

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

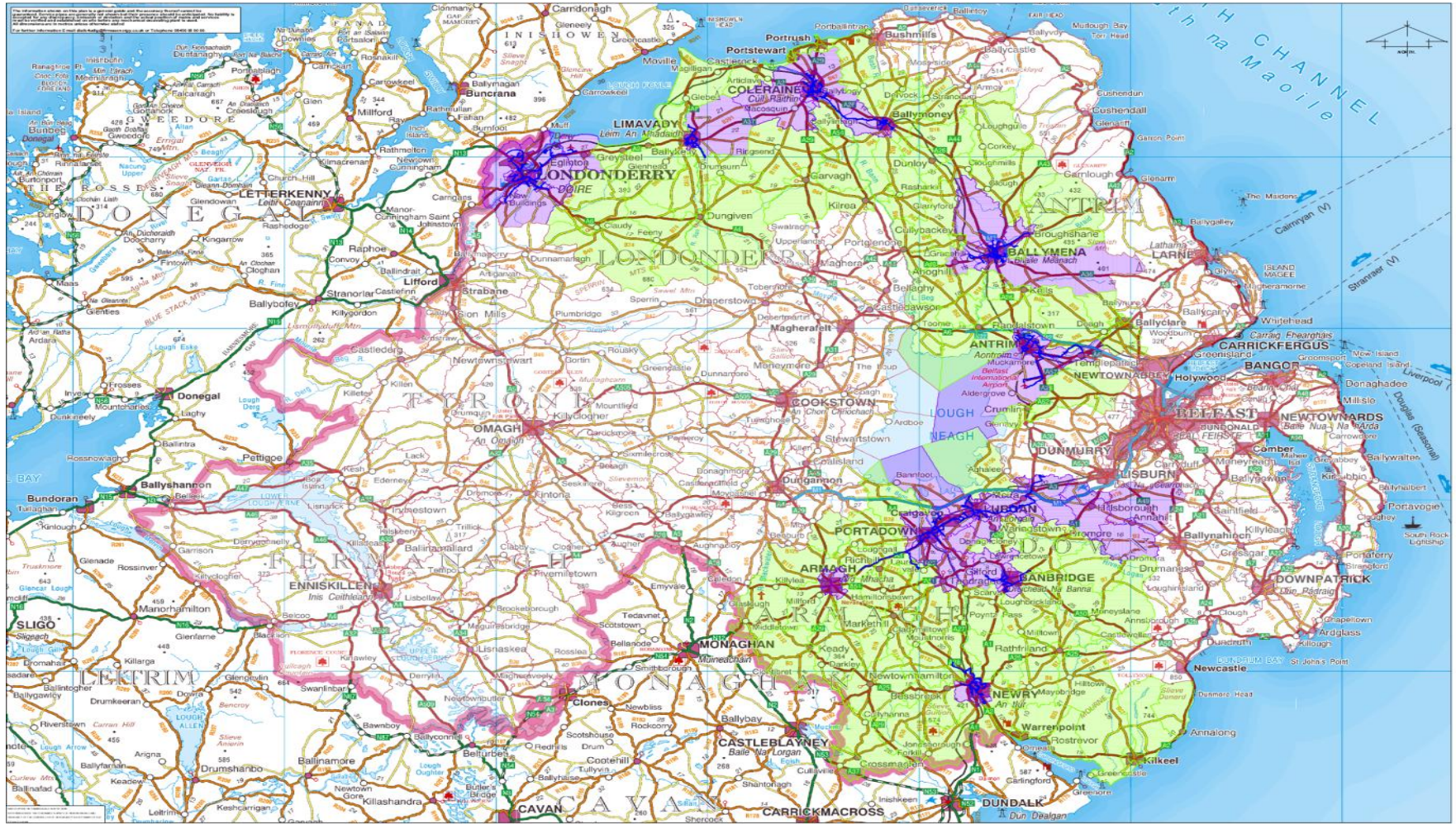
Overview of Gas

- 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

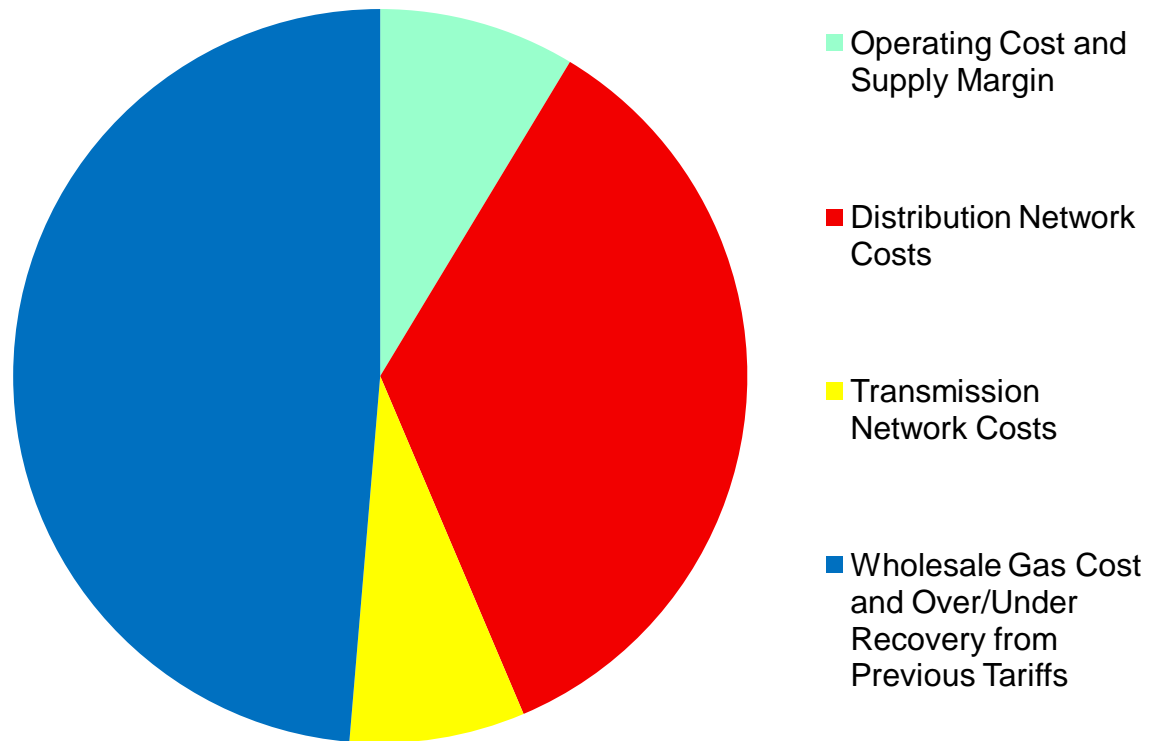


What is a price control?

- 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.

| Distribution Tariff: Domestic | | |
|-------------------------------|---------------------------|-------------------------|
| | PNGL (pence per therm) | FE (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.

