

Response to Proposed Modification of Gas Conveyance Licences

Date: 10th May 2017

Introduction

GNI (UK) Limited (“**GNI (UK)**”) is pleased to have the opportunity to respond to the Utility Regulator’s Notice under Article 14(2) of the Gas (Northern Ireland) Order 1996 - Proposed Modification of Gas Conveyance Licences - Gas Transmission Price Control Process Amendments.

Regulatory Instructions and Guidance

GNI (UK) is agreeable in principle to the licence modification introducing a new licence condition on Regulatory Instructions and Guidance (“**RIGs**”). In practical terms, GNI (UK) believes that the current business plan excel template as prepared by the Utility Regulator (“**UR**”) and submitted by GNI (UK) within the GT17 process provides sufficient information for the purposes of a revenue review. GNI (UK) anticipates that any new RIGs would be implemented in accordance with the timelines followed by Ofgem, whereby GNI (UK) would be notified of any new requirements in advance of the commencement of the relevant price control period.

Review Process for Price Control Determinations

GNI (UK) welcomes the intention to amend its licence to ensure that GNI (UK) has recourse to the Competition and Markets Authority (“**CMA**”) in connection with the GT17 price control decision (and all subsequent price control decisions).

GNI (UK) has reviewed the proposed modification in detail and has identified some substantive issues with the proposal, together with a number of drafting issues. In the interests of expediency, and of facilitating UR’s review, we have sought to provide legal drafting to address certain drafting issues. This drafting is attached in Schedule A. Other drafting issues are noted at Schedule B. Substantive issues relate to the scope of review and certain issues around the application of the disapplication process.

1. Scope of Review

The proposed Condition 2.2.22(a) sets out when Condition 2.2.22 applies and therefore in respect of which decisions a Disapplication Notice can be served. In summary, these are certain decisions relating to Allowed Operating Expenditure, the inputs into the Rate of Return calculation (but not the Rate of Return itself) and the Capital Revenue Requirement. GNI (UK) believes that a wider set of decisions, which under the licence are determined by UR, should be included within the scope of the disapplication notice process including:

- A special operating expenditure forecast review (Condition 2.2.4(i)); Unforeseen Operating Expenditure (Condition 2.2.4(j));
- Actual Uncontrollable Operating Expenditure (Condition 2.2.4(k));
- conveyance charges after the expiry of the Revenue Recovery Period (Condition 2.2.8(c)(ii));
- tax allowances and debt interest (paragraph 2(d) of Annex A); and
- inflation (paragraph 3 of Annex A).

As a general comment, GNI (UK) notes that all of these elements go to making up the price control framework within which it operates. The availability of a recourse to the CMA for each of these elements goes to whether or not it can be considered that there is a merits based review mechanism in place for the overall price control framework and, ultimately, whether there has been a complete implementation of the Third Package.

In particular, the operation of Conditions 2.2.4 (i) (j) and 2.2.4(k) is a key element of GNI (UK)'s price control framework. In previous price controls, UR has used these mechanisms to facilitate increased allowances for necessary activities (e.g. the Northern Ireland European Development Project). GNI (UK) has also sought during GT12, albeit unsuccessfully, additional funding for Repex and Opex which was not provided for in the original price control determination. In circumstances where GNI (UK) has expressed concern that the allowances proposed for GT17 are set at unrealistically low levels, interim measures will necessarily become more important and may go to the overall reasonableness of the price control determination. While GNI (UK) acknowledges that it would have recourse to judicial review in respect of any decisions made under these conditions, it considers that a merits based review would be more appropriate here in order to give effect to the requirements of the Third Package. We consider it difficult to view any application under these conditions in isolation of the original price control determination. In light of the inherent link between a decision under these conditions and the original price control determination, we consider that a merits based appeal mechanism should be applied here.

As a matter of principle, GNI (UK) considers that all elements of, and decisions in relation to, a price control determination should be amenable to a merits based review. As such, notwithstanding an apparently limited scope for dispute in relation to tax allowances, debt interest and inflation (paragraphs 2(d) and 3 of Annex A), on the basis that the licence reserves discretion on these issues to UR, then as a matter of principle, we consider that these must be subject to the same appeal mechanism as other elements of the price control.

Finally, we consider that decisions as to Allowed Revenue after the expiry of the Revenue Recovery Period must be amenable to a merits based review, as this is essentially a form of price control. While this does not have an immediate impact for GT17, this must be addressed in the licence in advance of the expiry of the Revenue Recovery Period. As GNI (UK) has no means to compel such a change in advance of the expiry of the Revenue Recovery Period, we request that this be amended as part of this licence modification. We note that, although this was not formally consulted upon, we do not consider that the availability of a review mechanism here can impact on any other licensee. As such, we request that this be addressed as part of this modification.

2. Process Issues

Process following Disapplication Notice

Condition 2.2.22(d) sets out in which circumstances the UR's decisions apply notwithstanding the service of a Disapplication Notice.

