



Peter Swann
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Competition and Markets Authority
Victoria House
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19 January 2017

Dear Peter

Re: Firmus Energy licence modifications appeal under Article 14B(1) and (3) of The Gas (Northern Ireland) Order 1996 (as amended by The Gas and Electricity Licence Modification and Appeals Regulations (Northern Ireland) 2015)

The Consumer Council is asking to be formally regarded as an interested third party to this appeal.

The Consumer Council's principal statutory duty is to promote and safeguard the interests of consumers in Northern Ireland (NI). We have a range of functions, duties and powers in respect of energy which are principally provided for through the Energy Order (NI) 2003.

The Consumer Council has a statutory function within the Gas (Northern Ireland) Order 1996 (as amended by The Gas and Electricity Licence Modification and Appeals Regulations (Northern Ireland) 2015) (the Order), whereby:

- Under Article 14B (2)(d) the Consumer Council has the power to appeal a licence modification to the CMA in the capacity of representing consumers whose interests are materially affected

by the decision. The Consumer Council is the only non licence body to have this power; and

- Under Article 14 (4)(b) the Northern Ireland Authority for Utility Regulation must send a copy of a notice stating that it intends making modifications to licence conditions to the Consumer Council.

As a statutory consultee within the GD17 Price Control process, we have engaged with the Utility Regulator and the three GDNs. However, as we have previously stated within this process, we would have preferred to see a formal consumer input to the process (as has been seen in Ofgem's RIIO process and the start to Northern Ireland Electricity Networks RP6 Price Control).

The Consumer Council fully supports the five principles of better regulation:

1. Consistency - rules and standards must be joined up and implemented fairly;
2. Transparency - be open and keep regulations simple and user-friendly;
3. Accountability - be able to justify decisions and be subject to public scrutiny;
4. Proportionality - only intervene when necessary. Remedies should be appropriate to the risk posed and costs identified and minimised; and
5. Targeting - regulation should be focused on the problem and minimise side effects.

The Consumer Council fully supports the extension and infill of the natural gas network across Northern Ireland. Natural gas offers consumers the following benefits over alternative heating sources:

- The cost of oil is volatile compared to natural gas and on average over the last five years natural gas has been 3.9% cheaper than oil;
- It is a regulated industry and offers protection for vulnerable consumers through Codes of Practice;

- Due to a variety of payment methods such as prepayment meters, low income consumers are less likely to self disconnect;
- Natural gas offers constant availability whereas oil requires delivery;
- Modern natural gas boilers provide high levels of energy efficiency; and
- Natural gas is the most efficient and lowest carbon producer of the fossil fuels and can provide a stepping stone to a fossil free energy future. The Consumer Council acknowledges and supports the aim of achieving a carbon free renewable energy industry in NI.

The Consumer Council has extensive experience in representing NI consumers in utility price controls and in doing so we bring a unique and important perspective. Over a number of years we have responded to Price Control Draft Determinations for all the network gas and electricity and regulated gas and electricity supply companies in NI. In recent years we have given both written and oral evidence to the Competition Commissions appeals into the Phoenix Natural Gas Price Control and the NIE Price Control. Along with the Regulator, the Department for the Economy and NIE we sit on the Consumer Engagement Advisory Panel (CEAP) which coordinates consumer engagement for the NIE Networks electricity Price Control.

We understand the grounds upon which the CMA will consider this appeal as laid out in Article 14D of ‘the Order’ and the four grounds in the Price Control Determination upon which Firmus Energy has brought its appeal. In making this submission, and in previous submissions that we have made in regarding the Price Control, we are clear that our role is not to assume the role of the regulator by scrutinising each line of the Price Control. Rather, we seek to help the Utility Regulator by identifying how the Price Control can deliver consumer benefits and where it may cause consumer detriment. In our response to the UR GD17 Draft Determination, we identified how the GD17 Price Control can benefit consumers by:

- Ensuring that the company delivers value for money for consumers;
- Increasing the take up of gas;

- Ensuring that there is sufficient investment to maintain a safe and resilient network;
- Balancing equitably the financial risks in the business between consumers and the company; and
- Creating an equitable balance of both the benefits and costs of investment between current and future gas users.

