# Consultation Paper

**OFREG and DETI proposals for the implementation and operation of a postalised tariff system for the Northern Ireland natural gas transmission network.**

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**PROPOSALS FOR THE IMPLEMENTATION AND OPERATION OF A POSTALISATION SYSTEM FOR TRANSMISSION TARIFFS IN NORTHERN IRELAND.**

**Section one: Executive Summary**

This paper sets out the Department of Enterprise, Trade and Investment (DETI) and the Office for the Regulation of Electricity and Gas (Ofreg) joint proposals for taking forward the implementation of a postalised charging system for the natural gas transmission network in Northern Ireland. With Bord Gais Eireann progressing their planned Northwest pipeline and proposed energy legislation likely to be enacted shortly, we feel that it is now an appropriate time to produce for consultation a set of initial proposals on how a postalised system should be set up and operated.

This paper addresses the high level principles behind a successful postalised charging system and it is not our intention for this paper to be inclusive of all the issues and detail; more work and consultation will be required next year. The proposals described in this paper flow from a series of discussions between Ofreg, DETI and the three existing gas conveyance licensees – Premier Transmission, Phoenix Natural Gas and Bord Gais Eireann - in the forum of the Gas Market Development Group - and reflects the ideas put forward and principles established in these discussions.

The possibility of implementing postalisation through an incremental approach was raised in the Gas Market Development Group discussions. Ofreg and DETI take the view that this approach is likely to be appropriate only if the initial transfer of costs from gas to electricity customers can be offset through creating other system cost reductions. We remain open to this possibility and discussions are still ongoing to identify such cost reductions. We believe the framework for postalisation suggested in this paper can apply irrespective of early postalisation or postalisation once the Northwest pipeline is operational. Also we believe that these proposals are broadly capable of dealing with the integration of the South-North pipeline.

A fundamental element of postalisation is the payment mechanism between shippers and the transmission operators (TOs). The options for this and issues relating to the structure of tariffs, over and under recovery and other tariff issues are discussed in section three of this paper. The paper proposes an exit point payment system with shippers paying exit charges to the operator from whose system they exit the postalised network.

The operation of a postalised tariff system will require a designated person to calculate tariffs and amounts due to the TOs in accordance with their required revenues as generated by their respective licences. This role, described as the Postalisation System Administrator (PSA), may be combined with other functions under postalisation. This paper looks at the possible functions of the PSA, its relationships with the TOs, the legal framework applicable to it, and who might perform this role.

Under any proposed postalised system it is important that all the parties have confidence in the security of the collection of revenue which underpins infrastructure investment. Ofreg/DETI believe the system discussed in this paper, based on ship-or-pay commitments from the two power stations and an increasing element of capacity charging, provides adequate security for both transmission operators and shippers.

Section four of the paper explores a possible combined operational regime for the NI transmission network following the completion of BGE's Northwest pipeline. We firmly believe that it is in all parties' interests to pursue an operational regime that minimises costs and complexities, while at the same time allows the TOs to operate their pipelines in a reasonable and efficient way. The transmission operators are currently engaged in talks amongst themselves on the best way to combine the three operational regimes and are due to report to us on their proposals by the end of January.

**Responses to this consultation paper should arrive no later than 31 January 2003.**

**Section two: Introduction**

The proposed completion of the Northwest pipeline by Bord Gais Eireann, due in 4th Quarter 2004, will extend the Northern Ireland natural gas transmission pipeline network and create opportunities for the supply of natural gas to new customers in the Northwest of the Province. Since the Assembly/Executive approved the concept of a system of postalised charges for the use of the NI transmission network (in Sept 01), where the transportation charges are the same along the network irrespective of distance, DETI and Ofreg have been working in close collaboration with the three transmission operators:- Phoenix (PNG), Premier Transmission (PTL), and Bord Gais Eireann (BGE) to develop the mechanisms for the successful implementation of a postalised transmission charging system for NI.

This purpose of this paper is to set out DETI/Ofreg's joint initial views on how postalisation should be implemented and the best way to operate a postalised charging system, and to invite comments from all interested parties on our suggestions. The proposals described in this paper are strongly based upon our discussions with the three transmission operators – in the forum of the Gas Market Development Group (GMDG)- and reflect the ideas raised and principles established in these detailed discussions. We would like to acknowledge the effort and positive attitude towards successful implementation of postalisation displayed by all three operators in these discussions.

