

Premier Transmission Limited and Belfast Gas Transmission Limited Operating Expenditure Review

Decision

2011/2012 – 2013/14

27 September 2012

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1 INTRODUCTION

Introduction

- 1.1 This paper sets out the Utility Regulator's decision on a level of controllable operational expenditure we feel is sufficient to ensure that Premier Transmission Ltd. (PTL) and Belfast Gas Transmission Ltd. (BGTL) operate their network effectively and safely, while incentivising them to create efficiencies. This decision covers the three years 2011/12, 2012/13 and 2013/14.
- 1.2 All figures are in September 2011 monies.

Company Overview

- 1.3 PTL is the owner and operator of the Scotland to Northern Ireland Pipeline (SNIP) which links Twynholm in Scotland with the Ballylumford power station in Co. Antrim. BGTL is the owner of the Belfast Gas Transmission Pipeline system (BGTP) which runs from Ballylumford power station to the Belfast distribution network. Both PTL and BGTL are wholly owned subsidiaries of Mutual Energy Limited (MEL). They are legally separate companies but have the same management team.
- 1.4 To improve the rate at which the SNIP and BGTP could be financed the normal regulatory control over any allowed operational expenditure accrued by both PTL and BGTL has been removed. In other words all of their operational expenditure is pass through thereby reducing the risk to the company and allowing them to achieve a lower rate of finance.
- 1.5 The resulting transfer of risk onto consumers (through potential inefficient operating costs) has been limited through corporate governance licence conditions contained within the conveyance licences held by both PTL and BGTL. One such condition allows the Utility Regulator to review the level of operating expenditure forecast to be incurred by PTL and BGTL for the next three gas years in the form of a shadow price control. This process is a monitoring exercise and does not prevent either PTL or BGTL from recovering their actual costs through their respective licences. Indeed any outperformance by PTL and BGTL is returned to customers. This review has therefore two aims: firstly to provide the PTL and BGTL management with an operating expenditure benchmark and secondly to provide greater transparency of operating costs to the wider public. This condition is an important part of mutualisation due to the pass through nature of the operating expenditure.
- 1.6 Condition 3.1.6 (b) (i) of both the PTL and BGTL Conveyance licences which states that the licensee must submit an estimate of its controllable operational expenditure for each of the next three gas years together with an explanation verifying the costs as reasonable estimates. Condition 3.1.6 (b) (i) then permits the Utility Regulator "to verify that such estimates are reasonable estimates".

Approach

- 1.7 We outlined our approach in our Consultation document dated the 12 June 2012. A summary of the approach taken is below:
- We have decided to undertake the review of both PTL's and BGTL's controllable operating expenditure jointly;
 - We commissioned engineering consultants to give advice and make comment on the engineering aspects of the PTL/BGTL submissions;
 - We used actual operating expenditure costs incurred by PTL/BGTL as trend analysis for operating expenditure costs going forward;
 - We considered a level of efficiency that we feel is achievable in the business over the next three years.
- 1.8 The submissions were analysed on a line by line basis to ensure a detailed analysis of the operating expenditure costs.

Duration

- 1.9 Historically, the PTL/BGTL shadow price controls have been set for three years. In the future we will consider whether a five year shadow price control would be more appropriate.

2 RESPONSES RECEIVED AND UTILITY REGULATOR VIEW ON RESPONSES

Introduction

- 1.10 In June 2012 we published our minded to decision on the level of controllable operational expenditure for PTL and BGTL for the three years 2011/12, 2012/13 and 2013/14.
- 2.1 The Utility Regulator received two responses to the consultation paper from:
- Mutual Energy; and
 - The Consumer Council.
- 2.2 We would like to thank the respondents for their time and input into the consultation process. Both responses have been published in full alongside this paper on the Utility Regulator website.
- 2.3 The key issues raised by the respondents were as follows:

MEL

- 2.4 MEL are concerned that the exclusion of uncertain projects in their entirety leads to an inefficient position of a permanent price control as each project would require an adjustment to the set allowance, a cost review and amendment process. While they felt it was justifiable in the case of very large items, such as changes to accommodate interoperability guidelines, they felt it was inefficient micro management on other items.
- 2.5 **Utility Regulator View** – a number of the costs that were excluded related to projects that were uncertain, with timelines and cost estimates which were based on high level estimates. The costs include expenditure associated with two major projects and a major non-routine maintenance operation. The two major projects are a SNIP uprating project and a reverse flow project. The forecast costs for the SNIP uprating project totals £750,000 for the three years (11/12-13/14). The forecast costs for the reverse flow project totals £9,504,000 with £200,000 for 12/13 and £9,304,000 for 13/14. The associated estimated expenditure forecasts are substantial and represent a significant proportion of the total maintenance. These projects are uncertain and therefore we do not consider it appropriate to give an allowance to these projects at this time.
- 2.6 MEL are concerned that the Utility Regulator has made virtually no provision in its allowance for any maintenance or replacement of plant equipment that has been identified as part of the inspections of the pipeline systems.
- 2.7 **Utility Regulator View** – it is difficult to quantify an allowance for maintenance or replacement of plant equipment which may or may not be required depending on the outcome of the inspections of the pipeline systems. We do not consider it appropriate to include an allowance for something that may not materialise. Should maintenance or

replacement of plant equipment be required then MEL can apply for these costs once estimates and timescales become more robust.

- 2.8 MEL consider that costs such as system planning, network code, SCADA, and control room operations will not continue at their current level as these costs have been ‘frozen’ in anticipation of CAG.
- 2.9 **Utility Regulator View** – while there is uncertainty regarding CAG the allowance proposed for PTL and BGTL for operations is an efficient allowance for both companies and therefore we have not changed the level of the allowance proposed.
- 2.10 MEL considers there is no basis for the proposed reduction in administration costs, particularly as the environment is far from ‘steady state’.
- 2.11 **Utility Regulator View** – we consider that there is more opportunity for PTL to reduce costs in the administration cost lines. Therefore we have not changed the allowance proposed.
- 2.12 MEL considers the reapplications for changes to the price control before the 31st August each year as per condition 3.1.6¹ (V) of the licence on a project by project basis as being time consuming, costly and inefficient.
- 2.13 **Utility Regulator View** – for those projects we have identified as uncertain and based on high level estimates, we would like to see detailed business cases before this expenditure is incurred. The benefits of these projects for customers should also be set out. Should the cost estimates above become more robust and the timing of the costs more certain, the above condition will allow the Utility Regulator to amend the controllable operating expenditure. We consider this a more acceptable approach than allowing costs for projects that may not materialize within this price control period.

CCNI

- 2.14 CCNI’s response stated that there was insufficient evidence to justify the expenditure proposed and that there was a similar issue in relation to the NIE RP5 Price Control. They felt it was unsatisfactory that the regulator does not have the required data to properly inform its decision making. They also stated that this means a full assessment and position for the Consumer Council is not achievable.
- 2.15 **Utility Regulator View** – CCNI have misinterpreted a line in the proposed allowances consultation. In their response they state that they:
- ‘note with concern that both PTL and BGTL have, in the option of the Regulator, failed to provide sufficient evidence or adequately justify the expenditure proposed. We note the same issue arose in the recent NIE RP5 Price Control.’*
- 2.16 Consequently, the CCNI also go on to say that *‘full assessment and position for the Consumer Council is not achievable’*.
- 2.17 CCNI have taken an explanation of two cost lines and applied it generally to the entire Shadow Price Control proposals. In fact, the CCNI comment refers to a very small

¹ 3.1.6 (V) of the licence allows the UR, “following a written request from the Licensee to review Budgeted Controllable Opex (BCO) for any Gas Year, provided that, if such a request is made in respect of the current Gas Year, such request is submitted before 31st of August in that Gas Year”.

