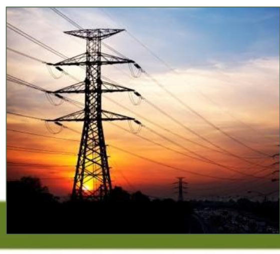
Conclusions paper on the introduction of entry charges into the Northern Ireland postalised regime for gas

5th February 2015


About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission	Value and sustainability in energy and water.
Our Vision	We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference

Act with integrity.

Abstract

This paper sets out the Utility Regulator's conclusions on the arrangements to introduce entry charges into the Northern Ireland postalised regime as required under European legislation. We plan to implement the changes by October 2015.

Audience

This document is likely to be of interest to regulated companies in the energy industry, government and other statutory bodies and consumer groups with an interest in the energy industry.

Consumer impact

The changes are necessary to ensure compliance with the European Gas Regulation and in particular the network codes required by the Regulation.

Contents

1. Purpose of this paper

1.1. This paper sets out the Utility Regulator's conclusions on the arrangements to introduce entry products and associated charges into the Northern Ireland postalised regime for gas.

1.2. These arrangements have been developed in order to ensure compliance with Regulation (EC) 715/2009 (the Gas Regulation) and the relevant European network codes (EUNCs).

2. Background

2.1. On 16th October 2014 the Utility Regulator published a Consultation Paper on the introduction of entry charges into the Northern Ireland postalised regime for gas.

2.2. The Consultation Paper outlined the European requirements which are addressed in the proposed arrangements, namely:

- That tariffs are set separately for every entry point into or exit point out of the transmission system as required by the Gas Regulation;

- The introduction and subsequent tariff arrangements for non-annual capacity products as required by the Capacity Allocation Mechanism (CAM) Code;

- The use of auctions as the mechanism to allocate capacity as required by the CAM code and the rules to calculate the reserve prices for such auctions.

2.3. The Consultation Paper also noted that the network code on tariffs had not been finalised yet and that the proposed arrangements for Northern Ireland did not cover every aspect of the draft tariff network code. However we have taken into account the rules set out in the draft tariff network code where it has been appropriate to do so. We will consult on the full implementation of the tariff code in late 2015/early 2016 once the code has been agreed.

2.4. The consultation paper also noted that Gas Distribution Network Operators (GDNs) would continue to book exit capacity but once CAM is implemented at entry it is appropriate for gas suppliers to book entry capacity and therefore to participate in the auctions for entry capacity.

2.5. We do not intend to replicate here in full the proposals for consultation but a summary is provided below.

3. Summary of issues consulted on

3.1. In summary the key features of the proposals consulted on were to:

- Allocate costs between entry and exit points in accordance with the postage stamp charging methodology in the draft EU tariff network code.
- Allow the split between the proportion of revenues to be recovered at entry and exit to arise from the reconciliation process
- Maintain the existing capacity-commodity split (75:25) in 2015.
- Apply multipliers and seasonal factors to the non-annual products using the full flexibility available.
- Reconcile revenues from entry and exit together in order to share the risk of under recovery among all users of the system collectively.
- Minimal change to how the commodity charge is billed – single charge billed at exit points
- In light of the introduction of a daily entry capacity product, remove the daily capacity product currently in place at exit points.
- Charge an appropriate tariff for capacity if suppliers nominate above the level of their booked capacity at an exit point.

4. Summary of responses received

4.1. We received eight responses to the consultation from the following companies:

AES	PNGL
BGE(NI)	Power NI Energy Ltd
ESB	MEL
firmus energy	SSE

4.2. The full responses have been published alongside this conclusions paper. We have summarised below the key issues raised by consultees and our considered response.

4.3. In general there is broad industry support for the proposals at entry. There was a mixed reaction to the proposal to remove the daily product at exit and to charge more than the commodity tariff if suppliers nominate above the level of booked capacity at an exit point. Responses to these specific issues are considered below.

Considerations in the design of the new entry tariff methodology

4.4. The majority of respondents agreed with the matters to be considered in the design of the new entry tariff methodology as presented in the consultation paper.

4.5. A number of respondents agreed with the Utility Regulator's approach to build upon existing arrangements were possible as this would facilitate meeting the October 2015 deadline and would also avoid changes to NI legislation which would not be possible in the available timeframe.

4.6. Power NI noted the need to implement the requirements by 2015 but did not accept that this should be the only driver of change. Also, where there are changes that could improve the general efficiency and operation of the market, then these should be considered at the same time.

