



***Consultation: Price Control for Northern Ireland's gas Distribution Networks (GD14)***

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## **Introduction**

The Consumer Council welcomes the opportunity to respond to this consultation.

The Consumer Council is an independent consumer organisation, working to bring about change to benefit Northern Ireland (NI) consumers. Our aim is to make the consumer voice heard and make it count.

## **Summary**

There are two broad issues in which the GD 14 Price Control can benefit consumers. The first is to ensure that the company delivers a high quality service at the lowest possible price to existing gas consumers. The second is to increase the take up of gas - an objective that has been deemed by the NI Government to be in the interests of all consumers.

The overall savings to consumers that the Regulator proposes are welcome but we are concerned whether the process of gathering and analysing information is sufficiently robust. The regulatory process appears to have been conducted in isolation from the key stakeholders of consumers and the NI government, both of which have a significant interest in the strategic and operational outcomes of GD14.

We believe that an opportunity still exists to use GD14 as a way to target and reduce fuel poverty in Greater Belfast and the Ten Towns Licence areas. This in turn could guide and inform the proposed extension of the gas network to the west of NI.

## **The consumer context**

It is important to understand the context for NI consumers against which the GD14 Price Control is taking place. Northern Ireland consumers, along with those living in other areas of the UK have seen their overall spending power

diminished in recent years. A recent report from the Joseph Rowntree Foundation<sup>1</sup> has examined the impact of the economic downturn on households in Northern Ireland since 2009.

The report found that 22% of people in Northern Ireland were living in poverty and that the number of retired households living in poverty had increased from 55,000 to 70,000. It also confirmed a higher percentage (21%) of pensioners live in poverty in Northern Ireland compared to their counterparts in the rest of the UK where the figure is 16%.

The Consumer Council's own research<sup>2</sup> shows that half of the adult population here is worried about making ends meet and over half are worried about making ends meet in the future. Furthermore, only half are managing to keep up with bills and credit without difficulties and more than one in four stated that they are worried that they, or someone in their household, will lose their job within the next year.

A significant factor in this is that consumers in NI pay the highest domestic energy costs in the UK<sup>3</sup>. In May 2013, Power NI increased its regulated electricity tariff by 17.8 per cent and following the 8.7% tariff increase on 1 April 2013, gas bills in the Greater Belfast area have risen by 38 per cent since 2009<sup>4</sup>. The increasing cost of energy is affecting nearly everyone in our society. Around 294,000 households in Northern Ireland are struggling to heat their homes to an adequate level and at 42 per cent NI's level of fuel poverty is by far the worst in any part of Great Britain and Ireland.

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<sup>1</sup> Monitoring poverty and social exclusion in Northern Ireland 2012, Joseph Rowntree Foundation

<sup>2</sup> Consumer Proficiency Research, 2011/2012. The Consumer Council

<sup>3</sup> Average energy bill in Northern Ireland is currently £879 more expensive than GB. Average annual bill NI- electricity £595 using 3,300kWh on Power NI's standard tariff with no discounts. Heating oil £1,746 using 17,500kWh source CCNI Domestic Cost of Gas vs Oil Report May 2013. Total £2,341. Average annual bill GB- Electricity £565 using 3,300kWh source Consumer Focus. Gas £861 using 17,500kWh source Consumer Focus/Futures Total £1,462.

<sup>4</sup> Source: CCNI Comparative Domestic Cost of Gas v Oil Report May 2013

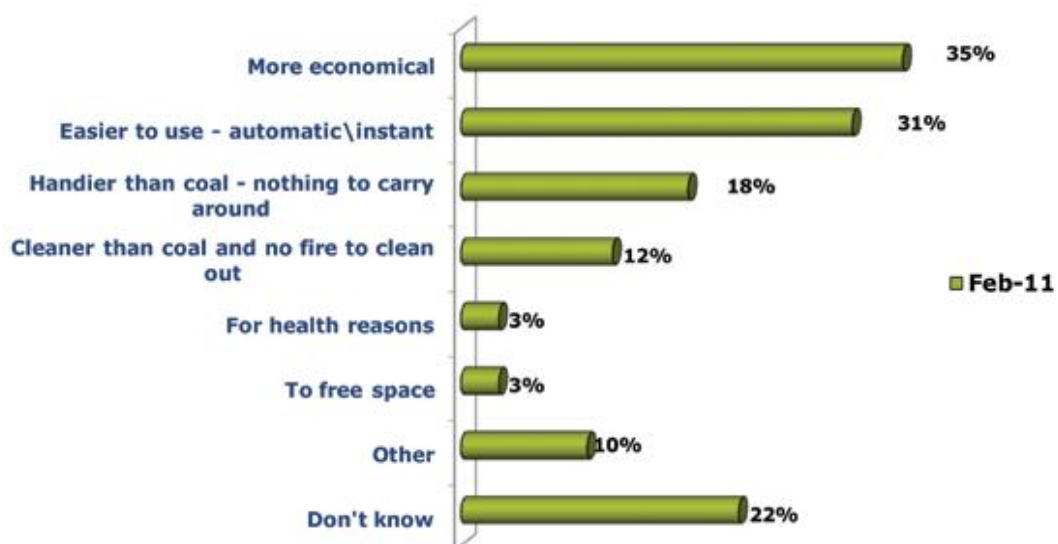
There is therefore an urgent need to reduce the overall energy costs of households in Northern Ireland.