In this appeal we wish to submit evidence only in relation to grounds (a) and (b) of Article 14D (4) of the Order as we feel the CMA, and other expert bodies, are better placed than the Consumer Council to assess whether there is an error in fact or in law, or whether the modifications achieve the effect stated by the Utility Regulator.

Grounds (a) and (b) require the CMA to consider whether the Utility Regulator gave proper regard and appropriate weight to its principal objective in gas and its general statutory duties in relation to gas. The principal duty of the Utility Regulator in relation to gas is to ‘promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland’. In carrying out this duty it must have regard to:

- The need to protect the interests of consumers; and
- The need to secure that licence holders are able to finance its activities.

In its Notice of Appeal, Firmus Energy stated on a number of occasions and against each ground that the Utility Regulator failed to have regard to and/or give appropriate weight to its principal objective and that it failed properly to have regard to and/or give appropriate weight to its statutory duty to secure that licence holders are able to finance their licensed activities. We believe that in considering grounds (a) and (b) of Article 14D(4) of the Order, the CMA will need to define what the principal duty the Utility Regulator has in relation to gas means in practice. In our view, the principal duty of the Utility Regulator in relation to gas can be defined as acting to develop a gas industry that provides a long term benefit to the NI economy and NI consumers.

We would ask the CMA to consider any points of conflict exist between the apparent interests of consumers and the ability of the company to finance its activities in grounds (a) and (b) of Article 14D(4) of the Order,

and whether the Utility Regulator reasonably and equitably reconciled these in its Final Determination.

To assist the CMA in assessing whether the Utility Regulator had regard and/or gave appropriate weight to its statutory duty to protect the interests of consumers, we provide a summary below of the engagement we had with the Utility Regulator and Firmus Energy during the GD17 process:

- Early in the GD17 process we attempted to set up a formal consumer engagement process with the three GDN's (Firmus Energy, Phoenix Natural Gas Limited and SGN) and the Utility Regulator. We had two meetings on this, but ultimately the GDN's were reluctant to provide data and unfortunately no meaningful progress could be made. After this the only formal exchanges on consumer views/issues were with the Utility Regulator. Once the Final Determination was published the Utility Regulator formally responded to our comments on its Draft Determination. We have attached this document as Annex 1 to this letter.
- Throughout the GD17 price control process, the Consumer Council has worked with the Utility Regulator and met formally/informally on several occasions. A timetable of our engagement as the statutory consumer representative is outlined below:
 - December 2014: The Utility Regulator published its Discussion Paper on Approach for the Gas Distribution Price Control GD17. We responded in February 2015;
 - 16 March 2016: The Utility Regulator published its GD17 draft determination. We formally responded on 31 May 2016;
 - 20 March 2016: We attended the Utility Regulator's GD17 consumer engagement workshop;
 - 10 May 2016: We attended an industry workshop that was hosted by the Utility Regulator. This workshop provided an overview of its Draft Determination.

- May 2016: We had bi-lateral meetings with the Utility Regulator to further interrogate aspects of GD17 and how it affected consumers.
- May 2016: The Utility Regulator consulted on its Draft Determination. In preparing our response we procured the services of 'Reckon' to provide expert economic analysis from the consumer's perspective. We have attached our response and the paper produced by Reckon as Annex 2 and 3 to this letter.
- 12 September 2016: We met with the Utility Regulator and obtained a final overview of GD17 and its impact upon consumers.
- 15 September 2016: The Utility Regulator published its GD17 final determination. At the same time the Utility Regulator formally responded to our comments on its Draft Determination.

In the section below we set out the material effect on consumers that is contained in the grounds of the appeal and summarise our views on these. More detail is contained in the attachments to this letter.

1: Opex

Material affect on consumers: The difference between the operating expenditure allowance requested by Firmus Energy and that determined by the Utility Regulator is £4.43m. Any increase in allowed opex will ultimately be paid for by consumers through their bills. It is therefore important that any increase in this allowance is fully justified and that it fairly balances the needs of the company and that of the consumer.

