Notice under Article 14(8) of the Gas (Northern Ireland) Order 1996

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

Decision Paper
30 July 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 paper sets out the decision to modify the high pressure gas conveyance licence of Premier Transmission Limited following consultation between 14 May and 14 June 2021. This 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
opex	Operating expenditure
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 Decision Paper

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, as set out more fully in the Energy (Northern Ireland) Order 2003.

1.2 This document sets out the decision regarding modifications to the high pressure gas conveyance licence of Premier Transmission Limited (PTL), as required in Article 14(8) of the Gas (Northern Ireland) Order 1996[1]. This follows the consultation which ran from 14 May to 14 June 2021. Three responses were received and these are summarised in section 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 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[2] in the current Gas Year and as overspend[3] 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 allowing relevant unspent allowances to be deferred by one year without going through the year-end reconciliation.

[1] https://www.legislation.gov.uk/nisi/1996/275/article/14
[2] Underspends form part of the year-end reconciliation, see paragraph 2.5
[3] These delays typically happen after the forecast for the following year has already been confirmed

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.

Decision

1.9 The modifications will proceed unchanged from the consultation.

1.10 The modifications are summarised in paragraph 2.20, shown in full in Annex A and will become effective 56 days from the date of this publication, which is 24 September 2021.

Document Structure

1.11 This decision paper is structured as follows:

1.12 Section 1 – Introduction. This provides an overview of the purpose and structure of this decision document.

1.13 Section 2 – Proposed Modifications. This outlines the matter being dealt with, an explanation of the remedy that consulted on and the effects of the proposed modifications. It finishes with the questions which were posed in the consultation document.

1.14 Section 3 – Responses and Next Steps. This includes a summary of the responses received and the timescale for making the modifications.

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

1.16 Annex B represents the notice under Article 14(8) of the Gas (Northern Ireland) Order 1996 of our decision to proceed with licence modifications.

1.17 Annexes C to E are the responses received to the consultation.

1.18 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.

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[4] , 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)[5] .

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

[4] http://gmo-ni.com/tariffs#annual-reconciliations

[5] 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.

Remedy to deal with underspend due to deferred capex allowances

2.13 This 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 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 reviewed MEL's proposal and, following some minor adjustments, we are content that the 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 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.

Licence Modifications

2.20 The licence modifications, which are unchanged from the consultation document, are set out in Annex A. 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.

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

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 will 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 Table 5:

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.

Questions from Consultation Document

We asked these questions in the consultation document.

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. Responses and Next Steps

Respondents

3.1 Three responses were received during the consultation period, which ran from 14 May to 14 June 2021. The respondents were:

a) EP Ballylumford Ltd, which owns and operates Ballylumford Power Station and EP Kilroot Ltd, which owns and operates Kilroot Power Station (together abbreviated to EP).

b) firmus energy (Supply) Ltd (feSL)

c) Power NI Energy Ltd Power Procurement Business (PPB)

3.2 The responses are included as Annexes C to E.

Comments from Respondents

3.3 PPB states that it fundamentally disagrees with the proposal for a number of reasons.

a) Firstly, it mentions that the proposal uses the term “capex”, yet those costs are treated like operating expenditure (“opex”) to be recovered within the year. It says that true capex costs would be depreciated over a number of years.

b) Secondly, it says that, having the proposal relating to only PTL would create a disparity with the GNI (UK) transmission pipelines.

c) Thirdly, the response says that, the build-up of an over-recovery would provide free working capital to the TSOs, so this proposal could incentivise overestimation of tariffs which will exacerbate the timing disparity for customers.

d) Fourthly, it voices its concern that consumers are being charged for projects that they would not benefit from. It further remarks that, “costs should never be recovered from customers in advance of the completion of the project to ensure customer charges are cost-reflective.”

3.4 EP does not support this proposal, and states that:

a) The amounts that could be deferred under this proposal may provide “free capital” for PTL, therefore providing a perverse incentive to over-forecast.

b) Potential misalignment between payment and refund if a shipper withdraws or a new shipper joins.

c) As it only applies to PTL, it may cause disparity with the other TSOs.

d) EP considers this is moving away from the basic principle of full reconciliation at year-end.

e) The data provided in the consultation indicated that variances caused by differences in capacity bookings are more significant than differences in the required revenue.

f) It would have been useful to get an indication of what proportion of the deviation in revenue requirement was due to deferral of PTL capital projects.

