Price Control for Phoenix Natural Gas Ltd and Firmus Energy Distribution Ltd and SGN Natural Gas ("GD17")

Tuesday 10 May 2016

Final

Outline of presentation

- Overview of gas & background to PNGL & FE & SGN
- What is a price control?
- How do we go about this?
- How do price controls affect consumer bills?
- 3 Key Areas
  - Rate of Return
  - Connection Incentive and Numbers
  - Infill Mechanism for further network development
- Next Steps
- Questions

Overview of Gas

Principal objective of UR

- Promote the development and maintenance of an efficient, economic, and co-ordinated gas industry in Northern Ireland

History

- Natural gas established in Northern Ireland in1996
- Nearly 50% Premises in Northern Ireland with access to natural gas

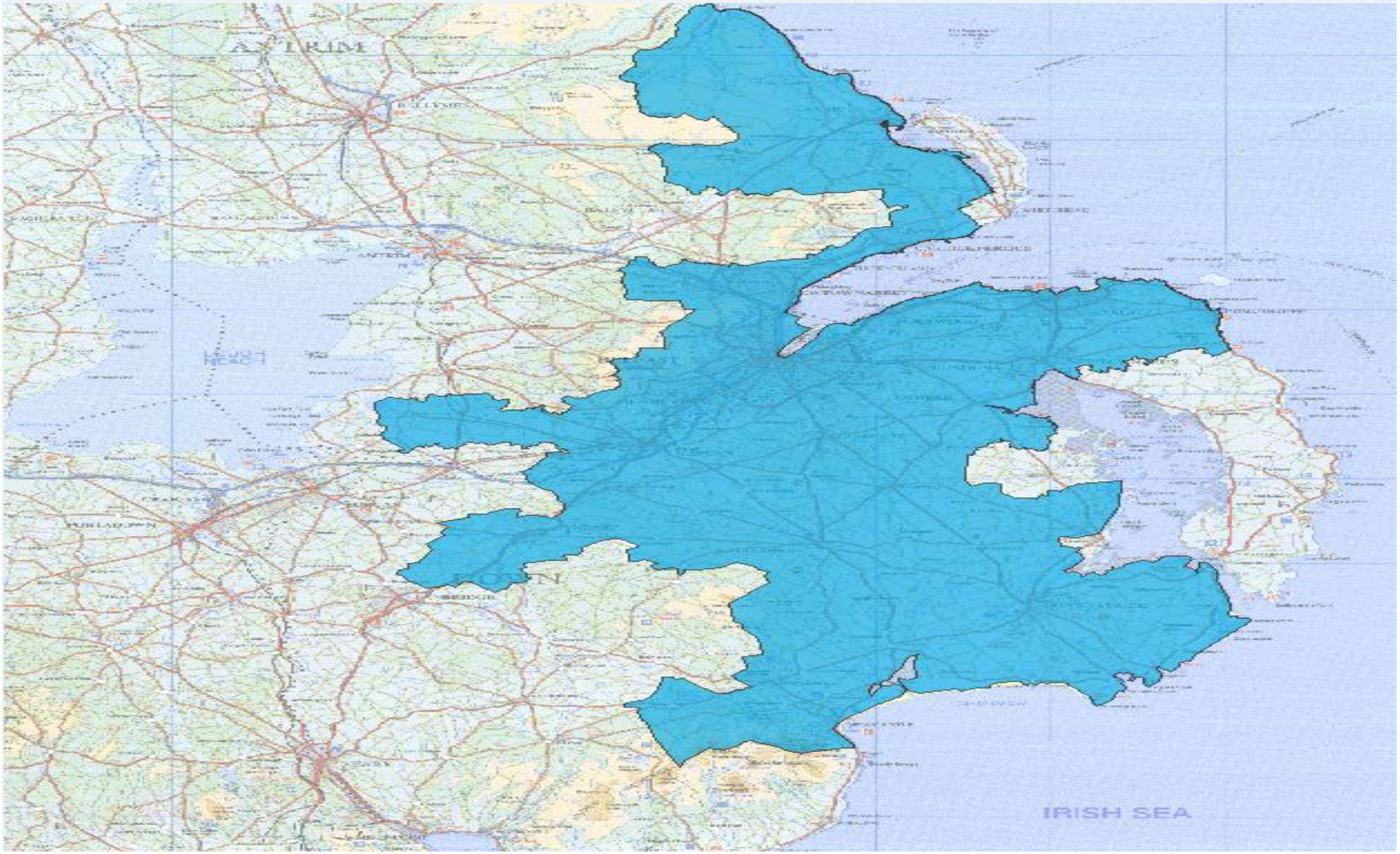
Customers

- End 2015 – Over 220,000 customers connected
- End 2015 – Nearly 200,000 customers are Readily Connectable potential customers

