



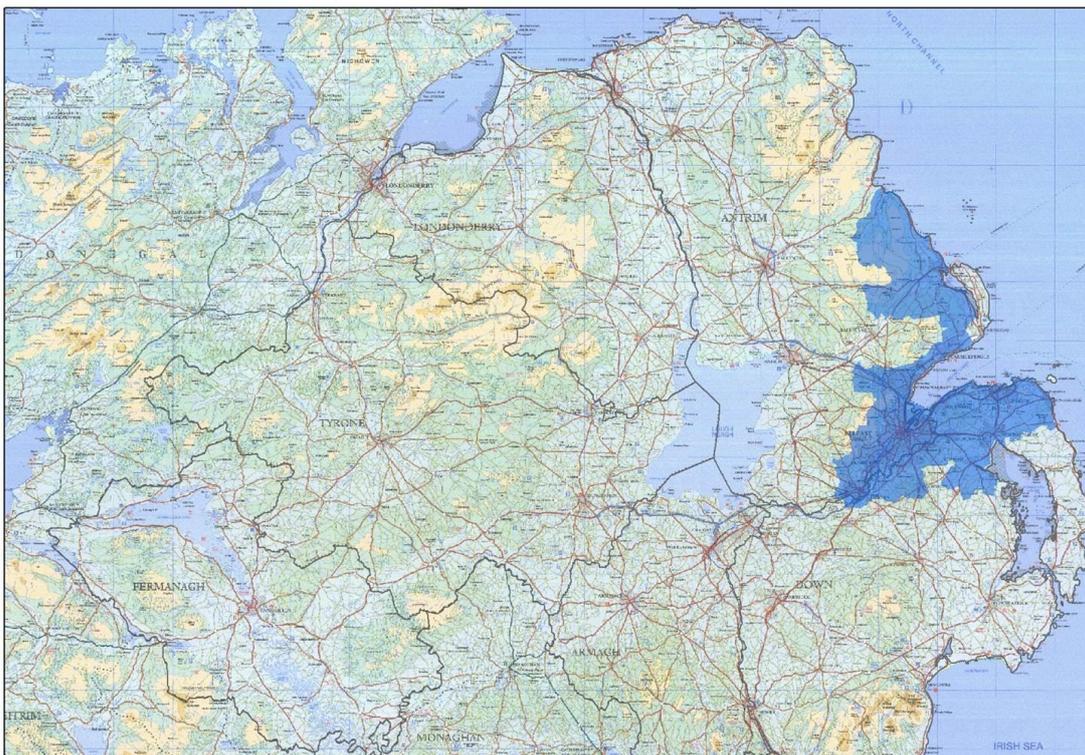
## Who we are

Phoenix Natural Gas Ltd. ("**Phoenix**") is the largest natural gas distribution business in Northern Ireland, being the owner and operator of the Licence<sup>1</sup> for the distribution of natural gas in the Greater Belfast Area and Larne.

We are responsible for the development of the pipeline network and also for providing a 24/7 operational and transportation service platform to Gas Suppliers.

At the time of its launch in 1996, the Phoenix project was one of the largest greenfield, private sector-led integrated gas transmission, distribution and supply investments in Western Europe. Our task was an unusual project in the United Kingdom, since it involved retrofitting a gas distribution network in a major city. Most importantly, we faced the challenge of developing a network and a market for natural gas from scratch.

The Phoenix network currently extends to over 3,300 kilometres of pipeline which distributes natural gas throughout our Licensed Area (figure 1) representing c.40 per cent. of the population of Northern Ireland.



*Figure 1: the Phoenix Licensed Area shown in blue*

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<sup>1</sup> Phoenix's original licence was a combined licence for the conveyance and supply of gas in our Licensed Area. The conveyance part of the licence allowed Phoenix to construct and operate both a transmission and distribution network in Northern Ireland, and the supply part of the licence allowed Phoenix to supply gas to customers from that network. In line with the requirements of the Second EU Gas Directive 2003/55/EC, Phoenix legally separated its gas supply division from its transmission and distribution business on 1 January 2007 and on 31 March 2008 Phoenix completed the sale of its transmission assets to Northern Ireland Energy Holdings. The supply and transmission parts of the original combined Phoenix licence now held by Phoenix have been revoked by DETI and all references to supply and transmission activities have been deleted from the licence.

