

Compliance with Article 13(6) of the TEN-E Regulation

22 April 2015



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; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference

Act with integrity.

Abstract

This paper provides a summary of the existing regulatory arrangements to evaluate investments in gas and electricity transmission infrastructure. It is published in accordance with Article 13(6) of the Trans-European Energy Infrastructure Regulation.

Audience

The paper is primarily intended for the gas and electricity transmission sector. It may also be of interest to the wider gas industry.

Consumer impact

There is no direct impact to Northern Ireland consumers at this time.

However the development of key gas and electricity transmission infrastructure supports the EU's core energy policy objectives of competitiveness, sustainability, and security of supply which impact all energy consumers.

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1. Introduction

Background and Purpose of Paper

- 1.1. The European Commission along with EU Member States has identified priority infrastructure corridors for electricity, gas and oil in Europe¹ which are needed to achieve the EU's core energy policy objectives of competitiveness, sustainability, and security of supply.
- 1.2. To facilitate the development of these priority corridors the European Community has adopted the Trans-European Energy Infrastructure Regulation (TEN-E Regulation)² which lays down guidelines for the timely development and interoperability of priority corridors and areas of trans-European energy infrastructure.
- 1.3. Under the TEN-E Regulation, infrastructure projects which support the implementation of these priority corridors may be granted Project of Common Interest (PCI) status. PCI status may allow for these projects to benefit from faster and more efficient permit granting procedures, access to European funding and improved regulatory treatment were appropriate.
- 1.4. In particular Article 13(1) of the TEN-E Regulation states that Member States and Regulatory Authorities shall ensure that appropriate incentives are granted where a project promoter incurs higher risks for the development, construction, operation or maintenance of a PCI compared to the risks normally incurred by a comparable infrastructure project.

¹Energy infrastructure priorities for 2020 and beyond: http://ec.europa.eu/energy/infrastructure/strategy/2020_en.htm

²TEN-E Regulation: http://inea.ec.europa.eu/download/calls2014/CEF-energy/regulation_3472013_tene_ener.pdf

- 1.5. To support this, Article 13(6) of the TEN-E Regulation requires that each National Regulatory Authority (NRA) publishes its methodology and the criteria used to evaluate investments in electricity and gas infrastructure projects and the higher risks incurred by them.
- 1.6. This paper provides a summary of the methodology and criteria of the existing regulatory arrangements to evaluate investments in transmission infrastructure in line with the requirements of Article 13 (6) of the TEN-E Regulation.
- 1.7. We expect present and future PCIs in Northern Ireland to be assessed under these arrangements, depending upon the nature of the project. As part of this assessment we also expect prospective investors to provide the Utility Regulator with a robust and detailed Cost Benefit Analysis to accompany their investment proposal.
- 1.8. The regulatory arrangements set out in this paper shall be kept under review to reflect any future legislative requirements or policy developments.

2. Methodology to evaluate investments in gas infrastructure

Licence Arrangements

2.1. We regulate investments in gas infrastructure through our licence regime. A project promoter must apply to the Utility Regulator for a licence to operate a high pressure gas pipeline or a gas storage facility. A request to construct the relevant piece of infrastructure is also required. These processes are set out below.

2.2. Conveying gas through a high pressure pipeline or storing gas in a gas storage facility are licensed activities in Northern Ireland. A project promoter seeking to carry out these activities must apply to the Utility Regulator for the relevant licence. A request to construct the relevant piece of infrastructure is also required.

2.3. Parties applying for a licence will be required to submit their application in line with the published methodology and criteria. The methodology and criteria used to assess licence applications and requests to construct infrastructure are set out in the document: 'Criteria for Gas Licence Applications and Applications for Consent to Construct Major Pipelines, Gas Storage or LNG facilities'³.

2.4. If approved, a licence may be granted with standard licence conditions or

³ http://www.detini.gov.uk/gas_published_criteria.

modified standard licence conditions if deemed appropriate by the Utility Regulator. Depending upon circumstances, special conditions may also be included in the relevant licence.

2.5. Licence conditions also reflect the treatment of operational and capital expenditure. The treatment of these costs for high pressure pipelines are set out below. Such licence conditions are not reflected in gas storage licences as they are commercial projects.

2.6. Where appropriate, licence conditions applicable to capital expenditure provide an incentive to the licensee to outperform forecast capital expenditure allowances. These allowances are set in advance of construction to ensure that the licensee takes on an element of risk with respect to capital expenditure.

2.7. This process includes a pain/gain sharing mechanism, the fundamental concept being that if the licensee under spends on their forecast capital expenditure costs they will give some of this back to customers. Similarly if the company overspends on its forecast, customers will underwrite some of the overspend.

2.8. Additionally there are currently two approaches to how we deal with the cost of capital in current licences. We either have periodic reviews where the cost of capital is reset regularly or the cost of capital is fixed over a longer period of time.

2.9. Two regulatory models have been adopted for the treatment of operating

expenditure; a revenue cap control or a pass through approach.

2.10. Under a regulatory cap model licence conditions reflect the requirement for a periodic price control review of operating expenditure. Whereas under an pass through approach, there is no regular price control and costs are passed on to customers. However the licence also includes conditions on a shadow price control and measures for the protection of consumers.