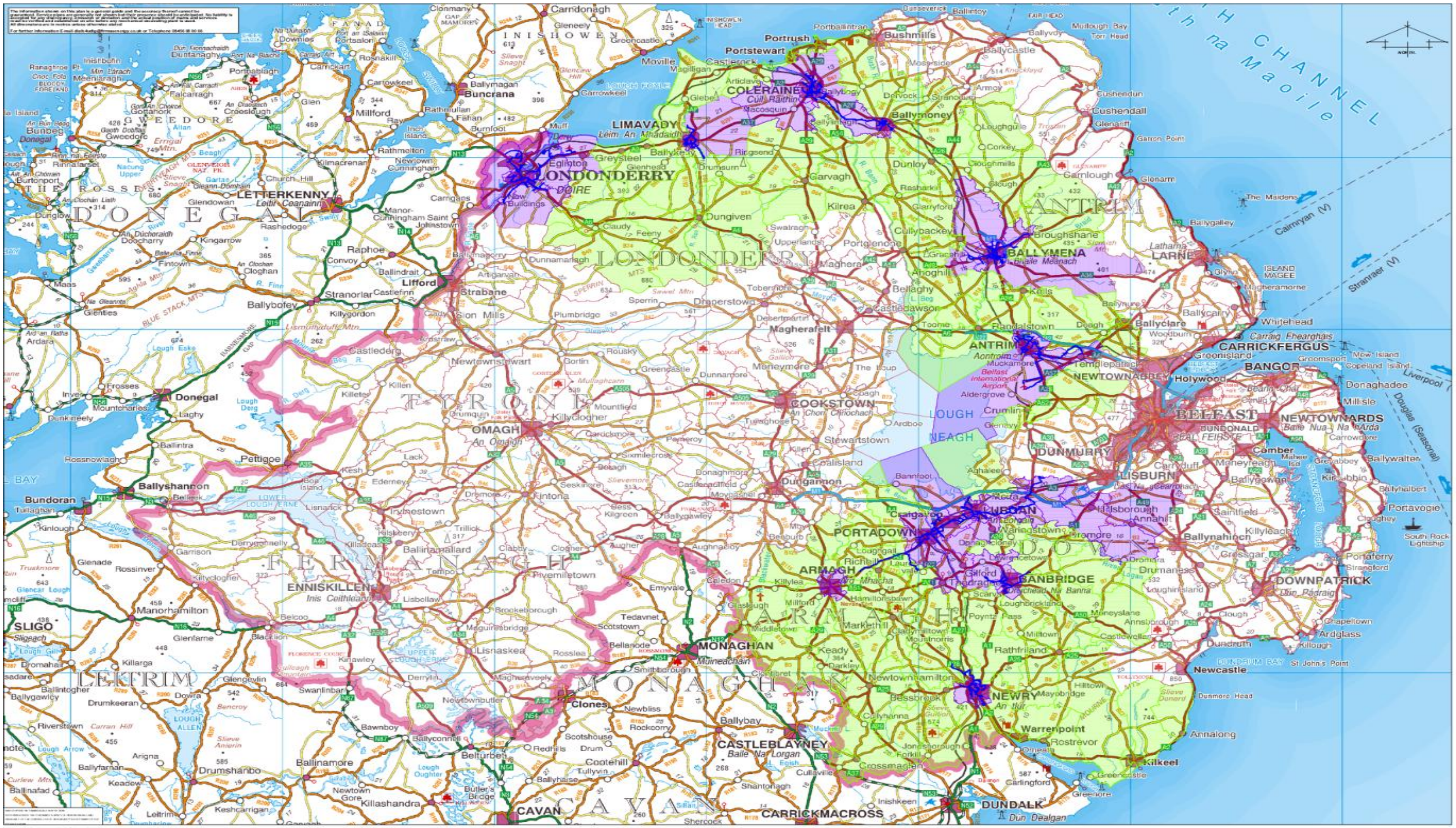
Pipe Laid

- End 2015 – ca. 4,500km of pipes laid

PNGL Area

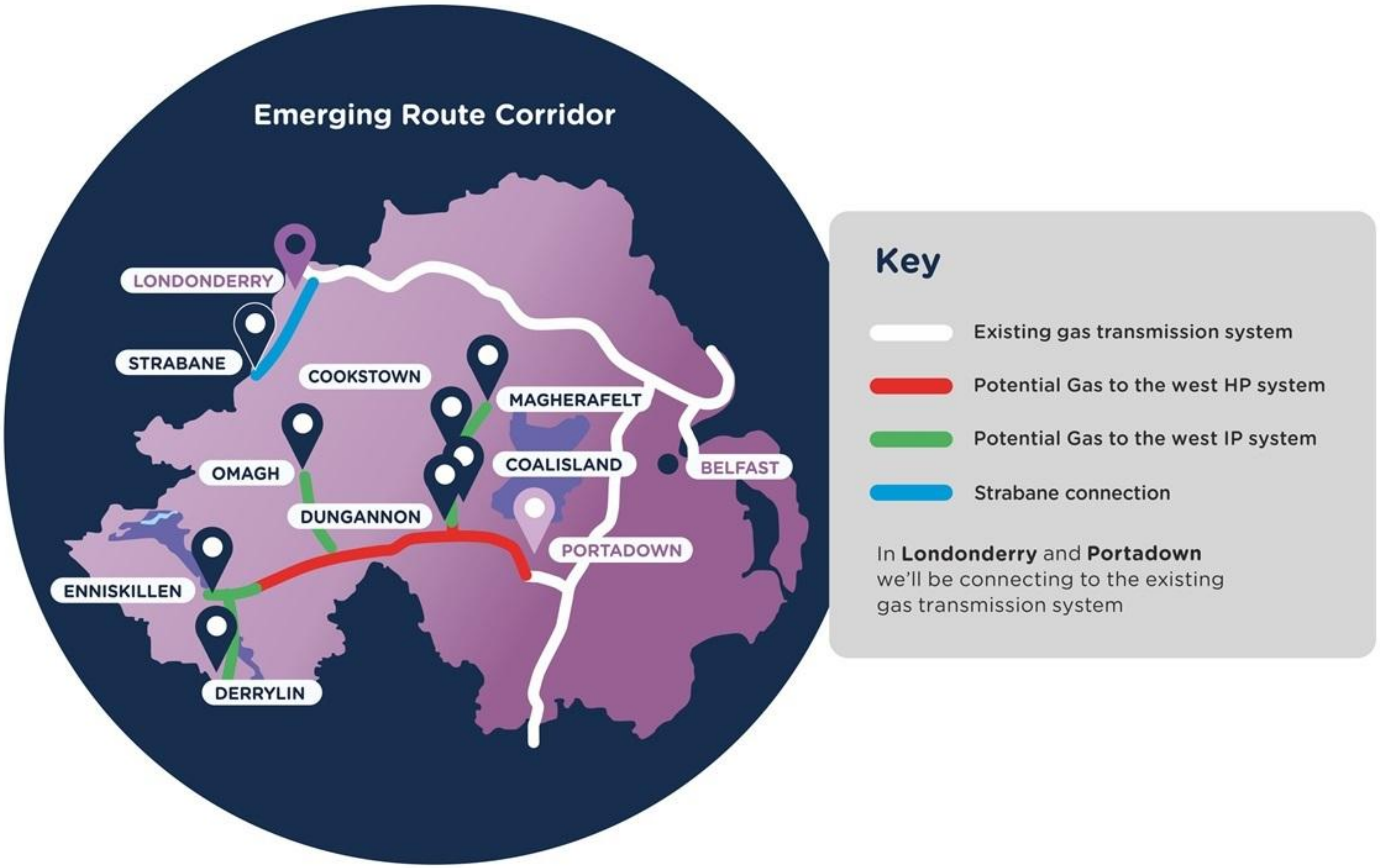


FE Area



LONDONDERRY
LIMAVADY
COLERAINE
Portrush
Portstewart
Bushmills
Ballymoney
Ballycastle
BALLYMENA
ANTRIM
LARNE
CARRICKFERGUS
BANGOR
NEWTOWNABBEY
BELFAST
NEWTOWNARDS
LISBURN
DUNMURRY
COOKSTOWN
OMAGH
Strabane
Donegal
LETTERKENNY
Buncrana
Dungannon
PORTADOWN
LURGAN
Craigavon
ARMAGH
BANBRIDGE
DOWNPATRICK
NEWRY
Warrenpoint
Kilkeel
Newcastle
ENNISKILLEN
MONAGHAN
Clones
CASTLEBLAYNEY
CARRICKMACROSS
DUNDALK
CAVAN
SLIGO
