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Mr. Eamon Corrigan
Gas Section
Northern Ireland Authority for Energy Regulation
6th Floor, Brookmount Buildings,
42 Fountain Street
Belfast BT1 5EE.

Ref: Consultation on "The Proposed acquisition of Premier Transmission Limited facilitated by Team Northern Ireland Limited.

Dear Eamon,

Below please find Energia's comments in relation to the above referenced consultation document:

Summary:

In principle Energia do not disagree with the mutualisation of the SNIP pipeline and can see where there could be real benefits in having this in place. However Energia are concerned in relation to some of the procedures and processes contained in the proposed mutualisation process, and do not fully support some of these. Energia has attempted to outline its concerns in this response paper.

Specific Comments:

(1) **Background to Acquisition:** Please confirm that when the paper talks about the completion of the transaction being conditional on the Purchaser obtaining long-term funding on reasonably acceptable terms that it is NIAER who are the party who will decide what is "acceptable" or not?

(2) It is a widely accepted that the cost of gas in NI has been kept artificially low in the last number of years due to the lucrative historic long term gas supply contract which PTL/Phoenix had signed with Centrica (a contract between one part of the then BG Group and another). By keeping prices low many customers have signed supply and connection agreements and have become gas customers. These customers are effectively "locked in" now due to the prohibititive cost of switching to alternative fuels. Hence if the delivered price of gas goes up substantially, all elements that go to make up the cost should be

looked at by the regulatory authority in an attempt to find efficiencies and avoid the closure of businesses due to unsustainable cost increases. Energia feel the risk of very high end user gas prices is very real and indeed are already being felt today. Energia are concerned that by mutualising the SNIP asset, while there may be some savings, ultimately if further cost cutting is necessary the Regulator may not have the power to impose change on the Owners of the newly mutualised asset.

(3) It is unclear why PTL will continue to be the Licence Holder after the new Owners of the SNIP CLG have been appointed? Energia are concerned as to who in this case will actually own the asset and hence who is liable if one of the licence obligations is breached? Some information around this would be useful for industry.

(4) Energia does not support the idea of a common parent energy holding company. Although interlinked, the gas and electricity markets are different with different risks, and hence require different expertise to operate in effectively. By keeping Moyle and SNIP companies separate NIAER and the markets are 100% guaranteed not to have conflicts of interest and thus there is greater comfort that the end user customers in each market are being best served. Energia also believe that the potential economic savings that "may" occur if the two were merged would be negligible in reality. Merging the two entities is likely to mean persons are effectively "multi-tasking" and hence one risks not doing the best job possible in either role.

(5) Energia firmly believes it is possible to achieve significant savings on the "8% real post tax rate of return" which PTL currently enjoys and thus fully supports the Authorities suggestion in this regard.

(6) If the physical asset life of the SNIP pipeline is expected to run until after 2050, and to date PTL had a full capital repayment deadline of 2021, Energia are curious to know if there was some reason why it appeared NIAER had not looked at requesting PTL to extend their payback period at a previous date?

(7) Most economic experts forecast that the outlook for prices for the raw fuels used in the energy sector (oil, gas, etc) are all very likely to increase year-on-year as the world demand for same increases year-on-year while at the same time the worlds supply of same is unlikely to increase. Taking this into account it appears to be inappropriate to follow a policy of "maximising savings now in return for higher charges later" as the "higher charges later" combined with the predicted increase in raw energy fuel prices is likely to be too great a burden in a short time span for industry to absorb. Energia recommend caution with such a policy. Energia would also argue the risks outlined here and the disjoint between this risk and that of the Electricity industry is further justification for keeping the operation and administration of the gas and electricity inter-connectors separate.

(8) While the reason stated to justify the removal of the regulatory control process over the operational expenditure appears on the face of it to have some merit Energia believe the merit may well be outweighed by the risk which will now

be taken by the end user. One possible risk is in the event that there might only be one or two credible suppliers/vendors of a certain required service/product. Armed with the knowledge that there is this lack of control, and in the knowledge the Board must act in a certain manner, some suppliers or vendors of specific services/products could play on the lack of argument that there is a control process, and effectively distort their pricing i.e. the control process acts as an argument against suppliers to keep costs down. It is suggested that perhaps an alternative might be to have reviews every number of years – thus between reviews there will be no regulatory intervention but at reviews there will be if there is something at fault found – contract renewals could be aligned with the review process. Another alternative is to lock in the relevant important contracts for the same period as the financing will be – hence the financiers have the comfort of knowing there will be no regulatory intervention and customers know the operational prices every year in advance.

