Consultation: The potential for extending the natural gas network in Northern Ireland

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The Consumer Council welcomes the opportunity to respond to this consultation.

The Consumer Council is an independent consumer organisation set up in legislation to safeguard the interests of Northern Ireland consumers, particularly the vulnerable and disadvantaged. We work to promote and protect consumer interest and bring about change to benefit consumers. Our aim is to make the consumer voice heard and make it count.

We represent consumers in the areas of transport, water and energy. We also have responsibility to educate consumers on their rights and responsibilities and to equip them with the skills they need to make good decisions about their money and manage it wisely.

Introduction

With the high level of fuel poverty and significant increases in the price of home heating oil, this consultation is an important one for the Northern Ireland consumer and the Northern Ireland Government. The decision on whether to extend the natural gas network is one that could provide benefits and also impose costs that will be felt by consumers for many years to come. The Consumer Council believes that policy makers must ensure that the consumer is placed at the heart of Northern Ireland’s energy strategy.

With fuel poverty levels in Northern Ireland at 44 per cent, many households are struggling to adequately heat their home, it is important that the Department looks to minimise the impact of fuel poverty on all households. Consideration should be given to the three main causes of fuel poverty; the cost of energy, the energy efficiency of homes and household income.

In securing Northern Ireland’s future energy needs, we believe that the Government will need to balance:

- Affordability
- Security of Supply, and;
- Sustainability

Executive Summary

The Consumer Council recognises the real benefits of gas to consumers in terms of costs, efficiency, ease of use, and the carbon emissions saved. For this reason the Consumer Council would wish to see use of the existing gas network maximised to its full potential, and in the absence of any viable alternative would like to see far more Northern Ireland households able to avail of the benefits of gas. This is increasingly important as Consumer Council research shows that the average natural gas bill in Northern Ireland is
£1,085\(^1\) cheaper that the average cost of heating a home with home heating oil.

However, the Consumer Council recognises that the price of natural gas is volatile and has in the last year increased considerably although not as much as home heating oil. Therefore, the Consumer Council believes that the Government when examining the cost/benefits of extending the existing gas network, also needs to seek independent advice over what the cost of gas will be in 2020 against other fuel sources, and see if these costs will be socially acceptable, in terms of fuel poverty and general affordability.

Furthermore, the Consumer Council recognises that renewable heat may present an alternative to natural gas in certain circumstances. This is recognised in DETI’s Strategic Energy Framework 2010 and in the recent DETI consultation on the Renewable Heat Incentive (RHI), and should be explored alongside the extension of the natural gas network.

The following are key points that must be taken into account by DETI when assessing the case for extending the natural gas network:

- Extending the natural gas network must make a significant contribution to eradicating fuel poverty in Northern Ireland;
- There must be an overall benefit to all consumers;
- The costs must not unfairly fall to consumers alone;
- Government must ensure that they get the best deal for the consumer from industry;
- The Government must ensure that the project is financially sustainable
- The cost of capital allowed for the project must accurately reflect the risks of a regulated market;
- The role of Renewable Heating must be considered as an alternative to natural gas.

**Affordability**

**Benefits of gas**

At 44 per cent of households, Northern Ireland has the highest level of fuel poverty in the UK. Northern Ireland has by far the worst level of fuel poverty across the UK (double that of England, and significantly more than Scotland and Wales) and among the worst in Northern Europe.

For an extension of the gas network to be successful it must make a significant contribution to reducing the cost of the average heating bill in Northern Ireland. This will in turn, help to eradicate fuel poverty in Northern Ireland.

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\(^1\) Using average annual natural gas bill for Northern Ireland of £492 and average annual home heating oil bill of £1577. The gas bill uses a weighting of the number of customers in the Belfast licence area and the 10 Towns licence area, and of the gas consumption levels between different payment types and applies from the 1\(^{st}\) October 2011. The home heating oil bill is based on the CCNI home heating oil survey using 5.25 fills of 500 litres on the spot price at 1 Sept 2011.
Ireland Home heating oil is still used by 68 per cent of homes in Northern Ireland and with its high and volatile cost is the reason why Northern Ireland has by far the highest number of fuel poor households in the UK. Consumer Council research estimates that on average it costs a household £1085 per year more to heat their house with oil as compared to gas.