This paper examines the major principles which need to be decided upon for the establishment and operation of a postalised charging system. We are aware that there is still a significant amount of detail and issues that are not contained in our proposals and we plan, following the end of the consultation period for this paper, to undertake more analysis and a series of further detailed consultations to finalise the postalised system in agreement with all interested parties. The adoption of proposed energy legislation will help to facilitate the implementation of the postalised system by providing a legal framework for establishing postalisation.

The initial thinking was for postalisation to be implemented from the date on which gas started to flow to the Northwest. However an alternative approach would be for postalisation to begin for the full extent of the network as it exists on the date on which the full arrangements are agreed and finalised. This would mean that the postalised tariff would apply initially to the Phoenix-PTL network, would subsequently apply to the Phoenix-PTL-Northwest pipeline network, and then next to the entire Phoenix-PTL-BGE (Northern Ireland) network. The principal benefit of this incremental approach is that it would allow the arrangements to be tested early and any problems with them to be resolved and for the system to become more sophisticated over time. This approach of starting simple and adding layers of complexity as all the players move up on their learning curves has been applied by Ofreg to each stage of electricity market development.

However this incremental approach creates a potential difficulty in that in the period before the completion of the Northwest pipeline, postalisation would result in a clear transfer of costs from gas to electricity consumers (as Ballylumford power station will now be paying a proportion of Phoenix transmission costs). It is currently Ofreg's and DETI's view that unless there are some offsetting cost reductions for electricity consumers to coincide with early postalisation such an approach cannot be supported. Although there are merits in an incremental approach to postalisation and we remain open to the possibility, unless potential offsetting cost reductions come to fruition, postalisation is planned to start when gas starts to flow to the Northwest.

**Section three: Payment mechanism, financial and common tariff issues**

3(a) Payment mechanism

Under a postalised system there are two options for the charging mechanism under which transporters will collect revenue from shippers: an entry point mechanism with shippers paying for volumes/capacity at the entry points to the postalised network; or an exit point system with shippers paying exit charges to the relevant TO from whose pipeline that shipper exits the postalised network (that shipper's "primary transporter"). We propose an exit point mechanism. Basically, each TO will collect payments from those shippers who exit the NI postalised transmission network from its own pipeline. It will not receive payments from shippers who are transiting gas through its pipeline for subsequent use further downstream.

We believe that an exit point payment mechanism is the simplest way of organising the postalisation payment system. The main advantage is that it is consistent with an operational regime where each TO remains responsible in operational and contractual terms for its own pipeline. Under the standard conditions for conveyance licences the contractual arrangements for the conveyance of gas are required to be set out in a Network Code, which governs the transportation service for which shippers pay transportation charges. Under the operational system discussed in Section 4, each shipper will only have to sign up to his primary transporter's Network Code. This means that under postalisation the payment should be between each shipper and his primary transporter. Therefore this system supports an exit point revenue collection mechanism and measurement of system capacity at exit points. Each TO will be collecting revenue from shippers that exit the network from his pipeline. Basically the system will work as: PTL collecting the revenue from Ballylumford powerstation; Phoenix the revenue from the Belfast downstream market, and BGE the Northwest revenue.

An additional advantage of this proposal is that it makes it easier for the future integration of the South-North pipeline in the postalised system, whereas a revenue collection system based at the SNIP entry point would need significant adaptation following the completion of the second entry point.

For all parties to have confidence in such a payment mechanism it will be necessary for there to be a satisfactory dispute resolution mechanism.

3(b) Assets and costs to be postalised

(i) Transmission costs

It is proposed that the gas transmission costs to be placed into the postalised system and recovered through the common tariffs will be those relating to: PTL's Scotland to Northern Ireland pipeline (SNIP) asset; Phoenix's complete transmission asset; and for BGE both the Northwest pipeline and South-North pipeline. It is envisaged that the South-North costs will be included following completion of that pipeline, although there would be the option of including South-North costs into the postalised tariff at the same time as the North-West pipeline in order to help smooth fluctuations in the tariffs over the early years. The calculation of each transmission operator's costs will be based upon its licence formulae.

(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, in respect of which a distribution licence is awarded, the cost of the distribution spur bringing gas to within 5 km of each such town will be postalised. Therefore these costs will also be included in the postalisation calculations.

(iii) Irish Inter-connector (IC) Cost Treatment

Ofreg/DETI support the principle that all NI consumers shall pay the same transmission charges irrespective of where the gas is delivered from. Therefore 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 other entry points (e.g. through the Irish-Interconnector and up through the South-North pipeline). Analysis will be required to develop a mechanism for IC costs inclusion in the postalised system; we intend to leave this work until closer to the date of the South-North completion. In the future there may also further entry points that the postalised system may need to make provision for.

