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Kevin O'Neill
Electricity Directorate
Utility Regulator
Queens House
14 Queen Street
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Dear Kevin

Northern Ireland Electricity Transmission and Distribution Price Control 2012-2017 Draft Determination

We refer to the Northern Ireland Electricity Transmission and Distribution Price Control 2012-2017 Draft Determination consultation paper, issued by the Utility Regulator (UR) on the 19th April 2012.

Phoenix Natural Gas Ltd (PNGL) does not have a full understanding of all the issues being consulted upon and as such this response will only provide some high level views about key principles being consulted on by UR.

It would appear that some of UR's proposals are of a retrospective nature, in particular those proposals relating to the costs and performance of Northern Ireland Electricity (NIE) prior to the most recent price control period. PNGL would have serious concerns with this aspect of the proposals to the extent that they undermine investor confidence; confidence which underpins incentives to operate efficiently and the ability of regulated utilities in Northern Ireland to raise finance at an efficient cost. If implemented, PNGL is concerned that the proposal will have the effect of increasing the risk faced by all companies regulated by UR, which will in turn mean investors will require a higher return on capital, leading ultimately to higher costs being borne by consumers.

The regulatory uncertainty created by proposals such as this from UR has already been experienced by PNGL. Following our own Price Control Determination, PNGL was placed on Ratings Watch Negative by Fitch. Following the referral of PNGL to the Competition Commission Fitch placed PNGL on Outlook Negative pending the outcome of the Competition Commission inquiry stating that "Fitch could change its view on predictability and supportiveness of the regulatory regime in Northern Ireland..." and "A revision of financial guidelines may lead to a ratings downgrade." PNGL is concerned that UR's proposals for the NIE price control will only serve to further undermine investor confidence in the regulatory environment in Northern Ireland.

PNGL also notes that the NIE proposals appear to result in a price control package that skews risk towards the downside, with very little opportunity for upside return. This is epitomised by, for example, the introduction of a reporter to sign off on capex plans, reflecting a drift towards more micromanagement in the regulatory framework. PNGL would urge UR to remember that best practice incentive regulation requires both that companies are penalised for poor performance, but (equally importantly) are appropriately rewarded for outperformance. A skew towards the downside in the price control package is likely to lead to investors requiring a higher cost of capital.

Finally, PNGL also notes the response of Fitch to the NIE proposals. Fitch stated that the proposal “provides for more challenging financing assumptions than Fitch Ratings would typically expect for a UK regulator. Together with the need for sizeable investment for renewables integration, the proposals raise concerns that the financial profile of the licence holder, Northern Ireland Electricity Limited (NIE, „BBB+/Negative), could deteriorate over the next five years.” Fitch also stated that the WACC proposals was low relative to NIE’s allowed WACC in the past, and in particular relative to “the 4.7% currently allowed for the electricity distribution networks in England and Wales, which additionally benefit from around 0.4% of incentives-based/additional income.”. PNGL agrees with Fitch’s observation and is concerned that UR would adopt a methodology that under-estimates the cost of capital.

Yours sincerely,

Ivan Bell

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Commercial Operations Director
Phoenix Natural Gas Ltd.