



GD23 - Gas Distribution Price Control 2023-2028

Draft Determination Annex G
Energy Strategy
March 2022



About the Utility Regulator

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

This annex forms part of the Draft Determination for the GD23 Gas Distribution Price Control. It provides a background to the development of the energy strategy for Northern Ireland. It also details the related approach, business plan requests, and Utility Regulator (UR) assessment of these requests as well as the resulting UR proposals for GD23.

Audience

Industry, consumers and statutory bodies.

Consumer impact

The consumer impact to gas consumers from the objectives of the Energy Strategy are not yet clear. Consideration will be given to both costs and benefits to consumers for any proposals submitted by the GDN's.



Contents

| | |
|---|-----------|
| Executive Summary | 1 |
| 1. Introduction | 3 |
| Purpose of this document..... | 3 |
| Structure of this document..... | 3 |
| 2. Energy Strategy Overview | 4 |
| 3. Detailed Approach to Energy Strategy - UR Proposals | 7 |
| 4. Price Control Submissions - Energy Strategy | 10 |
| Overview..... | 10 |
| Firmus energy GD23 requests..... | 11 |
| Phoenix Natural Gas GD23 requests | 12 |
| SGN Natural Gas GD23 requests..... | 13 |
| 5. UR Proposals | 14 |

Executive Summary

This Annex highlights the key elements of the energy strategy which was published by the Department for the Economy (DfE) in December 2022. Two of the key aims of the energy strategy are a reduction in carbon emissions and a phasing out of fossil fuels.

This Annex also sets out the findings of our assessment of the requests and key comments made by the GDNs for the GD23 price control with respect to the energy strategy.

We are aware that our statutory duties may be amended as a result of the energy strategy and this will be taken into account for any of the decarbonisation/energy strategy submissions we receive from GDNs.

As the practicalities of the energy strategy become clearer, the gas industry must work through the implications and find practical solutions to achieve net zero carbon while considering the required resources necessary to achieve these aims.

The consequences of the Energy Strategy and the costs associated with achieving the aims will only become clearer as the elements within the energy strategy are further progressed. As a regulator we have a duty to protect both current and future consumers and, in line with this, we have proposed a ring fenced uncertainty mechanism to help achieve the ambitions within the energy strategy. This means that an allowance will be provided as need is identified.

This ring-fenced uncertainty mechanism will capture costs from the energy strategy which will not be subject to the materiality threshold. We still reserve the right to turn down certain submissions of low materiality if the resources required by us to analyse the submissions is unreasonably extensive for the value of the submission.

Any project that requires funding from this ring fenced uncertainty mechanism, will require a business case submission to us. These projects will be analysed, must have prior approval from us in most cases and meet the core principles below:

- Demonstrate how the project will contribute to the achievement of net zero carbon.
- Illustrate how the proposal incorporates a reduction in fossil fuel usage.
- Demonstrate how the project aligns with the core aims detailed in the energy strategy.

The energy strategy is a live document that will be regularly updated and as such we have approved an allowance for one decarbonisation analyst for each of the

separate GDNs to ensure each company is aware of the latest changes and has an employee to help support this. We are aware of the joint working the Gas Network companies have undertaken to date and welcome this approach.

We actively encourage joint submissions from all 3 GDNs, aiming to utilise the synergies between all 3 companies, ensuring the best possible outcome for the consumers of Northern Ireland. This is in line with the effective joint working the GDNs have established in the relation to the Energy Strategy work to date.

1. Introduction

Purpose of this document

- 1.1 This document forms part of the draft determination (DD) for the GD23 price control. This is the price control for the three gas distribution network operators (GDNs) in Northern Ireland (NI):
- Firmus energy (Distribution) Ltd (FE)
 - Phoenix Natural Gas Ltd (PNGL)
 - SGN Natural Gas Ltd (SGN)
- 1.2 The price control covers the 6-year period from 1 January 2023 onwards.
- 1.3 More specifically, this document is an annex to the main GD23 draft determination document. It provides a background to the development of the Energy Strategy for Northern Ireland. It also details the related approach, business plan requests and key comments, and Utility Regulator (UR) assessment of these as well as the resulting UR proposals for GD23.