(iv) Cost of operating the postalisation system

Any justified cost associated with operating the Postalisation System Administrator (PSA) function and the postalised system, shall also be included into the postalised tariffs.

3(c) Converting the total postalised costs into tariffs

(i) Capacity/commodity split

Table one shows our proposal on the capacity/commodity proportions to be applied in calculating the postalised tariffs:

*Table one: Capacity-Commodity Split*

| ***Year*** | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | After 2011 |
|---|---|---|---|---|---|---|---|---|---|
| ***Split*** | 25:75 | 25:75 | 25:75 | 25:75 | 50:50 | 50:50 | 50:50 | 75:25 | 75:25 |

This is the current agreed profile under the PTL licence with a further increase in the capacity proportion from 2011 onwards. If postalisation is implemented before 1 October 2004 the current PTL profile will apply.

We propose that the postalisation year would run from 1 0ctober to 30 September, the same as the gas year. Work will be required to co-ordinate the current operators' licence years with this period.

A key factor behind our proposals is the need for a high level of revenue security. In the absence of any volume related ship-or-pay arrangements, capacity charging provides more secure revenue flows into the system than commodity based tariffs. With the current Ballylumford powerstation ship or pay contract (SoP) ending in 2011, we feel that the capacity element needs to be increased to 75% to coincide with the termination of that contract. The revenue security should remain high due to the remaining SoP from ESB/ESBII[1] for the Northwest pipeline and the proposed higher capacity proportion of charges. We think we would have difficulty in justifying a higher capacity proportion from that date since the 75-25 ratio is a fair reflection of the long term split in the postalisation cost base between fixed and variable costs.

In determining the capacity-commodity split for the period up to 2011, it is necessary to balance a number of competing factors. A high commodity proportion would support the early development of town distribution and the SoP from Ballylumford will offer security in respect of commodity charges up to its expiry. However there are also good arguments supporting capacity charges; these are the need to encourage efficient capacity bookings by shippers and to minimise possible volume determined over or under recoveries (although we do accept that volume based SoPs create a cap for under-recoveries). We believe our proposed profile strikes the right balance

[1] **Electricity Supply Board (ESB)/Electricity Supply Board International Investments (ESBII)**

between these factors. Also, as it is an extension of the current PTL charging profile, the current shippers and consumers have been aware of this profile for some time and have already factored it into their cost analysis.

However we are conscious of the need to support the development of town gas systems and are keen to hear responses on whether our proposed capacity-commodity profile is appropriate for Northern Ireland. Even within our proposed profile there are options to provide assistance to towns, either through introducing a monthly capacity booking regime that will allow shippers to profile their level of capacity booking over the year, or introducing a holiday from capacity charges for new distribution networks. We also welcome views on these options.

3(d) Duration for setting the postalised tariff.

With a high commodity proportion of the charges in the early years we see merit in limiting the tariff duration to one year. Therefore each year, total postalisation costs will be divided up based upon forecast volumes and capacity booked for that year. We consider it to be beneficial to also publish indicative tariffs for the following five years when announcing the annual postalised tariffs.

3(e) Determining usage for tariff calculation

*Forecast Volumes and Costs*

Each transmission operator will be required to submit the forecast volume for each of its shippers along with the assumptions and methodology behind such forecasts. There may be a need for a mechanism that enables TOs to request shipper's own forecasts in this process. Ofreg or the PSA under Ofreg supervision will then in turn verify these forecasts before the tariffs are calculated. There should be a reasonable degree of certainty over the volume forecasts – generation needs will be well established and the distribution volumes are discussed as part of price control processes. Ofreg will also inform the PSA of the forecast total system postalisation costs for the year.

*Capacity Bookings*

The definition/measurement of the level for capacity booking by Northern Ireland customers is dependent upon the discussions on which operational regime is appropriate for the three networks. We propose that booked capacity is measured at exit points and hence each shipper pays for the level of capacity booked at the point where he exits from the whole NI system.

3(f) In-year revenue transfers between the Transmission Operators

The proposed exit point mechanism for collection of revenues will create significant variations between each TO's cash flows and their respective licence determined annual required revenue, creating the need for a revenue reconciliation process between the operators. Delaying this process to the end of the postalisation year may expose certain operators to difficulties in matching loan repayments to revenues and possible credit risk between the operators. Therefore we suggest an in-year, probably six-monthly, re-allocation of revenues between the operators. This re-allocation mechanism should be based under a simple and transparent formula managed by the Postalisation System Administrator (PSA). To minimise the credit risk associated with transfers between the TOs, we recognise that a proportion of revenues may need to be adequately ring-fenced within the TOs.

