9 June 2023

Emma Todd

The Utility Regulator

14 Queens Street

Belfast

BT1 6ED

Dear Emma

firmus energy welcomes the opportunity to respond to the Utility Regulator's consultation regarding short term Exit capacity for gas transmission in Northern Ireland.

As a Distribution Network Operator (DNO) in Northern Ireland, we currently have responsibility for booking Exit capacity on behalf of gas suppliers operating in our licenced area. As a gas supplier in Northern Ireland we have a responsibility to our customers to ensure end prices paid by consumers are not adversely affected by any changes that may be implemented to transmission Exit capacity booking. In considering our views and response we have focused on the impact that new products could have on DNOs, gas suppliers and gas consumers in Northern Ireland.

Merits of introducing short term exist capacity products.

In 2016, firmus energy provided input into the Utility Regulator's Call for Evidence on potential reforms of the gas transmission Exit arrangements[1]. At that time, we did not feel we could support the introduction of short-term products at Exit due to the uncertainty surrounding the impact of such a regime change, particularly regarding the impact on volatility of the annual Postalised reconciliation. We highlighted that it would be extremely difficult to envisage a regime that would require the DNO to book sort term capacity products on behalf of distribution shippers. The view at that time was that the introduction of such products must apply to all shippers, resulting in the removal of the DNO obligation to book Exit capacity. In conclusion, firmus energy suggested that any further consultation

[1] Appendix 1 – Exit Capacity Review for NI Transmission Discussion Document – fe response 2016

on this subject was supported by more detailed demonstration of the impact of regime change. We therefore welcome the further analysis and potential scenarios presented in the current consultation and have considered this information to help guide our current views on the matter.

Demand for short term products at Exit continues to come from the power sector within Northern Ireland and we understand the benefits that might be realised within this sector due to greater flexibility. However, as highlighted within the consultation, ultimately, the introduction of short-term capacity products must align with the Utility Regulator's statutory duties to protect the interests of licence holders and consumers. Having reviewed the information presented in the consultation, the data to consider a cost benefit analysis is not yet available and therefore it is difficult to conclude that the introduction of short-term products at Exit will positively impact upon electricity consumers. It is evident, however, that there are several potential negative impacts on the gas licence holders and potentially consumers that must be carefully considered.

The consultation asks respondents for views on which Exit capacity products should be available at Exit. As a DNO, we continue to be of the view that a continuation of the obligation to book capacity at Exit would result in the DNOs availing of the annual capacity products only. It remains difficult to envisage a scenario where the DNOs could book short term capacity products on behalf of gas suppliers. We are also not sure that all gas suppliers would be supportive of the DNO making decisions regarding short term capacity bookings on their behalf.

As a gas supplier, firmus energy is of the opinion that the introduction of short-term transmission Entry capacity products has been a positive development within the gas market. However, it is significant to note that the successful implementation of short-term products for Entry is due to suppliers' autonomy to book according to their actual forecast capacity requirements. For short-term products to be of similar benefit to suppliers at Exit it would necessitate removal of the 1 in 20 obligation held by DNO's and the introduction of a suitable mechanism that allowed suppliers to independently determine and book the mix of capacity products that best suited the needs of their profile. Further views on the 1 in 20 obligation are detailed later in our response.

Gas Scenario Analysis

In terms of any further risks or consequences that may arise as a result of introducing short term capacity products, it is important to highlight that the modelling used within the consultation assumes that the forecasted required revenues are equal to the actual required revenues. However, this is often not the case, and it is important to highlight that risk of volatility in the annual reconciliation continues to present challenges to Shippers. The introduction of short-term capacity products at Exit might well increase this existing volatility[2].

This existing volatility, and the potential for future greater volatility, should short term Exit products be introduced, presents significant concern for gas suppliers. Published transmission tariffs provide clarity and transparency for end consumers. It can be difficult for suppliers to recoup end of year under recoveries or reimburse end of year over recoveries presented as a bullet reconciliation. Suppliers' ever changing customer base due to switching activity adds to the difficulty in fairly administering reconciliations to customers. Any changes within the market that risk increasing volatility of annual reconciliation payments would be detrimental to suppliers and ultimately consumers.

