

Notice under Article 8(4) of the Gas (Northern Ireland) Order 1996

19 July 2012

Phoenix Natural Gas Limited (PNGL) is fully supportive of the further development of the natural gas industry throughout Northern Ireland in a transparent and consistent manner.

Natural gas has been available in the PNGL Licensed Area since 1996. As at 31 December 2011, PNGL had made gas available to c.292,000 properties, of which c.148,000 (51 per cent.) have connected to the PNGL network.

The PNGL licence ensures that the vast majority of industry, businesses, homeowners, public sector housing and new housing developments are provided with the opportunity to make the switch to natural gas. The mandatory development plan which was embedded in PNGL's 1996 licence reflected the primary objective for both PNGL and the Utility Regulator (UR) of making gas available widely within the PNGL Licensed Area, since this would facilitate the future growth of the natural gas market. The mandatory development plan required PNGL to develop a sustainable network through which natural gas would be available to no less than 81% of all properties within its Licensed Area, within a fixed rolling timescale. PNGL has always met (and in fact exceeded) its licence obligations in respect of network coverage and has also been successful at extending its Licensed Area to make natural gas available to Comber and to several large commercial premises in adjacent areas.

Following completion of the North West transmission pipeline in 2004 and the South North pipeline in 2006, firmus energy (firmus) was granted a licence which concentrates on providing natural gas primarily to businesses, public sector housing and new housing developments in the ten towns along these transmission pipelines.

The firmus "ten towns" operation has made natural gas available to c.46,000 properties in the 7 years since its licence was granted, out of a total potential of c.140,000, with only c.11,000 customers choosing to switch to natural gas in this period. With homeowners only able to connect to the network if their properties are adjacent to the routes designed to meet business demand for natural gas **and** a low regulatory target of connecting only 400 homeowners each year, it is reasonable to assume that the vast majority of connections to the firmus network are businesses, public sector housing and new housing developments. The firmus business model is therefore currently, based on these high level figures, excluding c.95,000 properties, or c.12% of the Northern Ireland population, from having the option of switching to natural gas. The existing firmus business model has made natural gas available to less than one third of properties in its Licensed Area and has connected less than 8% of properties in its Licensed Area.

PNGL has proven that the natural gas industry in Northern Ireland can be successful if licensees are clearly targeted with making natural gas available to the maximum number of people economically viable. PNGL's operation has delivered true benefits including preventing c.3m tonnes of CO₂ from entering NI's atmosphere by customers connected to the PNGL network. Millions of pounds of energy efficiency savings have been enjoyed and over £600m has been invested in the local

economy. Jobs have been created, new opportunities for businesses developed, and brand new enterprises established.

In relation to the proposed licence extension to the firmus Licensed Area, PNGL would ask for clarification on the following:

The firmus Licensed Area

The table in Schedule 1 of the firmus licence has two columns:

- Can UR confirm that the left-hand column of Schedule 1 of the firmus licence contains the Electoral Wards of the “ten towns”? Can UR confirm that these towns and the Electoral Wards which have been designated as Additional Development Areas (i.e. Strand, Atlantic, Portstewart, Parkgate, Doagh, Ballyclare North, Ballyclare South, Ballyrobert, Derryleckagh, Burren, Kilbroney, Clonallen and Seaview) are currently subject to exclusivity?
- Can UR confirm that the right-hand column of Schedule 1 of the firmus licence (excluding the 13 Electoral Wards listed above which have been designated as Additional Development Areas) details Electoral Wards currently within the firmus Licensed Area but, given that they have not been designated as Additional Development Areas, are now no longer subject to exclusivity? If so:
 - Can UR confirm the process that UR will follow should either PNGL or firmus wish to convey gas to one of these Electoral Wards?
 - Can UR confirm the business model that will be applied should either PNGL or firmus wish to convey gas to one of these Electoral Wards or indeed to Electoral Wards (such as Bushmills and Ballylough) which currently fall outside the PNGL and the firmus Licensed Areas i.e. will extensions benefit the vast majority of homeowners as per the PNGL licence or only those adjacent to routes developed to meet business demand for natural gas as per the firmus licence?
 - Can UR clarify whether the firmus classification of the Electoral Ward of Dunluce as falling within its exclusive area (see “Drawing No. Bushmills 4” published as part of the notice) is correct given that the Electoral Ward of Dunluce lies within the right-hand column of Schedule 1 of the firmus licence?
 - If the Electoral Ward of Dunluce is no longer subject to exclusivity, can UR confirm the process that UR has followed given that firmus is proposing to construct the pipeline infrastructure necessary to bring gas to the Old Bushmills Distillery through the Electoral Ward of Dunluce?
- PNGL notes that the Electoral Wards of Bushmills and Ballylough do not currently fall within either column and are not therefore within either the PNGL or the firmus Licensed Areas. Can UR confirm that firmus is not seeking exclusivity for the Electoral Wards of Bushmills and Ballylough as part of proposed licence extension?

