

# **Consultation on CMA Decision on GD17 referral by firmus energy**

**19 December 2017**



# About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

## Our Mission

Value and sustainability in energy and water.

## Our Vision

We will make a difference for consumers by listening, innovating and leading.

## Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

## Abstract

The UR published a decision paper on the GD17 licence modifications for FE's gas conveyance licence on 28 October 2016. FE appealed against elements of the GD17 Decision by submitting a Notice of Appeal (NOA) to the CMA on the 25 November 2016, and has commented on these costs as part of that appeal. Our response to the FE submission was submitted on the 19 January 2017. The CMA made its decision on 27 June 2017 following engagement and representations made by firmus energy, CCNI and the UR. This consultation is made pursuant to the CMA final decision for the UR to make a decision on Grounds 2A connection targets and Grounds 2B non additionality. We welcome stakeholder feedback on any aspect of this Consultation document.

## Audience

The licensee affected, other regulated companies in the energy industry, government, other statutory bodies and consumer groups with an interest in the energy industry.

## Consumer Impact

The CMA decision will set a precedent for other regulated entities and price controls. The overall impact on consumers will be expected to be minimal; however the process will impact on future activities and price control allowances.

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## ACRONYMS AND GLOSSARY

CCNI	Consumer Council for Northern Ireland
CMA	<p>Competition and Markets Authority.</p> <p>The Competition and Markets Authority (CMA) is a non-ministerial government department in the United Kingdom, responsible for strengthening business competition and preventing and reducing anti-competitive activities. The CMA began operating fully on 1 April 2014, when it assumed many of the functions of the previously existing Competition Commission and Office of Fair Trading, which were abolished.</p>
FD	Final Determination
FE	firmus energy (Distribution) Ltd
FOIA	Freedom of Information Act 2000
Gas Order	The Gas (Northern Ireland) Order 1996
GD14	This is the name given to the price control for PNGL and FE covering the period 2014 – 2016 (calendar years).
GD17	This is the name given to the next price control for the NI GDNs. It is proposed to cover the period 2017 – 2022 (calendar years).
GDN	Gas distribution network operator – FE, PNGL and SGN
i.e.	that is
NI	Northern Ireland
Opex	Operating expenditure
OO (Domestic)	<p>Owner Occupied Domestic Premises which do not fall into the definition of:</p> <ul style="list-style-type: none"> <li>• Domestic New Build;</li> <li>• NIHE;</li> <li>• Housing Association</li> </ul>
PNGL	Phoenix Natural Gas Limited
SGN	SGN Natural Gas Limited

Third Gas Directive	Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC
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# 1 Introduction

## Purpose of this Document

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- 1.1 With this document we are consulting on licence modifications we propose to make to Condition 4.7 of the gas conveyance licence for Firmus Energy (Distribution) Limited.
- 1.2 We (the Utility Regulator, the Authority) consider that the licence modifications proposed in this document are required to comply with our legal and regulatory obligations (summarised in section 'Legal and Regulatory Framework' below), to give effect to our conclusions on matters which were remitted back to us for reconsideration and determination by the Competition and Markets Authority (the CMA) following an appeal by Firmus Energy (Distribution) Limited (FE) in respect of a decision on licence modifications made by the Utility Regulator to implement the GD17 final determination.
- 1.3 GD17 is the price control period for Gas Distribution Networks: firmus energy (FE), Phoenix Natural Gas Limited and SGN which sets allowances for companies to run their businesses and invest in the gas network for the period 1 January 2017-31 December 2022.
- 1.4 In September 2016 we published our [decision](#) on GD17 and our statutory consultation on licence modifications to enact the price control allowances into the respective licences of GDNs. Following careful consideration of consultation responses and other relevant factors, on 28 October 2016, the UR published its decision to modify the gas conveyance licences of the three GDNs in NI (the GD17 Decision).
- 1.5 On 25 November 2016, FE brought an appeal to the CMA against the Decision to modify the conditions of its licence. On 28 December 2016, the CMA granted FE permission to appeal to the CMA. The CMA reached its [final determination](#) on 28 June 2017.
- 1.6 FE's appeal had four grounds, further subdivided into 12 sub-grounds. The CMA upheld the Utility Regulator's price control decisions in respect of nine sub-grounds. For the remaining three sub-grounds, the Utility Regulator had already made a [decision](#) on one area (GIS costs). The Order of the CMA which gave effect to its final determination remitted two grounds of appeal back to the Utility Regulator for reconsideration and determination as follows:
  - Ground 2A – in respect of Connection Targets;
  - Ground 2B – in respect of connection incentive Non-Additionality.
- 1.7 We have concluded our reconsideration of the matters remitted to us and we now propose licence modifications necessary to give effect to the conclusions we have reached.

- 1.8 The purpose of this document is to consult on the proposed licence modifications to bring them into effect.

## Approach

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- 1.9 We have reconsidered the two matters remitted back to us by the CMA.
- 1.10 In respect of Ground 2A - Connection Targets, we obtained additional information from FE on the processes it used to collect properties passed and properties connected data and how it determined property type. Based on this historical information we recalculated connection projections for owner occupied properties for GD17 to arrive at revised connection targets. More detailed information on our reconsideration of Ground 2A - Connection Targets is given in Chapter 2.
- 1.11 In respect of Ground 2B – Non-Additionality, we reconsidered three approaches which we had initially presented to the CMA in response to the FE appeal. In addition, we commissioned a consumer survey to allow consumers in the FE area to tell us:
- the reasons they connected to gas;
  - whether they could recall exposure to FE advertising/activities prior to connecting to natural gas; and,
  - whether being exposed to FE advertising/activities had, in any way, influenced their decision to connect to natural gas.
- 1.12 Based on a review of previous methodologies and the additional information provided by the consumer survey, we reached conclusions on a reasonable level of non-additionality. More detailed information on our reconsideration of Ground 2B – Non-Additionality is given in Chapter 3.
- 1.13 We then considered other consequential effects of our reconsideration and determination of connection targets and non-additionality. This included the impact of reducing connection projections on capital investment, operational costs and projected gas volumes. The revised values were used in our financial and tariff models for GD17 to calculate revised “determined values” which are included in Condition 4.7 of the licence.
- 1.14 In proposing the licence modifications outlined in this consultation, we have considered the comments and further information we have received from FE as well as other relevant factors and analysis.

## Legal and Regulatory Framework

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- 1.15 Our principal objective in carrying out our gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so consistently with our fulfilment of the objectives set out in the

European Gas Directive<sup>1</sup>, and by having regard to a number of matters, as set out more fully in the Energy (Northern Ireland) Order 2003<sup>2</sup>.

- 1.16 In fulfilment of our duties, we may propose to make modifications to gas licences under Article 14 of the Gas (Northern Ireland) Order 1996<sup>3</sup> (the Gas Order). Article 14 sets out, in particular, the process we need to follow when making licence modifications. We need to give notice of at least 28 days of the proposed modification. We must give due consideration to any representations made during this period and, if we decide to proceed to modify the licence, publish our decision together with the licence modifications, stating the effect of the modifications and the reasons for any changes made from the consultation version. The effective date for the licence modification must be at least 56 days after the publication of the licence modification decision.
- 1.17 Since the coming into effect of the Gas and Electricity Licence Modifications and Appeals Regulations (Northern Ireland) 2015<sup>4</sup> on 6 February 2015, the consent of the licence holder is not required for a modification to their licence. However, any licence modification decision made under Article 14 of the Gas Order may be appealed to the CMA by:
- the licence holder concerned;
  - any other licence holder materially affected by the decision;
  - a qualifying body or association representing a licence holder concerned or a licence holder materially affected by the decision; or
  - the Consumer Council for Northern Ireland.
- 1.18 If an appeal is brought to the CMA, the CMA will as a first step decide whether or not to give permission for the appeal to proceed. If permission is granted, the CMA has a period of 4 months, or in the case of licence modifications relating to price controls- 6 months, in which to determine the appeal. These timelines can be extended to 5 months and 7 months respectively, if required.

## Document Structure

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- 1.19 This consultation document is structured as follows:

- Chapter 2 sets out our reconsideration and determination of Ground 2A – Connection Targets.
- Chapter 3 sets out our reconsideration and determination of Ground 2B – Non-Additionality.

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<sup>1</sup> Directive 2009/73/EC of the European Parliament and the Council of 13 July concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC.

<sup>2</sup> <http://www.legislation.gov.uk/nisi/2003/419/contents>.

<sup>3</sup> <http://www.legislation.gov.uk/nisi/1996/275/contents>.

