



**Common Arrangements for Gas
Transmission Tariff Methodology and Regulation in Ireland and Northern
Ireland
Phoenix Distribution (Northern Ireland) Limited response
15th August 2008**

Phoenix Distribution (Northern Ireland) Limited (Phoenix) welcomes the opportunity to respond to the Common Arrangements for Gas (CAG) consultation paper on transmission tariff methodology and regulation in Ireland and Northern Ireland.

Overview

Timescales and availability of information to allow an informed choice to be made

Phoenix accepts that an all island approach to the setting of transmission tariffs may potentially bring benefits to the natural gas industry and reduce the level of complexity that currently exists by having different methodologies in both jurisdictions. We agree that a common tariff may assist in the development of Supply competition on all island basis as Shippers would operate under one regime. However as a non-Supplier we are not aware of how real these issues are in impacting competition in supply throughout Ireland. We also agree that the proposals could address some of the security of supply issues which exist.

However having considered the details of the consultation paper our initial assessment of the options proposed is that irrespective of the option chosen consumers in Northern Ireland (NI) will see increased transmission costs. As we have detailed in our response to previous consultations the benefit to the consumer must be one of the ultimate objectives, if not the primary objective, and we could not support the introduction of a common tariff at any cost. We understood from the Memorandum of Understanding issued by both Regulators which states that 'All island common arrangements for gas will deliver benefits primarily to consumers' was also the ultimate objective of both Regulators yet figures contained in this consultation suggest differently, in particular for NI consumers. We would also again reiterate that a significant amount of expense was incurred by NI consumers in recent years in delivering a Postalised regime and it would seem inappropriate that these benefits are lost totally in an attempt to create all island structures.

On several occasions the Utility Regulator (UReg) and the Commission for Energy Regulation (CER) have confirmed that no jurisdiction will be worse off

than the current position i.e. the counterfactual, and as such Phoenix would only be supportive of any changes to the tariff regime if this principle objective is delivered. It is key that the counterfactual argument considers all possibilities i.e. cost of additional requirement on SNIP versus utilisation of the interconnectors (ICs) for NI's marginal gas.

It is Phoenix's view that this key assessment criteria is missing and that this should be the number one priority in any assessment of the options identified and again we would reiterate that it is difficult to support any particular option in its absence.

We believe that the transmission tariff methodology is one of the most critical elements of the all island project and we cannot understand the short timescales for response to this section of the work plan and the need to have the methodology agreed and finalised by September 2008. Even with a two week extension to the consultation period we feel that this area needs further industry discussion. In addition we believe that the amount of information provided in the consultation is insufficient to allow industry participants to make a fully informed choice on the options given. We accept that further information was made available to industry on 22nd July following requests made at the 9th July industry forum but again the timescales given to industry to consider these models was wholly inappropriate. We have gained some comfort from both Regulators that this is only the first stage of the consultation process and that further consultations and workshops will take place before any decisions are made.

We would point out that the reasonably complex regime of Postalisation in NI took approximately 18 months to develop and implement and we would therefore question the timescales for the delivery of the all island tariff methodology which would appear to a more complex issue within the next six months.

The paper also states that as part of CAG a Cost Benefit Analysis (CBA) is being developed which will set out the benefits associated with the introduction of the new Common Arrangements. A preliminary high level cost benefit analysis paper was received by consultees on 30th July and our initial assessment of the analysis is that the level of detail and breakdown in costs did not provide the information we believe would be necessary to allow us to assess all options being considered for tariffing. A more quantified breakdown by option and an indication of whether these are attributable to NI or RoI would enable us to assess the benefit for NI consumers as well as assess the counterfactual argument. It is impossible to appreciate each option without the appropriate CBA and therefore we ask both Regulators to consider this as the detailed scope of the CAG project is revealed and that any further CBA covers each scenario to enable industry to better appreciate the proposed options. Furthermore it would be extremely useful if costs and benefits included in any CBA were in both Euro and Sterling and assumed exchange rates provided.

In relation to the issue of information being provided by jurisdiction the CBA paper states that it is 'difficult to apportion the level of costs and benefits

accruing to each jurisdiction and that 'an extensive review and consultation of the current arrangements' is required before harmonisation of tariffs can go forward. Phoenix would therefore ask how can the Regulators ensure that neither jurisdiction is worse off from the current position and again how can a decision on the tariff methodology be taken within the next month if it is not clear what this impact is and as stated extensive consultation is necessary. Phoenix would argue that extensive consultation has not taken place to date.

Phoenix would also welcome formal confirmation from both Regulators that gas will be commercially able to flow from Corrib and LNG Shannon to NI and therefore any benefits that changing the regime to accommodate these two projects will definitely flow through to NI.