(9) If Members become Board Directors then there is an argument to say that it is very difficult for the Members to perform their task of policing the Board Directors correctly and firing them if they do not perform properly or if they behave inappropriately. There is a conflict here which can only be overcome by preventing Members becoming Board Directors.
There is no real strong argument to suggest that there should be any Members appointed from the public recruitment process but there is a strong argument to suggest that at least some of the Board of Directors should be appointed by the Members through a Public recruitment process.
The Authority should monitor the appointment process to ensure it is being performed in an independent, non-biased, fair fashion.

(10) The Authority must maintain at all times (either through a Licence condition or otherwise) the right to perform an audit of any and all aspects of the manner in which the SNIP CLG is being run. Having this right the Authority must activate it on occasion so it is seen to be a real right and a real threat against inappropriate business activities. This will provide an additional incentive to ensure proper running of the company in the interest of consumers.

(11) A real disincentive for board members would be if the Company does not produce a surplus any year then the Members would be obliged to elect one (or more) member(s) of the Board to leave the Board and be replaced. The reverse then is also true – if the Board do achieve a surplus as expected the Board members would all keep their positions on the Board. In order to maximise the incentive for a surplus, a real and tangible reward should be provided to the Board. The decision of the nature of this “reward” must be taken by the Authority alone, but it is suggested it be similar to the mechanism used in the private sector to incentivise performance.

(12) Management Performance targets should include the following:

a. Safety
b. Reliability and performance of the pipeline
c. Fulfilment of contractual and licence obligations

d. Maximising the availability of the pipeline
e. Maximising available capacity which is economical
f. Openness and Transparency of operations through regular reports to industry.
g. Operational expenditure performance (criteria = best value for money)

(13) Energia fully supports the notion suggested by the Authority of having the Board develop a management incentive plan linking pay to performance.

(14) Energia find it difficult to see that the corporate governance arrangements proposed “will ensure that the SNIP CLG will be commercially focused in order to drive performance”. Energia further do feel that “the incentives on the CLG to be seen to generate surpluses in order to reduce energy costs” are “strong” as suggested. The model proposed while it is anticipated a large deficit “surplus” will force action appears to allow in any year for no surplus to be generated and indeed a slight deficit without any form of correction, or any reprimand towards the Members or the Board. This is unlikely to be the case in the private business sector where action would be very likely to take place if targets (which are usually stretching) set by the company are not met or exceeded – this is a serious incentive to private sector executives to perform. That said it is accepted it is unlikely one could ever achieve this level of incentive in the model proposed and as such one must simply put in place the best mechanisms possible to achieve the required outcome. While the “incentives” outlined appear to go some way to achieving the required result Energia would suggest that the best mechanism for incentivising SNIP CLG to perform is having the normal regulatory control on the licensee’s operational expenditure. Energia would ask if the Authority has any analysis or figures showing the extend of the “lower financing costs” directly attributable to the relaxing the regulatory control regime and if this is adequate compensation for the increased financial risk to end users? Without this or some detail it is an impossible decision to comment on, as the risk appears to be so great that it would encourage one NOT to relax the normal operational expenditure regulatory control process as proposed.

(15) Energia fully supports the Ring Fencing provision as suggested.

(16) Energia has concerns in relation to the idea proposed by TNI of having NI Electricity consumers form an alternative collection agency in the form of a CAA in case gas customers cannot pay. Energia advocate keeping the two markets separate to the maximum extent possible as, although the markets are linked, the risks faced by each are different in many regards. Energia believe that a true real approach should be made to the market so as to confirm that the figures of 0.3%-0.5% are correct, and what exactly it is. If the figures are correct and/or if the financial sector requires further “comfort” perhaps an addition to the “normal commercial insurance” could give them the comfort they need at a relatively small additional fee. Then and only then, armed with all the information outlined above, should one attempt to understand the “extra” saving that could be made by having a CAA with the Electricity market end users and ascertain if this is sufficient to justify the existence of the CAA and the linking of the markets in this way? Energia believes any saving

may, if anything, only be marginal and is likely not to justify this proposed linkage and shared risk arrangements between the two markets.

In the case of an electricity “Supplier” in NI who does not “ship” gas any benefit through savings in Gas Transportation charges achieved via a CAA may not be passed through to the electricity “Supplier” from the gas “Shipper” (who may be the Operator of the power station supplying power to the Electricity Supplier) e.g. where the end price has been fixed in advance. In this case the Supplier is taking extra risk through the CAA without any benefit. The same situation may arise if electricity users who do not use gas, do not see a benefit in the end price of electricity if the prices they pay have been fixed in advance.

All these aspects should be considered before one decides to definitely go with the CAA as proposed.

Yours sincerely,

Derek Russell

Derek Russell
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Energia