



**Scotland-Northern Ireland Pipeline
(SNIP)
Moving to an Entry Exit Tariff Regime
Consultation Paper
June 2011**

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1. Introduction

1.1 Purpose of this paper

The purpose of this paper is to consult on the possible options for dealing with a number of issues arising from the move to an entry exit transmission tariff regime in Northern Ireland from the current fully postalisised regime. The issues which the paper deals with in light of this move to entry exit include the underwriting of the Scotland Northern Ireland Pipeline (SNIP), dealing with ‘SNIP mitigation’ and setting entry required revenue.

The Utility Regulator (UR) and the Commission for Energy Regulation (CER) are also working on tariff issues within the Common Arrangements for Gas (CAG) project and we recognise the interlinkages between the issues in this paper and CAG generally. Any decisions made by UR will be taken alongside CAG decisions to ensure the treatment of SNIP will be consistent with the CAG harmonized tariff regime.

1.2 Structure of this Paper

The remainder of the document is set out as follows:

- Section 2: Background;
- Section 3: Requirements of legislation;
- Section 4: Assessment Criteria;
- Section 5: Implications of moving to entry/exit;
- Section 6: Underwriting of SNIP in any entry/exit regime;
- Section 7: SNIP Mitigation;
- Section 8: SNIP Entry required revenue; and

- Section 9: Summary of Questions.

1.3 Request for comment

The paper sets out specific questions on which we seek industry response although we are interested in hearing from all parties on issues they may wish to raise.

The Utility Regulator intends to publish all comments received. Any confidential information that respondents wish not to be published must be clearly marked as such.

The Utility Regulator invites comment on this consultation paper by close of business on 21 July 2011. Responses, preferably in electronic format, should be returned to:

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As a public body and non-ministerial Government department, the Utility Regulator is bound by the Freedom of Information Act (FOIA) which came into full force and effect on 1st January 2005. According to the remit of the Freedom of Information Act, it is possible that certain recorded information contained in consultation responses can be put into the public domain. Hence, it is now

possible that all responses made to consultations will be discoverable under FOIA – even if respondents ask the Utility Regulator to treat responses as confidential. It is therefore important that respondents note these developments and in particular, when marking responses as confidential or asking the Utility Regulator to treat responses as confidential, should specify why they consider the information in question to be confidential.

2. Background

The current transmission tariff regime in NI is based on a fully postalised transmission system. This means that there is only a single tariff which is charged to all users at their exit point irrespective of where they exit or what pipelines they use.

As SNIP, along with the other transmission pipelines in Northern Ireland, is a designated pipeline this, in practice, means that all NI gas users pay for SNIP in all circumstances. This current arrangement ensures that even if there is a new source of gas production in NI, this would not result in increased transmission prices for customers. However an entry exit regime could result in a new source of gas increasing prices for customers and this is explained in Table 1 below. This example is purely illustrative and the figures are not based on actuals but it should provide readers with some understanding of the issue.

Example: Implications of a new entry point with entry exit regime

- the price of gas in NI is set by the GB price plus the SNIP tariff (say $100 + 5 = 105$);
- if a new NI entry point, such as a local gas field, were to be established (e.g. a gas field in Rathlin), NI gas users might move their capacity from SNIP to the new entry point;
- this movement of capacity towards the new entry point would, if demand is unchanged, reduce the amount of capacity booked on SNIP;
- less capacity would be booked at SNIP, increasing the per unit tariff. The new supply would therefore result in an increase in the SNIP tariff. However the price of gas in NI would continue to be GB price plus SNIP but now would be higher (say $100 + 7 = 107$); and
- assuming the new producer decides to price to market they would then charge 107 for their gas and all NI users would be paying higher charges for their gas with the increase resulting in increased profits for the Rathlin gas producers.