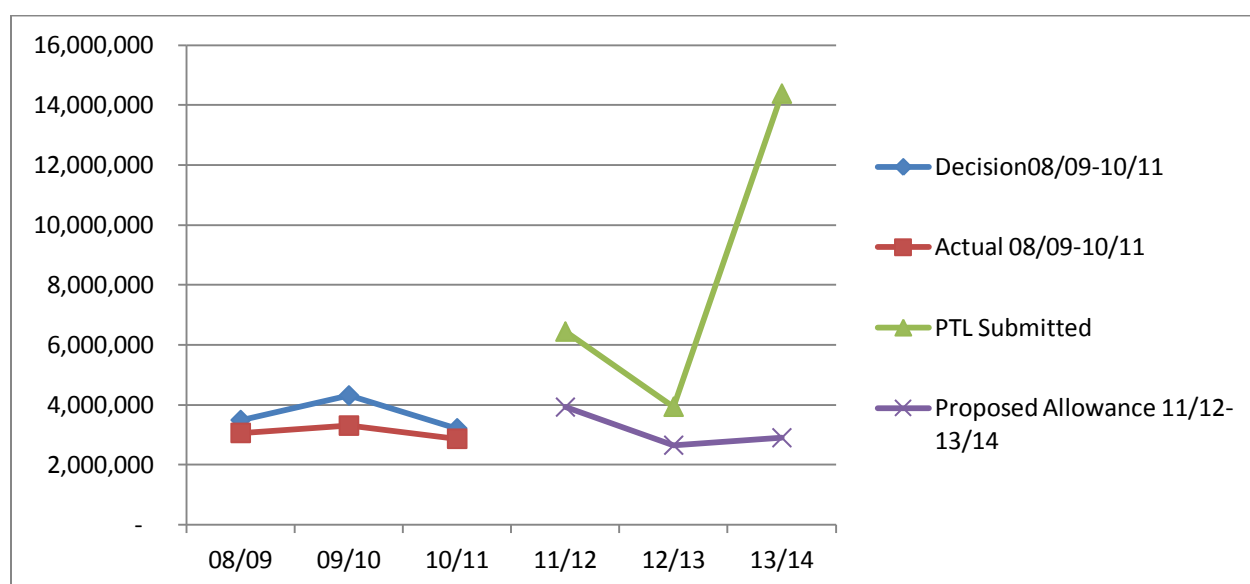
proportion of the costs, approximately 5% of the total PTL/BGTL submission and this is clear from the June consultation paper.

- 2.18 In addition, the Utility Regulator has adequate information to make a robust decision on the appropriate levels of expenditure for both PTL and BGTL. We therefore believe a full assessment of the price control is facilitated by the information, particularly in light of the fact that we have published more detailed information on the PTL and BGTL shadow price control than has previously been done in order to allow for greater transparency and to allow interested parties to respond in more detail to our proposals.

3 PTL CONTROLLABLE OPERATING EXPENDITURE

- 3.1 Having taken into account the responses to the consultation and provided our views to these responses in section two, we have come to the decision that our proposed allowance for PTL as set out in our June consultation paper will be our final decision.
- 3.2 Table 1 below we set out our decision on the total opex allowances alongside PTL's proposals for 2011/12, 2012/13 and 2013/14.
- 3.3 Overall, our decision for PTL is £240k greater than PTL's actual costs for the years 08/09-10/11 (see appendix A for PTL actual costs).
- 3.4 Graph 1 below illustrates this. It shows PTL's allowed opex for 08/09-10/11, actual opex for years 08/09-10/11, and PTL's forecast opex for 11/12-13/14 against our decision for 11/12-13/14.

Graph 1 – Total Controllable Operating Expenditure, Decision and Actual V Forecast, £'000



