PTL Response to CAG Transmission Tariff Methodology and Regulation in Ireland and Northern Ireland Paper 27th June 08

Introduction

PTL respond to the paper on behalf of both Premier Transmission Ltd and Belfast Gas Transmission Ltd.

Since the mutualisation of the Scotland to Northern Ireland Pipeline (SNIP) in 2005, PTL has reduced the cost of transportation in NI by £6m per annum. Mutualisation of the Belfast Transmission Pipeline (BTP) in March 2008 introduced a further £5m per annum in savings. The mutual model applied to transmission assets we operate in NI is therefore delivering approximately £11m savings per annum, incorporating the cost of capital savings and the fact we have consistently keep the cost of operation significantly lower than the previous owners.

These savings have only been possible by obtaining very low costs of capital from the bond markets, which has been secured by having a stable regulatory environment and successful operational model. PTL has a duty to its fund providers to ensure a continued secure regulatory environment and successful operational regime and can only support changes through the CAG work streams that;

- in no way increase the risk of full revenue recovery through a system which minimises market risk and shipper default risk.
- maintain PTLs ability to invoice and generate at least its required revenue in a secure regulatory regime such that our fund providers are satisfied,
- does not erode the reduction in NI transportation cost savings achieved to date, and
- does not add operational risk or incur un-proportional cost.

PTL believe that the CAG should build on the success of mutualisation to reduce the cost of transportation to Northern Ireland consumers. Access to Corrib, Storage etc on an all island basis should not be at the expense of increased transportation tariffs for Northern Ireland. PTL would go further to suggest that mutualisation of Transmission Assets should be considered by owners and regulators as a way to avoid tariff increases.

Furthermore PTL will be required to notify and gain approval from its financiers prior any change to our current financial, commercial and operational arrangements. We believe the correct timing for this notification and approval is when a clearer cost picture of the likely arrangement options has been developed.

The consultation paper questions are included overleaf.

Existing Transmission Tariffs

1: Have we adequately described the differences / commonalities between the two markets?
Yes, in respect of the Northern Ireland market which we have working experience, we believe that the Postalisation tariff structure is adequately described.

Assessment Criteria

2: Do you feel that all the relevant criteria have been covered in this document and are there other criteria you feel should be included?
In general we believe that all the relevant criteria have been covered in the document. Although mentioned in section 3.2. Protecting Consumers we feel that a stronger emphasis should be placed on ensuring that either jurisdiction is not adversely impacted in respect of tariffs as a result of the tariff methodology reform.

3: Do you have a view in relation to the priority of the criteria and whether some criteria should be considered more important than others.
As per the response in question 2 we feel that one of the most important criteria is to ensure that either jurisdiction is not adversely impacted in respect of tariffs as a result of the tariff methodology reform. It is possible to develop a common tariff methodology approach which does not necessarily require tariffs in different regions/jurisdictions to be identical, for example the GB market, an Entry/Exit methodology approach is adopted while both Entry and Exit tariffs vary according to exit region or entry point.
Also as discussed earlier and contained within section 3.2.3. of the document, it is vitally important that PTL gains approval from its financiers prior to any change to our current financial, commercial and operational arrangements. Ensuring that parties who have invested in the gas markets in Ireland are not disadvantaged by the CAG is fundamental to long term investor confidence.

Reform Options

4: Do you feel we have adequately represented the appropriate reform options at Entry and Exit? What further reform options do you feel warrant further investigation?
At this stage we agree that the reform options are adequately represented. In respect of the Exit options we believe also that the South-North pipeline can be dealt with under the “Two Exit Point” option also. A similar example is the use of the SNIP by Stranraer Shippers whereby the forecast revenue to be received at the Stranraer Exit point is taken off the NI postalised revenue prior to the NI tariffs being determined. Subsequently a separate tariff is invoiced at the Stranraer exit point throughout the year and the revenue received reduces PTL’s required revenue which in turn reduces year end tariffs.

