Price Control for Phoenix Natural Gas Ltd and firmus energy Distribution Ltd (“GD14”)

Friday 6 September 2013
Outline of presentation

- Overview of gas & background to PNGL & FE
- What is a price control?
- How price controls affect consumer bills
- Impact on consumer bills
- Price control process
- Utility Regulator proposals:
  - PNGL Capex & Opex
  - FE Capex & Opex
- Connections incentive mechanism
- Infill mains allowance
- TRV
- WACC
- PNGL Domestic Meter Exchanges
- Questions
Overview of Gas

- Principal objective of UR is to promote the development and maintenance of an Efficient, Economic, and Co-ordinated Gas Industry, in Northern Ireland

- Natural Gas Established in Northern Ireland in 1996

- End 2012 - Nearly 180,000 Customers connected

- Just Under 4,000km of pipes laid
Background to PNGL
Background to firmus energy
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
• Forms a Regulatory Asset Base
• This results in setting a charge for use of the pipes by consumers
• GD14 is proposed to cover 3 years (2014 – 2016)
How price controls affect consumer bills

• PNGL and FE charge suppliers (e.g. Airtricity and firmus Supply) for use of the network

• Suppliers pass-through this charge to consumers in their bills – c.35% of a tariff customer’s final bill is distribution charges

• The Utility Regulator regulates this charge to protect consumers
Impact on consumer bills

- Price control proposals would result in reduction to PNGL & FE distribution tariffs.

<table>
<thead>
<tr>
<th>Distribution Tariff: Domestic</th>
<th>PNGL (pence per therm)</th>
<th>FE (pence per therm)</th>
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</thead>
<tbody>
<tr>
<td>Previously determined tariff</td>
<td>43.37</td>
<td>51.33</td>
</tr>
<tr>
<td>GD14 minded to tariff</td>
<td>37.18</td>
<td>38.91</td>
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<tr>
<td>Difference</td>
<td>- 6.19</td>
<td>- 12.42</td>
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</table>

- Annual savings for a domestic customer (based on average consumption of 410 therms/annum):
  - PNGL: annual savings of £25/annum
  - FE: annual savings of £51/annum

- Difference will be greater for I&C customers, in particular large burning industrial customers

- Refer to consultation, chapter 13.
Price Control Process

• UR consults on Approach to price control

• PNGL & FE Submit a Business Plan including request for costs.

• UR Consider and Review

• Benchmark where appropriate

• Make a Draft Determination For Consultation

• Review Consultation Responses

• Make a Final Determination
Utility Regulator Proposals for PNGL Capex

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<tbody>
<tr>
<td>Capex</td>
<td>£40.8 million</td>
<td>£38.3 million</td>
<td>- £2.5 million</td>
<td>- 6%</td>
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</tbody>
</table>

**PNGL Capex Trending (£2012)**

- **Capex PC03 Actuals (Retro Adjusted)**
- **Capex PNGL12 Forecast**
- **Capex GD14 Submission**
- **Capex GD14 'Minded to'**
### Utility Regulator Proposals for PNGL Opex

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<tbody>
<tr>
<td>Opex</td>
<td>£50.3 million</td>
<td>£39.0 million</td>
<td>- £11.3 million</td>
<td>- 22%</td>
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</tbody>
</table>

**PNGL Opex Trending (£2012)**

- **Opex PC03 Actuals (Retro Adjusted)**
- **Opex PNGL12 Forecast**
- **Opex GD14 Submission**
- **Opex GD14 'Minded to'**
# Utility Regulator Proposals for FE Capex

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<tbody>
<tr>
<td>Capex</td>
<td>£39.2 million</td>
<td>£28.2 million</td>
<td>- £11.0 million</td>
<td>- 28%</td>
</tr>
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### FE Capex Trending (£2012)

- **Capex Actuals (Retro Adjusted)**
- **Capex Forecast**
- **Capex GD14 Submission**
- **Capex GD14 ‘Minded to’**
## Utility Regulator Proposals for FE Opex

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<tbody>
<tr>
<td>Opex</td>
<td>£26.3 million</td>
<td>£14.2 million</td>
<td>- £12.1 million</td>
<td>- 45%</td>
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**FE Opex Trending (£2012)**

