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11th June 2008

Dear Roisin

CAG Discussions paper on the options for the Gas Operational Regime

Please find attached Phoenix Distribution's response to the discussion paper on the options for the gas operational regime on an all island basis.

If you have questions in relation to Phoenix Distribution's response please do not hesitate to contact me.

Yours sincerely

Ivan

Ivan Bell
Commercial Operations Director
Phoenix Distribution Limited

Phoenix Distribution Consultation Response
11th June 2008

Introduction:

Phoenix Distribution (Phoenix) fully supports the principle of exploring opportunities to reduce the cost that customers pay for natural gas in Northern Ireland. We believe that any change that would remove complexity, create a more efficient operation and provides greater security of supply has to be encouraged. We therefore welcome the opportunity to comment on NIAUR and CER's initial thinking on the high level options for the framework governing the gas operational regime in an all island context. The points made in this paper are only our initial views based on our thoughts at this stage of the project. As the project develops and further information is made available it is possible that our initial thinking may change.

Section 2 - CAG Vision and Goals

2.2 Goal of the work stream

Q1. Are there any other criteria against which to evaluate the options for common operation?

The paper states that the vision of the common arrangements for gas regarding operations is to operate gas transmission systems on a single all island basis. Phoenix would be fully supportive of this vision as long as the fundamental principle of delivering cost benefits to all customers, irrespective of whether the customers live in the North or South of Ireland is delivered. Phoenix would be concerned that the significant amount of time and money which was invested in the development of a Postalised transmission regime in Northern Ireland together with the benefits it brought would be lost as a result of any move to a regime that aligned itself more with the current southern industry operation. Further we have seen in recent years the benefits to the NI gas industry and consumers of mutualisation of part of the transmission networks and we would be concerned that again this would be lost as a result of any all island approach.

Q2. Do you have a view on whether any criteria should be prioritised over others?

With regards the specific goals of the workstream we have the following comments:-

(i) Efficient. We fully support the goal as described.

(ii) Cost Effective. Again we fully support the goal as described.

(iii) Customer Friendly. We are fully supportive of the desire to minimise the number of network codes to a level that is most efficient but as our comments later will show Phoenix is not supportive of having a single code or single operator for transmission and distribution and as such feels there will always be a need for more than one interface between suppliers and operators.

(iv) Transparent. Again we are fully supportive.

(v) Consistent with EU Legislation. Again we are fully supportive. Unable to comment as we are not fully familiar with the European Commission's third legislative package for electricity and gas.

(vi) Compatible with present and future developments towards an EU single market in gas. See comment to (v) above.

In relation to the prioritisation of these criteria we feel that all of the above are equally important and that each operational arrangement should be assessed against each criterion before agreement to implement is given. However ultimately the cost of implementing each regime change has to be a fundamental consideration. Phoenix could not support changes to the regime at any cost.

Q3. What is your initial view of the costs/benefits of common operational arrangements for shippers/suppliers?

The paper states that the initial cost benefit analysis indicates that significant savings can be made through single operation of the gas transmission network and that savings of £10m NPV would be delivered over a 10 year period. However Phoenix believe that for Shippers/Suppliers to fully assess the cost / benefits to them they would need to understand more fully the assumptions upon which these savings were calculated and also the breakdown of benefit between Northern Ireland consumers and Southern Ireland consumers allowing a proper assessment of the impact of changes in the jurisdiction in which they operate.

Section 3 – All Island system operation functions

Q4. Which functions should be performed on an all island basis?

Phoenix believes that as many as possible of the functions listed could be carried out at transmission level on an all island basis. However it is difficult to assess which functions give the best ultimate solution for the consumer as the level of detail in the paper does not enable us to determine the cost benefit analysis of each one.

However Phoenix is of the firm view that we should retain the operation of its distribution system. With our experience as a previous transmission network owner and operator, it is our opinion that a transmission system with a few offtakes is relatively straightforward to operate via a control room, whereas a distribution system with over 110,000 customers is much more complex to operate on a daily basis. This is because although key areas of the operation can be managed via a Control Room, a distribution system experiences many more activities on a daily basis i.e. gas emergencies, maintenance, interruption to supply due to damages, general interruption to customers for localised network constraints, extension to the network, hundreds of new customers per week and many more. The ability to operate the network while dealing with all these activities can only happen effectively by undertaking the operation locally in conjunction with the field based operatives.