The modelling undertaken and presented in the consultation via various scenarios, assumes that any variances between forecast and actual capacity booking occur at Exit only and no variances are applied at Entry. Whilst we acknowledge that the purpose of this approach is to isolate the impact of the Exit Capacity products in each scenario, it is important to highlight that any variance from forecast at Exit will most likely also be reflected at Entry. Figure 1 below reflects the indictive reconciliation payments by sector, as presented in the consultation paper (scenarios only include assumptions regarding variances between forecast and actual Exit capacity bookings). However, Figure 2 below illustrates the impact of the same variances also being experienced at Entry. This highlights the very real risk of volatility in the regime and the additional volatility that Exit capacity products could potentially introduce. It also highlights that, whilst helping to address the cost allocation of the annual reconciliation between the sectors, the smoothing of the seasonal multipliers significantly increase the potential quantum of the annual reconciliation. While it is acknowledged that the presented

[2] In Gas Year 2021/2022, the Actual Required Revenue was £3.2m higher than the Forecast Required Revenue. A large proportion of this under recovery was offset by higher than forecast revenues, however, there remained a £0.9m bullet payment required from Shippers and is a demonstration of the existing volatility.

scenarios all result in lower transmission tariffs, this benefit is negated by the larger end of year reconciliation payments which are more difficult for suppliers to manage. In the scenarios, DNO's are assumed to continue to book 1 in 20 annual capacity, increased volatility is therefore directly attributable to introduction of short-term products for Power, but the gas sector is adversely impacted by increased annual reconciliations. It is therefore essential that any introduction of the smoothed multipliers (as proposed in the Utility Regulator's current consultation on seasonal multiplier factors for gas transmission) is supported by robust mechanisms to address the volatility of the annual reconciliation.

