



EUROPEAN COMMISSION

Brussels, 10.07.214

C(2014) 4939 final

<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>		<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
--	--	---

Subject: **State aid SA.36290 (2014/N) – United Kingdom
Northern Ireland Gas Pipeline; extension to the West and the
North West.**

The European Commission wishes to inform the United Kingdom that, having examined the information supplied by your authorities on the matter referred to above, it has decided to raise no objections to the notified aid measure.

I. PROCEDURE

The Rt Hon William HAGUE
Secretary of State for Foreign Affairs
Foreign and Commonwealth Office
King Charles Street
London SW1A 2AH
UNITED KINGDOM

Commission européenne, B-1049 Bruxelles – Belgique
Europese Commissie, B-1049 Brussel – België
Telephone: 00-32 (0) 2 299 11.11.

1. Following pre-notification contacts, by electronic notification of 02 June 2014, the United Kingdom notified, pursuant to Article 108(3) of the Treaty on the Functioning of the European Union (hereinafter referred to as TFEU), the project of financing the extension of the natural gas network to additional towns in the West and North-West of Northern Ireland.

II. DESCRIPTION OF THE MEASURE

Background and objectives of the notified project

2. The notified project consists of a proposed extension of the natural gas network to the West and North West of Northern Ireland (namely Dungannon, Cookstown, Magherafelt, Coalisland, Omagh, Enniskillen/Derrylin and Strabane). The project will involve investment in the provision of approximately 169 km of new natural gas transmission (high pressure) and some 142 km of new gas distribution (low pressure) infrastructure to facilitate the provision of natural gas to the seven towns identified above.
3. According to estimates of the Northern Ireland authorities, the proposed project could save 86 000 tonnes of CO₂ annually by 2052 and bring greater fuel choice to some 34,000 consumers in these areas, provide an option for businesses to use a cleaner, more efficient and cheaper fuel, help to reduce the dependence on coal and oil for household heating and help to alleviate fuel poverty.
4. The Northern Ireland authorities have stressed that, in the absence of public funding the transmission network will not be constructed over the defined 2 year period. Natural gas has been available in Northern Ireland since 1996 and during this time no applications were made by gas companies to the Utility Regulator for a licence to extend the gas network to the West and North-West areas. A smaller and more dispersed population, and smaller number of businesses in the West regions of Northern Ireland contributes to a reluctance by investors to bring forward proposals for gas network extension in this area.
5. The Northern Ireland authorities have informed that consumers in Northern Ireland are at greater risk of energy poverty than consumers in other regions of the UK. In 2012, 42% of energy consumers in Northern Ireland were considered to be in a situation of fuel poverty. This compares to approximately 13% in England, and 33% in Scotland.

Beneficiaries

6. The direct beneficiary of the measure will be the licensee with the responsibility to implementing the gas transmission (high pressure) infrastructure. Given the significant positive externalities that transmission infrastructure provides to the participants of the gas market, further indirect beneficiaries of the measure are the businesses, industries and households that will be connected to the natural gas network.

