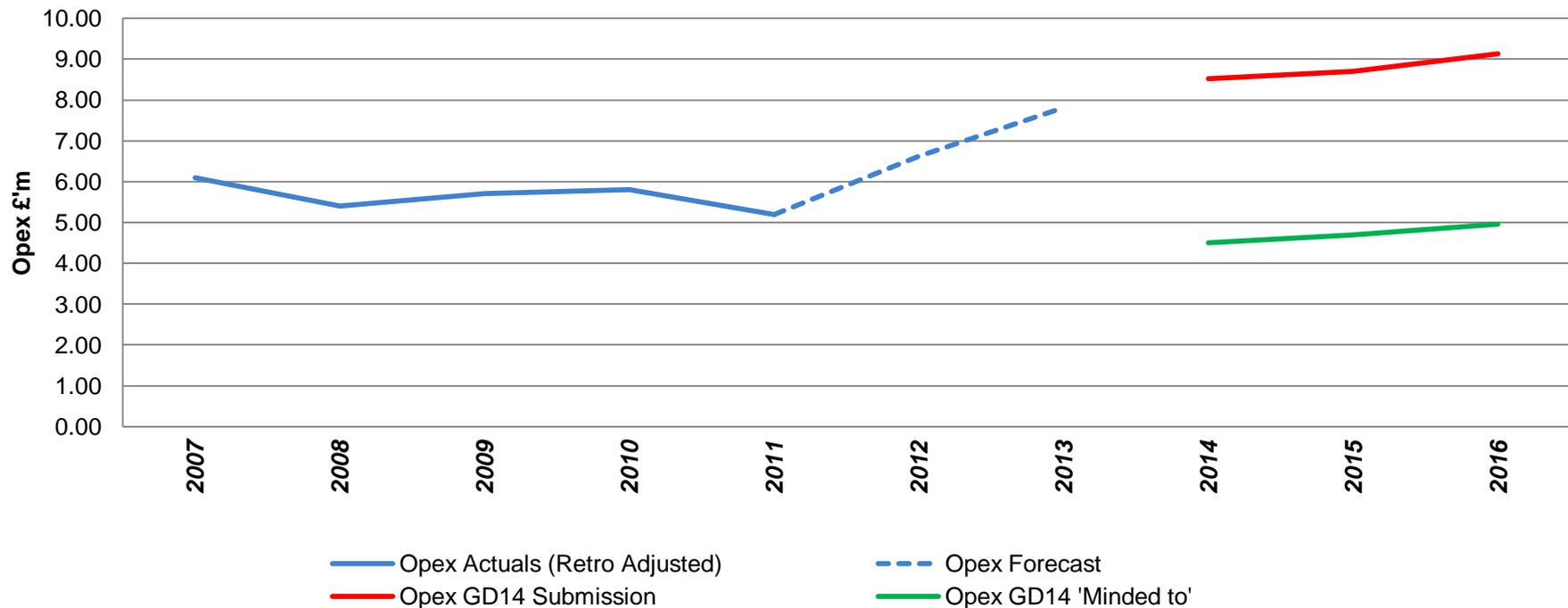
**FE Capex Trending (£2012)**



# Utility Regulator Proposals for FE Opex

| FE   | FE Requested (2014-2016) | Utility Regulator proposals (2014-2016) | Total Difference | % Difference |
|------|--------------------------|---|------------------|--------------|
| Opex | £26.3million             | £14.2 million                           | - £12.1 million  | - 45%        |

FE Opex Trending (£2012)



# Connections Incentive Mechanism

- GD14 aligns the approach for PNGL and FE.
- Mechanism which remunerates PNGL and FE on the basis of connections – an allowance is granted per connection.
- Allowance applies to owner-occupier (OO) domestic connections only
- Allowance excludes 25% of targeted connections as it is assumed that some customers would connect to gas without any direct selling or marketing.
- The mechanism emphasises the need for connections to be economic.
- Allowance per connection is calculated using the formula:

$$\text{Allowance per connection} = (\text{Revenue per connection}) - (\text{Direct capex cost per connection})$$

- Previously direct capex costs only included service and meter costs. However, infill mains costs are also included for GD14

- Using this formula, the proposed allowance per connection is £480
- Based on our proposed connection targets, this provides allowances as follows:
  - PNGL: c.£2.3 million per annum
  - FE: c. £600k per annum
- As a result of Competition Commission recommendation we proposed a risk/reward incentive to:
  - reward PNGL & FE if they exceed their target connections by increasing the per connection allowance for the additional connections, and
  - penalise PNGL & FE if they do not meet their target connections by reducing the per connection allowance
- Refer to consultation, paragraphs 5.12 – 5.45 & 6.10 – 6.34.