The separation of the transmission operation from the distribution operation and leaving the distribution operation with the asset owner is entirely consistent with GB where each sold off LDZ is operated by the asset owner. With a TSO and a DSO in operation there will be a requirement to have some form of operational agreement in place between the two operators. The framework for such an agreement has already been developed, approved by the Regulator, and entered into by Phoenix and PTL. Phoenix is also currently progressing a similar agreement between itself and BGE (NI) to deal with the interface at the Lisburn Offtake. Phoenix therefore believes that the delivery of the any necessary TSO/DSO Interface Agreements should not be an issue going forward.

In addition Phoenix's Control Room has been set up to undertake more tasks than that performed by a traditional Control Room, such as Supply Point Administration, isolation requests, Network Design and Record digitisation, which has delivered both the commercial operation, required for Supply competition, and the physical operation at the least cost to the consumer. It is therefore Phoenix's opinion that the operation of its distribution system is already being delivered by the least cost option.

As the consultation document details, Phoenix currently books and holds capacity on the Postalised Network on behalf of all Suppliers who operate within its Distribution licence area of Greater Belfast. This is a service carried out on behalf of greater Belfast Suppliers by PDL with no cost benefit to PDL. As the regime has developed it has become increasingly complicated from a Distribution perspective with PDL now acceded to three transportation codes, having to provide credit support to the Postalised regime for capacity booking, manage a cashflow on behalf of Suppliers as well as carryout out a year end reconciliation. Phoenix would therefore be concerned that any all island approach would further complicate this capacity booking service it currently carries out for Great Belfast suppliers and in particular require it to accede to further network codes and increasing its exposure to costs associated with being a party to a network code.

The capacity booking service also has issues outstanding, in particular the issue of Greater Belfast Suppliers unable to secure CSEP certificates to provide to their NTS counterparty for booking exit capacity at Moffat as well as having to submit all nominations on the PTL system as interruptible nominations and we therefore ask that any all island solution addresses these issues for Greater Belfast Suppliers.

With regards the operation of the Transmission networks, Phoenix is of no strong view as to which solution is the best ultimate solution for the consumer as the level of detail in the paper does not enable us to determine the cost benefit analysis of each one.

Q5. What is your preliminary view of how transportation charges should be collected and distributed?

Phoenix feel that the use of a Postalised System administrator similar to that currently used in NI is a possible solution to the collection and distribution of transmission charges. This option has proven in NI to be an exceptionally cost effective method for the collection of Transmission Charges. The use of an independent body has the made the process fully transparent and has ensured that collection and disbursement of charges is carried out in a strictly controlled and timely manner.

As detailed in our answer to Q4 above the operation of a Distribution Network is more complex and this is also the case for the calculation of distribution charges. As we indicate in our response above we would propose that this function is carried out independently of transmission charging.

Section 4 - Options for system operation

4.2 Options for single system Operation

4.2.1 Coordination between multiple combined TSO/TOs

Q6. How complex would it be to create a single IT interface for nominations with multiple TSOs?

Phoenix believe that this is a specific question for PTL and Bord Gais who currently operate the IT systems used in both parts of the Island together with their current system providers.

Q7. What level of IT investment might be needed to create such an interface?

Please see response to Q6 above. We do believe that it is critical that the costs of creating such an interface are made available to industry as soon

as possible to allow a full cost benefit analysis to be carried out. Previously in NI when system changes were proposed to make both GTMS and GTMBS more compatible the amounts being quoted were very significant.

4.2.2 Multiple combined TSO/TOs with a single service provider

Q8. Should new transporters coming into the market be required to contract with the SSP?

One of the primary functions of the all island project is to remove complexity from the current regimes for Shippers and Suppliers. Therefore it would seem appropriate that any new transmission network should be incorporated into the final agreed all island format to ensure the simplified processes are maintained for users of the Networks. However the inclusion of new networks into the current regime may not necessarily bring additional cost benefits to the existing system. Phoenix would like to understand if the example given of the new Shannon development has been factored in to the cost benefit analysis by the CER and if incorporated what cost benefits are achieved.

Q9. Would any other steps be required to implement this option?

As described in our answer to Q8 above the cost implications of including a new network into a current regime would need to be assessed against maintaining a simple, easy to operate regime for Shippers and Suppliers.

4.2.3 Single TSO

Q10. Other than the options outlined, how else might a single TSO be appointed?

It may not be practical to appoint a single TSO on a tendering basis routinely. It may be more practical to appoint a TSO initially on a tendering basis and then ensure that that TSO delivers the required objectives in the most cost effective way through tight and effective regulation. To replace a TSO on a regular basis will incur additional costs and could potentially increase Health and Safety risks at the time of changeover.

Q11. Would any other steps be required to implement this option?

