Decision on Bord Gáis Networks Short Term Tariff Analysis 2010

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Abstract:

This paper sets out the decision of the Commission for Energy Regulation ('the CER') regarding a revised short term capacity tariff and related analysis put forward by Bord Gáis Networks (BGN) in July 2010.

Target Audience:

Gas Customers, Suppliers, Shippers and Producers.

Related Documents:

Consultation Note on BGN Short Term Tariff Analysis 2010 (CER/10/134) Published on the 5th of August 2010.

BGN Short-Term Tariff Analysis Paper (CER/10/132) Published on the 5th of August 2010.

Decision on Transmission Exit Capacity Transfers in the Gas Market (CER/10/089) Published on the 17th of June 2010.

Short Term Tariff Analysis Response and Decision Paper (CER/07/115) Published on the 9th August 2007.

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1.0 Introduction

1.1 Purpose of this paper

On the 5th of August, the CER published a Consultation Paper on a revised short term capacity tariff in light of the BGN submission, *Short Term Tariff Analysis July 2010* (CER/10/132). In the Consultation Paper (CER/10/134), the CER invited comments on BGN's revised tariff and analysis. This paper sets out the CER's response to comments received and the CER's decision on a revised short term transmission capacity tariff.

1.2 Background Information

Under the Gas (Interim) (Regulation) Act, 2002, the CER is responsible for regulating charges in the natural gas market. Under Section 14 of that Act the CER may set the basis for charges for transporting gas through transmission systems.

In 2007 BGN developed a tariff methodology for the pricing of short term transmission capacity products in accordance with the EU Regulation EC1775/2005. This methodology sets the prices for monthly and daily capacity products at entry and exit as a percentage of annual tariffs.[1] Short term tariffs were introduced to the Irish gas market on 1st October 2007. In the CER's Decision Paper on the subject (CER/07/115), it was noted that following the introduction of short term products, the CER would keep the take up and pricing of these products under review.

In June 2010, the CER published a Decision Paper on Transmission Exit Capacity Transfers in the Gas Market (CER/10/089). In this paper the CER examined the price of exit capacity transfers (also referred to as 'secondary capacity'). As part of its decision, the CER committed to carrying out a consultation on the current short term capacity tariff which would focus on the potential for reducing short term prices in order to provide greater flexibility to shippers, while also ensuring that sufficient incentives remain for the booking of annual firm capacity. BGN have accordingly undertaken an initial review of these tariffs following further discussions with the CER having taken into account the modifications to secondary capacity transfers set out in the Decision Paper. The CER also noted in its decision that a further more detailed examination of the respective seasonal pricing levels of the short term capacity tariffs will be undertaken in 2011.[2]

1 Short term tariffs have the same commodity element as annual tariffs.
2 See Section 6 of CER/10/089.

1.3 Comments Received

The CER received comments to the Consultation Paper (CER/10/134) from five parties.

Non-confidential responses are listed below and are published in conjunction with this paper on the CER website unless otherwise requested.

1. Bord Gáis Energy Supply
2. ESB Independent Energy
3. Phoenix Energy
4. Vayu Limited
5. Viridian Power & Energy Limited

In reaching its decision, the CER has taken due account of the arguments presented in all of the submissions and representations made by the parties above. The principal points raised by respondents are summarised in Section 3 and are accompanied by the CER's response.

2.0 Proposed Revision to Short Term Tariff Levels

Taking into account the CER's recent decision on secondary capacity[3], BGN put forward a reduction in the prices of short term capacity. In their submission BGN proposed that the short term monthly multipliers be reduced from an overall level of 210% as set in 2007/08 to 190%. The reduction would be applied only to the winter and shoulder months as a discount already applies to the summer months. The daily multipliers would also reduce as they are a function of the monthly multiplier.[4]

Short Term Multipliers	Current 09/10 Monthly	Proposed 10/11 Monthly	French Monthly	Danish Monthly
October	15%	13.2%	8%	7%
November	15%	13.2%	17%	11%
December	20%	17.6%	33%	21%
January	35%	30.9%	67%	25%
February	40%	35.3%	67%	25%
March	30%	26.5%	17%	21%
April	15%	13.2%	8%	11%
May	8%	8.0%	8%	6%
June	8%	8.0%	8%	6%
July	8%	8.0%	4%	6%
August	8%	8.0%	4%	6%
September	8%	8.0%	8%	6%
Sum Over Year	210%	(*) 190%	250%	147%

It was also noted that it is intended that the reduced short term multipliers address the issue of minimal take up of the short term products and encourage additional bookings, whilst also ensuring that adequate incentives are present for the booking of annual firm capacity.

To estimate the impact of these revised short term products, BGN examined three scenarios of shipper behaviour following the implementation of the proposed changes to the short term tariff levels.

