

**Responses to Ofreg/DETI consultation paper on proposals for the implementation and operation of a postalised tariff system for the Northern Ireland natural gas transmission network.**

**February 03**

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## 1. Bord Gais Eireann's Response

### **RE: BGE comments on consultation paper entitled OFREG and DETI proposals for the implementation and operation of a postalised tariff system for the Northern Ireland natural gas transmission network**

BGE is supportive of the OFREG and DETI approach to the development of a postalised tariff system and the framework presented in the December 2002 consultation paper. We are in agreement with the approach and most of the proposals in the paper, consequently we have attempted in this letter only to illustrate the points where we feel clarification may be required. We have also endeavoured to answer some of the questions raised by OFREG and DETI in the paper. In the main, we find the paper well presented and reasonable.

Section 3: Payment mechanism, financial and common tariff issues.

#### 3(a) Payment Mechanism

Adopting the exit point based system including an exit point payment mechanism will clearly allow the future inclusion of the South-North Pipeline. An entry point based system would clearly require significant modification after completion of the South-North Pipeline, and indeed may lead to an unduly complex system at that time. BGE feels that it is in the interest of all parties to implement a system that may easily accommodate the future additions to the postalised system, including the South-North Pipeline, and as the paper proposes, BGE believes this should be the exit point based system.

#### 3(b)(iii) Irish Inter-Connector cost treatment

BGE note the proposal in the paper to address the issue of inclusion of the appropriate portion of IC costs in the postalised tariff at a future date closer to completion of the South-North Pipeline. At that time there may be alternative sources of supply available to Northern Ireland gas consumers and shippers, and it will be possible, due to the completion of the South-North Pipeline, to offer such a

choice in supply. BGE feels that the development of the postalised system, as outlined in the paper contemplates this possibility.

### 3(c)(i) Capacity Commodity Spilt

BGE supports the move to a higher capacity component in the tariff structure. However, we believe that a fair reflection of the long term fixed:variable cost structure is closer to 90:10, or even 95:5, than 75:25. We are supportive of the view that developing distribution businesses need to have a degree of flexibility on capacity costs. We believe that a mechanism to allow a lower capacity component or a shorter capacity booking period should be used for developing distribution businesses. As it is likely that there will be spare capacity on the networks following construction of the South-North Pipeline, this should not give rise to any system planning or capacity constraint issues.

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

BGE supports the proposal to re-allocate revenues among the operators within the year. The frequency of this re-allocation is a trade-off between the level of revenues due to be transferred, and the administrative complexity of more frequent transfers. BGE suggests that the frequency be determined each year depending on the projected transfer amounts, rather than fixing at six-monthly from the outset.

## Section 4: Combined operational system for the three pipelines.

BGE agree that the development of the operational arrangements may continue in parallel with the development of the postalised tariff system.

With regard to the effect that the operational regime will have on the revenue collection system under postalisation, it is our intention, and we believe the intention of the other TO's, to develop a flexible operational regime, which can accommodate the postalised tariff system. The adoption of the exit point mechanism outlined in the consultation paper will allow this flexibility. As the PSA will oversee the reconciliation of revenues for the TO's, and it is intended that Shippers will have a relationship with the TO from whose system they exit the gas, the operational interface relationship between the three TO's may be developed in parallel with the development of the postalised tariff system, and they should have little or no impact on each other.

BGE agree that the operational regime implemented should be such that there can be no question of the party operating their part of the transmission system using

their position to the advantage of any affiliate. The consultation paper specifically refers to affiliates involved distribution/supply activities, however this is equally true of all affiliates.

BGE agree with the statement in the paper that there should be no confusion over responsibility for risk within the three gas transmission systems and BGE feel that this objective is best served by each transmission system asset owner operating their own system. BGE fully endorse the principle that the individual TO is responsible for the safe operation of that TO's pipeline system. It is vital therefore that the TO has control of sufficient tools to meet this responsibility. This is a tried and trusted system with many European and indeed world-wide precedents. The possible alternative mentioned in the consultation paper of a single operator is a highly novel and untried system. There would be a high level of risk in implementing such a system, and there would be an inevitable lack of clarity in the lines of responsibility between the three TO's. The issues concerning liabilities in such a regime, as the paper correctly points out, would be a very complicated area, and would inevitably be time consuming and costly to resolve. BGE favour agreeing and implementing a system which builds on existing arrangements in Northern Ireland, and has tried and trusted precedents. It is BGE's intention to build on systems already in existence and to develop a framework where gas transportation will be as seamless, as cost effective, and as safe as possible.

We note OFREG's and DETI's intention to explore a system in line with current European recommended best practice (EASEE Gas and GTE) which is itself based on many years experience and established principles with regard to interconnected pipeline systems in the USA. We are confident that with the co-operation of all parties, a system whereby the "pancaking" of operational rules will be avoided.

With regard to the possibility of shippers exiting from two separate systems; The system proposed in the consultation paper is one where a shipper will have a contractual relationship with the TO from whose system they exit the gas. By having each TO's Code take account of the terms of OFREG approved inter-TO arrangements, this will act to promote consistency between codes, while allowing the separate TO's scope to offer different products to shippers where this is possible. This has the effect of promoting competition between TO's as it offers shippers and end users choice between the different products offered. BGE feel that the consistency between the Codes as discussed above will make it possible for shippers to operate on one or more systems, and will not be unduly complex for shippers or end-users. Moreover, we have recently seen instances where codes in adjacent systems, including in Northern Ireland, tend to converge over time. It is BGE's intention to endeavour to have a high level of consistency between our NI Code, the inter-TO arrangements, and the codes in other relevant adjacent systems.

BGE are in agreement with OFREG's statement that the inter-TO arrangements should be a standardised form, moreover they should build on arrangements already in existence, and incorporate European recommended best practice.

## 2. Centrica's Response



energy management group

### **RE: Proposals for the implementation and operation of a postalisation system for transmission tariffs in Northern Ireland**

We would firstly like to thank you for the opportunity to comment on this consultation.

#### Section One

British Gas Trading (as a major shipper through the SNIP pipeline and supplier of gas to Northern Ireland) supports the principles of postalisation on the basis that it benefits customers in aggregate and should improve competition between suppliers with little or no downside to Transmission Operators. However, there is an important need for an underwriting of initial investment by the Long Term Ship or Pay contracts to ensure consumers do not unduly subsidise future network growth. Also, those that underwrite the initial investment should not now be disadvantaged against new players as this would certainly have a detrimental effect on encouraging future investment.

In addition there will be an inevitable impact upon on all parties by means of contractual changes in order to cope with the new regime – this could take a significant amount of time and effort. It is essential that these changes be minimised both in order to avoid unnecessary cost and administration and to facilitate the smooth transition into a postalised regime.

It is evident that the five parties involved to date have put a lot of work into the postalisation discussion

but we remain disappointed that other industry representatives (including ourselves) were not invited to participate given the potential impact that postalisation will bring. We are of the opinion that involving additional parties in the initial stages could have enabled the Director to present a more detailed and thought out proposal to the industry.

### Section Two

We firmly agree with your comment that further work and consultation will be required this year if postalisation is to be adopted in the Province. At this stage it would be useful to have an indication as to which areas you feel have not been covered in sufficient detail and indeed the process you intend using to develop them further (participants, project timescales, meeting schedules etc).

You indicate that the adoption of proposed energy legislation would help facilitate the implementation of a postalised tariff. We are keen that the postalisation process is not unduly delayed and as a result are keen to know what contingencies have been put in place should the introduction of such legislation be delayed. Is it envisaged that postalisation can succeed in the absence of this legislation?

We acknowledge your preference that the introduction of postalisation should not be delayed until the commissioning of the BGE Northwest connection but before supporting such a proposition we would wish to see how and to what extent offsetting cost reductions for electricity consumers would be introduced. Irrespective of whether these reductions can be agreed upon we would be reluctant to support an incremental approach unless it can be demonstrated that every aspect of postalisation has been discussed and agreed upon. Although it is an important step for the NI energy market it is not one that should be rushed into.

### Section Three

We are concerned that your proposal to include charges associated with the delivery of gas to NI through other entry points could lead to high levels of cross subsidisation, of BGE for example, when looking at your example to include costs through the Irish Interconnector and up through the South-North pipeline. In addition there is a need to understand the principles and high level costs at this stage in order to decide if this is the best approach. All the types of allowable costs should be understood in principle in advance to avoid any unexpected price shocks.

It is vital that all costs associated in operating and administering the postalisation system must be economically and efficiently incurred against an agreed need, with the Director having a duty to monitor and Shippers having the right to appoint an independent auditor.

Moving to the issue of the capacity / commodity split, it is mentioned that the PTL profile will apply should postalisation be implemented before 1 October 2004. What profile will be adopted should there be a delay in implementation?