### What natural gas can do for NI consumers

Northern Ireland has the largest percentage of domestic homes using heating oil in Western Europe - with 68 per cent homes (82 per cent in rural areas) using heating oil as their primary heating source<sup>5</sup>. We believe that there is a direct correlation between this and the high level of fuel poverty in Northern Ireland.

The Consumer Council's review of energy prices has shown that the estimated annual gas and oil bills in Northern Ireland are £1,089 for gas and £1,746 for oil<sup>6</sup>. This means that on average consumers using oil spend an estimated £657 more annually than the average gas consumer.

Natural gas can therefore provide considerable savings to consumers and it is this that has persuaded around 189,000<sup>7</sup> consumers to convert from oil to gas. The table below illustrates why consumers convert to gas:



Source: Customers Experience of Natural Gas in Northern Ireland- Consumer Council June 2012

<sup>5</sup> Northern Ireland House Condition Survey 2011

<sup>6</sup> Source: CCNI Comparative Domestic Cost of Gas v Oil Report May 2013

<sup>7</sup> Utility Regulator consultation paper on GD14 Price Controls

Furthermore, natural gas customers have expressed overall satisfaction with their experience of natural gas and in our most recent survey in 2012, expressed real enthusiasm for it<sup>8</sup>.

In terms of sustainability, the Consumer Council acknowledge and support the aim of achieving a carbon free renewable energy industry in NI. However, natural gas is the most efficient and lowest carbon producer of the fossil fuels and can provide a stepping stone to this.

The Consumer Council believes that in the short to medium term, tackling the acute problem of fuel poverty is a priority for Northern Ireland. The figures show that all consumers will benefit from converting to natural gas from oil, but without doubt the biggest beneficiaries would be those households in fuel poverty. Of those households in fuel poverty, 75 per cent have an annual income of £14,999 or less, 49 per cent are renting privately and 66 per cent are not currently using mains gas.

The consultation document notes that within the Greater Belfast licence area, 90 per cent of properties can readily connect to gas, and 48 percent have done so. This leaves around 140,000 households that are paying more for their heating bills than they need be.

Fuel poverty is the product of three factors; low income, high fuel prices and poor household energy efficiency. By converting to gas consumers will pay a lower (and less volatile) price for fuel and by fitting a new condensing boiler will improve the energy efficiency of the their home. We therefore believe that converting to gas will help tackle fuel poverty in NI.

### **Operational- costs and outcomes**

Overall we welcome the Regulator's proposals which give an annual saving to existing natural gas consumers of £25 per annum and £51 per annum for

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<sup>8</sup> Customers Experience of Natural Gas in Northern Ireland- Consumer Council June 2012

PNG and firmus respectively. Whilst the cost of natural gas is the key priority for consumers it needs to be balanced with the need to ensure the highest standards of safety, continuation of supply and customer service standards.

These standards can be assured through a transparent process of comparing and analysing agreed information against established criteria by the Regulator and the company. We are concerned at the considerable differences between the requested and allowed costs for both companies, notably the 45 per cent gap in the firmus opex allowance. This raises a concern about the regulatory process, and the accuracy/extent of information used by parties to arrive at these proposals.

Unfortunately this is the same issue that we raised in relation to the NIE, RP5 Price Control which is currently awaiting determination from the Competition Commission. In that instance we saw how each party to the Price Control blamed the other for the 'information gap'. In GD14 we can only speculate that the parties involved will do the same. Whatever the reason, uncertainty to this extent should not exist in a Price Control process.

For future Gas Distribution Price Controls, engagement between the Regulator and the regulated company to agree and deliver the required information must be the key priority at the very outset of the price control process.

The Consumer Council's view is that a significant aspect of this information gap is the failure by both PNG and firmus to introduce an asset management system that satisfies the Regulator and consumers. In the case of PNG, we stated two years ago that the consumer was losing out because of the PNG failure to implement PAS55. Consumers can have no confidence in the arguments presented by either the company or the Regulator around asset management when there is no agreed and verifiable data.

Consumers must have confidence that the regulatory process is robust. The Regulator must instruct PNG and firmus to introduce an asset management

system that satisfies the Regulator and consumers on the robustness of the data provide by the companies.

