<u>Consultation paper</u>

RECOMMENDATIONS FOR THE IMPLEMENTATION AND OPERATION OF A POSTALISATION SYSTEM FOR NATURAL GAS TRANSMISSION TARIFFS IN NORTHERN IRELAND.

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DETI

Department of Enterprise, Trade & Investment

ofreg

OFFICE FOR THE REGULATION OF ELECTRICITY & GAS

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June Public Consultation Paper on Postalisation Implementation

Section one: Introduction

Following the announcement by the Northern Ireland Assembly and Executive in September 2001 approving the concept of postalised charges for the NI natural gas transmission network, Ofreg and DETI have been working towards designing the mechanisms required for a successful implementation of such a system.

Currently the Northern Ireland gas transmission network covers the Scotland to Northern Ireland pipeline (SNIP) owned by Premier Transmission and the Phoenix Natural Gas transmission pipeline used to transport gas from the Ballylumford Power station –the point where the SNIP ends – into Greater Belfast . The transmission network will expand initially, in 2004 with the completion of the Northwest section of the scheduled Bord Gais Eireann (BGE) network supplying gas to Derry. There will an further extension also in 2006 with the building of the Southnorth section of the BGE network, which will connect the NI transmission network with the Republic gas transmission network. These extensions to the existing network will add two more groups of consumers – the Coolkeeragh Power Station, and distribution towns located along the BGE pipeline - to the existing groups of Ballylumford Power Station and the Greater Belfast distribution market. Postalisation means that these four groups of consumers will face common tariffs for the transportation of gas along the transmission network.

During 2002 we held a series of talks with the three transmission operators:- Phoenix (PNG), Premier Transmission (PTL) and Bord Gais Eireann, which led to a public consultation paper issued in December 2002. That paper set out Ofreg/DETI's initial thoughts on how postalisation should be accomplished.

After evaluating the comments to the December paper[1] and holding discussions with all the relevant parties, plus progressing our own analysis on postalisation, we are now in a position to set out, in this paper, our recommendations on how postalisation would best operate for Northern Ireland. This paper adds on a significant amount of detail to the issues raised in the December paper.

Although Postalisation is a simple concept – a common tariff to be applied to gas transported throughout the transmission network – it requires detailed supporting legal and financial structure for the system to function. Having three separate transmission pipeline owners adds complexity for designing this supporting structure. Furthermore we have concluded that to facilitate implementation of postalisation there should be a combined operational regime for

[1] A copy of all the public available comments is available from the Ofreg's website http://ofreg.nics.gov.uk/pdf%20files/12%20February%202003.pdf

the postalised network to coincide with the start of postalisation. It is the purpose of this paper to explain how Ofreg and DETI intend to design the legal and financial structure behind postalisation plus the integrated operational regime.

In reaching the decisions set out in this paper Ofreg and DETI have acted in accordance with the new principal objective and general duties relevant to our gas functions (explained in section two), and have had full regard to relevant EC law principles and requirements. We have sought to adhere to the following principles in our approach to the development of the postalisation system which we consider will ensure that our objectives and duties are fulfilled.

- Transparency – participants should be able to understand and observe all the workings of the postalisation system.
- Cost efficiency – the costs incurred both in the implementation and running of the postalisation system must be justified and reasonably incurred.
- Cognisance of the demands of Northern Ireland gas customers – the significant majority of gas demand will be from the two power stations, Ballylumford and Coolkeeragh. The rest of the gas demand will come from the growing distribution markets. The postalisation system must be designed to balance the requirements of both these customer groups.
- Minimum disruption to the existing structures – any amendments to existing system should be a necessary requirement for implementation of postalisation
- Easy integration of Southnorth pipeline in 2006 – preventing any need to overhaul the postalisation system in 2006 to cope with the Southnorth pipeline.

We believe that observing these principles will lead to a successful implementation of a postalisation system that benefits both transmission operators and customers using the network. Section two explains the legislative and regulatory framework behind postalisation. Section three sets out our recommendations on the key parameters of the payment system for postalisation. Using our recommendations on the parameters, section four develops the procedures needed for the operation of the postalisation financial system. Section five analyses how to combine the operational regimes for the postalised network. The required licence modifications required for implementation are outlined in section six. Concluding we have included some illustrative financial modelling to show broadly how the payment system will operate.

Responses to this consultation paper should arrive no later than 8 August 2003.

Section two: Regulatory and legal framework for postalisation implementation

The Energy (Northern Ireland) Order 2003 (the "Energy Order"), made on 27th February 2003, contains provisions to permit the implementation of a postalised charging system. This section summarises these provisions and the wider regulatory framework in which they will operate. The relevant articles of the Order are set out in Appendix one.

The organisation and functioning of the natural gas sector in the European Community are subject to common rules intended to establish a competitive market in natural gas. These rules are laid down principally in the Internal Market Gas Directive (Directive 98/30 EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas). The principles and requirements laid down by this Directive provide an overarching framework within which the regulatory system for conveyance and supply of gas through pipes in Northern Ireland operates. The Directive lays down basic criteria and procedures concerning authorisation of construction and operation of natural gas facilities, rules with regard to transmission, distribution and supply undertakings, requirements for third party access and market opening and general requirements to establish mechanisms to avoid anti-competitive conduct.

The Energy Order established with effect from 1st April 2003 a combined regulatory authority, the Northern Ireland Authority for Energy Regulation (the "Authority"), in place of the existing offices of Director General of Electricity Supply for Northern Ireland and Director General of Gas for Northern Ireland. The Energy Order lays down a new principal objective for the Department and the Authority, together with general duties, which are to direct the manner in which they exercise their respective functions in the gas sector.

The Authority principal functions in relation to gas are the grant, modification and enforcement of licences and the exercise of competition powers in relation to agreements or conduct relating to the conveyance, storage or supply of gas in Northern Ireland.

The new principal objective of the Department and the Authority in carrying out their respective gas functions under the Gas (Northern Ireland) Order (the "Gas Order") and the

Energy Order is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland.

The principal general duty of the Department and the Authority is to carry out their respective gas functions in the manner which each considers is best calculated to further the principal objective, having regard to:-

(a) the need to protect the interests of consumers of gas;

(b) the need to secure that licence holders can finance their licensed activities;

(c) 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; and

(d) the need to protect the interests of gas licence holders in respect of prices and terms on which services are provided by one gas licence holder to another.

The Department and the Authority are specifically permitted to have regard to the interests of consumers of electricity in relation to the exercise of their gas functions. They are also subject to a number of secondary duties relating to promotion of the efficient use of gas, safety, security of supply and the facilitation of competition. The principal objective and general duties of the Department and the Authority are reproduced in Appendix one.

In accordance with and to give effect to the primary duty to have regard to the need to secure a postalised tariff, the Energy Order sets out a mechanism for the identification of pipelines which are to be subject to the common tariff (designation) and a power to impose licence modifications for the purpose of implementing a system of postalisation.

Article 59 of the Energy Order permits the Department, after consultation with the Authority, to designate any pipeline which either is a high pressure pipeline (i.e. a pipeline whose design operating pressure exceeds 7 bar gauge), or is connected to a designated high pressure pipeline, as a pipeline which will be subject to the postalised tariff. Before making a designation the Department must give notice and allow time for representations or objections to be made. A designation order may provide that the designation of a pipeline will cease on the happening of a specified event and may also provide for designation to have effect for a specified period during which the designation will not be revoked or cease to have effect.

Article 60 of the Energy Order allows the Department, after consultation with the Authority, or the Authority, with the consent of the Department, to modify the conditions of an individual gas conveyance or supply licence or the standard conditions of such licences where necessary or expedient for the purpose of implementing or facilitating the operation of arrangements designed to secure the postalisation of gas conveyance tariffs through designated pipelines. The power to modify licence conditions under Article 60 may be exercised only once in relation to the designation of any pipeline. Before making any modifications the Department or Authority must consult the relevant licence holder and such other persons as it considers appropriate and any modifications made must be published.

The power under Article 60 to modify licences for the purpose of introducing postalisation is in addition to the general powers to modify the conditions of individual licences and standard conditions of licences by agreement, following a reference to the Competition Commission or under other statutory provisions which are set out in Articles 14 to 18 of the Gas Order as amended.

To achieve postalisation two actions emerge from the Energy Order provisions; the Department must designate the pipelines to be included in the postalisation system; and secondly the licences must be modified to become consistent with the system. Through discussing and developing the detail on the operation of postalisation, this paper formulates the required licence modifications.

Section three: Deciding the financial parameters of the postalisation System

This section explains the reasons behind our recommendations on the major parameters of the postalisation system.

(A) Assets and costs to be postalised

(i) Transmission costs

The respondents to the December paper broadly agreed with our proposed transmission costs to be included into the postalised system and recovered through the common tariff. These costs will be: Premier Transmission Limited's (PTL) Scotland to Northern Ireland pipeline (SNIP); Phoenix Natural Gas (Phoenix) complete transmission asset; and the scheduled Bord Gais Eireann (BGE) network – the Northwest and Southnorth pipelines. As explained under section two, the Department will designate these pipelines to be included in the postalisation system and hence subject to the common tariff.

Each transmission operator's allowed costs which are to be recovered through the postalisation tariff will be determined according to their respective licence revenue determination formula. For both Phoenix and PTL some work is required to amend their existing licence formulae to make them consistent with postalisation. Regarding BGE, Ofreg is currently working them in developing a formula for the determination of their allowed revenue based upon the principles outlined in their licence. The required recovery period for each operator will be consistent with the postalised year of October to September.

In December, we discussed the timing of the inclusion of the Southnorth pipeline costs into the postalised tariff. The Southnorth pipeline is schedule to be commissioned in 2006, two years later than the Northwest pipeline. We raised the option of allowing the recovery of the costs of the Southnorth pipeline to start at the same time as Northwest costs recovery, in 2004. This option has the benefit of smoothing fluctuations in the tariff during the initial years. A number of respondents disagreed with this option, arguing that it is inappropriate for costs to be recovered via postalisation until they have been properly and efficiently incurred. We recommend that the Southnorth costs be included in the postalisation tariffs once the pipeline is commissioned.

(ii) Spurs for distribution along the BGE network

The Department has decided that, in order to help the development of each of the distribution towns contained in the awarded licence, the costs of the distribution spur bringing gas from the BGE network to within 5km of each such town will be postalised. Therefore it is envisaged that these costs will be recovered through the postalised tariff.

(iii) Treatment of costs associated with transporting gas to Northern Ireland through alternative entry points to the SNIP

In our December paper we outlined our support for the principle that all NI consumers shall pay the same transmission charge irrespective of where the gas is delivered from. Following on from this we felt that any postalised system that includes the costs of the SNIP must also include the unit charges associated with the delivery of gas to Northern Ireland through the Irish-Interconnector (IC).