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3 Decision on Transmission Exit Capacity Transfers in the Gas Market (CER/10/089)
4 BGN Short-Term Tariff Analysis Paper (CER/10/132)

3.0 CER's Response to Comments Received

This section summarises the principal comments received from interested parties and includes the CER's responses to those comments. It should be noted that all respondents welcomed the proposed reduction in the short term transmission capacity tariffs, as well as the in-depth analysis and consultation to be undertaken next year.

3.1 Cost of Product and Product Take Up

All of the respondents stated that the proposed decreases in short term multipliers are not large enough taking into account the current low cost of exit capacity transfers and that the reduction would not be sufficient to increase short term capacity bookings by shippers on a consistent basis.

One respondent noted that, while these products may notionally provide flexibility, the high price of these products limits this flexibility. As a result, short term products would only be used as a last resort, i.e. when exit capacity transfers ('secondary capacity') are unavailable.

CER's Response:

It should be noted at the outset that, as per the CER's decision on exit capacity transfers (CER/10/089), the floor price for BG Energy NDM secondary exit capacity will be increased in two stages up to October 2012, when the transfer of NDM capacity will no longer be allowed. The CER does not consider that the comparison of secondary and short term capacity constitutes a constructive assessment. It should also be noted that the current price of secondary capacity does not, in our view, reflect the very low probability of interruption. It is not intended that the cost of short term capacity will ever align with that of secondary capacity and short term capacity products should not be interpreted as a simple substitute for existing secondary capacity. The CER is of the view that the cost of short term capacity should be examined in the context of firm annual capacity.

It is recognised that during this 2 year period the level of short term capacity multipliers should be examined in order to enhance the use and flexibility of the product where possible. It is with this in mind that this review has been instigated.

Regarding the reduction to the multipliers set out in the BGN submission, it is agreed that the proposed revision to the short term tariff multipliers is unlikely to result in a dramatic change in shipper booking strategies at this time. It should be taken into account that an important consideration in reviewing the multipliers is that the percentages should only be reduced to the extent that the change does not result in a disincentive to book firm annual capacity. It should also be noted that this revision is the first step in a two part process. Respondents' comments will also be considered in the context of the analysis and consultation to be undertaken in 2011.

Regarding flexibility, the ability to adapt these capacity products to appropriately match a customer profile can only be judged when they are actively utilised by the shipper in question and not as a once-off or last-resort measure in the absence of large amounts of NDM secondary capacity.

3.2 Short Term Capacity and Changes to Transmission Exit Capacity Transfers

One supplier contended that the removal of the ability to make transfers of exit capacity from the NDM market and the restriction of capacity within sectors from 2012 will act as a barrier to entry to prospective new suppliers. This party also noted that the cost of secondary capacity, in contrast with that of short term capacity, allows suppliers to book capacity in an efficient and effective manner.

CER's Response:

The CER recognises the sizeable benefits currently provided by secondary capacity to certain suppliers and end-users and that these will be removed over the next two years as per the CER's decision (CER/10/089). It is noted that this decision may create difficulties for prospective new entrants to the gas market taking into account in particular the potential advantages available to existing suppliers in booking capacity to match their developed portfolios. This portfolio benefit and a further reduction in short term will therefore be examined as part of the 2011 consultation.

3.3 Other Member States as a Reference Point

A number of respondents made suggestions regarding the comparison of current and proposed Irish short term capacity prices with those in other EU Member States. Two parties called for further countries to be examined; the prices applied in Holland and Belgium were put forward in this regard. One of these respondents also stated that the uptake rate of these products should be compared with that in Ireland. Another party called for the following information in analysing the Irish case: *'(1) a brief outline of the suitability of the French and Danish gas markets for comparison with Ireland, including the availability of short term products; and (2) an analysis of the short term capacity products and their performance in the respective markets, including depth of the market/liquidity'*.

CER's Response:

The CER thanks respondents for their suggestions. It should be firstly recognised that market rules and capacity products in other Member States are unlikely to align closely with those in Ireland. This is particularly the case in light of the prevalence of secondary capacity sales in Ireland where the probability of interruption is extremely low.[5] Therefore, the CER does not consider that a comparison of the uptake rate of short term products between Ireland and other Member States would provide any major insights.

However, further information on the uptake of short term products in other Member States with similar markets may prove useful. The CER will consider such a comparison in the 2011 consultation.

3.4 BGN Analysis of Tariff Change

One respondent stated that '*the scenario analysis is outdated and as such is likely to offer little in the way of impacts of any proposed change*'. This party suggested that a number of variations to the monthly tariff multipliers and a number of scenarios in this analysis should be put forward and examined. This respondent stated that no consideration is given as to how the CER's decision on exit capacity transfers may impact upon demand for the short term capacity product. The respondent also called on the CER and/or BGN to clarify the changes to the tariff that they consider to be necessary and to set out a timeline in relation to the tariff changes.