<sup>4</sup> <http://www.legislation.gov.uk/nisr/2015/1/contents/made>.

- Chapter 4 considers any other consequential effects on other areas of the price control as a result of any changes in regards to Ground 2A & Ground 2B.
- Chapter 5 deals with proposed licence modifications with reasons and effects.
- Chapter 6 deals with Next Steps.

## 2 Ground 2A - Connection Target

### Background to owner occupied connection targets

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- 2.1 The GD17 final determination includes a mechanism which incentivises the company to deliver and exceed owner occupied connection targets:
- A connection incentive allowance is provided for each owner occupied connection made over and above a Non-Additionality limit. The Non-Additionality limit is fixed as a percentage of the ex-ante connection target and is not recalculated on the basis of actual connections delivered. In the GD17 final determination, the Non-Additionality limit was set at 25%.
  - The connection incentive is subject to a ‘collar’ whereby a GDN which underperforms the ex-ante annual connection target by more than 50%, it would receive only 25% of the per connection allowance for any OO property connected.
- 2.2 In both parts of the mechanism described above, the connection incentive allowance realised by FE in GD17 is dependent on the ex-ante connection target determined by the Utility Regulator.
- 2.3 For the GD17 final determination the Utility Regulator used a connection model where the number of connections made in a particular year is a fixed percentage of the number of properties which are available to connect in that year. For these purposes, the number of properties which are available to connect is a fixed percentage of the number of properties passed at the end of the year, less the number of properties connected by the start of the year. The equation underpinning the conceptual model is set out below:

$$c_n = a\% \times \left( * (100 - b)\% \times \sum_1^n pp - \sum_1^{n-1} c \right)$$

Where	$c_n$	is the number of properties connected in year n.
	$a$	is the connection rate of properties available to connect.
	$b$	is the percentage of properties passed which will always resist connection and (100%-b) is the percentage of properties passed that will connect at some point in the future (assumed to be 15% for GD17).
	$pp$	is the number of properties passed in any year.
	$c$	is the number of properties connected in any year.

- 2.4 Using historical information on properties passed and properties connected provided by FE, the Utility Regulator determined a connection rate of 5% per annum and an owner occupied connection target of 20,450 for GD17.
- 2.5 In its Notice of Appeal, FE submitted that the Utility Regulator had made an error when it determined the owner occupied connection target because the owner occupied property target for GD17 explicitly excluded Housing Association properties while the historical data on which the targets were set included Housing Association properties. FE provided the CMA with new information on owner occupied properties passed and properties connected excluding Housing Association properties.

## CMA Final Determination and Order

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- 2.6 In its determination, the CMA concluded that *“the GD17 Decision in relation to the connection incentive was wrong to the extent that the UR had used incorrect Housing Association data to set the connection target.”* The CMA decided to remit the matter back to the UR for reconsideration and determination with directions that the UR:
- Recalculate the connection target from 20,450 to the figure which would result from the UR’s connection model, having corrected for the error in respect of Housing Association data.
  - Calculate the consequential effects of the amendment above on those elements of the GD17 price control which are directly linked to the GD17 connection target.

## Reconsideration and determination of Ground 2A – Connection Target

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- 2.7 In July 2017 we asked FE to provide information on its processes for collecting, storing and processing properties passed and connection information and supporting data necessary to conduct our review.
- 2.8 Following receipt of information from FE, we met the company to review its methodology for recording properties connected, including the work it undertook in January 2017 to identify Housing Association properties.
- 2.9 Based on this review we have concluded that the properties passed and property connected data provided by FE to the CMA should be used to recalculate the owner occupied connection targets for GD17.
- 2.10 In line with the CMA direction we have recalculated the connection target using the connection model we used in the GD17 final determination. Having corrected Housing Association data we have determined a revised connection rate of 5% and a revised GD17 owner occupied connection target of 19,400. The revised connection target is shown in Table 1. This is equivalent to the CMA Final Determination of 19,403 with 3 properties deleted from the 2022 year for rounding purposes, to result in a connection target over GD17 of 19,400.

Connections (p.a.) - Owner Occupied	2017	2018	2019	2020	2021	2022	Total
<b>GD17 FD</b>	2,600	2,950	3,300	3,600	3,900	4,100	<b>20,450</b>
<b>Proposed Connection targets</b>	2,468	2,808	3,134	3,401	3,655	3,934	<b>19,400</b>

*Table 1: Proposed connection targets for GD17 compared to GD17 FD values*

2.11 The impact of the revised connection target on GD17 revenue is dependent on the non-additionality applied to connection incentive which is a remitted matter (see below). If the 25% non-additionality used in the UR's final determination for GD17 was confirmed, the revised target would reduce the capex allowances by circa £1.2m.

# 3 Ground 2B- Non-Additionality

## Background to non-additionality

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- 3.1 The GD17 final determination includes a mechanism which incentivises the company to deliver and exceed owner occupied connection targets. This mechanism was outlined in paragraph 2.1 above. A connection incentive allowance is provided for each owner occupied connection made over and above a non-additionality limit.
- 3.2 In the GD17 final determination, as in GD14, we used a concept of non-additionality in respect of connection incentives allowances, as we consider that there will be a certain number of OO connections that would occur anyway without any direct marketing or selling to these customers. We describe these connections as “non-additional”. Since FE could in theory avoid any sales-related costs to connect such customers, no allowance will be applicable for these customers.
- 3.3 At a practical level, this concept is underpinned by a wide range of activities (in addition to firmus energy activities) which support and promote the gas industry and will raise awareness and influence people’s choice to convert to gas. For example:
- i) A number of commercial and other organisations have now been advertising gas for a period of 20 years. Familiarity with gas as a fuel has built up over that period.
  - ii) Gas suppliers are now competing for customers in the area and will be conducting sales and marketing activities in relation to the services they offer.
  - iii) Consumer bodies such as Which and the CCNI provide readily accessible information about gas.
  - iv) Press coverage on the development of the gas network in Northern Ireland has been considerable in recent years.
  - v) The government substantially supports gas as a fuel. The Department for the Economy's website includes information indicating the benefits of gas.
  - vi) When one household converts to gas they are likely to tell family, friends and neighbours about their experience, influencing local groups and wider networks.
  - vii) Persons resident in the Licence Area commute or otherwise travel to the Greater Belfast area on a regular basis and will notice the marketing of gas in that area.
  - viii) Even within the Licence Area, PNGL's marketing activities that get national coverage are likely to have an impact on persons residing in the area. For example, PNGL have previously conducted television advertising on national television and are currently undertaking a radio advertising campaign on Cool FM, which is a national radio station. This advertising will promote gas in FE's area.

- ix) Boiler replacement, change of ownership and renovation will each mean that the property owner in question is incentivised to proactively seek out information about potential options for switching to gas, rather than relying on receiving sales and marketing materials. Assuming a uniform distribution of boiler replacements over time, 5% of properties which use oil fuel will need to replace their boiler every year and it may be cheaper to switch to gas (in addition to the other benefits).
- 3.4 The non-additionality limit is fixed as a percentage of the ex-ante connection target and is not recalculated on the basis of actual connections delivered. As a result, the revenue which consumers pay for gas distribution is dependent on both the ex-ante connection target (see Chapter 2) and the level of non-additionality applied.
- 3.5 In the GD17 final determination, the Non-Additionality limit was set at 25%. If the limit was higher the consumers would pay less and if the limit was lower consumers would pay more. The impact of varying the non-additionality limit on the value of connections incentive realised in GD17 is shown in Table 2. This assumes that the number of connections made equals the connection target.

Non-additionality limit	Connection incentive value realised	Variance from 25% baseline
15%	£10.36m	£1.22m
20%	£9.75m	£0.61m
25%	£9.14m	£0m
30%	£8.53m	-£0.61m
35%	£7.92m	-£1.22m

Note 1 £m stated in December 2014 prices

**Table 2: Impact of non-additionality limit on the value of connection incentives realised**

## CMA Direction with further Areas considered as follows

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- 3.6 In its determination, the CMA concluded that:
- i) setting a non-additionality rate on a basis that has been so fundamentally undermined that it cannot stand falls short of the UR's principal objective, its statutory duties and the stated effect in the GD17 Decision;
  - ii) that the non-additionality rate is a major driver of FE's connection allowance revenue. As a result, setting the non-additionality rate on a basis that has been so fundamentally undermined that it cannot stand risks FE receiving less revenue than it should. In our view, this falls short of the UR's statutory duty to have regard to the need to secure that licence holders are able to finance their licensed activities.

