



## **PAPER TO ETI COMMITTEE ON DEVELOPMENT OF THE NATURAL GAS INDUSTRY IN NORTHERN IRELAND**

### **Background**

1. Unlike the rest of the United Kingdom where the natural gas industry started in the 1970s, Northern Ireland, due to not having any indigenous natural gas, only gained access to supplies of natural gas in the 1990s. The purchase of Ballylumford Power Station (the provider of approximately 50% of Northern Ireland's electricity) by British Gas for conversion from oil to gas firing as part of the restructuring and privatisation of the local electricity supply industry acted as a catalyst for establishment of a natural gas industry in Northern Ireland. The baseload requirement of Ballylumford provided the opportunity for the development of a commercially viable downstream (meaning the gas operations that take place after the production phase through to the sale to the consumer) natural gas industry in Northern Ireland.
2. Premier Transmission Ltd (then known as Premier Transco) constructed an undersea gas pipeline between Scotland and Northern Ireland (SNIP) and gas arrived in Islandmagee (Ballylumford Power Station) in September 1996. SNIP supplies the requirements of both Ballylumford Power Station and the downstream retail gas markets. Ballylumford became fully operational on gas in April 1997. The conversion of Ballylumford to natural gas, along with construction of the SNIP, the Belfast Transmission Pipeline and associated works secured assistance of almost £69 million from European Regional Development Fund (ERDF). In 2005, Coolkeeragh Power Station in Londonderry became operational, and is supplied with natural gas from SNIP via the North-West gas pipeline.

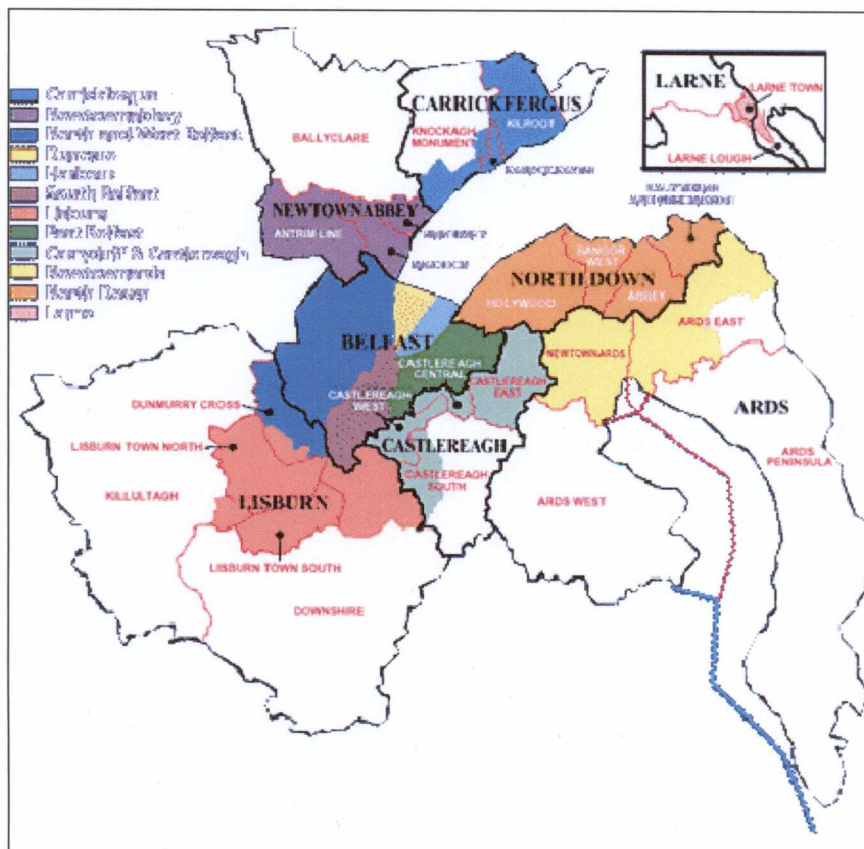
### **Phoenix Natural Gas**

3. In September 1996 a licence was granted to Phoenix Natural Gas for the staged development of the industrial, commercial and domestic gas markets in the Greater Belfast and Larne areas. Initially the company was 100% owned by British Gas, but it was subsequently taken over in 2003, by East Surrey Holdings (ESH).
4. In November 2005 Terra Firma Investments completed the acquisition of East Surrey Holdings, the parent company of Phoenix Natural Gas. Terra Firma continued to operate Phoenix under the terms of its original 1996 licence from the Regulatory Authority. However all parties accepted that this 20 year licence did not provide a sufficiently long period for recovery of capital and maintenance costs, with the need to significantly raise gas distribution charges identified.