In order for natural gas to reduce household energy bills and fuel poverty in Northern Ireland not only should it be extended into new areas but it must achieve a high level of uptake. Of the two models used in the feasibility study the BM2 model, (which assumes an uptake of 70 per cent of existing households) provides the best opportunity for this.

Other opportunities also should be taken to convert more households from home heating oil to natural gas. Within the existing PNG and firmus licence areas there remain a significant amount of households that are not on gas but are located within reach of a transmission/distribution pipe. Consideration must also be given to ‘filling in the gaps’ in the distribution network within the existing licence areas and increasing the take up of gas in them. Whilst there will be a cost to the consumer it will be more economical per new connection than a far reaching network extension.

Introducing natural gas provides an opportunity to give consumers a regulated fuel as an alternative to the unregulated heating oil market. Regulation can protect consumers not only on price, but also by providing minimum standards of customer service, support for vulnerable and low income customers and information and advice on budgeting and energy efficiency. Currently, the 68 per cent of households in Northern Ireland that rely on home heating oil receive none of these protections.

Furthermore, gas is a fuel that, unlike home heating oil, can use Pay As You Go Meters. In the firmus, 10 Towns Licence areas, 85 percent of households use Pay As You Go Meters and consume 26 per cent less gas than Direct Debit customers saving them money as well as reducing carbon emissions. Pay As You Go Meters also give households greater opportunities to budget for their energy use throughout the year.

It is the case that many rural areas of Northern Ireland are unlikely to be ever connected to the gas network. Other viable solutions need to be found for these consumers, particularly those suffering from fuel poverty. Solutions could include alternative energy sources such as micro-generation and community type CHP projects.

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2 Using average annual natural gas bill for Northern Ireland of £492 and average annual home heating oil bill of £1577. The gas bill uses a weighting of the number of customers in the Belfast licence area and the 10 Towns licence area, and of the gas consumption levels between different payment types and applies from the 1st October 2011. The home heating oil bill is based on the CCNI home heating oil survey using 5.25 fills of 500 litres on the spot price at 1 Sept 2011.

3 firmus energy
Additional costs

The reverse side of the coin from the benefits of gas is the cost of extending the gas network. The cost to consumers must be at a level that will represent a negligible increase to consumers and in any case would be substantially offset by the savings made by consumers that converted to gas from home heating oil.

Whilst fuel poor households must be a priority, all consumers need to see their costs kept as low as possible. All households, businesses, industry and the public sector are under financial pressure particularly in the current financial climate.

The consultation shows that the cost of the distribution network would be self-financing, even using the more ambitious model BM2, with the exception of a marginal negative NPV for Strabane. This is a major consideration in favour of extending the network.

However, the estimated cost of the new transmission network is more problematic. The consultation suggests that a postalised charging system for the increased transmission costs will add 1-1.5 per cent to the average bill. This would increase the current average Phoenix Supply domestic gas bill from £603 to £612. This seems a modest amount. However, any change in the amount that consumers will need to pay must be seen in the context of the additional costs for energy that consumers are being expected to pay in the future.

The consultation highlights the cost of Northern Ireland Government’s renewable energy target and the UK Governments Market Reform proposals. DETI’s Strategic Energy Framework estimates that each household in Northern Ireland will need to pay between £49 and £83 a year extra to reach the target of 40 per cent renewable energy by 2020. Furthermore the Utility Regulator has estimated that the current submission by the electricity network operator, NIE, to maintain and upgrade the grid would add 12 per cent to electricity bills in 2012.

In addition to these rising costs must be added the possibility that the cost of energy overall will continue to increase. This year Northern Ireland consumers have endured increases in the price of gas ranging from 28.4 per cent to 39.1 per cent and in electricity of 18.6 per cent.

