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Richard Hume
Gas Branch
Utility Regulator
Queens House
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26th November 2014

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

Dear Richard,

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 (BGT), which hold licences to convey gas granted pursuant to the Gas (NI) Order 1996.

The operation of a postalised tariff system for the Northern Ireland gas transmission network has been in place since 2005 and has ensured that the charge for transporting gas along the designated transmission network is the same irrespective of where the gas is off-taken for final use. The postalised regime is underpinned by a detailed financial and legal structure to support the operation of the system.

The introduction of entry charges into the Northern Ireland gas network will result in significant changes for both Shippers and Transmission System Operators (TSOs) alike such as the use of auctions for the sale of short term entry capacity products. Therefore it is essential that, in advance of October 2015, we ensure that these changes and their implications to the market are well understood and implemented in such a way as to protect the Northern Ireland consumer.

The mutualisation of the Scotland to Northern Ireland Pipeline and the Belfast Transmission Pipeline is delivering savings to Northern Irish consumers on the operation of our gas pipelines in Northern Ireland. These savings have only been made possible by obtaining 100 per cent bond debt financing of PTL and BGT at very low costs of capital. This low cost of finance has been secured by having a stable regulatory environment and successful operational model. PTL and BGT have a duty to their fund providers to encourage a continued secure regulatory environment and successful operational regime and can only support changes that will not have an adverse effect on these critical areas, in particular on the stability of their cash flows. Therefore this is a key consideration of MEL's when analysing the impact of the Utility Regulator's (UR's) proposed changes to the tariff regime.

While we are fully supportive of the principles to introduce entry charges into the Northern Ireland postalised regime in order to achieve compliance with European legislative requirements, we have a responsibility to the NI consumer of ensuring that any changes do not adversely impact the low cost of capital achieved by our mutual model financing arrangement so that savings can continue to be maintained for the Northern Ireland energy consumer.

Questions

Question 1: The requirements for the new entry tariff methodology

We agree with the requirements for the new entry tariff methodology as detailed in section 4 of the consultation. In particular, it is vital that the underwriting of PTL and BGTL pipelines is maintained within the new tariff regime in order to enable us to continue to provide savings to the Northern Ireland energy consumer.

It is also important that the new entry tariff methodology will be fully compliant with Article 13 of the Regulation (EC) 715/2009 and compliant with the draft EU tariff network code in so far as possible, subject to the final drafting, in order to minimise the impact of further changes in 2017.

We agree that a movement away from postalisation would be a lengthy process, requiring a change in government policy and legislative change along with significant changes to the network codes and transmission licences and therefore implementation in advance of October 2015 would not be feasible. Furthermore it may require changes to our financing structure and therefore there is a risk that any move away from postalisation would undermine the mutual financing model and consequently result in higher costs for NI consumers.

Question 2: The proposal to apply the postage stamp cost allocation methodology

We strongly support the view that the postage stamp cost allocation methodology is the most suitable method given the nature and size of the NI gas network. This methodology is consistent with the NI legislative common tariff requirement and ensures equality among Shippers as the charge for transporting gas along the designated transmission network is the same irrespective of where the gas is off-taken for final use.

This methodology is also supported by the existing Postalised System Administrator (PSA) mechanisms which facilitates the revenue transfers between TSOs to enable common tariffs to be applied over a network where there are currently three TSOs. This is a significant component of the administration of the NI arrangements which are in place to deliver a postalised charging arrangement, and this is embedded in the licence, the support contracts and in the systems and operations of the TSOs.

Question 3: The proposal to maintain the current 75:25 split at exit and at entry for 2015 but to revisit this again for 2017 once the EUNC on tariff is finalised.

In light of the fact that the 2017 tariff network code is likely to require any entry commodity charge to be primarily driven by the costs of the volume actually flowed we think it would be difficult to justify the current 25% commodity charge. A lower commodity element such as 90%:10% may be more representative of the variable costs associated with the volume actually flowed. This could be implemented as part of the changes for October 2015 or iteratively by changing it by smaller amounts each year until 2017. Such a split would also be in line with the Republic of Ireland market.

Question 4: The proposal that the entry-exit split should be an output from the reconciliation process

We strongly support the view that the entry-exit split should be an output from the reconciliation process. This ensures that prices are the same for capacity at both entry and exit therefore supports compliance with NI common tariff legislation.