It is mentioned that 75:25 ratio has been established as being fair. What is the basis for this assumption?

It is also indicated that the Postalisation System Administrator / Ofreg will verify the volume forecast volumes submitted by each transmission operator. It is unclear as to why it is anticipated and on what basis any verification would take place.

If the proposals for dealing with under / over recoveries are adopted then shippers have to incur or benefit from these differences. They will then have to change their future supply prices accordingly (which may or may not be possible). If they are exiting or have exited the market what will happen to any reconciled amounts? We believe that a preferred method for dealing with any under / over recoveries is to use the “K” type approach as used in Transco’s pricing formula, which recognises that end consumers will remain as customers irrespective of the shipper or associated regime that transports gas to the Province.

We acknowledge that the minimum payment guarantee from the Ballylumford ship-or-pay agreement should not be adversely affected for any party and welcome the invitation to discuss how this is to be successfully achieved.

With regard to the appointment of a PSA we agree with the recommendation that an agent be appointed to administer the process (please note our earlier comment that any costs associated with running the postalisation system should be economically and efficiently incurred against an agreed need). However, the scope of the role of the PSA must be constantly reviewed in light of any further developments to the NI energy market such as the introduction of a NI System Operator.

#### Section Four

It is clear that the principles discussed in this section will require a great deal of development. We acknowledge and support the comment that the operational regime for NI should be designed in parallel with the implementation of postalisation. It is inevitable that a successful and efficient postalised system would be unachievable in the absence of a common approach to operability. We await the outcome of the report from the three TOs aimed at presenting the best way to combine the three operational regimes and hope that this document can form the basis of any future discussion.

We acknowledge your reference to the work being carried out by GTE and EASEE gas and agree that some of the topics being tabled could be relevant to the postalisation process. However, these forums are at an early stage and are tasked with discussing a wide range of issues, the majority of which are not relevant to the specific issue of postalisation in Northern Ireland. We therefore support the development of the Northern Ireland regime proceeding.

The balancing regime between the systems and the subsequent charges incurred by shippers needs to be thought through and discussed in detail to ensure that shippers on one network are not prejudiced by the actions of another shipper on an adjacent system. One example is that there must be adequate metering facilities installed at all offtakes from different systems including the interface to the North West pipeline in order to ensure that upstream shippers are not providing a shrinkage service to those on the North West system. In addition we believe that metering is now required at the interface between the PTL and Phoenix networks.

We are in agreement with your approach to ensure that commercial conditions are kept as consistent with one another as is reasonable practicable and developed / modified on a collective basis. However, it is imperative that existing contractual arrangements are not prejudiced in any way. For example, we see no reason why the Network Codes used for each system cannot be identical. The paper alludes to circumstances in which it would be justified for BGE to be treated as an exception from other shippers on the PTL and Phoenix pipelines – we would like to know in which circumstances this would be envisaged as we would not expect this to be the case.

We believe that many of the proposals put forward in this consultation are either unachievable in the absence of a single NI System Operator or would require a lengthy and costly process to move from the existing regime(s) to the postalised system as currently presented. In addition it must be

acknowledged that the resultant level of contractual implications for all parties that postalisation will generate is going to be significant and one that cannot be underestimated.

#### Section Five

Is it the intention that all existing Licences will need to be changed to introduce the concept of postalisation and if so at what stage of the implementation process should we expect to see any draft Licence changes?

We understand that this is the first step in what is going to be a major development for the energy market in Northern Ireland and look forward to participating in the forthcoming discussions. In addition we would welcome the opportunity to discuss the issues raised in this paper and therefore would like to request to meet with the Director and his team in the near future. We would certainly welcome a response to the points raised in this letter to increase our understanding of the proposals.

### 3. Coolkeeragh ESB response

#### Coolkeeragh ESB Response to the Consultation Paper on Postalisation

##### Introduction

Coolkeeragh ESB welcomes this opportunity to input into the consultation for the implementation and operation of a postalised tariff system for the Northern Ireland natural gas transmission network. We welcome the positive approach taken by the three pipeline operators on the implementation of postalisation with DETI and Ofreg.

As the NI gas industry develops the implementation of postalisation and the operation of the gas system are of vital importance to gas users. In broad terms we favour tariffs that are competitive, predictable, fair and which are conducive to growth of the gas industry. We also favour an operational system that is flexible, simple, cost effective, fair and transparent and which provides for secure and efficient system use.

In considering whether to implement postalisation immediately or at the commencement of the NW pipeline we believe that the incremental approach will offer a vital opportunity to allow arrangements to be tested early, for problems to be resolved and for participants to learn. The incremental approach would also present an opportunity to bottom out necessary licence changes.

The response hereunder is set out in the same order as the consultation paper with specific attention given to the areas upon which particular emphasis was placed in the section on consultation responses.

## Payment Mechanism, Financial and Common Tariff Issues

### Exit Point Payment Regime

**Coolkeeragh ESB supports the concept of an exit point revenue collection mechanism. With three pipeline owners/operators in Northern Ireland it is preferable for users to pay a tariff to a single entity rather than to each individual pipeline owner. We concur that the exit point revenue collection mechanism makes it easier for the future integration of the S-N pipeline and obviates the need for significant adaptation.**

In the event that an exit point capacity mechanism is put in place it will be necessary to ensure that a seamless and secure transfer from the current capacity process be carried out. It is appropriate that a postalised exit charge should convey equal firm rights to all exit capacity holders. We concur with the position that there is a need for a satisfactory dispute resolution mechanism to give parties confidence in such a payment mechanism.

### Assets and costs to be postalised

We concur that transmission assets such as the PTL SNIP, the Phoenix complete transmission asset and for BGE both the Northwest and the South-North pipeline should be included in the postalised tariff. As the gas market is developing in Northern Ireland it is important to carefully consider the optimum way of recovering costs. We consider it appropriate to delay the inclusion of the S-N pipeline in the postalised tariff until the costs are incurred as this would be in line with best industry practice and common accounting methodology. However, costs could be added as incurred e.g. development costs during construction.

**We believe that it is important to have rigid testing and control over the appropriate level of interconnector cost inclusion in the postalised tariff. We support the introduction of a Postalisation System Administrator (PSA) and that justified costs of the PSA should be included into the postalised tariff.**

In conclusion we favour a fair and predictable tariff regime to meet the needs of users and to ensure that that the tariffs are as competitive as is practicable.

### Capacity Commodity Split

It is important that the capacity commodity split reflects the true costs and encourages efficient use/booking of the gas system. The most appropriate capacity commodity split is one that reflects the long-term split in the cost base between fixed and variable costs.

A 90:10 capacity commodity split is the gas industry norm and such a split is in use internationally and in the Republic of Ireland. We suggest that a 90:10 split be adopted in Northern Ireland. Such a split should support efficient use of the gas system.

We would like to see the programme for implementing an appropriate capacity commodity split brought forward to encourage efficient booking and to reduce exposures to the

under/over recovery of tariffs. Coolkeeragh ESB concur that a transition to the appropriate capacity commodity split is required and also feel that it is appropriate to bring forward such a transition. The natural triggers for introducing the appropriate change are the introduction of postalisation and the introduction of a second entry point.

We would like to see incentives to stimulate gas growth examined. The introduction of reduced capacity commitments for new users should be considered in line with best international practice. Perhaps the introduction of a second entry point and associated additional capacity could also be a trigger for re-considering such a concept on the proviso that longer-term capacity bookings received precedence and/or that an appropriate premium were paid for profiled capacity bookings.

#### Duration for setting the postalised tariff

It is imperative for all users to have tariff visibility and predictability. Gas transportation tariffs represent a major cost to all users. It is therefore necessary that users can confidently predict their tariffs. Given the high fixed cost nature of the gas system and that the assets are regulated, it should be possible to provide adequate tariff certainty.

**It is desirable to have a tariff duration that provides predictable and competitive tariffs and that is conducive to the development of the gas industry. We are of the view that a longer-term levelised tariff can best satisfy the above criteria. We understand that adjoining systems in Great Britain (Transco) and in the Republic of Ireland (Bord Gais) operate a 10 year levelised tariff.**

**We feel that a levelised tariff with higher back end payments of transmission costs, to when volumes are higher, should be considered. It would be necessary to ensure shortfalls in revenue in the early years were properly accounted for and that financing costs were also included. Such an arrangement should offer competitive and predictable tariffs, which would act as an impetus to the growth for the developing gas market.**

On the subject of tariff predictability and certainty there are two aspects, the notification given to suppliers of tariff changes and the quantum of tariff changes. A longer-term tariff duration would minimise the quantum of tariff change and reduce the importance of tariff notification to users. For a shorter tariff duration as envisaged in the consultation paper the notification of 1 month referred to in Annex 1 is insufficient for users and a notification period of 3-6 months would be more appropriate. In the event that an annual tariff were implemented we would concur that a rolling five-year tariff projection would be beneficial to users.