- 3.7 In the Order of the CMA , the CMA decided to remit the matter back to the UR for reconsideration and determination with directions that the UR:
- i) *undertake further analysis to calculate a revised non-additionality rate, consult publicly on the proposed revised non-additionality rate, and determine the revised non-additionality rate;*
  - ii) *calculate the consequential effects of the amendment under sub-paragraph i) above on those elements of the GD17 price control which are directly linked to the non-additionality rate and invite and consider representations from the FE on any proposed changes to the GD17 price control.*

## Review of evidence presented to the CMA during the appeal

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### ***FE evidence to support its view on non-additional rate***

- 3.8 In its Notice of Appeal to the CMA, FE stated that UR had failed to provide evidence to justify the 25% non-additionality, which was not substantiated with evidence and suggested that 5% was a more appropriate figure.
- 3.9 FE cited 2 pieces of evidence it considered supported its claim that the 25% non-additionality was wrong:
- i) It did a trial of 200 properties, in Loughgall, of which it did not undertake any advertising activity for a period of 5 months, of which during that time no connections were made.
  - ii) It submitted a survey of customers in the FE area which indicated that over 24% after seeing the FE advertising would be interested in switching.
- 3.10 The CMA concluded for the trial, the sample size was too small and of insufficient duration. The survey did not ask appropriate questions and the sample size was limited, which therefore could not provide robust evidence to the correct level of non-additionality.
- 3.11 The CMA concluded that although the evidence was not sufficient, it did demonstrate that it was possible to conduct a natural experiment and undertake market research to obtain evidence.

### ***UR evidence to support its view on the non-additionality rate***

- 3.12 The CMA was critical on the lack of quantitative analysis that could have been undertaken to demonstrate its assumption of 25%, (e.g. a Survey) although it did point to the information already provided and indicated that it could be used to indicate a wide range of values.
- 3.13 The CMA did not put much weight on the PNGL I&C customers experience, that when the connection incentive was dropped the effect it had on overall connections, as in its

opinion the evidence as presented did not provide any direct linkage to the relationship to OO customers.

3.14 The CMA had a number of concerns with the evidence presented with regard to the Republic of Ireland (ROI) market as follows:

- That the ROI market had advertising (see Annex 3) undertaken by the Network company to target customers not connected to natural gas.
- The effect of Supply competition on the ROI market and the impact Gas supply company advertising would have on raising awareness of Gas and therefore an increase in the level of connections.
- Clarification on the calculation of properties and properties passed in the ROI market, to identify the connection rate.

3.15 The CMA therefore did not consider, that the evidence as presented, in terms of the ROI market, could be used to compare a market with no sales and advertising on connections.

### Further work undertaken to calculate a revised non-additionality rate

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3.16 In response to the CMA's direction we have under taken four pieces of analysis to calculate a revised non-additionality rate:

- i) An assessment of how connection rates for small I&C consumers in the PNGL area changed when a connection incentive was withdrawn in 2014.
- ii) A survey of consumers to assess the reasons and influencing factors which caused them to connect to gas.
- iii) An assessment of connection rates in ROI taking account of the differences in incentives and marketing regimes.
- iv) A case study focusing on a peak in connections in the Greater Belfast area which occurred over the period 2010 to 2016.

3.17 We have considered the results of this work including the analysis undertaken to calculate a revised non-additionality rate in turn in the subsequent sections.

### Withdrawal of incentives for small I&C consumers in the PNGL area

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3.18 In the PNGL12 price control (covering 2012 and 2013), PNGL was granted and incentives for I&C connections of £60k over 2 years, based on projected connections. This I&C incentive was not continued for GD14, nor for GD17.

3.19 In this assessment we considered the impact of the withdrawal of the connection allowance on the smallest meter size (U6 meters), which typically serve small shops,

offices or other commercial premises. Most domestic properties are served by U6 meters. Our analysis and the comparisons drawn is predicated on the assumption that gas consumption and economic drivers for I&C which would be served by a U6 meters to connect to gas are similar to those of domestic properties.

3.20 Information provided by PNGL on U6 I&C connections over the period 2011 to 2016 is shown in Table 3.

	New I&C Connection						
Meter Size	2011	2012	2013	2014	2015	2016	Total
U6/G4	144	143	156	140	170	150	903

**Table 3: Customer connections for U6 meters from 2011-2016**

3.21 From the above data it is apparent that I&C new connections remained relatively stable over the 2011-16 period and there was no obvious amendment to customer numbers as a consequence of removing the Connection Incentive. From the above data it could be concluded that the Connection Incentive has no direct impact on customer connections. This would indicate that non-additionality is high.

3.22 However, this is a small group of connections in an area which Advertising, Marketing and promotional material was still present and may have had an influence on choices made by I&C consumers. In light of this, we have drawn no conclusions about non-additionality from this part of our analysis.

## Survey of owner occupiers on their reasons for connecting to natural gas

### **Introduction to the survey of owner occupiers**

3.23 In its final determination, the CMA suggested that a survey may provide useful information (refer to paragraph 5.147) that could provide evidence for the basis of the non-additionality figure.

3.24 We commissioned a survey of owner occupiers on their reasons for connecting to natural gas which was carried out in October and November 2017. The survey covered customers who had connected to Natural Gas in the FE area from 2013 - 2016, who were Owner Occupied and had made the decision to connect to gas. Responses were obtained from a 1,002 customers that was spread in proportion to the numbers of connections in the main towns served by firmus energy, selected from a total number of 7,000 owner occupied properties connected in the FE area.

3.25 Our aims and objectives when commissioning the survey were to undertake research to clarify the reasons why domestic owner occupied customers switched to natural gas. This research was carried out to assist our understanding on whether the fixed % assumption for non-additionality is appropriate. The survey focused on:

- the reasons consumers connected to natural gas; and,
  - whether consumers had been exposed to advertising and/or activities carried out by firmus energy and whether they had in any way been influenced by in their decision to connect to natural gas by this exposure.
- 3.26 We developed an initial set of survey questions with our survey contractor. We then shared this with firmus energy. We received representations from the company and considered these and engaged with firmus energy before deciding on the final form of the survey.
- 3.27 The survey was carried out as a face to face interview, with a set questions, that were unprompted (ask customers openly) or prompted (directed customers based on selection of responses). The survey explored four issues:
- i) Respondents were asked (unprompted) how they became aware that natural gas was available in their area. Respondents could provide multiple reasons.
  - ii) Respondents were invited (unprompted) to say why they had connected to natural gas. Having listed their reasons for connecting to natural gas, respondents were then asked (unprompted) to identify their most important reason for connecting.
  - iii) Respondents were then asked if, prior to connecting to natural gas, they had seen or heard any firmus energy advertising or activities prior to connecting to gas. This was a prompted question which offered respondents a list of 19 advertising and other activities carried out by firmus energy which are specifically designed to or could prompt awareness of gas, the advantages of gas, and support for gas connections and how to go about making a gas connection.
  - iv) Finally, respondents were invited to say whether being exposed to firmus energy activities had in any way influenced their decision to connect to natural gas.
- 3.28 The survey report produced by the survey contractor is included as Annex 2 of this consultation. Our analysis of the survey and the conclusions drawn from the results are given in the subsequent sub sections.

***Awareness that natural gas was available***

- 3.29 Respondents were asked (unprompted) how they became aware that natural gas was available in their area. Respondents could give more than one reason.
- 3.30 When asked how they became aware that natural gas was available in their area, the most common response was roadworks/construction activities/laying gas mains with 36% identifying this as a reason they became aware of gas mains in their area. Word of mouth, friends/family and neighbours/acquaintance were the other main reasons identified.

- 3.31 13% of respondents identified firmus energy advertising/activities as a reason, with 6% saying that they had seen advertising/activities by suppliers other than firmus energy.
- 3.32 These results suggest that awareness of natural gas amongst owner occupiers who have connected to the gas network was initially prompted by construction activities and person-to-person communication. It also suggests an awareness of advertising by suppliers other than firmus energy through advertising/activities which is about half that of awareness prompted by advertising/activities of firmus energy. While we have not drawn any specific conclusions on non-additionality from these results, they point to the influence of the types of activities by others which we identify in paragraph 3.3 above which underpin the concept of non-additionality.

