Notice under Article 14(2) of the Gas (Northern Ireland) Order 1996

Proposed Modification of Premier Transmission Limited Licence to allow Deferral of Capex Allowances

Consultation Paper

14 May 2021

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, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.

Our vision

To ensure value and sustainability in energy and water.

Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.

Abstract

Transmission charges, which comprise around 10% of a domestic gas bill, are calculated using a postalised regime, which is fully reconciled every year to facilitate the lower financing costs available for mutualised pipelines. Currently, any cost allowances which need to be deferred into the following Gas Year are treated as underspend in the current Gas Year and as overspend in the following year.

This proposed modification will operate by adding defined unspent capital allowances to the actual expenditure in the year and then subtracting it in the following year. This has the effect of allowing relevant unspent allowances to be deferred by one year without going through the year-end reconciliation.

This is intended to reduce the volatility of the year-end reconciliation amount by up to £1m or 2% of the total required revenue.

Audience

This document is likely to be of interest to regulated companies in the energy industry, particularly gas shippers, suppliers and network operators. It may also be of interest to government and other statutory bodies and consumer groups with an interest in the energy industry.

Consumer impact

As the reconciliation amounts in the transmission charges comprise a small proportion of the final price charged by suppliers, this modification is not expected to have any impact on consumer prices

Contents

Acronyms and Glossary

BGTL	Belfast Gas Transmission Limited, a TSO
capex	Capital expenditure
EU	European Union
FOIA	Freedom of Information Act
GNI (UK)	GNI (UK) Limited, a TSO
MEL	Mutual Energy Limited, owner of PTL, BGTL and WTL
PTL	Premier Transmission Limited, a TSO
TSO	Transmission System Operator GNI (UK), PTL, BGTL and WTL. WTL is not a TSO (Transmission System Operator) as defined by the European Commission but it is referred to as a TSO in this document for simplicity.
UR	Utility Regulator
WTL	West Transmission Limited, a TSO

1. Introduction

Purpose of this Consultation

1.1 The Utility Regulator's (UR) principal objective in carrying out the duties associated with its 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 its fulfilment of the objectives set out in the European Gas Directive[1] as amended for EU Exit[2] , and by having regard to a number of matters, as set out more fully in the Energy (Northern Ireland) Order 2003.

1.2 This document sets out for consultation our proposals to modify the high pressure gas conveyance licence of Premier Transmission Limited (PTL) as required in Article 14 (2) of the Gas (Northern Ireland) Order 1996[3].

1.3 PTL, along with Belfast Gas Transmission Ltd (BGTL) and West Transmission Limited (WTL) form part of the Mutual Energy Limited (MEL) group of companies.

Overview of Proposed Licence Modifications

1.4 Transmission charges, which comprise around 10% of a domestic gas bill, are calculated using a postalised regime, which is fully reconciled every year to facilitate the lower financing costs available for mutualised pipelines.

1.5 MEL has reported that capital projects for the mutualised pipelines, whose funding is explained from paragraph 2.3, sometimes need to be delayed. There are examples of typical capex projects at paragraphs 2.8 and 2.9. The reconciliation process means that capex allowances which are delayed into the following Gas Year are treated as underspend[4] in the current Gas Year and as overspend[5] in the following year.

1.6 This contributes to the volatility of the year-end reconciliation amounts, which is explored in paragraph 2.7 and paragraph 2.22.

1.7 These modifications are intended to reduce such volatility. They will operate by adding defined unspent capital allowances to the actual expenditure in the year and then subtracting it in the following year. This has the effect of

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[1] 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.
[2] Ahead of the UK's exit from the EU on 31 December 2020, the Gas Directive was transposed into UK law under the European Union (Withdrawal) Act 2018
[3] https://www.legislation.gov.uk/nisi/1996/275/article/14
[4] Underspends form part of the year-end reconciliation, see paragraph 2.5
[5] These delays typically happen after the forecast for the following year has already been confirmed

allowing relevant unspent allowances to be deferred by one year without going through the year-end reconciliation.

