



**PRICE CONTROL FOR NORTHERN IRELAND'S GAS  
DISTRIBUTION NETWORKS**

**AIRTRICITY RESPONSE TO UTILITY REGULATOR  
CONSULTATION PAPER**

**20<sup>TH</sup> SEPTEMBER 2013**

## INTRODUCTION

Airtricity welcomes the opportunity to respond to the Utility Regulator's consultation paper on price control proposals for Northern Ireland's two gas distribution companies.

SSE plc, through its wholly-owned subsidiary completed its acquisition of Phoenix Supply Limited (PSL) from Phoenix Energy Holdings Limited in June 2012. As Airtricity, we supply around 120,000 gas customers in the Greater Belfast and Ten Towns licence areas.

The Utility Regulator's final determination on the appropriate costs allowances for PNGL (and to a lesser extent, Firmus Energy) will have some effect on the costs we pass through to our customers, and the service that we can provide to our customers.

Our response follows the structure of the consultation paper and provides high level commentary on some of the details behind the Utility Regulator's proposals for both Northern Ireland GDNs.

We hope that our comments are helpful. If you would like any further discussion on our submission, please do not hesitate to contact Connor Powell at [connor.powell@airtricity.com](mailto:connor.powell@airtricity.com)

## INFORMATION PROVISION AND BENCHMARKING

Relative to previous price control determinations, we welcome the level of detail provided by the Utility Regulator in terms of both:

- I. Some breakdown of specific operating and capital expenditure items.
- II. Detail regarding the reasoning behind decisions to disallow or adjust specific Operating or Capital Spending items.

We would also agree that alignment of price controls for the two GDNs will facilitate benchmarking between the two companies in the future, once properly comparable costs have been established and understood by the Utility Regulator.

The age, business model and profile of both networks are more equally comparable to one another, rather than to GB GDNs which tend to be facing different challenges.

## DURATION OF PRICE CONTROL

The initial ***Price Control for Northern Ireland's Gas Distribution Networks GD14*** paper favoured a 5 year, rather than a 3 year price control. This approach appears to have been revised on the basis that the two benefits of longer price controls are less than the benefits

offered by having an opportunity to revise the cost of capital for PNGL and FE. Those benefits are:

*“promot[ing] long term planning of the Business Plan which will secure continuity of investment between years and between price control periods.”*

and;

*“Challeng[ing] the GDN’s to improve their efficiency and performance at an achievable and sustainable rate.”*

It is unfortunate that some of the incentives to outperform the price control are dampened or entirely lost through a shorter price control duration. Airtricity would hope that NIAUR’s focus on capturing financial rather than operational and construction outperformance will be reversed once it has an opportunity to set a cost of capital through the CAPM model.

However, one unintended and unmentioned positive of the shorter price control duration will be that the GD17 Price Control will align with the retail price control that applies to Airtricity Gas Northern Ireland Ltd (AGSNIL). We feel that benefits will be derived by clearly setting out and separating supply and distribution business functions and the costs associated with them.

The consultation states that the intervening period will be used to establish and agree information structures and submission procedures. We believe that AGSNIL should be involved in these discussions over the transitional price control period. This will ensure that Distribution and Retail price controls set for 2017 onwards are consistent in approach and properly assign the costs faced by supply and distribution businesses.

## **REGULATED ASSET VALUES AS MULTIPLES OF TOTEX**

The consultation paper states that:

*“It is noteworthy that the ratio is far higher for PNGL than other utilities, suggesting that the risk it faces is lower. FE is at an earlier stage in the development of its network and consequently the proportion of its value represented by deferred revenue is smaller. Hence the cost of capital in GD17 will take into account this reduced risk compared to other networks.”*

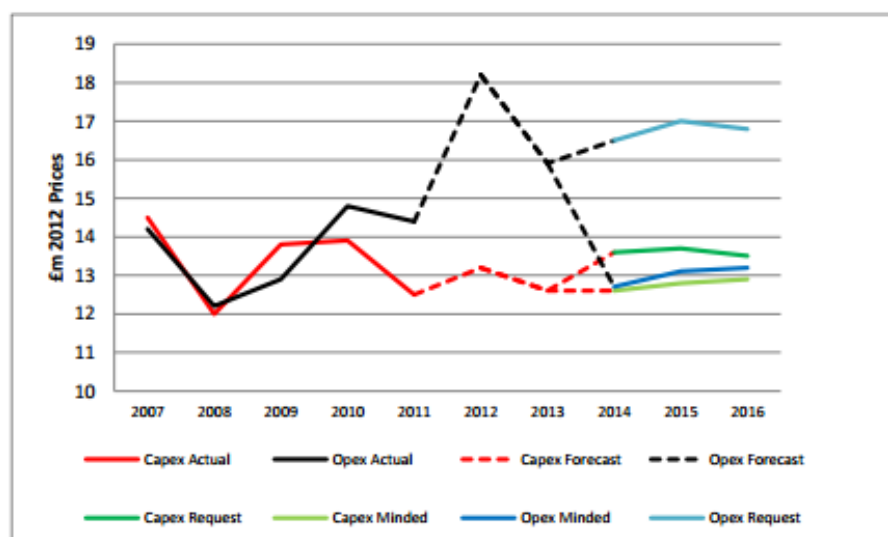
Airtricity believes that such an approach would likely act as a direct disincentive to future network investment, as new investments would receive a WACC that is lower than the actual cost of capital for the GDN. This would be a poor outcome for all users of the PNGL gas network.