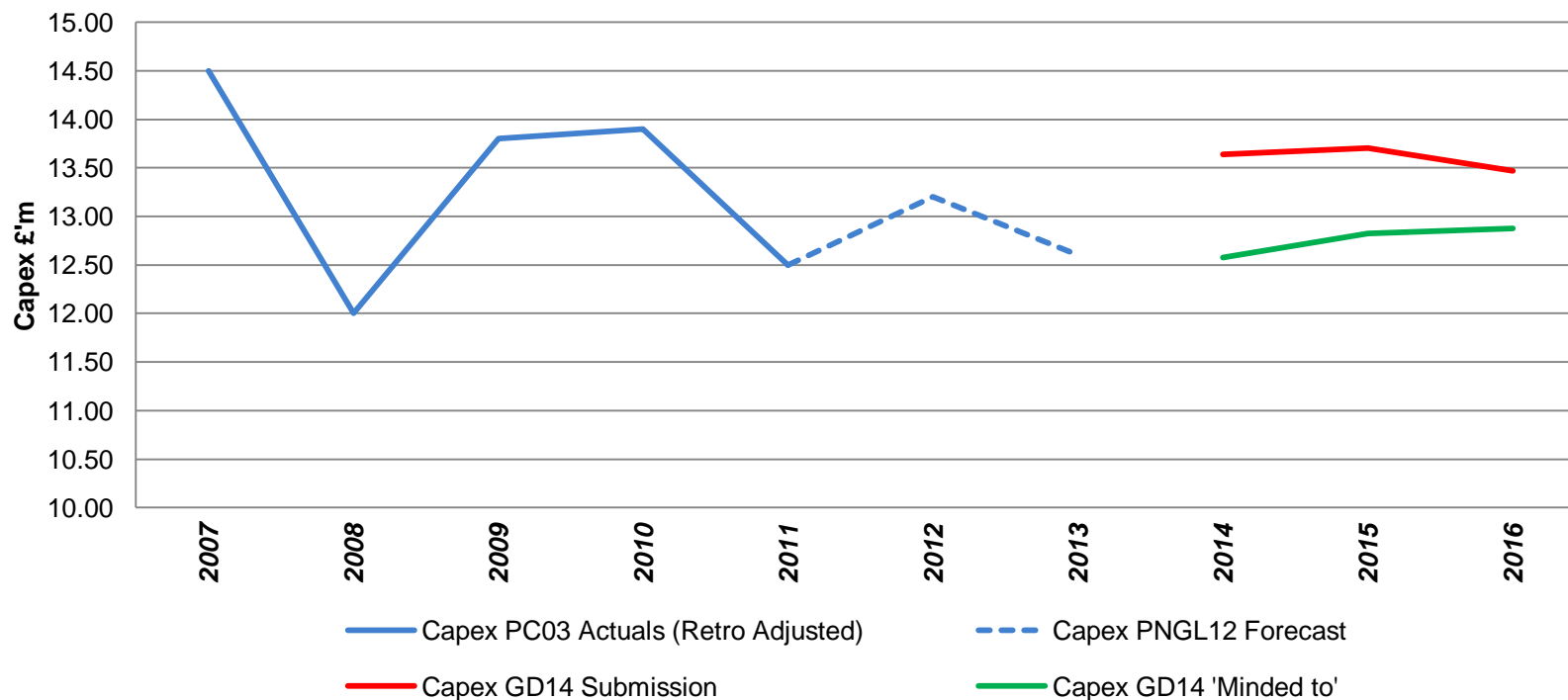
Price Control Process

- 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% |

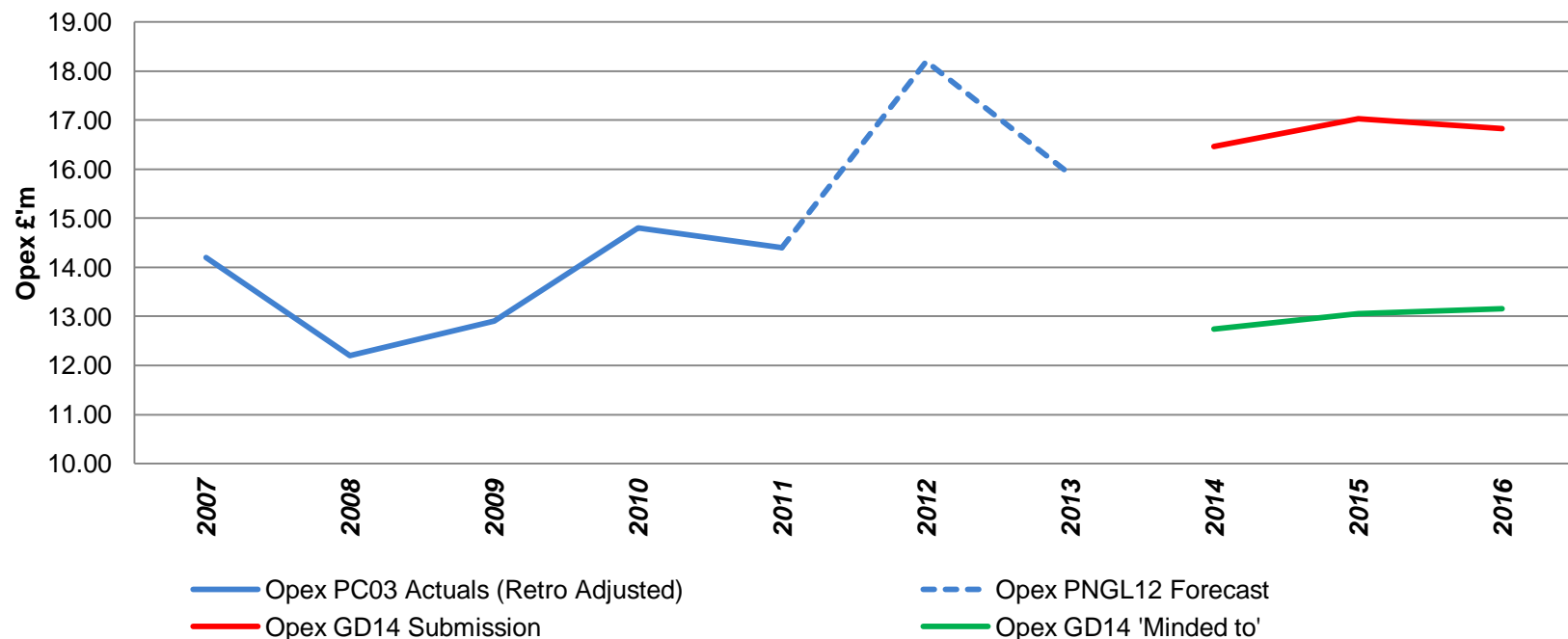
PNGL Capex Trending (£2012)



