

# Gas Network Extension in Northern Ireland

Utility Regulator Workshop  
Tuesday 7 May 2013

# Assessment Criteria

# Assessment (Pass / Fail Criteria)

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- Proposed that before an application is evaluated further it must pass all of the following criteria
  - Applicant Identification
  - Organisation Structure
  - Economic and Financial Standing
  - Management & Operational Capability
  - Signing of Pre Qualification Certificate

# Assessment (Economic Standing)

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- Proposed that an applicant must demonstrate it has the necessary financial strength to support the necessary expenditure over time required by the licence(s)
  - Proposed that for T net assets or access to debt and equity finance should equal 120% of £100m
  - Proposed that for D net assets or access to debt and equity finance should equal 120% of £100m
- Proposed that with regard to both debt and equity finance the applicant must demonstrate that in the past 5 years it has
  - raised an equivalent level of finance by that means
  - has a letter of comfort from an institution with a Grade 'A' credit rating
  - holds equivalent debt or equity in an infrastructure business

# Assessment (Management Capability)

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- Proposed that an applicant demonstrates it has the necessary expertise to build and operate a regulated asset of a similar size and complexity to those required by the licence(s)
  - Proposed that for T - owned, developed and operated in the last five years a similar network >7 barg
  - Proposed that for D - owned, developed and operated in the last five years a similar network <7 barg
- Proposed that the example should demonstrate
  - delivering technical, regulatory and statutory requirements
  - managing the necessary resources / contracts
  - engaging with external stakeholders
  - managing to specified operational standards

# Assessment (Marked Criteria)

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Criterion	T	D
Applicant Determined Cost	70%	60%
Operational Business Plan	20%	20%
Innovation & Technology Transfer	10%	10%
Maximising Connections		10%
Total	100%	100%

# Assessment (Applicant Determined Cost)

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- Proposed that the Data Workbook will be used to capture the necessary data
- Proposed Data Workbook being consulted on
  - Effective means of data capture and workbook formulae
  - Appropriateness of proposed cost lines
  - Cost line definition
- Proposed marking scheme
  - Applicant with lowest NPV receives full marks
  - Every 1% increase in NPV will reduce marks by 5% - a 20% increase equals zero marks

# Assessment (Operational Business Plan)

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- Proposed that this will be used to evaluate
  - robustness of ability to build and operate assets
  - robustness of cost estimates contained in the Data Workbook
- Evaluation of plan to build and operate
  - Tendering arrangements and securing of key resources inc staff
  - Management of external stakeholders inc regulators
  - Interactions with other network operators
- Evaluation of cost estimates
  - Identification and application of cost drivers
  - Link to necessary outputs and risk management
  - Completeness and consistency with Data Workbook
  - Underlying assumptions



# Assessment (Technology Transfer)

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- Proposed that the ability of the applicant to bring new technology / techniques to the local industry should be evaluated
  - Current involvement in innovation
  - Planned application to Northern Ireland

# Assessment (Maximising Connections)

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- Proposed that a connections incentive will be provided to fund this activity
  - Experience of delivering connections in an area not previously connected to the gas network
  - Development of ancillary industry
  - Developing relationships with social landlords and local industry
  - Targeting of vulnerable consumers

# Assessment (Questions)

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- Q.9. We would welcome views on our proposed criteria and weightings for each criterion.
- Q.10. In relation to the criterion 'Economic and Financial Standing' do respondents agree that the appropriate capital value for the network extension against which applicants should be required to provide proof of net assets should equal the total costs of the network over 40 years?
- Q.11. Should there be an opportunity to rectify any omissions from the application?
- Q.12 Do respondents consider that the proposed workbook is sufficient to capture the cost information necessary for the Utility Regulator to assess applicant determined costs effectively?

# Treatment of Costs

# Treatment of Costs (Overview)

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- Proposed that this will not be a fixed price process
- Proposed that for those costs which are competed on the output from the process will be used to set price control allowances
- Proposed that applicants will be asked to submit a proposal based on the FMA network design and development plan
- Proposed that applicants will set out their cost estimates in the Data Workbook
- Proposed that costs are split as follows
  - Capital Expenditure
  - Operating Expenditure
  - Financing Costs

# Treatment of Costs (Transmission)

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- Proposed that these costs will be competed on
  - Design & Project Management
  - Contingency – a model construction works contract will be developed to ensure this cost is not incorporated into tendered rates
  - Other Capital Costs – costs to be identified by applicant
  - Controllable Operating Expenditure – recognise that certain of these activities will be tendered however believe that a competent applicant will be capable of robust estimate
- Proposed that Controllable Operating Expenditure estimates for each of 40 years are required and these must be justified in Operational Business Plan

