Premier Transmission Limited and Belfast Gas Transmission Limited Operating Expenditure Review

Utility Regulator Consultation Paper

March 2009

Contents

Executive Summary

Premier Transmission Limited (PTL) is the owner and operator of the Scotland to Northern Ireland Pipeline (SNIP) which links Twynholm in Scotland with the Ballylumford power station in Co. Antrim. Belfast Gas Transmission Limited (BGTL) is the owner of the Belfast Gas Transmission Pipeline (BGTP) which runs from Ballylumford power station to the Belfast distribution network. Both PTL and BGTL are wholly owned subsidiaries of Northern Ireland Energy Holdings – a company limited by guarantee and are therefore financed through a long term bond.

To improve the rate at which the SNIP and BGTP could be financed the normal regulatory control over any allowed operational expenditure accrued by both PTL and BGTL has been removed. The resulting transfer of risk onto consumers, through potential inefficient operating costs, can be limited through corporate governance licence conditions contained within the conveyance licences held by both PTL and BGTL. One of which is a condition that, in the form of a shadow price control, allows the Utility Regulator to review the level of operating expenditure forecast to be incurred by PTL and BGTL for the next three gas years.

This process is a monitoring exercise and does not prevent either PTL or BGTL from recovering their actual costs through their respective licences. Indeed any outperformance by PTL and BGTL is returned to customers. This review has therefore two aims: firstly to provide the PTL and BGTL management with an operating expenditure benchmark and secondly to provide transparency of operating costs to the wider public.

This review has taken the form of a standard price control in that we have used benchmark information, sought engineering consultant advice, used actual operating expenditure costs incurred by PTL and BGTL as a benchmark for operating expenditure costs going forward and considered a level of efficiency that we feel is achievable in the businesses over the next three years.

In summary our minded to decision for the PTL and BGTL controllable operating expenditure for gas years 2008/09, 2009/10 and 2010/11 is as follows:

	2008/09	2009/10	2010/11
Premier Transmission Ltd	3,100,210	3,790,133	2,800,912
Belfast Gas Transmission Ltd	1,176,000	1,322,640	838,966

This compares to the PTL and BGTL forecast of:

	2008/09	2009/10	2010/11
Premier Transmission Ltd	3,781,261	4,334,457	3,588,825
Belfast Gas Transmission Ltd	1,391,000	1,651,000	1,271,000

1. Introduction

The Northern Ireland Authority for Utility Regulation (the "Utility Regulator") is issuing this consultation to update all interested parties on the process for the review of the PTL and BGTL controllable operating expenditure for gas year 2008/09 and the following two gas years.

This paper sets out the Utility Regulator's minded to decision on the level of controllable operational expenditure we see as being appropriate for PTL and BGTL to operate and maintain their networks effectively and safely.

The Utility Regulator seeks views on all aspects of this paper and responses should be sent to Ian Davidson by Friday 17th April 2009 at ian.davidson@niaur.gov.uk or:

Ian Davidson
Queens House
14 Queen Street
Belfast
BT1 6ER

Respondents may ask for their responses, in whole or in part, not to be published, or that their identity should be withheld from public disclosure. Where either of these is the case, we will ask respondents to also supply us with the redacted version of the response that can be published.

It should be noted that although the start of the review period has passed i.e. 1st October 2008, all figures are for the period commencing 1st October 2008.

All figures quoted in this paper are 2008/09 prices unless otherwise stated.

2. Background

PTL is the owner and operator of the SNIP which links Twynholm in Scotland with the Ballylumford power station in Co. Antrim. BGTL is the owner of the BGTP system which runs from Ballylumford power station to the Belfast distribution network.

Both PTL and BGTL are wholly owned subsidiaries of Northern Ireland Energy Holdings[1] ("NIEH") and have the same management team but are legally separate companies. PTL became part of the NIEH Group in 2005 while BGTL became part of the group in March 2008 when NIEH acquired the Ballylumford – Torytown Pipeline from Phoenix Natural Gas Limited. The acquisition of both PTL and BGTL were funded by long-term bond finance. NIEH also owns the Moyle electricity interconnector.