This underwriting of SNIP was reinforced by its mutualisation which guaranteed NI gas users would continue to underwrite SNIP in return for a reduced cost of capital and savings of £41.5m. This commitment has been achieved through the postalised transmission exit tariff regime in NI whereby all shippers in NI pay a single transmission tariff at their exit point. The required revenues of all the transmission pipelines are included in this tariff so all shippers contribute to all transmission pipelines.

It has been decided that CAG will incorporate an entry exit transmission tariff regime which will mean moving away from the current NI postalised regime. The reasoning for this decision was set out in the UR/CER tariff paper of December 2008 although it is worth noting that an entry exit regime is now a European requirement under Regulation (EC) No. 715/2009 so the move to an entry exit tariff regime would have had to be made even without CAG.

The issues raised within this paper should be considered alongside ongoing work within the CAG project. The ultimate aim is that the issues here will fit into the CAG harmonised tariff regime. We are working closely with CER on this and have included a reference to this workstream within the CAG workplan (published on 7th June) to ensure there is a clear plan in place to arrive at consistent decisions. Likewise CER are considering specific issues with the treatment of IC e.g. see consultation CER/11/002 and this has also been included for reference in the CAG workplan.

3. Requirements of legislation

Directive 2009/73/EC

The role of all European regulators in tariff setting is clearly set out by the relevant European legislation. Article 32 of the Gas Directive states that tariffs for third party access, or the methodologies underlining them, shall be approved by the national regulatory authority, prior to their entry into force. The tariffs should apply to all eligible customers and be applied objectively and without discrimination.

Article 41 of the Directive states that the duties and powers of the regulator include:

“1(a) Fixing or approving in accordance with transparent criteria, transmission or distribution tariffs or their methodologies;

8. In fixing or approving the tariffs or methodologies the regulatory authorities shall ensure that transmission and distribution operators are granted appropriate incentive, over both the short and long term to increase efficiencies, foster market integration and security of supply and support the related research activities.”

Regulation and Framework Guidelines

The Gas Regulation (EC) 715/2009 provides some more detail on the qualitative requirements that transmission tariffs should fulfil. They “shall facilitate efficient gas trade and competition, while at the same time avoiding cross subsidies between network users and providing incentives for investment”. They shall also “reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent, while including an appropriate return on investments”.

The focus of the reasoning behind the part of the European regulation to introduce an entry exit regime was to facilitate the trading of gas through zones rather than along contractual paths. While there may be limited trading action in NI, the move from a postalised regime to entry exit will meet this principle. Tariffs form one of the forthcoming framework guidelines which are currently being worked on by the EC, regulators and transmission operators. Some of the criteria currently being considered in designing tariffs include:

- Facilitating gas trade and competition
- Avoiding undue discrimination
- Providing signals for new investments
- Ensuring recovery of allowed revenues by the TSO

There is a lot of uncertainty over what the final outcome of this process is although it has the potential to have a large impact. For example consideration is being given to oblige interconnectors to auction capacity with a reserve price of zero. UR continues to monitor these developments and will ensure any tariff regime in NI is line with the eventual outcome of this process.

Northern Ireland Legislation

All NI gas transmission pipelines are included in a fully postalised transmission system which is consistent with Northern Ireland legislation. The Energy Order 2003 is clear that the Utility Regulator (UR) must, in carrying out its duties, have regard to:

The need to secure that the prices charged in connection with the conveyance of gas through designated pipelines are in accordance with a common tariff which does not distinguish (whether directly or indirectly) between different parts of Northern Ireland or the extent of use of any pipeline.

This reflects a clear government policy that all customers in Northern Ireland should pay the same tariff for using the designated pipelines which currently include all the transmission pipelines in NI. We will be discussing with DETI how they wish to address any changes to primary legislation as part of the implementation of CAG. It would be possible to retain the principle that all shippers should pay the same price for using any designated pipeline in NI while introducing an entry exit regime.

4. Assessment Criteria

The criteria for assessing these tariff options will essentially be against the Utility Regulators statutory duties which are set out in the Energy (Northern Ireland) Order 2003. The current principle objective is:

The principle objective of the Department and the Authority in carrying out their respective gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so in a way that is consistent with the fulfilment by the Authority, pursuant to Article 40 of the Gas Directive, of the objectives set out in paragraphs (a) to (h).

