



Manufacturing NI's response to the "Price Control for Northern Ireland's Gas Distribution Networks (GD17) Draft Determination".

Manufacturing NI represents some 550 businesses across NI, many in the gas distribution network area and the proposed extension areas.

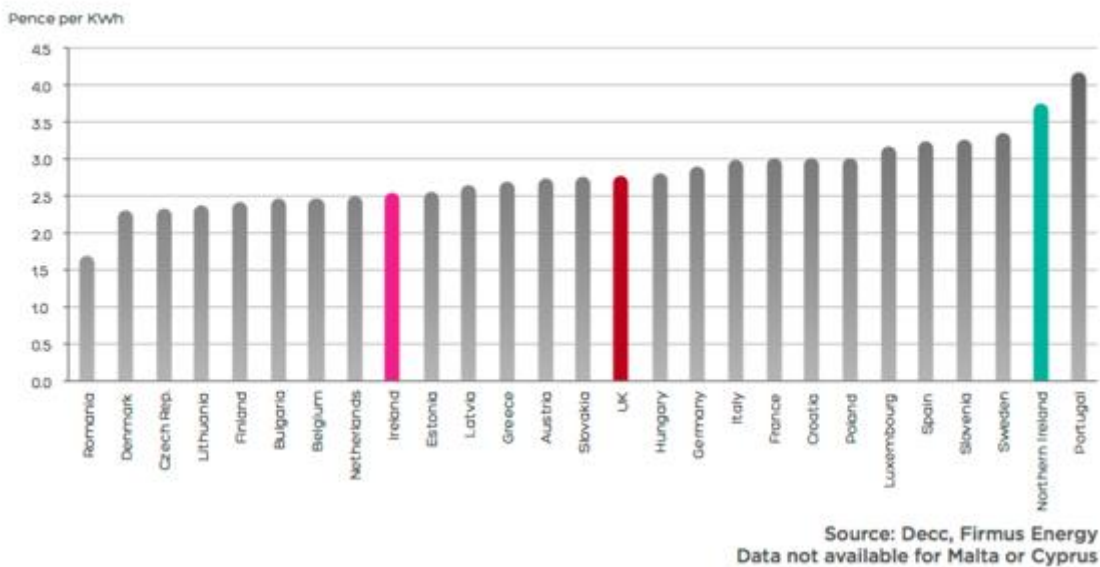
We recently published research from Oxford Economics on the economic impact manufacturing has on the NI economy, on jobs, GVA, exports and a raft of other economic measures. This is available here: <http://goo.gl/m4UlwQ>

In summary, the report shows that no other part of our economy delivers these outcomes more than the manufacturing sector...

- 214,000 direct and supported jobs, 1 in 4 of all jobs in the economy.
- A £9.9bn total GVA contribution, around 30% of the economy.
- Productivity at £55,700 is 38% higher than NI average with advanced manufacturing contribution 27% more.
- Exports at £6bn, almost two-thirds of all export sales.
- £254 million in R&D in 2014, accounting for over 60 percent of total business investment
- Attracting £900 million in FDI Between 2010 and 2014.

In addition, the report also uncovered the cost pressures on NI's manufacturing and how this impacts on competitiveness and ultimately the NI Executive's priority to grow the NI economy. Most relevant, for what we believe to be the first time, an EU comparison on final delivered gas prices for was reported. Oxford Economics estimate that the average unit cost of Gas for a typical industrial and commercial user is the second highest in the EU, 35 percent higher than the equivalent cost in the UK and 47 percent higher than the cost in Ireland. As the gas wholesale price is the same regardless of location in the EU, this difference can only be explained by the cost of gas distribution.

Fig. 33. Industrial gas prices in the EU for small consumers, ex Vat, H1 2015



Of course, given the relatively recent capital investment in the gas network, there may be good reasons for some of this price differential. However, we believe that it is critical that the Utility Regulator does what it can to improve NI's competitiveness, contribute to the economic development of the region and protect consumers for prices which reward the networks at the expense of the consumer. In this regard, we support much of what is proposed in the GD17 Draft Determination as this is one of very few levers that the Utility Regulator has to in its disposal in order to protect consumers now and in the future.

