

WTL Financing Regulatory Decisions and Arrangements to Allow Financing Pre Construction Completing

3 August 2018



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 and 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 specialists, legal advisors and administration professionals.

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

Following a competitive process, a licence was granted to WTL (West Transmission Limited) in February 2015 to convey gas to the west of Northern Ireland (Gas to the West). A key part of the licence application bid was the proposal for WTL to obtain finance by raising a bond for the investment. This paper sets out the changes to the regulatory arrangements the Utility Regulator has put in place to facilitate the financing transaction. This includes changes to licence arrangements and our decision to grant security consent.

Audience

This document will be of interest gas transmission licence holders. It is also likely to be of interest to other regulated companies in the energy industry, government and other statutory bodies as well as consumer groups with an interest in the energy industry.

Consumer Impact

The financing secured means that the cost of debt repayments will be around 35% less than they were expected to be when WTL won the Gas to the West tender in 2014. This amounts to an additional saving of about £50m in present value terms over and above the customer savings already expected from the bidding process.

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1. Executive Summary

- 1.1 Following a competitive licence application process in 2014, a licence was granted to WTL (West Transmission Limited) in February 2015 to convey gas to the west of Northern Ireland (Gas to the West). A key part of the licence application bid was the proposal for WTL to obtain finance by raising a bond for the investment once the network is fully operational.
- 1.2 Given the historically low cost of debt for corporate bonds, WTL approached the Utility Regulator to explore the potential to raise the bond for the investment in a timely manner, whilst construction of the network is still ongoing, rather than (as originally intended) waiting until construction is complete.
- 1.3 With the agreement of the Utility Regulator to assess the viability of securing lower financing costs, WTL approached financiers. The financing deal secured by WTL means that the cost of debt repayments will be around 35% less than they were expected to be when WTL won the Gas to the West tender in 2014. This amounts to an additional saving of about £50m in present value terms over and above the customer savings already expected from the bidding process.
- 1.4 Throughout the preparation and completion of the financing transaction, the Utility Regulator has worked closely with WTL and industry to put in place the required regulatory arrangements. These can be broadly categorised into two groups:
 - Changes to Licence Arrangements
 - Granting of WTL Security Consent
- 1.5 This paper provides further details on these arrangements. It also contains, in Annex 6, the notice under Article 62 of the Energy (Northern Ireland) Order with respect to our decision on the giving of related directions under the WTL conveyance licence and the granting of security consent.

2. Background

- 2.1. Following a competitive licence application process in 2014, The Northern Ireland Authority for Utility Regulation (the Authority, the Utility Regulator) granted a licence to WTL (West Transmission Limited)¹ in February 2015 to convey gas to the Gas to West area.
- 2.2. Consistent with their original licence application WTL is working in partnership with SGN (SGN Natural Gas Limited) to deliver the network. SGN is responsible for constructing and financing the network prior to its handover to WTL.
- 2.3. A key part of the licence application bid was the proposal for WTL to raise finance by raising a bond to pay SGN for their investment once the network is fully operational.
- 2.4. Given the historically low cost of debt for corporate bonds, WTL approached the Utility Regulator to explore the potential to raise the bond for the investment in a timely manner, whilst construction of the network is still ongoing, rather than (as originally intended) waiting until construction is complete.
- 2.5. With the agreement of the Utility Regulator to assess the viability of securing lower financing costs, WTL approached financiers. As part of a competitive process, a preferred bidder was identified in June 2018 and on 19 July 2018 the financing deal was executed.
- 2.6. Throughout the preparation and completion of the financing transaction, the Utility Regulator has worked closely with WTL to ensure the pre-construction financing provides benefits to the consumers and industry in Northern Ireland, and to put in place the required regulatory arrangements. These can be broadly categorised into two groups:
 - Changes to Licence Arrangements
 - Granting of WTL Security Consent

¹ The licence was granted to Northern Ireland Energy Holdings Limited on 11 February 2015. The company changed its name to West Transmission Limited on 28 April 2015.

3. Changes to Licence Arrangements

- 3.1. When the WTL licence was granted, it was anticipated that WTL would raise a bond to pay SGN for their investment once the network is fully operational. The licence was designed to facilitate such arrangements.
- 3.2. For example it contained provisions which permit the licence holder to request the rate of return to be fixed for an extended period over a number of price control periods. It was envisaged that this rate of return would match the interest rate paid on the bond. The licence also contained provision for Eligible Pass-Through Costs to be fully funded by consumers. This provision is in line with the Belfast Gas Transmission and Premier Transmission licences and was included to facilitate financing entirely by debt in the form of a corporate bond.
- 3.3. However, as a result of changing the timing for raising of the necessary finance from post to pre-construction some amendments were required to the process by which capital allowances are calculated. Consequently, the Utility Regulator [consulted](#), on 28 March 2018, on modifications to the WTL gas conveyance licence to facilitate pre-construction financing. Two formal consultation responses were received, from [WTL](#) and [SGN](#). Following consideration of these responses, the Utility Regulator published the related [decision](#) on 9 May 2018. The licence modifications took effect from 4 July 2018.
- 3.4. One of the challenges when preparing the licence modifications was the uncertainty arising from the timing of the transaction: Certain details required to be embedded in the licence would only be known shortly before the execution of the financial transaction, Furthermore, a go/no-go decision with respect to the proposed financial assessment, based on a final assessment of the benefits, would also only be possible shortly before the execution. To address this timing issue, the licence modifications allowed for the Authority to issue specific directions with the effect of modifying the licence, in particular:
 - Direction under Conditions 5.1.1 and 5.1.2 of the WTL conveyance licence
This direction as set out in Annex 1 was issued on 19 July 2018. The reason for our decision to issue the direction was to facilitate pre-construction financing by WTL and the achievement of the associated consumer benefit as set out in chapter 5 of this document. The direction had the effect of switching off, from the date of execution of the financing deal, those licence conditions that are no longer required in light of the new financing arrangements, and of switching on those licence conditions that are required instead.
 - Direction under Condition 6.5.1 of the WTL conveyance licence
This direction as set out in Annex 2 was also issued on 19 July 2018. The reason for our decision to issue the direction was to facilitate pre-construction financing by WTL and the achievement of the associated consumer benefit as set out in chapter 5 of this document. The direction had the effect of updating the licence with certain details specific to the financial transaction which were only finalised in a timely manner to the execution of the financial transaction, including details on the “Fixed Amount” as defined in Condition 6.5.1 of the WTL gas conveyance licence with supplemental provisions and certain definitions.