1.8 If the deferred allowance is not subsequently spent, the modification will treated it as underspend one year later than it would otherwise have been.

Document Structure

1.9 This consultation paper is structured as follows:

1.10 Section 1 – Introduction. This provides an overview of the purpose and structure of this consultation document. It sets out how to respond to the licence consultation as well as equality considerations.

1.11 Section 2 – Proposed Modifications. This outlines the matter to be dealt with, an explanation of the proposed remedy and the effects of the proposed modifications. It finishes with the consultation questions.

1.12 Section 3 – Next Steps. This outlines the indicative timetable for the next steps of the modification process

1.13 Annex A shows the proposed changes to the PTL licence as tracked changes to the relevant licence conditions. Proposed deletions are indicated by red text that has been struck through, while proposed additions are indicated by red text which is underlined.

1.14 Annex B represents the notice under Article 14(2) of the Gas (Northern Ireland) Order 1996 of our licence modification proposal

Responding to this Consultation

1.15 The purpose of this notice is to bring the proposed modifications to the attention of persons likely to be affected by them, and to invite representations or objections in connection thereto. In line with Article 14(3) of the Order, any representations or objections with respect to the proposed modifications may be made on or before 12.00 noon on 14 June 2021 to:

Jillian Ferris
Utility Regulator
Queens House
14 Queens Street
Belfast BT1 6ED

Email: Gas_networks_responses@uregni.gov.uk

cc'ed to jillian.ferris@uregni.gov.uk

1.16 While the Utility Regulator's office remains closed due to the Covid-19 pandemic and staff continue to work from home, we would prefer for responses to be submitted by e-mail. If that is not possible and you wish to submit a response by post, please telephone the office on 028 9031 1575, to ensure that your response has been received.

1.17 Individual respondents may ask for their responses (in whole or in part) not to be published, or that their identity should be withheld from public disclosure. Where either of these is the case, please provide also a non-confidential version suitable for publication.

1.18 As a public body and non-ministerial government department, the Utility Regulator is required to comply with the Freedom of Information Act ("FOIA"). The effect of FOIA may be that certain recorded information contained in consultation responses is required to be put into the public domain. Hence it is now possible that all responses made to consultations will be discoverable under FOIA, even if respondents ask us to treat responses as confidential. It is therefore important that respondents take account of this. In particular, if asking the Utility Regulator to treat responses as confidential, respondents should specify why they consider the information in question should be treated as such.

1.19 The Utility Regulator has published a privacy notice for consumers and stakeholders which sets out the approach to data retention in respect of consultations. This can be found at https://www.uregni.gov.uk/privacy-notice or, alternatively, a copy can be obtained by calling 028 9031 1575 or by email at info@uregni.gov.uk.

1.20 This paper is available in alternative formats such as audio, Braille etc. If an alternative format is required, please contact the office of the Utility Regulator, which will be happy to assist.

Equality Considerations

1.21 As a public authority, the Utility Regulator (UR) has a number of obligations arising from Section 75 of the Northern Ireland Act 1998. These obligations concern the promotion of equality of opportunity between:

a) persons of different religious belief, political opinion, racial group, age, marital status or sexual orientation;

b) men and women generally;

c) persons with disability and persons without; and

d) persons with dependants and persons without.

1.22 UR must also have regard to the promotion of good relations between persons of different religious belief, political opinion or racial groups.

1.23 In the development of its policies, UR also has a statutory duty to have due regard to the needs of vulnerable customers i.e. individuals who are disabled or chronically sick, individuals of pensionable age, individuals with low incomes and individuals residing in rural areas. Some of the above equality categories will therefore overlap with these vulnerable groupings.

1.24 In order to assist with equality screening of the proposals contained within this consultation paper, UR requests that respondents provide any information or evidence in relation to the needs, experiences, issues and priorities for different groups which they feel is relevant to the implementation of any of the proposals. Furthermore, UR welcomes any comments which respondents might have in relation to the overall equality impact of the proposals.