**In summary, we believe the introduction of a longer-term levelised tariff is appropriate.**

Determining usage for tariff calculation

**The accuracy of forecasts and the verification of forecasting methodologies for the purpose of tariff setting and tariff predictability are of vital importance. In determining usage for tariff calculation a higher capacity commodity split would encourage users to accurately forecast volumes and to book their capacity accordingly.**

### **In-year revenue transfers between the TOs**

We acknowledge the need for revenue reconciliation between owners. It is presumed that users, who would be paying a postalised tariff, would be held harmless by this process. We welcome the fact that revenue transfers are to be managed with transparent formulae by the Postalisation System Administrator.

### **Dealing with under/over-recoveries**

On the subject of dealing with over/under recoveries we would again point out that a higher capacity commodity split, as is appropriate, should minimise the scale of any over/under recoveries. We do not support an end of year reconciliation as it results in tariff uncertainty for users who normally contract in advance with their customers. Over/under recoveries should be carried forward such that users may forecast their volumes and plan on the basis of a firm tariff. Any surplus or deficit can then be factored into the next or subsequent tariff periods. Under a levelised tariff any surplus or deficit would be carried forward and applied over future years which as aforementioned is beneficial for energy customers.

We concur that a common published credit policy should be incorporated in codes to ensure the fair treatment of all shippers.

### **Postalisation System Administrator (PSA)**

#### ***Functions of the PSA***

Tariff determination is a key function for the PSA in conjunction with Ofreg. We would reiterate that tariff predictability is a major issue for the NI gas industry. The administration of over/under recoveries under a levelised tariff would result in a tariff adjustment going forward rather than payments and rebates. While the levelised tariff approach would add complexity, we feel that it is justified.

We favour a regime whereby the treatment of over/under recoveries is smoothly introduced over the remainder of the tariff period or over subsequent tariff period(s). It is worth noting that a higher capacity commodity split minimises the scale and effect of volume mismatches.

Revenue redistribution is most important for asset owners and a key function of the PSA. We are of the view that the PSA should be independent and importantly neutral to credit

risk. We agree that bilateral revenue transfers between the operators are preferable so long as the proper procedures are in place to ensure that PSA determinations are acted upon. We concur that Ofreg/DETI should oversee that the process be carried out in an open and transparent manner.

### ***Who will become the PSA***

We are of the view that the second or third options are most consistent with the principle of independence and the perception of independence. The third option should involve lower set up overhead in terms of recruitment and incorporation and should also be easier to change and therefore more conducive to the incremental approach of implementing postalisation. We concur that the choice of agent, under option three, should be subject to Ofreg approval.

### ***Legal Controls***

**The legal controls adopted should ensure that the PSA can fully perform its duties with the necessary level of regulatory control. We concur that the optimum structure should become more apparent as the postalisation system is finalised.**

### **Combined operational system for the three pipelines**

We welcome the inclusion of this section on the operational regime and that further consultation on this issue will be afforded to interested parties. The inclusion of a set of principles that any combined operational regime must honour is appropriate. In particular, to have as seamless as possible an operational regime in order to minimise transaction costs and complexity for shippers and to minimise both the one-off implementation costs and operational costs of the postalisation system are welcome.

It is our view that any additional infrastructure, operational constraint or degradation in system performance on account of the choice of one operational regime should be factored in considering the choice of regime. For example the introduction of layers of volumetric control would have the effect of reducing the pressures available to customers.

It is also imperative that users are not obliged to comply with several network codes, to nominate on more than one pipeline, to balance more than once and are not exposed to pancaking charges. The introduction of an exit point payment regime should ensure that users need only secure exit capacity from the Northern Ireland gas system rather than over multiple pipelines. With respect to Annex 2 if shippers are to balance on the Northwest then it is imperative that they are not obliged to balance again on other pipes i.e. subject to pancaking. We welcome the fact that Ofreg are opposed to any such pancaking of charges. We concur that the treatment of Northwest shippers on SNIP with regard to balancing and scheduling charges needs to be discussed.

As a shipper we would favour having to comply with a single common code and having a seamless relationship with a single operator. On the subject of adopting the PTL code as the

common code we feel that there could be merit in incorporating some of the proposed BGE code improvements, which are currently under review. We recognise that developing and agreeing code changes takes time and would welcome any measures that would facilitate the timely introduction of a new code.

With respect to the benefits of having one system operator versus the benefits of having inter-operator agreements we believe it is in the interest of all users to further examine the benefits of each. Intuitively a single system operator should be more effective and efficient.

For a shipper on the NW pipeline, at the end of the three pipelines, it is key that the combined operational system introduced does not impose unnecessary complexity, cost or risk upon users.

In the context of an all-island energy market, it may be beneficial to explore if the system operators can co-ordinate with one another. It may be that it is possible through the planning and/or operations of the networks to capture synergies. In the electricity market the two system operators endeavour to do this and have already made significant operational savings for all customers by doing so.

4. Northern Ireland Electricity response

**NORTHERN IRELAND ELECTRICITY plc**

**Response to the consultation paper:**

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



## Executive Summary

- (i) A postalised tariff for the gas transmission network will increase costs to electricity customers. This has been confirmed by DETI in its impact assessment of June 2002 which estimated the increase at 0.6% for domestic customers and 1.4% for industrial customers. It is not clear whether this estimate remains valid under the most recent proposals set out in the Ofreg/DETI consultation paper. NIE's response to the paper is made from the point of view of minimising the extent to which gas postalisation will require electricity customers to subsidise gas customers.
- (ii) Where policy decisions support cross subsidies from one class of consumer to another there should be transparency around the quantum of the subsidy, but there is little financial analysis provided in the paper. Likewise, the absence of numerical analysis makes it difficult to comment on the various options for the design of the postalised arrangements which are presented for consultation.
- (iii) The structure to be adopted for the operation of the pipelines is a fundamental issue that must be addressed. It is difficult to see how arrangements comprising three pipeline operators and three network codes is the most efficient solution for a system as small as the N. Ireland system. It creates the potential for confusion, a lack of clear responsibility and the likelihood of dispute. NIE firmly believes that arrangements based on a single Transmission Pipeline Operator, who is an independent undertaking and is operating to a single Network Code and carrying out the function of the postalisation system administrator are likely to be more efficient, less complex and more in line with EU Directive requirements. The proposed design appears to be biased towards the collective needs of the three individual pipeline owners and indicates a need to review whether the membership of the Gas Market Development Group is sufficiently representative of all stakeholders.
- (iv) The approach as to how gas postalisation is implemented can only be properly considered once the operational structure is established. In whatever structure is adopted, NIE favours an approach which minimises the impact on electricity prices – and its main features are as follows:

- The issue of which payment mechanism model is most appropriate and the other financial issues in relation to tariffs and the role of the Postalisation System Administrator would also be easier to assess if there is only one pipeline operator and revenue collector involved. As we explain in Section III, a charging system that is solely exit based is not considered viable as settlements need to be referenced back to the entry point. It is also difficult to make a complete assessment without a description of the options for the entry point model and without full access to the detail of how the issues of customers' pressure requirements and linepack are to be handled. NIE also have particular concerns in relation to the costs of balancing the system and ensuring that incentives remain on shippers to operate efficiently, and we believe the exit point regime could create more difficulties in effectively balancing across three networks;
- The issue of capacity vs. commodity based charging is of key importance as it has a fundamental influence on how much consumers pay and the relative competitiveness of generation both within N. Ireland and with generators in the RoI. NIE favours moving quickly to a high capacity charging regime which would help alleviate the burden being imposed on electricity customers through postalisation;
- All costs which are to be included in the postalised tariff should be subject to rigorous regulatory scrutiny before introducing postalisation to ensure that only the efficient level of costs is included. NIE has asked Ofreg to review what it believes to be an inefficient level of operating costs currently within the charges for SNIP;
- The components of cost to be postalised should be kept to a minimum. Inclusion of costs associated with further distribution spurs and the delivery of gas to the entry points to the N. Ireland system will contribute to the impact on electricity bills. Under the scenario outlined in the paper, Northern Ireland customers would be contributing to the costs of the Republic of Ireland's gas interconnectors;
- The inclusion of ship or pay obligations tends to create anomalies within a postalised tariff regime since they bias the costs against gas used for electricity generation. The current anomaly that exists in relation to the take or pay provisions (in relation to transportation charges) relating to LTI3 gas should be removed, and any issues in relation to payment security should be addressed on the same basis for pipeline users;