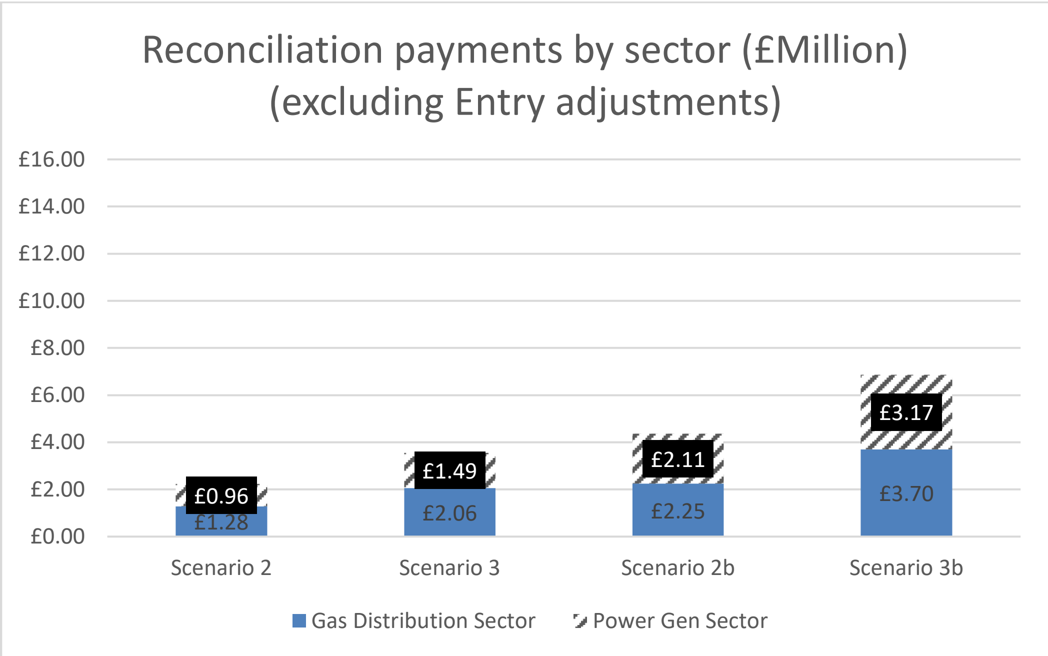

Figure 1

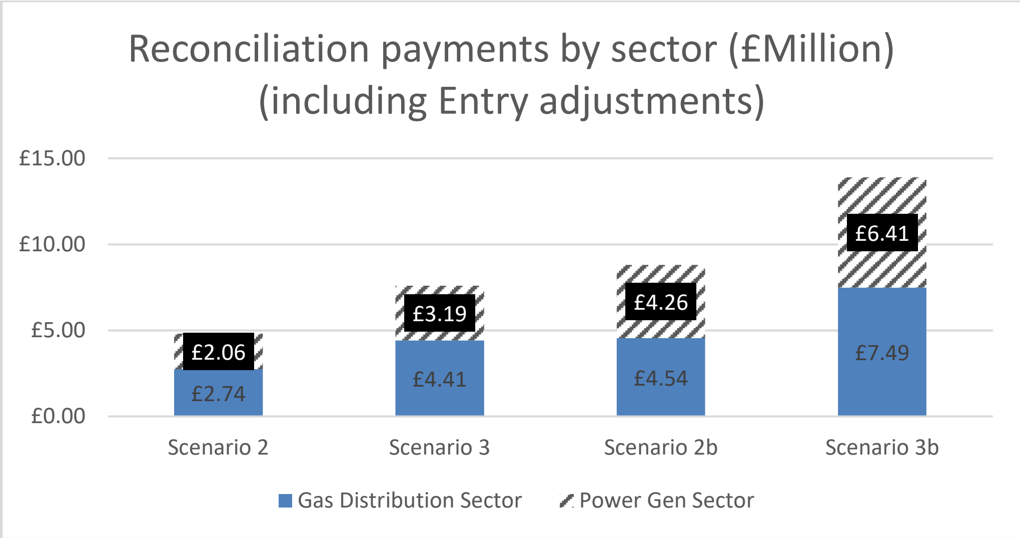

Figure 2

The DNOs jointly undertook to analyse scenarios to further test the impact of the introduction of short terms Exit capacity products and to consider possible alternative approaches.

<u>Forecast tariffs for 2026/2027</u>

It was important to consider the scenarios, as set out in the consultation paper, using a future gas year. As has been acknowledged, the demand for gas from the power sector is anticipated to reduce substantially in the coming years. The forecast transmission tariffs published by GMO NI on 31st May 2023 demonstrate a forecast reduction on power sector demand of 40% in the 5-year period between gas year 2023/2024 and 2027/2028. This reduction in volume and capacity is putting upward pressure in the forecast tariffs. We therefore considered that it was important to understand how the scenarios would look using the forecast tariff for gas year 2026/2027. Figure 3 below reflects the scenarios based on 2022/2023 tariffs, as used by the Utility Regulator in the consultation document. Figure 4 then shows the same scenarios using the latest forecast tariff for 2026/2027. As expected, the trends remain the same, however, these graphs demonstrate the significant forecast movement in the tariff in a relatively short period of time. Therefore, the quantum of any reconciliation will also increase over this period.