5: In relation to mitigating the effect of declining interconnector utilisation, have all the viable options been set out? What option do you feel is missing? What level of price incentive, if any, do you feel is an adequate signal to incentivise indigenous gas production/storage?
The decision to construct IC2 was taken prior to any discussions in respect of the CAG and therefore any revenue recovery issues in respect of the IC2 should be addressed by the ROI jurisdiction. Similarly the decision was taken to construct the South North pipeline, the increase in cost which is currently borne by the NI consumer and apart from any future usage by ROI Shippers, is not anticipated to be spread across ROI consumers.
If IC2 provides a security of supply function, as indeed it was intended to, it should be funded by a charge across the consumers in the ROI jurisdiction.

6: Do you think we should harmonise the capacity/commodity split?
We understand that the differences in the capacity /commodity split are related to the development of the industry in each jurisdiction, however it would seem logical that points which may be utilised by consumers in both jurisdictions should have a harmonised capacity/commodity split, for example some of the entry points. For points that are independent in respect of jurisdiction then the capacity/commodity split harmonisation may not be as important, for example if the onshore tariffs in each jurisdiction are independent. PTL would propose to comment further on capacity/commodity split harmonisation once a clearer picture of the tariff methodology is developed.

7: Do you think we should aim to harmonise non annual gas capacity products? What products do you feel should be available?
We would anticipate that non annual gas capacity products would be provided under the Network Code. Under the CAG Operational consultation response we proposed that it should simplify arrangements for shippers and may be more efficient to have a single code at transmission level and therefore we feel non annual gas capacity products should be harmonised. The products which should be made available are those which are required under European requirements such as EC 1775 **and also** clearly required by Shippers.

Assessment

8: Do you feel that we have adequately described Postalisation under the selected criteria?
We feel that Postalisation is adequately described under the various assessment criteria. The paper however gives the impression that there would be implementation issues; we do not see this as an issue as the model currently exists in NI and could be extended.

9: Do you feel that Postalisation is a viable option for the harmonisation of transmission tariffs in the two jurisdictions?

Postalisation works well in NI. It is understood and is favoured by our financiers and its credit arrangements are fundamental to mutualisation. Logic dictates that a larger market would enhance such credit arrangements and therefore we believe Postalisation is a viable option. It creates a significant incentive for gas industry development and produces the lowest tariff for consumers. We have grave concern about the potential for increase in NI tariffs as a result of all island postalisation and agree that some form of revenue transfer would be required.

10: How should we deal with revenue transfer between the two jurisdictions under postalisation?
If any reform option increases the aggregate transmission tariff in one jurisdiction then there should be some form of revenue transfer. It seems that the only feasible way of achieving this is by determining the counterfactual and subsequently making the appropriate revenue transfer. This however is imperfect and could become subjective over time, with loss of cost control by the transporter.

11: How should we deal with currency risk arising from the Postalisation option?
This will have numerous effects on the various stakeholders and we assume each will respond accordingly. We answer this question from a revenue recovery perspective. PTL currently has a strong licence which ensures revenue recovery via the postalised regime. Under this postalised option we would require that any under recovery into any notional all island pot during the year as a result of currency would need to accounted for in year-end tariffs and bullet payments and vice versa for any over recovery as a result of currency risk.
Furthermore, under any of the other methodology options proposed at entry and exit, it is essential that our current position of complete revenue recovery is maintained and that a mechanism would be developed to mitigate any currency risk.

Entry Options

12: Do you feel that we have adequately described the entry options under the selected criteria?
The entry options are generally adequately described. We have concerns about the implementation of any Moffat entry tariff where the SNIP is combined with the ICs. From the current position where the SNIP is close to full capacity it may be seen as an unacceptable risk by our financiers to combine the SNIP with a potentially under-utilised asset, it also raises concerns that NI tariff's will increase to cover IC costs..

13: How should we deal with revenue transfer between the two jurisdictions under the relevant options?
See question 10 response above.

14: How should we deal with currency risk arising from the above options?
See question 11 response above.

Exit options

15: Do you feel that we have adequately described the exit options under the selected criteria?
We feel that the exit options have been adequately described under the selected criteria.