### ***Reasons for connecting to natural gas***

- 3.33 Respondents were asked (unprompted) why they had connected to natural gas. Respondents could give more than one reason. Having listed their reasons for connecting to natural gas, respondents were then asked to identify their most important reason for connecting.
- 3.34 Only 8% identified firmus energy advertising/activities or financial incentives as one of the reasons they connected to natural gas and 5% of respondents identified these as the main reason.
- 3.35 The main reasons for connecting, provided a range of results as follows (unprompted), ranked in the highest order : Convenience 20%, Friend family recommendation 17%, Cheaper than alternatives 15%, Problems with existing heating system 12%, Neighbour/Acquaintance recommendation 9%, Environmentally friendly 8%. These results represent 80% of all responses. FE marketing and financial incentive were less than 5% of responses.
- 3.36 These unprompted questions suggest that very few consumers could recall being influenced in their decision to connect by firmus energy advertising activities and financial incentives. This indicates that the level of non-additionally could be very high and up to 95%, say in the range 75% to 95%.
- 3.37 However, there is a risk that advertising/activities could be under represented as a reason for making a connection because respondents did not recall it, did not consider it significant enough to report or did not wish to admit being influenced by advertising. As a result we place little weight on this result in our determination. The survey included further prompted questions on advertising and activities and whether these in any way influenced respondents' decision to connect to natural gas. The outcome of this work is discussed below starting at paragraph 3.42.
- 3.38 It is also clear from the survey that many of the reasons given by consumers for connecting to natural gas are environmental, lifestyle and financial benefits which are actively promoted by firmus energy in its advertising and activities as set out in Figure1 which shows information abstracted from a firmus energy web page in November 2016.

3.39 Table 4 provides a mapping of the reasons given by consumers for connecting to gas between those linked to firmus energy advertising and activities, including the benefits of gas promoted by firmus energy in its advertising. All responses categorised as 'other' have been included in this category. Reasons which are not linked to firmus energy advertising and activities is then limited to recommendations from friends/ family/ neighbours/ acquaintances, problems with existing heating systems and house renovation.

***Constant supply and peace of mind***  
By switching to natural gas, you'll never run out of fuel again.

***More ways to save***  
If your property uses energy efficient appliances, you'll burn even less fuel, and that means more money for the things you really want.

***Efficient***  
Cooking with natural gas means efficient precision cooking for restaurants.

***Cleaner***  
Natural gas burns 30% more cleanly than oil or coal. It's easier on the environment, less wasteful and reduces boiler maintenance costs.

***Easy to budget***  
With a pay as you go meter you simply pay for what you use. If you prefer to pay by monthly direct debit we can install a credit meter.

***Secure***  
No concerns about fuel theft, spillages or cleaning up.

***Best use of your space***  
No need for an oil tank; there is also the potential to remove the hot and cold water tank, allowing you to make the best use of the space in your home.

*Quotes taken from firmus energy web page on 30 Nov 2016*

***Figure 1: Some benefits of Natural Gas promoted by firmus energy.***

Reasons not linked to FE advertising/activities	Reasons linked to FE advertising/activities
Recommendation from friend or family	Give more space in garden / outside (e.g. with removal of oil tank)
Recommendation from a neighbour / acquaintance	Financial incentive – Other government (e.g. boiler scrappage scheme)
Problems with existing heating system	Convenience (never run out, instant hot water, hot shower etc.)
House renovation	Thought it would be cleaner
	Financial incentive – Firmus Energy
	Thought it would be cheaper than alternatives
	Get rid of the hotpress
	Pay-As-You-Go / pre-payment card allows budgeting / no big bills
	More energy efficient
	Seen or heard Firmus Energy advertising / activities
	Other

**Table 4: Mapping reasons for connecting to natural gas to benefits promoted by firmus energy**

3.40 Mapping the reasons for connecting to gas to the two categories in Table 4 allowed us to identify respondents who gave reasons exclusively in one or other of these categories and respondents which gave reasons in both. The results of this allocation is set out in Table 5.

	Number	%
Reasons not linked to FE advertising/activities only	319	32%
Reasons linked to FE advertising/activities only	517	52%
Reasons given in both categories	166	17%
All respondents	1002	100%

Note 1 Figures may not add due to rounding

**Table 5: Reasons for connecting linked to firmus energy advertising and activities**

3.41 32% of respondents did not give a reason linked to firmus energy advertising and activities. 17% of respondents gave reasons for connecting to gas in both categories. This indicates that the level of non-additionally is in the range 30% to 40%. In this assessment we have assumed that the benefits of gas given by respondents as a reason for connecting to gas have been communicated solely by firmus energy. However, firmus energy is not the sole source of information on the benefits of gas, nor is it the sole source of incentives to connect to gas. To allow for this we consider there is

an indication in this analysis that non-additionality will be greater than 30%. There is no indication in this analysis that non-additionality is less than 30%.

***Exposure to Fe Advertising/ Activities prior to Connections***

- 3.42 The design of the survey included a question on exposure to firmus energy advertising/activities prior to connecting and whether this exposure had influenced the decision to connect. This was included to address the possibility that when asked their reasons for connecting, respondents would not recall firmus advertising/activities unprompted or that they would not recognise this as a reason for their decision.
- 3.43 In part, the treatment of the benefits of gas as a reason for connecting which is described above also seeks to address this point.
- 3.44 Respondents were provided with an extensive list of activities/advertising carried out by firmus energy (19 in total) and were asked whether they had been exposed to them. Those who could recall being exposed to these activities (after being prompted) were asked whether this exposure had, in any way, influenced their decision to connect to natural gas. The survey elicited the following response:

	Exposure to firmus energy advertising/activities	Exposure in any way influenced the decision to connect (of those exposed).
Yes	70%	60%
No	7%	30%
Don't know/ can't remember	23%	10%

***Table 6: Survey results showing effect of exposure to FE activities in influencing gas connections***

- 3.45 The main areas that the responder recalled were as follows: TV - 30%, Letters/Leaflets, Post/ – 25%, Construction activity 20%, Vehicle Branding 20%. Other areas were mentioned, however, were relatively small in overall scale.
- 3.46 To draw conclusions from the results of the survey, it is necessary to consider how those who responded don't know/can't remember are considered and what weight the influence of firmus energy advertising and activities had in the decision to connect to gas compared to the other activities. In the conclusions below we have assumed as a starting point that the influence reported by respondents was the sole reason they decided to connect to gas. However we recognise that, because of the wide range of other influences that this assumption is conservative and likely to under estimate non-additionality.
  - i) At one extreme, the survey results show that only 21% (70% multiplied by 30%) of respondents could confirm that they had both been exposed firmus energy advertising

and activities and had not been influenced by it. This would indicate a lower limit on non-additionality of 21%. However this takes no account of those who responded don't know/can't remember and does not take account of other influences and both would indicate non-additionality higher than 21%.

- ii) At another extreme, the survey results show that 42% (70% multiplied by 60%) of respondents confirmed that they were both exposed to firmus energy advertising and were influenced in their decision to convert to gas. This might indicate a level of non-additionality of 58%. However, this takes no account of those reporting don't know/can't remember. Assuming that some of these were influenced in their decision, the level of non-additionality might be lower than 58%. However, we must recognise that firmus energy advertising and activities is not the sole influence on the decision to connect to gas and non-additionality could be higher.
  - iii) The survey shows that only 7% of respondents expressly said that they had not been exposed to firmus energy advertising and activities before making the decision to connect to gas. If we discount this and assume that all respondents had been exposed in some way, then the number of respondents reporting that firmus energy advertising and activities had in anyway influenced their decision to connect is in the range 30% to 40% as a minimum (those responding 'no' or don't know/ can't remember').
  - iv) An alternative would be to make some decision on those who responded 'don't know can't remember'. Taking a balanced assumption that 50% of should be positive and 50% negative, then 54% (83.5% multiplied by 65%) of respondents were both exposed to firmus energy advertising and were influenced in their decision to convert to gas. This might indicate a level of non-additionality of 46%.
  - v) If we made a more cautious assumption that 75% of those responding don't know can't remember are positive and 25% negative, then 58% (87.3% multiplied by 67%) of respondents were both exposed to firmus energy advertising and were influenced in their decision to convert to gas. This might indicate a level of non-additionality of 42%.
  - vi) Finally, if we assume that 75% of those reporting 'don't know can't remember' were positive and 50% of those reporting 'no' were in fact positive, then 75% (90.8% multiplied by 82.3%) of respondents were both exposed to firmus energy advertising and were influenced in their decision to convert to gas. This might indicate a level of non-additionality of 25%.
- 3.47 A low level of non-additionality (say 19%) can only be supported by an unrealistic interpretation of the data. Specifically, that we assume that 67% of those who could not identify that they had been influenced by firmus energy advertising/activities in a major decision in the last three years had been influenced, and that for those influenced by firmus energy advertising/activities, that this was the main reason of sole reason for making a connection. This seems wholly unreasonable in light of the response to unprompted questions on how respondents became aware that gas was available and the reasons for making connections.