2022 / 2023 forecast tariffs

2026 / 2027 forecast tariffs

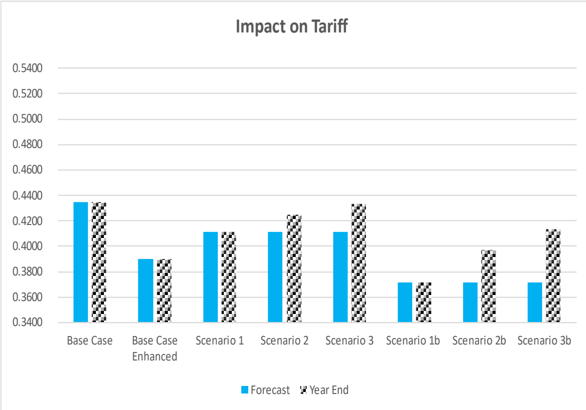

Figure 3

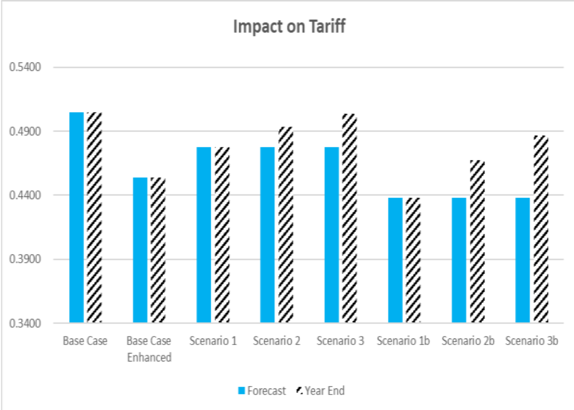

Figure 4

<u>Weighting of seasonal multipliers towards summer months</u>

An element of the proposal to smooth seasonal multipliers is to address the cost allocation issues identified by the introduction of short-term capacity products at Exit. The short-term capacity products are primarily used by power generators in the summer months when the wind is low. It is difficult to say how behaviour will change with the introduction of smoothed seasonal multipliers. It is possible the smoothing may serve only to incentivise the use of short-term capacity products and potentially increase the volatility of the annual reconciliation. We have therefore considered whether the seasonal multipliers should be weighted towards the periods where there is highest demand for these products, to encourage the booking of annual products and reduce the potential for volatility. This analysis concluded that the weighting of seasonal multipliers into the summer months could reduce the tariffs. However, it would potentially have an even greater impact on the volatility of the annual reconciliation, as demonstrated in figures 5 and 6 below. It is difficult to establish if the summer weighting would incentivise power generators to book a greater proportion of the capacity requirement annually and therefore difficult to establish if this is a realistic view of the potential reconciliation.

2022 / 2023 forecast tariffs

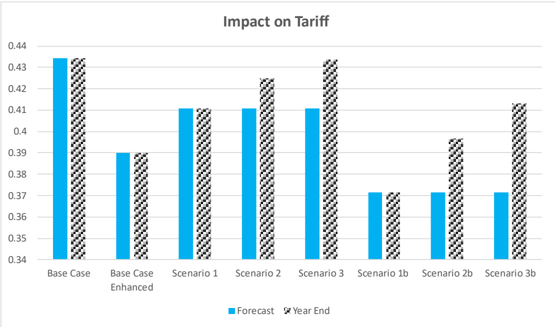

Figure 5

Seasonal Multipliers weighted to summer months

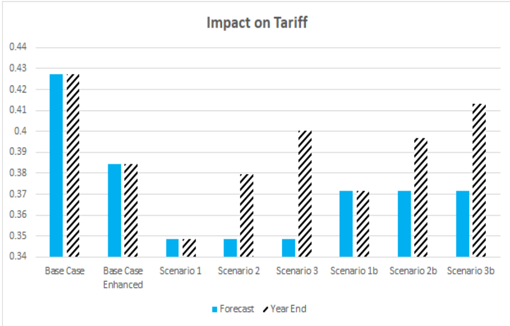

Figure 6

Introduction of an ex-ante Entry:Exit split

The consultation paper seeks views on the potential for an ex-ante Entry:Exit split. Analysis of scenarios that could see a higher weighting of the tariff toward entry was conducted. As expected, this resulted in an increase in the Entry tariff and reduction in the Exit tariff. In the absence of short-term capacity products at Exit, the adjustment of the weightings might offer power generators a solution to the flexibility issues. However, consideration of the impact for gas consumers, particularly large energy users with a low load factor, should be considered further if such an approach was taken.