Process to evaluate connections to the high pressure gas network

2.11. There is also the potential for private investors to connect to the high pressure gas network. Connections are subject to the connection policy of the relevant TSO, which is approved by the Utility Regulator.

2.12. Commercial projects connecting to the high pressure network are market-driven so the assessment of the potential revenues and whether they compensate for the risks of the project lie with the investor.

Process to evaluate upgrades to the high pressure network

2.13. The high pressure pipelines in Northern Ireland are relatively new. As such it has not been necessary to upgrade the existing network. We have therefore not been required to carry out an evaluation of replacement capital expenditure.

2.14. We do however carry out network modeling to assess the ability of the current network to meet future demands on the system through the annual

capacity statement⁴. We currently model future demand and supply scenarios over a ten year period. To date the modeling has indicated that the network can meet future scenarios and investment is not required. If there is future investment required, we expect to evaluate the proposals on a case-by-case basis.

⁴ [Northern Ireland Capacity Statement](#)

3. Methodology to evaluate investments in electricity infrastructure

3.1. Investments in electricity infrastructure are also regulated through our licensing regime and price control framework. The Competition Commission ((CC) now the Competition and Markets Authority (CMA)) in its Final Determination⁵ on NIE's RP5 price control (covering 01 January 2013- 30 September 2017) has specified provisions within the price control framework for the Utility Regulator to adjust maximum revenue and the Regulated Asset Base (RAB) during the price control period. These provisions are set out below.

3.2. The CC has provided a mechanism to allow for assessment of additional investment projects to increase the capacity and capabilities of the transmission system and includes investment to accommodate renewable generation. However, it does not allow for asset maintenance expenditure or provisions for cluster infrastructure.

3.3. The CC has ruled that NIE's licence should include a provision to allow the Utility Regulator to determine adjustments to the licensee's maximum regulated revenue and RAB to 'allow for the costs of necessary investments of this nature.' This is referred to as the D5 mechanism and the Utility Regulator is currently in the process of reflecting these aspects within NIE's licence via a series of licence modifications. Any adjustments should be limited to the expected efficient costs of delivery of the investment project. There is a cost sharing mechanism between the licensee and consumers - 50% of such differences should be passed through to consumers via adjustments to NIE's

⁵ <https://www.gov.uk/cma-cases/northern-ireland-electricity-price-determination>

maximum regulated revenue and RAB.

3.4. Projects outside the D5 mechanism include:

- Distribution works directly required to facilitate transmission developments;
- Asset replacement expenditure; and
- Other projects, due only to the scale or uncertainty of those projects.

Criteria for additional investment application

3.5. The procedure requires the licensee to apply to the Utility Regulator for funding relating to specific projects. A prerequisite is that any project should relate to investment requested by the system operator (e.g. SONI) who considers that the project would reflect an appropriate development of the transmission network. If and when any of those projects is approved or recommended by SONI, it would become eligible for review by the UR as part of the D5 provision set out above.

3.6. The system operator and the licensee will work together to produce submissions for this purpose in a format to be determined by the Utility Regulator. This should include option analysis with a minimum of 3 options presented by the system operator e.g. SONI, including a 'do nothing' option. Each option shall have a Cost Benefit Analysis carried out taking into account whole life cost of ownership. This option analysis will be submitted to the Utility Regulator for review before proceeding with pre-construction work (Phase 1). Any Cost Benefit Analysis carried out will demonstrate the optimal timing to invest with deferral of projects considered as an option. The submission shall include a full breakdown of costs that have been estimated for the project. The preferred option should detail the benefits of the project

and the risks if the project did not proceed.

UR decision-making process

3.7. The CC has provided guidance to the UR in evaluating submissions from licencees. This should involve:

- Consideration as to whether NIE has already received some funding in relation to the project within the price control.
- An assessment as to whether the project is in the interest of consumers. This should include consideration of alternative options including operational measures which could avoid/ delay the need for the investment and delaying a decision until additional information is provided regarding its need and design considerations.
- Determination of an appropriate upfront cost allowance, against which NIE would face financial exposure under the 50/50 cost risk-sharing mechanism.
- Consider the use of agreed delivery dates or milestones for the project, with financial penalties for late delivery.

Benefits of this approach to evaluating investment

3.8. The benefits of this approach are that:

- There would be no upfront cost allowances for such projects.
- The UR would only determine the allowed costs for each project when needed and the regulated revenue and RAB would be adjusted accordingly.
- The approach could allow flexibility and a fresh review of expected project costs if there had been substantial changes to the nature or scope of the

project since it was included in the investment plan used for the determination.

UR governance procedures

3.9. The UR governance procedures apply in relation to consideration of requested funding. A scheme of delegation, approved by the board, sets out the scope and extent of delegations granted to different grades of staff in the office across a range of decisions including the consideration of requested funding. Within the scheme, specific delegations apply to requests according to (1) whether or not they sit within a price control and (2) do or do not involve a policy change. The scheme of delegation is reviewed regularly and updated as necessary.

Reporting

3.10. Following project approval NIE must report the outturn measures and costs as documented in the latest current version of the Transmission Regulatory Instruction and Guidance templates.

3.13 Requested amounts will be subject to regulatory assessment, public consultation and determination, as the Utility Regulator considers appropriate.