16: How should we deal with revenue transfer between the two jurisdictions under the single exit option?
See question 10 response above.

17: How should we deal with currency risk arising under the existing exit option?
See question 11 response above.

Mitigating the effect of declining Interconnector utilisation

18: Should there be any attempt to mitigate the effect of declining utilisation of the interconnectors?
We believe the declining effect of the interconnectors should be mitigated. As per above the decision to construct IC2 was taken prior to any discussions in respect of the CAG and therefore any revenue recovery issues in respect of the IC2 should be addressed by the ROI jurisdiction. Similarly the decision was taken to construct the South North pipeline, the increase in cost which is currently borne by the NI consumer and apart from any future usage by ROI Shippers, is not anticipated to be spread across ROI consumers.

19: Do you feel that we have adequately described the relevant options under the selected criteria?
We feel that the relevant options have been adequately described. We disagree with the point that mutualisation set up requires significant upfront costs. For both the mutualisation of the SNIP and the BGTP, the set up and transaction costs were saved within the first year due to the lower cost of capital, 2.46% on SNIP and 2.39% on BGTP.
We also note that the apart from reducing the allowed rate of return the other various options do not reduce the total revenue requirement.

Capacity and Commodity charges

20: Do you feel that we have adequately described the option of harmonising capacity & commodity charges under the selected criteria?
We feel that the capacity & commodity options have been adequately described under the selected criteria.

21: What is an appropriate level at which to harmonise?
From a transporter point of view we prefer the highest Capacity element to be included in any tariff, but appreciate a commodity element may be required to assist gas industry development and align with wider environmental policy.

Tariff smoothing
We agree that the methodology of tariff smoothing should follow once any actual tariff methodology is decided, however would emphasise that prior to agreeing any tariff smoothing solution we would need to gain approval from our financiers.

Auctions
22: Do you agree with our analysis of the applicability of auctions?
We agree with the analysis applicability of auctions. Auctions generally are associated with congested assets. For the example where NI has a separate SNIP entry tariff it would be reasonable to assume that SNIP congestion would occur and that an auction may be required. In this case we raise two points;

(i) What SNIP Capacity should be auctioned? We would require current long term capacity bookings to be maintained and subsequently any auction capacity would only be any available firm capacity,
(ii) Assuming that PTL could over recover during any auction where does this over recovery go? We would assume that it would be used to mitigate any increase in the NI aggregate tariff against the counterfactual.

Next steps
23: Do you agree with our selection of viable options for further analysis?
• What additional options should be included for further analysis and why?
• What options should be excluded from further analysis and why?
We would expect that the Separate entry tariff option would require further analysis. All other entry/exit options raise the aggregate NI tariff which would be unacceptable without a revenue transfer mechanism to mitigate. It may be difficult to develop a revenue transfer mechanism which compares against the potentially much varied counterfactual. The Separate tariff option appears to be most aligned with the counterfactual and therefore offers a step approach.
As per the response in question 12 we raise concern about SNIP being combined as a single Moffat Entry.

24: Which is your preferred option for entry / exit?
As per question 23 above it seems that Separate entry and exit options are most aligned with the counterfactual which offers a step approach. However further analysis,

discussion and consultation with our stakeholders would be required before a firm opinion could be reached.

25: Which is your preferred option for mitigating the effect of declining interconnector utilisation?
We believe the security of supply function of the interconnector merits its funding through a levy on all gas users in the ROI.

Conclusion
In general we feel that the various options have been adequately described and assessed. We raise the following points in respect of such options;

- we believe it is possible to develop a common tariff methodology that does not require jurisdiction tariffs to be identical,
- we feel it would be unacceptable for the tariffs in each jurisdiction to be adversely affected through the CAG project. Any increase in tariff in a jurisdiction must be mitigated by some form of permanent revenue transfer mechanism,
- we acknowledge that the declining interconnector utilisation is an issue which needs to be resolved, however we would expect that it would be resolved via an ROI solution, and
- as per our previous comments PTL will be required to notify and gain approval from its financiers prior any change to our current financial, commercial and operational arrangements.