# Infill Mains Allowance

- Infill mains are smaller pipelines that go down local roads so that more properties are readily connectable to natural gas (i.e. ‘properties passed’).
- Principle of this approach is to incentivise network development to areas where there is the greatest prospect of securing the most gas connections.
- We determined an economic allowance per property passed is £507. This was based on a calculation of revenues and cost of passing properties.
- Proposed incentive to extend network:
  - Failure to achieve target number properties passed - penalty of £50 for each property
  - Passing more properties than target – reward of £20 per additional property over the target
- Proposed target properties passed:

| Existing Housing Domestic and I&C |       |       |       |
|-----------------------------------|-------|-------|-------|
|                                   | 2014  | 2015  | 2016  |
| <b>PNGL</b>                       | 3,000 | 3,000 | 3,000 |
| <b>FE</b>                         | 5,431 | 5,070 | 3,987 |

| New Build Domestic |       |       |       |
|--------------------|-------|-------|-------|
|                    | 2014  | 2015  | 2016  |
| <b>PNGL</b>        | 2,300 | 2,550 | 2,750 |
| <b>FE</b>          | 2,454 | 2,454 | 2,454 |

# PNGL Total Regulatory Value (TRV)

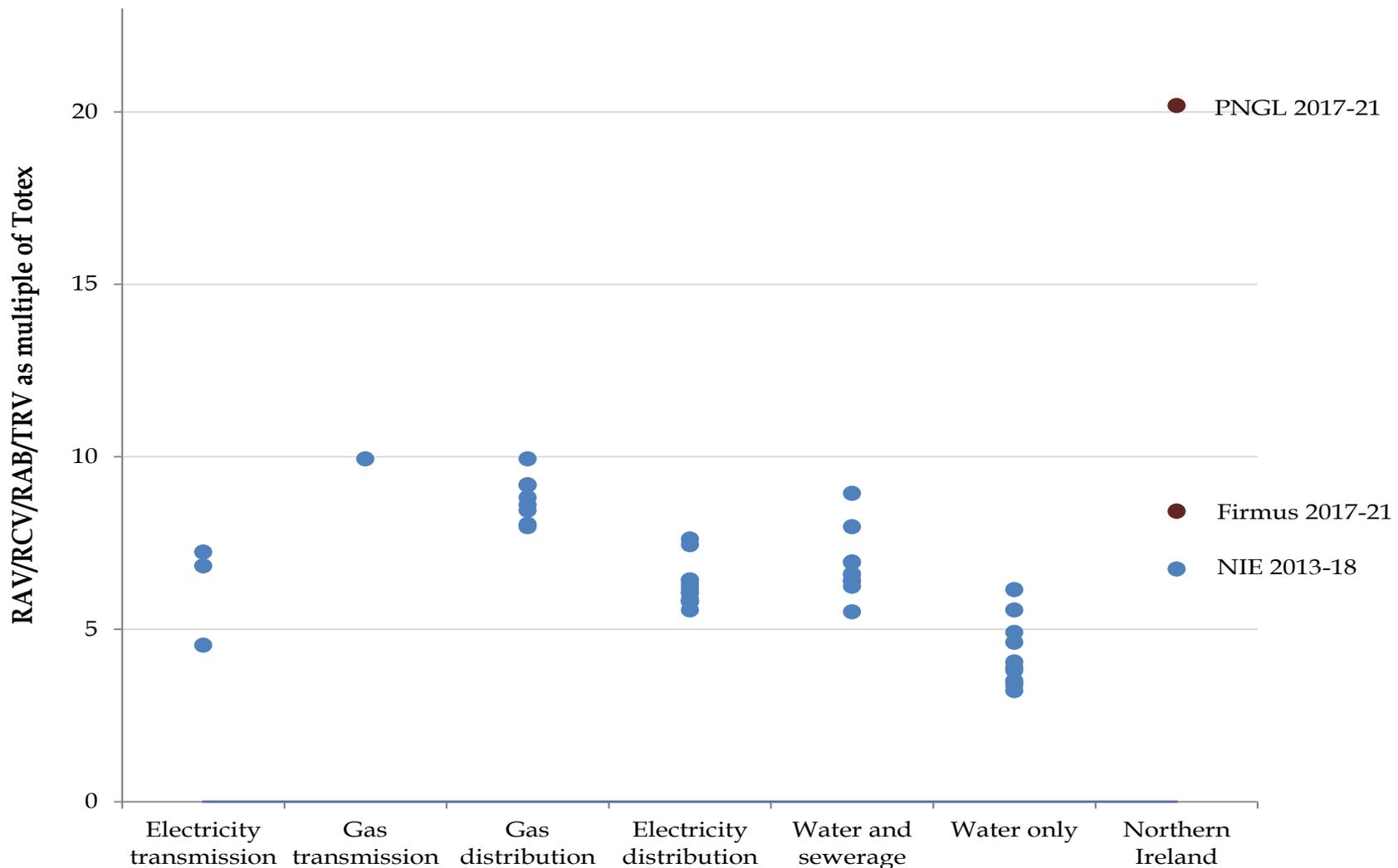
| <i>Components</i>  | <i>£ m</i>   |
|--|--------------|
| Net investment, less depreciation plus working capital                                   | 213.3        |
| Historical under-recoveries of revenue (1996-2006)                                       | 73.0         |
| Unspent allowances: including deferred capex and historical outperformance (1996 - 2006) | 65.6         |
| Profile adjustment   | 85.2         |
| <b>Total TRV</b>   | <b>437.1</b> |