3.48 The assessment of respondents' awareness of firmus energy advertising and activities above provides evidence of non-additionality on the range 30% to 50% with weaker support for values below 30%. In assuming in this section of the analysis that the influence of firmus energy advertising and activities was the sole influence in the decision to connect to gas, non-additionality above this range is plausible.

## Rol gas market as a comparison

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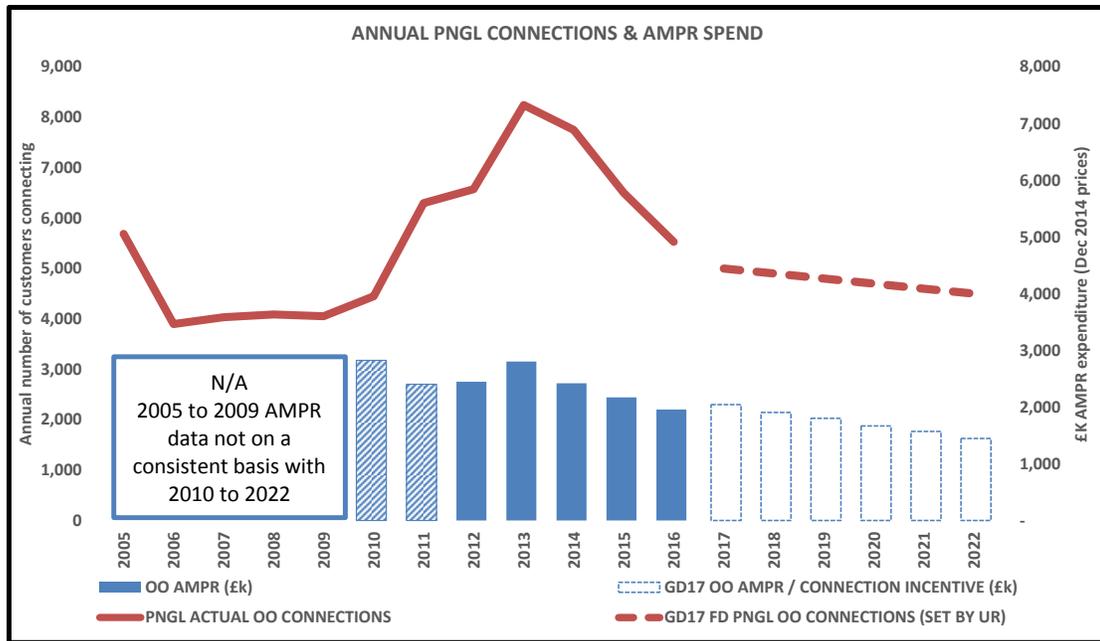
- 3.49 To provide further evidence of non-additionality, we analysed the development of the gas market in the Republic of Ireland and compared recent rates of connections and differences in the advertising and activities which support owner occupier connections.
- 3.50 Gas Network Ireland (GNI) is the gas distribution network operator in the Republic of Ireland and the company is subject to regulation by the Commission for Regulation of Utilities (CRU).
- 3.51 GNI previously entitled Bord Gais or BGE, introduced Natural Gas when the Kinsale gas field came on-line in 1978. The natural gas network expanded from that point and homes in Cork and Dublin started to get connected from the early 1980s. The inter-connectors with UK were built in 1993 and 2001. Prior to BGE there were several local "Town Gas" gas companies. The few remaining gas companies in the early 80s were merged into BGE as the Natural gas network expanded.
- 3.52 The full analysis of this section is included in Annex 3.
- 3.53 We believe that the Rol market provides useful analysis, in terms of how a network develops over time. Leaving aside the different regulatory regime that it operates under, the principles of developing a network and getting customers to connect is fundamentally the same. Also the Rol market has had the effect of supply competition and the effect it has had on customers connecting to gas.
- 3.54 We have taken data that is publicly available from GNI and the CRU, to draw parallels with the FE data in terms of connections and properties passed for similar OO connections. To replicate a comparable connection rate for ROI data, we have used the FE model assumptions, in that 15% of customers will never connect, with a constant connection rate for the remaining properties. This assessment gave a connection rate for Rol of 2.8%, compared to an equivalent connection rate in the firmus energy area of 5%.
- 3.55 We estimate the effect of supply competition on gas connections to be in the region of 22% during the period, when this activity was most prominent, however, this factor appears to have a short time effect and diminishes when supplier promotional activities drops off. This experience would be similar from the observations that have been made in the PNGL area, when retail competition and customer switching commenced. Adjusting the Rol connection rate for supply competition gives a connection rate of 2.3% compared to an equivalent connection rate in the firmus energy area of 5%. This suggests that non-additionality could be as high as 46%.

- 3.56 GNI does not have the same incentive based funding for advertising and marketing available to FE, the effect of connection charges payable by consumers in RoI will act as a disincentive to connections, for example:
- GNI has not had the same incentive based funding for advertising and marketing available to firmus energy. The CRU introduced an incentive for GNI for connections it attains over and above its projected Business as Usual connections as part of its PC4 determination which began in October 2017, however this connection incentive is much more limited than that which is available to firmus in the GD17 period.
  - The general level of advertising and marketing activity by GNI is not of the same type and scale as that experienced by firmus energy.
  - GNI consumers have to contribute €250 for connections whereas firmus are funded to provide these free of charge with the cost recovered over time through consumer bills. This is likely to act as a disincentive which will depress connection rates.
  - Unlike the situation in NI there is no dedicated government incentives in RoI to target connections to the gas network, rather there are grants in RoI for installing heating controls as well as a new boiler but the grant does not favour gas over oil.
- 3.57 It is reasonable to assume that some part of the connection rate in RoI will be attributable to GNI activities but that this will not be high. Assuming that up to 50% of connections would not be made without GNI's limited marketing activities, we arrive at a range for non-additionality of 20% to 45%. However, due to the lack of directly comparable data and the need to allow for some impact of GNI activities, we do not place a strong weight on this assessment.

### Greater Belfast case study

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- 3.58 We undertook a case study of connection performance by PNGL in the greater Belfast area to determine whether any information would inform decisions on non-additionality in the firmus energy area.
- 3.59 In particular, the case study focused on the rapid increase and decrease in the rate of connections which occurred in the period 2010 to 2016.



**Figure 2: Annual PNLG connections and AMPR expenditure**

- 3.60 The detail of the case study is reported in Annex 1. The case study identified a number of concurrent changes which might contribute to the change. However, there was insufficient data to undertake a statistically robust analysis capable of distinguishing between the impacts of different factors on connection rate reach specific conclusions on non-additionality.
- 3.61 The main findings from our case study are summarised below, the detail of the analysis and graphical presentation can be found in Annex 1.

**Advertising, Marketing and Public Relations (AMPR)**

- 3.62 Expenditure on Advertising, Marketing and Public Relations (AMPR) by PNLG remained broadly constant over the period 2010 to 2016 with a slightly downwards trend. The change in expenditure does not explain the initial increase or subsequent reduction in connections over the period from 2010 to 2016.

**Boiler Replacement and other Government Schemes**

- 3.63 The NI Executive provides funding for various ‘social schemes’ to assist customers in modernising their heating systems and insulate their homes throughout Northern Ireland. These include the Boiler Replacement Allowance open to households with income lower than £40,000 and who have an inefficient boiler of at least 15 years old. A grant of up to £1,000 is available. There are other schemes including the Northern Ireland Sustainable Energy Programme (NISEP) and the Warm Home Scheme / Affordable Warmth Scheme which provide similar schemes.

- 3.64 The introduction of the Boiler Replacement programme in 2012/2013 appears to coincide with the increase in gas connection numbers and the glide path that occurred from this peak downward in 2014 to 2016.

### *Oil prices*

- 3.65 Households between 2011 and 2013, noticed a significant increase in heating oil costs and the evidence from PNGL suggested that households sought to research cheaper/ stable alternatives, on heating which contributed to the overall peak connection period. The reduction in connection numbers from 2014 occurred at the same time as oil prices were falling.

### *Retail competition*

- 3.66 In November 2010, the UR opened the Greater Belfast Area to gas supply competition amongst domestic customers. This encouraged a new entrant (Firmus Energy Supply) into the domestic customer market, which competed against the incumbent company on price and service.
- 3.67 The increase in connections in the PNGL area began at the time that supply competition was introduced and continued over an initial period which saw relatively high levels of switching. Connection numbers began to decline by the time levels of switching had reduced to low levels. The results suggest that the visible advertising and marketing campaign undertaken by Firmus Energy's supply business in Greater Belfast may have spilled over to encourage connections, but that the effect is short lived. This reinforces the indication that there was a material but short lived impact on connection numbers of the RoI gas market on the introduction of supply competition.