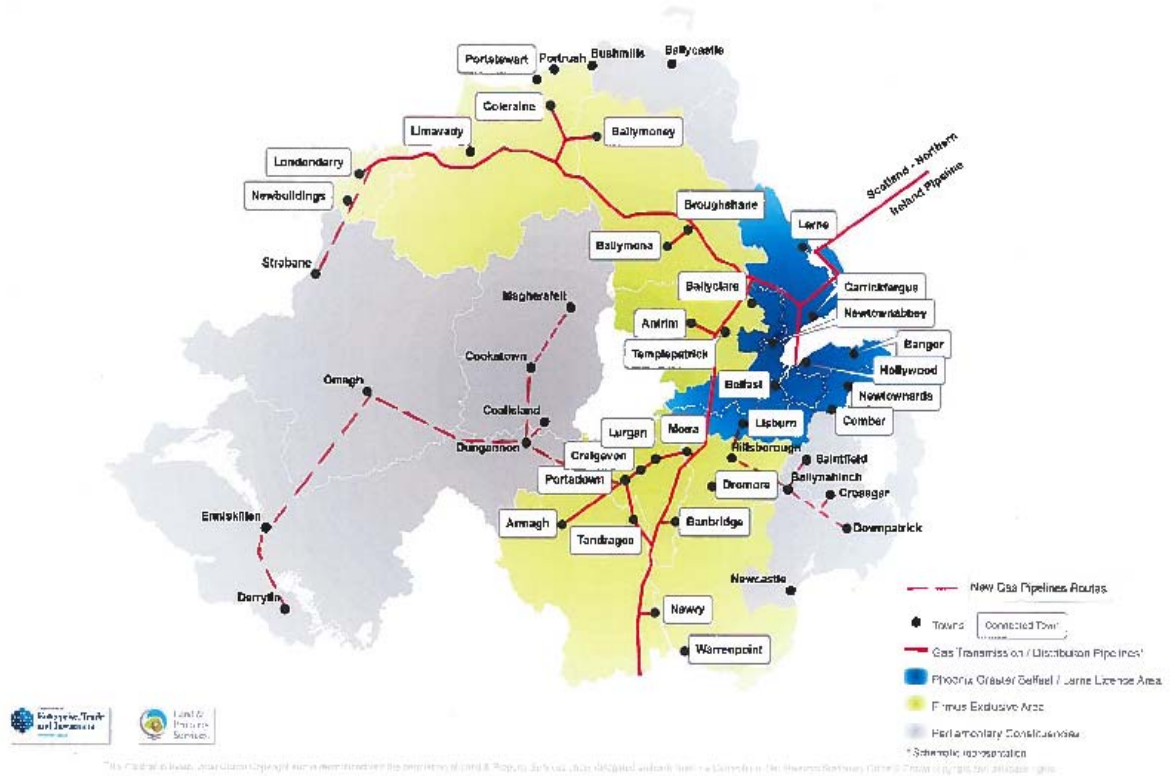
7. The licensee will be selected through an open and transparent competition on the basis of clear assessment criteria. The Utility Regulator will monitor the progress and the costs involved in the network development. Only agreed costs will be passed through to consumers at a regulated rate of return via the regulatory Price Control process. In particular, the licensee will not gain a return on the share of capital expenditure subsidised by the aid.

The Northern Ireland Gas Market

8. Northern Ireland has two natural gas licensed areas, providing gas to approximately 160,000 consumers. Approximately 90% of consumers are in the Greater Belfast, Lisburn and Larne gas licence area developed since 1996, while some 17,000 consumers are currently connected to gas in the licensed area serving 12 towns and cities outside Greater Belfast. The existing gas network in Northern Ireland also provides natural gas to 2 of the 3 power generating stations – at Ballylumford in East Antrim and Coolkeeragh near Londonderry in the North-West.
9. While natural gas accounts for around 70% of energy consumption for heating in Great Britain, it currently only accounts for some 17% of home heating in Northern Ireland, where oil remains the dominant fuel for heating and used for almost 70% of homes.

Figure 1: Map of the current and planned gas transmission network in Northern Ireland.

Natural Gas Availability in Northern Ireland



National regulatory framework for gas transmission in the UK

10. Legal basis for implementing the project is the Energy (Northern Ireland) Order 2003 (No. 419 N.I. 6).
11. The new gas network will be maintained by the licensee(s) and network operation will be governed by existing arrangements in accordance with national and EU energy policy and legislative requirements.
12. The costs relating to gas transmission and distribution networks are currently paid for by consumers¹ through regulated prices established pursuant to the process of regulated price controls, i.e. included in retail bills as a price per unit of gas charged to the final customer.
13. Gas transmission costs are ‘postalised’, i.e. established as one common tariff paid by consumers across Northern Ireland irrespective where they live.

¹ State aid was granted for the construction of the North-South gas transmission pipeline connecting the Republic of Ireland to West Belfast, Northern Ireland. The measure was considered compatible with the Treaty by the Commission with Decision C(2002)2599fin.