To improve the rate at which the SNIP and BGTP could be financed the normal regulatory control over any allowed operational expenditure accrued by both PTL and BGTL has been removed. In other words all of their operational expenditure is pass through thereby reducing the risk to the company and allowing them to achieve a lower rate of finance.

The resulting transfer of risk onto consumers, through potential inefficient operating costs, can be limited through corporate governance licence conditions contained within the conveyance licences held by both PTL and BGTL. One of which is a condition that, in the form of a shadow price control, allows the Utility Regulator to review the level of operating expenditure forecast to be incurred by PTL and BGTL for the next three gas years. This process is a monitoring exercise and does not prevent either PTL or BGTL from recovering their actual costs through their respective licences. Indeed any outperformance by PTL and BGTL is returned to customers. This review has therefore two aims: firstly to provide the PTL and BGTL management with an operating expenditure benchmark and secondly to provide greater transparency of operating costs to the wider public. This condition is an important part of mutualisation due to the pass through nature of the operating expenditure.

The condition in question is Condition 3.1.6 (b) (i) of both the PTL and BGTL Conveyance Licences which states that the Licencee must submit an estimate of its controllable operational expenditure for each of the next three gas years together with an explanation verifying the costs as reasonable estimates. Condition 3.1.6 (b) (i) then permits the Utility Regulator "to verify that such estimates are reasonable estimates".

We have decided to undertake the review of both PTL's and BGTL's controllable operating expenditure jointly and PTL and BGTL have submitted their forecast controllable operational expenditure for gas years 2008/09, 2009/10 and 2010/11 for the operation and maintenance of the SNIP and BGTP pipelines respectively.

[1] NIEH is a company limited by guarantee which has been formed to acquire and hold important energy infrastructure assets

3. Process

The process undertaken in arriving at our minded to decision on the controllable operating expenditure of PTL and BGTL has involved a detailed review of the controllable operational expenditure estimates submitted by PTL and BGTL and then taking a view on what we see as being an appropriate allowance. This review has taken the form of a standard price control in that we have:

(i). benchmarked the PTL and BGTL controllable operating expenditure costs against the operating expenditure of other energy/utility companies;

(ii). made use of engineering consultants to give advice and make comment on the engineering aspects of the PTL and BGTL controllable operating expenditure submissions;

(iii). used actual operating expenditure costs incurred by PTL and BGTL as a benchmark for controllable operating expenditure costs going forward; and

(iv). considered a level of efficiency that we feel is achievable in the business over the next three years.

Following this process we have come to a view on a level of controllable operational expenditure we feel is sufficient to ensure that PTL and BGTL operate their network effectively and safely, while incentivising them to create efficiencies in operating their networks.

One potential significant impact on the operating expenditure of both PTL and BGTL is the proposed implementation of the Common Arrangements for Gas ("CAG") project. For the purposes of this exercise however we have assumed CAG has no effect on the operating expenditure of PTL and BGTL and so our decision for 2010/11 does not include the expected efficiencies CAG will bring and their effect on the PTL and BGTL operating expenditure. For further information on CAG see the Utility Regulator website (www.niaur.gov.uk).

4. Efficiency Factor

As stated in section 3 (iv), as part of our review of both the PTL and BGTL controllable operating expenditure we have considered a level of efficiency that we feel is achievable in the businesses over the next three years. As with any price control, the reason for the inclusion of an efficiency factor is to incentivise PTL and BGTL to continue to improve the efficiency at which they operate their respective networks. We have therefore included an efficiency factor in our decision for gas years 2009/10 and 2010/11 for both PTL and BGTL.

The efficiency factor we have applied is consistent with that used for the Ofgem Distribution Price Control i.e. 1% - an efficiency factor of 2.5% offset by a 1.5% allowance for real price effects. We have applied this to the PTL and BGTL total controllable operating expenditure.