The aspects of PNGL's TRV that relate to past outperformance are likely to have an atypical risk profile relative to typical capital expenditure. However, as the referral of the PNGL12 price control to the Competition Commission illustrated, the regulatory risk associated with recovery of this agreement appears to be relatively high. Any change to the approach should seek to ensure that regulatory risk to recovery is minimised.

## OPEX AND CAPEX ALLOWANCES

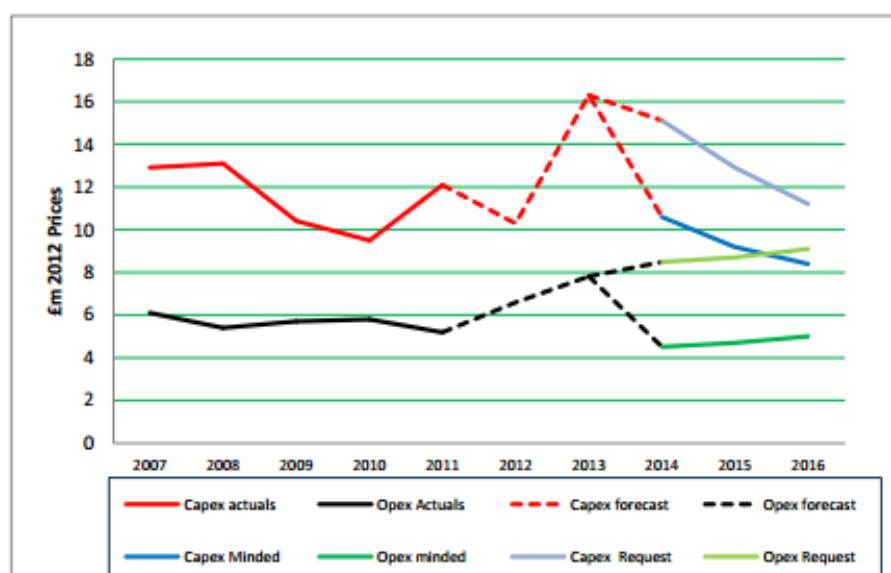
We do not have access to the detail behind both price control submissions, but we would note that the overall, cumulative effect of disallowances and adjustments leaves a substantial difference between requested expenditure (both Capital and Operating) and minded-to expenditure for both GDNs. The PNGL submission and minded-to determination from NIAUR is shown below:

Figure 1 – PNGL operating and capital expenditure submission & proposed allowances, £m



Source: PNGL and the Utility Regulator

Similarly, the Firmus Energy submission and minded-to determination from NIAUR is shown below:



Source: FE and the Utility Regulator

The determination implies that NIAUR has discovered substantial efficiencies relative to those outlined by both GDNs and in addition to the overall efficiency target of 1%<sup>1</sup> for both opex and capex.

We would note that some assumed efficiency will be ‘captured’ by the Utility Regulator through imposed regulatory changes over the price control period, such the changes to the provision of Codes of Practice and Terms and Conditions of Gas Contracts (both suggested in ***Consultation on measures for the purposes of the EU Third Internal Energy Package***).

Looking at the customer number and network expansion assumptions (particularly for Firmus Energy), we are concerned that it might be difficult for the GDNs and NIAUR to reach agreement.

## RESPONSIBILITY FOR METER READING

The consultation notes that gas suppliers are currently responsible for meter reading on both gas networks in Northern Ireland, with the responsibility falling on gas suppliers through licence obligations. While there is no change suggested to the current arrangements in the consultation paper, Airtricity believes that there is no reason that meter reading should become a GDN activity, as it is a service that is naturally sits within gas supply.

Suppliers should have an opportunity to assess the value and quality of their meter reading service and adjust their provision accordingly if it falls short. Moving the activity to the GDN would mean that suppliers would be depending on distribution network price controls for the provision of a fundamental service.

## MATERIALITY THRESHOLD

A materiality threshold for additional costs of £100,000 appears relatively high, particularly as many of the additional costs imposed on GDNs (and other energy companies) tend to be the result of regulatory or legislative changes imposed. We believe that a lower threshold would be more appropriate.

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<sup>1</sup> We would also note that this efficiency factor will not be adjusted through Real Price Effects (RPEs) as in GB because:

*“[NIAUR believes] that the economy will continue to be relatively low growth which will dampen inflationary pressure on labour and materials relative to other goods and services.”*

We don’t think that NIAUR’s macroeconomic forecasts provide substantial grounds for assuming that GDNs in Northern Ireland will be immune from RPEs for the next price control periods, and would appreciate more detail on this judgement in the Final Determination.