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% |

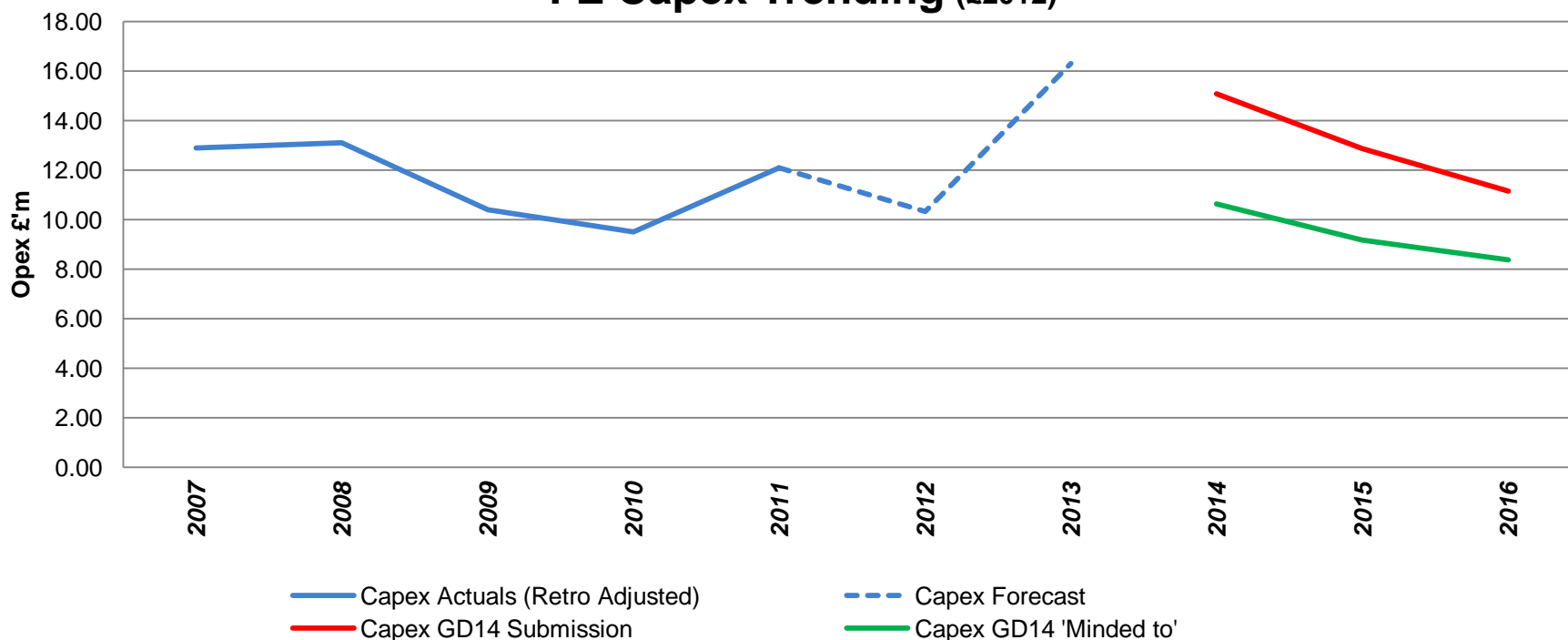
PNGL Opex Trending (£2012)