Structure of this document

- 1.4 This document is structured in a number of chapters as follows:
- a) Chapter 1, Introduction, provides an overview of the purpose and structure of the document.
 - b) Chapter 2, Energy Strategy Overview, provides background information on the development of the energy strategy for Northern Ireland and its relevance for the GD23 price control period.
 - c) Chapter 3, Detailed Approach to Energy Strategy - UR Proposals, sets out the approach we have taken in considering the implications of the development of the energy strategy for the GD23 price control.
 - d) Chapter 4, Price Control Submissions - Energy Strategy, summarises, for each of the three GDNs, the requests and key comments made by the GDNs in their business plan submissions with respect to the energy strategy for Northern Ireland.
 - e) Chapter 5, UR Proposals, sets out our assessment of the requests and key comments made by the three GDNs for the GD23 price control with respect to the energy strategy for Northern Ireland.

2. Energy Strategy Overview

- 2.1 Pursuant to the UK Climate Change Act, the United Kingdom (UK) is required to have a 100% reduction in Green House Gas (GHG) emissions by 2050 compared to 1990 levels. It was furthermore announced on 20 April 2021 that the UK government will set into law the further climate change target to reduce emissions by 78% by 2035 compared to 1990 levels.¹
- 2.2 Northern Ireland contributes to the UK carbon budgets, and will hence also need to play its part in meeting the above targets. In this context, The Path to Net Zero from the Department for the Economy (DfE) has an overarching vision for energy in the next 10 years.
- 2.3 The Energy Strategy for Northern Ireland identifies different scenarios to demonstrate how different energy systems could look in the future. These scenarios entail different assumptions on the role of gas in the future energy mix.
- 2.4 The Energy Strategy also recognises the importance of replacing high carbon heating sources with lower zero carbon sources in households and businesses. Overall, it highlights a phasing out of fossil fuels for more renewable alternatives to help decarbonise heat, power and transport.
- 2.5 DfE stated that the energy sector generates approximately £1.06bn in turnover annually and provides 5,300 full time equivalent jobs and the aim is to double the size of this sector by generating local market opportunities in place of importing fossil fuels. Two of the potential replacements for natural gas are biomethane and hydrogen.
- 2.6 DfE also noted "Regardless of where it is produced, zero carbon gas will need to be introduced into the gas network in Northern Ireland. We believe that biomethane injection should be the initial focus, with hydrogen more likely to play a role in the medium-term as the technologies and market solutions are further developed."²
- 2.7 We are actively engaged with the natural gas industry in Northern Ireland to facilitate the injection of biomethane into the natural gas network. The first connection is expected in 2022.

¹ [UK enshrines new target in law to slash emissions by 78% by 2035 - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035), 20 April 2021.

² [Department for the Economy: Energy Strategy for Northern Ireland, Consultation on Policy Options, March 2021](#), pages 103-104.

- 2.8 The energy strategy has not fully elaborated on specifics with regard to the energy transition and certain aspects may only become clearer as the implementation of the strategy progresses.
- 2.9 DfE did confirm that "as natural gas has lower emissions than oil we will continue to encourage people with access to the gas network to connect to it. This policy will also be considered further in the planned Decarbonising Heat Consultation."³
- 2.10 DfE also confirmed that it will take forward heat network trials and demonstrators, to further identify if geothermal or, where feasible, waste heat can contribute to the energy transition.
- 2.11 However, it can already be seen today that this work has the potential to impact on a number of aspects that are relevant for gas distribution price controls, e.g.:
- a) Path towards achieving the net zero target as driver for future demand for mains gas.⁴
 - b) Future demand for mains gas as driver for future network charges (which typically are largely based on capacity requirements and volumes of gas flowed) and economic development of the gas distribution networks.
 - c) Economic attractiveness of mains gas compared to other fuels as driver for future gas demand.
 - d) Greening potential of mains gas as driver for reputational and/or economic attractiveness of mains gas.
 - e) Policy decisions on levies, support and/or penalty mechanisms as driver for the economic attractiveness of mains gas or certain qualifying variants thereof compared to other fuels.
 - f) Potential legislative changes with respect to the role and vires of the Utility Regulator as driver for decision taking, including with respect to regulatory allowances, price control targets and changes to the regulatory framework.

³ <https://www.economy-ni.gov.uk/sites/default/files/publications/economy/Energy-Strategy-for-Northern-Ireland-path-to-net-zero.pdf>, page 45

⁴ The term mains gas as used here refers to gas that can in principle be conveyed through gas distribution networks. This could include e.g. natural gas, biomethane as well potentially in the future hydrogen.

g) Future needs with respect to development and maintenance of the gas distribution network (including security of supply considerations) as driver for associated costs, investment decisions and contributing factor to the assessment of the economic life of the infrastructure all of which will in turn impact on network charges.