CER's Response:

The CER agrees that the most current data has not been included as part of BGN's analysis of the effect of the revised tariff multipliers. It should be taken into account that this analysis presumes that secondary capacity is fully utilised by shippers; the BGN submission notes that: '*the extent of incremental reaction as a result of the short term product pricing (i.e. reaction over and above the uptake of the NDM secondary capacity transfer product)*' has only been considered. Therefore, given that no spare secondary capacity is taken as being available, the analysis is appropriate for the examination of the future scenario where the transfer of NDM secondary capacity will no longer be allowed in accordance with the CER's recent decision on the subject.[6] In this way, the incremental effect on the market of the changes to short term capacity multipliers is not influenced by shippers' prior purchases of secondary capacity.

It should be noted that the CER does not merely have one particular objective in reviewing the short term capacity multipliers. The revision to these multipliers has been carried out in order to achieve a balance between three principal objectives as noted in the BGN submission. The current (and any future) changes to the cost of short term capacity should:

- provide an incentive to book long term capacity
- increase gas use where appropriate (e.g. during the summer months)

[5] This issue has been addressed in Section 4.4 (i) of CER/10/089.
[6] Decision on Transmission Exit Capacity Transfers in the Gas Market (CER/10/089)

- remain a flexible product for certain system users (e.g. for factories who would only utilise gas for a number of hours a day for a number of weeks/months).

Taking this into account, the CER intends to undertake a further consultation on the pricing of the short term products in Q1 2011. This consultation will include the following:

- Analysis of the differentials between multipliers in the winter, shoulder and summer months;
- Impact of various reductions in monthly percentages, in particular for the summer months;
- Benefit currently experienced by certain shippers in their booking portfolios;
- The potential for fuel switching to gas from other fuels (and avoiding the opposite) and how this might be affected by short term tariffs.

As regards the timeline for implementing changes to the short term tariffs, the proposed change to the multipliers will take effect on the 1st of October 2010 (see Section 4). The CER has already commenced business planning with BGN on the examination of the further change to the short term capacity tariff in 2011. The CER expects that this analysis will commence in Q1 2011 and that a consultation paper in light of BGN's results will subsequently be published. It is expected that the CER will issue a decision concerning these matters in Q2 2011.

Lastly, the CER is of the view that the examination of a range of variations in the tariff levels may be appropriate and this will be considered as part of the 2011 consultation.

A further respondent commented that the impact of the proposed change[7] appears to be little different from the results associated with that of the current tariff.

CER's Response:

The CER considers that the analysis is appropriate taking into account the changes to be made to secondary capacity sales over the next two years.[8] It is acknowledged that the proposed revision to the tariff multiplier itself does not constitute a major change and it follows that BGN's analysis of the proposed change does not differ markedly from that for the current tariff. The CER does not consider, however, that this brings into question the rationale for or the benefit of the proposed reduction. This review has been undertaken as the CER considers that a gradual process in amending the tariff levels is the most prudent approach that will also to serve to prevent tariff volatility.

[7] See Tables 5 and 6 of the BGN submission. BGN Short-Term Tariff Analysis Paper (CER/10/132)

[8] Decision on Transmission Exit Capacity Transfers in the Gas Market (CER/10/089)

3.5 Price of Summer Short Term Capacity

One respondent recommended that amending monthly factors applied to the months of May to September to reduce prices would act as a means of encouraging more users of gas at non-peak times.

Another party noted the fact some of the monthly multipliers are slightly cheaper than the equivalent long-term capacity rate.[9] This party contended that it is flawed to have the cost of the short term regulated tariff cheaper than the cost of long term rates as it is contrary to the principle of encouraging longer term bookings. They also noted that it is unjust that annual users are paying more of the costs for the network to be available to all customers, including summer users, for 12 months of the year.

A confidential section in one response put forward the view that the reduction to the summer prices of short term capacity discriminates in favour of summer users of gas. They also referred to the pricing principle in BGN's submission which states that, in accordance with the EU Regulations 1775 of 2005 and 715 of 2009, the tariffs or tariff methodologies shall be applied in a non-discriminatory manner.

CER's Response:

There are customers who are solely or predominantly summer users of gas and it is hoped that the current short term multipliers during the summer months will encourage additional use of the system. The CER considers, however, that the benefits of the current summer multipliers for short term capacity are not merely confined to these customers. Any incremental purchases of short term capacity will result in additional revenue that will give rise to a capacity tariff that is lower than it otherwise would be, thereby providing a net benefit to all shippers and end users.

For the avoidance of doubt, the CER intends to examine the potential for further reductions in the price of short term capacity during the summer months.