- NIE has previously argued for a derogation to be applied to the transportation of gas supplied under the LTI3 contract such that the postalised tariff would not apply. In the absence of a derogation there is a case for including the excess cost of LTI3 gas within the postalised tariff on the grounds that this contract (the cost of which is borne by electricity customers) was part of the arrangements which underpinned the initial stages of the development of the gas infrastructure for Northern Ireland. This would remove the market distortion created by the “minimum take” aspects of the LTI3 contract;
  - The postalised tariff should not be introduced incrementally, i.e. prior to commissioning of the North West pipeline. Nor should the costs of the South-North pipeline be included early so as to smooth postalised tariffs. Early introduction of these components would only serve to increase the cost of gas transportation for use in electricity generation prematurely;
  - The cost of operating the postalised system should be embraced by an incentive regime to drive them towards their efficient level. In this regard, the dispute resolution procedures that will be required are likely to be much simpler where responsibility and ownership are clearly established, and this again illustrates the potential pitfalls of having multiple network operators.
- (v) As we have already mentioned, it is difficult to comment on a number of the issues on which the consultation paper seeks views. NIE would suggest that in order to adequately inform all interested parties and enable transparent and detailed understanding of the issues to be addressed, DETI/Ofreg should provide a simple financial model of the postalisation regime that includes the key assumptions, e.g. costs to be postalised, forecast capacity bookings and commodity imports, etc. This would then allow the key variables in the model to be adjusted and clearly demonstrate the impact on gas transportation costs for the different user groups that would arise under the various options.
- (vi) Finally, we note that there is no indication that Ofreg/DETI have considered how the proposed arrangements would impact on a possible refinancing of SNIP through a 100% debt funded, low cost borrowing structure which was the subject an earlier Ofreg consultation paper.

## I Introduction

1. This submission sets out NIE 's response to the Ofreg/DETI consultation paper entitled "Ofreg and DETI proposals for the implementation and operation of a postalised tariff system for the Northern Ireland gas transmission network". NIE welcomes the opportunity to comment on what will be a major change to the charging regime for the transportation of gas in Northern Ireland.
2. In previous representations on the subject NIE has sought to highlight the impact of gas postalisation on electricity prices since postalised charges will, in effect, require electricity customers to subsidise the cost of providing new gas infrastructure. This cross-subsidy arises because under postalised charges the cost of gas delivered to Ballylumford Power Station will include a contribution to the cost of the entire gas transmission system, not just SNIP. The increased cost will be reflected in Ballylumford's long term power purchase agreements and then passed on to customers via the Bulk Supply Tariff. In responding to the present consultation exercise NIE has continued to adopt the perspective of electricity customers.
3. To the extent that policy decisions support cross subsidies they should be accompanied by transparency. The likely costs to each market participant should therefore be set out in both the postalised system and under the counterfactual (i.e. the system without postalisation) so that it is clear which sector is being subsidised, who is providing the support and the quantum of the subsidy.
4. NIE believes that consultation to date has been unhelpfully narrow and that the current paper represents the views of asset owners and gas transporters only. The lack of detail in the paper and the lack of input from shippers and end users have resulted in a significant deficit of detail. Amongst other things, NIE is concerned as to how the existing gas supply and transportation contracts may be affected. These considerations are not presented in the paper and this raises questions as to the role of the Gas Market Development Group and the representation on it. It is NIE's view that in order to achieve a balanced outcome, this group should include representatives from all stakeholders.

5. Whilst the Ofreg/DETI paper aims to address the high level principles of what the postalised charging system ought to deliver, no analysis has been provided to illustrate the relative gas transportation costs that can be expected under the various postalisation options presented in the paper and the effect of varying the assumptions. The absence of such scenario modelling makes it more difficult to address the impact of issues such as the capacity/commodity split. Nevertheless NIE's response to the issues raised is set out in the following sections.

## II Implementation

6. Ofreg / DETI have considered whether an incremental approach to postalisation could be adopted whereby the postalised tariff would apply initially to the PTL-Phoenix network only - i.e. before the North-West pipeline has been commissioned. They acknowledge that the early adoption of postalisation would serve only to transfer costs to electricity customers and they do not support early postalisation unless it is accompanied by offsetting cost reductions.
7. NIE considers that any offsetting cost reductions for electricity customers would be welcome in their own right and should in any case be strenuously pursued by Ofreg/DETI. Any postalisation mechanism should not take effect until the North-West pipeline is commissioned and gas is ready to flow. The inclusion of the cost of the Phoenix pipeline prior to this date will only serve to increase the cost of gas transportation to Ballylumford prematurely. This would create an immediate and unnecessary cross-subsidy from electricity customers to existing gas infrastructure in the Greater Belfast area.

## III Payment Mechanisms, Financial and common tariff issues

### **Payment Mechanism**

8. Ofreg / DETI propose a payment mechanism based on settlement at the "exit points". However, the paper does not offer any explanation as to how an "entry point" system would operate and it is therefore difficult to contrast and comment on the two options. The present payment mechanism seems to be based on an "entry point" system and our comments here reflect the need to relate all capacity booking, settlement, balancing and payments mechanisms back to the entry point.

9. The view of the most appropriate payments system depends on the structure of the model for operating the transmission pipelines. NIE believes that since all the gas for the market must flow through Moffat/Twynholm (at least until the South – North pipeline is commissioned), SNIP will be the primary determinant of the capacity and volumes of gas available to Northern Ireland and it would therefore be more rational for settlements to be based on an entry point mechanism.
10. It is NIE's view that the entry points are the key limitations to the gas infrastructure in N. Ireland and that the entry points must therefore be the reference points for booking and allocating capacity. The role of the exit points is therefore subservient to this although they are needed for settlement purposes, e.g. to establish what gas a shipper or customer has removed from the system. It is clear that entry and exit points cannot be dealt with in isolation since the whole basis of balancing the system depends on shippers delivering an amount of gas to the entry point equivalent to the amount they remove at their exit points.
11. A settlement mechanism based on exit points potentially introduces additional distortions in relation to payments for guaranteed pressure and in the allocation of the cost of balancing actions incurred to maintain the integrity of the system.
12. The paper claims the exit point mechanism is the simplest method and is consistent with the operational regime. However, this argument is based on the presumption that having three different pipeline operations is optimal or viable which, in a small system like Northern Ireland's, must be open to debate.
13. NIE fails to see how the need to link payments to any particular asset owner is relevant to the proposed selection of an exit point mechanism as there must be a redistribution of funds in any model. NIE favours keeping the system as simple as possible with one network operator and one network code. Such a structure would remove a lot of complexity from a user perspective and it would also remove the need for interface agreements where there are multiple operators and network codes involved.
14. NIE agrees that a dispute mechanism will be required. However, the procedures required for the exit point mechanism with three system operators and three network codes are

likely to be much more complex and will therefore increase the potential for disputes [would therefore add additional costs to be recovered from N. Ireland customers].

15. The paper suggests that the exit point mechanism would make it easier to integrate the South-North pipeline, whereas an entry point mechanism would require significant adaptation. NIE believes that this would be less problematic than having multiple exit point settlement regimes and indeed, the entry point mechanism would allow incremental development of the system and learning and experience to be acquired with a single entry point prior to the South-North pipeline being constructed.

### **Assets and Costs to be Postalised**

16. DETI/Ofreg propose to include the following components within the postalised costs: (i) the costs of the three pipelines, (ii) the distribution spurs for the BGE network based on a 5km rule, (iii) the Irish interconnector and (iv) the costs of operating the postalised system.
17. It is difficult to comment on the totality of costs to be postalised without reasonable estimates of those costs having been clearly set out. It would help move the whole debate forward if a model were produced setting out all the assumptions, costs and predicted usage in such a manner that the impact of the assumptions and proposals could be easily understood. However, the following points can be made:
18. All costs to be included in any postalisation regime must be critically appraised to ensure they are not higher than they need be. NIE has been concerned about the level of costs that are currently being charged for the use of SNIP and in particular the operating costs (both predictable and unpredictable operating costs). NIE has asked Ofreg to review these on a number of occasions.
19. The paper suggests that there is an option to include the cost of the South-North pipeline at the same time as the North-West pipeline is included in order to help smooth fluctuations in tariffs. NIE does not believe any costs (relating to the capital value of assets or operating costs) should be recovered via the postalisation mechanism until they have been properly and efficiently incurred.
20. The proposal is to include the cost of the distribution spurs to within 5 km of each distribution town. It is not clear from the paper whether these towns have already been

pre-selected but if the proposal is to include costs incurred to select any such spur then additional costs will be added to the totality of the postalised costs. NIE has concerns in relation to the transparency of this aspect of postalisation and specifically whether the potential costs to be included are different to those assumed by Ofreg and DETI in their previous impact assessment on electricity prices. It is clear that the inclusion of the cost of further spur lines to connect additional towns will increase the burden on electricity customers.