We did not address the opex directly in our response to the Draft Determination as it involved taking a view on the methodology adopted and the data revealed. We believe that the CMA is best placed to assess the validity of methodology and data used.

2: Connections Incentive

Material affect on consumers: The Business Plan submitted by Firmus Energy aimed to connect 16,724 domestic owner occupier properties between 2017 and 2022. By contrast, the Final Determination by the Utility Regulator set a target of 20,450. If the relief sought by Firmus Energy is implemented there will be a 22% reduction in the number of properties that Firmus Energy is targeting to connect during the Price Control period. Therefore this ground will materially affect the ability of 3,726 consumers to connect to natural gas.

From our discussions with the Utility Regulator, it is clear that the connection incentive was never intended to be a long term allowance and with this in mind, both PNGL12 and GD14 proposed reducing the incentive allowance by 50% from 2017. We believe it is reasonable, that since these proposals, for the GDNs to have implemented strategic measures to adequately manage this proposed reduction in the incentive.

We have seen no evidence that the connections incentive actually make a difference to the number of connections that are made by a GDN. Furthermore, the setting of connections targets is not transparent and in the final analysis the GDNs in NI have comfortably exceeded them. Finally, as there is no requirement on the GDNs to show how the connections allowance is actually spent, consumers cannot transparently see a direct correlation between the connections allowance received and connections made.

In its Draft Determination, the Utility Regulator proposed a collar on the connections incentive which we opposed on the basis that it removed any incentive to keep making connections if a connections target had not been met. We were pleased to see that the Utility Regulator recognised that this represented a potential detriment to consumers and removed the proposal from its Final Determination. This suggests that the Utility Regulator did have regard to its duty to protect consumers on this matter.

3. Under recoveries

Material affect on consumers: The Rate of Return that is applied to the under recoveries will be reflected in the price paid for gas

by all Firmus Energy customers. This is a material affect on consumers of natural gas in the Firmus Energy licence area.

Recognising the detrimental affect that the 7.5% rate of return on under recoveries has had on consumers, we support the proposal to reduce this to LIBOR +2%. While this might cause upward pressure on gas prices until 2019, the overall reduction in gas distribution charges set out in Utility Regulator Draft Determination provides an opportunity to remove the under recovery without noticeable impact on consumers. In our response to the Draft Determination, we asked the Utility Regulator to consider whether it is a fair distribution of risk and reward between customers and Firmus Energy which will result in customers being charged an additional £4.3m over 3 years to clear the under recovery, and we would welcome the CMA's view on this.

4: WACC and financeability

Material affect on consumers: The Utility Regulator Final Determination set the overall WACC for FE at 4.3%. In its appeal Firmus Energy seeks relief by the setting of a WACC of 4.9%. The 0.6% difference between the two figures will be reflected in the final bill of all Firmus Energy natural gas consumers. According to the Utility Regulator, every 0.1% added to the WACC of Firmus Energy will add £1.33 to every annual consumer bill. On the basis of Firmus Energy's proposals consumers would on average be asked to pay an additional £7.98 per year as compared to the Utility Regulator's Final Determination.

We welcome the approach of the Utility Regulator to refinancing. It attempts to bring certainty to revenue streams and reduce the financial risk to consumers. We believe that based on the evidence in the Draft Determination the Utility Regulator conducted a thorough review of the rate of return. However, we noted that without explanation, the Utility Regulator has chosen an asset beta rate at the high end of its own range rather than one in the middle of the range.

As a matter of process we wish to point out that unlike previous Price Control appeals in which we were asked to submit evidence and despite

our unique statutory role in the appeals process, we were not advised directly of the CMA's 19 January 2017 deadline to declare interest as a third party and submit a statement. We only became aware of the CMA's 19 January 2017 deadline on 11 January 2017 when we were advised that that deadline had been published on the CMA website. As such we have had five working days to prepare this submission.

We would welcome the opportunity, if afforded by the appeal panel, to expand further on this paper and/or give oral evidence to the panel.

Please do not hesitate to contact me if you wish to discuss this further.

Yours sincerely

John French
Chief Executive