We acknowledge the concerns expressed by a number of parties in their response to the December consultation paper with regard to IC costs. However we would like to make clear that we intend only costs associated with capacity required (and the associated volumes) over and above maximum SNIP capacity will be included into allowed postalised costs[2]. The details and methodology of how such costs are defined will require further analysis to develop an appropriate mechanism for IC costs inclusion in the postalised system. While we feel it is important to highlight the broad thrust of this mechanism now, we intend to leave the detailed work until closer to the date of the Southnorth completion.

Ofreg/DETI are aware of the possibility of NI gas being sourced from indigenous Irish fields such as Corrib and Seven Heads. Whilst this may not become a reality for a number of years, we would like to seek comments now on how such developments would be dealt with by the postalised system. One possibility would be for Ofreg, at the start of the year, to determine an allowed annual capacity and volumes figure for surplus demand over and above maximum SNIP capacity. The costs associated with bringing this surplus gas in the most cost efficient up to the entry point of the Southnorth would be allowed to be recovered through the postalised tariff. Our initial thoughts are that this may be more equitable than allowing only gas which comes through IC into postalised costs. We are willing to listen to other arguments

[2] There may be technical reasons that need further exploration (e.g. to maintain pressure) to justify allowing more IC costs into the postalisation system above simply the costs cause by demand exceeding SNIP capacity.

and suggestions here though we would like respondents to bear in mind the principle that only demand over SNIP maximum capacity shall be allowed into postalised costs.

It is still unclear what costs Northern Ireland gas transported through the Republic of Ireland will bear. At the moment neither RoI nor NI have a transit tariff. There are ongoing discussions in the European Commission on the principles for pricing transit gas and Ofreg and CER shall bear these in mind as part of our regular meetings.

We would welcome views on:

The treatment of IC entry tariffs in postalised tariff

Allowance for other RoI transportation costs

(iv) Cost of operating the postalisation system

Any justified cost associated with operating and managing the postalisation system will also be included into the postalised tariffs.

(B) Proposed start date of postalisation

We raised the possibility in our December paper of postalisation commencing before completion of the Northwest pipeline (NW) through an incremental approach. Ofreg and DETI took the view that this approach was likely to be appropriate only if the initial transfer of costs from gas to electricity customers resultant from early postalisation could be offset through creating other system cost reductions. While we received some positive feedback of the benefits of early postalisation to test the system and iron out any problems, the cost reductions have not materialised and we are now aiming to implement postalisation on the operational commencement date of Northwest.

The NW is scheduled for completion around September/October 2004. With our intention for the postalised year to run from 1st October to 31st September each year, we plan for postalisation to start on 1st October 2004. As it becomes clear next summer when NW pipeline will be commissioned we will hold discussions with the parties about coinciding the NW operational commencement date and the start of postalisation, 1st October 2004.

(C) Capacity/commodity split

Following the responses to the December consultation paper, we have decided to increase the proposed capacity proportions to be applied in calculating the postalised tariff. We are now advocating the capacity/commodity proportions detailed in table one:

Table one: Capacity-Commodity Split

Year	2005	2006	2007	2008	2009	2010	2011
Split	50:50	50:50	50:50	50:50	75:25	75:25	75:25

The postalisation year would run from 1 0ctober to 30 September (i.e. 2005 is Oct 2004 to 30 Sept 05), the same as the gas year.

Our starting position when deciding upon the appropriate capacity/commodity split for the postalised network is to look towards economics. Economic theory suggests that efficient utilisation is best achieved through short-run marginal pricing. However for gas pipelines this is generally not feasible because the resulting charges are insufficient to recover the full fixed costs of the infrastructure. Therefore the solution is to apply a two-part tariff, consisting of an annual capacity charge based upon peak usage and a commodity charge calculated according to actual gas flows. For efficient utilisation of the pipeline the commodity charge should be set to recover variable costs and the capacity charge established at a level sufficient to recover the pipeline's fixed costs.

In December we put forward one key reason for justifying a move away from this economic principle: to support the early development of town distribution[3]. Also we recognised that the volume dependent ship-or-pay commitment by Ballylumford for the PTL pipeline meant that a significant commodity proportion would not overly weaken the financial security of the payments. On the other hand we also noted the benefit of capacity charging for preventing capacity hoarding. Therefore we proposed a staggered increasing of the capacity proportion towards the long-term split between fixed and variable by the end of the Ballylumford ship-or-pay in 2012.

We received three responses favouring a higher capacity proportion all agreeing with the economic theory that a higher capacity percentage will lead to more efficient usage of the network. Furthermore these respondents questioned whether 75:25 was the right reflection of the split between fixed and variable costs in the postalised network and argued that 90:10 would be a more appropriate reflection, based on international examples. The 75:25 split put

[3] Town distribution consumers tend to have low load factors (the ratio of average daily consumption/peak day consumption). Since all users are required to book enough capacity to cope with the peak day, a higher capacity

forward in the December paper is based upon Ofreg's knowledge of the capital and operational costs to be included in the postalised tariff. However there is the possibility that this may change over time, and hence may need to be examined in the future.

Two responses argued for 100% commodity charging, although for quite separate reasons. One thought that a 100% commodity was required to make any new distribution towns viable. We appreciate this view but we have concluded that if new distribution towns require financial assistance then that assistance should be made through more explicit channels e.g. government grants, rate exemptions or some sort of transmission charging holiday. Varying the capacity-commodity to try to foster new distribution towns is too blunt an instrument.

In December we put two possible options to assist town development. Regarding capacity payment holidays, some respondents argued against the suggestion of a capacity payment holiday on the grounds that such a holiday would be complex to administer and could lead to inefficient capacity bookings. We also put forward monthly capacity bookings as another option to assist any new towns. One reply was in favour of the monthly capacity bookings although it was noted that such a system would only be beneficial if there was sufficient spare available capacity as not to force the shippers to compete in capacity bookings (as this could force shippers to book peak day capacity throughout the year to ensure they received sufficient capacity). This will only become the case for Northern Ireland following the completion of the South-North pipeline. Hence we are currently of the view not to introduce monthly capacity bookings. Such a mechanism would significantly complicate the postalisation system and would only result in minimal benefits to the new distribution towns.

Also we must have consideration for the existing distribution network and have therefore evaluated the effect any recommended capacity/commodity profile could have on the growth in the Greater Belfast market. This was the key reason for the gradual stepping-up of capacity proportion in the current PTL charging formula. A higher capacity proportion will add to the cost of transporting gas along the transmission network to the Greater Belfast area. However the overall effect of postalisation, with the above proposed capacity/commodity split will be to decrease the total current costs of transporting gas to Belfast. Therefore the proposed capacity/commodity split detailed in table one should not adversely affect the continuing development of the Greater Belfast market.

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proportion relatively disadvantages low load consumers because on average they only use a small proportion of their booked capacity which they are paying for throughout the year.

The second reason put forward for a 100% commodity tariff system was to ensure that all consumers pay the same effective charge per unit for gas transportation. It is true that the effective charge (total actual consumer payments/total actual volumes) varies amongst the different consumer groups as you introduce a capacity proportion, with high load factor consumers facing a comparatively lower effective charge. However if two consumers were to book the same level of capacity and use it in identical ways, then they would pay the same effective charge.

Taking these views into account, and appreciating the need for efficient utilisation of the network and for the system to be financially secure, we now propose that the capacity element of charging will be 50% for the first four years and 75% for the next three ending in Oct 2011; this will give the Authority time to judge the appropriate split for after 2011. We believe that this is the appropriate commodity/split in light of the arguments presented to us. An additional advantage of a higher capacity proportion is that it reduces the exposure faced by consumers to under/over recovery of revenue – a concern expressed by some respondents – hence adding to the financial stability of the postalisation system.

We have decided not to put forward explicitly a proposed split for after October 2011. Instead we consider that the proportions will be decided by the Authority closer to the time and that this decision will be based upon a set of principles, set out below. This will enable us to reassess the financial security of the payments in light of the ending of the Ballylumford ship-or-pay contract, and the split between fixed and variable costs.

The Authority when deciding upon the capacity/commodity proportions for calculating the postalisation tariffs after 2010 will take into account:

The split between fixed and variable costs within the postalised network.
European practice and any EU recommendations or guidance
The continued financial security of the payments within the postalised system.
The impact on tariff stability

Although the decision by the Authority will be based upon the circumstances in 2010, we imagine that they will recommend a move to a higher capacity proportion, possible 90%.

We welcome views on:

Are these the appropriate principles to be taken into account in deciding upon the capacity-commodity split post 2010?

(D) Tariff duration for postalisation/coping with under/over recoveries.

The decisions on both these parameters are closely inter-linked; the duration will determine the magnitude of the possible deficits/surpluses at the end of the tariff period. In December we proposed a system of annual tariffs with any under/over recoveries dealt with through an end-of-year reconciliation payment. In light of further analysis and the responses received to the December consultation paper, we still believe that this mechanism is the most appropriate.

A number of the responses argued against the end-of-year reconciliation payment arguing that any under/over recoveries should be dealt with in the following year. One party went further and argued for a long-term 10-year levelised tariff. These respondents argued that it is very important for there to be predictability in the postalised tariff as this enables end-users to set long term supply prices. This argument applies for both power stations setting fixed prices for long term electrical supply contracts and gas distribution companies setting supply contracts. They also expressed the difficulty for suppliers passing through potentially significant end-of-year bullet payments to their respective customers. These are strong arguments with which Ofreg has considerable sympathy, however we are still minded to recommend our December proposals.

With a network with three separate operators, a system of carrying over any annual differences between forecast and actual volumes creates problems with respect to calculating the appropriate rate of return and deciding on how to share out the difference amongst the three operators, especially when certain operators may have revenue guaranteed by ship-or-pay commitments. A further problem is caused by the timing; at the point at which you publish the postalised tariffs for the coming year it is probable that you would not be in a position accurately to know the full extent of the annual differences.

An end-of-year bullet payment ensures that customers who used the network in that year pay their appropriate share of the actual costs for that year. Likewise the ship-or-pay commitments will be calculated according to the actual performance during the year not on the start of the year forecasts.

There are five possible causes of an over/under recovery in total postalised costs at the end of the year:

- When actual annual volumes turn out different from the start of the year forecasts
- Variations in certain defined costs that are allowed to be passed through at the end of year. The terms of this type of passthrough will be set out in operators' licence conditions and regulated by Ofreg.
- Annual Inflation. The postalised tariff will be expressed in nominal terms, and hence total postalised costs will be multiplied by a forecast inflation figure at the start of year. We envisage that any difference with the actual out-turn in inflation will be passed through at the end of the year reconciliation.
- Capacity bookings. There is the possibility of suppliers requesting more capacity during the postalised year. The extra revenue from this increased capacity will pass through at the end of the year.
- Interruptible service revenue. Any revenue earned from suppliers using an interruptible service will pass through to suppliers at the end of the year. (Interruptible service is discussed in detail later on in this paper).