2.12 The inter-dependency of these matters increases the complexity of associated considerations.

2.13 Also, any investment in building and extending a gas distribution network is a long-term investment, as is the cost associated with constructing such a network in the first place. Thus, decisions taken today impact present as well as future customers. It will therefore be important to carefully consider such decisions, including in the context of the new energy strategy for Northern Ireland.

3. Detailed Approach to Energy Strategy - UR Proposals

- 3.1 This chapter complements the chapter on approach in the main GD23 draft determination document. The approach set out in that main document, including in particular the application of the price control principles, is also relevant for our assessment of requests and key comments relating to the energy strategy.
- 3.2 In addition, some aspects of our approach to the GD23 price control relate specifically to the assessment of requests and key comments with respect to the energy strategy. These are detailed in this chapter.
- 3.3 Our related detailed approach is based on our Final Approach for the GD23 price control⁵.
- 3.4 In our Final Approach document we acknowledged that there was uncertainty on the outcome and direction of travel with respect to the energy strategy for Northern Ireland, which was under development at the time of writing of the Final Approach.
- 3.5 We also noted similar concerns that had been expressed by the GDNs as to the effect of such uncertainty on the business plan submissions, which were due to be submitted largely before the outcome of the work on the development of the energy strategy would be known.
- 3.6 We recognised these issues, and the unknown nature of the scope and scale of changes that may be required as a result of the energy strategy. We explained that we did not want to pre-empt the outcome of the work on the energy strategy but provide the flexibility to address new policy objectives arising from it.
- 3.7 We also noted that whilst more certainty might arise over the course of the price control process before the publication of the final determination, time to review and consider resulting changes or proposals may be limited.
- 3.8 On this basis, we proposed the introduction of a ring-fenced uncertainty mechanism, designed to specifically deal with any outcome of the energy strategy. We wish to maintain this proposal for the Draft Determination as there are still elements of uncertainty after publication of the energy strategy.

⁵ [Utility Regulator: Gas Distribution Networks GD23 Price Control, Our Approach to GD23, November 2020.](#)

3.9 We considered that a ring-fenced uncertainty mechanism would provide some certainty for the GDNs whilst at the same time allowing for a more complete review of the appropriateness of energy strategy-related proposals and strategy implementation options.

3.10 As part of our draft determination, we have given further consideration to the appropriateness and potential design of such an uncertainty mechanism. In so doing, we have considered the business plan submissions by the GDNs, the suitability of uncertainty mechanisms already available under the GD17 price control to address uncertainties related to the energy strategy, as well as the energy strategy itself, that have become available since the publication of our Final Approach.

3.11 We had asked the GDNs to submit their business plans on a business as usual basis, as far as this can be done. We have also assessed the requests in the business plan on this basis, assuming that (unless the final energy strategy indicates otherwise):

- a) Connections from existing, and a reasonable level⁶ of new build, properties to the gas network should continue to be made.
- b) The infill projects proposed by FE and PNGL which were part of a package determined as economic in the GD17 price control period, should be completed.
- c) The infill for the eight core towns proposed by SGN, which was envisaged in the decisions to proceed with Gas to the West and in the GD17 price control period, should be completed.
- d) Further consideration will be given to economically efficient network extensions and these will go through the relevant approval procedures.
- e) The repayment period for the regulatory asset base for each of the three GDNs will remain unchanged.

Further details on our approach to connections, infill projects, network extensions and recovery period, are set out in, Annex F for Capital Investment Detail and recovery period can be seen in more detail in each of the separate GDN Pi models.

3.12 Notwithstanding this business as usual assumption for the purposes of the business plan drafting and assessment of related requests, we remain of the

⁶ We note from the Energy Strategy - Consultation on Policy Options paper considerations on the uplifting of Building Regulations which may impact negatively on the viability of mains gas for new build premises.

view that there is a level of uncertainty that is best addressed by means of uncertainty mechanisms under the price control.

4. Price Control Submissions - Energy Strategy

Overview

- 4.1 This chapter is complemented by the introduction and price control submissions chapters in the main GD23 draft determination document.
- 4.2 Whilst the price control submissions chapter in the main GD23 draft determination document provides an overview of overall GDN performance during the GD17 price control period and the GD23 outlook, this chapter focuses specifically on the requests and key comments made by the GDNs in their business plan submissions with respect to the energy strategy for Northern Ireland.
- 4.3 We note that Innovations and the Energy Strategy, are closely linked, but we make a distinction between the projects which relate to the:
- a) Energy Strategy (i.e. focus on a reduction in carbon emissions and a phasing out of fossil fuels.)
 - b) Innovation (i.e. Projects not related to the energy Strategy that require investment in the business, over and above normal activities.)
- 4.4 With this distinction in mind, the energy strategy states, "it specifically targets net zero carbon and affordable energy as part of our wider action to address climate change and deliver an economy that is ten times better than today through innovation."⁷
- 4.5 All three GDNs provided an aligned update on their co-operation with respect to the energy transition. In it, they highlighted:
- a) The ongoing work by the gas distribution and transmission operators on a strategy that recognises the role that the gas industry can play in a lower carbon society and in ultimately facilitating the UK's 2050 net zero target, including the set-up the Energy Transition Co-ordination Group as well as separate operational groups (e.g. the biomethane working group) to drive forward specific work streams.
 - b) The need for a change to the regulatory framework to maximise the potential for the gas industry in facilitating UK's 2050 net zero target.