A fundamental part of the Phoenix business plan has been to extensively develop all sectors of the market delivering the benefits of natural gas to homes and businesses throughout our Licensed Area. To that end Phoenix has had a clear focus in meeting (and in fact exceeding) its licence obligations in respect of coverage of the network. As at 31 December 2014, we had made gas available (in accordance with the terms of the Licence) to c.307,000 properties and connected c.182,000 (59 per cent.) properties to our network.

From an environmental point of view, Phoenix is dedicated to helping make Northern Ireland a cleaner, healthier place to live and work. In operating the business we have attained International Standard ISO 14001 (Environmental Management System) accreditation. In addition, the conversion of properties to natural gas produces c.25 per cent. less carbon dioxide emissions than other fossil fuels. In the last c.19 years natural gas consumers across the Phoenix Licensed Area - businesses in the public and private sectors and households - have prevented c.4 million tonnes of carbon dioxide from entering the atmosphere.

### **Purpose of this Paper**

Our business is a natural monopoly; the construction of a natural gas network is asset intensive and it does not make sense nor would it be economic for another business to lay another natural gas network alongside the Phoenix network.

Price controls are generally needed for natural monopolies as a proxy for competition. Our business is regulated under licence by the Northern Ireland Authority for Utility Regulation (the Utility Regulator, “UR”). UR carries out price controls on Phoenix and the other network companies in Northern Ireland to ensure that we remain amongst the most efficient operators in the UK.

We recover our costs from Gas Suppliers. Gas Suppliers set the actual tariffs that are charged to consumers. Our costs currently make up c.35 per cent. of a domestic natural gas consumer’s bill.

Our current price control runs until 31 December 2016. This paper provides an overview of the submission we have made to UR of the costs we need to drive our business forward, and in particular the costs we need to run our business over the six year period from 2017 to 2022. This six year price control period is referred to as “**GD17**”.

## Our GD17 Business Plan

Our GD17 Business Plan has been submitted to UR and essentially sets out the costs we need to run our business over the six year GD17 price control period i.e. from 2017 to 2022. This Business Plan has been developed to deliver upon our Vision and our Corporate Objectives:

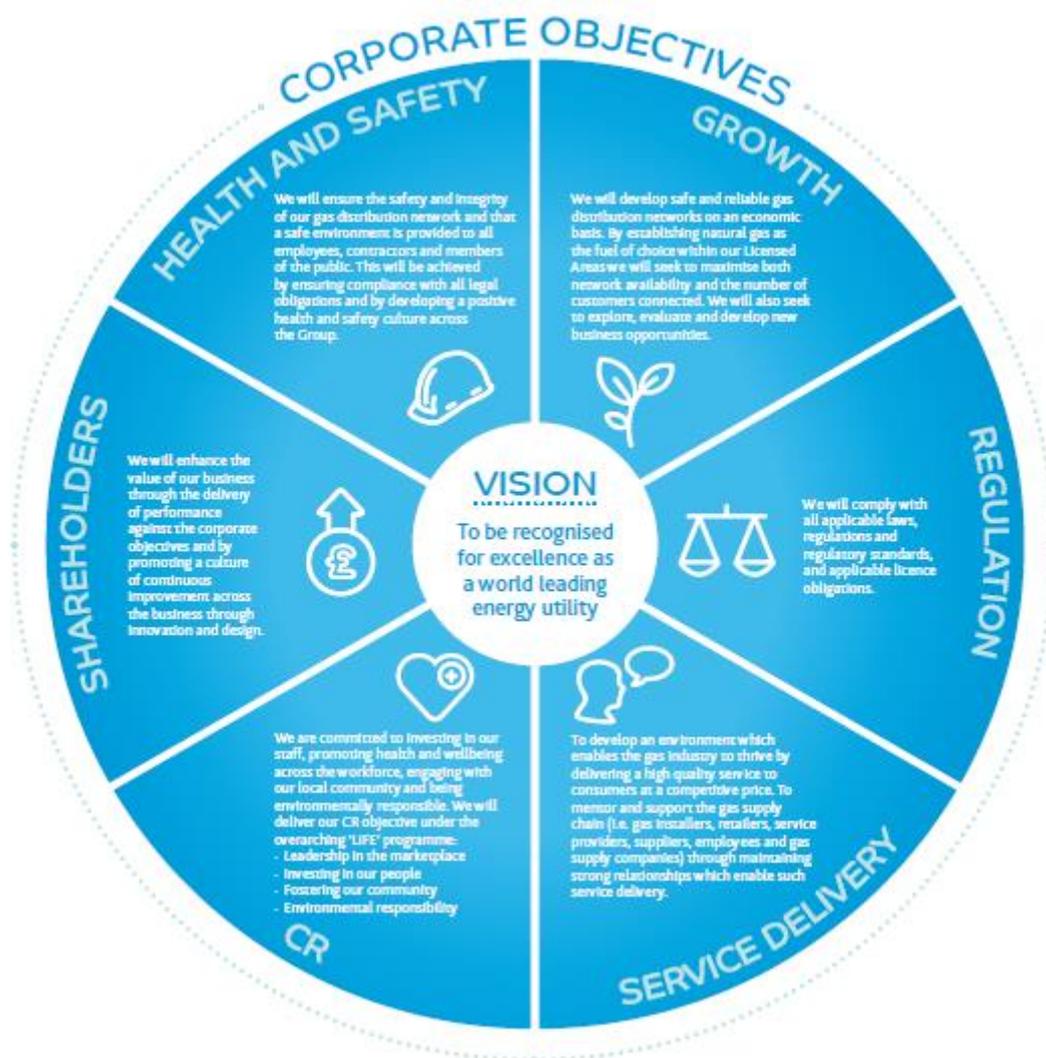


Figure 2 - Our Vision and Corporate Objectives

### Stakeholders' views

We have always recognised the importance of effective engagement with a broad range of stakeholders to achieve our Corporate Objectives. Our stakeholders provide us with a better

understanding of the impacts that may be felt by an individual or group and allow us to articulate our own values, strategy, explain our commitments and proactively improve relationships.

To ensure that our GD17 Business Plan reflects current views, we have undertaken additional research to explore current attitudes and perceptions of gas consumers and potential gas consumers with respect to:

- Attitudes towards safe and reliable network operation;
- Identifying differences in views on the introduction of connection charges among gas and non-gas consumers;
- Attitudes towards the extension of the gas network within our Licensed Area;
- Perceptions of our Marketing initiatives;
- Perceptions of gas among potential gas consumers not currently connected;
- Attitudes towards gas and likelihood of connecting to gas if connection charges are applied; and
- Satisfaction with heating systems among non-gas consumers.

Furthermore 13 representatives of key stakeholders (see figure 3) took part in our research to ensure that, as well as developing quantitative trends, there was an opportunity to gather more qualitative views of organisations in key areas of the business in GD17.

<b>Stakeholder organisation</b>
Energy Saving Trust
National Energy Action
NI Natural Gas Association
Business in the community
Northern Ireland Independent Retail Association
Northern Ireland Housing Executive
Confederation of British Industry – Northern Ireland
Bryson Energy (part of the Bryson Group)
Manufacturing NI
Institute of Directors
Age Sector Platform
Federation of Small Business
Consumer Council for Northern Ireland

*Figure 3 - List of participating stakeholder organisations*

The overwhelming majority of consumers surveyed felt that it is very important to have a safe and reliable supply of gas. This was further reflected with high levels of agreement that the current levels

of maintenance on our network should be sustained to support the existing performance levels of the gas network.

There were also high levels of support for continued free connections to the gas network and for extending the gas network within our Licensed Area.

Further, there was broad support among consumers for us to continue to market the benefits of converting to natural gas to ensure as many consumers as possible take advantage and also for our corporate social responsibility programme.

In terms of incentives there was broad support for continuing to provide incentives for all new customers converting to natural gas, while less than one quarter of consumers felt that incentives should be restricted to only those households in fuel poverty.

The results of the stakeholder consultation broadly reflected the results of the consumer survey with respect to network operation, new connections to the network, extension of the gas network and marketing initiatives to support the development of the natural gas industry. Like consumers, stakeholders indicated that a safe, reliable supply is important and that current levels of maintenance should be sustained.

In line with the results of the consumer survey, the stakeholder consultation also identified that stakeholders believe it is important for us to continue to offer a free standard connection to the network and that this should last for the duration of the next price control period.

Perhaps more so than consumers, stakeholders were favourable to the extension of the network for both domestic and commercial properties.