The mechanism of these passthroughs are detailed in section four. In practice we envisage the resulting end-of-year bullet payments to be comparatively small, and could work either way.

The concerns raised by some respondents should be eased by the fact that the financial system will contain mechanisms to improve the predictability of both the annual tariff and the magnitude of the reconciliation payments. Within the proposed design of the system there is a good degree of predictability; 50% of the revenue will be collected from known capacity bookings (increasing to 75% in 2008) and the ship-or-pay commitments from the two power stations create a minimum level of guaranteed revenue into the system, capping any under-recovery.

Ofreg will ensure that only necessary in-year variations in required revenues will be passed through at the end-of-year reconciliation. We intend to publish indicative tariffs for the following four years when announcing the annual postalised tariff. To inform suppliers of the likely magnitude of the end-of-year reconciliation, the TOs will circulate actual volumes each quarter (differences in costs may also be calculated and displayed).

Possible "ship wreck" clause

However there always remains a risk, even under an annual postalisation tariff of large unexpected variations in either volumes and allowed costs. One possible protection against such variations is a shipwreck clause, which would enable Ofreg either or both (a) to step in and change the postalised tariff during the year in order to reduce the end-of-year reconciliation amounts and (b) to cap the amount to be recovered at the end of year reconciliation if it was felt that consumers couldn't absorb the necessary bullet payment. This shipwreck clause would only be invoked in extreme circumstances that will have to be clearly specified in the licences.

We welcome views on:

The appropriateness of such a shipwreck clause and the possible situations where it may be required.

(E) Interruptible service

Suppliers tend to vary their utilisation of booked firm capacity over the year, reflecting the fluctuations in the demand and supply of gas. However it is difficult to forecast some of these fluctuations, and consequently an amount of booked firm capacity may be unused at any time. Although this amount varies over the gas year and can be unpredictable, it creates the option of offering short-term interruptible service in addition to firm capacity. Experience shows that such services are attractive to suppliers and lead to a higher use of capacity. Also the availability of an interruptible service can reduce the incentives to hoard spare capacity for anti-competitive reasons. Capacity hoarding is only effective if it prevents other suppliers from obtaining access but interruptible service would allow suppliers to access any unused firm capacity.

We recommend that an interruptible service is made available to suppliers on the postalised network. The ability to ship on an interruptible basis is currently available on SNIP. We wish to explore the appropriate pricing regime structure and how postalisation should cope with interruptible revenues.

The pricing of the interruptible service has to be carefully managed to strike the balance between making the service attractive to encourage more network utilisation and not creating perverse incentives on suppliers by removing the need to book firm capacity. There is the fear that if an interruptible service is subject to a low price, shippers will be reluctant to book firm capacity, especially if they perceive the risk of interruption to be small. Removing the requirement to book firm capacity will lead to inefficient use of the network and increase the postalised capacity charge. Pipelines are built to service firm rather than interruptible suppliers.

Options for the pricing of interruptible service

(a) Interruptible suppliers pay only the commodity charge

With the commodity proportion proposed at 50%, under this option interruptible suppliers would receive a considerable discount (potentially higher than 50%) compared to firm suppliers. The discount will increase as the commodity proportion decreases. Whether this option is appropriate depends upon assessing if the discount creates a disincentive to book firm capacity. As mentioned above this will depend upon how the supplier perceives the risk of being interrupted and hence the need to book firm capacity. The postalised network will move from a tight capacity system, where the system is finding it difficult to meet all demands, to abundant available capacity following the commissioning of the Southnorth pipeline and hence a second entry point in 2006. With abundant capacity, the risk of interruption is small thereby making interruptible service a close substitute to firm capacity. Therefore we feel this price attached to interruptible service will be too low leading to under-booking of firm capacity.

(b) 100% load factor basis.

Even though interruptible suppliers will be making reservations and nominations, we believe that they should only be exposed to a commodity charge. Since interruptible suppliers do not place capacity expansion demands on the pipeline, that interruptible commodity charge should be priced at a discount to the charges imposed on a firm capacity holder. As expressed above the discount cannot be too low as to weaken the benefits from booking firm capacity. A common and widely used method in other systems (e.g. USA and Argentina) is to price interruptible service at the price a firm capacity holder would be paying if it had a 100% load factor, which is the cheapest charge possible for a supplier if he booked firm capacity. This option charge is calculated according to the formula below:

$$\text{Interruptible charge} = \frac{\text{Total postalised required revenue}}{\text{Total forecast firm capacity booked x365}}$$

Proposed Pricing Regime

The discount for an interruptible service under option (b) is lower than (a) and more accurately reflects cost causation and hence we favour this approach. The only problem we envisage with option (b) arises from the situation at Ballylumford Power Station of having two separate suppliers. The major supplier holds the firm capacity and has the right to interrupt its gas supply. When that supplier interrupts, the power station is able to turn to the secondary supplier to ensure a continuous supply of gas. In this situation, it is inefficient for the power station to book firm capacity for both suppliers (effectively double booking) since both suppliers are not required at the same time. Therefore when the major supplier interrupts its gas supply, the power station continues to transport gas through its secondary supplier using the major supplier's firm capacity on an interruptible basis. As the interruptible charge under (b) is more than the commodity charge proposed under option (a) the power station will face a higher overall charge. This seems unfair especially when it is caused by the major supplier making a commercial decision to interrupt its gas supplies.

To cope with this we propose that for interruptible gas delivered at an exit point, as long as the sum of total gas delivered (both firm and interruptible) is below that exit point Maximum Daily Quantity (MDQ) (total for all suppliers at that exit point), then the price applied to interruptible gas is option (a) – the postalised commodity charge. However if the interruptible gas results in the exit point exceeding the MDQ, then that proportion of interruptible gas above the MDQ will attract the option (b) price – the 100% load factor basis. We are comfortable that this will not create the disincentive to book firm capacity since a supplier's level of firm capacity will determine its MDQ.

We welcome views on:

Should an interruptible service be offered on the postalised network?

Whether the proposed pricing regime is appropriate?

The second issue concerns how the postalisation calculations will accommodate payments for the interruptible service. There seem to us to be two alternatives. One is for the total payment received for interruptible service to be forecast at the start of the year and subtracted from the total required revenue to determine the forecast postalised tariffs. The other possibility would be to credit back to all firm capacity holders the total payment received for the interruptible service at the end of year reconciliation. The interruptible payment will be divided out amongst all firm capacity holders (on the whole postalised network) based upon each proportion of total firm capacity booked on the network. Since interruptible quantities are difficult to predict we favour the revenue crediting mechanism to cope with interruptible payments received under postalisation. This crediting back the revenue collected from the interruptible service creates an incentive on firm capacity holders to ensure that the transmission operators are correctly providing the interruptible service.

For interruptible service to be effective, operators should publish timely and detailed information about the use of the system and its capacity. The terms governing the interruptible service need to be included in the network codes and can be discussed in the supplier-operators discussions forum.

(F) Payments under postalisation: exit point mechanism and the financial security

In December we advocated an exit point payment mechanism, where suppliers pay the postalised commodity and capacity charges based upon their booked capacity and volumes transported at the point where they exit the transmission network. A supplier will not have to pay the tariff when it exits pipelines which it is transiting through (e.g. Coolkeeragh gas transporting through PTL pipeline).

This seems the simplest way to organise the postalisation payment system and the respondents agreed with this mechanism. Therefore the system will be; PTL collecting revenue from Ballylumford Power Station; Phoenix the revenue from the Belfast downstream market and BGE the revenue from the Coolkeeragh Power Station and distributions towns along its network. Revenue transfers will occur between these operators to equalise their revenue requirement with the payments they received.

The foundation of postalisation will be the relationship between supplier and the operator from whose pipeline that supplier exits the postalised network (that supplier's "primary operator”). Each transmission operator has agreed to accept the credit risk associated with the suppliers that exit the NI transmission network from its pipeline (“end-user exit point supplier”).

We remain of the view, that both operators and suppliers will have confidence in the level of financial security under the proposed postalisation system. The ship-or-pay arrangements from the two power stations, guaranteeing a significant proportion of the total postalised costs plus the high capacity proportion within the tariff structure, protects the recovery of the postalised costs.

The agreement between BGE and ESB/ESBII allows for ESB/ESBII to pay BGE the postalised tariff for gas transportation services to Coolkeeragh. Should the total amount of transportation revenue recovered by BGE in any year be less than the total allowed conveyance revenue attributable to the Northwest Pipeline under BGE's licence in Northern Ireland then ESB/ESBII will make up this shortfall. The agreement also allows for account to be taken of other users of the Northwest Pipeline when calculating this shortfall.

The ship-or-pay between Centrica, the supplier to Ballylumford Power Station, and PTL guarantees full recovery of PTL total allowed costs up to September 2011. Centrica pay the total PTL allowed revenue adjusted to account for contributions from other users.

Through postalisation, the total costs are spread across all consumers based upon consumers’ relative proportion of capacity booked and volumes. There will be four groups of consumers; ESBII, Phoenix, Premier Power and new towns. These consumers will, as a collective unit, be exposed to the total postalised costs. The inability of one consumer to contribute to the cost recovery will result in a transfer of costs onto the remaining consumer groups. However the ship-or-pay arrangements from the power stations (on top of the capacity payments) will lessen the amount to be transferred if any of the stations experiences difficulties.

Section four: Designing the legal and financial infrastructure for postalisation

Taking the parameters recommended in section three, this section sets out Ofreg/DETI's recommendations on how the financial system would operate and the legal framework needed to underpin the system. The key elements of the postalisation financial system are:

- the determination of the postalised tariff,
- revenue collection;
- revenue transfers among the transmission operators; and
- the settling up of under/over recoveries at the end of the tariff period.

We currently envisage that there would be four parties involved in these procedures:

- Transmission operators (TOs)
- OFREG
- Postalisation system administrator (PSA)
- Suppliers/consumers.

There are three fundamental aspects of the structure that we need to determine:

- each party's functions, obligations and rights under the financial system: one key aspect of this is the extent to which a party should have the right to challenge those determinations made under the financial system and the process for resolving disputes between the parties;
- the lines of communication and the required information flows between the different parties;
- in respect of each obligation, whether it should be the subject of a licence commitment, a contractual commitment or both.

