

<b>Title:</b> Gas (Designation of Pipelines) Order (NI) 2019	<b>Regulatory Impact Assessment (RIA)</b>
	<b>Date:</b> 20 December 2018
	<b>Type of measure:</b> Subordinate Legislation
<b>Lead department or agency:</b> Department for the Economy (DfE)	<b>Stage:</b> Final
	<b>Source of intervention:</b> Postalisation of costs associated with constructing and operating new high pressure gas pipelines to provide natural gas to towns in the West (part of the Gas to the West project).
<b>Other departments or agencies:</b> Northern Ireland Authority for Utility Regulation (the Utility Regulator)	<b>Contact details:</b> Fred Frazer
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### Summary Intervention and Options

#### What is the problem under consideration? Why is government intervention necessary?

The NI Executive has approved grant assistance for a major project to extend the natural gas network to further towns in the West ('Gas to the West'). The economic viability of the project is supported by "postalising" the costs associated with constructing and operating the major new inter-town gas pipelines. This means that these costs will be added to a "postalised" pot and recovered from all NI gas consumers (business and domestic) over a 40 year period through a common transmission tariff within gas bills. This follows established policy for the development of the natural gas industry in NI. To give effect to this policy, all high pressure (HP) gas transmission pipelines in the West will be "designated" for the purposes of the common tariff under Article 59 of the Energy (NI) Order 2003. A Designation Order has already been put into place (in October 2016) in respect of the HP sections of the new pipeline from Maydown to Strabane which was constructed as part of the first phase of Gas to the West. With the remaining HP pipelines in the West due for completion by Q2 2019, it is now proposed to make a further Designation Order.

#### What are the policy objectives and the intended effects?

The overall strategic objectives for gas network extension are:

- (i) To promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland;
- (ii) To extend the availability of natural gas, as a more efficient and potentially cheaper fuel, providing additional fuel choice, thus enabling businesses to improve their competitiveness in an increasingly global market place;
- (iii) To extend the availability of natural gas as a lower carbon fuel, displacing more polluting fossil fuels, thus providing environmental benefits; and
- (iv) To enable domestic consumers within the towns considered to connect to natural gas, thus contributing to reducing fuel poverty.

The proposed designation of major pipelines within the new gas network in the West for the purposes of the common tariff is in accordance with established postalisation policy underlying development of the natural gas industry in NI which aims to ensure the economic viability of major gas assets by spreading costs across all gas consumers in NI.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

A 'Do Nothing' option was considered and rejected because failing to designate the HP gas transmission pipelines in the West and therefore not including their costs within the common tariff would result in the project being uneconomic. The Department's preferred option is to implement Designation Orders, including the proposed 2019 Order in respect of the HP sections of the new gas pipelines which will serve Dungannon, Coalisland, Cookstown, Magherafelt, Omagh, Enniskillen and Derrylin. This will permit application of a common gas transmission tariff to these pipelines in accordance with agreed principles of postalisation for the NI gas industry.

<b>Will the policy be reviewed?</b> There are no plans at present to review postalisation policy.		<b>If applicable, set review date:</b> N/A
<b>Cost of Preferred (or more likely) Option</b>		
<b>Total outlay cost for business</b> £m	<b>Total net cost to business per year</b> £m	<b>Annual cost for implementation by Regulator</b> £m
It is estimated that postalisation of the HP sections of new inter-town pipelines in the West will add between 0.32% and 0.38% to gas bills for businesses in NI.	This represents an increase in their annual gas bill of around £8 for a small company using 2,500 therms of gas per year, or around £8,000 for a larger energy user using 2m therms of gas per year, in consideration of spring 2018 prices.	Contained within administrative budgets.