We support proposals that raise awareness of the benefits of natural gas and provide an incentive to householders to convert to gas. However we are conscious that a Price Control must also deliver for existing gas consumers and therefore these proposals need to be considered in the round. The efficacy of the proposed £480 per owner occupier property connection and the £507 figure for the economic test for properties passed depends on the appetite that remains amongst consumers within the existing licence area for gas.

It is questionable whether, as is suggested, the NI gas industry with a 48 per cent connection rate in Belfast should be described as immature. Furthermore, will the cost of persuading the remaining 52 per cent to take up gas be more or less than it has been with the first tranche. Setting aside that there will always be a significant number that will never be able to, or choose to convert, convincing those that may convert but have not already done so may be harder to do. This is because up to now they have resisted or avoided all previous efforts to persuade them to convert.

In order to understand this issue better further research is required that tests the appetite for gas within the existing licence areas, but also beyond into areas that are being proposed as new areas for gas. The Consumer Council plans to include such research in its Forward Work Plan for the Energy Team in 2014/15.

We support the proposal to remove the right of customers to have a free meter exchange regardless of the type of meter and instead limit free meters exchanges to those from credit to Pay As You Go (PAYG) meters. The proposal supports the principle that the consumer who benefits from a service should incur the cost of it. However, by retaining free meter exchanges from credit to PAYG meters, it also recognises the social benefits of PAYG meters and hence encourages their use. The social benefits of PAYG meters are well

recognised in Northern Ireland and are highlighted in the Consumer Council report 'In Control'<sup>9</sup>. PAYG meters help consumers reduce their gas consumption, manage their finances better and avoid falling into debt.

### **Strategic- maximising the use of gas for the benefit of consumers**

The GD14 Price Control is an opportunity for Government, the Utility Regulator and stakeholders to consider the cost of getting more consumers to use gas, who should pay for it and who should be the beneficiaries. The DETI Strategic Energy Framework for NI contains a target that will 'agree a strategy to incentivise gas connections and increase gas uptake in existing and future license areas'<sup>10</sup>. This is an issue that will not only benefit potential gas users in the existing licence areas but also those in DETI's proposals for taking 'Gas to the West'.

To encourage consumers to convert from oil to natural gas potential users will need to be convinced of the benefits it will bring and the practical barriers to converting must be removed. These barriers may be considerable. Firstly gas may not be available where they live, secondly there are considerable costs involved in converting and thirdly if the householder is a tenant the decision to convert will be out of their control.

The Consumer Council would ask the Regulator to consider to what extent the proposals outlined in this consultation will help address each of the barriers by:

- Keeping the overall cost of natural gas to the end user as low as possible whilst ensuring that the companies provide the highest standards of service;
- Ensuring the companies increase the demand for natural gas by raising awareness of the benefits it can provide;

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<sup>9</sup> In Control- Consumer Council 2006

<sup>10</sup> DETI Strategic Energy Framework September 2010, SEF 8.



- Creating incentives to distribution companies to infill the network, maximise connections and promote energy efficiency;
- Directing the focus of the companies' development activities towards tackling fuel poverty;
- Providing data that will enable the Northern Ireland Government to make informed decisions on the interventions it can take to maximise the uptake of gas.

The Consumer Council believe that fuel poor households should be targeted for help in connecting to gas. It is these households that will most benefit from converting to gas and that are least likely to convert without significant help.

Research shows that fuel poverty is at its greatest extent in households with incomes below £15,000 and amongst private tenants. Furthermore households using oil have higher levels of fuel poverty than those using mains gas.<sup>11</sup>

Private tenants are also the group of consumers who have the least control over both the fuel used in their home and the standard of energy efficiency in their home. Therefore allowances and incentives to increase connections should be targeted at the fuel poor and particularly at fuel poor private tenants. However, the Utility Regulator does not have the power to introduce such a policy which is why it is essential that the NI Government influence the detail of this Price Control.

The manner of the intervention that the companies make should include providing energy efficiency advice and insulation measures. It is pointless fitting a highly efficient condensing boiler and system if the heat produced is lost through poor insulation.

In considering who pays for the incentives and allowances to increase connection three models could be considered;

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<sup>11</sup> Northern Ireland House Condition Survey 2011

- The cost is passed on to all gas customers through the distribution charge;
- Government subvention;
- The cost is ring fenced and spread across only the customers who connect to gas after the allowance is made. This would be particularly applicable in the instance were an easily geographically defined group of customers are targeted.

GD14 proposes a connections allowance and incentive, and a properties passed allowance and incentive. We believe that the introduction of a risk/reward incentive both for new connections and properties passed is a very positive development for consumers. The companies are likely to work harder and be more innovative if they are rewarded for success and penalised for failure.