The consultation also summarises the tariff structure differences and commonalities in RoI and NI but misses one key point. The NI natural gas industry is much more immature and is still developing rapidly. Changes to regimes can be seen as added complexity in their own right and complexity adds to costs which may well impact on the growth of the NI market. Continuous and significant change is not good while a consumer base is still developing.

We have detailed below our comments on some of the specific proposals included in the consultation paper

Decline in Utilisation of ICs

- 1) Phoenix accepts that even under the current transmission tariff arrangements that the decline in utilisation of ICs has an impact on NI due to the fact that at some stage SNIP will be fully utilised and gas will have to flow to NI via one of the ICs. However the paper does not make clear what the starting position is for its assumptions. Phoenix would like to understand what percentage of gas flows is assumed to flow through the ICs to NI and when utilisation of the ICs by NI shippers is forecast to happen.
- 2) NI consumers should not be penalised by what appears to be the RoI having a considerable value of stranded assets as part of its transmission networks. The decision to build a second interconnector in the South of Ireland was a RoI decision and the benefit that will be delivered via the taxation regime of Corrib and LNG Shannon coming on stream will be to the benefit of the RoI exchequer and as such Phoenix would ask if the impact of the under utilisation of ICs, which are in practice state owned, should therefore be offset by the significant benefits that the RoI exchequer will gain from Corrib and LNG Shannon.
- 3) The proportion of gas coming via the ICs in the future will still be small in comparison to the percentage of NI gas delivered via SNIP. Therefore as a principle Phoenix does not want a solution to the under

utilisation of ICs disproportionately impacting the overall transmission tariff of all gas delivered to NI i.e. a solution that produces an increase in the tariff by 10% for 100% of the gas delivered to NI is much worse than if the solution was a 20% increase (compared to the assumption of today's tariff) for 10% of the gas marginally delivered through the ICs.

- 4) We note from the most recently published NI Pressure Report that the existing NI Transmission network has sufficient capacity to cater for significant load growth and no reinforcement is anticipated to be required before 2013. We note from the CBA that there is a reinforcement proposed that is estimated to cost €662k (medium case), but it is not explicit in the CBA when this will be required. We would therefore ask if this is anticipated to happen before 2013 why the NI consumer should receive any increase in transmission costs until it is completely necessary to include it in to the NI equation.
- 5) Much benefit has been achieved through the mutualisation of the majority of the transmission assets in NI and this cannot be eroded by implementing an ineffective solution to the IC problem i.e. a solution that underwrites the ICs at a higher rate of return than is theoretically deliverable cannot be justified. The consultation paper states that mutualisation would be an administrative burden. This claim was considered inaccurate by PTL as they stated that payback would be achieved within the first 12 months of operation.
- 6) Many of the options outlined simply reprofile the charge to consumers and in some cases actually increase the total cost to the consumer over the life of the asset. As such a combination of proposals that deliver the lowest charge over the life of the asset and deal with the short-term reduction in utilisation should be considered. Smoothing of tariffs is a tried and tested approach by Phoenix because it charges consumers at the long term price not the short term price.

Capacity Commodity Split

The NI gas market is still being developed with the majority of forecast growth coming from the domestic sector. The current Phoenix customer base has a low load factor (39%) with the majority of consumers using gas for heating purposes. Any further move to a 90:10 or 80:20 capacity commodity split impacts greatly on Phoenix's customer base and in particular the domestic sector and could curtail any future potential growth. The table below shows the impact on an average domestic consumer in Greater Belfast if the current 50:50 split in place for current gas year 2007/2008 was to move to a 75:25, 80:20 or 90:10 split.

Capacity: Commodity split	Annual Transmission Charge for Average Domestic consumer (£)	Pence per kWh	Pence per kWh Increase
50:50	£31.82	0.257	
75:25	£35.94	0.290	13%
80:20	£36.76	0.296	16%
90:10	£38.41	0.310	21%

Note: Assumes Postalised tariffs for 2007/2008 and an average annual consumption of 12,402 kWh for a domestic consumer

Phoenix would therefore discourage any further increase in the capacity commodity split within the NI transmission system whilst the NI gas market attempts to grow its customer base.

In addition the paper makes the case that the traditional method of deciding what level of capacity commodity split should be adopted i.e. capacity costs usually reflect fixed capital costs and commodity reflects operating costs. Therefore it could be argued that the split in NI should be adjusted in favour of a more equitable level of capacity and commodity as PTL's capital costs under the mutualised model make up a smaller proportion of its total costs than under a traditional model. As such Phoenix would request that the move to a 75:25 split be removed and the 50:50 level maintained.