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% |

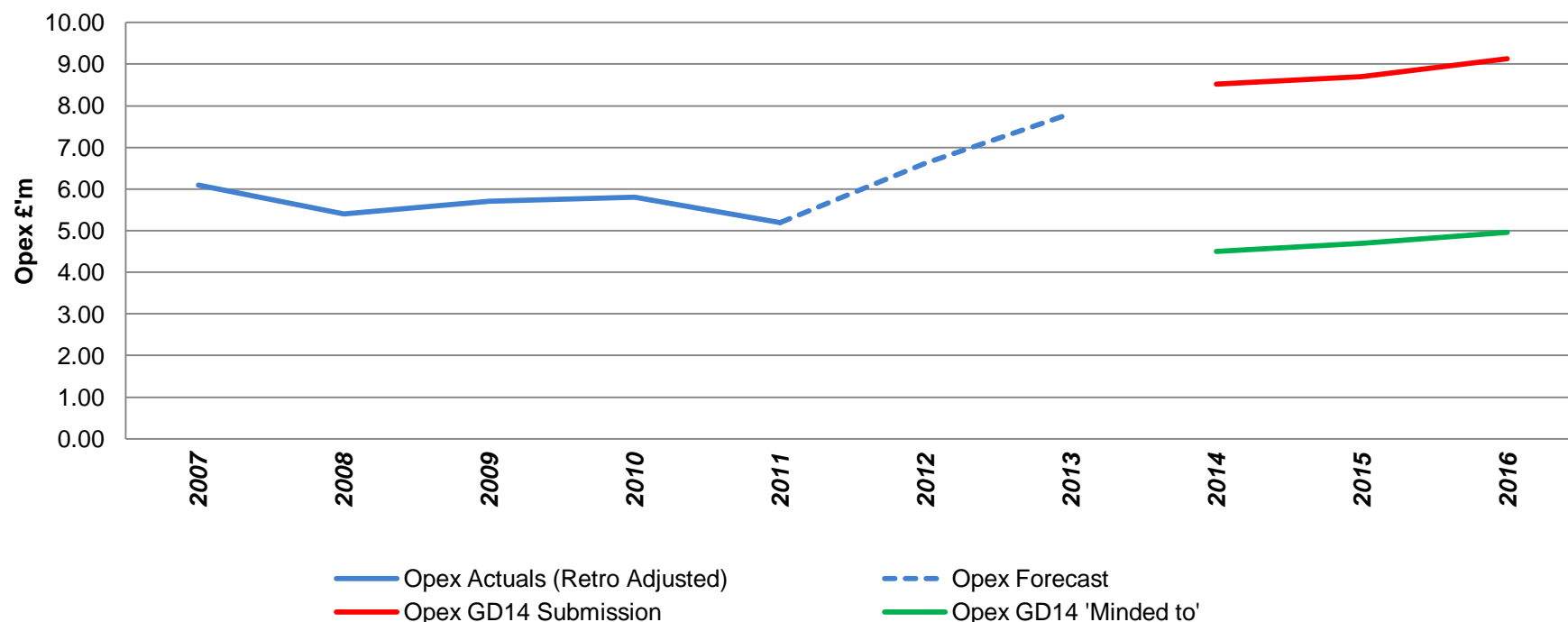
FE Capex Trending (£2012)



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 |
| PNGL | 3,000 | 3,000 | 3,000 |
| FE | 5,431 | 5,070 | 3,987 |

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

PNGL Total Regulatory Value (TRV)