### *Housing Market*

- 3.68 There has been an increase in house sales over the period 2010 to 2016 as the housing market recovered from the historic crash in 2007. Connection numbers declined from a peak in 2013 at a time house sales plateaued at the recent high levels. There are conflicting possibilities on how connection numbers relate to house sales. People might choose to connect to gas when they move to a new property. Alternatively, when house sales are low, people may decide to remain in existing properties and invest in renovation. Without specific data it has not been possible to conclude to what extent the rate of house sales has on the gas connections.

## **Reconsideration and determination of Ground 2B – Non-additionality**

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- 3.69 We have considered four lines of investigation and analysis to reconsider and determine the connection incentive non-additionality rate for firmus energy in GD17:

- i) An assessment of how connection rates for small I&C consumers in the PNGL area changed when a connection incentive was withdrawn in 2014.
- ii) A survey of consumers to assess the reasons and influencing factors which caused them to connect to gas.
- iii) An assessment of connection rates in RoI taking account of the differences in incentives and marketing regimes.
- iv) A case study focusing on a peak in connections in the Greater Belfast area which occurred over the period 2010 to 2016.

3.70 We have drawn no conclusions from how connection rates for small I&C consumers in the PNGL area changed when a connection incentive was withdrawn in 2014 because connection rates for this small category of properties could have continued to be influenced by the on-going advertising carried out by PNGL.

3.71 We have drawn three conclusions from a survey of consumers which assessed the reasons and influencing factors which caused them to connect to gas.

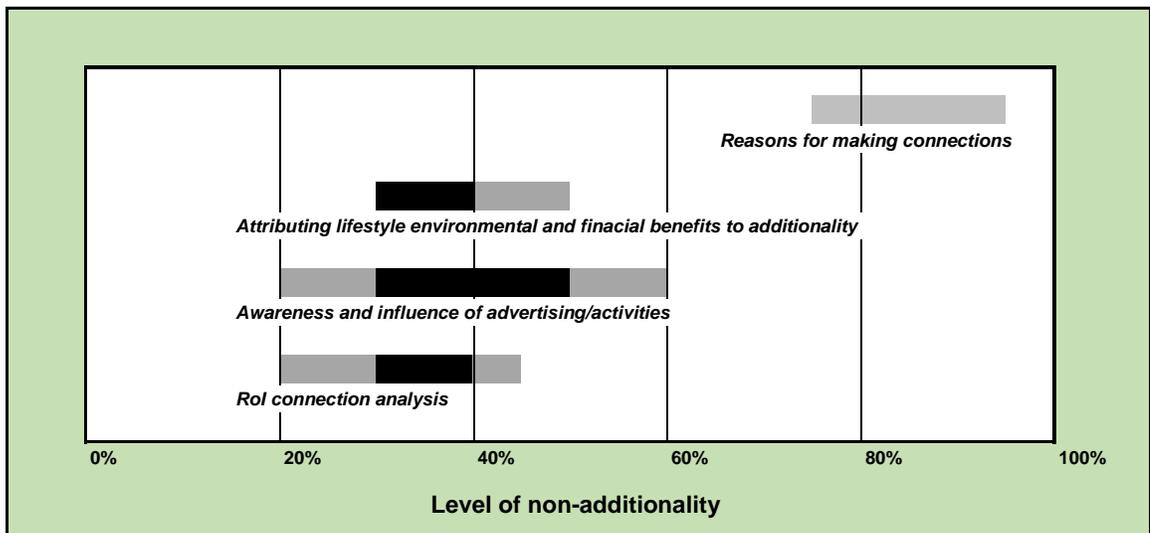
- i) When asked to give their reasons for connecting to gas, very few consumers could recall being influenced in their decision to connect by firmus energy advertising activities and financial incentives. This indicates that the level of non-additionally could be very high and up to 95%, say in the range 75% to 95% (see paragraph 3.36). However, there is a risk that advertising/activities could be under represented as a reason for making a connection because respondents did not recall it, did not consider it significant enough to report or did not wish to admit being influenced by advertising. As a result we place little weight on this result in our determination.
- ii) A larger number of consumers gave environmental, lifestyle and financial benefits which are actively promoted by firmus energy in its advertising and activities as reasons for connecting to gas. If we assume that these connections were made solely as a result of firmus advertising and activities then this indicates that the level of non-additionally is in the range 30% to 40% (see paragraph 3.41). However, firmus energy is not the sole source of information on the benefits of gas, nor is it the sole source of incentives to connect to gas. To allow for this we consider there is an indication in this analysis that non-additionality will be greater than 30%. There is no indication in this analysis that non-additionality is less than 30%.
- iii) The assessment of respondents' awareness of firmus energy advertising and activities provides evidence of non-additionality on the range 30% to 50% with weaker support for values below 30% (see paragraph 3.48). In assuming in this section of the analysis that the influence of firmus energy advertising and activities was the sole influence in the decision to connect to gas, non-additionality above this range is plausible.

3.72 From our analysis of owner occupied connections in RoI and taking account of the relatively limited funding and the activities undertaken by GNI to promote connections

compared to firmus energy we concluded that non-additionality is in the range 20% to 45% (see paragraph 3.57). However, due to the lack of directly comparable data and the need to allow for some impact of GNI activities, we do not place a strong weight on this assessment.

3.73 The Greater Belfast case study identified a number of concurrent changes which might contribute to the change. However, there was insufficient data to undertake a statistically robust analysis capable of distinguishing between the impacts of different factors on connection rate reach specific conclusions on non-additionality.

3.74 From the various workstreams undertaken, we have charted a range of values that could be used (below), to come to a proposal for this consultation of an appropriate % Non-additionality figure.



**Figure 3: Level of non-additionality from workstreams undertaken by the UR**

3.75 Taking the various strands of analysis in the round, the survey data and Rol connection analysis provides strong support for non-additionality at 40%. The non-additionality of 25% determined for firmus energy in the GD17 final determination is at the lower end of a range supported by the survey results. While the data would support an increase in non-additionality for GD17, we have concluded that this is not appropriate at this stage of the GD17 process. We are therefore minded to confirm the non-additionality rate of 25% for GD17 to support the development of the gas sector.

3.76 Adopting a non-additionality value of 25% and a connections value of 19,400 would result in a connection incentive value of £9.14m as compared to the GD17 FD value of circa £9.64m.

3.77 We welcome feedback on this approach and our proposals.

## 4 Effect on any other areas of the Price Control

- 4.1 The CMA's direction requires the UR to calculate the consequential effects of any amended connection targets and the impact on any change to the % Non-Additionality figure.
- 4.2 We will deal with each point in turn.

### Connection Target

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- 4.3 In our submissions to the CMA, we identified the following consequential effects which are directly linked to the connection target that would occur if a change was made to the connection target:
- Emergency Call Centre and first response opex.
  - Asset maintenance opex and metering.
  - Economic level of mains laying and consequently infill levels.
  - Impact on Capital Investment.
- 4.4 In our response to the CMA, we estimated that a reduction in the GD17 connection target to 19,400 would reduce FE's revenues in relation to the Emergency Call Centre and First Response Opex allowance by approximately £69k. We did not estimate the impact of the other consequential effects identified, as they were so small as to not be material.
- 4.5 On review, we have consider that we could not make adjustments for the other consequential effects identified. In view of this, we intend to reduce the final determination by £79k in respect of Emergency, Call Centre and First Response Opex, but not make any other adjustments for any other consequential effects. This changes the total that was previously allowed in GD17 FD from £6.85m to the proposed figure of £6.77m.
- 4.6 We also considered the effects on the Economic level of mains laying and consequently infill levels, by a reduction in the connection target. Whist reducing the target did have a small effect on the economic test and the level set of meters per property passed, the overall impact was so small, that on balance, no change was necessary.
- 4.7 By reducing that connection target by 1,000 domestic consumers, the associated capex in terms of domestic services for existing properties and meter costs, in conjunction with applicable reduction to the Traffic Management Act (TMA) has also been removed from the capital investment programme.

4.8 Any areas will still be subject to the Uncertainty Mechanism<sup>5</sup>, based on actual outputs, as described in GD17 FD.