Source: UR

PTL Opex Summary

Table 1 – PTL Operating Expenditure Summary

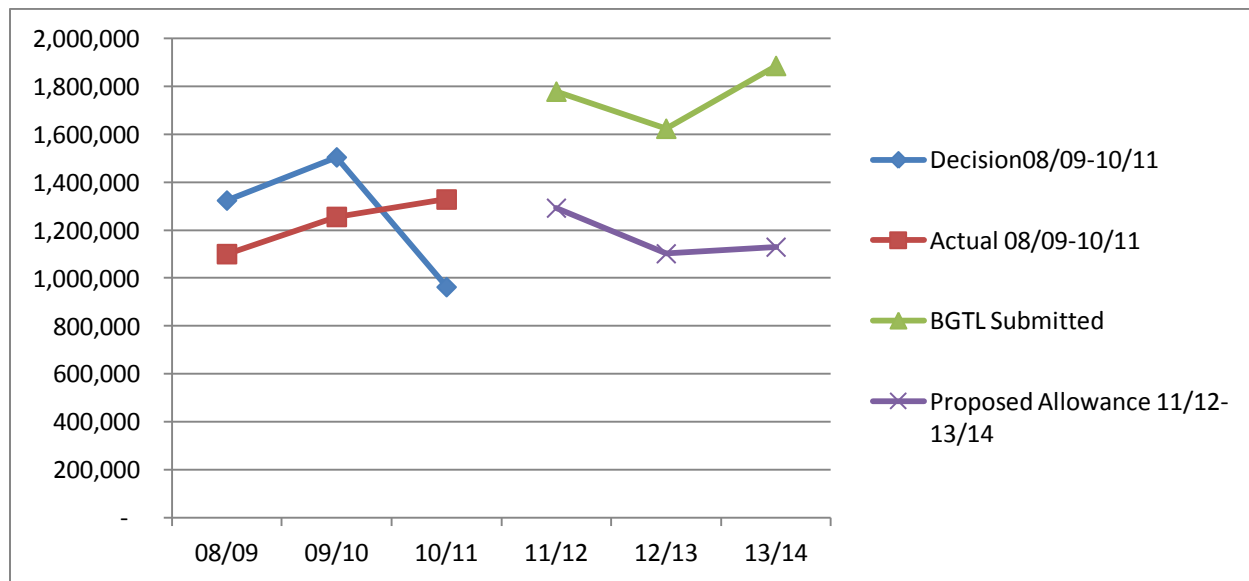
Cost Item	PTL Submission				UR Decision				Difference				
	2011/12	2012/13	2013/14	Total	2011/12	2012/13	2013/14	Total	2011/12	2012/13	2013/14	Total	Total %
Maintenance													
Landowner Liaison	51,310	46,310	46,310	143,930	42,000	37,000	37,000	116,000	-9,310	-9,310	-9,310	-27,930	-19%
Crop & Drainage Settlements	48,210	48,210	48,210	144,630	36,000	36,000	36,000	108,000	-12,210	-12,210	-12,210	-36,630	-25%
Engineering Works	2,206,699	1,534,832	11,965,188	15,706,719	1,772,873	658,180	977,351	3,408,405	-433,826	-876,651	-10,987,837	-12,298,315	-78%
Maintenance Total	2,306,220	1,629,352	12,059,708	15,995,279	1,850,873	731,180	1,050,351	3,632,405	-455,346	-898,171	-11,009,357	-11,370,223	-71%
Operations													
Planning	30,500	30,000	20,500	81,000	6,500	6,500	6,500	19,500	-24,000	-23,500	-14,000	-61,500	-76%
Operations	1,403,421	915,622	910,622	3,229,666	879,805	802,805	807,805	2,490,415	-523,616	-112,817	-102,817	-739,251	-23%
Operations Total	1,433,921	945,622	931,122	3,310,666	886,305	809,305	814,305	2,509,915	-547,616	-136,317	-116,817	-800,751	-24%
Administration													
Insurance	431,000	416,000	431,000	1,278,000	405,000	405,000	405,000	1,215,000	-26,000	-11,000	-26,000	-63,000	-5%
Office costs and other admin	344,304	252,804	264,804	861,911	215,169	213,169	215,169	643,507	-129,135	-39,635	-49,635	-218,404	-25%
Administration	1,928,713	691,920	694,750	3,315,383	564,472	491,472	415,972	1,471,916	-1,364,241	-200,448	-278,778	-1,843,467	-56%
Total Administration Costs	2,704,017	1,360,724	1,390,554	5,455,295	1,184,641	1,109,641	1,036,141	3,330,423	-1,519,376	-251,083	-354,413	-2,124,871	-22%
Total PTL Costs	6,444,158	3,935,698	14,381,384	24,791,240	3,921,819	2,650,126	2,900,797	9,472,743	-2,522,339	-1,285,571	-11,480,586	-15,288,497	-62%