5. On 28 November 2006, after protracted discussions, the then Northern Ireland Authority for Energy Regulation (NIAER) and Terra Firma/ Phoenix came to a mutual agreement regarding the licence negotiations. The new Phoenix licence extends the previous licence by 30 years, to 2046, allowing costs to be recovered over a longer period, therefore providing regulatory certainty, and investor confidence. The agreement also included provision for the sale of the Phoenix gas transmission business which includes the Ballylumford to Knocknagoney gas transmission pipeline – also known as the Belfast Transmission Pipeline (BTP).
6. In May 2007, Phoenix announced that Northern Ireland Energy Holdings (NIEH) was the preferred purchaser of its gas transmission business. NIEH is a “not for dividend” company which owns and operates the Moyle electricity and Scotland to Northern Ireland (SNIP) gas interconnectors with Great Britain. NIEH obtained the necessary funding for the BTP by means of a mutualised bond at a low financing rate, thus ensuring a financial return in the region of £25 million over 40 years to Northern Ireland consumers. The transaction was concluded on 31 March 2008.

### Belfast Gas Market

7. Phoenix Natural Gas Ltd (PNG) has a licence to develop its network in the areas defined in the map below. This includes Carrickfergus, Carryduff, Castlereagh, Duncrue, East Belfast, Harbour, Larne, Lisburn, Newtownabbey, Newtownards, North and West Belfast, North Down and South Belfast. In 2007 the licence was extended to include the electoral wards of Comber North, Comber South, Comber East, Comber West and Lisbane and also to connect the Temple Quarry to the network.



As of the 31 December 2007 the number of premises which could be readily connected to the Phoenix network was approximately 258,000.

8. At present there are approximately 116,500 natural gas customers in the Phoenix licensed area of Greater Belfast and Larne, of which 107,000 are domestic and 9,500 are industrial and commercial. Some of the more well known companies currently supplied by Phoenix include FG Wilson, Montupet and Ryobi Aluminium Casting UK Ltd as well as the NHS Hospitals and Belfast City Council.
9. The Phoenix domestic customer base was reviewed at the end of March 2008 in advance of the tariff review. At that time the domestic customer base was as follows:

Payment Method	Number of Customers	Percentage by payment method
Standard Credit	24,182	23
Direct Debit	25,896	24
Pay As You Go (PAYG)	56,873	53
<b>TOTAL</b>	<b>106,951</b>	<b>100%</b>

#### Competition levels in the market

10. Full gas supply market opening commenced on 1 January 2007 in the Greater Belfast and Larne licensed areas. Although the Belfast market is fully open to supply competition, to date no domestic customers have switched suppliers.
11. Minimal switching has taken place in the non-domestic sector. Energia, the retail electricity and gas supply arm of the Viridian Group, made the first customer switch in Belfast with Thompson Feeds. In December 2007, Allied Bakeries in Belfast switched to being supplied gas by *firmus energy*.

#### BGE/Firmus Energy

12. On 21 September 2001 the Northern Ireland Executive announced its support for the development of a multi million pound project to extend the gas network. The support was in the form of a grant package up to £38m, including an Irish Government contribution of £8.5m.
13. The project involved the construction by Bord Gáis Éireann Northern Ireland (BGE NI), a subsidiary of the state owned Republic of Ireland gas company, of two gas transmission pipelines. A gas pipeline from Dublin to Antrim (known as the South - North pipeline) was completed in October 2006. This pipeline connects with the first pipeline in the project, from near Carrickfergus to Londonderry (the North- West pipeline) which was completed in November 2004, and which supplies gas to Coolkeeragh power station.
14. These gas transmission pipelines will facilitate the supply of gas to towns along their route e.g. Newry; Armagh; Banbridge; Craigavon; Antrim; Ballymena; Ballymoney; Coleraine; Limavady and Londonderry, by *firmus energy* which is the gas distribution and supply subsidiary of BGE (NI). Key commercial customers who have connected to date include Altnagelvin Hospital, the University of Ulster at the Magee campus, Michelin Tyres in Ballymena, and Armaghdown Creamery at Banbridge.

15. The BGE / *firmus* licence is different from that granted to Phoenix Natural Gas in Belfast in that gas will only be provided in the *firmus* licence area where there is an economic case for doing so, hence not all potential customers will be provided with a gas supply. Target customer groups are industrial and commercial (I&C), public sector, NIHE, and private new build housing. *firmus* had around 3,000 customers and aim to have approximately 60,000 customer connections over the period of the current licence.