4.7. ESB noted that underlying requirements of European legislation should also be considered, including transparency, cost reflectivity, non-discrimination, facilitation of efficient gas trade and competition, avoidance of cross-subsidy between shippers and avoidance of cross-border trade distortion.

4.8. We welcome the views of respondents regarding the requirements of the new entry regime in particular the recognition of the importance of European compliance deadlines. We would also highlight that we are engaged in work to create single system operation in NI for the purpose of improving the efficiency of the operation of the gas network.

Cost Allocation Methodology

4.9. The consultation paper proposed to allocate costs between entry and exit points in accordance with the postage stamp charging methodology as set out in the draft EU tariff network code. This approach would maintain a common tariff in Northern Ireland. The majority of the consultation respondents agreed with this approach.

4.10. AES stated a preference for the Capacity Weighted Distance approach on the basis that a shipper who makes use of a small part of the transmission system should not pay the same charges as a shipper who makes more extensive use of the system. However, the AES response does not recognise that this is in conflict with the legal requirement in NI for a common tariff. Taking all these factors into account we therefore intend to proceed with the introduction of the postage stamp methodology.

4.11. The common tariff and the postalised regime have been in place since 2004 and have served NI well. The regime has clearly worked for investors to the benefit of gas users with the postalised charging and payments system forming the basis for the guarantee of PTL's and BGTL's revenues which in turn facilitates significant savings in the form of a reduced cost of capital and so reduced costs for gas users.

Capacity-commodity split at entry and exit

4.12. The consultation proposed that we maintain the existing capacity-commodity split (75:25) in 2015.

4.13. The consultation responses indicated agreement with retaining the existing 75:25 split in 2015. However MEL did highlight that a 90:10 split may be more appropriate in light of the proposed tariff network code.

4.14. We do not intend to change the existing capacity-commodity split as part of the introduction of entry charging. When the tariff code is finalised we will assess whether this split is compatible with the code and review whether the split is cost reflective. Following this we intend to consult on any changes necessary for 2017.

Multipliers/seasonal factors

4.15. The consultation paper proposed that we apply multipliers and seasonal factors to the non-annual products using the full flexibility available. The rationale for adopting this approach was that we wish to ensure that non-annual tariffs reflect the cost of providing capacity to meet peak demand as this is the basis on which the network has been built.

4.16. The majority of respondents welcomed the application of multipliers and seasonal factors, seeing them as an appropriate method of optimising system use. However, Power NI stated that in the absence of congestion it is not clear why a seasonal factor is required.

4.17. We note the general support for the application of either multipliers and seasonal factors or a combination of both. In relation to the views expressed by Power NI, the consultation paper set out the advantages of seasonal factors including efficient network use and cost reflectivity of prices. We do not consider it appropriate to apply seasonal factors only once congestion occurs. However, that said we recognise that we will need to establish a balance between multipliers and seasonal factors, if both are used.

4.18. We will establish the level of multipliers and seasonal factors to apply in the gas year 15/16 during the postalised tariff calculation process in June/July 2015. For this purpose we will review the appropriateness of applying the multipliers/seasonal factors applicable in Ireland to the NI regime in order to minimise the impact of any divergence on the SEM. Prior to the entry into force of the EU tariff network code we will again need to review the multipliers/seasonal factors in order to ensure compliance with the code and we will consult on the enduring approach at that time.

Retention of a single PoT

4.19. The consultation proposed to retain a single PoT for holding revenues from both entry and exit. There were no objections to this proposal from respondents, so we intend to retain a single PoT within the new arrangements.

Reconciliation

4.20. The consultation paper proposed to reconcile revenues from entry and exit together in order to share the risk of under recovery among all users of the system collectively. Reconciling revenues from entry and exit together means that the split between the proportion of revenue to be recovered at entry and exit shall arise from the reconciliation process, i.e. we will not decide in advance to recover say 40% of revenues from entry.

4.21. All respondents except Power NI supported this proposal. The Power NI response did not address the question directly and instead argued that end of year bullet payments should be discontinued and any shortfall should be recovered from tariffs in the following gas year. Power NI argued that, 'in relation to power station demand, the gas will have been consumed throughout the previous 12 months and those variable cost elements are required, by licence obligations, to be included as part of commercial offers into the Single Electricity Market. There is no scope to retrospectively go back to change such bids just because a bullet reconciliation exists under the gas charging arrangements'.