Paragraph 2 of the Energy Order, condition 14 states that the Authority must also have regard to:

“The need to ensure a high level of protection of the interests of consumers of gas” and as discussed above:

The need to secure that the prices charged in connection with the conveyance of gas through designated pipelines are in accordance with a common tariff which does not distinguish (whether directly or indirectly) between different parts of Northern Ireland or the extent of use of any pipeline.

Paragraph 5 of the same section states that subject to paragraph 2, the Authority shall carry out its functions in the manner best calculated to:

Secure a diverse, viable and environmentally sustainable long term energy supply

Based on these duties we have summarised below our view of how these criteria should be applied.

Developing the industry

The principal objective of the Utility Regulator is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland.

The tariff regime should seek a balance between development on the demand and the supply sides. For instance, a tariff regime that greatly encourages the extension of the network could potentially result in inappropriately high tariffs for all customers. At the same time, a tariff that over incentivises exploration may not be appropriate either. We recognise that a balance must be struck.

Protecting consumers

Protecting the short and long-term interests of consumers is an essential criterion for UR. Ensuring that prices are as low and stable as possible, while ensuring the long-term viability of the industry, is key to protecting consumers. This is linked to the promotion of competition and the benefits it should bring to customers. This is set against the principle of cost recovery and the need for TSOs to recover allowed revenues since without cost recovery the consumer may in time, be exposed to a volatile uncertain market in the future. The reduction of price volatility is another important aspect of the protection of consumers. Short to medium term tariff volatility can have some negative impact on consumers and the chosen tariff regime should be mindful of this.

Common Tariff

The need to ensure prices charged on designated pipelines are done in accordance with a common tariff is very clear. The implication of this is that all shippers should pay the same for using the designated pipelines. We need also to take into account other relevant legislation as described in section 3.

Diversity/ Security of supply

The security and diversity of gas supply in Ireland and Northern Ireland is another consideration for UR. It is important that UR considers the impact of any tariff regime on potential investment in security of supply.

5. Implications of moving to entry exit

The legislative commitments guaranteeing recovery of the NI transmission designated pipelines' required revenue has been implemented until now under the postalised tariff regime via a single capacity and a single commodity tariff for all gas transported on the NI transmission network.

Under an entry exit regime a gas shipper will pay:

- a capacity and commodity tariff at their entry point to the all island network and;
- a capacity and commodity tariff at their exit from the all island network.

The tariffs are likely to be different at different entry points and different at the two exit points (NI and Ireland). Notwithstanding the above constraints, the entry exit tariff regime for NI must ensure that the total revenues collected by NI TSO's via their tariffs must be sufficient to meet their total required revenues. Table 2 below shows the likely sources of revenue to pay for the NI network's total required revenue under the CAG:

Table 1: Entry and Exit Tariffs by pipeline under CAG

Pipeline	TSO	NI Exit Tariff	Entry Tariff
SNIP	PTL	✓	✓
Belfast Gas Transmission Pipeline	BGTL	✓	X
North West Pipeline	BGE(NI)	✓	X
South North Pipeline	BGE(NI)	✓	X

It is clear that the total revenue arising from the entry and exit tariffs in Table 2 must equal the total required revenue of the NI TSO's. A decision is required as

to how much of the total required revenue is allocated to entry and how much to exit and this is discussed in section 8.

As part of the CAG tariff regime UR will be setting the required revenues for one entry point (perhaps as part of a Combined Moffat) and one exit point (from a tariffing point of view) and the total required revenue is a fixed number (so if the entry tariff falls, the exit will increase and vice versa). This is of course separate from CAG operation whereby shippers will be able to book any entry point, irrespective of where they exit.

We are assuming that the introduction of an entry exit tariffing regime will be done in parallel with the introduction of CAG which will treat the South North pipeline (SN) as part of the NI exit zone. This means that we do not have to identify entry required revenues for SN.