3.6 Gas Capacity Products and Peaking Plants

One respondent referred to the use of exit capacity transfers by OCGT plants, taking into account the importance of such plants alongside renewable generation in the SEM. This party commented: '*lower load plants cannot commercially justify booking firm capacity due to a high level of uncertainty on the level of market dispatch'* and therefore called on the CER *'to give a firm commitment that it will considerably reduce the price of short term capacity products before it eliminates capacity transfers.'* The respondent proposed that alternatively, secondary capacity transfers should be retained.

[9] The current and revised level of the summer short term multipliers is 8% of the cost of the annual capacity tariff. This figure is less than 1/12 of the annual charge (i.e. 8.3%).

CER's Response:

The CER does not intend to review its decision on exit capacity transfers. As previously stated, the CER will examine the introduction of further reductions to short term capacity as part of the 2011 consultation.

Regarding arrangements for OCGT plants, the CER recognises the importance of secondary capacity, and similarly short term products, to peaking plants in the SEM. It should again be noted, however, that the purpose of short term products is not merely to act as a cheap substitute for secondary capacity. The CER is tasked with striking a balance between providing flexible capacity products at a reduced price to encourage gas use and with ensuring that the incentive remains to book long term capacity.

In relation to secondary capacity, it should also be noted that the CER, as part of its recent decision, has allowed exit capacity transfers within the same customer sector partly in order to ensure that gas-fired generating stations are able to 'replace' other plants by making use of spare exit capacity.[10]

Regarding the role of OCGTs in facilitating renewable generation, this is an important issue in the development of the SEM itself and it may be appropriate that it is raised as part of the SEM.

Lastly, within day short term capacity was introduced in order to facilitate OCGTs in the SEM. Should shippers desire any additional flexibility in relation to within day short term capacity, this issue may be best addressed at the Code Modification Forum.

3.7 Short Term Products and CAG

Another respondent noted that there are no short term capacity products available in Northern Ireland and proposed that those in place in Ireland act as a model for adoption as part of the CAG project.

CER's Response:

The CER is not in a position to comment on the suitability of such products on an all-island basis. This issue will be addressed in conjunction with the Utility Regulator as part of a review of non-annual gas products in the event that the CAG project recommences.

[10] See Section 4.2(i) of CER/10/089.

3.8 Interruptible Products

One respondent noted that the introduction of interruptible products was mandated by EC Regulation 1775 of 2005 and has again been set out in Regulation 715 of 2009. The respondent therefore calls on the CER to ensure that BGN/Gaslink develop these products.

CER's Response:

It is recognised that interruptible products are a requirement under EU Third Package legislation. The introduction of interruptible gas capacity products has been referenced in a number of previous CER and CAG papers. [11]

The business rules for regulated interruptible products at the Entry were developed in 2008 but the product was not systemised on GTMS due to CAG being in development and due to the absence of congestion on the system.

The CER has not changed its position in this regard. The CER intends to utilise the business rules previously developed as a starting point for progressing the work item with the Utility Regulator in the event that the CAG project recommences. In any event, it is the CER's intention to have interruptible products operational by October 2012.

[11] See Annex 3 of the Common Arrangements for Gas Consultation Paper *Transmission Tariff Methodology and Regulation in Ireland and Northern Ireland* (CAG/08/004) and *Review of Transmission Exit Capacity Transfers in the Gas Market* (CER/10/037).

4.0 CER's Decision on Short Term Capacity Tariffs

The CER is of the opinion that the changes to monthly percentages in the winter and shoulder months proposed in the Consultation Paper will serve to enhance the ability of shippers to optimise their capacity booking portfolios through short term products, whilst ensuring that sufficient incentive remains to book firm annual capacity.

The CER hereby directs Gaslink to implement the short term capacity tariff multipliers as per Table 4.1 below. These percentages will be effective from the 1st of October 2010.

Table 4.1: 2010/2011 Short Term Capacity Multipliers

Short Term Multipliers	**Monthly**	**Daily**
October	13.2%	0.66%
November	13.2%	0.66%
December	17.6%	1.18%
January	30.9%	2.06%
February	35.3%	2.35%
March	26.5%	1.76%
April	13.2%	0.66%
May	8.0%	0.40%
June	8.0%	0.40%
July	8.0%	0.40%
August	8.0%	0.40%
September	8.0%	0.40%
Total Percentage of Annual Tariff*	190%	342%
*Any difference in the total is due to rounding.		

The CER intends to undertake a further consultation on the pricing of the short term products in Q1 2011. This consultation will include the following:

- Analysis of the differentials between multipliers in the winter, shoulder and summer months;
- Impact of various reductions in monthly percentages, in particular for the summer months;
- Benefit currently experienced by certain shippers in their bookings portfolios;
- The potential for fuel switching to gas from other fuels (and avoiding the opposite) and how this might be affected by short term tariffs