2. Modifications to allow Deferred Capex Allowances

2.1 The transmission charging regime in Northern Ireland is based on a common or postalised tariff. The principle of postalisation was approved by the NI Executive and Assembly in September 2001 and was implemented in NI on 1 October 2004. Postalisation is based on a postage stamp charging methodology which means that the charge for transporting gas along designated pipelines will be the same irrespective of where the gas is off-taken for final use.

2.2 Pipelines subject to the postalised tariff are designated by the Department for the Economy ("DfE") under Article 59 of the Energy Order. The high pressure pipelines designated to date for this purpose are as follows:

- SNIP (Scotland to NI Pipeline) operated by Premier Transmission Limited (PTL)
- BGTP (Belfast Gas Transmission Pipeline) operated by Belfast Gas Transmission Limited (BGTL)
- NWP (North West Pipeline) operated by GNI (UK) Ltd
- SNP (South North Pipeline) operated by GNI (UK) Ltd
- Gas to the West operated by West Transmission Limited (WTL)

2.3 The long term stable cash flows provided by the postalised model has allowed the pipelines operated by PTL, BGTL and WTL to be 100% debt financed at a much lower rate than would be available under an equity financed model. They form part of Mutual Energy Limited (MEL), a mutualised company which is limited by guarantee with no shareholders.

2.4 The postalised regime is designed to ensure that the actual required revenue of PTL, BGTL and WTL is fully recovered within year, so that differences between forecast and actual cost are corrected at year end. This is different to the normal debt/equity model, where the regulated company takes the risk of cost variances.

2.5 The year-end reconciliation process retrospectively adjusts the tariff for actual volumes and the actual required revenue of the mutualised pipelines. Suppliers then either pay for an under-recovery or receive a repayment for an over-recovery and there is no facility to roll forward under- or over-recoveries.

2.6 This, in practice, means that all NI gas users pay for the mutualised pipelines in all circumstances. NI gas users underwrite the mutualised pipelines in return for significant savings in the form of a reduced cost of capital.

2.7 Every year-end reconciliation so far has been due to an over-recovery of revenues, so suppliers have received a repayment. This is further explored from paragraph 2.22. The table below, extracted from the Postalisation Reconciliation Explanatory Note for Gas Year 19/20[6] , illustrates that the two main components of the reconciliation amount are a difference in the required revenue of the mutualised companies ("Deviation in Revenue Requirement") and a difference between forecast and actual use of the network ("Deviation in Revenue Collection"). These are further explored in the Explanatory Note.

Table 6 **Bullet Payment Calculation**	(£)
Forecast Revenue Required	61,786,215
Actual Revenue Requirement	59,785,468
Deviation in Revenue Requirement	-2,000,747
Forecast Revenue Collection	61,783,570
Actual Revenue Collection	64,118,603
Deviation in Revenue Collection	2,335,034
Deviation in FRR and Forecast Collection	-2,645
Bullet Payment to Shippers	4,333,136
Postalised Tariff Adjustment	-6.76%

Table 1 - Extract from Postalised Reconciliation Note 19/20

2.8 One of the reasons for the deviation in the revenue requirement is capital projects which have been delayed into the following Gas Year. This has mainly occurred on projects planned by PTL, or projects due to be undertaken by GNI (UK) on the Scotland Pipeline and charged to PTL under the terms of the Transportation Agreement (TA)[7] .

2.9 An example of this would be the biennial seabed survey which is normally planned for summer-time, but a postponement due to weather conditions has previously pushed it into the next Gas Year. MEL has reported that cost savings are sometimes available by postponing work, for example, by waiting until a ship is in the vicinity in a few months' time. Table 5 at

[6] http://gmo-ni.com/tariffs#annual-reconciliations
[7] The Transportation Agreement (TA) is a contract between GNI (UK) and PTL to give effect to a Treaty between the British and Irish Governments originally signed in 1993 when the two governments agreed not to build separate gas pipelines to link into the GB gas network. It sets out the terms under which gas to NI can flow through part of the Irish pipeline between Moffat and Twynholm in Scotland.

paragraph 2.24 summarises some of these projects.