Timetable and detailed process for financial determinations during the postalised year

Ofreg/DETI has given some thought to the processes which would need to be completed during the course of a postalisation year and the timetable which would be required in order for a tariff to be in place at the beginning of the gas year - 1st October. An outline timetable for the process is set out in Appendix two. The main steps in the process are described below.

Step 1 – establishing postalised tariff for the Year

In order to calculate the postalised tariff (i.e. capacity and commodity tariffs) for the next Year, the following elements will need to be established:

- Total postalised allowed costs. This will be the sum of the revenue requirement for each TO for the Year, derived from their licence revenue formula. For legal transparency, we contemplate that all postalised allowed costs (as discussed in section three) will be derive from the licence conditions determining the operators allowed revenue. Costs arising in the course of the year and other variable elements of the annual revenue requirement will be discussed and agreed between each individual TO and OFREG;
- capacity bookings and volume forecasts: the TOs will have the ability to request information from their shippers to help them produce volume forecasts for the following Year. It is envisaged that volume forecasts will be subject to a joint verification process involving Ofreg, the TOs and shippers/end users. Ofreg expects the industry to play a key role in establishing robust forecasts and will only want to assess whether the assumptions and methodology behind the volume forecasts are within reason. We need to prevent parties deliberately over or under-stating volume forecasts;
- capacity/commodity split: this will be set out in the standard licence conditions as part of the formula for calculation of postalised tariffs.

The total postalised costs (calculated by Ofreg following agreement with the each TO on their own required revenue) and capacity and volume forecasts (which will have been the subject of consultation with Ofreg and the industry) will be provided to the PSA which will calculate the postalised tariffs using the established formula. The postalised tariff will require an allowance for yearly inflation – Ofreg will inform the PSA of the expected annual inflation rate (based upon a recognised index forecast) to be used in the calculations.

We would welcome views on:

What would be the appropriate inflation index to use when calculating the postalisation tariff?

The tariff and the tariff calculation will be made available to Ofreg, the TOs and the suppliers so that parties can check the calculation. After a short period for comment the postalised tariffs for the following Year, together with indicative tariffs for the following four years, will be published one month before the start of the Postalised Year.

Step 2 – in Year inter-TO revenue transfer

In order to avoid significant cashflow imbalance during the Year, the PSA will calculate the entitlement of each TO based on the actual volumes shipped up to the mid-year point in accordance with a formula which will allocate revenue by reference to annual revenue requirement.

After considering the various possibilities, Ofreg believes that the most straight-forward and transparent system would be one that divides up all revenues collected or deemed to be collected, in proportion to each TOs percentage of total annual required revenue. To carry out this procedure we need to calculate, for each year in which postalisation operates, each TOs percentage share of total annual required revenue. Each TOs ‘allowed semi-annual revenue’ for a period will be calculated by multiplying their percentage required revenue by total deemed shipper receipts (i.e. revenue collected or which is deemed to have been collected) in the period. The amounts to be transferred for that period will then be calculated as the difference between each TO’s own deemed receipts from their exiting shippers and their allowed semi-annual revenue for the period. This system balances perfectly leaving no surpluses or deficits.

Hence this formula will ensure that each operator should have received their appropriate share, based upon percentage required revenue, of total revenue collected in the first six months of the gas year at the mid-year point. We can present the above in a formula which is outlined below for a TO company Q.

Transfer Formula

$$\%\ RR_Q = (RR_Q / RR_{Total}) * 100$$

$$AR_Q = \%\ RR_Q * SR_{Total}$$

$$\text{Transfer to } Q = AR_Q - SR_Q$$

Where:

RR Total = *Required Revenue (Annual)*

RR_Q = *Q's Required Revenue*

$\% \, RR_Q$ = *Q's RR as a Percentage of Total RR*

AR = *Allowed Semi-Annual Revenue*

SR Total = *Total (Deemed) Semi-Annual Shipper Receipts*

SR_Q = *Q's (deemed) Semi-Annual Receipts from Shipper's exiting on Q's network*

We view the decision on whether to have the in-year inter-operator revenue transfer on a monthly, quarterly, or a yearly basis primarily as an issue for the operators. Consideration is being given to the desirability of requiring each TO to place revenue in excess of the monthly equivalent of the annual revenue requirement into a ring-fenced account.

We welcome comments on:

Frequency of in-year inter-operator revenue transfers

Step 3 – In Year volume/cost update

At the end of each quarter (after allowing time for meter validation and close out of allocation) the TOs will pool information with each other and with Ofreg in relation to their existing shippers' actual volumes over the previous three months. Quarterly volume figures will also be made available to all shippers. TOs will also be required to inform of any unexpected variations in costs which they are entitled to pass through at the end of year reconciliation.

Step 4 – End of Year (EoY) reconciliation process

This sequencing of the required actions under this EoY reconciliation will be:

(a) Ship-or-Pay reconciliation

TOs will notify the PSA/Ofreg of out-turn actual exit volumes. TOs, where applicable, will check that any minimum volume commitments under ship or pay agreements have been met and adjust the actual exit volumes accordingly. The adjustment would establish the power stations volumes as the higher of actual volumes or any deemed minimum volume as expressed under their ship-or-pay arrangements.

(b) Allowed cost differences pass through

Any cost differences in relation to allowed operating expenditure which TOs are entitled to pass through at the end of the year will be submitted to Ofreg to check that cost differences are justified under the licence and in accordance with the licence.

(c) Calculation of the revised postalisation commodity tariff

The postalisation commodity tariff will be recalculated by the PSA to take account of actual volume (noting any adjustment made under (a)) figures, cost differentials and actual inflation figures and the revised calculation will be notified to Ofreg TOs and shippers.

(d) Calculation of the revised capacity postalisation tariff

The capacity tariff could also need to be amended at the end of the year. A possible reason could be crediting back of interruptible payments to all firm capacity holders. Also, although capacity is booked on a yearly basis the actual level of capacity booked may vary from the start of year levels since suppliers may request extra capacity during the year. Any cost difference, plus inflation differences to be passed through at the end of the year will be divided between the revised capacity tariff and commodity tariff depending upon the capacity-commodity split.

Each TO will notify its exiting shippers of any additional payment or credit entitlement based on the revised tariff. Also respective TO will inform their Power station of any required extra payment to meet their ship-or-pay commitments.

(e) Inter-operator revenue transfer

The PSA will calculate the TOs' entitlements and out-turn receipts (based on out-turn volumes/deemed receipts) and notify each TO of any end of Year inter-TO transfer.

The timing of the end of year reconciliation process is still undecided. It is envisaged that this could not occur earlier than two months after the end of the postalised year – i.e. in December – to allow the out-turn inflation figures to be established and to allow time for cost variances to be audited by OFREG.

<u>Aspects of the Legal and Financial framework</u>

A: The postalisation system administrator: appointment, functions and control

Of the three options for the Postalisation System Administrator ("PSA") put forward in the Consultation Paper the consultation responses tended to support the appointment of a third party (such as a firm of accountants) to carry out the PSA functions under contract with the operators.

Ofreg has reviewed the various tasks which will need to be done in order to calculate the postalised tariffs, do the final end of year reconciliation and mandate transfer payments between the TOs. Our conclusion is that as far as possible obligations, including in particular obligations to provide or publish information both to Ofreg and to users, should be placed on the TOs under the standard licence conditions rather than on the PSA. This is because the PSA will not be licensed and the only control exercised over it by Ofreg will be indirect.

The required functions that the PSA must perform will be identified in standard licence conditions in each operator's licence. The TOs, if requested by the Authority, will be required to be party to an agreement, governing the appointment of the PSA and enforcing the required functions. The Authority will have the power to consent to the TOs not appointing a PSA or terminating the PSA agreement. The standard licence conditions will provide that at any time when a PSA is not appointed, the TOs will where appropriate provide information and respond to directions from Ofreg. We will require the right to approve the proposed PSA and the terms of the contract ("PSA Agreement").

Taking this approach of placing obligations on the TOs rather than the PSA, the functions of the PSA are actually quite limited. They amount to receipt and inputting of data, running various models which will have been constructed by Ofreg in conjunction with the operators and doing revised calculations when out-turn volumes are known.

Therefore we want to reconsider whether a third party accounting body is appropriate for the PSA role. Ofreg appreciates that such a body would add transparency and independence to the system but we are concerned –especially now in light of functions of the PSA- that the costs of appointing and operating the PSA may be disproportionate to these benefits. Hence it may be appropriate to reconsider the alternatives, especially if the costs appear likely to be substantial: whether this limited PSA function could be performed by one of the TOs with appropriate ringfencing; or whether instead Ofreg carries out the functions, although we have some concern whether as regulator we should be carrying these management functions, as opposed to retaining a strict regulatory role.

Consequently we have asked the TOs to hold initial discussions with prospective accounting bodies regarding likely costs, willingness to perform the role etc. Following this information we will decide on whether to proceed with appointing a third body accounting firm or follow one of the alternatives. In any event we are keen for the appointment of the PSA to be done on a tender basis to ensure that the best value is achieved.

Regardless of the decision regarding the appointment of an independent accountant, it seems sensible to construct the arrangements with flexibility for Ofreg to perform the PSA functions in case of "emergency" (i.e. PSA incompetence/insolvency). Therefore whilst as stated above the PSA functions will be listed in a TO licence condition, the Authority will have the power to consent to the TOs not appointing a PSA/or cancelling the PSA agreement. The licence conditions will provide that at any time when a PSA is not appointed, the TOs will provide information and respond to directions from Ofreg performing the PSA functions.

B: Inter-Transmission Operator Agreement

Each TO will be subject to licence obligations in standard licence conditions which will set out the formulae for calculation of postalised tariffs, reconciliation payments to/from suppliers and inter TO transfer payments. In addition it is envisaged that the right to receive, and the obligation to make, payments to ensure that each TO receives its allowed revenue from the aggregate postalised tariffs collected by the three TOs will be the subject of an agreement between the TOs (the "Inter TO Agreement"). Each TO will be obliged by its licence to be a party and remain a party to such an agreement (Ofreg will have the right to approve and amend this agreement to ensure that it is consistent with postalisation). This agreement, covering the mechanics of the revenue transfers between the TOs, will reflect the postalised arrangements set out in the standard licence conditions.

Ofreg considers that the in-year transfers and end of year transfers between TOs are primarily a matter for the TOs who will want to ensure that they receive their entitlement under the postalisation arrangements. Ofreg does not envisage that it will need to approve the calculation of the required transfers (if an independent PSA is appointed to perform these calculations) or police compliance with the Inter TO Agreement. Ofreg will expect to intervene only where there is a public interest in so doing.