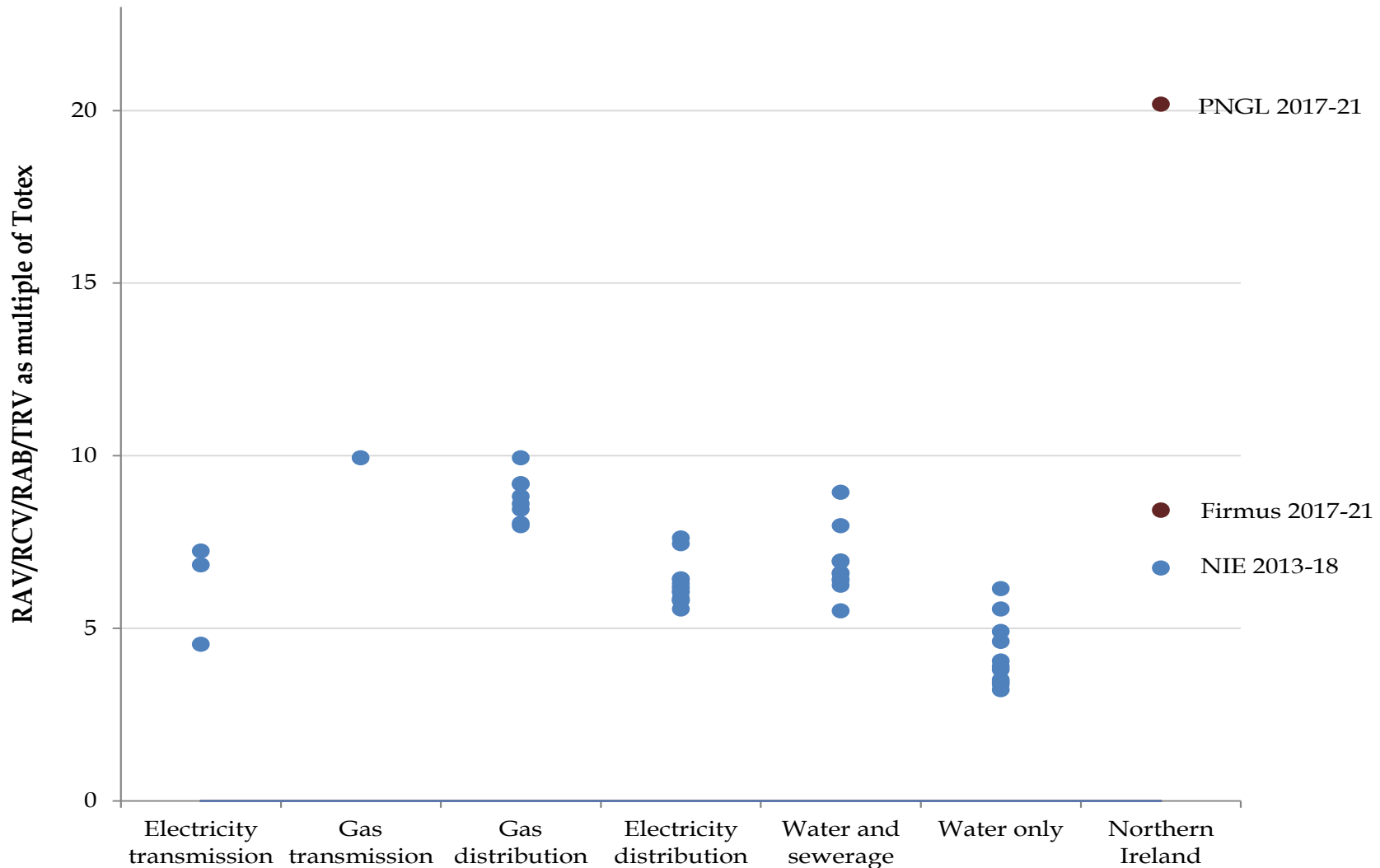
| <i>Components</i> | <i>£ m</i> |
|--|--------------|
| Net investment, less depreciation plus working capital | 213.3 |
| Historical under-recoveries of revenue (1996-2006) | 73.0 |
| Unspent allowances: including deferred capex and historical outperformance (1996 - 2006) | 65.6 |
| Profile adjustment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

- 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 20th September 2013, 5pm**
- We welcome comments on our proposals
- Send responses to 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

Update on Approach:

www.uregni.gov.uk/publications/update_on_our_overall_approach_for_the_price_controls_of_nis_gas_distributi

Thank you for your
participation