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Tel: 01 2303666

10 August 2011

Re: CER Consultation on “The Regulatory Treatment of the BGÉ Interconnectors”

Shannon LNG is responding to the CER consultation paper entitled “The Regulatory Treatment of the BGÉ Interconnectors” which was published on the 1st of July 2011 (the July consultation paper). That paper presented four options of which two, Options 1 and 2 appear to have been effectively eliminated from further consideration by the CER.

Shannon LNG has retained Matheson Ormsby Prentice (MOP) to review the consultation paper from a legal perspective and retained the Brattle Group to review the consultation paper from an economic and regulatory perspective.

Shannon LNG has provided a detailed review of the consultation paper in Appendix A. The MOP legal review of the consultation paper is provided in Appendix B. The Brattle Group review of the consultation paper is provided in Appendix C.

Legal

MOP have advised that the CER’s proposals are contrary to Irish and EU legislation as they: (i) amount to focused discrimination, (ii) propose tariff structures that are not cost reflective; (iii) provide a cross-subsidy in favour of GB suppliers and the Moffat Entry Point; (iv) distort intra-state trade; (v) constitute a fundamental barrier to entry for new market entrants such as Shannon LNG; and (vi) are in breach of CER’s duties to ensure effective competition and to protect consumers.

MOP have also advised that a departure now from the established and repeatedly confirmed Irish Separate Entry/Postalised Exit tariff structure, would be a material breach of the CER’s statutory duty to act in as consistent a manner as practicable. MOP have also expressed the view that in expressly adopting and confirming the Irish Separate Entry/Postalised Exit tariff structure introduced by the 2001 Ministerial Directives to give a specific signal to encourage off-shore developers and gas infrastructure developers to enter the market, the CER made and repeated a specific and express representation to Shannon LNG as part of a very small and defined group that the Irish Entry/Postalised Exit tariff structure, would continue.

Significantly MOP have stated that the CER does not have the required powers under the legislation to impose a cross-subsidy on market participants in favour of BGN and/or GB gas suppliers nor to discriminate in favour of BGN and GB gas suppliers, nor to limit or interfere with competition, nor to interfere with Shannon LNG's property rights and related legitimate expectations, in the manner envisaged in the options identified by the CER. Accordingly, a decision by the CER that reflects any of the CER's Options 3 or 4 or the Hub Proposal or any equivalent measure, would be *ultra vires* the powers of the CER.

Without prejudice to Shannon LNG's rights to challenge the legality of any decision of the CER, Shannon LNG is still interested in working with the CER to find a stable, predictable and long term Interconnector tariff design that recognises the costs of transporting gas from Scotland to Ireland while protecting consumer and investor interests.

Economic and Regulatory

Option 4 would eliminate the Interconnector (IC) tariff by transferring all of the IC costs to the onshore rate base. The proposal goes further than is required to address gas price volatility, and at the same time harms producers and investors. It will undercut new supply projects and reduce competition. Option 4 will also increase the price of gas at the NBP, costing consumers in Ireland and Britain millions of euro. It is not a proportional solution to the CER's apparent issue, and discriminates against other sources of gas in Ireland in favour of gas from GB. As such we cannot support this option.

Option 3 would set a maximum IC tariff, and the 'stranded' IC costs would be recovered from the onshore rate base. If amended as Shannon LNG has proposed in our 4 March and 15 June letters, Option 3 would better balance the interests of Irish gas consumers and industry investors by ensuring the regulatory regime continues to attract future investment without increasing retail prices.

Specifically, an amended Option 3 would **set a stable IC tariff that does not vary with throughput**. An amended Option 3 is consistent with previous policy decisions and historic tariff levels adjusted for the expectations that investors had when they committed capital to projects in Ireland.¹ Any costs of the ICs not recovered in IC revenues would be recovered from onshore exit points allowing entry points to compete based on their costs.

Policy

The Dáil debates (Appendix D) on tariff design and the subsequent November 2001 Tariff Directives (Appendix E) very clearly set out the Government position that non-users of the Interconnector would not have to pay for them. Any move away from this principle, in light of which Shannon LNG and others have invested millions of euro, can only be achieved in a proportional and rational manner based on a clear set of principles for future Interconnector tariff design and publication of the complete Interconnector cost data. We call on the CER to publish the tariff design principles for an amended Option 3 with full publication of Interconnector cost data.²

¹ These expectations incorporated the Corrib volumes being included as planned in the IC tariff.