In particular, we would comment on the following areas:

Price Control period

We support the UR's ambition that GD17 would be a 6-year period. Price controls are expensive processes for all parties with the final bill picked up by the consumer. Additionally, a 6-year Price Control period allows for great certainty in planning for businesses which is helpful to secure budgets and indeed release investment.

WACC

We welcome and support the UR's view that the WACC should be reduced from 7.5%. There has not been a better time to 'buy' debt and equity. Rates are at record lows for a prolonged period of time. There is no requirement for WACC rates on 7.5%. Indeed, a 4.30% for Firmus and Phoenix in our view is still very attractive for the companies and, as rumoured, prospective buyers.

"Negative Watch"

We understand that whilst there is no requirement for Firmus, there remains a requirement for PNGL to have a view from a "Ratings Agency". In our view, Rating Agencies do not provide an

independent view. They are funded by the companies themselves. Whilst PNGL may say they are concerned as being on “negative watch” as a result of the publication of this draft determination, it must be remembered that in GD14, there were similar concerns yet PNGL were sold at a high valuation within weeks of the Final Determination. We do not support the view that a “negative watch’ view from a rating agency, funded by PNGL, will have a detrimental impact on the company and as a result consumers so would encourage the UR to remain firm in their outcomes in the Draft Determination.

The UR will be aware of the deep concern about the performance and validity of rating agencies and the EUs determination to address these concerns including encouraging companies themselves to provide credit assessments.

Financeability

We believe that PNGL is sufficiently funded. Decisions on its gearing and how it rewarded investors through dividend have clearly pointed towards their view of supporting investors at the expense of consumers in our view.

From reading the Draft Determination, there remains some debate from us on the Firmus plan however which we would encourage the UR to provide some review to ensure that its proposals offer the opportunity for greater penetration of commercial gas users in their network area. As things stand, the level of detail in the draft determination requires consumers (and representatives) to trust that the UR analysis on this – which we do – however, perhaps some further clarity on the Firmus plan in particular would be beneficial.

Note – we do not believe any “prior commitments to investors” is a sufficient reason to amend a Draft Determination. Protecting consumers must be the primary responsibility.

SGN Business Plan

We do not see any reason why there should be any amendment from SGNs planned build and uptake numbers from their successful bid to win the “Gas to the West” contract. Indeed, should the UR consider this, we believe this could be subject to legal challenge from unsuccessful bidders given that this bid was awarded a relatively short time ago. We would encourage the UR to ensure that SGN deliver on their plan as already approved when winning this contract and public investment.

Forecasting Horizon Period

We support the plan from Firmus to extend the period from 30 to 40 years. This bring them in line with PNGL (and indeed SGN) and in our view would provide keener prices which will encourage more connections.

Firmus Under Recoveries

We support the proposal for the rate of return on under recoveries to shift to LIBOR +2%. As the UR will recall, a shift in how this was managed had a negative and indeed shock impact on bills for large gas users.

Profile Adjustments

We are concerned about the potential removal of Profile Adjustment. Gas remains more expensive than oil as a fuel and indeed available forward hedges remains competitive beyond winter 2018. Removing the Profile Adjustment now would have a negative impact on bills at a time when all the companies are keen to get more connections which, for business users, is largely decided on a straight cost saving basis. As already confirmed above, business gas users are already at a hugely significant cost disadvantage to competitor markets in the EU. Removing this Profile Adjustment now would widen rather than narrow this competitive gap and be counterproductive.

Pain / Gain Mechanisms

We support the inclusion of these in determinations – in gas and otherwise. This is a useful motivation for companies to drive better value which is shared with customers.

As presented in evidence above supplied by Oxford Economics, NI's business gas consumers are at a very significant cost disadvantage to competitors across the EU, particular those markets within the British Isles. Every effort must be made to ensure that costs are removed to ensure competitiveness and grow the economy and take up of the gas opportunity.

We are happy for this submission to be published.

Manufacturing NI
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www.manufacturingni.org