## % Non Additionality Figure

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- 4.9 UR considers the non-additionality mechanism as part of a component, of the overall package forming the Connection Incentive mechanism.
- 4.10 In reviewing the Connection Incentive, which is made up of a number of separate components that formulates into a simple economic test, with the principle that costs outlaid should be recovered over a suitable timeframe.
- 4.11 FE in its referral chose 1 component (the % Non-Additionality) out of over 10 components as an error. It is important to note that all these components are inter-related and provide a connection allowance value and should not be considered in isolation.
- 4.12 During GD17, we listened to the feedback from the DD consultation responses on the level of financial support in terms of the connection incentive, the connection targets and the appropriateness of further areas. It was identified by all GDN's that greater financial assistance was needed, to address market conditions and the effect of going into new areas, which required more awareness, to build on the momentum created when gas is 1<sup>st</sup> made available.
- 4.13 To that end, we reviewed various options of changing the individual components of the connection incentive available to us, which had been used in GD14, but were not persuaded to change any elements. However, we undertook a review and created a "New Areas Allowance" and considered it was important to incentivise GDNs to gain as many new connections as possible. This review resulted in FE being awarded an additional £2m of additional allowances, based on achieving actual connections, which, in overall terms, exceeds the level of allowance allocated during GD14. This allowance was available to any new connections, so as not to restrict this specifically to new areas.
- 4.14 On further review of this area, and considering the information now available, we feel that changing the New Area component is not appropriate, as any changes would be relatively minor in terms of the overall effect.
- 4.15 All actual connections will still be subject to the Uncertainty Mechanism, based on actual outputs, as described in GD17 FD.

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<sup>5</sup> [https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/2016-09-15\\_GD17\\_Final\\_Determination\\_-\\_final\\_0.pdf](https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/2016-09-15_GD17_Final_Determination_-_final_0.pdf) - Section 9

## Volumes Target

4.16 By adjusting the Connection target for OO customers down from 20,450 to 19,400, this has the effect of reducing the volumes of gas. The overall effect of this reduction, for the GD17 period is approx. 1.1 million therms of gas.

Volumes (therms '000) Total	2017	2018	2019	2020	2021	2022	Total
<b>GD17 FD Volumes</b>	61,980	60,443	62,623	64,913	67,306	69,782	387,047
<b>Proposed Volumes</b>	61,955	60,366	62,487	64,708	67,017	69,415	<b>385,948</b>

**Table 7: Impact on FE Volume allowances due to proposed amendments**

## Overall Impact on Opex allowances

4.17 The overall impact on Opex allowances is demonstrated in the table below. The total adjustment to price control allowances due to the proposals made in this Consultation document, is a reduction of approximately £0.6m over GD17.

FE Opex - Summary (£000 Dec 2014 prices)	2017	2018	2019	2020	2021	2022	Total
<b>GD17 FD (Include GIS Decision)</b>	6,512	6,470	6,622	6,833	7,107	7,383	40,928
<b>Proposed Opex Allowance</b>	6,438	6,392	6,532	6,729	6,982	7,297	<b>40,369</b>

Note1 Figures may not add due to rounding

**Table 8: Impact on FE Opex allowances due to proposed amendments**

## Overall Impact on Capex allowances

4.18 The table below illustrates the impact on Capex allowances due to the proposed amendments to the GD17 price control allowances following the CMA Decision. The total adjustment due to the proposals in this document is a reduction in allowances of approximately £1.2m.

FE Capital Investment Summary (£000 Dec 2014 prices)	2017	2018	2019	2020	2021	2022	Total
<b>GD17 FD</b>	17,121	14,300	14,496	14,778	15,129	15,353	91,177
<b>Proposed Capex Allowance</b>	16,969	14,137	14,308	14,554	14,855	15,169	<b>89,992</b>

Note1 Figures may not add due to rounding

**Table 9: Impact on FE Capex allowances due to proposed amendments**

## Revenue

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4.19 The table below shows the impact on Revenue over GD17 as a consequence of our proposals. The overall impact is a reduction in revenue of circa £0.5m.

Revenue (£000 in Dec 2014 prices)	2017	2018	2019	2020	2021	2022	Total
<b>GD17 FD (Includes GIS)</b>	18,020	18,015	18,906	19,847	20,835	21,860	117,484
<b>Proposed Revenue</b>	18,004	17,976	18,841	19,752	20,702	21,693	<b>116,968</b>

*Table 10: Impact on Revenue allowances due to proposed amendments*

# 5 Proposed Licence Modifications

## Proposed Determination Values

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- 5.1 In September 2016 we published our decision on GD17 and our statutory consultation on licence modifications to enact the price control allowances into the respective licences of GDNs. On 28 October 2016, the UR published its decision to modify the gas conveyance licences of the three GDNs in NI (the GD17 Decision).
- 5.2 On 25 November 2016, FE brought an appeal to the CMA against the Decision to modify the conditions of its licence. On 28 December 2016, the CMA granted FE permission to appeal to the CMA. The CMA reached its final determination on 28 June 2017.
- 5.3 The Order of the CMA which gave effect to its final determination remitted two grounds of appeal back to the Utility Regulator for reconsideration and determination as follows:
- Ground 2A – in respect of Connection Targets;
  - Ground 2B – in respect of connection incentive Non-Additionality.
- 5.4 We have concluded our reconsideration of the matters remitted to us. In Section 2 above we have set out our reconsideration and determination of connection targets (Ground 2A). In Section 3 above, we have set out our reconsideration and determination of non-additionality (Ground 2B). In Section 4 above, we have set out our determination of the consequential effects of our reconsideration and determination of connection targets and non-additionality.
- 5.5 To give effect to our reconsideration and determination of these issues, it is necessary to modify the licence by deleting the table of Determination Values from Condition 4.7 of the Licence and replacing it with a revised table of Determination Values which has been amended to reflect these changes.

## Proposed Licence Modifications

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- 5.6 We propose to modify Condition 4.7: Current Designated Parameters and Determination Values of the Licence to include the additional values as proposed below. These values are for consultation and we welcome feedback on an aspect thereof. These amendments have been made as a result of the following changes:
- Amendment of the connection numbers to 19,400 as explained in Section 2;
  - Setting of the non additionality value of 25% as explained in Section 3;
  - Consequential amendments to opex and capex as a result of the changes outlined in Sections 2 and 3 and as explained in Section 4.

- 5.7 The Determination Values below, are set on the Average 2014 price base of the FE licence, as opposed to the price base used in GD17 FD, which used December 2014 prices for all GDNs due to the fact that different licences have different price bases. Therefore the figures discussed in Chapters 2-4 above are in December 2014 prices and need to be adjusted to Average 2014 prices before they are included in the FE licence.
- 5.8 The Designated Parameters do not change, with regard to this proposed licence modification.
- 5.9 We present below the current licence Designated Parameters and Determination values and also the proposed values based on the above amendments.
- 5.10 The table below represents the current Determination Values in Condition 4.7 of the Licence.

Description (for Conveyance Categories <i>i</i> and Formula Years <i>t</i> )	Determination Values	t=2017	t=2018	t=2019	t=2020	t=2021	t=2022
Volume (therms)	$V_{E,t}$ $i=1$	11,228	12,780	14,462	16,267	18,185	20,197
	$V_{E,t}$ $i=2$	8,336	8,850	9,352	9,844	10,325	10,796
	$V_{E,t}$ $i=3$	6,380	6,374	6,368	6,362	6,355	6,349
	$V_{E,t}$ $i=4$	1,161	927	927	927	927	927
	$V_{E,t}$ $i=5$	13,375	13,361	13,361	13,361	13,361	13,361
	$V_{E,t}$ $i=6$	21,500	18,152	18,152	18,152	18,152	18,152
Capital Expenditure	$C_{E,t}$	17,021	14,216	14,412	14,692	15,041	15,264
Operating Expenditure	$O_{E,t}$	6,475	6,432	6,584	6,793	7,065	7,340
Annual Depreciation	$D_{E,t}$	4,378	4,797	5,209	5,650	6,069	6,356
Cash Flow (calculated in accordance with Condition 4.4.6)	$F_{E,t}$	-5,581	-2,738	-2,199	-1,753	-1,392	-871
Revenue Per Unit	$P_{E,t}$ $i=1$	0.4359	0.4359	0.4359	0.4359	0.4359	0.4359
	$P_{E,t}$ $i=2$	0.3062	0.3062	0.3062	0.3062	0.3062	0.3062
	$P_{E,t}$ $i=3$	0.2745	0.2745	0.2745	0.2745	0.2745	0.2745
	$P_{E,t}$ $i=4$	0.2180	0.2180	0.2180	0.2180	0.2180	0.2180
	$P_{E,t}$ $i=5$	0.2572	0.2572	0.2572	0.2572	0.2572	0.2572
	$P_{E,t}$ $i=6$	0.2336	0.2336	0.2336	0.2336	0.2336	0.2336
Total Conveyance Revenue	$R_{E,t}$	17,915	17,910	18,796	19,732	20,714	21,733
Depreciated Asset Value (calculated in accordance with Condition 4.4.7)	$DAV_{E,t}$	118,306	127,726	136,929	145,970	154,942	163,849
Regulatory Value (calculated in accordance	$TRV_{E,m}$						202,571

**Table 11: Current FE Licence Determination Values**

5.11 The table below represents the effect of the proposed licence modifications, in terms of the values changing for the GD17 price control period.