C: Arrangements for resolving disputes

As outlined in the description above of the PSA agreement and the Inter TO agreement it is envisaged that arrangements for postalised tariffs will be set out in standard licence conditions in the conveyance licence of each TO but that the relationship between the TOs and the PSA and the rights and obligations of the TOs to each other will be governed by these contracts (in each case in a form approved by Ofreg).

Where a dispute arises as to whether a TO has complied with an obligation under its conveyance licence Ofreg will have a role, and a duty to take action if it considers that there has been a breach of a licence obligation. Where issues arise which relate to the interpretation of the licence, whether in relation to the calculation of an individual TO's allowed revenue, the basis on which volume forecasts are to be drawn up or the interpretation of any aspect of the formulae for calculation of tariffs or transfers, it is likely that Ofreg will have a role and may have the power to make a determination which effectively resolves the dispute, subject to any right of review by the Courts.

Where there are contractual arrangements in place, creating rights and obligations between the TOs or between the TOs and the PSA, Ofreg considers that it will generally be appropriate for disputes under these contracts to be subject to resolution by the Courts. In the event that a dispute were to arise which involved an issue affecting the interpretation of a licence it might be appropriate for Ofreg to be involved in the resolution of such a dispute. However, Ofreg's current view is that contractual disputes should be subject to private party enforcement and dispute resolution.

Section five: Combined Operational Regime for the postalised network

Appendix three shows the NI transmission network following the completion of the BGE Northwest and Southnorth pipelines. Extending the existing network creates issues surrounding how the three pipelines should operate together, for example what should be the rules governing the transportation of gas across the network and the rights and obligations of both operator and supplier. We are pleased to see that the respondents to the December paper agreed with the need to work towards these issues through the development of a combined operational regime in parallel with the implementation of postalisation. This section discusses these issues and sets out the current stage in the process of combining the operation of the three networks.

Since December the three operators have produced their joint proposal on the operation of the transmission network. Their proposal was the result of detailed discussions amongst the operators and we appreciate the effort displayed by them in producing their proposal. There have also been two meetings of the supplier-operator forum looking into the interoperability of the postalised network and we appreciate the inputs made by the suppliers at these meetings.

The main points of the TO proposal are:

- Each TO will remain responsible for the operation of its own pipeline.
- There will be two regimes for balancing – one covering the combined Phoenix and PTL network (for which PTL will take responsibility) and the other for the BGE network.
- How the three pipelines will operate together will be set out in separate operator-to-operator agreements at the two interfaces. These agreements will cover:
    - Ownership of equipment
    - Information flows
    - Recognition of common emergency rules
    - Liability
- Volume control (including meter) and pressure protection equipment need to be inserted at the Carrickfergus interface between the BGE and Phoenix pipelines.
- The distribution company will act as the shipper on the transmission network for suppliers in that distributor's licenced area. For example, Phoenix conveyance will ship gas across the PTL pipeline on behalf of all suppliers in the Greater Belfast market.

For suppliers exiting the PTL/Phoenix system– the proposals mean little change to the current regime. These suppliers balancing area remains the same – between their Moffat entry allocation and their exit point allocation. PTL will be responsible for achieving balance across the two pipelines.

Suppliers exiting the BGE network have a choice of either requesting BGE to act as their transit shipper on the PTL/Phoenix pipelines up to the Carrickfergus interface or to act independently and be responsible for the supply of their own gas up to Carrickfergus. This requires contracting separately with both PTL and Phoenix. Furthermore the independent supplier will be subject to both balancing areas.

The merits of this proposal should be assessed against the set of principles listed in the December paper that the combined operational regime must honour. These are:

- To have as seamless as possible an operational regime in order to minimise transaction costs and complexity for shippers.

- To minimise both the one-off implementation costs and operational costs of the postalisation system.

- Security of supply and safety standards must not be compromised.

- The system must comply with relevant EU legislation, e.g. third party access based upon transparent and non-discriminatory rules.

- That the party(s) chosen to run the operational regime cannot use its position to the advantage of any affiliate involved in distribution/supply activities (i.e. adequate ring-fencing provisions to ensure no commercial advantage).

- There should be no confusion about who has responsibility over which risks within the system.

Furthermore any evaluation of the TO proposal must be also done with reference to any credible alternatives. Any proposal has to be not only consistent with the technical aspects of the postalised network but also deal with the existence of three separate pipeline owners and hence the associated commercial implications.

The most discussed alternative has been an independent single system operator, a regime strongly supported by the suppliers/customers in their responses to the December consultation paper. The postalised transmission network is a small and simple system and from a technical aspect, an independent single operator seems intuitively to be the best solution. However the commercial realities of having three separate asset owners plus their strong opposition to such a regime makes this alternative very difficult to achieve.

Under the Energy Order conditions on postalisation implementation (section two), the Authority/Department, has no powers to impose a single independent operator regime on the three operators.. Furthermore the complexity entailed in drafting the legal contract governing the relationship between the single operator and the three pipeline owners plus the implementation costs of establishing the independent single operator, decreases any advantage this alternative has over the operators' proposal of the asset owners continuing to operate their respective pipelines. The possibility of a single system operator may emerge in the future if the ownership structure of the pipelines changes.

Another alternative is a dominant operator regime which is an informal single operator system. Under this alternative each operator will retain some operational responsibility for its own pipeline, but one operator will be appointed as the dominant operator and given overall responsibility for balancing the whole network (and hence a single balancing area) and for co-ordinating and then submitting all suppliers nominations/renominations to the Moffat Agent. Each operator could retain some operational responsibility over its own pipeline (in terms of maintenance etc.) and its own code. This alternative is an extension of the current arrangement between PTL and Phoenix, where PTL has responsibility for balancing the Phoenix transmission system.

However this alternative likewise suffers from the commercial considerations of having three owners. Developing the conditions governing the relationship between the dominant operator and the other two could become very complex and time consuming[4]. This alternative will lead to the dominant operator providing a transportation service to a "virtual" exit point from their system which is physically located on another pipeline, and hence there may be certain elements in the provision of this service which is outside the dominant control. This would make it difficult for the dominant operator to accept liability when operating the others' pipelines.

The TO proposal satisfactorily meets the principles and can be delivered. It is a practical and sensible solution to combining the operational systems and we endorse the proposal as the

[4] For example, what functions will be given to individual operators and which ones to the dominant.

framework for producing the combined operational regime for the postalised network. However the TO proposal puts forward only the principles of how the system will operate, most of the detail needs to be considered and agreed. There has already been two sessions of the Northern Ireland Operator-Shipper forum which has been very successful. Further meetings shall examine the issues to finalise the detail governing the operational regime.

In these meetings Ofreg/DETI will ensure that the combined regime will:

A have no unjustified capital expenditure.

The vital component of the TO proposal is having two balancing areas. This needs volume control to be installed at the interface between the Phoenix pipeline and BGE Northwest pipeline (Carrickfergus interface). The TOs propose that as well as installing volumetric control of flow the volumetric regulators will be fitted with high pressure overrides which would act to protect the SNIP/Phoenix system in the event that the Northwest pipeline, when being fed gas from the Southnorth, were to be operating at an excess pressure. With the BGE pipelines designed for a maximum allowed operating pressure of 85barg, compared to the maximum pressure of 75barg on the SNIP/Phoenix, this pressure protection equipment is required to meet legislation/industry specification.

Most of the technical justification for volumetric control arises following the construction of the Southnorth pipeline. We foresee that following Southnorth completion there will still be significant flows of gas into the Northwest pipeline from the SNIP/Phoenix system. If there is a mixture of gas from SNIP and SN to NW pipe on every day then pressures at the SNIP/PTP side of the Carrickfergus interface will need to be marginally higher than that in the NWP for SNIP/PTP gas to be able to enter the NWP. In order to get the correct volume of gas delivered in from the SNIP/PTP to the NW pipe there must be volumetric control. Without volumetric control, and hence relying on either pressure control or a floating system will result in no control over the volume of gas that will flow and hence too much or too little gas along each route. Volumetric control will also enable customers on the SNIP/Phoenix system to source gas from the Republic and have it delivered via the Southnorth.

Most of the technical reasons for this capital expenditure arise from the Southnorth completion and some parties have questioned whether the expenditure should be deferred until then, and also whether the interface between the Northwest and Southnorth pipelines is more appropriate location than the Carrickfergus interface. Since this equipment will be required in the future, the only savings from deferring the expenditure will be the financing costs. This potential saving is far outweighed by the costs of deferring. Delaying the expenditure creates the need to develop an interim operational arrangement different to the TO proposals, which is likely to be the dominant operator alternative. As discussed above, the costs and complexity of developing the legal framework needed for such a system reduces its advantages, especially when that system will only be used for two years. There is also the technical risk of subsequent installation on a "live" pipeline.

TOs have also suggested another possible technical advantage from this investment through decreasing the need for balancing actions[5]. The point is open to argument, since the volume control will decrease the use of system linepack to deal with imbalances thereby creating possibly more balancing actions.

Therefore we currently take the view that there is justification for installing this capital at the Carrickfergus interface for the Northwest pipeline. However installing this equipment will decrease the delivery pressure at Coolkeeragh which may create extra pressure maintenance costs in the network. We want to explore the potential of such costs with the operators.

Beside the need to ensure that all capital expenditure is justified and efficient, there is an duty on Ofreg to make sure that the total operational costs are minimised. With this in mind, we have asked the three TOs to explore possible economics of scale from combining operational functions.

B Ensure equality of treatment for all suppliers on the postalised network.

We believe that it is a vital principle that all suppliers are treated equally and face the same transportation rules irrespective of which part of the postalised network they use. With some of the specifics of the operators proposals not clear, there is the fear that there will be differential treatment for exiting suppliers on the PTL/Phoenix system compared to the BGE system exiting suppliers. Furthermore with there being two operational regimes, suppliers whose gas is transported through both (e.g. gas to Coolkeeragh) may be subject to pancaking of rules.

The two most important components where equality is a requisite are:

[5] A balancing action is required when the operator has to purchase/sell gas outside the system to deal with any imbalances.

Balancing. All suppliers on the postalised network must be subject to the same balancing area; the difference between its Moffat entry allocation and its exit point allocation. This applies also to any Northwest/Southnorth supplier that doesn't request BGE to act as its transit shipper. We would expect that the gas prices attached to the imbalances are the same on both systems and likewise the calculation of the imbalancing charges.

Nominations/renominations timetable. All suppliers must have the same rights to nominate and renominate during the day. Under the TO proposal, suppliers initially inform BGE of their required intake, who then aggregates the NW/SN quantities before passing the information onto PTL. Customers on the PTL/Phoenix only have to inform PTL of their intakes. This implies that there is a difference in the allowed timetable for suppliers to submit their information as opposed to suppliers on the Phoenix/PTL system. The operators have ensured us that with available IT systems, the information flows between the operators will be streamlined and any timing differences will be minimal.

