Power NI Energy Limited
Power Procurement Business (PPB)

Proposed Modification of PTL's Licence To allow Deferral of Capex Allowances

Consultation Paper
14 May 2021

Response by Power NI Energy (PPB)

14 June 2021.

Introduction

PPB welcomes the opportunity to respond to the UR consultation on the proposed modification of Premier Transmission Limited Licence to allow for the Deferral of Capex Allowances.

Comments

PPB fundamentally disagrees with the proposal for a number of reasons.

Firstly, there is a disparity between the statement that the proposal relates to the deferral of unspent capital costs, when these "Capex" costs are treated more like Opex and are sought to be recovered in one year whereas if they were truly Capex costs the standard approach would be for that capital cost to be depreciated over a number of years which would spread the cost over a longer period and reduce the volatility of the annual cost recovery required. Similarly if the cost were Capex, then the fact there is no facility to roll forward under or over recoveries (as per paragraph 2.5) is irrelevant.

The proposal is only in relation to Premier Transmission which would create a disparity relative to the other transmission pipelines operated by GNI (UK). There is no need for any change and a common arrangement should be retained for all the transmission pipelines.

Reconciliation payments have been such that there is always a repayment of the over-collection of revenues in each gas year. There is no interest paid to compensate for the fact that customers have paid more than they should have and are in effect providing free working capital to the TSOs, while the TSOs are benefitting from such over-payments. This arrangement in itself could incentivise ongoing overestimation of tariffs which creates costs for customers. Any proposal to accrue unspent capital costs will only exacerbate the timing disparity for customers.

Finally, our major concern is that customers are being charged for capital projects when they consume gas even though they are not getting any benefit from that capital project. Hence the wrong customers are being charged and the charges are not cost-reflective which we consider is a fundamental principle that must apply. Indeed, given that these are capital projects, and as we note above, these Capex costs should not be appearing in tariffs until each project is complete, the tariff recovery should only reflect the depreciation cost rather than the full capital cost being treated as Opex. In that way consumers who benefit from the expended capital contribute to the cost. Such costs should never be recovered from customers in advance of the completion of the project to ensure customer charges are cost reflective.

Specific Questions

Do Respondents agree that UR should consider ways to reduce the volatility of the Postalisation reconciliation amount?

There is merit in assessing the volatility of the year end postalisation amounts to ensure that such volatility only arises as a result of genuine forecasting errors and not for spurious reasons. As we note above, the fact there is no penalty or interest charge of any kind does not provide any disincentive to setting tariffs such that there is an over-recovery through the year which provides a cashflow benefit for the TSOs and an artificial funding cost for customers. This should be reviewed.

Do Respondents consider that the modification proposed is an effective way to deal with capital projects which get deferred into the following year?

No. Customers should not be paying for assets or facilities that they are not using and for which they are getting no benefit. Capital projects by their nature are for the benefit of customers once the project is complete and the cost should only be recovered from customers from that point onwards when they are "benefitting" from that capital investment. It is also a misnomer to call these capital projects when they appear to be fully "expensed" as though they were Opex in the year without recovery being spread over the life of the capital project, For example in relation to the bi-annual seabed survey, it would be more appropriate for the cost to be recovered over a 2 year period.

Charging customers for capital projects that are not complete and for which they may not receive any benefit (e.g. if they cease or reduce their gas consumption in the following year) does not satisfy any cost reflectivity test and hence we are surprised that the UR are even contemplating such a proposal given it would not be protecting the interests of consumers as regards the price of the service that would include costs that are unrelated to the cost of providing services to them in that year.

Do Respondents agree that the roll forward of the underspent forecast amounts should be limited to one year?

We do not believe any roll forward is warranted given it would result in tariff charges that are not cost-reflective.

Do Respondents have any further views on how the volatility of the year end reconciliation amount can be managed?

As already noted, the focus should be on ensuring tariffs are set more accurately and that there is a disincentive to the TSOs deriving and setting higher than necessary tariffs. Such an outcome provides a cashflow benefit at zero cost but which results in year-end reconciliation payments.

One would expect that if it was merely due to forecasting errors, there would be an equal probability of the reconciliation required being a rebate to customers or an additional charge to customers. However, it is clear from Table 4 that there is always a substantial surplus generated through each tariff year that is then not repaid until c 3 months after year-end and without any compensation to customers for their early, and unnecessary, payments.

The approach of effectively treating Capital project costs as Opex also results in non cost-reflective cost recovery from the customers benefiting from that Capex. This should be assessed to ensure the recovery of Capex costs is appropriately allocated (and hence recovered) through the depreciation policies. This may also help smooth out the revenues to be recovered and could reduce hence reduce volatility in the reconciliation amounts.

We consider that these actions would help manage and mitigate volatility.