3(g) Dealing with under/over recoveries

Calculating tariffs based upon forecast volume creates the possibility of under or over recovery of the total costs during the year. Also possible changes to the total postalisation system costs during the year will lead to under/over-recoveries. The extent of these under/over recoveries is minimised through capacity charging and the volume based ship-or-pay commitments providing a floor to actual volumes.

There are two approaches to deal with these: an end-of-year reconciliation or carrying forward the deficit/surplus into the following year. An end-of-year reconciliation through a bullet payment/rebate to shippers is better for the TOs as it means full recovery of costs in-year. Also it eases the calculation of the following year tariffs. Hence we propose a system with end of year bullet payments to rectify any difference between actual and forecast volumes.

When total actual volumes differ from total forecast volumes for a given postalisation year[2], this end of year reconciliation will be required. This reconciliation will calculate an annual out-turn required payment for each shipper to reflect any tariff revisions due to total volume out-turns differing from forecasts (including any ship-or-pay floor as required). Any difference between this adjusted annual required payment and the sum of that shipper's monthly payments for that year will be passed on to that shipper. To pre-warn shippers of the probable magnitude of the

[2] **And also when total system costs differ from forecast over the postalised year.**

reconciliation payments at the end of the year, total actual volumes figures should be circulated every quarter.

We feel that it is a fair principle that shippers pay their proportion of system costs based upon their actual volumes. Under/Over recoveries should not be targeted to individual shippers whose actual volumes differed from forecast. Under this system the TOs will not be exposed to all volume risk associated with their exiting shippers.

Furthermore, we propose that where a SoP commitment is linked to the postalised tariff, that commitment should reflect the minimum guaranteed volumes at actual out-turn adjusted tariffs, not at the forecast tariff generated at the start of the year.

**When an under-recovery is caused by differences between actual volumes/costs and forecasts, that under-recovery will be passed through to all shippers at an end of year reconciliation process. The TOs will not be exposed to any volume risk under this system.**

It is possible that another type of under-recovery could arise over the postalisation year, caused by delay in payment or dispute over volumes between the shipper and its primary transporter. Such an under-recovery may remain un-rectified by the end of the yearly reconciliation process. For such an under-recovery we propose that the relevant primary transporter remains responsible for collecting this revenue shortfall, since that TO has the direct payment relationship with that shipper. Therefore each TO will bear all the credit risk associated with the shippers who exited the network from its pipeline. Under this system such an under-recovery is deemed as being temporary in the sense that the shortfall in payment will be or should be forthcoming in the short term. Hence if a payment is in dispute or delayed, the PSA for the purposes of calculating the appropriate levels of revenue transfers between the TOs will deem that the relevant TO has received the disputed/delayed payment. As stated above, it will be that TO's responsibility to recover the disputed revenue from its exiting shipper. This mechanism preserves the underlying contractual and commercial relationship, and other operators are not exposed to disputes with shippers that they have no formal contractual relationship with.

Similarly, failure by a shipper to honour its ship or pay commitments will be treated in the same way so that the PSA will deem the relevant transporter to have payments to which it was entitled. It seems reasonable that the responsibility for collecting committed payments under ship-or-pay agreements remains with the transporter who is party to that contract and that the other transporters aren't exposed to this risk.

It is appropriate for all TO's to have a common published credit policy, included in their Network Codes, to ensure fair treatment of all shippers.

**When a under-recovery has been created by a payment dispute, delayed payment or other problems in collecting payment through shippers including a shipper's failure to honour its contractual commitments, then such an under-recovery will be the exposure solely of that shipper's primary transporter. Under this system, each TOs will take the credit risk associated with their exiting shippers**.

3(h) Ship or Pay arrangements and system financial security.

Secure recovery of the total system costs under postalisation will be ensured by the ship-or-pay arrangements (SoP) from the two power stations which are the major system users and also the capacity proportion of charges. This should give each of the transmission operators sufficient confidence that costs will be recovered and that there is no loss in value to its investment.