⁷ <https://www.economy-ni.gov.uk/sites/default/files/publications/economy/Energy-Strategy-for-Northern-Ireland-path-to-net-zero.pdf>, page 13

- c) The significant potential for further gas network development and the associated carbon reductions that conversions to natural gas attract.
- d) Capability of the (polyethylene) gas network for transporting low carbon fuel alternatives such as biomethane and, ultimately, hydrogen.
- e) No regret options to deliver carbon reductions that can be progressed now (e.g. persuading consumers to switch to natural gas, installing energy efficiency measures).

4.6 In addition, each GDN provided individual comments as part of its business plan submission which are set out below.

Firmus energy GD23 requests

4.7 In addition to the points made in the aligned update on GDN co-operation with respect to the energy transition, FE highlighted in its business plan submission:

- a) The role of the GDNs in facilitating net zero and the importance of innovation to achieve this.
- b) The importance of flexibility in reflecting the evolving strategic landscape within UR's current vires so as to avoid economic regulation arbitrarily constraining the opportunity for decarbonising mains gas; and the need to accommodate, within the GD23 determination, a potential review of our vires should this arise from the energy strategy.
- c) The need for appropriate, flexible and agile funding mechanisms to enable optimum contribution by the GDNs to NI's road to net zero.
- d) The uncertainty associated with volume forecasts, in particular considering the inter-dependency between focus on energy efficiency enhancements resulting from the energy strategy and average gas consumption.
- e) FE's own drive to reduce its carbon footprint.

4.8 With respect to innovation funding mechanisms, FE proposed that these should comprise of different elements:

- a) The existing GD17 innovation funding principles for the purpose of funding larger and reasonably more mature innovation projects.

- b) A specific use-it-or-lose-it innovation allowance to overcome the challenge of funding early-stage innovation activities.
- c) Specific innovation re-openers related to the pathway towards net zero carbon, focussed on innovation, designed to ensure appropriate level and speed of funding and linked to changes arising from the energy strategy (and associated subsequent policy decisions) to the extent that such changes drive additional innovation spending requirements.

4.9 FE also set out focus areas for innovation in GD23 and five potential decarbonisation projects, which are currently at different stages of development.

Phoenix Natural Gas GD23 requests

4.10 In addition to the points made in the aligned update on GDN co-operation with respect to the energy transition, PNGL highlighted in its business plan submission:

- a) The importance of any reopeners being appropriately defined within the regulatory framework so that all parties understand what projects may trigger a reopener, the timescales and what aspects of the FD may be subject to review.
- b) That the materiality threshold should not apply to costs required to implement the conclusions reached by DfE on the new energy strategy as such costs are outside the control of DNOs but the fact that they will exist is reasonably foreseeable.
- c) The importance of DfE's work with us on reviewing the adequacy of our legislative remit in the context of the energy strategy to assist us in transitioning from the traditional role of an economic regulator and to provide the direction and momentum for innovation and delivery of solutions to facilitate Northern Ireland's net energy transition.
- d) The ongoing work by the Biomethane Working Group and PNGL's support for a similar approach when Northern Ireland begins to consider the use of hydrogen on the network.
- e) PNGL's own drive to reduce its carbon footprint.

4.11 With respect to innovation funding mechanisms, PNGL proposed that a Gas Networks Innovation Fund should be established and governed by us, to allow the Distribution Network Operators (DNOs) and other interested parties to apply for funding to trial innovative projects.