Source: UR and PTL

4 BGTL CONTROLLABLE OPERATING EXPENDITURE FORECASTS

- 4.1 Having taken into account the responses to the consultation and provided our views to these responses in section two, we have come to the decision that our proposed allowance for BGTL as set out in our June consultation paper will be our final decision.
- 4.2 Table 2 below we set out our decision on the total opex allowances alongside BGTL's proposals for 2011/12, 2012/13 and 2013/14.
- 4.3 Overall, our decision for BGTL is £160,727 less than BGTL's actuals for 08/09-10/11 (see appendix B for BGTL actual costs).
- 4.4 Graph 2 below illustrates this. It BGTL's allowed opex for 08/09-10/11, actual opex for years 08/09-10/11, and BGTL's forecast opex for 11/12-13/14 against our decision for 11/12-13/14.

Graph 2 – Total Controllable Operating Expenditure, Decision and Actual V Forecast, £'000



Source: UR

BGTL Opex Summary

Table 2 – BGTL Operating Expenditure Summary

Cost Item	BGTL Submission				UR Decision				Difference				
	2011/12	2012/13	2013/14	Total	2011/12	2012/13	2013/14	Total	2011/12	2012/13	2013/14	Total	Total %
Maintenance													
Landowner Liaison	13,500	13,500	13,500	40,500	4,500	4,500	4,500	13,500	-9,000	-9,000	-9,000	-27,000	-67%
Engineering Works	1,219,781	1,106,714	1,365,153	3,691,648	792,484	602,440	629,840	2,024,764	-427,297	-504,273	-735,313	-1,666,883	-45%
Maintenance Total	1,233,281	1,120,214	1,378,653	3,732,148	796,984	606,940	634,340	2,038,264	-436,297	-513,273	-744,313	-1,693,883	-45%
Operations													
Operations	52,065	52,065	52,065	156,195	52,065	52,065	52,065	156,195	-	-	-	-	-
Operations Total	52,065	52,065	52,065	156,195	52,065	52,065	52,065	156,195	-	-	-	-	-
Administration													
Insurance	132,000	132,000	132,000	396,000	132,000	132,000	132,000	396,000	-	-	-	-	-
Office costs and other admin	224,614	182,114	182,114	588,842	184,066	184,066	184,066	552,198	-40,548	1,952	1,952	-36,644	-6%
Administration	136,367	137,327	140,767	414,461	127,248	127,248	127,248	381,744	-9,119	-10,079	-13,519	-32,717	-8%
Total Administration Costs	492, 981	451,441	454,881	1,399,303	443,314	443,314	443,314	1,329,942	-49,667	-8,127	-11,567	-69,361	-22%
Total BGTL Costs	1,778,327	1,623,720	1,885,599	5,287,646	1,292,363	1,102,319	1,129,719	3,524,401	-485,964	-521,400	-755,880	-1,763,244	-33%

Source: UR and BGTL

5 EFFICIENCY FACTOR

Efficiency factor

- 5.1 Our decision on the efficiency factor has not changed since the draft proposals. We have decided that an efficiency factor of 1.5% p.a. (compounded) of total controllable operating expenditure is achievable for the business over the next five years.
- 5.2 As with any price control, the reason for the inclusion of an efficiency factor is to incentivise PTL and BGTL to continue to improve the efficiency at which they operate their network. The figure of 1.5% is low and was used by Ofgem in the one-year rollover (to operating in the period 1 April 2012 to 31 March 2013) to the current gas and electricity transmission price controls (TPCR4) which expired on the 31 March 2012. We have therefore included the efficiency factor in our decision for gas years 2012/13 and 2013/14.

Impact of efficiency factor on the allowance

- 5.3 The table below shows the impact of the efficiency factor of 1.5% p.a. (compounded) on our decision on the allowance for PTL and BGTL.