- Outperformance is normally shared with consumers.
- Competition Commission determined it should not be for 2012 and 2013.
- We have proposed that there are no adjustments to PNGL TRV and none of this historic outperformance will now be shared with consumers.

# Weighted Average Cost of Capital (WACC)

- This is the return given to PNGL & FE for investing in the gas network.
- For PNGL & FE, we propose to set a rate of return of 7.5% (pre tax, real) for 2014 – 2016.
- For 2017 we will determine WACC at the next price control using CAPM in line with other regulators.
- We have included some initial thoughts on this in consultation.
- We have used GB GDN rate of 4.83% for modelling purposes.

# Regulated asset values as multiples of totex across UK regulated sectors



- PNGL current policy
  - One free domestic meter exchange (from credit to prepay or vice-versa) at a domestic property per annum
  - Additional meter exchanges will be charged to customer
- Proposed new policy
  - Credit to prepay meter exchanges will be free to customer
  - Prepay to credit meter exchanges will be charged to customer (with exception for vulnerable customers)
- Refer to consultation, paragraph 5.84 onwards & paragraph 1.30 in appendix 1.

**ANY FURTHER  
QUESTIONS**

# Next Steps

- Consultation ends: **Friday 20<sup>th</sup> September 2013, 5pm**
- We welcome comments on our proposals
- Send responses to [paul.harland@uregni.gov.uk](mailto:paul.harland@uregni.gov.uk)
- Final decision will be published in December 2013

## **Useful Links:**

GD14 Consultation:

[www.uregni.gov.uk/uploads/publications/PNGL12\\_Final\\_Decisions\\_FINAL.pdf](http://www.uregni.gov.uk/uploads/publications/PNGL12_Final_Decisions_FINAL.pdf)

Update on Approach:

[www.uregni.gov.uk/publications/update\\_on\\_our\\_overall\\_approach\\_for\\_the\\_price\\_controls\\_of\\_nis\\_gas\\_distributi](http://www.uregni.gov.uk/publications/update_on_our_overall_approach_for_the_price_controls_of_nis_gas_distributi)

Thank you for your  
participation