SGN Natural Gas GD23 requests

- 4.12 In addition to the points made in the aligned update on GDN co-operation with respect to the energy transition, SGN highlighted in its business plan submission:
- a) The importance of continuing to work towards implementing greener alternatives to natural gas during the GD23 price control period.
 - b) The need for innovation, aligned with the Energy Strategy, to transform the energy system and natural gas networks and to enable and facilitate net zero by 2050, and the importance of innovation informing future developments of the energy strategy.
 - c) The potential for Northern Ireland to rapidly progress towards decarbonisation of the gas network through both biomethane and hydrogen.
 - d) SGN's focus on ensuring that the regulations are in place to enable biomethane to be connected as cost effectively as possible and on ensuring maximisation of delivery of biomethane to the network.
 - e) SGN's own drive to reduce its carbon footprint and contribute to achieving the SGN group's long term target to achieve net zero emissions by 2045.
- 4.13 With respect to innovation funding mechanisms, SGN has proposed that certain funds which might otherwise be returned to customers under the uncertainty mechanism, could be retained for innovation projects, should the GDN have a suitable proposal.
- 4.14 SGN also described a number of specific projects it believes should be developed through the GD23 Price Control as part of the drive to achieve net zero by 2050.
- 4.15 In addition, SGN has stated additional resource requirements to facilitate the management of the transition to a decarbonised future.

5. UR Proposals

- 5.1 The Energy Strategy was published by DfE on 16 December 2021. A key paragraph in the Energy Strategy was, "Whilst our vision of net zero carbon and affordable energy is clear, there will be many uncertainties along the way. We also need to take account of and learn from new policies, technologies and developments, including those taking place in other jurisdictions. This is why the Energy Strategy will be a live document which will be regularly reviewed and updated."⁸
- 5.2 At this very early stage in the energy transition and as mentioned in 5.1, the implications to the gas sector of what may arise from the Energy Strategy are unknown apart from the key principles of developing innovative solutions on the path to net zero carbon and a reduction in fossil fuels.
- 5.3 As the practicalities of the Energy Strategy become clearer, the gas industry must work through the implications and find practical solutions to achieve net zero carbon while considering the required resources necessary to achieve these aims.
- 5.4 We are also aware that our statutory duties may be amended as a result of the energy strategy as it stated, "As the Utility Regulator is a critical policy enabler we will develop an appropriate mandate to support a net zero carbon future, including reviews of licencing and regulatory regimes."⁹ We will monitor any changes to our statutory duty and this will be taken into account for any of the energy strategy submissions we receive from GDNs.
- 5.5 We recognise the difficulty each GDN had in submitting an innovation business plan prior to publication of the DfE's energy strategy and appreciates the work of the GDNs in their submissions.
- 5.6 We agree that there needs to be a mechanism in place to deal with unforeseen energy strategy costs. These energy strategy costs will be treated as a re-opener which would entail a specific ring-fenced uncertainty mechanism that will not be subject to the materiality threshold. We still reserve the right to turn down certain submissions of low materiality if the resources required by us to analyse the submissions are unreasonably extensive for the value of the submission.

⁸ <https://www.economy-ni.gov.uk/sites/default/files/publications/economy/Energy-Strategy-for-Northern-Ireland-path-to-net-zero.pdf>, page 13

⁹ <https://www.economy-ni.gov.uk/sites/default/files/publications/economy/Energy-Strategy-for-Northern-Ireland-path-to-net-zero.pdf>, page 57

- 5.7 These energy strategy costs, subject to the ring-fenced uncertainty mechanism, will be inclusive of both capital and operational expenditure.
- 5.8 Any project that requires funding, subject to the ring fenced uncertainty mechanism as mentioned in paragraph 5.6, will require a business case submission to us. These projects will be analysed, must have prior approval from us in most cases and meet the core principles below:
- a) Demonstrate how the project will contribute to the achievement of net zero carbon.
 - b) Illustrate how the proposal incorporates a reduction in fossil fuel usage.
 - c) Demonstrate how the project aligns with the core aims detailed in the energy strategy.
- 5.9 In addition to the core principles outlined in paragraph 5.6, we actively encourage joint submissions from all 3 GDNs, aiming to utilise the synergies between all 3 companies, ensuring the best possible outcome for the consumers of Northern Ireland.
- 5.10 While the uncertainty mechanism would be specific in terms of the energy strategy, it would follow the same principles for all of the GDNs.
- 5.11 Some elements within the current uncertainty mechanism already have risks and rewards attached to them, e.g. incentive for exceeding properties passed. Due to the inherent uncertainty we are unable to suggest rewards or penalties at this early stage, however this may be considered in future as the energy transition becomes clearer.
- 5.12 After careful consideration in the scope and scale of this area, we have also decided to approve an allowance for 1 full time employee for each GDN. A condition for this role is that the GDN's continue to work together ensuring synergies to achieve the best possible outcome for the consumers of Northern Ireland. We consider this an appropriate level of resource to allow the GDNs to continue to engage with future development of the live Energy Strategy.