21. The postalisation of costs relating to the delivery of gas to N. Ireland through other entry points (e.g. the South North interconnector) would remove any incentive on users to deliver their gas in the most cost effective manner since users would be able to smear any additional costs they incur across all other gas consumers (regardless of whether they had used the most efficient entry point or not). The scenario outlined as an example where gas is imported to RoI across its interconnectors and shipped into NI via the South-North pipeline would result in N. Ireland customers (both electricity and gas customers) also helping to fund the RoI's gas interconnectors. NIE does not support the inclusion of Irish interconnector costs within the postalised tariff. Any costs incurred outside the N. Ireland transmission system boundary should represent part of the commodity cost and the cost should properly sit with the party incurring the cost

[The only exception to such an arrangement would be if SNIP were fully utilised and therefore additional costs would be incurred in any case and the costs to be included represented the least cost option].

22. NIE also consider that any additional spurs to the pipeline network should be justified and paid for outside the postalisation arrangements e.g. any additional towns that would like to be connected along the routes or any spur to supply gas consumers in Donegal.
23. It is not clear what costs are to be covered by the "cost of operating the postalisation system". Any costs included within the postalised tariff ought to reflect the efficient level of costs and ideally be embraced by an incentive regime which drives them towards their efficient level.
24. NIE has previously argued for a derogation to apply to the transportation of gas under the LT13 gas contract such that the postalised tariff would not apply. The justification is

that the LTI3 contract was one of the components underpinning the construction of SNIP which in turn facilitated the development of the downstream gas infrastructure including the extension to the North West. However, the contract is out of the market with excess of costs of around £25m pa currently being borne by electricity customers in respect of LTI3 gas supplied to Ballylumford. It is unreasonable that electricity customers should be required to bear the further additional costs which would arise under a postalised tariff. However, in the event that Ofreg/DETI decide not to grant a derogation, then there is a strong case for including the excess cost of LTI3 gas as part of the postalised tariff on the grounds that it was, in effect, part of the cost of developing a gas infrastructure for Northern Ireland.

### **Converting postalised costs into tariffs**

25. The paper seeks views on the balance between capacity charges and commodity charges that should be reflected in the postalised tariff. In the absence of any modelling it is difficult to evaluate the impact on gas transportation costs of the different weightings for the capacity/commodity charging options presented in the paper.
26. In principle, (and subject to the removal of certain anomalies), NIE favours moving immediately to a tariff regime that is weighted towards capacity charges as this would help to minimise the costs to electricity customers (since capacity weighted charging in combination with the CCGT's high load factor minimises the cost of gas delivered to Ballylumford).
27. Ofreg and DETI present the argument against capacity charges on the grounds that commodity charges would be more conducive to the early development of town distribution. However, commodity weighted charges would increase costs for electricity customers compared to the costs under a capacity-weighted tariff. The argument is therefore unlikely to find favour with electricity customers who have already made a substantial contribution to the development of the downstream gas industry by bearing (i) the costs of converting Ballylumford to burn gas, (ii) the majority of the SNIP costs and (iii) the high cost LTI3 gas contract that was an integral part of bringing the gas pipeline to N. Ireland. If further support for the development of town distribution is needed then this should be provided transparently by some means other than through the imposition of a postalised tariff which is unduly weighted towards commodity charges.

28. The paper argues for retaining the current charging profile associated with SNIP charges (which reflects a 25/75 capacity/commodity split in 2004 evolving to a 75/25 split by 2011) on the basis that this has already been factored into users' business plans. However, the concept of postalisation will make substantial changes to many users' business plans and therefore the business plan argument should not be used to justify a commodity-weighted tariff.
29. If postalisation is to work effectively the current anomalies in the charging arrangements (as outlined below) must be removed. Postalisation will not give the same transportation cost for all gas as this will depend on the amount of capacity booked and the actual volume transported, i.e. it will depend on the load factor or utilisation of the capacity booked. However, the principle of postalisation implies that if two users were to book capacity and use it in identical ways, their costs would be the same.
30. This is not the case at present because of the distortion whereby the actual LTI3 usage of approximately 250m therms per annum is subject to Take-or Pay provisions (in relation to transportation) of 342 m therms for the purposes of calculating transportation charges. Hence, if another user booked the same capacity as is held by Centrica for shipping LTI3 gas and imported 250 m therms of gas, that user would pay a lot less for their gas transportation. Such an anomaly should not exist in a postalised regime and ought to be removed.

#### **Duration for setting the postalised tariff**

31. NIE does not object to the postalised tariff being calculated annually and believes that there is a need to give indicative costs for future years, considering the changes in costs and volumes that are likely to be experienced, especially in the early years.

#### **Forecasting capacity requirements, volumes and costs**

32. In considering the information which will form the basis for setting the postalised tariff the paper emphasises the need for accurate estimates of capacity requirements, volumes to be transported and the costs applicable on a yearly basis. Whilst the need to forecast such factors is common in the energy industry, NIE would not be as convinced as Ofreg appears to be that there will be a reasonable degree of confidence over volume forecasts. This is because the uncertainty as to how electricity markets will develop in response to

further market liberalisation over the next number of years will in turn create uncertainty in the predictions of volumes of gas to be burned in power stations.

33. In relation to reference in the paper to capacity bookings, NIE does not consider that it is possible to book capacity at exit points without reference to the constraints imposed by the entry point(s). As has been referenced earlier, NIE considers that an entry point regime is likely to be the most appropriate for the N. Ireland gas transmission system and firmly believes that all capacity should be booked on the basis of the entry point.

### **In-year revenue transfers**

34. NIE believes that there should only be one transmission pipeline operator, and consequently the need to transfer funds should be between the single collector of funds and the pipeline asset owners (and pipeline operator if different). On this basis there should be a monthly transfer of funds to redistribute the revenue collected.

### **Dealing with under/over recoveries and ship-or-pay arrangements**

35. The paper proposes an end of year reconciliation to deal with under/over recoveries through a bullet charge/rebate to shippers. This method appears to be similar to the current gas transportation charging regime which ensures full recovery for PTL through the application of year end reconciliation charges or rebates. In the past any charges have been mainly applied to NIE PPB and Phoenix who have captive customers, and they have not caused too much of a cashflow problem for NIE as a user. However, as the number of users increases with increasing competition in the electricity and gas markets, year-end adjustments will create more uncertainty for cashflows and will become more complicated for users and ultimately final customers.
36. Furthermore, NIE expects that a bullet payment system would provide incentives to bias the forecasts that operators submit for the purposes of setting the postalised tariff, (e.g. by under-estimating gas requirements) thereby ensuring tariffs are high to improve their cashflows. The bullet payment system will require greater regulatory scrutiny than would be required under the alternative whereby any under- or over-recoveries are built into the following year's tariff.
37. In addition, with the alternative system NIE expects that pipeline users would have greater certainty of their cost base within the year. For example, in the model where bullet payment reconciliations are made after the year end, an energy retailer could not

offer a simple fixed price contract for the supply of electricity or gas to a customer since part of the cost base is variable and unhedgeable.

38. Ofreg / DETI propose to retain ship or pay provisions but NIE does not accept the need for such provisions in a postalised charging system. If the objective of a postalised tariff is to ensure all users pay on equal terms, creating additional requirements for “ship or pay” immediately distorts the costs of transporting the associated gas and results in differential pricing. An illustration of this distortion arises in the context of LTI3 gas supplied to Ballylumford (as explained in paragraph 30 above).
39. The paper contends that the ship-or pay arrangements will provide financial security to the pipeline owners and operators. Given that the postalisation arrangements are underwritten by primary legislation, NIE does not see the need to retain any ship or pay arrangements and all users should be treated equally. In addition, the same financial security arrangements should be established for all pipeline users and this, combined with the legislative backing, should provide all the security needed by the pipeline owners/operators.
40. The paper states that “the inability of these consumers to contribute to the cost recovery will result in the transfer of costs.....”, and that the “SOPs from the power stations will lessen the potential impact on the other groups”. This again appears to skew the cost of the financial underpinning of the gas infrastructure towards electricity customers to the benefit of gas consumers. The concept of postalisation should be equality for all gas pipeline users and therefore there should be no additional obligations on the power station users.
41. Again, the lack of numerical analysis and transparency of the costs and assumptions used makes it difficult to comment on the assertion that the ESBII contract will cover the full recovery of the annual costs of the North-West pipeline. NIE remains to be convinced of this and would like to understand the analysis that underpins this view.
42. NIE also remains to be convinced of the economic rationale for constructing the South-North pipeline rather than putting compression on SNIP or within the Northern Ireland pipeline network. Again, greater transparency of the various costs is needed to enable informed comment to be made.