2.10 When a capital project is postponed in this way, the deferred expenditure is treated as underspend in the Gas Year and then treated as overspend in the following year. This contributes to the deviation in revenue requirement, shown in Table 1, and therefore contributes to the volatility of the year-end reconciliation.

2.11 While variances which are caused by forecast inaccuracies are, by their nature, difficult to control, the delayed capital projects are timing related, rather than true variances.

2.12 UR has been in discussion with MEL to explore ways to more effectively deal with deferred capital projects to minimise the volatility of the year-end reconciliation amounts. This proposed modification therefore addresses one of the causes of the variances in the year-end reconciliation.

Proposed remedy to deal with underspend due to deferred capex allowances

2.13 This proposed remedy has been developed with MEL taking into consideration the requirements of their financiers and seeking to maintain the principle of fully reconciling postalisation revenue every year. We wish to avoid a situation where PTL is holding customer revenue any longer than necessary.

2.14 MEL has proposed draft licence modifications to the PTL licence which provide for defined capex allowances to be excluded from the scope of the year-end reconciliation process and be rolled forward to the next year. It will operate by adding defined unspent capital allowances to the actual expenditure in the year and then subtracting it in the following year. This has the effect of allowing relevant unspent allowances to be deferred by one year without going through the year-end reconciliation.

2.15 We have reviewed MEL's proposal and, following some minor adjustments, we are content that the proposed licence modifications tightly define the circumstances under which capital allowances can be deferred. The drafting ensures that the unspent amount can be rolled forward for one year only.

2.16 The proposed licence modifications will operate in the following way:

- The term "Specific Project" defines which relevant forecast expenditure can be considered for this calculation. A minimum value of £200,000, adjusted for inflation, is applied to find the "Qualifying Specific Project".

- The forecast expenditure for the Qualifying Specific Project in the first Gas Year is the “QSP Forecast Amount”.

- Any underspend of the “QSP Forecast Amount” is called the “QSP Spending Shortfall” and underspends are collated across all Qualifying Specific Projects in the first Gas Year to comprise the “Unspent QSP Amount”.

- The Unspent QSP Amount is added to the actual expenditure in the Actual Required Revenue calculation, so that it is treated as if it has been spent in the first Gas Year.

- In the second Gas Year, the “Unspent QSP Amount Reversal”, which is equal to the Unspent QSP Amount in the first Gas Year, is subtracted from the Actual Required Revenue.

2.17 The table below demonstrates how the modification would operate if the deferred capex allowance is spent in full in the following year. Without the modification, the unspent amount is treated as an underspend in one year and an overspend in the next. With the modification, the defined deferred capex allowance is added to the actual revenue in the first year and subtracted in the second year, so that it is treated as though it was spent in the year in which it was originally forecast. The right hand column shows that the totals of the two years are equal, with and without the modification.

Comparing Under/ overspends (-)	GY 22/23	GY 23/24	Total of both years
1. without modification	£000s	£000s	£000s
Forecast Required Revenue (FRR)	26,000	26,000	52,000
Actual Required Revenue (ARR)	25,000	27,000	52,000
under/ overspend (-)	**1,000**	**-1,000**	**0**
2. with this modification			
FRR	26,000	26,000	52,000
ARR with adjustments:			
actual expenditure (Bt)	25,000	27,000	52,000
Xt Unspent QSP Amount	1,000		1,000
Yt Unspent QSP Amount Reversal		-1,000	-1,000
adjusted ARR	26,000	26,000	52,000
under/ overspend (-)	**0**	**0**	**0**

Table 2 - Deferred Capex Allowance is spent in following year

2.18 If the deferred capex allowance is subsequently not spent in the following year, it will be treated as underspend one year later than it would otherwise have been and returned to suppliers through the year-end reconciliation. This table shows that, without modification, the unspent amount is shown as an underspend in the first year. With the modification, the deferred capex allowance is added to actual expenditure in the first year, then subtracted in the second year. The subtraction in the second year reduces the actual revenue and therefore makes the deferred amount appear as underspend. The right hand column of the table shows that the totals of the two years are the same, before and after modification.