Through postalisation, total costs of the Northern Ireland transmission system are spread across the four groups of gas consumers; ESBII, Phoenix, Premier Power and Extension towns (plus any other major future users). All consumers will, as a collective unit, be exposed to the total postalised costs. The inability of one of these consumers to contribute to the cost recovery will result in transfer of costs onto the remaining consumer groups. However the SoPs from the power stations will lessen the potential impact on the other groups.

With ESBII building a new merchant power station, other parties may have some uncertainty about the financial contribution of ESBII to the system. We believe that the contract agreed between ESB, ESBII and BGE fulfils BGE's licence requirement to provide evidence of a satisfactory contract underwriting the cost of the Northwest pipeline. Since it is calculated to cover the full recovery of the annual costs of the Northwest pipeline over a 20-year period, this contract provides sufficient protection to the other consumer groups.

If ESBII suffers a substantial loss of load before the completion of the South-North, the costs of the Northwest pipeline will be fully covered by the SoP; other customers will continue to pay for the costs of the remaining infrastructure, as in aggregate they currently do. If ESBII experiences difficulties after South-North completion the costs of the Northwest will again be recovered through the ESBII's SoP, and the remaining system costs will pass through onto all consumers.[3]

[3] **If a power station experiences difficulties in year causing a shortfall in actual volumes compared to forecasts then the end-of-year reconciliation mechanism described in section 3(g) will work to pass the remaining (net of receipts from that station including any SoP commitment) total system costs onto the other customers.**

We support this because the South-North replaces the need for compression on SNIP and therefore the costs to customers associated with that compression were South-North not to be built.

Under Ballylumford's Ship-or-Pay the costs of the SNIP are guaranteed up to Oct 2011. There is a potential risk to the system after this date; however the proposed capacity proportion of charges (75%) should provide sufficient protection.

Some transmission operators have raised the scenario of a power station defaulting on its ship-or-pay commitments. With both the ship-or-pay commitments underwritten by secure companies we see this possibility as very, very remote. However as stated before, the operator who is the counterparty to the ship-or-pay contract will be separately exposed to this risk and will remain responsible for rectifying any shortfall in ship-or-pay payments. When redistributing the collected revenue to reconcile payments with the TO's required revenue, the PSA will deem that transporter[4] to have received the shortfall.

There is a technical issue around how the Ballylumford ship-or-pay agreement should be integrated into the postalisation calculations, which we need to discuss separately with the relevant parties. We want to ensure that the value of the minimum payment guarantee from Ballylumford isn't adversely affected under postalisation.

3(i) The payment chain and the role of a Postalisation System Administrator

We have already identified some of the role and functions of the Postalisation System Administrator (PSA) in earlier parts of the paper. This section expands on this and explores some of the issues surrounding the establishment and operation of the PSA.

**What will be the functions of the PSA?**

The initial functions of the PSA can be divided into three areas (there is the possibility that as the postalised system matures over time it would become appropriate to allocate extra functions to the PSA):

[4] **The level of credit that which each shipper has to provide when signing onto the Network Code of a TO should provide some comfort and financial breathing space for that transporter.**

**Tariff determination**

The PSA role in the tariff determination is essentially mechanistic; it will co-ordinate the collection of the volume forecasts and the capacity bookings from the TOs. In conjunction with Ofreg, the PSA will calculate the postalised tariffs for the following year. Ofreg will have the final decision over the setting of the postalised tariffs (through approving or adjusting the volume forecasts and total postalised costs). The volume of work required from the PSA here should not be substantial as the relevant formulae shall all be in place.

**Shipper End-of Year Reconciliation**

Annex 1 sets out a proposed process for revenue collection and end of year reconciliation in more detail. Once actual out-turn volumes for the postalisation year have been identified, the transmission operators will submit these to the PSA. The PSA, with Ofreg's approval, then re-calculates each exit shipper's required payment and notifies the relevant TO of the necessary end-of-year payment/rebate for the shippers exiting its system. We envisage that shippers will be exposed to this payment by the end of the first month in the next postalisation year.

**TOs Revenue Redistribution**

Following this reconciliation process, the PSA can calculate the amount that each of the transmission operators should have received from shippers ('Deemed Shipper Receipts') and by how much these payments differ from their required revenue. The function of the PSA here is to reconcile these differences through calculating the necessary revenue transfers between the operators. The PSA will ensure that this process is consistent with the in-year transfers of revenues between the TOs.

One option is that these revenue transfers will be passed to the PSA who would re-direct them to the relevant operators. Alternatively, the PSA could identify the amounts and the TOs could carry out the necessary transfers directly between themselves. The latter option is the most simple and efficient method as long as the proper procedures are in place to ensure that the PSA determinations are acted upon.