As a result of the move to an entry/exit regime UR will need to consider the following issues:

- (i) How the link between all NI customers and the SNIP entry point will be retained;
- (ii) Whether new entry points should be incentivised through increased charges for customers;
- (iii) If not, how to design a mechanism to ensure new entry points do not increase the marginal price of gas in NI; and
- (iv) Assuming that part of SNIP costs are applied to entry, how SNIP required revenues will be split between a new entry point and the NI exit point.

Q1: Do respondents think we have correctly identified the issues connected with moving to an entry/exit regime?

6. Underwriting of SNIP in Entry Exit regime

Given the explicit need to ensure all NI gas users underwrite SNIP there will be a link between any SNIP entry point required revenue and the NI exit point to ensure that any under recovery of SNIP entry required revenue will be moved to the exit point and paid for by all NI gas users. For the avoidance of doubt this under-recovery would include any non payment of tariffs and will essentially ensure the current arrangements whereby all NI customers underwrite SNIP are enshrined in the new arrangements. UR considers that this will have no impact on customers as they currently underwrite 100% of SNIP required revenues anyway.

Under the current postalised tariff regime, while a particular TSO may issue an invoice, payment against that invoice is made to a central account (“pot”), from which payments are then distributed in proportion to each TSO’s required revenue. This arrangement has worked satisfactorily and is well understood by market participants. It would seem appropriate to continue this arrangement under an entry/ exit regime.

Underwriting SNIP will be achieved in the design of the NI exit tariff formulae which will be similar to the current postalised formulae and will continue to allow SNIP recover monies through the NI exit tariff. This will mean that SNIP required revenue will continue to be included in the formulae for calculating the exit tariff. The exact detail of this calculation will depend on the final decision on Combined or Separate Moffat and whether there is a specific Moffat bank account. This is covered in the CAG tariff consultation paper on the Harmonisation of All Island Moffat Entry Tariff Structures which will be issued shortly. Our initial thinking is that if SNIP entry is not linked to a specific Moffat bank account it could continue to be part of the current NI postalised account. If it is part of a Moffat bank account any under recovered revenue at the entry point would be allowed to be

recovered through the NI exit tariff – possibly in the end of year reconciliation payment.

This will require changes to the licence formulae which will involve further work and consultation.

Q2: Do respondents have any views on the proposals for ensuring SNIP is underwritten in entry exit regime?

7. SNIP Mitigation

In earlier CAG papers published in 2008, CER and UR considered the issue of IC mitigation and what a regulator should do when the tariff design and regulatory structure leads to a new entry point increasing the marginal price of gas for all customers. While the focus of the discussions has previously been on IC it is sensible for us to consider how this should be dealt with for SNIP. This is described as 'SNIP Mitigation' for ease of reference purposes only as it is really an issue for NI gas users and not SNIP or its owners. This would not have been an issue under the postalised exit regime but becomes one under entry exit.

To gain a better understanding of the potential magnitude of the issue we provide an example here which is based on very high level figures. If we are to assume that half of SNIP users moved to a new Rathlin entry point, and UR did nothing, the SNIP tariff would double. This could increase the marginal price in NI by just under 1 pence per therm which would cost NI customers £4m per annum and increase producer profits by a corresponding amount. These figures assume that SNIP entry required revenue is £4m. The extent of the impact is dependent on how much of SNIP's required revenue is included within the entry point and how much within the exit. If we assumed in the example above that SNIP entry required revenue is £12m the impact would be increased to £12m. This is further discussed in section 8 below.