## Gas Prices

16. On 24 April 2008 Phoenix Supply Limited (PSL), the gas supply company within Phoenix Natural Gas, announced a 28% price increase to be applied from 1 May 2008. PSL advised that this increase was due to the rising wholesale cost of gas.

17. On 31 March 2007 PSL reduced natural gas tariffs by an average of 14.6% which reflected the reduction in wholesale gas costs at that time. The company has been able to maintain its prices at this level for the whole of the past 12 month period, including the recent winter period. Tariff change announcements in recent years by Phoenix for their licensed area of Greater Belfast and Larne have been as follows:

October 2004	11.3% increase (↑)
October 2005	29.9% increase (↑)
January 2006	17.3% increase (↑)
October 2006	14.5% increase (↑)
March 2007	14.6% decrease (↓)
April 2008	28% increase (↑)

18. However, since the third quarter of 2007 the wholesale energy market has been very challenging and there have been constant and sustained increases in wholesale oil and gas prices (recently oil prices have been consistently around \$120 per barrel). This has contributed to a significant increase in prices within the wholesale gas market.

19. There have also been a number of other factors which are influencing wholesale gas prices. For example, UK wholesale prices are now subject to a greater degree of influence from global markets as a consequence of the increased reliance on Liquefied Natural Gas (LNG) imports. Over recent months, several significant cargoes of LNG destined for the UK have been diverted to other countries leading to upward pressure on wholesale prices.

20. PSL has indicated that the wholesale gas prices predicted for the summer period are currently trading at significantly higher levels than those seen in the same period last year. Predicted prices for the winter of 2008/9 are currently trading at just over 40% higher than recent winter prices. PSL hope that they will be able to maintain the recently announced level of prices for the next 12 months.

21. Gas prices have also been rising in Great Britain as the result of the increase in wholesale prices. The major suppliers in Great Britain announced increases in their prices during the recent winter period as follows:

Supplier	Price increase	Effective Date
Npower	17.2%	5 January
British Gas	15%	11 January
EDF	12.9%	18 January
Scottish Power	15%	2 February
Eon	15%	8 February
Scottish & Southern	15.8%	1 April

22. Phoenix has indicated that their price increase is greater than those in Great Britain (GB) because wholesale gas prices have risen even further since these increases were announced. They also suggest that if wholesale prices remain at their current level it is likely that the GB gas companies will be forced to increase their prices, and there is current press speculation to this effect. Gas prices have traditionally been higher in Northern Ireland due to additional gas transmission costs involved in transporting gas from Scotland, greater levels of competition in the much larger GB market, and the costs of developing new gas infrastructure in Northern Ireland.
23. *firmus energy*, which is currently taking gas to customers in the towns along the routes of the North West and South North Pipelines, announced a 2 year price cap in January 2006, and this has since been extended to 1 January 2009. *firmus* also announced, in March 2007, a 6% decrease in tariffs for smaller commercial consumers.
24. *firmus energy* has a much smaller customer base with around 3,000 consumers compared to Phoenix with 116,000 customers. This, along with being part of Bord Gáis, allows them greater potential to absorb wholesale energy increases over the short term.

## Network Expansion

### Phoenix Natural Gas

25. Phoenix Supply has advised that it is now primarily focused on the expansion of its customer base and that the physical development of its network in its original licence area is almost complete. In 2008 Phoenix has continued to expand its network into Comber and to Temple Quarries, near Carryduff. Furthermore, Phoenix Supply is reported to be currently exploring the possibility of supplying natural gas in the Republic of Ireland although it is not yet clear how it proposes to do this.
26. Phoenix recently wrote to the Department welcoming the opening up to competition of the natural gas market in the Greater Belfast and Larne areas but requested that the Department should bring forward supply competition in the other licence areas of Northern Ireland and allow Phoenix to operate in these districts. However this is unlikely to be supported as the new gas market outside Belfast requires a period of exclusivity to develop.