Common network codes for the three pipelines

Under the accepted TO proposed operational regime, each operator will have its own transportation code setting out the operational rules for its own pipeline. It is essential that each operator has a contractual relationship –in the form of a network code- with all parties shipping gas on their pipeline. This includes transit suppliers who exit the postalised network from another pipeline. In December we expressed our strong desire for the terms of these separate codes to be very similar if not identical. We remain convinced that to have equality of treatment for all customers, the codes must be synonymous. Furthermore how the three codes operate together and are cognate with each other must result in a seamless, simple combined operational regime. With the possibility of a Northwest supplier having to sign up to three codes, we must protect against that supplier being subject to operational pancaking. The PTL code has been in operation since 2001and Phoenix have indicated that they will adopt this code for their transmission pipeline. As BGE are working towards producing a proposal for their own network code, a lot of the detail regarding how the three codes fit together remains opaque. We see the series of the operator- supplier forum discussions over the next six months (the next meeting of which is scheduled for August –date yet to be finalised), as the arena to finalised the details and to ensure that the codes met our concerns.

Integration of South-North and the consistency with Irish system transportation costs inclusion

One of the difficulties that emerged during their discussions for the TOs was to how to deal with the inclusion of the Sorthnorth pipeline two years after the completion of the Northwest pipeline. The TO have decided to make their proposal such that Southnorth pipeline can be easily incorporated. In section three we outlined our intention to allow only the costs of transporting the excess gas above the SNIP maximum capacity required to meet NI demand through other possible entry points (i.e. Irish Interconnector). The details of this mechanism will be developed in the future. The operational rules for the postalisation network need to consistent with this principle, in the sense that they don't lead to an inefficient use of SNIP. SNIP must be used to its maximum capacity and remain the principal pipeline for flowing gas into Northern Ireland. What isn't clear from the TO proposal is who makes the choice between transporting gas via the SNIP or through Irish Interconnector for gas suppliers on the BGE network.

We would welcome views on:

Any aspect of the above discussion approving the TO proposals for combining the operational regimes.

Section six: Outline of draft licence conditions required for postalisation

This is an overview only of what the special and standard Conditions in the TO Licences might cover. Special Conditions would, as far as possible, be in a standard format.

Allowed Revenue (Special Condition)

1 Calculation of allowed revenue

1.1 Each TO's Licence would contain provision for annual allowed revenue to be calculated in accordance with a specified formula. PTL's and PNG's conveyance licences already contain charging formulae; BGE's licence sets out principles on the basis of which a formula is to be inserted. Where an existing formula does not generate an annual allowed revenue figure, required for the purpose of calculating the postalised tariff, appropriate adjustments will be required for the purpose of giving effect to the existing formula in a postalised system. Further adjustment is needed to Phoenix's existing formula to align their required revenue calculation with the postalisation year (Oct – Sept).

The Special Conditions specifying how each Licensees' required revenue is to be calculated will (in the case of existing formulae) identify how capital and operating costs are to be passed through and any provisions for adjustment or review (whether annually or at periodic intervals).

1.2 The Licence will specify the information requirements to support auditing of allowed revenue and specified cost reviews to take place at specific intervals or to be initiated by the TO or by the Authority. The timing of reviews will be consistent with the postalised year ("Year") which will run from 1st October to 30th September.

2. Postalised Conveyance Charges (Standard Condition)

2.1 Postalised Charges

At any time when, and to the extent that, a TO's infrastructure is designated as part of the postalised system for the purpose of Article 59 of the Energy (Northern Ireland) Order 2003 (the "Energy Order"), the TOs shall charge exiting shippers the postalised tariff which will be calculated in accordance with the postalised tariff formula and revenue apportionment formula. The TOs must also pay (or charge) to the shippers further sums to reflect any adjustment resulting from the end of year reconciliation referred to in Condition 2.5.1.

2.2 Calculation of Postalised Charges

The postalised tariff for shippers will be calculated in accordance with a formula comprising a Commodity charge and a Capacity charge.

Forecast Commodity charge =

$$\frac{\text{Total Forecast Postalised Allowed Revenue x Commodity Percentage}}{\text{Total forecast annual Volume}}$$

Forecast Capacity charge =

$$\frac{\text{Total Forecast Postalised Allowed Revenue x Capacity Percentage}}{\text{Total Capacity Booked x 12}}$$

With charges be payable on a monthly basis, total forecast capacity which is booked on a yearly basis, is multplied by 12 to calculate the monthly capacity tariff.

Interruptible commodity tariff: as described in section three

2.3 Definition of Letters and Other Symbols

The Licence will contain formulae, assumptions, definitions (letters and symbols) for calculating the postalised tariff, annual reconciliations and inter-TO payments. For example, for the above formulae, total postalised allowed revenue will be the sum of the annual allowed revenues for each of the TOs calculated according to the special condition of their licence.

2.5 Annual Correction of Charges

2.5.1 The Licence will contain formulae for annual adjustment of the postalised tariff to take account of inflation differences, interruptible revenue, outturn volumes, including ship or pay and any costs permitted to be passed through under the TOs' respective Licences;

2.5.2 The Licensee will calculate each shipper's adjusted annual exit charges from adjusted postalised tariff determined by PSA and shippers' actual volumes (which will determine the need for credits to or further payments from the shippers).

2.6 Inter TO Reconciliation Payments

The Licence will set out an inter TO revenue apportionment formula (which will be applied by the PSA to calculate inter TO payments under the Inter TO Agreement.

Transfer Formula

$$\% \, RR_Q = (RR_Q / RR_{Total}) * 100$$

$$AR_Q = \% \, RR_Q * SR_{Total}$$

$$\text{Transfer to Q} = AR_Q - SR_Q$$

Where:

RR Total = *Required Revenue (Annual)*

RR_Q = *Q's Required Revenue*

$\% \, RR_Q$ = *Q's RR as a Percentage of Total RR*

AR = *Allowed Semi-Annual Revenue*

SR Total = *Total (Deemed) Semi-Annual Shipper Receipts*

SR_Q = *Q's (deemed) Semi-Annual Receipts from Shipper's exiting on Q's network*

Frequency of transfers to be decided.

2.7 Information and other Obligations

The Licensee may:

2.7.1 procure forecasts of volumes from shippers exiting on the Licensee's infrastructure;

The Licensee will:

2.7.2 furnish forecasts of volumes for the following five years to the Authority not later than 15 weeks before beginning of each Year;

2.7.2 furnish to the Authority the annual allowed revenue for the next five years calculated in compliance with Condition 1 not later than 15 weeks before the beginning of each Year;

2.7.3 furnish to the PSA forecast volumes and allowed revenue, subject to adjustments notified by the Authority, not later than 8 weeks before the start of each Year (details of forecast volumes including shippers' forecasts will be publicly available);

2.7.4 co-operate with the PSA and other TOs in relation to the matters set out in these Conditions;

2.7.5 publish the postalised charges not later than 1 month before the start of the Year and publish annual corrections;

2.7.6 inform shippers of quarterly actual volumes. [*Note: This may also be a Network Code obligation.*]

The Licence will include fallback provisions permitting the Licensee to charge conveyance charges based on allowed revenue/volume if Licensee's infrastructure (or part of it) ceases to be designated as part of postalised system.

3. Postalisation System Administrator

3.1 PSA Primary Obligations

Unless the Authority otherwise directs or consents, the Licensee will do all things within its power to enter into and be party at all times thereafter to arrangements with a person (the "Postalisation System Administrator" or "PSA") who must fulfil the criteria set out in Condition 3.2 below. The PSA will carry out the activities specified in Condition 3.3 pursuant to an agreement (the "PSA Agreement") between the Licensee, the PSA and the TOs which fulfils the criteria referred to in Condition 3.3 and remains approved by the Authority.

3.2 PSA Criteria

The person fulfilling the functions of PSA from time to time pursuant to Condition 3 must:

3.2.1 be a competent, fit and proper person to fulfil the PSA Functions having the systems and controls in place to fulfil those functions; and

3.2.2 have sufficient suitably qualified and skilled personnel to enable it to perform the PSA Functions.

3.3 PSA Functions

3.3 The activities of the PSA to be provided under the PSA Agreement in accordance with Condition 3.1 are the following:

(a) The receipt from each of the TOs of the following data in respect of the following five Years:

(i) the volumes of gas which each of the users of that TO's designated pipeline forecasts to flow through that pipeline;

(ii) the levels of firm capacity bookings for that TO's designated pipeline;

(b) The receipt from each of the TOs of the actual outturn volumes for that TO's designated pipeline for each 3 month period; and

(c) The receipt from each of the TOs in respect of the previous Year of the end of year actual out-turn volumes for that TO's designated pipeline;

(d) The calculation of the postalised tariff through application of the postalisation formula contained in Condition 2.2 and notification thereof to all TOs and to the Authority no later than 6 weeks before the beginning of the following Year subject to the provisions of Condition 4.2;

(e) The recalculation of the postalised tariff formula and revenue apportionment formula applying actual outturn volumes and notification of the results to all TOs and to the Authority no later than [2 months] after the end of the each Year subject to the provisions of Condition 4.2;

(f) On the basis of the recalculated postalisation tariff, the calculation of any payments to be made by or received from the TOs to each other, in accordance with their respective Licences and the Inter TO Agreement, no later than [3 months] in respect of the previous Year;

(f) The provision to the Authority of such information relating to its activities as the Authority may reasonably require;

(g) such other postalisation related activities as the Authority may designate by written notice to the PSA and the TOs.

3.4 Enforcement and termination

The Licensee must:

3.4.1 enforce the obligations of the parties to the PSA Agreement whenever required, or whenever so directed by the Authority by notice, and in accordance with the terms of the direction;

3.4.2 not waive any rights under the PSA Agreement without the prior written consent of the Authority; and

3.4.3 whenever directed or permitted by the Authority by notice (but not otherwise), exercise its rights to terminate the PSA Agreement.

3.5 If the Authority appoints a person other than the PSA (including for the avoidance of doubt the Authority itself) to carry out the functions of the PSA, the Licensee will comply with all obligations under the Licence as if that person were appointed PSA.

4. Inter TO Agreement

4.1 Unless the Authority otherwise consents, the Licensee will:

4.1.1 at the time that it enters into the arrangements referred to in Condition 3.1 above also enter into; and

4.1.2 be a party at all times thereafter to

a binding agreement (the "Inter TO Agreement") with the TOs, in a form approved in advance by the Authority pursuant to which it is will make the reconciliation payments (calculated in accordance with the revenue apportionment formula).