The proposed business model

As described above, the “ten towns” licence granted to firmus concentrates on providing natural gas primarily to businesses, public sector housing and new housing developments; homeowners may only connect to the network if their properties are adjacent to routes designed to meet business demand for natural gas. In contrast, the PNGL licence ensures that the vast majority of industry, businesses, public sector housing, new housing developments and homeowners are provided with the opportunity to make the switch to natural gas.

UR’s Press Release reports that the proposed extension is part of a larger investment package, totalling around £8m, for the firmus Licensed Area. UR quotes the three elements of the proposed investment package and we discuss each of these separately:

1. £1.5m investment to make gas available to the Old Bushmills Distillery, around 400 existing residential properties and a further 45 properties in Northern Ireland Housing Executive (NIHE) estates in the Bushmills area, and a number of small and medium-sized commercial entities;
 - Given that the Electoral Wards of Bushmills and Ballylough do not currently fall within the firmus or the PNGL Licensed Area, can UR confirm whether this investment follows the firmus business model or the PNGL business model i.e. will the extension benefit the vast majority of homeowners as per the PNGL licence or only those adjacent to the route designed to bring gas to the Old Bushmills Distillery as per the firmus licence?
 - If the investment follows the PNGL business model, can UR confirm whether this signals UR’s acceptance that the PNGL business model is more aligned with Northern Ireland energy policy? Can UR also confirm that the PNGL business model will be applied to all future licence extensions where entire Electoral Wards are granted? Can UR confirm whether this signals UR’s acceptance of the PNGL business model over the firmus business model and if so, whether the PNGL business model will be rolled out across the firmus Licensed Area?
 - If the investment follows the firmus business model and only those adjacent to the Old Bushmills Distillery pipeline will benefit, can UR confirm why it made the decision to propose awarding firmus the entire Electoral Wards rather than extend the firmus Licensed Area to include the route of the pipeline as per the PNGL licence extensions to the McQuillan and Temple quarries and the Cranmore Pet Crematorium?
 - Can UR confirm if this investment brings the benefits of natural gas to consumers within the three Electoral Wards of Dunluce, Bushmills and Ballylough?
 - Can UR confirm that it will place an obligation on firmus to make gas available to the existing 400 residential properties? If not, the claim of an additional £1.5m investment by firmus is misleading as this can only be realised if the outputs upon which the investment is based are achieved.

- Can UR confirm when the benefits of the £1.5m investment will be fully realised i.e. when will the Old Bushmills Distillery, the c.400 existing residential properties, the 45 NIHE properties and the number of SMEs be able to connect to the network? Can UR confirm whether firmus will be incentivised to deliver this investment as quickly as possible?
 - UR's principle objective is to ensure industry development is economic. UR's interpretation of this objective in the past has meant granting approval to projects that are expected to break even or better. Can UR therefore confirm that this investment is economic i.e. that the financial model to bring the benefits of natural gas to the Electoral Wards of Bushmills and Ballylough via the Electoral Ward of Dunluce, shows a NPV positive outcome? If not, can UR explain why it has deviated from this policy?
 - Can UR confirm what rate(s) of return has been determined for the £1.5m investment and over what period this rate(s) of return has been applied?
 - Can UR confirm the level of distribution charges assumed for the investment and how these compare with the current charges within the existing firmus Licensed Area?
2. £2.2m to extend the gas distribution network to connect to new industrial customers in Ballymena and Coleraine and make gas available to other properties along the proposed pipeline route;
 - Ballymena and Coleraine are within the original firmus "ten towns" Licensed Area. The "ten towns" licence granted to firmus concentrates on providing natural gas primarily to businesses, public sector housing and new housing developments. This £2.2m investment is therefore part of the original firmus business plan and does not signify any additional investment by firmus above that required to meet its licence requirements.
 3. £4.4m to facilitate new connections proposed by the NIHE in its properties. This investment will be in associated mains, connections and meters that should supply in excess of 2,000 properties.
 - The "ten towns" licence granted to firmus concentrates on providing natural gas primarily to businesses, public sector housing and new housing developments. This £4.4m investment in public sector housing is therefore part of the original firmus business plan and does not signify any additional investment by firmus above that required to meet its licence requirements.

The additional investment proposed by firmus above that required to meet its licence requirements is therefore the £1.5m investment to make gas available to the Old Bushmills Distillery, the c.400 existing residential properties, the 45 NIHE properties and a number of SMEs (see point 1 above). It could therefore be interpreted as misleading for UR to suggest that an additional c.£6.5m is being invested by firmus (see points 2 and 3 above) when this investment is required by firmus in order to meet the terms of its licence.

We believe that these critical points raised by PNGL need to be addressed by UR in order to deliver the required level of regulatory transparency and enable PNGL to make an informed decision before it is able to support the proposed licence extension. Therefore unfortunately due to the lack of information provided by UR in its consultation, PNGL objects, at this time, to the proposed licence extension.