PTL Response to CAG Draft Conclusions Paper on Transmission Tariff Harmonisation in Ireland and Northern Ireland

Summary

This response is on behalf of both Premier Transmission Ltd ("PTL") and Belfast Gas Transmission Ltd ("BGTL").

We recognise that there are potential strategic benefits of CAG, such as increased competition, improved investment environment and security of supply. However the benefits should not be at the expense of increased transmission tariffs for NI. We commit to the CAG process with a focus on the interests of NI consumers.

PTL and BGTL will give their full support to changes that protect the legitimate interests of its funders and give clear demonstrable benefits to NI consumers. Regarding our funders, PTL and BGTL will be required to notify and gain approval from its controlling creditor prior to any change to financial, commercial and operational arrangements. The cost and the potential time implications of this process must be accommodated within the CAG workstream. Regarding the benefits to NI consumers, our analysis of the model provided leads us to believe that most options proposed are likely to lead to increased transmission tariffs for NI consumers.

PTL suggest that further mutualisation of transmission assets should be considered as part of CAG, to significantly reduce tariffs.

We make the following observations:

- Our analysis suggests that the options for harmonisation of transmission tariffs suggested are not likely to reduce charges to NI consumers. Several of the options proposed are likely to increase costs, without a complex and non transparent means of revenue transfer between operators in two jurisdictions.
- The allowed revenue entitlement of PTL and BGT is underpinned by shippers on the postalised regime. Any change to the PTL or BGTL licences will require the agreement of our controlling creditors.

- We have exercised an option to obtain additional capacity on “fair commercial terms”, on the SNIP pipeline, which has the potential to meet NI capacity requirements for many years to come.

If Entry / Exit Tariff’s are to be introduced, our preferred option would be a separate SNIP entry at Moffat with a single tariff at all exit points in NI. Our analysis suggests that this is the only entry exit option likely to avoid increases in tariffs for NI consumers.

The potential changes outlined in this paper represent a fundamental change to the regulatory regime and will require primary legislation and considerable licence changes. In order to attract and retain investment in the NI gas market, it is important to have long term stability and adherence to the terms agreed when investors enter that market. The NI customer has benefited from PTL and BGT achieving the lowest cost of capital in the industry based upon the allowed revenue pass through clauses and the security of the postalised system. It will be essential that PTL’s and BGTL’s allowed revenue remains unchanged under CAG, and its ability to meet any revenue shortfall is enshrined in its licence. We expect this to require primary legislation and major licence modification.

We note that postalisation was introduced quite recently, at great time and expense, and has been important in our ability to raise low cost capital from the bond markets and to achieve real benefit for NI consumers.

This paper suggests that SNIP “is full (around 2011)”. PTL believe that SNIP has a physical capacity greater than the current commercial arrangements. An option to obtain this capacity “on fair commercial terms”, has been exercised. We have begun discussions to obtain this value for the benefit of consumers in NI. We believe that the cost of additional capacity achieved though these discussions should also be used as a “counterfactual” to any other options considered in this paper.

Introduction

Since the mutualisation of the Scotland to NI 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 currently 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 funding providers to ensure a continued secure regulatory environment and successful operational regime and can only support changes through the CAG work streams that;

- Does not erode the reduction in NI transportation cost savings achieved to date by mutalisation.
- In no way increases the risk of full revenue recovery through a system which minimises market risk and shipper default risk.
- Maintain our ability to invoice and generate at least our required revenue.
- Does not add operational risk or incur additional cost.

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.

Access to Corrib, Storage etc on an all island basis should not be at the expense of increased transportation tariffs for NI. 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. PTL believe that the CAG should build on the success of mutualisation to reduce the cost of transportation to NI consumers.