Ballyshannon
Bundoran
LOUGH NEAGH
DONEGAL
LONDONDERRY
ANTRIM
TYRONE
FERMANAGH
ARMAGH
DOWN
MONAGHAN
CAVAN
LEITRIM
NORTH CHANNEL

SGN Area


Emerging Route Corridor
LONDONDERRY
STRABANE
COOKSTOWN
MAGHERAFELT
OMAGH
COALISLAND
BELFAST
DUNGANNON
PORTADOWN
ENNISKILLEN
DERRYLIN
Key
Existing gas transmission system
Potential Gas to the west HP system
Potential Gas to the west IP system
Strabane connection
In **Londonderry** and **Portadown** we'll be connecting to the existing gas transmission system

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 to grow the Network
- GD17 is proposed to cover 6 calendar years (2017–2022)
- Paid for by consumers via Network Charges

How do we go about this?

- GD17 Consultation on Approach 19 December 2014

  http://www.uregni.gov.uk/uploads/publications/2014-12-19_GD17_Price_Control_Scope_-_Final.pdf

- GD17 Updated Approach 17 April 2015

  http://www.uregni.gov.uk/uploads/publications/2015-04-17_GD17_-_Approach_Document_-_Final.pdf

- GD17 Business Plan Submission Templates 14 May 2015

  http://www.uregni.gov.uk/uploads/publications/2015-05-14_Business_Plan_RIGS_-_FINAL.pdf