- **Opex Actuals (Retro Adjusted)**
- **Opex Forecast**
- **Opex GD14 Submission**
- **Opex GD14 'Minded to'**
• GD14 aligns the approach for PNGL and FE.
• Mechanism which remunerates PNGL and FE on the basis of connections – an allowance is granted per connection.
• Allowance applies to owner-occupier (OO) domestic connections only
• Allowance excludes 25% of targeted connections as it is assumed that some customers would connect to gas without any direct selling or marketing.
• The mechanism emphasises the need for connections to be economic.
• Allowance per connection is calculated using the formula:

\[
\text{Allowance per connection} = (\text{Revenue per connection}) - (\text{Direct capex cost per connection})
\]

• Previously direct capex costs only included service and meter costs. However, infill mains costs are also included for GD14
Using this formula, the proposed allowance per connection is £480

Based on our proposed connection targets, this provides allowances as follows:

- PNGL: c.£2.3 million per annum
- FE: c. £600k per annum

As a result of Competition Commission recommendation we proposed a risk/reward incentive to:

- reward PNGL & FE if they exceed their target connections by increasing the per connection allowance for the additional connections, and
- penalise PNGL & FE if they do not meet their target connections by reducing the per connection allowance

Refer to consultation, paragraphs 5.12 – 5.45 & 6.10 – 6.34.
Infill Mains Allowance

- 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 determined an economic allowance per property passed is £507. This was based on a calculation of revenues and cost of passing properties.
- Proposed incentive to extend network:
  - Failure to achieve target number properties passed - penalty of £50 for each property
  - Passing more properties than target – reward of £20 per additional property over the target
- Proposed target properties passed:

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<tr>
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<th>Existing Housing Domestic and I&amp;C</th>
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<th>New Build Domestic</th>
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<tbody>
<tr>
<td>PNGL</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>FE</td>
<td>5,431</td>
<td>5,070</td>
<td>3,987</td>
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Outperformance is normally shared with consumers.

Competition Commission determined it should not be for 2012 and 2013.

We have proposed that there are no adjustments to PNGL TRV and none of this historic outperformance will now be shared with consumers.

**PNGL Total Regulatory Value (TRV)**

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<th>Components</th>
<th>£ m</th>
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<tr>
<td>Net investment, less depreciation plus working capital</td>
<td>213.3</td>
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<tr>
<td>Historical under-recoveries of revenue (1996-2006)</td>
<td>73.0</td>
</tr>
<tr>
<td>Unspent allowances: including deferred capex and historical outperformance (1996 - 2006)</td>
<td>65.6</td>
</tr>
<tr>
<td>Profile adjustment</td>
<td>85.2</td>
</tr>
<tr>
<td>Total TRV</td>
<td>437.1</td>
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</table>
• This is the return given to PNGL & FE for investing in the gas network.
• For PNGL & FE, we propose to set a rate of return of 7.5% (pre tax, real) for 2014 – 2016.
• For 2017 we will determine WACC at the next price control using CAPM in line with other regulators.
• We have included some initial thoughts on this in consultation.
• We have used GB GDN rate of 4.83% for modelling purposes.
Regulated asset values as multiples of totex across UK regulated sectors

![Diagram showing regulated asset values as multiples of totex across UK regulated sectors.](image)
PNGL Domestic Meter Exchanges

• PNGL current policy
  – One free domestic meter exchange (from credit to prepay or vice-versa) at a domestic property per annum
  – Additional meter exchanges will be charged to customer

• Proposed new policy
  – Credit to prepay meter exchanges will be free to customer
  – Prepay to credit meter exchanges will be charged to customer (with exception for vulnerable customers)

• Refer to consultation, paragraph 5.84 onwards & paragraph 1.30 in appendix 1.
ANY FURTHER QUESTIONS
Next Steps

• Consultation ends: **Friday 20th September 2013, 5pm**

• We welcome comments on our proposals

• Send responses to paul.harland@uregni.gov.uk

• Final decision will be published in December 2013

**Useful Links:**
GD14 Consultation:

Update on Approach:
www.uregni.gov.uk/publications/update_on_our_overall_approach_for_the_price_controls_of_nis_gas_distributi
Thank you for your participation