43. NIE is not clear what is meant by the statement that the “minimum payment guaranteed from Ballylumford isn’t adversely affected under postalisation”. NIE believes that the current distortion whereby NIE’s customers must pay for the transportation of 342 m therms per annum, even though the average gas take under the contract has been around [250m] therms, must be removed to ensure equality.

#### **The payments chain and the role of the PSA**

44. NIE believes the structure with three transmission pipeline operators is inefficient and that there should only be one operator. In addition, this party, who should be independent from market participants, should carry out the role of PSA as part of their Transportation Pipeline Operator’s (TPO) functions.
45. The proposals to operate the PSA function as an “agent” will only serve to create another layer of bureaucracy with additional costs added to the overall system. It will also create an additional specific credit risk. Furthermore, the need to deal with multiple operators is likely to result in the need for additional dispute resolution procedures, creating additional costs to be recovered through the postalised charge.

#### **IV Combined Operational System for the three pipelines**

46. NIE supports the Ofreg/DETI view that the operational arrangements for the pipeline need to be revised at the same time as postalisation is introduced. However, NIE believes that the operational arrangements must be changed more radically, such that there is only one Transmission Pipeline Operator (TPO) and only one Network code. This can still facilitate having three pipeline asset owners (probably also responsible for the pipeline maintenance under the direction of the TPO).
47. The TPO should be an independent undertaking (as already envisaged and agreed in principle for the ETSO in Northern Ireland (SONI)) i.e. neither the TPO nor any affiliate should have any commercial interest in shipping or supply of gas. NIE believes that this structure best provides the assurance market participants require that the market will be transparent and non-discriminatory. Whatever structure is finally determined will have to be compliant with the new gas directive (amending 98/30/EC). A structure with a single TPO would greatly simplify the interactions of gas users in that they would only have to interact with one single entity. The consultation paper recognises this problem of

shippers having to be party to a number of codes and such an outcome would do little, other than to add complexity and cost.

48. This structure would also support the “entry point” regime for booking capacity, settling gas throughput, acquiring enhanced services (e.g. pressure enhancement) and balancing the system. It would also help the management of meter errors, shrinkage, and the issue of connection costs.
49. NIE also has concerns in relation to linepack and how this would be operated within an “exit point” regime. NIE considers that this would be much easier to manage if there were only one TPO and all settlement is based on the “entry point” mechanism.
50. The issue of Network Code system charges, and in particular balancing and scheduling charges, needs to be very carefully considered. The system of postalisation must not dilute the incentives on shippers to remain in balance and should ensure the transparent allocation of costs incurred to those parties creating those costs.

## **V Other Issues**

### **Pressure**

51. It is not clear from the paper how pipeline pressure will be managed within a postalised gas transmission system. Questions include: How is pressure maintained and controlled? Who has responsibility? What is the minimum pipeline pressure going to be? If higher pressure is required by anyone, who pays for it? Who assesses the need for additional compression and against what criteria? The structure of the operational and postalisation regime will have implications for each of these issues and it is important that these questions are addressed and resolved in a transparent, efficient and cost effective manner.

### **Linepack**

52. At present only PTL, BGE and Phoenix have access to linepack, but only in their respective systems. The paper does not address how linepack will be managed under a postalised regime. Who will have access to linepack and how will it be accessed, given that each pipeline will materially affect linepack in an adjacent pipeline? Neither is it clear who will pay for linepack nor how it will be recovered. NIE are concerned that linepack could be unfairly used by operators to support other elements of their business. A single independent operator should address such an issue.

### **Transparency of information**

53. In a postalised charging system, it will be vital that all contracts, codes, charges, etc are fully transparent. Unlike the opacity of the current transportation arrangements for SNIP, information must be readily available to all market participants. NIE would suggest that a monthly report should be produced and made publicly available and should cover such information as:

- Total gas throughput (entry/exit) per day;
- Daily availability of linepack;
- Pressure variation;
- Balancing actions and causes;
- Incident reports on restricted days; and
- Relevant market prices

5. Phoenix Natural Gas response



Phoenix Natural Gas'  
Response to Ofreg & DETI  
Proposals for the Implementation & Operation  
of a  
Postalised Tariff System for the Northern Ireland  
Natural Gas Transmission Networks

January 2003

Contents

1. Introduction
2. Incremental Introduction of the Postalised System
3. The Postalised Transmission Asset Operating Regime
4. Payment Mechanism, Financial & Common Tariff Issues

## **1. Introduction**

Phoenix Natural Gas ('Phoenix') welcomes the opportunity to comment on Ofreg and DETI's proposals for the implementation and operation of a postalised tariff system for the Northern Ireland natural gas transmission networks.

We appreciate Ofreg's acknowledgement of the 'effort and positive attitude towards the implementation successful implementation of postalisation displayed by all three operators in these discussions' (Section 2, page 5) and would like to re-emphasise Phoenix's commitment to making the postalisation arrangements work.

## **2. Incremental Introduction of the Postalised Tariff System**

The natural gas industry is already paying a premium for transmission charges following the reduction in throughput to Ballylumford Power Station as a direct consequence of cost reductions for the electricity industry with the closure of trading units there and the investment in the CCGT. This increase in charges is estimated at between 1 and 1.5 pence per therm (originally SNIP charges were expected to remain at around 3 pence per therm and latest estimates show them approaching 4.5 pence per therm) and this year alone, will cost the natural gas consumers at least £1m.

Therefore, there is an urgent need to see the implementation of the postalised tariff system, which will deliver a re-balancing of transmission charges towards natural gas consumers, in advance of the delivery of natural gas to Coolkeeragh Power Station in the final quarter of 2004.

The Executive Summary (Section 1, page 3) and Introduction (Section 2, page 6) of the consultation paper references the need to see cost reductions in order to see an incremental approach to the introduction of the postalised tariff system. However, natural gas customers are already paying more due to the knock-on impact of decisions taken in the electricity industry.

**Phoenix urges the Director General to implement the postalised tariff system from 1<sup>st</sup> October 2002 (the start of the SNIP contract year), to give a two-year bedding in period for the system between Phoenix and Premier Transmission Ltd (PTL), before**

**the introduction of the Bord Gáis (BGE) transmission pipeline in October 2004. Incremental implementation would help to ensure that the benefits due to accrue from Coolkeeragh Power Station for electricity consumers actually crystallise.**

### **3. The Postalised Transmission Asset Operating Regime**

It is also important to stress that Phoenix is working with the other two transmission asset owners, PTL and BGE, to deliver an operating regime for the postalised system that minimises costs and complexities, as desired by Ofreg and, indeed, all electricity and natural gas consumers.

The three transmission owners, Phoenix, PTL and BGE, are due to meet again in the first week in February and Phoenix would expect detailed proposals to be provided to Ofreg thereafter. Phoenix envisages that these proposals will address the issues raised in Section 4 of the Consultation Paper.

### **4. Payment mechanism, financial & common tariff issues**

This section of our response concentrates on issues raised in Section 3 of the Consultation Paper.

#### **4.1 Payment Mechanism**

As previously discussed, Phoenix agrees in principle with the exit point system as favoured in the Consultation Paper.

In respect of Network Codes, Phoenix envisages that distribution shippers will sign up to the relevant Code of distribution transporter from which the shipper exits. The distribution transporter will secure the capacity in the transmission network upstream, following the 'transient shipper' approach, as outlined in your paper in relation to Bord Gáis in Section 4.

This approach will effectively remove one of the key barriers to entry in the competitive supply market.

#### **4.2 Assets & Costs to be Postalised**

Phoenix would object strongly to the costs of the South North pipeline being included in the postalised tariff before it is commissioned (page 8). The economics of natural gas development are stretching enough, even in the current Phoenix area, without early extra costs being added.

Further, whilst we recognise that detailed discussion is required in the future about how the South North pipeline is integrated into the postalised tariff, for the same reason as above, we would be concerned about Irish inter-connector costs being added to the postalised tariff.

#### **4.3 Capacity Commodity Split**

It is highly likely that each of the towns outside of the current gas licence area will be sub-economic. With this in mind, a 100% commodity transmission tariff would be more appropriate, rather than introducing a capacity element. The impact of 50/50 capacity charging on domestic distribution charges is illustrated below:

Typical domestic load factor: 25%

Assumed power station load factor: 100%

Revenue to be raised: 200

Two types of load on the system:

1. Power Station 50 units per day average, 50 units on peak day.
2. Total Domestic load 50 units per day average across the year, 200 units on peak day.

(cont...)

Therefore, the domestic load books 200/250 of the peak day load (80%), with the power station booking 20%.