It is vital there is mutual trust and confidence between the PSA, Ofreg, shippers and the individual transmission operators. At each stage, Ofreg/DETI would see the processes being conducted in an open and transparent manner so that all parties have access to the information used to derive the tariff calculation, the end of year reconciliations, and the required revenue transfers between the TOs.

**Who will become the PSA?**

The possibilities are:

- One of the three Transmission Operators takes on the PSA role. That function will be ring-fenced within that operator to ensure no possible conflict of interests.

- The three TOs form an independent body to carry out the PSA functions.

- The TOs, in consultation with and subject to the approval of Ofreg, appoint an agent (such as an accounting firm) to carry out the PSA functions under contract.

From our preliminary discussions with the TOs, they have indicated that they favour the third option as it is seems to be the most cost efficient way. The TOs believe that the PSA role is a straightforward administrative function and should not be subject to significant liabilities in its performance, particularly if the PSA does not receive and hold monies. Whether such an option is acceptable depends upon how deep the functions of the PSA become and hence the necessary level of regulatory control and legal support needed. Ofreg/DETI recognises that each option offers advantages and disadvantages and would welcome comments on the perceived best option.

**Under what legal control will the PSA operate?**

As mentioned above, it is not yet clear what legal framework will be appropriate for the PSA. A separate licence for the PSA function will be possible under the proposed energy legislation which enables the granting of a licence for activities associated with the conveyance of gas. If the PSA role were to be performed by an existing licensee it could be subject to specific conditions under that licence. Alternatively, if the PSA role is contracted to a third party, control could be exercised indirectly through provisions in each contracting TO's licence.

To summarise, the functions of the PSA that need to be regulated are:

Collection of volume forecasts and levels of capacity bookings

- Calculation of the postalisation tariffs through application of the prescribed formula

- Implementation of the formula for calculation of the end-of-year reconciliation payments

- Implementation of the formula for calculation of the in–year TO transfers

- Monitoring of the terms and process for the revenue transfers

The establishment of the PSA will also require modifications to all the transmission operators' licences to define the relationship between the TOs and between the PSA and each of the TOs. Such conditions could be:

- Requirement to notify the PSA of forecast volumes and capacity bookings
- Requirement to notify the PSA of end of year actual volumes
- Requirement to keep postalised revenues or a proportion of same in a ring-fenced account
- Requirement to transfer to other TOs the amount of revenue determined by the PSA.

We favour inserting a common standard condition into all the operators' licences, to cover these new functions and relationships.

**Section four: Combined operational system for the three pipelines**

It is true that the development of a postalised tariff system can theoretically happen independently to the development of a combined operational arrangement for the three pipelines. However, since the operational regime will influence the revenue collection system for postalisation, we believe that it is important that the operational regime for NI is designed in parallel with the implementation of postalisation.

With this in mind, Ofreg/DETI asked the three transporters to hold discussions amongst themselves with the aim to develop an agreed proposal for the NI transmission operational regime following the completion of BGE's North-West pipeline. The transporters plan to report back to Ofreg/DETI with their proposals by January 2003. All the parties have agreed that the combined operational regime must honour the following principles:

- 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.

The operational discussions seem to be moving towards an Inter-TO arrangement for the postalised network. Our understanding of how such a system will work is that each operator will have responsibility for the operation of his own pipeline and the inter-operability of the system will be governed through bi-lateral operator to operator agreements. Shippers are required only to have a direct commercial relationship (through a Network Code) with the operator who operates that shipper's exit point, his primary transporter. Therefore as regards nominations and capacity bookings each shipper has to deal only with his primary transporter and is simply required to

balance his input into Moffat with his output at his exit point. We understand that BGE will act as a transit shipper on the BTP and SNIP on behalf of the Northwest shippers/customers.

Although this proposed outline for the NI operational system has yet to be agreed among the TOs, it seems to us to be a sensible and workable solution. It ensures that the system doesn't create too much contractual complexity for shippers and minimises the disruption to the current system. One possible alternative to this type of operational regime is for a single operator for the whole network. Potential benefits of such a regime included simplicity of operations for shippers, however such a regime could result in uncertainty in who has responsibility over liabilities and require drafting of detailed legal contracts governing the relationship between the single operator and the three pipeline owners. Such contracts are likely to be costly and time-consuming to develop and finalise.