There is an argument that the increased profit to the gas producer set out in the example above would provide an incentive for new gas entry points through gas production or LNG facilities. This could result in increased security of supply and thus provide a benefit to all customers. Indeed this is how the prevailing tariff mechanism works in Ireland. UR's initial view is that this is a very blunt tool to incentivise security of supply and diversity and could be ineffective in the NI context. It is questionable whether it has a significant incentive on indigenous gas

(which could be more dependent on geology, tax regimes etc) and would offer no incentive to storage. UR has never been approached by a potential gas producer or LNG facility to highlight that the current fully postalised system is a significant barrier to investment. While we recognise the importance of ensuring a clear and transparent price for LNG and gas producers, SNIP provides a link to the most liquid gas market in Europe. This allows such developers price at NBP and puts them in a similar position to parties looking to invest in GB. We believe that this link is very important and provides a high level of assurance to investors. It is not clear that it is consistent with duties of UR and the criteria set out above to provide an additional incentive.

The UR considers that any security of supply/diversity incentive should be considered using the following principles:

- What security of supply is required?
- What does (will) the market provide?
- How can additional supply (if required) be efficiently incentivised?

We believe that security of supply/diversity incentives is a high level question that will have to be considered along with DETI. Indeed DETI and DCENR have done some work on security of supply issues in the past and continue to work very closely together on the issue.

Table 2: Mitigation Assessment against the Criteria

UR Minded to Position		
Criteria	Assessment	Comment
Developing the industry	Moderate	Mitigation would ensure that prices are kept down which benefits the overall industry.
Protecting consumers	Good	Prices are the key concern of consumers and mitigation clearly protects consumers.

Common Tariff	Good	Mitigation should ensure that there is a common tariff in NI.
Security of supply	Moderate	Mitigation will not make any diversity/security of supply incentives any worse from the current position

Table 3: No Mitigation Assessment against the Criteria

UR Minded to Position		
Criteria	Assessment	Comment
Developing the industry	Moderate	Some additional incentive for new entry points could be argued to enhance development of the industry
Protecting customers	Poor	'No mitigation' would increase prices for consumers with doubtful benefit in return.
Common Tariff	Poor	It might not be possible to continue with a common tariff if 'No mitigation' is chosen.
Security of supply	Good	There may be some benefit from incentivising new entry points

In terms of criteria the main question here is the balance between protecting customers and promoting security of supply. Our initial view is that the potential security of supply benefit is very uncertain and it is questionable if this is the most efficient way to deliver security of supply. Set against this, the cost to NI customers would be certain and our initial view is that this outweighs the security of supply benefits.

Q3: Do respondents believe that there is merit in incentivising new entry points and possibly improving diversity of supply through increased prices for all customers?

If it is decided that NI customers should not pay higher tariffs when a new source of production is connected, then we will need to design a mechanism to avoid this. We have identified a number of options below to avoid such increases in marginal price.

Option 1

Oblige all NI users to match exit capacity bookings with SNIP/Moffat entry capacity bookings.

This would maintain the current principle whereby all shippers pay for SNIP irrespective of whether they use it. This would not prevent shippers booking other entry points if they so wish.

It has the advantage of being relatively simple and solving much of the problem. One problem remaining, however, would be the commodity element of the SNIP tariff which could be avoided by a shipper who moved to another entry point. We would have to give further consideration to how it would be implemented, particularly in relation to short term and interruptible capacity.

Option 2

Move all SNIP required revenue to exit tariff.

This would possibly be the simplest solution and would solve the problem completely, ensuring that all shippers paid for all TSO required revenues at the exit point. However this solution may be inconsistent with the approach to Moffat in CAG.

Option 3

Put in place a reconciliation mechanism to ensure all shippers using designated pipelines in NI pay the same tariff.

This would see any shipper who has not contributed to SNIP entry costs and thus pays less than other NI shippers, paying a reconciliation amount to bring their

payments in line with all NI shippers. This could solve the problem without obliging shippers to book SNIP capacity. We would need to work through the detail of the design but the outcome may be that the reconciliation payments are very similar to the cost of booking SNIP.

Q4: What do respondents think about the options to prevent increases in NI marginal price for gas and are there any other options that should be considered?