# Treatment of Costs (Distribution)

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- Proposed that these costs will be competed on
  - Mobilisation Costs- cost that the licence holder would incur in advance of commencement of operations including preliminary network design, customer liaison, contractual negotiations
  - Controllable Operating Expenditure – recognise that certain of these activities will be tendered however believe that a competent applicant will be capable of robust estimate
- Proposed that capital costs will not be competed on
- Proposed that Controllable Operating Expenditure estimates for each of 40 years are required and these must be justified in Operational Business Plan

# Treatment of Costs (Financing)

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- Proposed that applicants will be free to submit whatever level of Weighted Average Cost of Capital they believe is necessary to reflect their level of risk.
- Proposed that the rate of return for the first price control period will be set in line with the costs revealed by the application process.
- Proposed that at the first price control review the rate of return will be set using the CAPM methodology



# Treatment of Costs (Questions)

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- Q. 13. We would welcome respondents' views on whether 40 years is the appropriate period over which operating cost data is to be provided.?
- Q. 14 Do respondents consider that the proposed controllable operating expenditure cost lines in the workbook are appropriate to capture this data effectively?
- Q. 15 Do respondents consider that the proposed workbook notes are sufficiently detailed to allow applicants to complete the workbook effectively?

# Treatment of Costs (Questions)

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- Q. 16 Do Respondents consider that the proposed definitions of Controllable Operating expenditure as set out in the notes accurately reflect the structure of costs and the cost divers a licence holder would expect to experience?
- Q. 17 Do respondents consider that the network design information as set out in the accompanying FMA documents is sufficient for applicants to develop a robust application?

# Transmission Regulatory Model

# Transmission Regulatory Model (1)

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- Proposed that application will be based on a pre determined network design and development plan (FMA) and regulatory model which UR would find acceptable if reflected in the final licence
- Proposed that regulatory model in final licence may be different or vary from that set out in competitive process if it can be demonstrated that such would better facilitate the Authority in achieving its statutory objectives

# Transmission Regulatory Model (2)

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- Proposed Regulatory Model - General
  - Revenue cap form of control with a quinquennial review
  - Designation of assets as part of postalised transmission system
- Proposed Regulatory Model - Capex
  - Capital allowances to be based on tendered rates / LPS data
  - Contingency determined competitive process
  - Certain capital cost treated as uncontrollable
  - Controllable Capex subject to verification process and a 5 year incentive mechanism
  - Working capital capitalised at LIBOR + 0.5%
  - Subvention of up to £32.5m is available

# Transmission Regulatory Model (3)

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- Proposed Regulatory Model - Opex
  - Expectation of Northern Ireland System Operator
  - Existing NI licence holders will require an appropriate allocation methodology
  - Structure of cost at price control reviews will not be amended
  - Uncontrollable costs will be pass through
- Proposed Regulatory Model - Finance
  - Allowances to be set on basis of CAPM methodology

# Transmission Regulatory Model (Questions)

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- Q. 18 We welcome respondents views on our proposals for the key features of the regulatory model to be used in the transmission 'competition.'
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- Q. 19 We welcome respondents views on the incentive proposed, and any other possible approaches, to ensure the pipeline is operational as quickly as possible.

# Distribution Regulatory Model



# Distribution Regulatory Model (1)

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- Proposed that application will be based on a pre determined network design and development plan (FMA) and regulatory model which UR would find acceptable if reflected in the final licence
- Proposed that regulatory model in final licence may be different or vary from that set out in competitive process if it can be demonstrated that such would better facilitate the Authority in achieving its statutory objectives
- Proposed that the network design and development plan will be the 'fat' business model developed by FMA

# Distribution Regulatory Model (2)

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- Proposed Regulatory Model - General
  - Price cap form of control with a quintennial review
  - Revenue recovery from extension consumers only but required to facilitate postalisation
  - Profile adjustment with opex capitalised
  - Fat network development plan
- Proposed Regulatory Model - Capex
  - Controllable Capex subject to a 5 year incentive mechanism
  - Assets to be depreciated over economic life

# Distribution Regulatory Model (3)

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- Proposed Regulatory Model - Opex
  - Existing NI licence holders will require an appropriate allocation methodology
  - Structure of cost at price control reviews will not be amended
  - Uncontrollable costs will be pass through
  - An allowance for the first ten years will be available as an incentive to connect existing owner occupied domestics
- Proposed Regulatory Model - Finance
  - Allowances to be set on basis of CAPM methodology

# Distribution Regulatory Model (Questions)

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Q. 20 We welcome respondents views on our proposals for the key features of the regulatory model to be used in the distribution 'competition.'