We consider that this proposal is of vital importance in maintaining the stability of our revenue stream throughout the gas year and in ensuring that the underwriting of the mutualised pipelines is achieved equitably from all points on the network, as originally intended in the design of the postalised regime. Although the risk of reconciliation payment cannot be eliminated, the common tariff will reflect the level of both exit and entry capacity forecast and therefore will ensure that all Shippers will still pay the same amount per kWh.

The introduction of short term entry products will introduce a further layer of detail around the accuracy of forecasts as Shippers will be required to provide forecasts for each product in advance of the gas year to set the tariff. There will inevitably be a level of uncertainty around this more detailed forecasting especially in the early years, therefore the sharing of risks among all gas users will be important in reducing the impact of deviations from forecast on the end of year bullet payment. We emphasise the importance of accurate forecasting to minimise the reconciliation payments following the gas year.

Question 5: The proposal to make full use of the flexibility to set multipliers and seasonal factors.

We welcome the application of multipliers to increase the price of non-annual products, as this should encourage Shippers to book long term products where it is appropriate for them to do so, and hence increase the stability of monthly cash flow. We also support the use of seasonal factors to increase the price of products to reflect periods of high demand.

We consider that it would be appropriate to apply the suggested restriction from the draft tariff network code that requires the arithmetic mean of the products of multipliers and seasonal factors to be between 0.5 and 1.5. Our analysis indicates that multipliers greater than this range could end up causing undesirable extreme fluctuations in our monthly cash flows.

Question 6: The proposal to retain a single PoT for holding revenues from both entry and exit.

We support the proposal to retain a single PoT for holding revenue from both entry and exit. We do not see any clear benefit of operating two separate PoTs.

A single PoT is more straight-forward from an administrative perspective. Separate bank accounts would require entry and exit charges to be invoiced separately adding an administrative burden and cost, and increased scope for errors around payments and distributions. In addition the PSA role would need to be extended to include the monitoring of two separate accounts, a further unnecessary administrative burden.

Question 7: The proposal to reconcile the entry and exit points together.

We support the proposal to reconcile the entry and exit points together this enables the entry and exit split to be an output of the reconciliation process, maintains a common unit rate for capacity and best enables equitable cost recovery from all network points.

Question 8: Discontinuing the daily capacity product at exit from 1 October 2015

The current daily capacity product at exit must be booked a month in advance of use therefore only provides limited flexibility to Shippers compared to that of the proposed new short term entry products. There has been no uptake/demand for the daily exit product. Given this, the fact that it sits outside the current postalised regime and that it is no longer required for EU compliance we understand the rationale for removing this product.

We support the proposal to consider in 2016 whether any non-annual products should be offered at NI exit points from 2016/17. It will be important to consider the benefits of non-annual products such as their ability to support the introduction of open cycle gas turbines to the network, as well as considering the potential costs associated with introducing new products such as the IT adaptations and revision to legal and contractual framework costs.

Question 9: The proposal that a supplier nominating above the level of booked capacity at an exit point will be charged an appropriate rate for capacity in addition to the commodity charge.

Ensuring that all Shippers pay for what they use is essential to ensure equality amongst Shippers in the NI network. It is of vital importance that Shippers are encouraged to forecast as accurately as possible to allow accurate tariff setting and to minimise the likelihood of large end of year reconciliation payments which are detrimental to both TSOs and Shippers alike.

We agree with the implementation of this principle however we note that the consultation (6.10) states that a supplier nominating above the level of booked capacity at exit point will be charged the reserve price for daily capacity in addition to the commodity charge. We wish to clarify whether this would be the charge applied or whether an appropriate charge is still to be determined in which case we would be happy to engage with UR and BGE, to analyse and determine the level of an appropriate charge.

Other comments

We note from point 5.81 of the consultation the UR view that the PSA function does not need to be performed by a third party and should be carried out jointly by the NI TSOs once the single NI TSO is established.

We consider that this role being carried out by an independent third party is an integral part of the postalised process and is key to the successful cooperation between the three TSOs which delivers this. It is of particular importance to our financiers that this role is independent and provides security around our monthly cash flows.

At a current cost of circa £15k per gas year, we believe the cost to bring the role "in-house" to the single NI TSO would be significantly more as it would involve a number of administrative tasks such as revision of financier and commercial agreements and dedicated time from the single NI TSO employees.

Conclusion

MEL welcomes UR's focus on introducing entry charges into the Northern Ireland postalised regime in advance of October 2015. We believe this regime will provide increased flexibility for Shippers and will provide a mechanism for achieving compliance with EU legislation.

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

Yours sincerely

Claire Stewart

Claire Stewart
Gas Analyst