The NI Government should consider where its interventions are best targeted in order to achieve its strategic objective of maximising connections to gas and developing the network. The Government is committed to a subvention of £32.5m for extending the gas network to the west of Northern Ireland. At best it is envisaged that this will connect 31,000 new customers, including Industrial and Commercial customers. In the Greater Belfast, Larne and Ten Towns licence areas there is the potential to connect another 100,000 mainly domestic customers. Whilst we accept that many consumers in the existing licence areas will never choose to connect to gas and some may never be reached by gas, there remains the potential to make more gas connections. The proposals for new connections and developing the network in GD14, both by the companies and the Regulator are conservative. However, they come at no direct cost to the NI taxpayer. The NI Government should consider whether a limited subvention in the existing licence areas could have a major impact for consumers.

This is not to say that the Government should necessarily abandon proposals to provide a subvention for gas to the west. It may be possible to provide a subvention in both existing and new licence areas. The NI Government should consider the evidence to consider where and how it will get most value for tax payers money in order to achieve its strategic energy objectives.

### **Operational - Financial matters**

We welcome the Regulators signal that a review of the Gas Distributor Networks (GDN) Weighted Average Cost of Capital (WACC) in 2016 will benchmark the companies with the risk in comparable industries. We agree with the Regulator that currently the NI GDNs' have no greater risk in their business than their GB counterparts. The recent sale of PNG is an indication that the investors are confident of receiving an acceptable return and that they believe that the regulatory environment in NI will not undermine that confidence.

We note that the regulator is essentially reiterating its view expressed at the outset of the PNG Price Control 2012-13 that the company has been significantly 'de-risked'.

The outcome of the subsequent Competition Commission referral on 'outperformance' only served to bolster this view. We disagreed with the Competition Commission's determination that allowed PNG to retain within its Total Regulatory Value (TRV) the benefit of 'outperformance' for the period of that Price Control. Whilst within its power to revisit this issue, the Regulator has chosen not to. We can understand its reluctance to do so considering that the Competition Commission has determined once in favour of PNG on this issue and may well do so again if it was to reach them. However, in our view the Competition Commission and the Regulators proposal within this Price Control provides PNG with an inflated TRV, from which it will earn an increased return to the detriment of gas consumers. This should be given consideration when determining the WACC that the company will receive.

Regarding the Regulator's proposed approach to deferred capex, we can find no explanation or justification for allowing PNG to receive payments twice for projects. Despite no requirement to do so from the Competition Commission, the Regulator is abandoning its approach first proposed in the PNG Price Control 2012-13 that consumers should only pay once, and only for assets for which they receive a tangible benefit. We supported that approach then and can see no reason why this should change.

We will be seeking an explanation from the Regulator on their rationale for the approach outlined in GD14 re 'outperformance' and 'deferred capex' in the context of the issues we have raised above.

### **Consumer engagement and the future of Price Controls**

In our response on the approach to GD14, in January 2013 we highlighted the importance of Business Plans, outcome based and engagement with consumers, Government and other stakeholders.

We have described how, at the strategic level, the GD14 Price Control presents an opportunity to consider the future of the natural gas industry in NI, both within the existing licence areas and beyond. To do this required a two way engagement by the Regulator with DETI, the Executive, NI consumers and other stakeholders. If this had been done we could have seen proposals that would have provided a range of cost options for the future of the industry. However, we believe that the opportunity still exists to modify the GD14 proposals in such a way that more fuel poor households will benefit from gas and that it can provide valuable information for the proposed natural gas extension to the west.

At an operational level engaging with consumers allows the Regulator to fashion its proposals in a way that reflects consumer requirements from the industry. Even back in December 2012 when the companies submitted their Business Plans, and in January 2013 when the Utility Regulator consulted on

its approach to GD14, the opportunity to consult meaningfully with consumers had been lost.

A number of the items that we raised in our consultation response in January 2013 have been addressed within the GD14 proposals, but a number have not. Those missing are the incentives for the fuel poor to convert to gas, customer service standards, the implementation costs of IME3 and environmental and sustainability targets. We would like the Regulator to consider these matters in its Final Determination and provide an explanation if they deem that the issues do not require action.

## **Conclusion**

We see the GD14 as being able to deliver for consumers on two levels.

The first is operational and can benefit existing gas customers. We welcome the savings that the Regulator's proposals provide for both firmus and PNG consumers. However, a deep concern remains that the information upon which those savings are based is not as robust as consumers are entitled to expect. Responsibility lies on both the companies and the Regulator to introduce verified, recognised asset management systems to provide consumers' with confidence in the regulatory process.

The second is the opportunity to enable more consumers to avail of the benefits of gas and in particular to target assistance at the fuel poor.

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The Consumer Council

# ***Making the consumer voice heard and making it count***

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