It is also the case that any increase in the postalised transmission element in the cost of gas, when combined with the other aforementioned costs, may impact on the ability of Northern Ireland power stations to compete in the Single Electricity Market (SEM). Northern Ireland power stations consume 65 per cent of the Northern Ireland gas and are fundamental to the economic viability of the gas industry in Northern Ireland.

4 Enterprise, Trade and Investment Committee, 15th September 2011.
DETI must explore every avenue to fund the additional costs of this project before it decides to add additional costs to hard pressed consumers. Options to explore must include:

- Government subsidy;
- A mix of Government subsidy and cross subsidy from Northern Ireland natural gas customers;
- European Union funding;
- Joint funding arrangements with the Republic of Ireland Government who have a shared interest in developing a gas network in the north-west.\(^5\)

**The future cost of gas against competing fuels**

The future cost of gas against competing fuels is fundamental to the consultation. If introduced in the areas proposed gas will be competing against heating oil and renewable heat.

International gas prices are volatile and it is only due to forward purchasing that gas suppliers are able to provide price stability for consumers. However, the Consumer Council recognises that natural gas is a more economical fuel source, when compared to other fuel sources, including electricity and heating oil.

We also recognise that whilst wholesale gas, and thus retail, prices have remained volatile, natural gas remains more than competitive with rival fuels such as oil, LPG and mains electricity. Whilst gas bills for Phoenix Supply customers have decreased by 12 per cent since January 2009\(^6\), they have risen by 43 per cent for Northern Ireland home heating oil customers\(^7\).

Whilst recognising the potential cost (and environmental) benefits of natural gas over other fossil fuels such as home heating oil, the Consumer Council would like to highlight Malcolm Wick MP’s independent report, “Energy Security – A National Challenge in a Changing World”\(^8\). The report discusses that in the future fossil fuels, including natural gas, are going to become even more prone to high or volatile prices, and possible disruptions in supply.

**Incentives**

Typically the upfront cost to domestic houses of installing a condensing gas boiler is around £2500\(^9\). In order to ensure that sufficient domestic customers convert to gas it will be necessary to provide a financial incentive. This has happened in the Belfast area and has seen some success with around 50% of households to whom gas is available having converted. However, the typical

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6 Phoenix Supply Ltd tariff
7 Consumer Council oil survey
8 www.decc.gov.uk
9 Energy Savings Trust
level of incentives available in Belfast of between £200 and £400 per household may not be sufficient to enable households on low incomes to convert.

The Consumer Council has stated previously that fuel poor households need to be identified and given financial support. Providing financial support that enables fuel poor households to convert to gas is a long term solution to lifting those households out of fuel poverty. The overall cost of extending the natural gas network needs to take into account the cost of providing this support.

**Public Sector Buy in**

If the gas network is extended it is essential that the Public Sector estate must be fully committed to converting gas. There are three reasons for this:

Firstly, the potential range of benefits that natural gas offers to reduce carbon emissions is well known. The Northern Ireland Government must lead by example and where it has the power to do so direct the public sector estate to adopt natural gas as an alternative to other fossil fuels. The caveat to this is that where natural gas is competing with Renewable Heat each scheme should be judged on how well they contribute to Government targets and are able to reduce the cost for consumers.

Secondly, the feasibility analysis of this project shows that by guaranteeing the demand for a large base load volume of gas, the case for extending the network is enhanced. The public sector estate will significantly contribute to the baseload required for the project to be economically feasible.

Finally, the substantial volumes of gas that the public estate could consume would help reduce the transmission charges for all gas consumers.

**Business Model**

As already discussed the Consumer Council believe that natural gas provides a number of significant benefits for the Northern Ireland consumer. For this reason we believe that the aim of the project must be to connect as many domestic households as possible. This is in addition to connecting as many businesses and public sector buildings as possible. We believe that the model BM2 will deliver the most benefit to Northern Ireland consumers and represents the best model for tackling fuel poverty.