- Submissions by PNGL, FE & SGN in 2 phases

  Phase 1 – 30 June 2015

  Phase 2 – 30 September 2015

- GD17 Draft Determination 16 March 2016 – for consultation

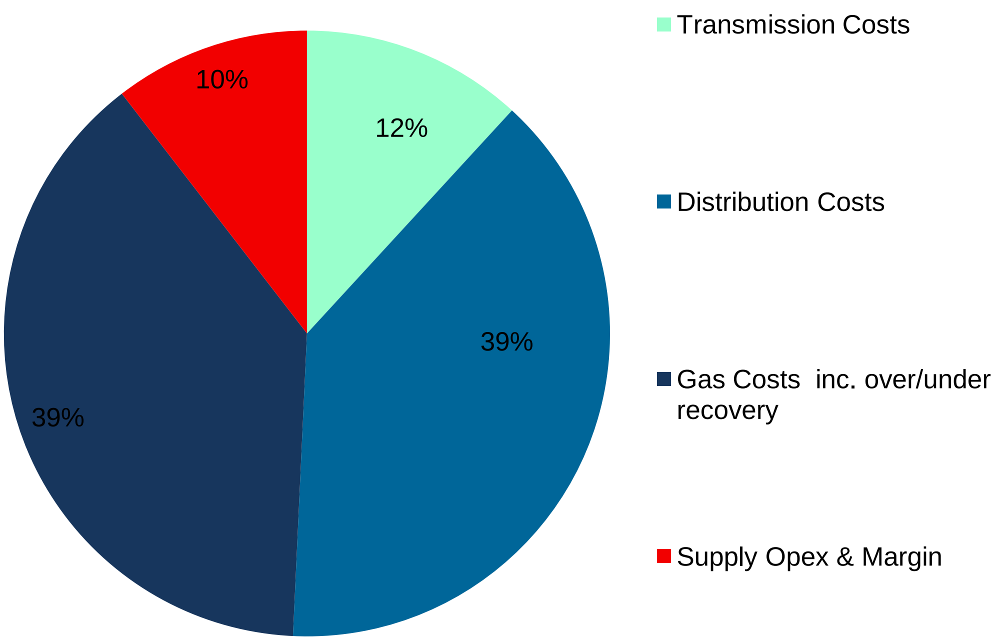
  http://www.uregni.gov.uk/uploads/publications/2016-03-16_GD17_Draft_Determination_-_Final.pdf

How do price controls affect tariff consumer bills? - PNGL

- PNGL charge the Supply company (e.g. Airtricity) for use of the network

- Suppliers pass-through this charge to consumers in their bills – c.39% of a tariff customer's final bill is distribution charges

- The Utility Regulator regulates this charge to protect consumers



Airtricity Tariff 1 April 2016

FE Supply tariff is Similar

http://www.uregni.gov.uk/uploads/publications/Briefing_Paper_on_SSE_Airtricity_Tariff_Review_-_Feb_2016.pdf

Key Figures (Post Efficiency)

GD17 Outputs (2014)	Key	PNGL		FE		SGN	
6 Year Duration		BPT	DD	BPT	DD	BPT	DD
Capex	£m	114*	87*	89	79	45	39
Opex	£m	107	82	48	35	13	8
Volumes	Therms m	964	951	398	403	116	166
New connections	000	53	54	26	30	6	9
Revenues	£m	357	308	126	101	18	22

*** PNGL Capex submission includes £2m in relation to East Down**

As requested by GDNs (Business Plan Templates (BPT)) and consulted on in GD17 Draft Determination (DD)

Impact on consumer bills

The table below shows the impact of the GD17 DD proposals on the existing domestic tariff compared to the GD17 GDN Business Plan submissions

P1 Tariff (pence per therm-ppt)			
GDN	GD14 Tariff	GD17 GDN Submitted Tariff	GD17 UR DD Tariff
PNGL (Sep £2014)	39.7	42.1	36.6
FE (Av £2014) - 40 yr Model	47.3	45.0	35.7
SGN (Av £2014)	N/A	37.1	32.1

Domestic Customer	Update for 1 April 2016 tariff reduction		
GDN	Distribution Tariff reduction (pence)	Overall Retail Saving Per Annum(£)	Overall Retail Saving
PNGL (Sep £2014)	-5.5	-21.9	-5.2%
FE (Av £2014) - 40 yr Model	-9.3	-36.8	-8.8%
SGN (Av £2014)	-5.1	-20.1	-4.8%

3 Key Areas

WACC- PNGL & FE

- WACC sits at 7.5% pre-tax real up to 2016. Modelling assumption in GD14 for 2017 onwards was 4.83%.
- Will use the Capital Asset Pricing Model (CAPM) for GD17 which is widely used within the Regulatory Industry
- This looks at the components needed in building up a rate of return e.g. gearing, equity and debt

WACC- PNGL & FE

- Cost of Debt
  – Approach is to link to market data on what companies with similar risk profile would pay
  – Debt currently cheap and GDNs will be raising significant amounts in GD17. Refinancing of Debt is due in 2017 (PNGL) & 2019 (FE)
- Proposing a Debt Adjustment Mechanism with a pain/gain approach
  – This will result in sharing of the differential between the rate set in GD17 and the rate achieved by the GDNs
- Cost of Equity
  – CAPM uses risk free rate and equity risk premium – not company specific
  – ‘Beta’ reflects the risk of the GDNs relative to the market.

