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29<sup>th</sup> October 2013

## **Congestion Management Procedures (CMP) Licence Modifications Consultation**

Dear Roisin

Mutual Energy Limited (MEL) is grateful to have the opportunity to respond to this consultation on behalf of its two wholly owned subsidiaries Premier Transmission Limited (PTL) and Belfast Gas Transmission Limited (BGTL), which hold licences to convey gas granted pursuant to the Gas (NI) Order 1996.

With regard to the above consultation, please find below some comments on the consultation and the draft licence text. Please note these comments are made with reference to the specific subsidiary concerned, where appropriate. MEL is broadly supportive of these licence amendments subject to the comments below (particularly concerning costs) as these are a necessary part of implementing the requirements of CMP.

### **1. Buy-back Costs and the Cap**

**Consultation Document Paragraph 2.24:** MEL's preference is indeed that there should be a cap on buy-back costs; in fact, it sees this as an essential protection for all parties. We explain why below:

The CMP Guidelines Legislation states that the Transportation System Operators (TSOs) should consider the risk of buy-back before determining how much, if any, Over Subscription (OS) Capacity to make available. We understand this to mean that the TSOs should be offering OS Capacity where they can be confident that it will help to alleviate contractual congestion, but not where it will trigger physical congestion and immediately necessitate buy-backs (BB), thereby incurring otherwise unnecessary costs.

In the case of Northern Ireland there is:

- a high level of capacity booked relative to that available (in relation to Moffat Entry Point in particular),
- high utilisation of peak capacity booked, and

- no evidence of contractual congestion.

Given that we believe that there is no contractual congestion, OS Capacity would only ever be 'in demand' at times of high flows when the system is running close to capacity limits anyway.<sup>1</sup> At other times, Shippers can (as now) use the available capacity in the system without need of OS Capacity.

It is unlikely to be appropriate for the TSOs to offer significant quantities of OS Capacity at peak periods. This is because there will be a high risk that to offer OS Capacity in such circumstances will increase the risk of physical congestion, and consequentially, of buy-backs being necessary.

Nonetheless if, having sold OS Capacity, there are nominated quantities greater than the system can accept (i.e. physical congestion), then all Shippers may offer their capacity for buy-back, and can potentially benefit financially from doing so. This creates an incentive for Shippers to 'over-nominate' in order to try and profit from a buy-back, and also increases the incentive for Shippers to price buy-back offers significantly in excess of the price at which the capacity was originally sold. If there is no cap on the buy-back costs that TSOs can incur, then the arrangement could create an unbounded gaming opportunity, at the potentially significant expense of all the other Shippers and the TSOs, as well as artificially creating or worsening physical congestion problems.

We therefore believe it is absolutely essential that there should be a cap on buy-back costs, and we believe it would be appropriate for this to be captured in the Licence as an obligation on TSOs.

As regards the specific level of the cap, in the Business Rules we proposed that the cap should comprise the revenues received over the preceding [3] months, and we intend to consult on this proposal as part of the OS Scheme. We believe this strikes an appropriate balance between protecting against the gaming incentive and ensuring that there are funds available for buybacks should they be needed. In any event we believe that buy-back costs for any given day should not be allowed to exceed the revenues received from the sales of OS Capacity over a year (i.e. the Scheme should not be allowed to produce net costs overall).

It will also be important to recognise that, whilst the scheme is intended to provide incentives to the TSOs to offer OS Capacity, PTL should also be expected to take a prudent approach to how much OS Capacity is offered, reflecting the current capacity situation at Moffat Entry Point, in order to avoid aggravating any physical congestion.

We do not believe it is necessary for the scheme to be permitted to produce net costs, since the scheme can be effective in delivering the intended incentive properties of the arrangement without creating artificially induced costs. The TSOs are incentivised to

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<sup>1</sup> MEL also has concerns that whilst the current interruptible capacity rules (and arrangements where DSOs hold firm capacity for the distribution networks) are in place and there is no overrun regime in NI, there would be little incentive for Shippers to purchase OS Capacity anyway.

offer OS Capacity, because they stand to receive a share of the benefit from the revenues if it can be made available. The TSOs will still be incentivised to minimise buy-backs, because buying back will reduce the incentive revenues they could receive. Shippers are incentivised to flow gas, rather than hoard capacity, because they will be allocated a share of any incentive revenue in proportion to their allocated gas flows at the Entry Point concerned. The requirement for TSOs to assess the risk of buy-back before offering OS Capacity should protect against the creation of any unnecessary physical congestion. The use of a buy-back cap should protect against the creation of an unbounded gaming opportunity.

