Response by Viridian Power & Energy to Commission for Energy Regulation's Consultation Paper - CER/10/134

Consultation Note on Bord Gáis Networks Short Term Tariff Analysis 2010

25th August 2010

1. Introduction

Viridian Power and Energy (VPE) welcomes the opportunity to respond to this Consultation Paper on Bord Gáis Networks' (BGN) Short Term Capacity Tariffs for 2010.

In our response to CER's recent review of exit capacity transfers (CER-10-037), we noted the need for a fundamental review of the pricing of short term capacity products if these products are to be seen as substitutes in the market for secondary capacity trading. The current pricing of short term capacity products can largely be seen to be prohibitively high, with a strong incentive for shippers to book annual capacity and to use alternative short term products (exit capacity transfers).

Following CER's recent Decision Paper on Exit Capacity Transfers (CER-10-089) this Consultation Paper advances the commitment to review short term capacity products and the associated prices. Within this response we shall specifically address the following points in relation to the first phase of this review;

- the proposed change to the short term capacity tariff multipliers;
- future changes in the market and to the tariff multipliers; and,
- the relevance of the comparators relied on by BGN in their short term analysis.

2. The proposed revision to BGN's short term capacity tariff multipliers

Proposed change to short term capacity tariff multipliers

Firstly, VPE welcomes the proposed move to revise the short term capacity multipliers such that the prices of such products, in general, are reduced. We note that the proposed revision is applied to winter and shoulder months (October – April), with the tariff levels for summer months remaining the same.

CER's stated objective in relation to this review, as well as for short term capacity products, is outlined as follows;[1]

"The reduction in short term multipliers is hoped to 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."

These objectives contain an inherent trade-off between the attractiveness of short term capacity products and the need to ensure that incentives to book annual firm capacity are not distorted. Clearly there is a need for short term capacity products in the market, however the relatively poor uptake of these products indicates that given

[1] CER Consultation Note on Bord Gáis Networks Short Term Tariff Analysis 2010, CER/10/134, 5 August 2010, p.6.

their price and the price of alternative short term products, these products are not competitive and therefore, unlikely to be serving the purpose for which they were designed. Even under the revised tariff weights, VPE consider there to be a strong incentive to book annual firm capacity.

Considering alternatives to short term capacity products the CER have previously indicated that differences in price between these products and exit capacity transfers are to be expected as a result of the interruptible risk associated with the latter. However, given the continued preference for exit capacity transfers, this indicates that this risk may be over-priced in the short term product. In relation to this issue and the relationship between short and long term capacity booking, it is important for the CER to try and understand the underlying demand for these products and how demand for these products interact.

Specifically in the current consultation, the scenario analysis is outdated and as such is likely to offer little in the way of impacts of any proposed change. Furthermore, the analysis only considers one set of proposed changes to the multipliers, it may be preferable at this stage of the consultation to provide a range of options for change. At the very least, justification for this specific change to multipliers should be provided. More generally, it would be useful if CER and/or BGN would make available their views on the changes considered to be necessary to affect a preferred outcome. In the lack of all of the above, it may appear as though this proposed revision of multipliers is uninformed and as such may not best address the shortcomings of the current products.

Future changes

The gas market in Ireland is changing and will undergo further significant changes in the coming years, most notably with the introduction of the All-Island Common Arrangements for Gas (CAG). In relation to this consultation, the recent Decision Paper (CER-10-089) on exit capacity transfers makes provision for;

- the removal of the RTF;
- the cessation of exit capacity transfers from NDM;
- the ring-fencing of capacity transfers within the remaining customer groups.

These changes directly affect the functioning of the alternative short term capacity product in the market, yet no consideration is given in the consultation paper to how these changes are expected to affect the demand for short term capacity products. Indeed the scenario analysis is still based on an incremental reaction based on the availability of NDM capacity transfers. We note it is very difficult to consider the effects of changes not yet enacted, however, in the interest of regulatory certainty and stability any changes proposed now should be with a view to their possible impacts in the future market such that the need for further changes are minimised.

We note that as part of the BGN submission, they have indicated the continued work that is ongoing in relation to assessing the scenarios contained therein. As part of analysis to be presented in 2011 there is a commitment to provide a more detailed analysis based on an updated model and assumptions. Although not explicitly expressed, we assume this is to be part of the second phase of the analysis on seasonal pricing levels. We would urge thin inclusion of a number of scenarios in this analysis to attempt to inform the likely future impacts of changes in the market.

In relation to changes in the market, BGN have expressed a preference for the form of adjustment that is appropriate in relation to short term capacity products:[2]

"BGN believes that a gradual change to the multipliers is the most responsible way forward for the industry as a whole as a significant change could result in subsequent tariff volatility."

It is unclear from this whether BGN consider there to be a need for significant changes to the current short term capacity tariff multipliers, although it does appear to indicate it. If indeed significant changes are thought to be required, it is important for such changes to be quantified. Furthermore, VPE considers it to be prudent on behalf of CER to ask for industry's views on preferred future options and for the subsequent tariff volatility to be assessed alongside the benefits accruing from the revised multipliers. This point relates to a previous one in relation to the need for transparency on the changes that are considered necessary to tariffs in the longer term. Even if gradual changes are preferred, a timeline for arriving at preferred tariffs should be provided.

Finally, we note that in view of the CAG there are no short term capacity products currently available in Northern Ireland. To facilitate the introduction of the CAG and the inclusion of short term capacity products, it is considered to be preferable for the system in the Republic of Ireland market to be stable and to provide a model for adoption in an all-island basis.

Relevant comparators

Since the introduction of short term capacity products in the Irish market, BGN have consistently provided an international comparison of monthly tariff percentages between the multipliers in Ireland and those in France and Denmark. Noticeable by its omission is any justification as to why these markets represent relevant benchmarks for the Irish market. The merits of an international benchmarking exercise will depend on how comparable the market are and how, given the different market arrangements (or structures) the outcomes vary. As part of the comparison presented by BGN, only the benchmark values are considered. To legitimise this international benchmarking exercise, the following should be provided alongside the current information;

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;

[2] BGN Submission to CER, Short Term Tariff Analysis, July 2010, p.10.

3. Conclusion

BGN's proposal for revision of the short term capacity tariff multipliers is welcomed. It is recognised that current price of such products makes them unattractive both when compared to annual firm capacity booking and to alternative short term capacity offerings (exit capacity transfers). However, as only one set of changes have been proposed for consideration, and no indication of the eventual full change is given, it is difficult to give a considered view on how appropriate the proposed changes are.

It is recognised that the proposed changes are in the right direction (lower tariffs) but their magnitude should be subject to further analysis. Information should be provided on what changes are considered appropriate and necessary to bring about the objectives of the short term capacity products. If further revisions are required, the views of market participants should be requested on the nature of these changes, (accelerated or gradual), and any modelling of future changes should be based on assumptions that reflect the market and the noticeable changes that have taken place, as well consideration for those due to take place.

Finally, the basis for comparison with international benchmarks should be legitimised. Reference to such benchmarks and allowing these to guide policy in the Irish market should be supported by evidence that the products offered in other markets are effective in terms of achieving their objectives and support liquidity in the market.