**Mutualisation**

Any organisation that is prepared to invest in a long term venture will require a rate of return on its investment that will reflect the risk involved. The cost of transmission and Distribution may represent a third of the final tariff that customers pay, so it is essential that this is kept as low as possible. Not only is this to ensure that consumers pay a fair price but also to ensure that as many as possible convert.
The Consumer Council would ask the Government to give consideration to mutualisation as a potential model for ownership of energy infrastructure in Northern Ireland. Northern Ireland Energy Holdings is such a mutualised company and the Consumer Council believes it represents a model of ownership that has the potential to bring short and long term benefits to the consumers of Northern Ireland.

**Licence areas**

The current situation of two gas licence areas which provides two different regulated gas tariffs (firmus in the 10 Towns and Phoenix Supply in Belfast), whilst at the same time providing two different tariffs for firmus energy (between its 10 Towns Tariff and its unregulated Belfast tariff) is confusing for customers. The Consumer Council believe that it is unsatisfactory for customers to be paying a different price for their gas on a locational basis within the small regional area of Northern Ireland. If multiple licence areas are chosen this provides the potential for further customer confusion.

Furthermore, a single, larger licence area is more likely to be attractive to competing suppliers to enter the market in the future. The Consumer Council supports the introduction of competition into Northern Ireland energy markets where it can be clearly shown that it will provide tangible benefits for consumer.

**Sustainability**

The Consumer Council recognises that the further roll-out of the natural gas network and the maximisation of the current network has considerable environmental benefits, being the least polluting fossil fuel, and can contribute to a lower carbon energy strategy for Northern Ireland.

However, the Consumer Council recognises that Renewable Heat offers an alternative to natural gas that provides a more complete contribution to a low carbon energy strategy and that DETI is currently consulting on a Renewable Heat Incentive Scheme (RHI).

The Consumer Council believe that it is essential that energy policy must be coherent and different strands must dovetail. Renewable Heat and natural gas both offer benefits to consumers and each can contribute to the DETI Strategic Energy Framework. However, the development of each should be planned to deliver mutual success for each project and to provide the most efficient outcome for Northern Ireland consumers. The worst case scenario would see a gas network developed that becomes a stranded asset that is economically unsustainable for either consumers or investors.

Many rural areas of Northern Ireland are unlikely ever to be connected to the gas network and receive the potential cost benefits associated with it. Typically, rural incomes are lower than urban incomes and many costs are higher. It is such rural areas that may benefit the most from a Renewable Heat Incentive.
In contrast, a number of urban areas already have a gas network or have the potential to reach many customers by having one developed. In Belfast half of the households to which natural gas is available are connected whilst in the firmus licence area 26 per cent are connected. According to the DETI Renewable Heat Incentive consultation urban areas, particularly Belfast, provide the best opportunity to develop Renewable Heat. However reinforcing the existing gas network and maximising the take up of gas in these areas, would provide a more economical solution to eradicating fuel poverty and reducing carbon emissions.

**Conclusion**

The Consumer Council believe that the key determinant on whether to extend the gas network is the contribution it would make to eradicating fuel poverty in Northern Ireland.

We believe that as a competitor to oil, natural gas can provide significant savings to Northern Ireland consumers. Both extending the natural gas network and ‘filling in the gaps’ in the existing network will bring savings to a significant number of households and businesses. This will help reduce fuel poverty and help local businesses to be more competitive. In addition, natural gas can make a contribution to reducing the carbon emissions and improving energy efficiency in Northern Ireland.

The Consumer Council believe that for the full benefits of natural gas to be realised, particularly in relation to eradicating fuel poverty, the network must aim to reach as many domestic households as possible. For this reason we would support the Business Model BM2.

In order to ensure that sufficient domestic properties avail of the opportunity to convert to natural gas, it will be necessary for there to be financial incentives available. These incentives should in the first instance be targeted at fuel poor households.

We note that the distribution element of the westward extension of the network provides a positive NVP and would effectively be self financing. Whilst the overall cost of the transmission produces a negative NVP. All possible avenues to finance the gap should be explored before turning to the consumer, including Government subsidy. Any additional cost to the consumer will only reduce the take up of the scheme and lessen the impact on fuel poverty and economic growth.
Making the consumer voice heard and making it count

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