<b>Does Implementation go beyond minimum EU requirements?</b>		<b>NO</b> <input checked="" type="checkbox"/>	<b>YES</b> <input type="checkbox"/>
Are any of these organisations in scope?	<b>Micro</b> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>	<b>Small</b> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>	<b>Medium</b> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
		<b>Large</b> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>	

**The final RIA supporting legislation must be attached to the Explanatory Memorandum and published with it.**

Approved by: Noel Lavery (Signed)

Date: 4<sup>th</sup> January 2019

**SUMMARY ANALYSIS AND EVIDENCE**

**Policy Option: 2**

**Description:** Designation of high pressure (HP) gas assets (> 7 bar) in the West for the purposes of the common tariff under Article 59 of the Energy (NI) Order 2003.

**ECONOMIC ASSESSMENT (Option 2)**

The Department's updated Full Business Case for Gas to the West (May 2018) estimated that, with grant assistance up to £31.6m (revised cap) towards the HP gas assets, the project should have an overall net present benefit to the Northern Ireland economy of £394m<sup>1</sup>. The underlying assumptions behind this estimate include the application of postalisation policy to enable costs associated with the HP gas transmission pipelines to be recovered from all gas consumers through a common transmission tariff over a 40 year period.

<b>Costs (£m)</b>	<b>Total Transitional (Policy)</b>		<b>Average Annual (recurring)</b>	<b>Total Cost</b>
	(constant price)	Years	(excl. transitional) (constant price)	(Present Value)
<b>Low</b>				
<b>High</b>				
<b>Best Estimate</b>			<b>£5.983m per annum</b>	<b>£239m</b>
<b>Description and scale of key monetised costs by 'main affected groups'</b>				
<p>Taking grant assistance up to £31.6m into account, it is estimated that the postalised common transmission tariff for NI gas consumers will have to increase by 3.5% to cover the costs associated with the new HP inter-town gas transmission pipelines and associated infrastructure in the West over a 40-year period. As the common transmission tariff represents about 10% of the costs in an average gas bill for most businesses, this translates to around £8 on a typical annual gas bill for a small company; around £300 on a typical annual gas bill for a larger business using 75,000 therms of gas each year; and around £8,000 on the annual gas bill for a large energy user using 2 million therms of gas each year. The total estimated annual recurring postalised cost is considered to be £5.983m per annum for the new HP networks (based on a 5 year estimate only) - this will be updated by the Utility Regulator as final project costs become known when the gas project is completed in 2019. This would equate to a total of some £239m over a 40 year cost recovery period, which is still to be defined, along with final costs.</p>				
<b>Other key non-monetised costs by 'main affected groups'</b>				
None identified.				
<b>Benefits (£m)</b>	<b>Total Transitional (Policy)</b>		<b>Average Annual (recurring)</b>	<b>Total Benefit</b>
	(constant price)	Years	(excl. transitional) (constant price)	(Present Value)
<b>Low</b>				
<b>High</b>				
<b>Best Estimate</b>			<b>£9.85m</b>	<b>£394m</b>

<sup>1</sup> Figures quoted in this RIA are drawn from the Department's Full Business Case on Gas to the West (Updated May 2018)

**Description and scale of key monetised benefits by ‘main affected groups’**

The key benefit of postalising the HP inter-town pipelines in Gas to the West is that it supports the project being economically viable, therefore facilitating provision of natural gas as an alternative fuel of choice to domestic consumers and businesses in the West. The overall project (with grant assistance) is estimated to have a net present benefit to the Northern Ireland economy of £394m. This includes the positive net benefits from environmental and fuel savings associated with extending the availability of natural gas.

**Other key non-monetised benefits by ‘main affected groups’**

Energy consumers in the West will benefit from having additional fuel choice. The project also offers potential for short term and longer term employment opportunities associated with development of a new energy industry, allowing additional skills from working in this sector to be realised.

**Key Assumptions, Sensitivities, Risks**

The results of the Department’s NPV analysis of Gas to the West, and of its assessment of the project’s impact on the common gas transmission tariff, are dependent on assumptions made about costs, customer uptake, and benefits of fuel switching and emissions reductions. The sensitivity analysis indicated that the project is most sensitive to changes in the forecast heating oil price and the resultant margin between heating oil and gas prices. Changes in forecast volume of gas sales would also have a large impact on the size of the NPV to the NI economy.