The power station pays commodity charge of 1 ( $200 \times 50\% / 100$ ) per unit average across the year and capacity charge of 0.4 ( $200 \times 50\% \times 20\% / 50$ ) per unit, **a total of 1.4 per unit transported.**

The domestic load pays commodity charge of 1 ( $200 \times 50\% / 100$ ) per unit average across the year and capacity charge of 1.6 ( $200 \times 50\% \times 80\% / 50$ ) per unit, **a total of 2.6 per unit transported.**

**Therefore, under a 50/50 capacity commodity regime the domestic load pays, on average, 86% more than the power station load, equivalent to a 30% higher charge than in a 100% commodity regime.**

Obviously, as the regime moves to the proposed 75/25 split, the impact on gas consumers is even greater. Therefore, it would be preferable that rules to prevent capacity ‘hogging’ and encourage efficient booking of capacity were developed rather than introducing capacity charging.

The concept of a capacity charge holiday for new distribution networks would discriminate against existing natural gas users, ironically leading to lower charges in new towns than those in Greater Belfast.

#### **4.4 Duration for Setting the Postalised Tariff**

Phoenix supports the concept of the tariff being set each year, with indicative tariffs being produce for a five-year horizon.

#### **4.5 In-year Revenue Transfer between Transmission Operators**

Phoenix supports the approach outlined in the paper and will respond formally to Ofreg's January letter on this issue.

#### **4.6 Dealing with Under/Over Recoveries & Credit Risk**

Phoenix supports the end of year reconciliation bullet payment approach with clear repayment timescales being defined in Licences.

The issue of credit risk needs further discussion. However, in principle, other Transmission Operators (TOs) should not be exposed to the risk of shippers exiting from another asset.

#### **4.7 Postalisation System Administrator (PSA)**

The role and responsibilities of the PSA needs to be defined clearly and, preferably, enshrined in a Licence. Phoenix supports the concept of an agent being appointed to carry out the PSA functions.



## 6. Premier Power Limited response

***Response to Ofreg consultation***

**“Ofreg and DETI proposals for the implementation and operation of a postalised tariff system for the Northern Ireland natural gas transmission network”**

*prepared by*

**Paddy Larkin**

*for and on behalf of*

**Premier Power Limited**

**31<sup>st</sup> January 2003**

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## **1. Introduction**

Premier Power Limited welcomes the opportunity to respond to Ofreg and DETI's postalisation consultation paper. This paper sets out our response to those issues included in the paper and those that we believe should have been covered.

## **2. Premier Power Limited**

Premier Power Limited is a wholly owned subsidiary of BG group plc. The company owns and operates Ballylumford Power Station, the largest power station in Northern Ireland. In recent years its long-term power purchase agreements with NIE were the subject of a buy out. Currently it is investing £200 million in a new 600 megawatt combined cycle gas turbine power station at the site. At present its power plant consumes the majority of the natural gas used in Northern Ireland.

## **3. Summary**

- The Coolkeeragh project is not the best option for future power generation.
- Alternatives for paying for new gas infrastructure have not been adequately assessed.
- There is no precedence for the proposed postalisation arrangements.
- The proposed South North pipeline should not go ahead on economic grounds.
- Existing electricity businesses should not be disadvantaged as a result of postalisation.
- NW pipeline capital costs should be kept to a bare minimum.
- Shippers and gas consumers should be more involved in developing the postalisation arrangements.
- It is unclear how the Ballylumford (PPL) ship or pay contract links to a postalised tariff.
- A tariff based on commodity only would be best for developing gas distribution zones and help generation competition to be on a level playing field.
- The network operating regime should be designed to minimise complexities at the shipper / operator interface and optimise operating costs, without compromising safety and security standards.

## 4. Response

### The Coolkeeragh / NW / SN project

A full public debate and assessment of this project has not taken place. This should be initiated forthwith as major cross subsidies, taxpayer's money and a long-term customer commitment is involved. Other options for electricity generation are available which could provide modern efficient plant without the need for unnecessary investment in gas pipelines. These should have been properly evaluated.

Where is the evidence that availability of natural gas will bring an increased level of economic activity commensurate with the gas network costs involved? What effect will an increased electricity price have on economic activity?

A significant percentage of the power from the new Coolkeeragh plant is likely to flow to the Republic of Ireland. In this case there is no advantage to the NI electricity consumer only the disadvantage of the long term cross subsidy that they will be paying.

There does not appear to be an overall, long term, co-ordinated energy strategy. Such a strategy should be produced and this project should be assessed against delivering that strategy, particularly in view of the long-term nature of this project.

### Paying for Gas Infrastructure

. The Government has a policy of encouraging gas investment outside of Premier Power and Belfast. In support of this, the Coolkeeragh Power project, the NW and SN Pipelines and new distribution ventures stand to benefit from significant Government financial and structural support. As regards the proposals for gas transportation charges, we believe that a thorough analysis be carried out to ensure that the benefits to new consumers outweigh the costs to existing consumers, and that postalisation is the most appropriate method of charging for gas transportation. We are not aware of any proper cost/benefit analysis having been done.

A pay as you go approach could be adopted for power plants, where shippers supplying power stations would pay the appropriate contribution to each pipeline that they use. A postalised tariff could then apply to all other users, which would be used to offset what the power stations have to pay. This method would ensure that 'anchor tenants' do not locate in uneconomic positions and then require a cross subsidy to be feasible

The current postalisation proposal does not align with GB system of charging.

Why are electricity customers / businesses, who will not have access to gas, expected to pay so that their neighbours/ competitors can avail of gas. Could taxation along the gas

corridors not be used to fund the additional costs? Or indeed if there is an expected general economic benefit then maybe a general tax would be appropriate. If this could not be achieved via rates increases then a targeted levy could be introduced on the electricity bills of those customers with access to gas.

We do not know of any precedence, anywhere, for postalising a collection of networks that is privately owned by different companies. What unknown risks are we being asked to take?

Why has serious consideration not been given to including the NI gas network in the GB charging system? We believe that the draft Energy Order gives Ofreg the powers to talk with other regulators in order to “coordinate” activities. This method could possibly even result in a decrease in NI gas transportation costs. The associated increase in GB transportation costs would be tiny.

In any event there should be some locational signaling to encourage gas demand customers to site close to the gas network. This is the case in most other pricing regimes.

## Postalisation Proposal

### *Electricity cost increase*

It has been stated, in this paper and elsewhere, that there will be a transfer of costs from gas to electricity customers (we estimate £1m approximately) and from eligible to franchise electricity customers (the mechanism for this is unclear but we estimate that it could be £4m approximately). Consequently there is also an expectation that electricity costs will increase. These cross-subsidies should not be considered, as electricity costs are already high for Northern Ireland.

If franchise electricity costs are to increase as a result of a postalised gas transportation tariff that is higher than the current tariff then no mechanism has been described which allows these extra charges to be billed to franchise electricity consumers. In the case where an existing shipper is not an electricity producer will the shipper bill the electricity consumer directly?

Furthermore electricity businesses should not be exposed to any postalisation implementation costs or any increase in their operating costs (other than possibly gas transportation) as a result of postalisation. An appropriate means to recover any such costs should be implemented by Ofreg. Additionally existing NI electricity businesses should not be disadvantaged with respect to future competitors as a result of postalisation.

## **South North Pipeline**

There does not appear to be a satisfactory rationale for construction of the South North pipeline – there should not therefore be any commitment from any part of government to this part of the project at this stage.

Compression on the SNIP/BTP/NW network could provide the required increase in gas transportation capacity for the foreseeable future. This would only cost a fraction of the SN pipeline costs. Even compression plus longer spurs to ‘gas disadvantaged’ towns would still cost less than the SN pipeline.

One could argue that the SN pipeline improves security of supply – but at what cost. The risk of failure of a pipeline is fairly remote. In any event both RoI and NI systems are connected to GB transmission system via a single pipeline. Most large users including power stations will be on an interruptible gas supply anyway and generally carry their own back up fuel. In the event of a pipeline failure power stations are the first to be interrupted, followed by large users. The linepack available in the system could supply the domestic market for a number of days. This is in the context of consumers already having a single point of supply into their premises and natural gas equipment that is much less reliable than the supply to it. Are consumers willing to pay the extra cost for the SN pipeline – we are not aware of any evidence to suggest that they are.

The Northern Ireland network should be fully utilised before any other transportation costs are incurred.

### ***Pipeline capital cost /Spurs / PRS's and transportation gas cost holidays on LDZ's***

The capital cost of the pipelines should be minimised and fixed at the pre-build stage. Any overrun on costs should be at the owner's risk.

Any additional costs that are not wholly necessary for the transmission of gas to Coolkeeragh should be fully assessed and be standalone economically.

It appears that this project which is justified on the basis that it will bring greater gas availability actually won't. It seems that to build the additional distribution infrastructure will again require some form of cross subsidy! If this is correct then DETI should clearly state this so that those anticipating a ready gas supply as a result of the NW/SN pipelines are fully informed.