Rate of Return (Weighted Average Cost of Capital)

Regulator / Company	PNGL	FE
Gearing	55%	55%
Pre-tax cost of equity	6.3%	6.3%
Cost of debt	2.26%	2.33%
Overall rate of return	4.21%	4.25%

Recommendation for FE and PNGL = 4.3%

Recommendation for SGN = 6.2%
(Set as part of Competitive Competition in award of the licence)

Connections Incentive Mechanism

Utility Regulator
ELECTRICITY GAS WATER

What is this for ?

The connection incentive is a per connection allowance to encourage the connection of domestic owner occupied (OO) properties (Includes rented properties). It is up to the GDNs how they spend this.

What is the Mechanism?

- The mechanism emphasises the need for connections to be economic.
- Allowance per connection is calculated using the formula:

Allowance per connection = (Revenue per connection) – (Direct capex cost per connection)

- Allowance excludes a certain % of targeted connections as it is assumed that some customers would connect to gas without any direct selling or marketing.

Connections Incentive Mechanism

- GD14 provided an allowance per connection of £573
- GD14 indicated that these costs may be reduced by 50% for GD17
- In GD17 using the Economic test, the allowance came to £420
- Consulting on a glide path to ease the transition from the existing allowance
- This allowance covers ca. £20m

Connection Incentive Glide Path	2017	2018	2019	2020	2021	2022
Allowance per Connection	550	520	500	470	450	420

- Refer to consultation, paragraphs 6.56 – 6.67, 6.200- 6.214, 6.435- 6.454

Connections Numbers

- Set connection numbers based on past history and future development of the network
- Keep as in GD14 a risk/reward incentive on connections
- Consider the connection targets should be set over duration of the price control as opposed to on an annual basis as in GD14

Connections Numbers

- Refer to consultation, paragraphs 6.69-6.75 & 6.215 – 6.226 & 6.435- 6.443

	Actual				Forecast	GD17 DD					
PNGL Connection Nos. - OO	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Business Plan Request	3,700	3,700	5,100	4,700	4,300	4,145	4,145	4,238	4,443	4,452	4,428
Determination Target	4,200	4,200	6,500	6,500	6,500	5,800	5,650	5,500	5,350	5,200	4,900
Actual	6,575	8,242	7,751	6,500	5,500						
FE Connection Nos. - OO	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Business Plan Request	400	400	2,000	2,000	2,000	2,466	2,537	2,622	2,753	2,100	3,246
Determination Target	800	800	2,000	2,000	2,000	2,600	2,950	3,300	3,600	3,900	4,100
Actual	1,879	2,155	1,620	1,980	2,000						

	2018	2019	2020	2021	2022	Total
SGN G2W application	1217	1217	761	761	761	4717
SGN GD17 BP submission	398	633	869	1105	1219	4386
UR draft determination	1294	1294	809	809	809	5015

Infill Mechanism

- Assessing economic levels of infill mains
  - 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 propose an economic allowance per property passed. (See Table 88 of DD)

- Propose to keep a risk/reward mechanism as in GD14

ANY FURTHER QUESTIONS

Next Steps

- Consultation ends: **Tuesday 31st May 2016, 12 Noon**
- We welcome comments on our proposals
- Send responses to Gas_networks_responses@uregni.gov.uk with cc to paul.harland@uregni.gov.uk
- Final decision will be published in September 2016

Useful Links:

GD17 Consultation:

http://www.uregni.gov.uk/uploads/publications/2016-03-16_GD17_Draft_Determination_-_Final.pdf

Thank you for your participation