This section has traced the broad framework of the probable operational regime for the postalised network, subject to the agreement of the relevant parties. However there are a lot of issues and details that need to be discussed and analysed, for example pressure guarantees, liabilities and the provisions for transiting shippers. The transmission operators are currently working on these issues and as mentioned above plan to submit their operational regime proposals to Ofreg/DETI during next January. Following receipt of these proposals we envisage that there will be a wide ranging consultation with all interested parties (e.g. shippers and consumers). Some of the issues that we wish to raise in these discussions are:

**How and where will the inflows and outflows be balanced across the network?**

Annex two shows the NI gas transmission network following the commission of the Northwest pipeline. We would anticipate that following completion of the North-West pipeline there will be two balancing regimes- firstly gas is balanced across the joint PTL-Phoenix system and then a separate balancing regime will apply on the Northwest. Hence in Annex 2, gas flows into Moffat are balanced with the outflows at the three exit points: EP1 (Ballylumford); EP2 (Carrickfergus) and EP3 (Phoenix). For the Northwest gas will be balanced between the inflow at EP2 and the exit points along that pipe.

**The commercial contracts with the shippers should be uniform across the system**

With each operator remaining separate and responsible for its own pipeline, it is possible that each operator would have his own Network Code. A shipper will only have to sign up to the network code for the pipeline he exits from. We strongly feel that the terms of these separate network codes should be very similar if not identical. With all NI gas flowing through Moffat and therefore subject to the Moffat Agency Arrangement plus with BGE becoming a shipper on both

the SNIP and Phoenix network there needs to be continuity between the three possible Codes with regard to operational rules. We feel there should be consistency between all terms of the network codes. We see all parties working towards a common set of terms for the network code and these terms will be kept under review and modified on a collective basis. With the PTL Code already operational and familiar to the NI shippers, we suggest that it forms the basis of discussions towards moving to a common Code.

**Under what terms will BGE act as a shipper on both the PTL and Phoenix networks?**

As a shipper on the PTL and Phoenix pipelines, BGE will have to be treated the same as other shippers except where differences are objectively justifiable.

In section 3 of this paper we propose that customers will pay the tariffs on exiting from the network - customers will pay for their exit capacity and exit volumes. This proposal is based upon the inter-TO operational regime proposal outlined in this section. Under our suggested exit point payment mechanism, shippers pay the postalised tariffs when they exit from the transmission network. Hence BGE as shipper who is transiting gas through the PTL-PNG network will not have to pay any postalised tariff for exiting at EP2. How BGE and other possible Northwest shippers are treated with respect to Network Code system charges (e.g. balancing/scheduling charges) as transit shippers on the PTL-PNG pipelines needs to be discussed.

**Would this suggested system create pancaking of operational rules?**

Gas destined for the Northwest could possibly be subject to three separate Codes, which in turn may create pancaking of operational rules. This would be unfair to consumers on the BGE network and we are keen to prevent any such pancaking. We are keen to explore a system along the lines similar to the operational business rules being developed by Gas Transmission Europe (GTE) and the European Association for the Streamlining of Energy Exchange-gas (EASEE) for increased interoperability between connected systems in Europe.

**Possible problem for any shipper who operates on both the PTL and BGE system.**

One of the advantages of this proposal is that each shipper needs only to have a relationship with the operator he exits from thereby alleviating the concern about entering into multiple commercial contracts. However under this inter-TO regime, any shipper who exits from two pipelines (i.e. a supplier who may be supplying gas to the Greater Belfast market and also to a gas extension town in the Northwest), will have to sign up to two Codes. Although we expressed our view that the Codes must be uniform, this could potentially add unnecessary costs and a level of complexity to that shipper.

**The bi-lateral operator-to—operator agreements should be based upon standardised templates**

Standardisation of Network Codes will help the inter-operability and the simplicity of the NI network. It is also important that the bi-lateral arrangements between the TOs governing the interface also ensure proper network integration. We believe that such bi-lateral agreements should as far as possible be in a standardised form across the NI network - we cannot see why the rules governing the interface arrangements should differ significantly at different points in the network. There has been strong support expressed recently in the European Commission for harmonisation of operational and commercial terms across pipelines which should be reflected in the planned NI set-up.

**Section five: Way forward_**

This consultation paper is among the initial steps of the process of designing and implementing a practical postalisation charging system for the NI natural gas transmission network. It opens out for discussion a package of proposals from Ofreg/DETI on the main principles underpinning a postalisation system. It is not the purpose of this paper to provide all the answers and necessary detail, more analysis and discussions will be required.