3.5 feSL is supportive, in principle, of the intention behind the proposed modification and states that it is: "important to consider if the mechanisms proposed within the Modification would have a material impact upon the annual reconciliation and ultimately achieve the underlying intention."

Question 1 - Do Respondents agree that UR should consider ways to reduce the volatility of the Postalisation reconciliation amount?

3.6 EP is supportive of UR considering ways to reduce the volatility of the year-end reconciliation amount.

3.7 With a reminder that it has previously raised concerns about the uncertainty of the annual reconciliation amount, feSL agrees with UR considering ways to reduce volatility, "particularly with regard to the timing and line of sight for Suppliers".

3.8 PPB notes that, although there is merit in assessing if the reconciliation amounts have arisen due to forecasting errors and "not for spurious reasons", it recommends a review of the lack of penalty on over-recovery amounts.

Question 2 - Do Respondents consider that the modification proposed is an effective way to deal with capital projects which get deferred into the following Gas Year?

3.9 PPB disagrees and states that, "Customers should not be paying for assets or facilities that they are not using and for which they are getting no benefit." It explains this is because it considers that costs should only be recovered once the project is complete. It state that if does not consider this would pass a cost reflectivity test and, "we are surprised that UR are even contemplating such a proposal given that this would not be protecting the interests of consumers".

3.10 feSL points out that, while the proposal could reduce the impact of underspends, there is no proposal to address potential overspends with a similar mechanism. This makes the proposal asymmetric which may introduce further volatility.

3.11 feSL acknowledges that GMO NI has begun to publish more information to meet their concerns about Shippers' ability to anticipate the year-end reconciliation amount. It notes that the large proportion of underspend occurs in quarter four, close to the end of the year. it finishes by saying:

> "we believe the carrying forward of over- and under- recovered revenue would appropriately address the challenges of volatility and provide a fairer process for Suppliers (and their customers) to manage tariff volatility."

Question 3 - Do Respondents agree that the roll forward of the underspent forecast amounts should be limited to one year?

3.12 PPB disagrees with any roll forward, on the basis that it would result in tariff changes that are not cost reflective.

3.13 feSL, while pointing out the asymmetric nature of the proposal, agree that the roll-forward of underspent forecast amount should be limited to one year. It asks if a one year period would have been sufficient for historic underspends. feSL also sought clarity on the treatment of any interest associated with the rolled forward amount.

Question 4 - Do Respondents have any further views on how the volatility of the year end reconciliation amount can be managed?

3.14 PPB states that the focus should be on setting accurate tariffs and having a disincentive to prevent TSOs from setting higher than necessary tariffs. It points out that the reconciliation amounts have always been over-payments, although it would expect there to be an equal probability of under-recovery to over-recovery. In addition, it states that effectively treating capital projects as opex is not cost-reflective as capex should be recovered through the depreciation policies, which would smooth out the revenue and could reduce volatility of the reconciliation amounts.

3.15 feSL, while acknowledging the underlying reasons for the current tariff mechanism, states that the most appropriate mechanism would be a rolling under- and over-recovery mechanism, similar to that used in the regulated supply tariff and the Distribution Conveyance Tariffs. Alternatively, further communications with Shippers are important and feSL is supportive of any enhancement in that regard.

Utility Regulator Response to Comments from Respondents

3.16 UR thanks the respondents for their views.

3.17 With regard to the comment that this proposal may cause disparity with other TSOs, UR did consider if the licences of BGTL and WTL should be similarly modified. As those pipelines tend not to have significant capital projects which get deferred in the manner described, we decided that there would not be benefit in extending the proposal to include them. The pipelines operated by GNI (UK) are recovered under a revenue cap arrangement, so deferred projects can roll into the following year without being treated as underspend.

3.18 All the respondents referred to the lack of penalty or interest charges in this proposal. Two respondents expressed concern that it provides "free capital" to the TSOs and PTL may have a perverse incentive to over-forecast. The year-end reconciliation in the postalised regime[6] corrects the tariff for the actual required revenue of the mutualised pipelines. If PTL were to either gain a financial benefit or suffer a penalty from holding the deferred capex allowance, that would be reflected in their actual required revenue and would not stay with PTL[7]. We are content that there is no incentive on PTL to over-forecast.

3.19 One of the respondents noted that this proposal moves away from the basic principle in the postalised regime of full reconciliation at year end. We consider that this modification improves the delivery of the year-end reconciliation by allowing delayed expenditure to be treated as though it happened on time. At present, such expenditure goes through the reconciliation process twice, firstly as an underspend and then as an overspend.