4.22. We have considered carefully the arguments put forward by Power NI. Of key concern to the Utility Regulator is that the end of year bullet payments underpins PTL's security of revenue because this in turn delivers low cost of capital for a significant proportion of the NI transmission system, benefiting <u>all</u> gas users. We consider that this significantly outweighs the impact of end of year bullet payments; accordingly it would not be prudent to move away from this method.

4.23. Furthermore, our proposals on the introduction of entry charges seek to manage the risk of mis-forecasting and thus of larger end of year reconciliation payments. We will also ensure that the current practice continues whereby actual volumes are circulated each quarter by the TSOs to suppliers to assist them in taking a view on the likely magnitude of the end of year bullet payment.

4.24. For these reasons, we intend to reconcile revenues from entry and exit together in a single end of year reconciliation process with a single bullet payment.

Overview of changes proposed at Exit

4.25. The consultation paper noted that minimal changes at exit points were necessary for 2015 compliance but that the exit point rules would be reviewed as part of the transition to a single code.

4.26. Two changes were proposed at exit:

- To remove the daily capacity product currently in place at exit points.
- To charge an appropriate tariff for capacity if suppliers nominate above the level of their booked capacity at an exit point.

4.27. There was a mixed reaction to our proposal to remove the daily capacity product at exit. There was some support for the proposal but there is also industry support, from the power stations in particular for offering the same variety of products at entry and at exit points in 2015.

4.28. Our view is that the introduction of non-annual exit products needs careful consideration as there are likely to be significant distributional impacts between domestic consumers and power generators. However, we will review the merits of introducing non-annual products at exit during 2015/16. Bringing this work forward into 2015 would put our compliance work for October 2015 in jeopardy as the scale of changes needed for October 2015 is already at the limit of what it is possible to deliver.

4.29. We are also conscious that the introduction of new postalised exit products would require significant changes to code and IT systems which it would be most efficient to make once the single code and single IT system is introduced (proposed for October 2016). For these reasons we will implement our original proposal in respect of daily capacity and review the products to be available at exit in 2016.

4.30. In relation to the charge if suppliers over nominate at exit, the responses indicate a level of recognition that it is not appropriate to continue to charge commodity only. Also, that the charge should reflect the probability of interruption/impact on the system. Power NI argued that any charge should not be penal and AES strongly disagreed with the proposal unless short term products are available at the exit point to enable them to manage their capacity position on a daily basis.

4.31. We proposed changing the charging rules to ensure that it is not possible to book a small amount of exit capacity, over nominate on this, and pay only the commodity charge. An appropriate charge is needed to incentivise suppliers to book an appropriate level of exit capacity. We note that no respondent put forward a view as to how this risk could otherwise be addressed.

4.32. Therefore we intend to implement a charge if suppliers over nominate at exit and we consider that this should be the annual firm exit tariff.

4.33. The TSOs have consulted on ‘a capacity ratchet’ at the exit point which would ensure that if a supplier over nominates on a day then their capacity booking will be increased by that amount and they will pay for the increased amount of firm capacity for a year. We will consider the precise terms of the code in relation to this mechanism when a final modification report is submitted. However, we believe that it is appropriate to indicate now what the charge itself should be – our view is that it should be the firm annual charge as this reflects the capacity product available at exit and should ensure that an appropriate amount of capacity is ultimately paid for at the exit point.

4.34. PNGL have argued that this proposal should not require them to undertake additional processes. However, the proposal will only impact on PNGL if insufficient capacity is booked at the exit, which has occurred only exceptionally in the past. PNGL have a licence requirement to book sufficient capacity for a one in twenty winter. Therefore we consider that this proposal is likely to have only a minimal impact, if any, on PNGL processes.

4.35. Our next step is to conduct the exit capacity review in gas year 2015/2016 and we will plan this work in Q3 of 2015. This review will need to ensure appropriate enduring rules are in place at exit, reflecting the interaction between the high and low pressure networks, and the requirements of a single transmission code.

Commodity charge

4.36. The consultation paper proposed that a single commodity charge would be billed at exit points similar to current commodity billing arrangements.

4.37. No respondent commented on the proposal therefore intend to make no changes to the current billing arrangements for commodity.

5. Next steps

5.1. Changes to the conveyance licenses of the TSOs will be necessary in order to implement these conclusions. We intend to commence consultation on these licence changes before the middle of February and will outline any further next steps as part of that process.