**BUSINESS ASSESSMENT (Option 2)**

<b>Direct Impact on business (Equivalent Annual) £m</b>				
<b>Costs: Negligible</b>	<b>Benefits: £0.288m 1200 small businesses</b>	<b>Net: £0.288m</b>	<b>SMEs</b>	<b>See below</b>

Benefits to businesses in the West will largely relate to the differential between oil and gas prices at any particular time. The Consumer Council NI has been collecting information on delivered heating oil prices since 2009 and, over the long-term, this shows that natural gas prices, which are regulated by the Utility Regulator, have been, on average, lower than home heating oil prices (for the equivalent energy levels).

It is estimated that, by 2022, some 1,600 businesses in the West could connect to gas, including up to 1,200 small businesses. Even with oil and gas prices being the same, there are commercial benefits for businesses to convert to natural gas due to the greater efficiency of gas; no requirement for on-site bulk fuel storage; and potential for efficient gas fired Combined Heat and Power (CHP) systems to reduce electricity costs. If gas prices were 10% lower than oil prices, disregarding conversion costs, a small business in the West connecting to gas could save around £240 per annum if their average heating bill was c£2,400. This equates to a saving of £0.288m per annum across 1200 small businesses in the West. For the estimated 58 larger businesses in the West, savings could be much greater.

**Cross Border Issues (Option 2)**

**How does this option compare to other UK regions and to other EU Member States (particularly Republic of Ireland)**

Postalisation of the costs associated with major gas transmission pipelines is permitted under the Gas Tariff Code which has been developed in line with the EU Gas Regulation (EC 715/2009). Postalisation is utilised in a number of EU Member States, including the Republic of Ireland.

## **EVIDENCE BASE**

### **Background**

Natural gas was first introduced to Northern Ireland via the Scotland to Northern Ireland gas pipeline in 1996. By end-2017, there were around 204,287 gas consumers in the Greater Belfast and Larne licence area and 37,293 in the 10 Towns licence area outside Belfast. Parts of the West and East Down were among the key remaining areas not connected to the natural gas network.

The Strategic Energy Framework 2010, which was endorsed by the NI Executive, supports further extension of the natural gas network where it is economic to do so. It is estimated that over 65% of homes in Northern Ireland are still dependent on oil for heating, and extending the natural gas network will help to reduce greenhouse gas emissions and fuel poverty.

### **Problem under consideration:**

The Department, in liaison with the Utility Regulator, proposes to extend the natural gas network to further towns in the West, namely Dungannon, Coalisland, Cookstown, Magherafelt, Omagh, Enniskillen/Derrylin and Strabane.

In January 2013, based on a detailed economic appraisal commissioned by the Department, the NI Executive agreed to provide grant assistance up to a maximum of £32.5m at a rate of 35% of eligible expenditure towards provision of the project's HP gas transmission pipelines in order to reduce the impact of consumers' gas bills.

The project is being delivered by private sector developers, West Transmission Ltd (WTL) and SGN Natural Gas (SGN), under exclusive gas conveyance licences granted by the Utility Regulator on 11 February 2015 following a competitive process.

Based on updated costs submitted by WTL and SGN, and verified by the Utility Regulator as part of its price control for Gas to the West (Verified Controllable Capital Forecast), the Department updated its economic appraisal on grant assistance for Gas to the West in May 2018. This resulted in a revised grant ceiling of £31.6m. The costs associated with the HP gas transmission pipelines which are not covered by the grant will have to be recovered over the 40-year licence period from gas consumers through the common transmission tariff element within their gas bills.