Comparing Under/ overspends (-)	GY 22/23	GY 23/24	Total of both years
1. without modification	£000s	£000s	£000s
FRR	26,000	26,000	52,000
ARR	25,000	26,000	51,000
under/ overspend (-)	**1,000**	**0**	**1,000**
2. with this modification			
FRR	26,000	26,000	52,000
ARR with adjustments:			
actual expenditure (Bt)	25,000	26,000	51,000
Xt Unspent QSP Amount	1,000		1,000
Yt Unspent QSP Amount Reversal		-1,000	-1,000
adjusted ARR	26,000	25,000	51,000
under/ overspend (-)	**0**	**1,000**	**1,000**

Table 3 - Deferred Capex Allowance not spent in following year

2.19 We considered if the licences of Belfast Gas Transmission Limited (BGTL) and West Transmission Limited (WTL) should be similarly modified, but we consider that those pipelines tend not to have significant capital projects which get deferred in the manner described.

Proposed Licence Modifications

2.20 The proposed licence modifications are set out in Annex A, which shows the changes to the current licence conditions. The modification involves the addition of two new terms to the formula for the calculation of PTL's Actual Required Revenue in Condition 3.1.4 (b) of the Licence.

$ARR_t = \quad (A_t + B_t + C_t + Z^*(S_t) \underline{+ X_t}) \; - \; (D_t + E_t + F_t + H_t \underline{+ Y_t})$.

Definitions of X_t and Y_t would be added to Condition 3.1.5 as follows:

X_t = in respect of :

(a) any Relevant Gas Year , the Unspent QSP Amount in respect of such Relevant Gas Year; and

(b) any Gas Year which is not a Relevant Gas Year , zero ;

Y_t = in respect of :

(a) any Gas Year which is immediately preceded by a Relevant Gas Year, the Unspent QSP Amount Reversal in respect of such Gas Year ; and

(b) any Gas Year which is not immediately preceded by a Relevant Gas Year, zero;

The new terms in those definitions would then be defined in Condition 3.1.7.2:

"**Specific Project**" means:

(a) a project for the carrying out of specific physical works (whether by way of repair, replacement, renewal, refurbishment, upgrade, enhancement, improvement, modification, addition or otherwise), but for the avoidance of doubt excluding any works as are referred to in (b) below; or

(b) physical works (irrespective of the number or nature of such works or how they are described, scoped or classified) carried out or proposed to be carried out by or for GNI (UK) in a given Gas Year and the costs (or part of the costs) of which are recoverable from the Licensee under the Gas Transportation Agreement and, for the avoidance of doubt, the physical works referred to in this sub-paragraph (b) shall constitute a single Specific Project.

"**Qualifying Specific Project**" means a Specific Project in relation to which the Licensee has included (pursuant to Condition 3.1.3 (b)(i)(bb)) as part of its Forecast Required Revenue for the Gas Year referred to in such Condition an amount in respect of Eligible Pass-Through Costs for such Gas Year of not less than £200,000 in September 2021 prices (such sum to be adjusted annually by reference to CPI_t)

"**Relevant Gas Year**" means a Gas Year in respect of which:

(a) the Licensee's Forecast Required Revenue includes an amount such as is referred to in the definition of Qualifying Specific Project (each such amount so included being a "QSP Forecast Amount"); and

(b) the costs incurred in such Gas Year in respect of any Qualifying Specific Project fall short of the QSP Forecast Amount in respect of such Qualifying Specific Project (

each such shortfall being a "QSP Spending Shortfall")

"**Unspent QSP Amount**" means:

(a) in respect of a Relevant Gas Year , the aggregate of all QSP Spending Shortfalls for such Relevant Gas Year ; and

(b) in respect of a Gas Year which is not a Relevant Gas Year , zero.