Financing: budget, aid intensity and duration

14. The total investment costs for gas transmission of the notified project are estimated at £93million.
15. A technical and economic feasibility study and a business case analysis performed in September 2012 on gas extension to the West and North-West of Northern Ireland concluded that the current level of postalised tariffs would not provide sufficient financing for the transmission infrastructure to be commercially viable. To overcome this funding gap, two additional financing sources have been considered:
- Increase of the postalised tariff or
 - Increase of the postalised tariff in combination with financial assistance from the government.
16. If the gas transmission infrastructure extension were to be financed exclusively through the tariffs, the increases in the postalised transmission tariff due to the project would apply to all gas consumers in Northern Ireland and not just in the new gas licence area. The estimated tariff increase would amount to about up to [...] implying the risk that existing gas consumers could switch back to other more polluting fuels. Furthermore, given the significant fuel poverty in the region, consumers would likely not be able to afford gas if they had to bear the full costs of the new pipelines.
17. Therefore a subsidy of up to £32.5 million is considered which will be delivered in the form of a grant based on a percentage of actual costs of the gas transmission element of the project. This is considered the necessary amount, to ensure that new gas networks are provided to all 7 towns avoiding unacceptable increases in gas transmission tariffs.
18. The proposed financial support at up to £32.5million will be complemented by a moderate increase to the postalised tariff. The proposed aid reflects previously approved levels of intervention for a major gas pipeline project in Northern Ireland².

Estimated financial requirements for the proposed infrastructure for two different business models³, BM1 and BM2.

Project Funding Options for separate business models	Government funding of gas transmission element of project	Total Revenue from increase to Tariff Postalisation Costs (Real £)	Average Adjustment to Postalised Transmission Tariff over capital repayment period (£ per therm of gas)	Weighted average %age adjustment to Postalised gas transmission tariff over capital repayment period
BM1 without Govt support	Nil	£[...]	[...]	[...]%

² Case COMP/13590 *Northern Ireland Gas Pipeline* (OJEU C/309/2002).

³ Two business models are considered for gas distribution: BM1 based on connecting key gas while domestic customers in existing owner-occupied private housing are only connected to the gas network if their residence is adjacent to the pipeline route, BM2 based upon making natural gas available to as many customers as possible where it is financially viable to do so.

BM1 with Govt support	£32,516,014	£[...]	[...]	[...]%
BM2 without Govt support	Nil	£[...]	[...]	[...]%
BM2 with Govt support	£32,516,014	£[...]	[...]	[...]%

19. According to the business plan, submitted in the notification, the £32.5 million aid and the tariff increase are estimated to yield an internal rate of return of [...] for the licensee of the transmission infrastructure. The commercial rate of return of the project was benchmarked against comparable rates of return for utilities in Great Britain.

III. ASSESSMENT

Presence of state aid

20. Article 107 (1) TFEU provides that “*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, shall, in so far as it affects trade between Member States, be incompatible with the common market*”.

Aid granted by a Member State or through State resources

21. The UK acknowledges that State aid is present in this project. The aid will be granted through State resources in the form of a grant to the undertaking that wins the licence competition. The aid is therefore considered to be granted from State resources within the meaning of Article 107(1) TFEU.

Favouring certain undertakings or the production of certain goods

22. The aid will provide a selective advantage to the firm obtaining the licence, when compared to other enterprises operating in the natural gas transmission and distribution sector. As this advantage is only granted to a single licensee in a specific sector, the Commission concludes that it has a selective nature.

Distortion of competition and affectation of trade between Member States

23. The undertakings will also be active in a sector in which trade is present in almost all Member States and although the UK does not know which company will win the licence competition, it is clear that the aid has the potential to distort competition and trade between Member States (for example, by promoting the use of natural gas over the use of other fuels).

Conclusion with regard to the presence of state aid

24. Taking the above into consideration, the Commission concludes that the financing of the project involves state aid within the meaning of Article 107 (1) TFEU.

Legality

25. The contract is scheduled for finalisation in the fourth quarter of 2014. Therefore the UK authorities did not put the aid measure into effect before a final Commission decision. Thus, the United Kingdom has complied with the stand-still obligation set out in Article 108(3) TFEU.

Compatibility under the Guidelines on State aid for environmental protection and energy 2014-2020

26. The Commission notes that the measure aims at developing gas transport infrastructure in Northern Ireland. As it regards support for gas infrastructure, aid for such project does fall within the scope of the Guidelines on State aid for environmental protection and energy 2014-2020⁴ ('EEAG').

Objective of common interest

27. In line with paragraph (203) of the EEAG, the Commission considers that energy infrastructure is a precondition for a functioning energy market. Aid to energy infrastructure therefore strengthens the internal market, it enhances the integration of different energy sources and energy supply in under-developed networks. The Commission therefore considers that aid to energy infrastructure thus contributes to an objective of common interest.