***Involvement of stakeholders***

It seems that the postalisation proposal has been worked up between DETI, Ofreg and the transmission operators.

There does not appear to have been any input from the pipeline shippers (who will probably be most affected by the proposals) or from electricity or gas customers. We believe that this consultation paper is the first opportunity for any involvement. These stakeholders should be fully involved as soon as possible. Their views are critical. After all the proposal is intended to maintain the economic position of all the transmission operators. Is this the case for the other stakeholders and if so how will this be achieved?

***Capacity : Commodity split***

The capacity : commodity split should be as much as possible towards 100% commodity. This will ensure that all consumers will pay a similar rate per unit for gas transportation. This will encourage growth of the gas industry and allow power plants with different load factors to compete on a level playing field. Weighting gas transportation towards capacity will only serve to further marginalise low load factor power plants causing their early closure and consequent loss of generation security.

A high commodity weighting would also assist in the development of low load factor distribution zones. These are unlikely to be developed before 2007 and their economics are questionable even with a tariff based wholly on commodity. Therefore the proposed strategy that rapidly increases the capacity element of the transportation tariff completely contradicts the intention to develop gas distribution along the route of the new pipeline (s).

A commodity based approach can still allow the pipeline owners to fully recover their charges via a reconciliation process. There already is a mechanism that allows Ofreg to reallocate any firm capacity booking that is unused. This mechanism could be used to ensure that there is no overbooking of capacity on the pipelines.

***Ballylumford SOP***

The paper refers quite a bit to the Ballylumford power station's ship or pay contract underwriting costs associated with postalisation. PPL buy most of its natural gas at the SNIP pipeline exit point therefore we cannot see our direct involvement in a commitment to postalisation. We believe that it is intended to refer to the shipper(s) who supplies Ballylumford and any ship or pay contracts that they might have with the pipeline operators

because we cannot see how PPL's existing contractual relationship with a shipper would change due to postalisation.

PPL does ship gas on SNIP in its own right, however this is not subject to a ship or pay arrangement.

Any intent for government to interfere with private company contracts will undermine investor confidence in both the electricity and gas markets. Already there is little enough appetite for new investment, other than the incumbents, in the energy market North or South.

### ***Other***

The operating regime should be developed so that it minimises complexities at the shipper/operator interface. Operating costs should also be predictable and optimised, but not in a way that compromises the safety or security of the system. . This is likely to mean all pipelines operating to a common network code.

The rationale behind Coolkeeragh avoiding costs if they have a loss of load is not clear. Does this regime apply to all power plants on the network?

With the current two pipeline operators, postalisation is not being considered unless there is an associated cost reduction. This principle is a good one and should also apply for any number of pipeline operators.

The introduction of the competitive market (which is based on the principle of having over supply of generation) brings a real possibility that volume forecasts for power plants will not be predictable. [ref GB plants currently].

It is not clear how capacity booking at an exit point allocated – given that there could be a bottleneck somewhere else in the system.

## **5. Conclusion**

There are inherent flaws and missed opportunities in the postalisation concept and its proposed implementation, which are likely to have a long-term adverse effect on electricity consumers. These should be addressed immediately and all affected stakeholders should be fully involved in the process.

We would welcome the opportunity to discuss our response further with DETI or Ofreg.  
Please contact us if this would be in order.

## 7. Premier Transmission Limited response



**PTL RESPONSE TO OFREG/DETI CONSULTATION ON  
POSTALISATION**

Premier Transmission welcomes the opportunity to respond to OFREG and DETI's postalisation consultation paper. These comments are in addition to those previously supplied to OFREG in our notes entitled "PSA Role & Responsibilities", "Payment Mechanism, System Financial Security & Payment Shortfalls", and the letter of 05.12.02 entitled "Comments on OFREG's Postalisation Paper".

We echo the view that "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". At this stage the TO's and OFREG/DETI have laid out the broad principles. There is indeed a considerable amount of detail that remains to be identified, resolved and negotiated. This in turn will lead to a number of significant modifications to Licence, Code and ancillary agreements. Implementing postalisation will require a considerable effort from all the TO's, Shippers and OFREG. We believe that a target date for completion should be set in order to drive this complex process forward and that this should be supported by a work-plan and timetable to be agreed by all. This in turn will help ensure that each of the participants can commit the resources required to bring about a successful outcome.

The consultation paper envisages a number of consultations in the future as the detail is developed. In terms of process, we believe that the detailed proposals should be formulated in workshops by the parties affected by the changes, (i.e. primarily TO's and Shippers). The output from these workshops can then be circulated more widely for comment through the formal consultation process. These workshops will also have to develop the dispute resolution mechanism, given that all the affected parties will be operating in a new and unfamiliar environment.

As regards implementation, we understand OFREG/DETI concerns about an initial transfer of costs from gas to electricity customers if an incremental approach is adopted. However, this is going to be a complex mechanism, without any precedent. In any event, there is a need to agree the detail well in advance of implementation to build confidence in the proposals. In addition, we believe that there is also a need to implement the system well ahead of any practical need (i.e. the commissioning of the NW Pipeline), in order to address any errors or omissions and to demonstrate that the mechanism is robust.

We note that OFREG and DETI support the costs of SN pipeline being passed through to all gas consumers and that the SN Pipeline removes the need for any costs associated with compression on Premier Transmission's SNIP system. It should be recognised that this approach will necessarily result in higher costs for gas consumers. Building a SN Pipeline is a much more expensive solution to N. Ireland's gas capacity needs than building compression on SNIP (where SNIP has economy of scale). SN Pipeline arguably will

result in improved security of supply (accepting that both systems ultimately connect to the same point in GB). However, no one party has explicitly raised security of supply as an issue and we are not aware of any party that is willing to pay for it voluntarily. We are not aware of any cost benefit analysis that supports the OFREG and DETI conclusion that it is economically desirable or beneficial to build the SN Pipeline.

#### Page 10 – Forecast Volumes and Costs

The Paper states that: “OFREG will also inform the PSA of the forecast total system postalisation costs for the year”. We maintain that the TO’s would inform the PSA of the annual revenue requirements. OFREG’s role would be to ensure that such costs are compliant with the Licence.

#### Page 12 – Dealing With Under / Over Recoveries

The Paper states that: “It is appropriate for all TO’s to have a common published credit policy, including their Network Codes, to ensure fair treatment of all shippers”. Clearly each TO should have a common (i.e. non-discriminatory) credit policy for all shippers exiting its system. However it is not absolutely necessary to have a common credit policy across all the pipelines comprising the NI Postalised System, so long as each TO has a direct contractual and credit relationship for all Shippers exiting from the pipeline in question (as discussed elsewhere in the OFREG Paper).

#### Page 15 – Tariff Determination

The Paper states that : “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 volume forecasts and total postalised **costs**)”. We are a little confused by the term “*tariffs*” (plural), as the objective is to develop one single tariff. We assume that this is a typographical error. In addition we had understood from discussions with OFREG that in concept this was a vetting mechanism to ensure that TO’s and Shippers did not game the system (for example that there was no double counting of volumes leading to an understated postalised tariff). This should not be or develop into a mechanism for disallowing legitimate transportation costs. OFREG already has powers allocated to it to review charges to ensure that they are consistent with the TO’s Licence.

#### Page 15 – Shipper End-Of-Year Reconciliation

The second sentence should read: “Once actual out-turn volumes *and annual revenue requirements* for the postalisation year .....”. Because of the lag in obtaining Government prepared indices, the final reconciliation payments will not be able to be invoiced and therefore made until April in the next postalisation year.

#### Page 15 – TO’s Revenue Redistribution

The last paragraph suggest that reconciliation payments should be made on trust. We do not consider this appropriate. There should be an absolute obligation on TO’s and Shippers to make reconciliation payments in accordance with the reconciliation report from the PSA (such report to be prepared in accordance with the mechanistic process previously agreed among the TO’s and Shippers).

Page 16 – Under What Legal Control Will The PSA Operate?

For the avoidance of doubt the PSA will collect the levels of capacity booking, but will have no role in allocating capacity.

Regarding the proposed conditions, we do not agree that postalised revenues should be ring-fenced. As indicated above, there should be an absolute obligation to make balancing and reconciliation payments, per the procedures agreed among the TO's and Shippers and administered by the PSA.

As regards who fulfils the role of the PSA, as the paper points out, the three TO's favour a third party carrying out this function. Once the rules have been established by the TO's, OFREG and the Shippers, the PSA role should be largely mechanical and as such a small cost to the system.

Regarding section 4, the TO's will revert to OFREG separately in February.

Premier Transmission looks forward to the detailed development of these principles and a rapid conclusion to the design stage of the postalisation project.