"**Unspent QSP Amount Reversal**" means:

(a) in respect of any Gas Year (whether or not itself a Relevant Gas Year) which is immediately preceded by a Relevant Gas Year, the Unspent QSP Amount in respect of such immediately preceding Relevant Gas Year

(b) in respect of any other Gas Year , zero.

2.21 In addition, we intend to take the opportunity to amend the outdated references to "Bord Gais Eireann", within the definitions at condition 3.1.7.2, to "GNI (UK) Ltd". These are also set out in Annex A.

Reasons and Effects

2.22 The reconciliation amounts have been significant in recent years, due to a number of reasons, one of which is the delaying of capital projects on the PTL pipeline. This table shows the composition of the reconciliation amounts over the past five years between deviation in the revenue requirement of the mutualised pipelines, and deviation in revenue collected due to differences in capacity bookings and commodity throughput.

Year end reconciliation amount	15/16	16/17	17/18	18/19	19/20
	£000s	£000s	£000s	£000s	£000s
Total	10,557	8,343	1,297	5,914	4,333
comprised of:					
Deviation in Revenue Requirement	1,310	3,030	2,798	3,626	2,001
Deviation in Revenue Collected	9,248	5,314	-1,500	2,289	2,335

Table 4 - Reconciliation Amounts

2.23 When forecast capital projects get deferred late in the Gas Year, as often happens with projects which are planned for summer-time, it is too late to re-forecast the expenditure in the following year.

2.24 PTL has provided information on projects which had underspends which were considered to be deferred in recent years. These are illustrated in the table below:

QSP Spending Shortfall	2016	2017	2018	2019	2020
	£000	£000	£000	£000	£000
PLC Change Out Scotland	116	-	-	-	-
IME3 costs	136	-	-	-	-
Rock dumping	-	-	-	607	-
Seabed Survey	595	-	251	-	605
GNI Projects	83	1,091	1,614	-	2,426
Potential Unspent QSP Amount	**930**	**1,091**	**1,865**	**607**	**3,031**

Table 5 - Potential Unspent QSP Amounts

2.25 Some of these spending shortfalls arose due to the project being deferred by weeks or months, and some were underspends.

2.26 As the nature of those spending shortfalls may not have been clear at the end of the Gas Year, we consider it is appropriate to allow these amounts to be rolled forward by one year.

2.27 The effect of allowing defined deferred capital allowances to be rolled forward is reduced volatility in the reconciliation amounts, which we estimate could be between £300,000 and £1,000,000 per year.

Consultation Questions

We welcome views on any aspect of the proposed modification and in particular:

2.28 Do Respondents agree that UR should consider ways to reduce the volatility of the Postalisation reconciliation amount?

2.29 Do Respondents consider that the modification proposed is an effective way to deal with capital projects which get deferred into the following Gas Year?

2.30 Do Respondents agree that the roll forward of the underspent forecast amounts should be limited to one year?

2.31 Do Respondents have any further views on how the volatility of the year end reconciliation amount can be managed?

3. Next Steps

3.1 This paper represents the Utility Regulator's proposals on modifications to the Premier Transmission Limited gas conveyance licences. The table below summarises the next steps and associated timelines for the licence modification process. We note that the timelines are indicative at this stage and may be subject to change.

3.2 Once we have considered responses, we will issue our notice of decision. The licence modifications will become effective 56 days after that notice of decision.

Next Steps	Indicative Date
End of statutory consultation on notice of proposal to modify gas conveyance licences closes	14 June 2021
Decision to modify gas conveyance licences published	August 2021
Licence modification effective date	End September 2021

Table 6 - Indicative Timelines

Annexes

Annex A sets out the proposed modifications tracked against the current licence drafting. Proposed deletions are indicated by red text that has been struck through, while proposed additions are indicated by red text that has been underlined.

Annex B represents the notice under Article 14(2) of the Gas (Northern Ireland) Order 1996 of our licence modification proposal.