5. PTL Controllable Operating Expenditure Forecasts

The table below shows the PTL forecasts of their controllable operating expenditure for gas year 2008/09 and the following two years:

Table 1: PTL Controllable Operating Expenditure Forecast

	2008/09	2009/10	2010/11
Maintenance	1,382,590	1,947,582	1,207,582
Operations	871,452	865,656	860,024
Administrations	1,527,219	1,521,219	1,521,219
Total Operating Expenditure	3,781,261	4,334,457	3,588,825

The following is a brief explanation of what the above forecasts for maintenance, operations and administrations cost lines cover:

- **<u>Maintenance</u>**

Land Management – this covers the cost of PTL's land liaison officer who acts as the on-the-ground interface between the Scottish land-owners and PTL. This cost line also covers any claims for drainage settlements with farmers.

Annual Engineering Works – this cost line relates to any maintenance, surveying and inspection work on the pipeline, regulators, meters and chromatographs and includes the survey of the offshore pipe every two years (due in 2009/10) via a Remotely Operated Vehicle (ROV) inspection. This ROV inspection accounts for the peak in operating expenditure in 2009/10. The internal pipe is also inspected with an Online inspection tool, “an intelligent pig” (offshore every six years and onshore every ten years). Other engineering work includes inspection and replacement of meters, regulators, the uninterruptible power supplies (UPS), chromatographs, above ground installations (AGIs), security and overhauls of water-baths.

MERC – The maintenance and emergency response contract (MERC) with Scotia Gas Networks which includes emergencies and routine inspections as well as a 24/7 call out and ancillary work such as AGI maintenance.

Engineering Compliance – this cost line covers an engineering audit, safety case review, an Emergency exercise, sub sea hazard analysis and specialised consultant support.

- **<u>Operations</u>**

System Planning – covers the appointment of an external consultant for any network analysis required.

Network Code – costs associated with the Gas Trading Management and Billing System (GTMBS) which (inter alia) records all nominations and allocations and enables shippers to be billed. These costs relate to software licence fees, hosting charges, shipper access costs and system training.

SCADA and Communications – costs relating to the communication routes between the meters and the SNIP agent including any call out charges, telephone line costs and technical support.

SNIP Agent – costs charged by BGE for the commercial and operational running of SNIP including any costs related to the 24 hour control room in Cork.

Software – costs in relation to the maintenance of the SCADA system including any modifications. This cost line also covers costs incurred by PTL for the provision of maps and Geographic Information Systems (GIS) costs.

- **Administration**

Insurance – covers insurance for the physical assets, third party liability insurance and office/staff insurance.

Office Costs – relates to the cost of the Ormeau Road office and any associated costs.

Salary and Associated Costs – the costs associated with the staff remuneration.

NIEH Recharges – any office, staff, audit, accountancy, legal and expenses incurred by NIEH and recharged to PTL.

6. PTL Uncontrollable Operating Expenditure

As with any price control there are costs which PTL and BGTL are considered to have no direct control over. These costs, known as uncontrollable costs will therefore not be subject to review in this process although the Utility Regulator will monitor such costs on an annual basis to ensure they are being efficiently incurred. For PTL these include:

- any costs that relate to the Transportation Agreement between BGE and PTL for Northern Ireland's capacity allocation between Moffat and Twynholm;

- Rates; and

- Utility Regulator Licence Fees.

To give an indication of the magnitude of PTL's uncontrollable operating expenditure the following table sets out their actual uncontrollable operating expenditure for gas years 2006/07 and 2007/08:

Table 2: PTL Uncontrollable Operating Expenditure

	2006/07	2007/08
PTL Uncontrollable Operating Expenditure	4,625,000	4,694,000

7. BGTL Controllable Operating Expenditure Forecasts

The tables below shows the BGTL forecasts of their annual controllable operating expenditure for gas year 2008/09 and the following two years:

Table 3: BGTL Controllable Operating Expenditure Forecast

	2008/09	2009/10	2010/11
Maintenance	871,000	1,131,000	751,000
Operations	55,000	55,000	55,000
Administrations	465,000	465,000	465,000
Total Operating Expenditure	1,391,000	1,651,000	1,271,000

- **<u>Maintenance</u>**

Land Management – relates to the costs associated with the liaison with landowners and payments to landowners to cover land drainage costs.