We also do not feel that different capacity commodity splits within each jurisdiction would be a barrier to developing an all island tariff methodology.

Reform Options

It is very difficult to determine what option is the best overall option for the NI consumer because depending on what methodology is chosen to deal with the impact of the under utilisation of the ICs will have a different impact on the options proposed. The 'benefit' of each option is confused because of the 'impact' of the IC issue and also the overarching principle objective that no jurisdiction will be worse off than the current position (and it is not clear what is the current position). With this principle in mind the option that gives the following:

- a) least overall cost to consumers
- b) ease of implementation
- c) all island opportunities

has to be the preferred solution.

The following provide some views on the options identified.

Postalisation

When considering the option of Postalisation for the transmission network, Phoenix would ask for clarity on what networks are to be included within the Postalised regime and what consideration has been given to the designation of new networks that may come on stream at a later stage. Will all new networks be automatically considered for inclusion within the Postalised regime? As the majority of transmission asset development will come from RoI, increasing levels of revenue will need to be recovered leading to an ever increasing tariff for the NI consumer.

Entry

If the three interconnectors at Moffat are to be combined as a single entry point then this will have implications for the current NTS exit reform proposals. In RoI it has been proposed to appoint a single party at Moffat who will secure all NTS exit capacity for RoI and Isle of Man. The initial assessment of what is required has indicated that significant costs will be incurred by shippers for this service. This compares to UReg's position which has suggested that the costs of providing such a service for NI outweigh its benefits and has taken the decision to 'do nothing' in relation to a single party provider. If all three interconnectors are to be combined to produce a single entry point then it would appear that an agreement is required on which scenario for NTS exit reform is the most viable. If NI is to avail of the single party service then the costs associated with the creation of and ongoing charges of such a service will also be targeted in part to NI. It is not evident from the cost benefit analysis paper provided if these costs have been included.

Based on the assessment provided in the consultation it seems to imply that separate NI and separate RoI entry points are the best approach. This deals with the issue of revenue transfer i.e. the methodology throughout Ireland is consistent but the tariffs charges are different.

Exit

Based on the assessment provided in the consultation it seems to imply that separate NI and separate RoI exit points are the best approach. This deals with the issue of revenue transfer i.e. the methodology throughout Ireland is consistent but the tariffs charges are different.

If it is determined that separate exit points for each jurisdiction are appropriate then the use of the South North Pipeline by RoI shippers, as highlighted in the paper, will require a system to be developed where any revenues generated will be returned to NI for the benefit of NI consumers.

Capacity Auctions

Phoenix's experience of capacity auctions when first introduced by National Grid in GB was to see NTS charges increase in one year by £0.5million (this included the rebate received through NTS commodity). This was as a result of the blind bidding process operated by National Grid which led to an over recovery of approximately £300 million. Phoenix would therefore like to understand what safeguards would be put in place to ensure shippers in RoI and NI were not exposed to the same level of risk.

In addition Phoenix currently books and holds all transmission capacity for Shippers who operate in its Greater Belfast Licensed Area. These costs are then passed on to Shippers on a monthly basis. Phoenix also carries out a year end reconciliation process. Phoenix would ask how this process would work if auctions were to be implemented and in particular we would keen to ascertain Shippers' view on how comfortable they would feel with a third party securing their capacity at auction.

Capacity Booking by Phoenix

Phoenix would ask that any preferred solution for all island tariff setting considers the impact on the capacity booking service which Phoenix currently undertakes for Shippers in Belfast with no cost benefit to itself. Phoenix would require further discussions with UReg on the service provided should its current remit be altered or extended.

Non – Annual Gas Capacity Products

These products should be developed if Suppliers wish to have them and they are also cost effective to deliver i.e. benefit should outweigh cost.

Summary

As highlighted earlier in its response, Phoenix has concerns that, irrespective of the option chosen, consumers in NI may see transmission tariffs increase significantly with the introduction of any all island approach to transmission tariffs. We also would reiterate our concerns with the apparent haste to agree the tariff methodology for what is possibly one of the most fundamental issues of the whole all island project. As mentioned previously we have gained some comfort from both Regulators that this consultation is the first stage of this process and we look forward to more detailed discussions on this important element of the project before any final decision is taken.

We would once again ask that the cost implications for consumers are given the highest priority in reaching any agreement and that a detailed CBA is provided for each stage of the CAG project. A fundamental commitment by

both Regulators is that that no jurisdiction loses out and is in fact kept whole by changes to the transmission tariff regime and as such Phoenix would only be supportive of any changes to the tariff regime if this principle objective is delivered.