4.2 [The Licensee will:

4.2.1 comply with its obligations under the Inter TO Agreement in all material respects;

4.2.2 promptly notify the Authority of any breach of any obligation by any party under the Inter TO Agreement;

4.2.3 not waive any rights under the Inter TO Agreement without the prior written consent of the Authority;

4.2.4 enforce its rights and the obligations of the other parties to the Inter TO Agreement whenever required, or whenever so directed by the Authority by notice, and in accordance with the terms of the direction; and

4.2.5 whenever directed or permitted by the Authority by notice (but not otherwise), exercise its rights to terminate the Inter TO Agreement.]

Note: Need for these enforcement rights in respect of their inter TO Agreement under consideration.

5 Other Licence Modifications

5.1 Network Code: modification of the existing Standard Condition to require the three TOs to develop their network codes in parallel and to develop arrangements which facilitate the operation of postalisation.

5.2 Co-operation in conduct of transportation business: a new obligation for each Licensee to co-operate in relation to operation of interconnected designated pipelines.

5.3 Arrangements (to the extent required) governing BGE as shipper on PTL/Phoenix networks (and Phoenix as shipper for those exiting on Phoenix network): any special provisions appropriate to cover the role of BGE as Shipper through PTL/PNG network and Phoenix as shipper through SNIP.

5.4 Distribution operator acting as transmission supplier: Standard Condition specifying that the activity of shipping on behalf of suppliers in the domestic market will be a ring-fenced activity under a distribution operator's licence subject to appropriate accounting and non-discrimination requirement.

5.5 Supply licence standard conditions: OFREG is considering whether any additional standard conditions will be required in supply licences, including for example specific information obligations or a requirement to pay the postalised tariff.

Section seven: Illustrative worked example on postalisation calculations

The postalisation tariffs are designed to pay for the designated transmission network. At its most basic it takes the costs of the assets (required revenue) and divides it out amongst the users of the pipelines. The tariffs are made up of a commodity charge and a capacity charge, which are split according to the profile outlined above. The commodity tariff is charged per unit of gas a consumer actually transports through the network. The capacity tariff is charged per unit of capacity booked on the network by the consumer for their annual peak day needs[6].

In order to provide greater transparency and understanding of the tariff we include below a forecast of how the tariff will be calculated in the first five years (2005-2009). We also include below a box example to illustrate how the tariff will actually work in practice, highlighting the system for reconciliation and inter-TO transfers. All the figures presented here are estimates and should not be regarded as a definitive view of the future postalisation price – there is a significant degree of uncertainty around several assumptions and the figures are only meant to be illustrative.

The Postalised Tariff (2005-09)

In order to calculate the tariff we start off with the costs of the NI network. These are outlined in Table 1 below which gives us a forecast of these costs for 2005-09. These figures take into account Capex, Opex and return on investment and emanate from each of the asset owners' licences. We also include charges, relating to the use of the Interconnector pipe (IC) between Scotland and Gormanstown (north of Dublin). This is because once SNIP is full this pipe will transport the required extra gas to the NI network via the SN pipe. It is envisaged that a mechanism will be put in place to ensure that only costs associated for the gas demanded above to SNIP capacity will be allowed into the postalised costs.

All figures are in 2001 prices and the gas year runs from 1st October to the 30th September e.g. 2005 runs from 1st October 2004 to 30th September 2005.

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6 For the purposes of this paper we use therms as our unit of gas (1 therm = 29.3 kWh).

Year	Total
2005	£31,000,000
2006	£31,000,000
2007	£37,700,000
2008	£38,000,000
2009	£38,400,000

Table 1: Postalised annual required revenue (2001 Prices)

Table 2 outlines our volume forecasts for NI over the five years. All figures here are in million therms. We present the figures for the four main consumers – the two generators (Ballylumford and Coolkeeragh) and the two distribution areas (Belfast and New Towns - which includes all towns supplied by the NW or SN pipelines.) We have forecast constant generating volumes and increasing Belfast and Towns volumes.

	Ballylumford	Belfast	Coolkeeragh	Towns	Total
2005	305	108	180	12	605
2006	305	119	200	25	649
2007	305	132	200	37	674
2008	305	145	200	46	696
2009	305	156	200	53	714

Table 2: Forecast Volumes (m therms)

Our final necessary input to calculate the tariffs is forecast capacity booked which is outlined in Table 3. This is based on volume and load assumptions for four consumers.

Year	Ballylumford	Belfast	Coolkeeragh	Towns	Total
2005	1.30	0.71	0.64	0.08	2.73
2006	1.30	0.81	0.64	0.17	2.92
2007	1.30	0.91	0.64	0.25	3.1
2008	1.30	1.03	0.64	0.31	3.28
2009	1.30	1.14	0.64	0.35	3.43

Table 3: Forecast Capacity (per peak day therm booked)

Translating these figures into tariffs is relatively simple and follows the formula below:

$$\text{Forecast Commodity Tariff} = \frac{\text{Total Required Revenue * Commodity Split}}{\text{Total Volumes}}$$

Forecast Capacity Tariff = Total Required Revenue * Capacity Split / Total Capacity Booked

By applying these formulae to our estimated inputs we produce the following tariffs for 2005-09. Commodity charges are per therm consumed while capacity charges are per peak day therm booked. The capacity charge is represented here as an annual charge so that if capacity charges are invoiced monthly the monthly charge will be peak day capacity *(capacity charge/12) and so on.

	Commodity Charges *Per therm*	**Capacity Charges** *Per peak day therm booked*
2005	£0.0256	£5.678
2006	£0.0239	£5.308
2007	£0.0280	£6.081
2008	£0.0273	£5.793
2009	£0.0134	£8.397

Table 4:Illustrative Postalisation tariffs

The calculation of the forecast tariff is only the first step in the postalisation process. A system must be put in place to deal with the circumstance where actual out-turn figures differ from our forecasts. We must also take into account such issues as inter-TO transfers.

EXAMPLE: Postalised Payment Mechanism 2007

Step one : Calculation of Forecast Postalised tariffs

Total Forecast Required Revenue	£37,700,000
Total Forecast Volumes	674m therms
Total Capacity	3.1m therms/day
Capacity:Commodity Split	50:50

Forecast Commodity Tariff = £37.7m/674m*50% = £0.0280 per therm

Forecast Capacity Tariff = £37.7m/3.1*50% = £6.081 per peak day therm booked

Step two: Inter TO Transfer (assuming this occurs six monthly)

This process has come about at the request of the TOs because some TOs will collect more money than their required revenue and others less. Waiting until the end-year-reconciliation to transfer these amounts may create cash flow problems so the TOs have agreed to take part in a semi-annual transfer (as well as the annual one). This process will not attempt to re-calculate the tariff and shall only effect the TOs and not any consumer.

PTL Deemed Receipts	£	8,430,693
BGE Deemed Receipts	£	6,237,465
PNG Deemed Receipts	£	5,050,228
Total Receipts	**£**	**19,718,386**

TOs in-year allowed revenue is calculated as a percentage of total deemed receipts. This percentage is equal to its share of annual required revenue.

PTL In-Year Allowed Revenue	£	9,414,614
BGE In-Year Allowed Revenue	£	6,119,499
PNG In-Year Allowed Revenue	£	4,184,273

Transfers are then calculated as the difference between deemed receipts and allowed revenue.

Six monthly inter-TO transfers

PTL	£	983,922
BGE	(£	117,966)
PNG	(£	865,955)

Under this example, Bord Gais and Phoenix will transfer to PTL £167,873 and £739,268 respectively. The details of the transfer mechanism will be set out in the inter-TO agreement.

Step three: End of Year Reconciliation

Calculating the actual Postalised Tariffs

Actual Volumes		Deemed Volumes	
Ballylumford	*305m*	Ballylumford	305m
Belfast	*142m*	Belfast	142m
Coolkeeragh	*200m*	Coolkeeragh	200m
Towns	*37m*	Towns	37m
		Total	684m

Any Ship-or-Pay commitments have been met by the power stations and hence deemed volumes are equal to actuals.

Total Required Revenue	£37,700,000
Total commodity req. revenue	£18,850,000
Actual commodity revenue collected	£19,129,674
Surplus	£279,674
Total Deemed Volumes	684 m therms
Actual Commodity Tariff	= 37.7m/684m*50% = £0.02756 per therm
Surplus to be rebated to all shippers	= 0.00041 pence per therm

Bullet Rebates

Coolkeeragh	*200m * .00041=*	*£*	*81,766*
Ballylumford	*305m * .00041=*	*£*	*124,708*
Belfast	*142m * .00041=*	*£*	*58,061*
Towns	*25m * .00041=*	*£*	*15,129*
	Total Bullet rebates		*£279,674*

The capacity tariff is unchanged because we have assumed that required revenue and capacity booking forecasts were accurate. Given that capacity is booked in advance and the bulk of required revenues will be known in advance the forecast capacity tariff is likely to be very accurate.

However, the actual commodity tariff is lower than the forecast tariff because we assume in this example that Phoenix ships 142m therms rather than the forecast 132m therms. We then recalculate the postalised tariff to reach our actual postalised tariffs. The TOs will have to redistribute the rebate between the actual and forecast tariffs (£0.00041 per therm) to the shippers based on deemed volumes. In this example deemed volumes are equal to actual volumes but in a case where a generator consumes less than their SoP, deemed volumes (which will take the SoP into account) will be higher than actual volumes. It is possible that if volumes are lower than forecast, TOs will have to collect a payment from shippers.

Any end of year rebates/payments are made, the final requirement is for inter-operator transfer payments to achieve balance between the operators allowed revenue and receipts.

End of year TO Transfer

PTL	£ 705,904
BGE	(£ 125,168)
PNG	(£ 580,736)

This will follow the same system as used above and calculates the annual transfer between the TO's. We then subtract payments already made in the In-Year transfer to reach the net figure for TO transfers.

Section eight: Implementation timetable

We attached a timetable detailing how we envisage the sequencing of the required workstreams necessary for the postalisation implementation. Following consultation on the recommendation on the design of both the financial and operational structure for the postalisation system, most of the work will be focused on producing the necessary legal contracts and regulatory documents required to support postalisation. These documents are:

For the financial regime:

- Licence modifications to the operators revenue determination formula
- Standard conditions required for the operational of the financial system
- Inter-TO agreement for the revenue transfers
- PSA agreement, governing the role and functions of the PSA.