3.20 With regard to the comment about treating over-spends in the same way to prevent asymmetry, the equivalent to expenditure being delayed would be expenditure happening earlier than planned. In that case, we would expect the TSOs to manage the other projects in that year to prevent an overall over-spend.

3.21 One respondent stated it may be appropriate to have a rolling under- and over-recovery mechanism. All network users benefit from the lower financing rates available for mutualised pipelines, however it does bring some constraints on the recovery of the required revenue.

3.22 Regarding the comment that allowing deferred costs to be recovered before the project has been completed may not pass a cost-reflectivity test, we

[6] Paragraphs 2.4 and 2.5
[7] At current interest rates, £1m deferred for a year would only earn around £5,000.

recognise that this proposal will allow costs to be recovered before they have been incurred. Already, the postalisation regime allows the TSOs' annual operating costs (which include the capital projects included in this proposal) to be recovered throughout the year in which they are forecast, rather than historically. This reflects the mutualisation arrangements, whereby NI gas users underwrite the mutualised pipelines in return for significant savings in the form of a reduced cost of capital. While there may some timing mis-alignments, we do not consider those adversely affect cost-reflectivity to the detriment of consumers.

3.23 One respondent pointed out that this proposal refers to capex and therefore ought to be recovered on a depreciation profile. The original capital costs of the PTL pipeline is recovered on a long-term basis through the bond payments under mutualisation. All subsequent costs by PTL are treated as opex and recovered in the year they are incurred. Some of these opex projects relate to maintenance or replacement of pipeline elements and we referred to these projects as "capex" in the consultation paper. Paragraph 5.6 of the Final Determination for the GT17 price control explains further:

> "Much of what might be described as capex in terms of accounting rules, we consider as being maintenance/repex. It does not add to the capacity of the existing pipeline network but rather replaces or upgrades existing equipment. We treat such spending in the same way as controllable operating expenditure (opex)."

3.24 We acknowledge the comment that deviations in revenue collected due to differences in capacity bookings[8] from forecast may be more significant than deviations in revenue requirement and is also a driver of volatility. However, we still consider that it is worthwhile taking this action to reduce the volatility of the year-end reconciliation.

3.25 One respondent noted that no indication was provided as to what proportion of the deviation in required revenue was due to deferred projects. Table 4 and Table 5 provides some data to allow this calculation, as one shows the deviation in required revenue over the past five years and the other gives an indication of PTL projects that may meet the definition of this proposal. The resulting proportion varies from 17% to 150%, which does not provide a suitable indication of any future proportion.

3.26 We sought information from PTL to answer the question about whether any historic projects were deferred by more than one year. PTL currently has one project which was deferred from last year, and is now planned for October, therefore being deferred by two gas years, but this is a rare example. It told

[8] See Table 4

us that these projects generally get deferred by one year only.

3.27 One of the respondents commented that timing differences could lead to mis-alignment if a supplier exits or a new supplier enters the market. Although we acknowledge that there may be some mis-alignment of charges if the suppliers in the market change during the deferral period, we do not consider that this will be significant. Some of the suppliers on the transmission network already face such mis-alignments when customers switch supplier.

3.28 One of the respondents made a request for Suppliers to have a clearer view of likely reconciliation amount during the year. The respondent acknowledged that GMO NI has increased the information provision that it provides during the gas year, however we recognise the suppliers' desire for earlier information on likely actual required revenue.

3.29 We recognise that allowing PTL to hold this unspent allowance for a year will prevent deferred expenditure from being returned to shippers as an under-spend at year-end. On balance, we are content that this approach reduces the volatility of the year-end reconciliation and improves tariff stability for customers.

Next Steps

3.30 This paper represents the Utility Regulator's final decision on licence changes to PTL's gas conveyance licence.

3.31 The modifications will proceed unchanged from those in the consultation paper dated 14 May 2021 and will take effect 56 days from the date of publication of this paper. The modifications will become effective on 24 September 2021.

Annexes

Annex A - Final modifications tracked against the current licence drafting.

Annex B - Notice under Article 14(8) of the Gas (Northern Ireland) Order 1996

Annex C - Response from EP Ballylumford Ltd and EP Kilroot Ltd

Annex D - Response from Firmus energy (Supply) Ltd

Annex E - Response from Power NI Energy Ltd Power Procurement Business