Need for state aid

28. Pursuant to paragraph (207) of the EEAG, the need for state aid in energy infrastructures not located in assisted regions is assessed on a case-by-case basis.

29. The business case analysis referred to in paragraph 15 indicates that the notified project would not be financially viable without the public financing. Indeed, the net present value calculated at the regulated financial rate of return [...] is negative, which means that the revenues generated by the project would not cover the expenses incurred. This is largely due to the significantly lower population density in the West and North-west region compared to the two natural gas licensed areas in Northern Ireland. As a consequence, no gas companies have to date applied for a licence to take natural gas to the seven towns in the West and North-West. Without aid, the infrastructure would not be realised in its entirety or not within the timescales required.

30. Therefore, the Commission considers that the aid is necessary.

Appropriate instrument

⁴ OJ C 200/01 of 28.07.2014.

31. The UK authorities have explored the possibility to finance the extension of the gas network to the West and North-West regions exclusively through an increase in tariffs. As mentioned in paragraphs 15 and 16, financing the transmission infrastructure solely by increasing the postalised transmission tariffs would reduce the incentives for users to switch to gas in the new license area, and thus increase the investment risk. Furthermore, it would even risk deterring existing consumers from the use of gas with the risk to switch to more polluting fuels in the other two licenced areas in Northern Ireland. The UK authorities claim that it would furthermore pose an unaffordable tariff increase to the significant share of population already exposed to fuel poverty.
32. Consequently, the Commission considers that financing the notified project partly from state resources and partly with an increase in the postalised transmission tariffs is an appropriate instrument to accelerate investments in the gas transmission system network in Northern Ireland.

Incentive effect

33. In line with paragraph (49) of the EEAG, the incentive effect occurs, if the aid induces the beneficiary to change his behaviour towards reaching the objective of common interest which it would not do without the aid.
34. As mentioned in paragraph 29, the investment would not be carried out to the same extent or within the given timeframe in the absence of aid.
35. The aid will be awarded on the basis of a competitive bidding process. Therefore, in line with the last sentence of paragraph (52) of the EEAG, it can be concluded that the aid to the notified project provides for the necessary incentive effect.

Proportionality

36. A state aid measure is proportional if the measure is designed in a way that the aid as such is kept to the minimum. In line with paragraph (211) of the EEAG, for energy infrastructures the eligible cost is the funding gap.
37. The funding gap is estimated to about £32.5 corresponding to about 35% of the costs of the transmission network. The aid intensity is therefore 100% of the funding gap which complies with paragraph (212) of the EEAG.
38. The financial analysis portrayed in paragraphs 15-19 indicates that with the planned aid, the project would yield a rate of return [...] which is in line with the regulated return on capital for similar projects (the Net Present Value of the project including the aid and the foreseen increase in postalised tariffs becomes positive). Given that the project underlies full tariff regulation, it is noted that the Utility Regulator will ensure that only acceptable costs will be borne by consumers and that the beneficiary cannot make excessive profits. The gas conveyance licence to be granted will provide for regular 5 year price control reviews at which ex ante allowances will be set for operating capital and financing costs.

It follows that the planned price control mechanism can be seen as preventing that any excess return is achieved.

39. Bearing in mind the above, it can be concluded that the state aid granted for the notified project is proportional.

Distortion of competition and balancing test

40. In line with paragraph (214) of the EEAG, given that the gas network extension will be subject to full internal market regulation (in terms of tariff setting, capacity allocation, congestion management etc.), the Commission considers that it does not have undue distortive effects on competition and trade.

Conclusion with regard to the compatibility of the measure

41. In light of the above, the Commission considers that the notified aid pursues an objective of common interest in a necessary and proportionate way and thus, is compatible with the internal market on the basis of the Guidelines on State aid for environmental protection and energy 2014-2020.

IV. CONCLUSION

42. The Commission has decided, on the basis of the foregoing assessment, to consider the aid compatible with Article 107(3)(c) of the Treaty on the Functioning of the European Union.
43. If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

<http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Registry
B-1049 BRUSSELS
Telefax n°: + 32-2-296.12.42

Please mention the name and number of the case in all correspondence.

Yours faithfully,

For the Commission

Joaquin ALMUNIA
Vice-President