² Shannon LNG has proposed a set of tariff design principles in our 4 March and 15 June letters. Alternatively, the CER could publish detailed tariff design principles for consultation with industry.

If Shannon LNG does not proceed with its project, it is likely BGÉ will have to reinforce the Interconnectors in Scotland at a cost of circa €245 million³. The Gas Capacity Statement 2011 confirms that in the absence of Shannon LNG, significant reinforcement of the Interconnectors is likely to be required.

There are many factors besides new gas supply points that could contribute to declining Interconnector throughput in the coming years yet the CER has failed to indicate why it is apparently exempting those from surcharges (i.e. wind generation displacing gas generation, users of the new electricity Interconnector etc). To single out competing gas suppliers and ignore these other factors appears to be discriminatory.

Competition will lead to lower gas prices

The CER's contention that prices will go up by 2.9% is flawed. The analysis ignores the following points set out in our 15th of June letter:

- The saving in Interconnector compressor fuel costs;
- The avoided Interconnector reinforcement costs;
- The benefits of increased gas-on-gas competition.

In addition, Brattle has advised that new supplies from Shannon LNG could lower NBP prices to Irish consumers by between €7 million and €11 million per annum.⁴ The total savings to Irish gas consumers from the Shannon LNG project is estimated at €50 million per annum.⁵

Shannon LNG would ask the CER to read this letter in conjunction with our 1st February, 4th March, 15th June and 13th July letters on this subject, the presentation we gave at the 3rd August workshop and the questions we raised at the 3rd August workshop (Appendix F).

August 3 Workshop

The CER presented three tariff options at the August 3 Workshop. We would note that the option entitled "*IC Tariff; No Change*" shows tariffs at or close to levels they have been over the last ten years and broadly consistent with the IC tariffs published by BGÉ in 2001 following the Government Tariff Directives of 2001, which included a forecast of the Corrib volumes⁶.

The option entitled "*IC Tariff: IC1 Pipe added to onshore RAB*" allocates the cost of IC1 to the onshore RAB as IC1 is stated to represent security of supply. For the avoidance of

³ CER Gas Capacity Statement 2006, Appendix B.

⁴ Point 14 of the Brattle memo to Shannon LNG states "we estimate that the SLNG project would lower the 2013 GB gas price by between 0.3 and 0.5 pence per therm". This equates to between approximately €7 million and €11 million per annum using the numbers quoted in the CER example.

⁵ €16 million from gas shrinkage, €25 million avoided IC reinforcement and €9 million from lower NBP prices.

⁶ Following the publication of the Government Tariff Directives of 2001, BGÉ published an IC capacity charge of €306 per peak day MWh and a commodity charge of €0.1689 per MWh – both were calculated on a 10 year levelised basis. The average capacity charge since the 2001/02 Gas Year is €291 per peak day MWh.

doubt, Shannon LNG does not see this option representing the option presented in our 4th of March letter. As stated above, Shannon LNG would be pleased to discuss with the CER a more detailed framework for our tariff design proposals.⁷

The option entitled “UK gas: IC set at LRMC” is not a proportionate solution to the issues identified by the CER and would provide a clear cross-subsidy to GB importers of gas to Ireland.

Conclusion

In conclusion, based on legal advice received from MOP, Shannon LNG does not believe the CER has the legal powers to introduce Option 3 and Option 4 as currently described in the consultation paper. Without prejudice to any legal remedy that Shannon LNG may take to protect its investment to date, Shannon LNG would encourage the CER to actively engage with industry along the lines set out in this letter to find a sustainable solution to this issue.

If the CER cannot develop Option 3 along the lines described above, then the current tariff structure, introduced by the Government in 2001, should remain in place for an extended period of time that recognises the large capital requirements and long term nature of the investment to be made by Shannon LNG.

Yours sincerely,



Enc:

Appendix A – Shannon LNG detailed review of CER/11/112

Appendix B – Matheson Ormsby Prentice legal review of CER/11/112

Appendix C – The Brattle Group opinion on CER/11/112

Appendix D – Dáil Éireann debates on transmission tariff design

Appendix E – Government Tariff Directives of November 2001

Appendix F – Questions raised by Shannon LNG at the 3rd of August workshop

⁷ We provide in Appendix A an overview of our IC tariff design proposal.