Draft Conclusions on a fully postalised regime

In general PTL agrees with the Regulatory Authorities assessment of the implementation of Postalistaion on an all island basis and that such implementation has advantages and disadvantages. We particularly note the following key advantages that Postalisation in NI delivers;

- The allowed revenue entitlement of the transmission asset owners are underpinned by the covenant of all Shippers on the postalised network in NI – to the extent that the last person shipping on the high pressure network in NI is underpinning any postalisation charges which are overdue for payment by former Shippers;
- No Designated Pipeline Operator has exposure to the credit quality of any other DPO, because (i) the postalisation charging system is underpinned by a trust arrangement (with the trust role being performed by a Postalisation Trustee) and (ii) the licences of DPOs and Shippers dictate that postalisation charges are paid directly to a ring-fenced trust account (commonly known as the "Postalisation Pot"); and
- The Network Codes of DPOs impose an obligation on Shippers (in appropriate cases) to provide credit support (a Letter of Credit or other acceptable security cover) in support of the amounts payable to their DPOs.

NI Postalisation provides a highly robust underpinning for the 100% debt financing of the mutualised assets – and this underpinning was a key factor in the shadow rating ascribed by the rating agencies to SNIP and BTP and in the decision of the Monolines to wrap the debt at a cost of finance which was (and continues to be) extremely attractive to consumers generating saving of some £11m per annum.

The RAs current position is to discount the existing arrangements and to move towards an Entry Exit tariffs, effectively dissolving the current NI Postalised regime. There is no question that such dissolution would require consent from our controlling creditor under the current financing arrangements. It is therefore critical that any new harmonised tariff structure protects the legitimate interests of the Controlling Creditors by preserving the

substance of the key features of the current NI postalised system summarised above both in the short term and long term.

The preferred approach of implementing an Entry Exit Regime

The draft conclusions paper appears to capture the advantages and disadvantages of an Entry Exit regime.

As stated in the draft conclusion paper, the move away from the successful NI postalised regime to entry exit will require major change to tariff structures and primary legislation. As per above the mutual company financing arrangements will also need to be revisited and amended to satisfy current obligations, again a considerable exercise of work and expense.

We believe that any new regime should;

- Provide benefits to NI consumers.
- Provide the guarantees and securities summarised above.
- Avoid the need for a counterfactual tariff calculation.

The Entry Exit regime that seems to align with the above criteria is separate Entry at Moffat and separate Exit. In this case we would not anticipate the current NI Designated Pipeline Operators required revenue to increase and subsequently the aggregate transmission tariff would not change.

Assuming that the SNIP Entry tariff remains lowers than the IC tariffs we recognise that there may be congestion on SNIP which could increase the SNIP Entry tariff via some form of auction or tariff setting. To avoid this complication one potential solution is to set the entry tariff for SNIP in line with the tariff for IC's. Any SNIP over recover should be used to reduce exit tariffs in NI.

The aggregate NI transmission tariff should remain unchanged. In this case as there is no requirement to transfer revenue between the North and South we do not see the need to determine a counterfactual, this is a significant benefit, as it is simple and transparent.

IC Mitigation

We do not accept that the Moffat entry points should be combined to resolve the IC under utilisation problem. Although the SNIP and ICs are connected to the GB market at one point (Moffat) they vary from a tariff and commercial perspective. A combined Moffat does not fully resolve IC under utilisation, particularly if additional supply points are added to the system. In our opinion it is likely that cost recovery will need to be moved to ROI exit and / or the cost of capital reduced to the lowest available as demonstrated by our mutual companies.

This paper suggests that PTL "is full (around 2011)" this is not the case, it has a physical capacity of some 50% more than the current commercial arrangements. An option to obtain this capacity "on fair commercial terms", has been exercised. We have begun discussions to obtain this value for the benefit of consumers in NI. We believe that the cost of additional capacity achieved though these discussions should be used as a "counterfactual" to any other options considered in this paper.

We would also note that the South North pipeline provides security of supply and is paid entirely by NI consumers.

We note that an option has been proposed to set SNIP and IC's tariffs at Long Run Marginal Cost under the "combined Moffat" scenario. Our initial thoughts on the LRMC proposal are that it is likely to result in under-recovery of required revenue on SNIP with a mechanism being required to recover any shortfall from the onshore system via the exit tariff. We have concerns that this situation would not be to the satisfaction of our controlling creditors as it removes PTL's ability to directly invoice and generate at least its required revenue.