Finally, we would also observe that there is an inherent difficulty in placing a financial performance incentive on a mutualised organisation. Any costs incurred would necessarily need to be recovered from Shippers and/or any revenues produced by the Scheme, whereas net incentive revenues will be directed to the social enhancement account. However, we acknowledge the legislative requirement, and believe that this is the most appropriate solution in the circumstances.

## 2. Other Costs

As discussed above, MEL believes all buy-back costs should be met from revenues generated by the sale of OS capacity.

**Consultation Document Paragraph 2.25:** The Utility Regulator (UR) notes that any other costs of buy-back are likely to be administrative, and are likely to be small.

MEL agrees that the administrative costs in running the arrangements are likely to be a small incremental addition to its normal running costs (Opex) and believes that the simplest approach would be to allow these to be recovered from within the postalised tariff. This approach has been used in relation to STC/VRF costs (where the TSOs were similarly obliged to offer their capacity in a new form) and we see no reason why it should not also apply here.

We do not believe that this calls for the setting of a specific extra revenue allowance for OS Capacity, simply that the activity of providing OS Capacity would be one of the normal operating activities of the TSOs to be included in their Opex allowance. This would therefore be accomplished as part of the existing annual processes for setting TSOs allowances.

We have some concerns with UR's proposal that administrative costs should also be met from OS revenues. Specifically, if TSOs were to recover potentially variable Opex costs from the OS & BB accounts, there would need to be a transparent mechanism to approve the costs to be deducted each time, before any incentive revenue sharing payments could be made. We think it would be important for Shippers that there should be complete transparency and appropriate control over the use of OS revenues.

Whilst using the OS Scheme revenues for administrative costs could be made to work, we believe this would introduce a new requirement for separate accounting for the TSOs

and (at minimum) a new annual (ex-post) approval process , which could be disproportionately cumbersome for the Regulator and for TSOs.

### 3. Drafting Points

MEL has identified the following drafting issues:

- a) In our view, the definition of Daily Capacity should also now exclude OS Capacity (for the purposes of the licence only – in the Code OS Capacity will be offered as Daily Capacity, but in the licence the definitions are intended ensure that the revenues are handled differently).
- b) Clause 2A.2.1.20, 4<sup>th</sup> para: We think it would be preferable to refer to 'net revenues received' instead of 'the revenues received and payments made'.
- c) Clause 2A.2.1.8, first para: We think this should also refer to OS Capacity (after the reference to Daily Capacity)
- d) We think there is some uncertainty around the way in which the term Exit Point is used in the licence drafting, ( specifically references to Exit Point and UC Exit Point, in the definition of Oversubscription Capacity, in clause 2A.2.1.20 para 2, and reference to the UC Gas Supplier in 2A2.1.20 para 4 (ii) ).

By including the definitions of UC Exit Point and UC Gas Supplier in the BGTL and BGE(NI) Licence, we assume that UR intended that where the term 'Exit Point' is used in the new drafting, it should relate to all the exit points on all the networks of the Designated Pipeline Operators, and including Stranraer (which is outside of the postalised network for the purposes of the licence).

Unfortunately, the existing definition of 'Exit Point' means that where it is used, it relates only to the network of the relevant Licensee (and it does not include Stranraer).

For the drafting to be accurate across all three licences, we suggest phrases should be used which refer to any or all of the exit points on any of the networks of the DPOs (as defined in their licenses) and including Stranraer.

- e) The definition of Entry Point Technical Capacity contains a reference to the Economic Network, (which for PTL includes the part of the network serving Stranraer in Scotland) but which is not a defined term in the BGTL Licence. Postalised System might be a more appropriate definition for the BGTL Licence, and in fact might be appropriate for all three licences, if an additional term to refer to the part of the network serving Stranraer could also be developed/utilised.

Should you wish to discuss any aspect of our response please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "Stephen English".

Stephen English  
Gas Contracts Manager