8. SNIP Entry Required Revenue

Various methodologies exist for splitting the total costs of a network across entry and exit points. These methodologies vary in complexity but generally the objective is to try to split the costs of the network between demand centres (exit points) and source centres (entry points) in relation to the network costs created by each centre. Theoretically a network with many distributed sources of gas and a concentrated demand centre will recover more of its costs via entry tariffs than via exit tariffs as more network is required to link the multitude of sources than to link the demand. The corollary also holds. An additional sophistication would be to weight the entry points (or exit points) depending on the network costs imposed by each of them. This sophistication then creates an incentive for gas sources (or demand centres) to locate at a particular point on the network.

For the purposes of this paper it is not planned to go into significant detail on some of the more complex possibilities available. The NI transmission system is a relatively small one and we do not envisage implementing a complex regime unless there are compelling benefits in doing so. Consequently and notwithstanding the methodologies described above, the rest of this section considers more simple methods of splitting the total required network revenues between entry and exit.

It is proposed that since the SNIP pipeline contains an entry and exit point then a proportion of only the SNIP pipeline required revenues should be recovered via the entry point tariff i.e. no other pipelines required revenue would be included in the SNIP entry tariff. The remaining proportion of the SNIP required revenue and the required revenue of the remaining NI transmission network would then be recovered via the NI exit point tariff.

Currently SNIP includes an exit point (Ballylumford Power Station) and so it does not seem sensible to include all SNIP required revenue within a SNIP entry point. There are no hard and fast rules about how the pipeline should be split between an entry and exit point. If the gas market had originally been built on a UK basis, as opposed to a GB basis, the pipeline could be considered as another exit asset. The structure of transmission tariffs can be set in many ways. As stated earlier UR is keen to keep the approach relatively simple. Our initial view is that the jurisdiction of these assets is not important. The current NI postalised exit tariff includes assets in Scotland and Ireland and this has been understood and paid for by all shippers.

How SNIP will be split between entry and exit will require some detailed consideration but we have set out some high level options below. The first option is to apply everything at exit point which would leave zero required revenue at entry and this has been discussed in section 7 above. The second option is to include the costs of the Twynholm site only. This is the point in Scotland where SNIP originates. The third option includes all of the costs of SNIP in Scotland and the final option includes all of the costs in Scotland plus the under sea costs. We have included some very high level numbers in the table to give some indication as to the potential impact on entry required revenue and more detailed work would be needed on this before it is finalised.

Table 4: Options for SNIP Entry Required Revenue

Option	Entry Point Required Revenue
100% applied at exit point	0
Twynholm Costs	£4m
Scotland Costs	£8m
Everything except NI costs	£12m

There is limited guidance from Europe on which of these options is more appropriate than another and there are probably many more options that could

be put forward. We have reviewed the options against the criteria but do not believe that they offer clear guidance on this question. There is also some linkage with some of the issues described in sections 6 and 7 above.

UR is also very aware of the need to consider any decision against the outcomes of the CAG consultations and in particular the decision on Combined and Separate Moffat.

UR retains an open mind on this issue, particularly in light of ongoing CAG consultations. We do recognise that if we are to apply consistent principles to the treatment of SN then we would include much of SNIP in the exit tariff. We would also highlight the potential impact of the required revenue on the SNIP mitigation problem. A lower entry required revenue would reduce the impact of an increased marginal price. However we are keen to understand the view of respondents as to which of the options might be most appropriate.

<p>Q5: What are respondents views on the appropriateness of the options for setting SNIP entry required revenue and are there any other options which have not been considered here?</p>
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9. Summary of Questions

Q1: Do respondents think we have correctly identified the issues connected with moving to an entry/exit regime?

Q2: Do respondents have any views on the proposals for ensuring SNIP is underwritten in an entry exit regime?

Q3: Do respondents believe that there is merit in incentivising new entry points and possibly improving diversity through increased prices for all customers?

Q4: What do respondents think about the options to prevent increases in NI marginal price for gas and are there any other options that should be considered?

Q5: What are respondents views on the appropriateness of the options for setting SNIP entry required revenue and are there any other options which have not been considered here?