Impact on prices in the SEM

The consultation acknowledges that more information is required from the power sector to make conclusions on the impact that the proposed changes could have on prices in the SEM. It is therefore difficult to form a view based on the current information available. firmus energy would suggest that, following receipt of any further information from the power sector, a full cost benefit analysis is conducted and presented to industry.

Ratchet Mechanism

In terms of the ratchet mechanism, we are supportive of maintaining a mechanism to prevent the intentional under-booking of Exit capacity, however, we consider that there is an opportunity to consider the replacement of the ratchet mechanism. The ratchet mechanism was introduced into the Exit capacity regime as part of the changes introduced for Entry and Exit capacity in Northern Ireland. As part of the consultation process undertaken prior to implementation of these changes (2014) the DNOs expressed their strong views that the Exit capacity ratchet mechanism should not have been applied to a DNO booking requirement. It was argued at the time that the DNOs already have a requirement to book a 1 in 20 requirement and therefore the concern regarding the intentional under booking did not apply. However, the decision was made to proceed with the implementation of capacity ratchets for all Exit Shippers. The DNOs have developed procedures to ensure that any capacity ratchet charges are passed through to the gas suppliers as efficiently as possible, however, if the DNO does not amend the Commoditised Exit Capacity Charge within year, the process results in the potential for further volatility within the DNO year-end reconciliation process. Since introducing the ratchet mechanism, the ratchet has only been applied once in the firmus energy Distribution network. We are therefore of the view that there is no requirement for a mechanism to manage Exit capacity bookings where the DNO continues to have a requirement to book capacity for a 1 in 20 demand. Where the 1 in 20 obligations does not apply, firmus energy considers an Exit capacity overrun mechanism to be a suitable means to incentivise shippers to book adequate capacity. This methodology appears to have been successful for Transmission Entry capacity booking.

Cost recovery between power and distribution sectors

We recognise that there is already an element of cross-subsidy inherent in the postalised transmission regime. The 1 in 20 requirement results in gas consumers paying a disproportionate amount for Exit capacity. The addition of new Transmission network users was anticipated to result in lower long-term network charges, as those new users would contribute more revenue than pipeline costs, however, it is important that any future regime change does not result in the gas distribution networks / consumers cross subsidising future Transmission connections. As outlined in the consultation paper, introduction of short-term Exit products for power only enables this sector to book capacity more closely aligned to expected demand, while the distribution sector continues to be comparatively disadvantaged by retention of the 1 in 20 booking obligation. Allocation of gas transmission required revenues therefore continue to be inequitable between the actual capacity requirements of the power and distribution sectors with an impact on cost borne by gas consumers.

Volatility risks

The consultation document demonstrates that there is a clear risk that the volatility of the reconciliation could increase because of the introduction of short-term capacity products. It is therefore vital that any move to introduce such products at Exit is supported by appropriate mechanisms to manage this volatility.

In 2021 the Utility Regulator introduced a modification to the PTL Licence to allow deferral of Capex allowances, to reduce the volatility of the annual reconciliation of transmission charges. firmus energy were supportive of efforts to reduce this volatility. However, we did highlight in our response to the licence modification that the proposals helped to reduce the impact of capex underspends, but they did not address potential overspends or under recoveries using a similar mechanism. We presented the case that an important element for Shippers is the ability to anticipate/forecast potential year end reconciliations, particularly if such reconciliations result in an invoice. Estimating the scale of any reconciliation remains extremely challenging, if not impossible, until after the Gas Year end. In our response to this licence modification, we made the point that seeking to defer capital expenditure into the following Gas Year would be the equivalent of carrying forward an over recovery of revenue from the current Gas Year. As such, we suggested a symmetric proposal ought to enable the carryover of any under recovered revenue. We considered that the carrying forward of over and under recovered revenue would appropriately address the challenges of volatility and provide a fairer process for Suppliers (and their customers) to manage tariff volatility. We would therefore reiterate this view, particularly in light of the £0.9m bullet payment required from Gas Year 2021 / 2022 and the potential for increased volatility introduced through short-term Exit capacity products.