Annual Engineering Work – costs associated with the maintenance of the meters, boilers, UPS and regulators. Also covers an intelligent pig inspection and ROV of the pipeline as well as health and safety work at the pressure reduction stations. Other engineering work includes security provisions, electricity charges and site inspections.

MERC – contract with Scotia Gas Networks which includes emergencies and routine inspections as well as 24/7 call out and ancillary work.

Engineering Compliance – this cost line covers consultancy support, emergency exercise costs and safety case review costs.

- **<u>Operations</u>**

SCADA and Communications – costs relating to communication between the meters and the SNIP agent.

SNIP Agent – BGTL's proportion of BGE control room costs for the operation of their pipeline.

- **<u>Administration</u>**

Insurance – covers insurance for the physical assets and third party liability insurance.

Office Costs – relates BGTL's proportion of Ormeau Road office costs and any associated costs.

Salary and Associated Costs – the proportion of BGTL costs associated with the staff remuneration.

NIEH Recharges – any office, staff, audit, accountancy, legal and expenses incurred by NIEH and recharged to BGTL.

8. BGTL Uncontrollable Operating Expenditure

As stated in section 6 there are specific costs which are outside of the control of both PTL and BGTL. For BGTL these uncontrollable operating costs include:

- Rates; and
- Utility Regulator Licence Fees

To give an indication of the magnitude of BGTL's uncontrollable costs the following table sets out their forecast uncontrollable operating expenditure for 2008/09:

Table 4: BGTL Uncontrollable Operating Expenditure Forecast

	2008/09
BGTL Uncontrollable Operating Expenditure Forecasts	260,000

9. Utility Regulator Minded To Decision

Following the process set out in section 3, we have come to the following minded to decision on the PTL and BGTL controllable operating expenditure for gas years 2008/09, 2009/10 and 2010/11:

Table 5: PTL Controllable Operating Expenditure – Utility Regulator Minded To Decision

	2008/09	2009/10	2010/11
Maintenance	987,082	1,647,082	747,082
Operations	821,452	810,656	800,024
Administrations	1,291,676	1,370,680	1,310,676
Efficiency Factor	0	-38,284	-56,870
Total Operating Expenditure	**3,100,210**	**3,790,133**	**2,800,912**

Table 6: BGTL Controllable Operating Expenditure – Utility Regulator Minded To Decision

	2008/09	2009/10	2010/11
Maintenance	691,000	851,000	371,000
Operations	55,000	55,000	55,000
Administrations	430,000	430,000	430,000
Efficiency Factor	0	-13,360	-17,034
Total Operating Expenditure	**1,176,000**	**1,322,640**	**838,966**

The most significant reductions made to the PTL and BGTL forecasts are as follows:

- The removal of a number of contingency engineering costs which had been included by PTL and BGTL for work associated with the breakdown and upgrade of equipment. This included costs built into the PTL and BGTL forecasts for repairs, replacements and upgrades. When work had not been identified by PTL and BGTL but instead had simply been included as an unforeseen contingency then this was removed;
- The alignment of MERC call out costs with historic costs as we did not accept the PTL and BGTL proposals that more call outs would be required going forward as equipment got older;
- PTL had included costs associated with a scheduled upgrade of a by-pass in Scotland which required supervision to ensure the SNIP was not at risk. These costs have been removed as we would expect PTL to be able to recover these costs;
- The removal of consultancy costs which PTL and BGTL had included but in our opinion and using our benchmark information these costs were too high based on the work involved; and
- The inclusion of an efficiency factor for 2009/10 and 2010/11 to encourage both PTL and BGTL to continue to achieve efficiencies in the operation of their respective networks.