The business model upon which the NI gas industry has been developed prescribes that the transmission tariff is "postalised", setting a common gas transmission tariff for all gas consumers in NI. It is proposed to follow this established model for the Gas to the West project, with the cost of the HP gas transmission pipelines and associated infrastructure added to the "postalised" pot from which the common (and strictly regulated) gas transmission tariff is calculated. This entails the Department "designating" the HP gas transmission sections of the new gas infrastructure in the West for the purposes of the common tariff under Article 59 of the Energy (NI) Order 2003. The HP section of the new gas pipeline from Maydown to Strabane, completed as part of the first phase of Gas to the West, was designated in October 2016. It is now proposed to designate the remaining HP gas transmission assets in the West, due for completion by Q2 2019, for the purposes of the common transmission tariff.

It is estimated that, after 40 years, the new gas infrastructure in the West could serve some 40,000 consumers. It is assumed that up to 70% of available domestic consumers will connect to gas, and between 70% and 100% of available business customers will connect, with the higher connection rates for larger energy users where greater efficiencies can be realised by switching from oil.

**Rationale for intervention:**

**Policy objectives:**

The overall strategic objectives for gas network extension are:

- (i) To promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland;
- (ii) To extend the availability of natural gas, as a more efficient and potentially cheaper fuel, providing additional fuel choice, thus enabling businesses to improve their competitiveness in an increasingly global market place;
- (iii) To extend the availability of natural gas as a lower carbon fuel, displacing more polluting fossil fuels, thus providing environmental benefits; and
- (iv) To enable domestic consumers within the towns considered to connect to natural gas, thus contributing to reducing fuel poverty.

The gas network may only be extended where it is economic to do so and the policy of postalising the cost of major inter-town pipelines and associated infrastructure has been developed on the basis of ensuring the economic viability of these assets<sup>2</sup>.

The policy of postalisation was first consulted upon in June 2002 as part of the preparation for the implementation of the Energy Order. This was followed by a paper on the 'Design of the Postalisation System for the Northern Ireland Gas Transmission Network' in December 2002; Recommendations for the 'Implementation and Operation of a Postalisation System for Natural Gas Transmission Tariffs in Northern Ireland' in June 2003; and a 'Decision Letter' in October 2003.

The Energy Order subsequently put in place the powers necessary to give effect to postalisation. In particular, Article 59 gives the Department the power to designate pipelines for the purpose of securing that the prices charged for conveyance of gas through designated pipelines are in accordance with a Common Tariff (Article 60).

The extension of the gas industry in Northern Ireland and the implementation of postalisation has been supported by the Utility Regulator who has been consulted about the terms of the proposed Designation Order for the HP gas transmission pipelines.

**Description of options considered:**

- **Option 1 – do nothing.**

If the HP transmission sections of the new gas network in the West are not designated, it will not be possible to recover costs through the mechanism of a common tariff. Failure to implement a common tariff would result in excessive and unacceptable costs being imposed on potential gas consumers in the West. Energy consumers in the West would be unlikely to switch from more polluting fuels, such as oil and coal, to natural gas which would result in the pipeline not being economically viable. This would likely result in natural gas not becoming available to both business and domestic consumers in the West. This option is therefore not carried forward.

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<sup>2</sup> Smaller distribution pipelines within towns are deemed economically viable at a local level and are not therefore added to the postalised pot.

- **Option 2 – do minimum.**

Implement Designation Orders for the HP transmission sections of the new gas network in the West to permit a common tariff to be applied in accordance with the agreed principles of postalisation. This action follows the precedent set for all high pressure gas transmission pipelines already constructed in Northern Ireland.

## **Costs and Benefits**

### **Costs and impacts on overall gas bills:**

As outlined above, the Utility Regulator price control for West Transmission Ltd has provided an estimate of the cost of providing the major inter-town pipelines and associated infrastructure for Gas to the West. This enabled the Department to calculate a revised grant ceiling of £31.6m.