Whilst we understand the difficulties in forecasting the use of capacity products, more thought should be given to incentivising accurate forecasts. If the DNO maintained the requirement to book an annual 1 in 20 requirement, gas suppliers and consumers should not bear the burden of the volatility caused by changes in actual capacity bookings against forecast bookings. The volatility should be addressed solely within the parts of the regime that produced the variances.

Views are also being sought on the concept of a 'buffer account'. We welcome all efforts to consider mechanisms to manage the reconciliation. At this stage we do not feel there is enough detail available to fully consider this option. We are keen to understand what support MEL could provide for such an account, including funding, and more detail around the mechanism for operation. However, such a mechanism would require substantial development and administration, therefore, in the first instance, efforts should be focused on mechanisms to prevent such volatility in the annual reconciliation.

1 in 20 obligation and capacity booking

firmus energy are of the view that DNOs would not be able to avail of short-term Exit capacity products. The current processes and administrative requirements to manage a 1 in 20 booking requirement involves a relatively straight forward capacity booking process, via a simple proforma. A move to short term capacity products would require significantly increased administration, possible requirement to use the Prisma system and could also result in an increased credit support costs. The current process also requires that firmus energy Distribution consult with gas suppliers on the level of Exit capacity required for the following gas year. It is difficult to envisage how this consultative process could work if there is a requirement to book short term products during times of higher demand.

The 1 in 20 obligation was introduced into the gas distribution licence to support the growth of supply competition. When introduced in the Phoenix Natural Gas Licence in 2004, the Utility Regulator stated that the reason for the modification was in recognition of the potential difficulties that a new gas supplier could face in trying to enter the Greater Belfast market, as they may not have been able to secure capacity on the upstream transmission pipeline. The transmission arrangements at that time required a Shipper to commit to pay for capacity for at least one year. The Licence modification was therefore implemented to remove this potential market entry barrier. This has subsequently proved to have effectively supported the development of gas supply competition in Northern Ireland.

The regime and the maturity of the competitive market has developed in the years post implementation. We therefore consider that there could be merit in reviewing the 1 in 20 requirements on DNOs in the future. The Biomethane workstream that gas network operators and the Utility Regulator are currently engaged in has identified that, as the volume of renewable gases injected into the distribution networks increases, there may be a future requirement to review the 1 in 20 obligation. However, the implication of removing this obligation will have an impact on the overall tariff structure for Transmission and the implications must be carefully considered. However, as the renewable gas market develops in Northern Ireland, the tariffing regime for the Transmission and Distribution networks will need to adapt to ensure equity and support future renewable connections. The 1 in 20 licence obligation should be reviewed in this wider context. Given an opportunity for licence reform to remove the 1 in 20 obligation, restructure of the Exit capacity booking process and introduction of a suitable platform to facilitate booking, firmus energy consider introduction of short-term Exit capacity products for gas suppliers to have potential benefits for suppliers and customers. The Entry capacity booking regime has operated effectively since the removal of the initial entitlement in 2020. Suppliers are experienced in managing capacity booking requirements and customers have benefitted from closer alignment of booking to actual demand.

Other matters

The paper does not provide information around the costs associated with the implementation of short-term capacity products at Exit. We anticipate that there will be a requirement to make amendments to the Delphi system and possibly Prisma. It is important that these costs and the time required to implement are carefully considered.

Conclusion

The proposal to introduce short term Exit capacity products into the transmission regime has the potential to offer greater flexibility to those Shippers that can avail of them. There is also the potential for the tariffs to reduce, which firmus energy would welcome. However, the recurring theme highlighted within the scenarios tested is the resultant volatility of the annual reconciliation, which must be addressed. As also highlighted, the use of the gas transmission system is expected to change, as the supply of renewable energy increases, and therefore there is a risk that gas consumers in Northern Ireland bear a disproportionate element of the transmission costs in the future. It is our view that there is currently insufficient information available to fully assess the impact of short-term Exit capacity products. We welcome further engagement with the Utility Regulator and industry on future proposals on this matter.