The drafting throughout Condition 2.2.22(d) refers to "Formula Amendments", which is the subject matter of the UR's original decision (and which will have been disapplied in whole or in part) rather than the subject matter of the licence modification. It should only be the subject matter of the licence modification that can ever apply under the licence (otherwise there is no effective recourse to the

CMA). Separately, we note that there is no requirement in the licence for the subject matter of the licence modification to be identical to the subject matter of the Formula Amendment – or indeed the part of the Formula Amendment that has been disapplied. In the event of a divergence between the original price control determination and the proposed licence modification to give effect to same, we are concerned that, as the modification is drafted, this may result in a gap in terms of recourse to the CMA. We understand this to be a drafting issue (rather than a substantive proposal) but this is an important issue and have sought to address this in the drafting provided in Schedule A.

The drafting in Limb (i) of 2.2.22(d) refers to the Formula Amendments applying in the period *from the date of that notice*. It is not clear what notice is being referred to here or why any amendment would have effect from the date of a notice (rather than the date on which the amendment was due to apply, for example, the Review Date).

GNI (UK) considers that limb (iii) of 2.2.22(d) should be deleted (and that the drafting of limb (ii) should be amended so that it applies in all circumstances where the CMA quashes the licence modification decision), for the following reasons:

- (a) The CMA has a statutory right to substitute its decision for the decision of the UR in relation to price control decision appeals. If Limb (iii) is intended simply to reflect these statutory rights, it is not necessary. If Limb (iii) is intended to go further, this is not appropriate and the CMA is unlikely to provide any “conclusion” or “decision” beyond its statutory powers.
- (b) If the CMA allows the appeal and remits the matter back to the UR, the drafting appears to give the UR the right to apply the Formula Amendment in accordance with its own conclusion or decision without going through the process under the licence for amendments or the statutory licence modification process. This means that GNI (UK) would not have recourse to the CMA in respect of these decisions. This differs from the position in GB, where if the CMA allows an appeal and gives directions to Ofgem to retake the decision, Ofgem would need to start again under the statutory process equivalent to Article 14 of the Gas Order.

Process regarding giving notice

While the UR is required to notify GNI (UK) of its determinations under paragraph 5 of Annex A, there are no equivalent requirements to those included in Condition 2.2.4 and 2.2.5 in relation to providing 28 days’ notice and an opportunity to make representations. These are important process elements that should be reflected in the licence.

Licence modification process

The trigger in Condition 2.2.22(c)(iv) (for Condition 2.2.22(d) to apply) is that the UR “*publishes a decision under Article 14(8) of the Order*” within six months after the date of the Disapplication Notice. GNI (UK) considers that this should refer to the UR deciding to proceed with the making of modifications to Condition 2.2 in order to avoid potential gap in the drafting such that UR was not actually required to make a modification to the conditions.

Other Modifications

GNI (UK) is agreeable to the other proposed amendments:

- to calculate the 15% threshold for a Special Operating Expenditure Forecast Review based on controllable operating expenditure; and
- to align the Review dates.

GNI (UK) assumes that the annual reporting set out in condition 2.2.4 (k) will be sustainably in line with the format used for the GT17 business plan and therefore will not introduce a new onerous reporting requirement. On this basis GNI (UK) is agreeable to the proposed modification.

GNI (UK) acknowledges the proposed next steps and welcomes the approach set out which allows for the implementation of the proposed licence modifications in advance of the Final GT17 Determination.

GNI (UK) would be happy to provide any further clarifications or comments if required.

SCHEDULE A
DETAILED DRAFTING

Note this drafting is provided to facilitate progress on a few of the points and is without prejudice to the other points raised in the main response above.

[See Separate Attachment]

SCHEDULE B
DRAFTING QUERIES

1. Conditions 2.2.4(g) and (h) each refer to forecast operating expenditure for each gas year “commencing on the next review date set out in such forecast”. The words “commencing on the next review date” are unnecessary (as the relevant gas years will be those set out in the forecast) and potentially incorrect (as only one gas year will commence on the next review date and we understand that the intention is to capture five).
2. Conditions 2.2.4(g) and (h) each also now refer to the forecasts (as amended in the case of (h)) being the allowed operating expenditure for such gas year “until the next review date”. The words “until the next review date” are also unnecessary and do not seem to make sense here (the preceding reference to “such gas year” refers to a single gas year rather than each of the five gas years up to the next review date).
3. Condition 2.2.19: new definitions
 - 3.1 The term “actual controllable operating expenditure” is already defined within the existing definition of “actual operating expenditure. Query whether the definition is required also.
 - 3.2 Query if the definition is correct - the “actual controllable operating expenditure” notified in accordance with condition 2.2.4(l) relates to a financial year¹ as opposed to a gas year – and it is the latter that is relevant when the term is used in condition 2.2.4(k) and (i). The new definition does not explain what the term means.
 - 3.3 The term “allowed controllable operating expenditure” is already defined within the existing definition of “allowed operating expenditure.” Query whether the definition is required also.
 - 3.4 Query if the definition is correct - it is not clear if the term "controllable operating expenditure" is intended to be capitalised and therefore to have the meaning of the defined term, "controlled operating expenditure". If so, the term “controllable operating expenditure” already excludes “uncontrollable operating expenditure” and therefore “uncontrollable operating expenditure” should not be excluded again

¹ Note also that Financial Year does not appear to be a defined term in the licence and elsewhere is used in lower case. Condition 1.2.1 provides that a financial year runs from 1 January to 31 December.