It is estimated that the costs associated with the HP gas transmission pipelines which are not covered by the grant will have to be recovered from gas consumers through an increase of 3.5% in the “postalised” or common gas transmission tariff over a 40-year recovery period. The common gas transmission tariff represents about 10% of the costs included in a gas bill so this will add between 0.32% and 0.38% to overall gas bills for businesses in NI. In practical terms, this would add around £8 to the typical annual gas bill for a small company using 2,500 therms of gas per year; around £300 to the typical annual gas bill for a larger business using 75,000 therms of gas each year; and around £8,000 to the typical annual gas bill for a large energy user using 2 million therms of gas each year.

It is important to note that the cost of the inter-town pipelines and associated infrastructure for Gas to the West are recovered from all gas consumers in Northern Ireland, including power generators, businesses, and domestic users.

***Please also note that this Regulatory Impact Assessment on the impact of the Gas (Designation of Pipelines) Order (NI) 2019 only considers the impact on businesses of costs associated with the high pressure gas transmission pipelines and related infrastructure in the West and not the impact on businesses of the total cost of the Gas to the West project.***

### **Benefits:**

#### CO2 Reductions

Natural gas produces 26% less carbon than fuel oil, and thus switching from oil to gas makes a significant contribution to reducing environmental impacts. It is estimated that up to 40,000 business and domestic consumers in the West will convert to natural gas, resulting in a reduction of over 60,000 tonnes of carbon dioxide (CO2) per annum by the final year of the 40-year project.

#### Business Competitiveness

The availability of natural gas in the West will provide an additional fuel of choice for businesses in the West. This could help to improve their business competitiveness and present an opportunity to increase export potential, along with options for installing gas-fired Combined Heat and Power (CHP) plants for on-site electricity generation. The indigenous and successful agri-food industry in the Dungannon/Cookstown area and the manufacturing sector has supported the Department making natural gas available in the West and its provision will assist development plans for some companies in this sector.

#### Small Businesses

The Gas to the West project will provide natural gas to Dungannon, Coalisland, Cookstown, Magherafelt, Omagh, Enniskillen and Derrylin. Strabane has already been connected to the benefits of gas. This will provide additional fuel choice to small businesses, with the potential to reduce energy costs given the greater efficiencies of natural gas.

## Employment

The construction and engineering sectors in Northern Ireland have been severely impacted by the economic downturn. Extending gas networks to the West will provide employment for around 200 engineering and construction staff involved in the design, planning, and installation process, with perhaps 35 permanent engineering jobs and on-site installation staff allocated to rolling out gas distribution networks and connecting consumers over a number of years in the selected towns. There will also be employment and re-training opportunities for heating engineers and installers of domestic and commercial heating installations as consumers convert to gas.

### **Rationale and evidence that justify the level of analysis used in the RIA (proportionality approach):**

#### **Risks and assumptions:**

Analysis of the Gas to the West project in the Department's updated 2018 economic appraisal assumes that the cost of the new inter-town pipelines will be postalised for the purposes of the common gas transmission tariff based on existing policy.

Assessment of the impact of the project on the common gas transmission tariff, and on the Northern Ireland economy generally, is also dependent on assumptions made about costs, customer uptake, and benefits of fuel switching and emissions reductions. The sensitivity analysis has indicated that the project is most sensitive to changes in the forecast heating oil price and the resultant margin between heating oil and gas prices. Changes in forecast volume sales would also have a large impact on the size of the NPV to the NI economy.

## **CONCLUSION**

The Department concludes that legal designation of HP gas transmission pipelines in the West follows established principles and practice for development of the NI gas industry. It ensures that the costs of such pipelines are spread across all gas consumers in NI and thus maintains the economic viability of the gas industry.

## **CONSULTATION**

The Department published a public notice on the draft Designation Order and invited any representations by **14 August 2018**. The public notice may be found on the Department's website at <https://www.economy-ni.gov.uk/consultations>. The Department received one response to the consultation from gas industry which was supportive.

## **MOITORING AND REVIEW**

The Department will liaise with the Utility Regulator who will monitor the operation of the common tariff structure agreed for the designated pipelines.

Compliance with gas licence conditions is enforced by the Utility Regulator who has the power to impose financial penalties in the event of a breach.