Table 3 – PTL Operating Expenditure, Impact of efficiency factor

Cost Item	UR Decision (including impact of the efficiency factor)		
	11/12	12/13	13/14
Maintenance	1,850,873	731,180	1,050,351
Operations	886,305	809,305	814,305
Administration	1,184,641	1,109,641	1,036,141
Less Efficiency Factor		39,164	85,104
Total Operating Expenditure	3,921,819	2,610,962	2,815,693

Source: UR

Table 4 – BGTL Operating Expenditure, Impact of efficiency factor

Cost Item	UR Decision (including impact of efficiency factor)		
	11/12	12/13	13/14
Maintenance	796,984	606,940	634,340
Operations	52,065	52,065	52,065
Administration	443,314	443,314	443,314
Less Efficiency Factor		16,290	33,144
Total Operating Expenditure	1,292,363	1,086,029	1,096,575

Source: UR

6 SUMMARY OF DECISION

6.1 In summary our decision for the PTL and BGTL controllable operating expenditure for gas years 2011/12, 2012/13, 2013/14 is as follows:

Table 5 – Proposed Allowances, £m

Cost Item	Submission				UR Decision				Difference	
	11/12	12/13	13/14	Total	11/12	12/13	13/14	Total	Total	Total, %
PTL Opex allowance	6.4	3.9	14.3	24.8	3.9	2.6	2.8	9.3	-15.5	-61%
BGTL allowance	1.8	1.6	1.9	5.3	1.3	1.1	1.1	3.5	-1.8	-34%

Source: PTL/BGTL and the Utility Regulator

7 CUSTOMER IMPACT

- 7.1 From table 8 below you can see that the impact of our proposals would mean a decrease of £0.67p on the domestic consumer's annual tariff against the previous decision for PTL and a decrease of £0.09p for BGTL. The table also shows the impact of our decision against PTL's and BGTL's proposed allowance. If we had accepted PTL's and BGTL's proposed allowance then the domestic customer would have been £4.58 per annum worse off in the case of PTL and £0.50p worse off for BGTL.
- 7.2 The customer impact will obviously change if the uncertain projects outlined in 2.4 become certain and PTL/BGTL carry out the work.

Table 6 – Impact on customers of opex and capex allowances

Impact on Consumers	UR proposed allowance V PTL previous decision	PTL proposed allowance V UR decision
Domestic consumer	Decrease of £0.67p	Decrease of £4.58
	UR proposed allowance V BGTL previous decision	BGTL proposed allowance V UR decision
Domestic consumer	Decrease of £0.09p	Decrease of £0.50p
AQ=400 therms Load factor = 37.5%		

Source: Utility Regulator

These are indicative and depend on assumptions made

APPENDIX 1 – PTL ACTUAL COSTS

Table 1 below shows PTL's actual annual controllable operating expenditure for gas the gas years 2007/08, 2008/09 and 2009/10.

Table 1 – PTL Operating Expenditure Actual Costs (uplifted to September 2011)

Cost Item	2008/2009	2009/2010	2010/2011
Maintenance			
Landowner Liaison	36,979	40,297	32,897
Crop & Drainage Settlements	50,601	8,406	46,683
Engineering works	850,737	1,096,599	798,124
Maintenance Total	938,318	1,145,302	877,704
Operations			
Planning	7,640	1,678	9,859
Operations	828,602	782,896	818,644
Operations Total	836,243	784,574	828,503
Administration			
Insurance	415,704	446,028	360,774
Office costs and other admin	196,450	216,658	198,689
Administration	674,215	713,094	600,394
Total Administration Costs	1,286,369	1,375,781	1,159,857
Total PTL Opex	3,060,930	3,305,657	2,866,064

Source: UR

APPENDIX 2 – BGTL ACTUAL COSTS

Table 2 below shows BGTL's actual annual controllable operating expenditure for gas the gas years 2007/08, 2008/09 and 2009/10.

Table 2 – BGTL Operating Expenditure Actual Costs (uplifted to September 2011)

<i>Cost Item</i>	<i>2008/2009</i>	<i>2009/2010</i>	<i>2010/2011</i>
Maintenance			
Landowner Liaison	17,452	20,133	10,231
Engineering Works	439,686	744,611	844,207
Maintenance Total	457,138	764,743	854,438
Operations			
Operations	71,381	65,985	48,330
Operations Total	71,381	65,985	48,330
Administration			
Insurance	228,394	76,418	136,136
Office costs and other admin	101,585	177,362	172,618
Administration	242,258	171,335	117,007
Total Administration Costs	572,238	425,114	425,761
Total BGTL Opex	1,100,757	1,255,842	1,328,529

Source: UR