Not that we are aware of.

4.2.4 Dual TSO

Q12. Would any other steps be required to implement this option?

Not that we are aware of.

4.3 Other Market Structures

Q13. What investment will be needed to support single system operation?

As this is at the Transmission level, Phoenix believes BGE and PTL are best placed to answer this question.

Q14. How should emergencies be managed under each option?

As this is at the Transmission level, Phoenix believes BGE and PTL are best placed to answer this question as long as the requirements of the distribution network operators are taken into consideration.

4.4 Assessment of Options

Q15. What is your view of how each option meets the goal?

The electricity market in Ireland does seem to have established an accepted approach whereby there is a single operator in the North and a single operator in the South. A consistent approach across gas and electricity may ultimately lead to greater benefits in the long term. In order to achieve this approach the Northern Ireland regime would have to identify who is best placed to undertake the operator role, BGE or PTL. There is obviously argument to support either party but a view maybe that greater long term benefits could be achieved by having a different operator in the North than the South i.e. PTL in the North and Gaslink in the South. These two parties could be benchmarked and performance regulated by each of the regulators in the same way that each of the Network Operators in GB are benchmarked and targeted to deliver efficiency gains in line with the best performing operator. It could be argued that this would deliver better long term performance benefits than having a single all island operator, with a natural monopoly, which because of its natural monopoly and incumbent status could make it difficult for other parties to obtain the work on a tender basis and as such the same single operator would be in place forever. The downside of this approach is that currently PTL outsource the commercial and physical Control Room Operations to BGE and therefore it would be hard to see how ongoing benchmarked improvements could be delivered when ultimately it is the same party undertaking a large percentage of the activities for both operators.

Q16. Are there any other costs which will need to be taken into account?

None that we are aware of.

Section 5 – Network Codes

5.2 CAG Network Code Options

5.2.1 Multiple Network Codes

Q17. How can we ensure that codes do not diverge over time?

See answer to Q21.

Q18. Are there any other implementation issues to consider?

Not that we are aware of.

5.2.2 Dual Network Codes

Q19. Are there any clear advantages of this option over multiple codes?

See response to Q24 below

Q20. Are there any other implementation issues to consider?

None that we are aware of.

5.3 Other Implementation Issues Q21, Q22 and Q23 all answered in Q21

Q21. Who should own the code?

Although Phoenix does not necessarily believe that a single network code is achievable given the timescales involved in this project (please see Phoenix's response to Q24 below) we do agree that the GB model is an example of how this could work. In GB each gas transporter is required by a condition in its licence to establish transportation arrangements (i.e. arrangements which enable gas shippers to use that transporter's pipeline system) and to have in place a network code (an individual network code), which sets out those transportation arrangements. The transportation arrangements (and network codes) are required to meet certain objectives set out in the licence condition (such as ensuring effective competition between gas shippers and gas suppliers).Thus NG and each of the four independent DN operators are required to have a network code. A gas transporter may only contract with gas shippers on the terms of its network code. However in order to maintain consistency of terms for use of different pipeline systems, the gas transporters are also required by their licences to establish collectively a Uniform Network Code (UNC). Each of the individual network codes must incorporate the UNC which contains all of the detailed rules required, and as the consultation document states the individual network codes are short one page documents which simply incorporate the UNC.

The individual network codes are codes, not contracts as such. However they are given contractual force through Framework Agreements signed by the gas transporter with the gas shippers (or other parties) who are to be bound by the rules in the UNC. Thus NG has signed a Framework Agreement with the gas shippers who use its system (the NTS and retained

LDZs), as has each of the independent DNOs. Each Framework Agreement contains accession arrangements to allow new gas shippers to sign. Any shipper wishing to ship gas on the NTS or LDZs must sign the relevant Framework Agreement(s) and thereby be bound by the UNC.

Q22. Is a single code feasible with multiple TSOs?

As above in Q21.

Q23. Are there any other implementation issues to consider?

As above in Q21.

5.4 Assessment of Code Options

Q24. What is your view of how each code option meets the goal?

Multiple Codes: In NI three transmission network codes currently exist and there is an obligation on each operator to consult with the other operators before proposed modifications to their code are made. This process has worked to date and several significant changes to the NI transmission regime have been successfully achieved for all codes by close cooperation between operators. However this method is extremely time consuming and changes to the current regime have taken significant period of time to implement (Streamlining process took approximately 12 months to deliver). Introducing further network operator codes into this process could make the continuing alignment of all codes increasingly difficult and long delays in implementing changes would not necessarily be acceptable to Shippers. Phoenix does not therefore believe that this option is the best solution.