For the operational regime:

- Common network codes for the three pipelines
- Interface agreements between the operators
- Emergency/safety rules and procedures

IMPLEMENTATION TIMETABLE FOR POSTALISATION: July 03 to Jan 04

	July-03	August-03	September-03	October-03	November-03	December-03	January-04
Financial System							
Total Postalised Revenue Determination		Discussions with operators regarding making their licence formula consistent with postalisation					
				Assessing passing through of distribution spurs			
Standard licence conditions		Drafting discussions with licence holders			Final draft circulate for consultation		
Inter-Transmission Operator Agreement		Agree transfer mechanism			Operators to finalise Agreement		
Postalisation System Administrator			Finalise role and functions	Finalise PSA Agreement		Tender process	
Operational System							
Transmission Operators - suppliers forum		Monthly meetings covering combining the operational systems as discussed in section six					
Network code drafting				Producing common network codes			
Interface Agreement between Operators					Submit for regulatory approval		

Section nine: Consultation Responses

Views are invited on all aspects of this paper from those who have in interest in this matter including consumers, consumer representatives and shippers. We are particularly keen to hear views on the issues and various questions raised by this paper.

Responses should arrive no later than Friday 8 August 2003 and be addressed to:

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Belfast
BT1 5EE
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Respondents are free to mark their replies as confidential, although we would prefer that as far as possible, we were able to put replies to the paper on Ofreg website. If you wish to discuss any aspect of this paper, please call either Eamon Corrigan or Brian McHugh on 028 90 311575.

Appendix one: Extracts from the Energy (Northern Ireland) Order 2003

PART III

OBJECTIVES OF REGULATION OF ELECTRICITY AND GAS

Gas

14. The principal objective and general duties of the Department and the Authority in relation to gas

(1) The principal 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.

(2) The Department and the Authority shall carry out those functions in the manner which it considers is best calculated to further the principal objective, having regard to -

(a) the need to protect the interests of consumers of gas;

(b) the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Gas Order or this Order;

(c) the need to secure that the prices charged in connection with the conveyance of gas through designated pipe-lines (within the meaning of Article 59) 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 pipe-line; and

(d) the need to protect the interests of gas licence holders in respect of the prices at which, and the other terms on which, any services are provided by one gas licence holder to another.

(3) In performing that duty, the Department or the Authority shall have regard to the interests of –

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age; and

(c) individuals with low incomes;

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

(4) The Department and the Authority may, in carrying out any gas functions, have regard to the interests of consumers in relation to electricity.

(5) Subject to paragraph (2), the Department and the Authority shall carry out their respective gas functions in the manner which it considers is best calculated –

(a) to promote the efficient use of gas;

(b) to protect the public from dangers arising from the conveyance, storage, supply or use of gas;

(c) to secure a diverse and viable long-term energy supply; and

(d) to facilitate competition between persons whose activities consist of or include storing, supplying or participating in the conveyance of gas;

and shall have regard, in carrying out those functions, to the effect on the environment of activities connected with the conveyance, storage or supply of gas.

(6) In this Article "gas functions" means –

(a) functions under Part II of the Gas Order; and

(b) functions under this Order relating to gas.

15. Exceptions from the general duties

(1) Article 14 does not apply in relation to functions of the Department under –

(a) Article 40 of the Gas Order; or

(b) Article 61.

(2) Article 14 does not apply in relation to anything done by the Authority in the exercise of functions under –

(a) Article 23(3) of the Gas Order; or

(b) Article 8.

(3) The Authority may nevertheless, when exercising any function under Article 23(3) of the Gas Order, have regard to any matter in respect of which a duty is imposed by Article 14 if it is a matter to which the Office of Fair Trading could have regard when exercising that function.

(4) The duties imposed by Article 14 do not affect the obligation of the Authority or the Department to perform or comply with any other duty or requirement (whether arising under this Order or another statutory provision, by virtue of any Community obligation or otherwise).

PART VIII

MISCELLANEOUS AND SUPPLEMENTARY

Common tariff for conveyance of gas through designated pipe-lines

59. Designation of pipe-lines for purposes of common tariff

(1) The Department, after consultation with the Authority, may by order designate any pipe-line as a pipe-line to which Article 60 applies; and references in that Article to a "designated pipe-line" are to a pipe-line which is designated under this Article.

(2) A pipe-line shall not be designated under this Article unless –

(a) it is a high-pressure pipe-line; or

(b) it is connected to a high-pressure pipe-line which is so designated.

(3) For the purposes of this Article a pipe-line is a high-pressure pipe-line if it has a design operating pressure exceeding 7 bar gauge.

(4) Before making an order under this Article, the Department shall give notice –

(a) stating that it proposes to make the order and setting out its effect; and

(b) specifying the time (not being less than 28 days from the date of publication of the notice) within which representations or objections with respect to the proposed order may be made,

and shall consider any representations or objections which are duly made and not withdrawn.

(5) An order under this Article may provide that the order (or so much thereof as designates any particular pipe-line) shall cease to have effect on the happening of any event specified in the order.

(6) If an order under this Article contains provision to the effect that the designation by the order of any particular pipe-line is, subject to any provision made by virtue of paragraph (5), to have effect for a period specified in the order, the Department shall not –

(a) revoke that order; or

(b) amend that order so that the designation of that pipe-line ceases to have effect,

before the end of that period.

60. Modification of gas licences: common tariff for conveyance of gas through designated pipe-lines

(1) The Department after consultation with the Authority, or the Authority with the consent of the Department, may in accordance with this Article modify –

(a) the conditions of a particular licence under sub-paragraph (a) or (c) of Article 8(1) of the Gas Order; or

(b) the standard conditions of licences under sub-paragraph (a) or (c) of Article 8(1) of that Order,

where it considers it necessary or expedient to do so for the purpose of implementing, or facilitating the operation of, arrangements designed to secure that the prices charged in connection with the conveyance of gas through designated pipe-lines 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 such pipe-line.

(2) The power to modify licence conditions under sub-paragraph (a) or (b) of paragraph (1) may not be exercised more than once pursuant to the designation of any pipe-line under Article 59.

(3) The power to modify licence conditions under sub-paragraph (a) or (b) of paragraph (1) includes power to make incidental, consequential or transitional modifications.

(4) Before making modifications under this Article the Department or the Authority shall consult the holder of any licence being modified and such other persons as it considers appropriate.

(5) Any modification of part of a standard condition of a licence under paragraph (1)(a) shall not prevent any other part of the condition from continuing to be regarded as a standard condition for the purposes of Part II of the Gas Order.

(6) Where at any time the Department or the Authority modifies under paragraph (1)(b) the standard conditions of licences under sub-paragraph (a) or (c) of Article 8(1) of the Gas Order, it shall also make (as nearly as may be) the same modifications of those conditions for the purposes of their incorporation in licences of that type granted after that time.

(7) Where the Department or the Authority makes any modifications under this Article it shall publish those modifications in such manner as it considers appropriate.

Appendix two: Timetable and detailed process for financial determinations during the postalised year.

<u>Step 1 – establishing postalised tariff for the Year starting 1st October:</u>

Early June: Operators will have the ability to request information from their exiting and transit suppliers to help them produce the necessary volume forecasts for the next five years (licence condition in suppliers licences for them to comply within a fixed number of days).

Mid June: TOs provide volume forecasts/capacity bookings for both exiting and transit suppliers on their systems, plus their own required revenues ("the elements for tariff determination"), for the next five years. This information (possible pooled together by the TOs beforehand) will be provided to Ofreg and also to the PSA. Submitted elements must also include an explanation and assumptions behind the volume and capacity figures.

July: The submitted elements for tariff determination will be circulated around all shippers. This will have two purposes; to give shippers an initial indicative of next years tariff and to give them an opportunity to comment on the proposed volumes forecasts.

1st week July: The outturn 3rd quarter volumes for that postalised year will become available – this will assist verification of the volume forecasts.

1st week August: Ofreg to decide upon submitted elements for tariff determination, and inform PSA/TOs[7].

2nd week August: Unless notified by TOs of amended elements for the postalised tariffs, PSA uses TO submitted elements and calculates the postalised tariffs using the established formula. PSA notifies postalised tariff to TOs OFREG and Shippers.

The postalised tariff will require an allowance for yearly inflation – Ofreg will inform the PSA of the expected annual inflation rate to be used in the calculations.

3rd week August: All parties have an opportunity to comment upon the PSA calculation of the postalised tariff.

1st September: TOs publish the postalised tariffs- the next year capacity and commodity charges plus the indicative tariffs for the following four years. Suppliers have one month's notice of new tariffs.

1st October: Start of the postalisation year.

Step 2 – In year inter operator revenue transfer

In order to avoid significant cashflow imbalance during the year the PSA will calculate entitlement based on postalised tariff and actual volumes to mid-year point. This will be done under the inter-TO agreement and the transfer amounts will be determined in accordance with the formula outlined in section four. Ofreg sees the decision whether to have the in-year inter operator revenue transfer on a monthly, quarterly or six-monthly basis as an issue for the operators.

Step 3 – In year volume/cost updates

2nd week January, April & July

A week after the end of each quarter, each operator will inform Ofreg of their exiting shippers actual volumes over the previous three months. Also if there are certain defined cost differences that are allowed through during the end of year reconciliation, operators must also inform Ofreg of any unexpected difference for these costs.

Ofreg (or the TOs) will circulate around all shippers the actual volumes (and the differences with the start of year forecasts) and any allowed costs differences around all shippers.

We are assuming that the quarterly volumes will be determined on a D+5 allocation.

Step 4 – End of year reconciliation

October/November

- Ship-or-Pay reconciliation.

Firstly TOs will notify PSA/Ofreg of out-turn actual/deemed exit volumes (plus any extra capacity bookings and revenue earned under the interruptible service). The operators beforehand will check whether Power station volumes have met their ship-or-pay commitment deemed volumes and adjust the actual exit volumes accordingly. Any defaulting Power station(s) will be required to pay the volume shortfall times in start of the year postalised commodity tariff on top of any normal bullet payment required for the end of year reconciliation- the PSA will assume that this amount has been paid.

- Allowed cost differentials pass through

TOs to notify Ofreg of any costs differentials in allowed operational expenditure which they are entitled to pass through at the end of year – Ofreg to verify the cost differentials.

- Calculation of the revised postalised tariff

Ofreg to inform the PSA of allowed costs differentials plus actual inflation figure. PSA taking the actual volumes (adjusted for any ship-or-pay volume shortfall), actual capacity, interruptible revenue will calculate the revised postalised commodity and capacity charge, and then notifies OFREG and TOs.

- TOs notify end users of additional credit/deficit payment based on revised tariff plus any ship-or-pay shortfall required payments. (1st week December)

At the same time, PSA (or TOs) calculates entitlements and receipts (based on out-turn volumes/deemed receipt) and notifies each TO of any end of year inter TO transfers.

Appendix three: Proposed NI transmission postalised network