Yours Sincerely

Mark Stevenson

Director of Regulation

Appendix 1 - Exit Capacity Review for NI Transmission Discussion Document – fe response 2016

Roisin McLaughlin
Utility Regulator
Fergusons Way 14 Queen Street
Kilbegs Road
Belfast
BT1 6ED

firmus energy Ltd
A4-A5
Antrim
BT41 4LZ

5th May 2016

Dear Roisin

RE: EXIT CAPACITY REVIEW FOR NI GAS TRANSMISSION – CALL FOR EVIDENCE

Thank you for providing firmus energy with the opportunity to respond to the published discussion document regarding potential reform of the Northern Ireland gas transmission exit arrangements.

Having reviewed the published discussion document, firmus energy believes that the key issues have been identified. As has been acknowledged throughout the paper, the potential impact of any regime change is a complex one and at present there is insufficient information available to fully appreciate the overall impact.

Short-term products

While firmus energy appreciates that the availability of short-term products might bring greater flexibility for shippers, it would seem that the shippers benefitting most from the introduction of such a regime would primarily be the electricity generators. There is little if any evidence of demand for such a regime change coming from those shippers operating on the distribution networks in Northern Ireland. It would appear that the proposed changes are attempting to resolve an issue that is specific to the electric generation regime in Northern Ireland. Firmus energy does not feel that it is appropriate to address electricity regime issues through changes to the gas regime and would suggest that these issues are addressed directly via the electricity framework. Firmus energy would also question if it is the correct time to address such issues and ask if it would be more appropriate to postpone the project until the I-SEM implications are fully appreciated.

Given the uncertainty surrounding the impact of such a regime change and the potential further uncertainty of annual reconciliations, firmus energy could not support the proposal for the introduction of short term exit capacity products at this time.

Capacity booking responsibilities
As the Distribution System Operator (DSO) in the Ten Towns network area, firmus energy currently books and holds transmission exit capacity on behalf of shippers operating on the network. As previously stated, there is little evidence of interest in short terms exit capacity products from distribution shippers. However, if such a regime was introduced, it would not be appropriate that the regime would only be available to electricity generators.

As a DSO, it is extremely difficult to envisage a regime that would require the DSO to book short term capacity products on behalf of distribution shippers and is not a scenario that firmus energy could support. Firmus energy therefore believes that the introduction of short term capacity products must apply to all shippers and must also result in the removal of the DSO obligations to book exit capacity.

In terms of the level of capacity booked, firmus energy would question the assumption in the paper that the current requirement on DSOs to book 1 in 20 peak level would be transposed onto shippers. There is no such obligation for electricity generators and therefore such a requirement would introduce further inconsistences and inequality to the regime.

Capacity Booking Platform
Given the uncertainty as to the most appropriate platform and the associated uncertainty of cost to introduce an appropriate capacity booking platform, firmus energy would be extremely concerned as to the potential cost implications and would therefore suggest that this element is of central importance in the consideration for regime change.

Ratchets
To date firmus energy has not received information regarding the amount of capacity booked at transmission exit and the implications of any capacity ratchets, therefore, it is difficult to comment on the appropriateness of the current mechanism. However, given that the capacity ratchets were only introduced in October 2015 and therefore has only been in operation for seven months, firmus energy would support the suggestion that it is too early to consider further change.

In conclusion, firmus energy does not believe there is sufficient evidence available to support the requirement to continue the review of the exit capacity booking regime at present. It is also very unclear as to the potential impact on the gas industry and therefore firmus energy would request that any further consultation on this subject is supported by more detailed demonstration of the impact of regime change.

We hope that these comments prove useful.

Yours sincerely

Lisa McCarthy
Transportation Services Manager
Firmus energy