Dual Codes: Although there is currently 3 transmission network codes in Northern Ireland the Belfast Gas Transmission Code was drafted to dovetail seamlessly into the PTL Transmission Code and many of the traditional activities of a Code are in fact done within the PTL Code on behalf of the two pipelines. As such Phoenix therefore believes that the amalgamation of the PTL Code and the Belfast Transmission Code could be achieved fairly simply. In addition large sections of the PTL Code and the BGE (NI) Code were drafted collectively in order to deal with the Postalised Regime and the remaining parts of the two Codes are either identical or similar. Therefore the move to a single Northern Ireland Transmission Code should be relatively easily achieved.

Therefore a single Transmission Code in the North and a single one in the South could be achieved in line with Phoenix's current view that there should be a single transmission operator in the North and one in the South.

Single Network Code: As the consultation document indicates, if gas arrangements were being developed again then a single code would be the optimal solution for the Island. However given the established regimes

North and South and the amount of work it would take to achieve this, Phoenix does not believe that this option could be delivered within the timescales set for this project. The Dual Network Code option brings many of the benefits of the single code option with a more realistic chance of being delivered by October 2010.

Q25. Are there any other issues we should consider in assessing which option best meet the goal?

Not that we are aware of.

Section 6 - Scope of all island system operation and code(s)

6.1 System operation at the distribution/retail levels

Q26. Should the single TSO cover distribution?

As detailed in our response to Q4 above, Phoenix is of the firm view that it should retain the operation of its distribution system. We believe that the most cost effective solution is to allow for a separate distribution code in NI and the retention of the distribution element in the RoI regime if thought appropriate.

The distribution regimes in NI and ROI have many fundamental differences, in particular in the areas of metering services, capacity booking processes, change of supplier routines and IT systems and we feel it would be costly to attempt to align both regimes. The basic principle behind the development of the Phoenix Code was to keep the processes as uncomplicated as possible for shippers bearing in mind the size of the market in which we operate and the maximum penetration we could ultimately achieve. We used a much simplified GB Network Code approach to help achieve this objective and we believe that the Code in its current format does achieve this aim. We would therefore not support any proposal to fundamentally change processes which would require a significant amount of investment by Phoenix which ultimately will lead to higher distribution charges for NI consumers. We therefore believe that the long term solution (not just interim solution) should be to retain the Phoenix Code in the North.

Although the Greater Belfast consumer has paid for the development of the Phoenix Code a mechanism could be found by which the Phoenix Code could be rolled out to the remainder of Northern Ireland and therefore adopted by firmus, and in some way ensure that all Northern Ireland distribution consumers pay for its development. Phoenix believes that the marginal cost of firmus adopting its Code would be significantly less than firmus developing its own Code from scratch ands would enable a single Distribution Code to operate throughout Northern Ireland.

In addition to the many fundamental differences in Distribution Code processes, the systems used in both regimes are significantly different also and to create an all island regime for distribution activities would require significant investment in NI in IT systems. Phoenix has developed its systems in line with the market size in which it operates. Although we accept that further automation may be necessary with further development of Supply competition we could not justify developing systems which require significant investment to ensure the current RoI regimes is replicated in NI.

As mentioned also above there is fundamental differences between the NI and RoI markets in relation to certain services provided by distribution operators. In particular in relation to meter reading services the responsibility rests with BGE in RoI and with Suppliers in NI. Any move to require Phoenix to carry out such a service would not only require significant licence changes in NI but would require major investment in IT systems by Phoenix. Although there are a number of Suppliers currently operating in Greater Belfast the number of customers switching suppliers has been extremely small and to date Phoenix has managed this process using a manual system to facilitate switching. As mentioned above this is one area we accept that further development is necessary but we would never envisage requiring a system similar to the Gas Map system in RoI.

Q27. Can a single TSO operate distribution in one half of the island and only transmission in the other?

See response to Q26 above.

Q28. Do we need a Xoserve function in CAG?

Phoenix would have concerns about the costs associated with this type of operation. Again we need to consider the size of the market on the island of Ireland compared to the GB network with over 20 million supply meter points and many hundreds of million pounds more of transportation revenue earned each year.

6.2 Scope of Single Network Code

Q29. What should the long term goal of CAG be in terms of code development?

See response to Q26 above.

Q.30 Should the UNC incorporate the distribution functions?

See response to Q26 above.

Q31. If the goal should be a combined Transmission and

Distribution UNC, can this be achieved by 2010?
See response to Q26 above.