### *Network Maintenance*

We have always recognised the importance of our network maintenance activities to ensure that we deliver a safe and reliable supply of gas.

Last year, work began to migrate toward the requirements of International Standard ISO 55001.

We are continuing to implement Reliability Centred Maintenance to ensure that we continue to operate an efficient maintenance program whilst working towards ISO 55001 accreditation.

## Key Deliverables

This market research has informed our proposals on a number of aspects of our GD17 Business Plan.

Our network maintenance activities over the six year period from 2017 to 2022 have been identified to ensure a safe and reliable supply of gas. In addition Phoenix is dedicated to improving the lifestyles of its consumers and to helping make Northern Ireland a cleaner, healthier place to live and work by delivering the benefits of natural gas to as many homes and businesses throughout its Licensed Area as are economically viable. We are therefore proposing the following key deliverables over the six year timeframe:

### Gas availability

In March 2012, a report commissioned by the Consumer Council for Northern Ireland recognised that a key strategic aim of Northern Ireland's Energy Policy should be the radical reduction of Northern Ireland's dependency on home heating oil.

Subsequently organisations such as National Energy Action and Age Sector Platform have recognised the importance of the continued development of the natural gas network and take up of natural gas, where available, reducing the current levels of fuel poverty in Northern Ireland.

We are therefore proposing to make natural gas available to a further c.5,000 properties<sup>2</sup> within our existing Licensed Area between 2017 and 2022. In doing so, we hope that we will be contributing to reducing the current levels of fuel poverty in Northern Ireland and reducing Northern Ireland's carbon footprint.

### Connections

We are proposing to connect c.50,000 properties to our natural gas network between 2017 and 2022, including c.24,000 existing owner occupied properties.

For existing householders, the cost of retrofitting a natural gas heating system is one of the primary obstacles to connection.

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<sup>2</sup> figure excludes new build housing. We are also proposing to make natural gas available to c.3,000 new build properties each year

The success of the development of the market in our Licensed Area is evidenced by the fact that at the end of 2014, c.18 years after our Licence was granted, c.59 per cent. of properties with access to our network have connected.

We are therefore requesting that UR maintains its current position whereby we are granted an allowance for the cost of providing a complete service connection and provision of a meter installation during GD17.

This will allow us to continue to offer householders a free standard connection to the network between 2017 and 2022.

### **Market development**

In our experience every property owner needs some level of market development activity i.e. advertising, meeting with an Energy Advisor or a financial incentive, to persuade them of the benefits of natural gas and to guide them through the connection process.

Our Sales team includes highly trained and experienced Energy Advisors who visit over 10,000 households each year. When introducing householders to the benefits of natural gas, we have consistently promoted the highest standard of energy efficiency products and appliances.

Attracting new homes and businesses to natural gas is challenging and must be tackled on a number of fronts to remain effective; there is no single message which can be communicated which will stimulate every consumer to switch to natural gas. We have demonstrated that our current market development activities have been successful in penetrating each market sector. These activities have focussed on (i) advertising and PR; (ii) providing a Sales team to identify and engage with prospective consumers to persuade them that, despite the obstacles to connection, the benefits of natural gas are a worthwhile investment; and (iii) incentivising domestic consumers to make the switch to natural gas.

Our GD17 Business Plan supports the continuing need to invest in market development activities over the six year price control period between 2017 and 2022 to maintain the prominence of natural gas in the minds of consumers across all market sectors, to persuade more homes and businesses of the benefits of natural gas and to guide them through the connection process.

## Outputs

Phoenix forecasts average annual costs of c.£33m (£2014) to facilitate delivery of its objectives over the six year period from 2017 to 2022.

These costs cover:

- i. the operating costs we need to run our business e.g. maintaining the network, providing an emergency service, manpower, IT systems etc.; and
- ii. the capital costs we need to develop our network e.g. making gas available and connecting properties to our network.

In addition we need to be compensated for the costs of financing these investments (both future and past investments) given that costs are recovered over a long timeframe. We have carefully considered prevailing financial conditions and are proposing a real, pre-tax cost of capital in the range of 4.9 to 5.5 per cent. over the six year period from 2017 to 2022. This compares to our current cost of capital of 7.5 per cent. which is fixed until 31 December 2016.

This information feeds into our regulatory model which calculates our annual revenue requirement of c.£60m (£2014) over the six year period from 2017 to 2022.