Description (for Conveyance Categories <i>i</i> and Formula Years <i>t</i> )	Determination Values		All Values in £(000's) and Indexed to RPI 2014					
			t=2017	t=2018	t=2019	t=2020	t=2021	t=2022
Volume (therms)	$V_{E,i,t}$	$i = 1$	11,203	12,702	14,327	16,062	17,896	19,830
	$V_{E,i,t}$	$i = 2$	8,336	8,850	9,352	9,844	10,325	10,796
	$V_{E,i,t}$	$i = 3$	6,380	6,374	6,368	6,362	6,355	6,349
	$V_{E,i,t}$	$i = 4$	1,161	927	927	927	927	927
	$V_{E,i,t}$	$i = 5$	13,375	13,361	13,361	13,361	13,361	13,361
	$V_{E,i,t}$	$i = 6$	21,500	18,152	18,152	18,152	18,152	18,152
Capital Expenditure	$C_{E,t}$		16,870	14,055	14,225	14,469	14,768	15,080
Operating Expenditure	$O_{E,t}$		6,400	6,354	6,494	6,690	6,941	7,255
Annual Depreciation	$D_{E,t}$		4,373	4,787	5,193	5,627	6,037	6,318
Cash Flow (calculated in accordance with Condition 4.4.6)	$F_{E,t}$		-5,371	-2,538	-1,987	-1,522	-1,128	-769
Revenue Per Unit	$P_{E,i,t}$	$i = 1$	0.4358	0.4358	0.4358	0.4358	0.4358	0.4358
	$P_{E,i,t}$	$i = 2$	0.3061	0.3061	0.3061	0.3061	0.3061	0.3061
	$P_{E,i,t}$	$i = 3$	0.2744	0.2744	0.2744	0.2744	0.2744	0.2744
	$P_{E,i,t}$	$i = 4$	0.2179	0.2179	0.2179	0.2179	0.2179	0.2179
	$P_{E,i,t}$	$i = 5$	0.2571	0.2571	0.2571	0.2571	0.2571	0.2571
	$P_{E,i,t}$	$i = 6$	0.2336	0.2336	0.2336	0.2336	0.2336	0.2336
Total Conveyance Revenue	$R_{E,t}$		17,899	17,871	18,731	19,637	20,581	21,566
Depreciated Asset Value (calculated in accordance with Condition 4.4.7)	$DAV_{E,t}$		118,159	127,428	136,460	145,302	154,033	162,795
Total Regulatory Value (calculated in accordance with Condition 4.4.8)	$TRV_{E,m}$							201,176

**Table 12: Proposed FE Determination Values**

- 5.12 The licence (Annex 6) sets out the figures for the full revenue recovery period until 2045.
- 5.13 The Determination Values that are required to change as a consequence of the proposed consultation implantations are detailed below.

Determination Values	Description (for Conveyance Categories i and Formula Years t)	Document Reference re: Reasons for Proposed Licence Modification
$V_{E,i,t}$	Volume	See section 4 on impact on Volumes and updated Connections.
$C_{E,t}$	Capital Expenditure	See sections 2 and 4 on capex.
$O_{E,t}$	Operating Expenditure	See sections 3 and 4 on opex.
$D_{E,t}$	Annual Depreciation	Changed to reflect updated capex numbers in sections 2 and 4.
$F_{E,t}$	Cash Flow (calculated in accordance with Condition 4.4.6)	Changed to reflect changes in opex, capex, volumes and allowed revenue, and calculated as a function of those.
$P_{E,i,t}$	Revenue Per Unit	Output of FE Pi model (published as Annex 5), in line with licence formulae.
$R_{E,t}$	Total Conveyance Revenue	Output of FE Pi model (published as Annex 5) in line with licence formulae.
$DAV_{E,t}$	Depreciated Asset Value (calculated in accordance with Condition 4.4.7)	Changed to reflect updated capex allowances and annual depreciation, and calculated as a function of those.
$TRV_{E,m}$	Total Regulatory Value (calculated in accordance with Condition 4.4.8)	The TRV has changed due to the updated values of the GD17 price control, in terms of costs, allowed revenue and rate of return, which must be returned to the licence holder via conveyance charges paid for by consumers.

**Table 13: FE - References for Substantiation of Proposed Determination Values**

## Reasons

- 5.14 The reason for the proposed licence modifications is to give effect to the reconsideration and determination of matters remitted to the Utility Regulator by the CMA in its final determination of the GD17 firmus energy appeal, specifically:
- The reconsideration and determination of connection targets which is described in Section 2 above.

- The reconsideration and determination of non-additionality which is described in Section 3 above.
  - The determination of the consequential effects of our reconsideration and determination of connection targets and non-additionality which is described in Section 4 above.
- 5.15 The reason for the licence modification is to ensure that FE receives an efficient set of allowances to operate its network functions, cognisant of the CMA recommendations and directions.
- 5.16 The reason for modifying the Determination Values is because they form an integral part of the licence formulae which in turn produces a set of revenues and prices which will drive the tariffs set by FE to operate its business.

## Effects

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- 5.17 The changes detailed above will result in a small decrease to conveyance charges and enable FE to recover all its allowable costs via tariffs.
- 5.18 This proposed decrease can be added to the existing PI model to show the effect of this change.
- 5.19 Should the proposed modification proceed to be made, it will have the following consequential effect on the existing domestic distribution network tariff:
- A 0.0001 p/therm, and
  - The impact on a final domestic bill will be 0.01% decrease or £0.05 less on an annual basis.

# 6 Next Steps

## Submission of Consultation Responses

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- 6.1 This is an open consultation paper. We invite stakeholders to express a view on any particular aspect of the paper or any related matter. Responses should be received on or before 12noon on 2 February 2018 and should be addressed to:

Paul Harland  
Finance and Network Assets

Northern Ireland Authority for Utility Regulation  
Queens House  
14 Queen Street  
Belfast  
BT1 6ED  
Tel: 028 9031 1575

Email: [Gas\\_networks\\_responses@uregni.gov.uk](mailto:Gas_networks_responses@uregni.gov.uk) with cc to [paul.harland@uregni.gov.uk](mailto:paul.harland@uregni.gov.uk)

Our preference would be for responses to be submitted by e-mail.

- 6.2 We note that we may make public any responses to this consultation on licence modifications. If you do not wish your response or name made public, please state this clearly by marking the response as confidential. Any confidentiality disclaimer that is automatically produced by an organisation's IT system or is included as a general statement in your fax or coversheet will be taken to apply only to information in your response for which confidentiality has been specifically requested.
- 6.3 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes; these are primarily the Freedom of Information Act 2000 (FOIA) and the Data Protection Act 1998 (DPA). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things with obligations of confidence.
- 6.4 In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Authority.
- 6.5 This document is available in accessible formats. Please contact Paul Harland on 028 9031 1575 or email: [Gas\\_networks\\_responses@uregni.gov.uk](mailto:Gas_networks_responses@uregni.gov.uk) with cc to [paul.harland@uregni.gov.uk](mailto:paul.harland@uregni.gov.uk) to request this.

## Timelines

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6.6 Table 14 provides an overview of the next steps.

Next Steps	Date
Closure of CMA FE Consultation paper on proposed licence modifications.	2 February 2018

**Table 14: Next Steps**

# Annexes

Document	Document Link
Annex 1	<a href="#">Case Study on Owner Occupied Gas Connections in Greater Belfast</a>
Annex 2	<a href="#">SMR Survey Results</a>
Annex 3	<a href="#">Case Study of the Republic of Ireland Market</a>
Annex 4	<a href="#">Examples of Gas Networks Ireland Marketing Material (2015-2017)</a>
Annex 5	<a href="#">FE PI Model</a>
Annex 6	<a href="#">FE draft license with marked up amendments</a>
Annex 7	<a href="#">Notice under Article 14(2) of the Gas (Northern Ireland) Order 1996 – Modifications proposed to the gas conveyance licence held by firmus energy (Distribution) Limited.</a>