27. In 1996 when natural gas was first brought to Northern Ireland, Phoenix was granted a licence to supply gas in the Greater Belfast and Larne areas, along with a period of supply exclusivity. This was to protect the company from competition during the initial period when they were investing heavily in gas infrastructure and concentrating on building a market with the inherent benefits of fuel diversity, fuel competition and environmental advantages. Similar provision has been granted to *firmus energy* to develop the gas market outside Belfast
28. In line with Gas Directive 2003/55/EC, as part of ongoing gas market liberalisation with the aim for gas customers to be free to choose their gas supplier, the gas supply market for industrial customers was opened in July 2006 which was 10 years after the granting of the initial Phoenix licence. Full gas supply competition for all customers in the Phoenix licensed area was introduced from 1 January 2007.
29. In the negotiations with Phoenix regarding market opening, the Department and the Northern Ireland Authority for Utility Regulation (NIAUR) considered that a period of 10 years supply exclusivity was sufficient to allow Phoenix to develop their market in the Greater Belfast and Larne areas. This was also considered appropriate as the company had managed to obtain over 100,000 customers which is the European Union recognised level for an emerging market.

#### Firmus Energy

30. In 2004 when BGE (NI) began construction of the North-West and South-North gas transmission pipelines, they applied for and were granted, a gas supply licence covering the towns and cities along the route of the pipelines. BGE (NI) was granted supply exclusivity and in keeping with the previously granted licence to Phoenix, DETI and NIAUR agreed to allow BGE (NI) periods of exclusivity to develop their market which they are doing through *firmus energy*, their gas distribution and supply company in Northern Ireland.
31. 5 year (industrial) and 8 year (SME / domestic) periods of exclusivity have been granted to *firmus energy* for their development of gas supply in the towns and cities outside Greater Belfast and Larne. This arrangement will be reviewed by the Department and NIAUR on an ongoing basis in line with the conditions set out in the supply licence and under our statutory duties. Any attempt to modify the licence without the agreement of the licence holder would be likely to result in the issue having to be referred to the Competition Commission.

#### Natural Gas Connections and further roll-out

32. In the Greater Belfast area, natural gas connections are around 40% of total potential connections given the coverage of the network. In addition, gas is not yet available to many areas within Northern Ireland. Not only does this reduce the total size of the natural gas market, it also limits the scope for potential suppliers in the domestic market to exploit economies of scale and scope through pursuing dual fuel offers.

33. NIAUR has advised that incentives to increase the number of customer connections rest with Phoenix Distribution in Greater Belfast and *firmus energy* in its licence area outside Belfast. As already stated, the *firmus energy* licence is different from that held by Phoenix in Belfast, and is likely to result in gas being unavailable in many residential housing areas in particular within the towns and cities being supplied by the company. Potential schemes to promote the uptake of natural gas in both the Phoenix and *firmus* licensed areas may involve offering incentives to the gas companies to increase their number of customer connections or offering financial assistance directly to customers connecting to gas to overcome the conversion costs. Any proposals involving government finance to increase gas customer connection rates would have to comply with EU State Aid rules.
34. Additionally, there are no plans to extend the natural gas network beyond the areas identified within both licences, and it is not currently planned to provide gas to areas in the west such as Enniskillen, Strabane or Omagh. In 2004, a feasibility study was commissioned to explore the possibility of extending the North-West Pipeline and taking gas to the West to Letterkenny via Strabane. However, the report findings considered that the development of a gas network in the west would not be provided for by the private sector as it was uneconomically viable, and therefore would require public financing. NIAUR and DETI intend to collaborate in considering how the uptake of natural gas can be increased within the currently licenced areas, and if further extension of the gas network can be justified in economic terms, and particularly in relation to the potential for carbon savings as consumers could switch from coal or oil to natural gas which produces less carbon.

### **Concerns about Promotion of the Gas Industry**

35. Both gas companies have highlighted to the Department that there has been an excessive allocation of finance towards renewable energy and its promotion via the Reconnect household microgeneration programme, while the benefits of natural gas as a low carbon fuel have not been sufficiently highlighted in recent years.
36. Phoenix and *firmus energy* argue that increased uptake of natural gas would have a greater impact on reducing CO<sub>2</sub> output than uptake of renewable energy and that low carbon energy solutions should also feature natural gas. Phoenix has advised that in 2007 alone, natural gas prevented over 242,000 tonnes of CO<sub>2</sub> from entering the atmosphere. The Department provided support to the 2007 Northern Ireland Gas Industry Conference which is organised by Phoenix, and continues to endorse the benefits of natural gas as the cleanest burning fossil fuel. The Department also secured from the European Commission and UK Treasury a five year extension until 2011 to an existing exemption from the Climate Change Levy which benefits business consumers of natural gas.

**Energy Division**  
**Department of Enterprise, Trade and Investment**

**12 May 2008**