3.5. The notice of our decision under Article 62 of the Energy (Northern Ireland) Order to issue the two directions is provided as Annex 6 to this paper.

4. Granting of WTL Security Consent

4.1. A pre-requisite for securing the financing was the putting in place of security arrangements. In so far as this involves a disposal of or relinquishment of operational control over a relevant asset, Authority consent may be required pursuant to Condition 1.12 of the WTL conveyance licence. This has in particular been the case with respect to the following:

- Security Consent – Financiers
To facilitate the raising of the bond, there was a requirement for WTL to enter into certain security documents which involve granting of security over the WTL network.
- Security Consent – Department for the Economy
The development of the Gas to the West network has attracted a substantive subvention from the Executive. In this context, the Department for the Economy has taken security in respect of repayment of the grant in the event that WTL breaches the terms of the grant. This is a second ranking security over the network and related property interests.
- Security Consent – SGN
Pre-construction financing has required certain amendments to the collaboration arrangements between WTL and SGN. In this context, the original security that SGN had been granted over the assets of WTL by way of a share charge and debenture had to be irrevocably and unconditionally released at the date of financial closing of the pre-construction financing. In partial substitution for the original security WTL entered with SGN into an agreement under which, to the extent that the cash raised by WTL (or a group company) as part of the financing is insufficient and WTL is required to pay SGN via a "true-up" mechanism provided for in the WTL conveyance licence, SGN will have the right to require WTL to grant security over the relevant assets in the form of the debenture. This third ranking security will rank behind the security granted to both the provider of the Financiers and the Department for the Economy.

4.2. In accordance with the provisions of Condition 1.12 of the WTL conveyance licence, the Utility Regulator has consulted with GNI (UK) as an "other licence holder liable to be materially affected by the disposal" on the granting of security consent in all three cases:

- Consultation on the Granting of WTL Security Consent – [Financiers](#) dated 18 May 2018
- Consultation on the Granting of WTL Security Consent – [SGN](#) dated 4 July 2018
- Consultation on the Granting of WTL Security Consent – [Department for the Economy](#) dated 16 July 2018

4.3. GNI (UK) responded to all three consultations. They noted that a key concern for GNI (UK) would be to ensure that, in the event of any enforcement of the security, any transferee of the WTL network will have the capability to discharge the function of transmission system operator (TSO).

- 4.4. We provided clarification to GNI (UK) that while the creation of the security is treated as a 'disposal' in its own right – and therefore requires the consent of the Authority under Condition 1.12 of the WTL Licence – the granting of that consent at this time does not entail any pre-approval of actions that might be taken later in the exercise of rights under the security documents. If the party to which the rights under the security documents are granted sought to transfer the WTL network assets to a third party, that would be a further 'disposal' which would require an additional consent under Condition 1.12. Similarly, if the security trustee or receiver sought to assign the WTL Licence to a third party, that would require a separate consent under Condition 1.10.
- 4.5. We confirmed that granting consent to the creation of the security does not imply any decision by the Authority to grant (or to promise to grant) the further consents that would be needed under these conditions in the future and that any such future decision would involve us exercising our discretion in the light of all the circumstances known to us at the time. We confirmed furthermore that in making any decision in relation to an application for consent, the Authority would act, as it is required to do, in accordance with the statutory objectives and duties in force at that time. An extremely important element in its considerations would certainly be whether the person to whom the network assets or licence were proposed to be transferred had the competence to perform the obligations of a TSO.
- 4.6. GNI (UK) confirmed that on this basis, they had no objection to the granting of the security consents.
- 4.7. With due consideration of the above, we have decided to grant the consents in the form of the Authority Security Consent Letters provided as Annex 3, Annex 4 and Annex 5 to this decision paper. The reason for our decision was to facilitate pre-construction financing by WTL and the achievement of the associated consumer benefit as set out in chapter 5 of this document. The notice of our decision under Article 62 of the Energy (Northern Ireland) Order is provided as Annex 6 to this paper.

5. Consumer Benefit

- 5.1. The financing secured means that the cost of debt repayments will be around 35% less than they were expected to be when WTL won the Gas to the West tender in 2014. This amounts to an additional saving of about £50m in present value terms over and above the customer savings already expected from the bidding process.

6. Annexes

Annex 1	Direction under Conditions 5.1.1 and 5.1.2 of the WTL conveyance licence
Annex 2	Direction under Condition 6.5.1 of the WTL conveyance licence
Annex 3	Authority Security Consent Letter – Financiers
Annex 4	Authority Security Consent Letter – Department of Economy
Annex 5	Authority Security Consent Letter – SGN
Annex 6	Notice of decision under Article 62 of the Energy (Northern Ireland) Order