Following receipt of the comments on this consultation paper, we intend to accelerate the necessary work to finalise the design of the NI postalisation system. This will involve further consultation with all interested parties on more specific issues. Some main parts of this work are:

On the financial aspect of postalisation:

ensuring that all transporters' licence formulae are consistent with postalisation

establishing the Postalisation System Administrator

drafting Licence modifications to introduce the concept of postalisation

On the operational aspect of postalisation:

discussing the transporters' proposals on the combined operational regime

drafting necessary modifications to the transporter's Network Codes

producing the bi-lateral transporter arrangements

We envisage that the bulk of this work will be done over the first six months of next year.

**Section six: 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 following issues proposed in this paper:

Capacity-commodity charging profile for the postalised tariff.

The financial security provisions underlying the payment mechanism.

The duration of the postalised tariffs being fixed for one year

The exit point payment regime.

Operational regime where each operator remains responsible for its own pipeline.

Responses should arrive no later than Friday 31 January 2003 and be addressed to:

Eamon Corrigan
Ofreg
Brookmount Buildings
Fountain Street
Belfast
BT1 5EE
eamon.corrigan@ofregni.gov.uk

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.

**Annex 1 – annual timetable for calculation of postalised tariff**

| *Year* | *Month* | *Action* |
|---|---|---|
| Base Calendar Year:- (existing pre-postalisation tariff regimes in place) | Jan | |
| | Feb | |
| | Mar | TOs seek indication of future capacity requirements from shippers. |
| | April | Capacity bookings taken by TOs for PP1. |
| | May | Volume forecasts for PP1 given by TOs to PSA and Ofreg.<br>Ofreg to verify volume forecasts as reasonable. |
| | June | Ofreg to confirm to PSA each of the TOs revenue requirements for PP1. |
| | July | Final capacity bookings confirmed by TOs to PSA and Ofreg. |
| | Aug | Tariff for PP1 calculated by PSA and confirmed by Ofreg. |
| | Sep | (first week) – PP1 tariff confirmed by PSA to TOs and shippers and made public. |
| Start of first postalisation period (PP1).<br>Each TO collects monthly payments from shippers. | 1st Oct | New PP1 (first postalised) tariff begins to be charged. |
| | Nov | |
| | Dec | |
| | Jan | Actual quarterly volumes circulated to shippers. |
| | Feb | |
| | Mar | TOs seek indication of future capacity requirements from shippers. |
| | April | Actual quarterly volumes circulated to shippers.<br>PSA collects six-monthly volumes and calculates in year TO transfers using agreed formula.<br>Capacity bookings taken by TOs for PP2. |
| | May | Volume forecasts for PP2 given by TOs to PSA and Ofreg.<br>Ofreg to verify volume forecasts as reasonable. |
| | June | Ofreg to confirm to PSA each of the TOs revenue requirements for PP2. |
| | July | Actual quarterly volumes circulated to shippers.<br>Final capacity bookings confirmed by TOs to PSA and Ofreg. |
| | Aug | Tariff for PP2 calculated by PSA and confirmed by Ofreg. |

| *Year* | *Month* | *Action* |
|---|---|---|
| | Sep | (first week) – PP2 tariff confirmed by PSA to TOs and shippers. |
| Start of postalisation period 2 | Oct | New PP2 (2nd postalised) tariff begins to be charged. |
| | | End of year PP1 adjustments calculated based on actual volumes and SoPs - any resulting bullet payments/rebates arranged at end of month. |
| | Nov | Net revenue transfers for PP1 completed. |
| | Dec | |

The table above maps out broadly how the first and start of the second postalised periods could unfold. We appreciate that this is broad brush at present and there is work needed with all relevant parties to progress the detail of how a postalised year would unfold and to ensure that the year integrates effectively with the relevant operational/network code activities.

We suggest that annual postalisation periods should coincide with gas years and the postalised tariffs would come in to play on the 1st October therefore each year.

TOs have initial roles to ascertain capacity bookings and volume estimates for use in the postalisation tariff calculation – as well of course for their own use in pipeline operation. This information is passed to PSA and Ofreg for verification and tariff calculation. The postalisation tariffs would then be calculated with the goal being to inform parties of the proposed tariff one month in advance of the relevant gas year/postalised period. At the end of the postalised period/gas year, the annual reconciliation necessary to distribute revenues between the TOs would then be undertaken based on their required revenues.

Annex 2: Proposed Northern Ireland Gas Transmission Network before South - North