15 Windsor Terrace,
Sandycove,
Co. Dublin.

Tel: 01 2303666

Mr. Stuart Coleman,
Commission for Energy Regulation,
The Exchange,
Belgard Square North, Tallaght,
Dublin 24.

16 March 2012

Re: CER Consultation on "The Regulatory Treatment of the BGÉ Interconnectors" CER/12/013 (the "Proposed Decision")

1. Overview

Before discussing in any detail the present Proposed Decision it might be useful to remind ourselves of where we were supposedly going with this process, now 15 months in the making and no end in sight.

> "The CER believes that the enduring treatment of the Interconnectors in relation to security of supply should be decided upon as soon as reasonably possible so as to give regulatory certainty to the market (both to current players and potential new participants)."[1]

In January 2011, the CER launched the present series of consultations. The preceding phrase was the almost closing statement in the consultation paper issued that month. As a guiding principle it makes a great deal of sense, but the principle has been abandoned in the CER's meandering search for the solution to the hypothetical problems they have tabled.

Over the past 15 months, the CER has floated many options, and rejected all of them in favour of the latest, a proposal that has never been raised during the consultations and which appears designed to achieve exactly the opposite of the CER's stated objectives. The Proposed Decision as presented by the CER, if adopted with little or no change, will do nothing to bring regulatory certainty to the market, but rather increase uncertainty and continue it for an indeterminate period of time. October 2014, over 2½ years from now and almost four years since the process started, is now mooted as the date upon which (maybe) suppliers in the Irish gas market might understand how the price of gas in Ireland will be set. All that we do know is that it will not be set in the way that it is today.

[1] "The Regulatory Treatment of the BGÉ Interconnectors in relation to Security of Gas Supply", CER/11/002, 4 January 2011, page 15

Indeed, the scheme now advanced by the CER seems destined to ensure uncertainties for suppliers (current and prospective) will continue for the foreseeable future, well beyond 2014. The CER's proposed tariff methodology combines arbitrary required revenue allocation between the onshore and offshore transmission systems with speculative future expansion costs and market demands (none supported by any actual data, but actually contradicted by all the evidence to date). It then creates an entry tariff regime (which everyone agrees sets a ceiling on wholesale gas prices on Ireland) under which the tariff could range from near zero to near infinity.

At each step, the CER has managed to raise the regulatory risk and uncertainty for BGE's competitors. In January 2011, the CER described three options which would have resulted in the revenues collected from the Interconnector shippers (the major source of Ireland's gas supply) being reduced from €50 million to about €30 million, with the €20 million balance being recovered from the BGN onshore transmission system or perhaps through a levy on the competing entry points. In the most extreme example, if Shannon LNG had captured 100% of the Irish gas market, we would have been required to pay this €20 million. When the legality and rational behind the proposals was challenged, the CER quickly altered course, introducing in July 2011 an unheard-of theory of a "diversity premium" with four new options, two of which it immediately proposed to reject. Either of the remaining two could, in the hypothetical worst case, have raised Shannon LNG's subsidy to users of the Interconnectors and BGN from the earlier €20 million up to €50 million per annum. Again, Shannon LNG and many other respondents questioned the legitimacy and fairness of the CER's proposed solutions.

Now comes a proposed decision which bears little resemblance to the options outlined in the earlier consultations. Through this proposed decision, the CER proposes to simply merge the two major components of the Irish gas transmission system, namely the onshore system and the Interconnectors between the UK and Ireland while also introducing a completely new tariffing arrangement. Now, Shannon LNG's potential subsidy to users of the Interconnectors and BGN will increase to €85 million. And even then we won't know until October 2014 (maybe) what the amount actually might be. Had the CER set out to achieve the opposite of its originally stated objectives it could not have done better. It has now delayed the final decision as much as conceivably possible, while creating the maximum uncertainty as to what that decision might mean for Shannon LNG and other industry players. Furthermore the escalation of financial risk to which Shannon LNG is being exposed carries a question as to whether the CER is acting in a punitive fashion towards parties who question their regulatory approach.

This uncertainty continues to have a serious impact upon the business of Shannon LNG.

The current proposal also highlights a glaring contradiction in the CER's thinking. On the one hand, the CER introduced the present consultation to address the alleged problem that when competing gas supplies arrive in Ireland through new entry points, the utilisation of the Interconnectors will drop dramatically and as a result the price of gas in Ireland will rise (absent any change to the current tariff regime). Then on 28th November 2011, the CER initiated another consultation designed to address the opposite problem, namely that the Interconnectors are allegedly inadequate to meet Ireland's gas supply needs and must be expanded[2]. As borne out by the statements made by the CER at the 20th January 2012

[2] "Mitigation Measures to address Potential Capacity Constraints at the Moffat Entry Point in 2013/14", CER/11/206, 28th November 2011

public workshop on the second consultation, there is no party expressing any interest in seeing the Interconnectors expand, let alone evincing any willingness to contract for capacity in such an expansion or pay for it.

Turning back to the current proposal, the CER now intends to introduce a new tariff methodology for entry points, namely the use of long run marginal costs (LRMC). However, as understood by the experts and as adopted by other regulators (most notably in the UK as the CER cites) LRMC is only appropriate for designing tariffs where there is congestion in the transmission system, a corresponding demand for new capacity and long term contracts are in place to underwrite capacity expansions. As the November consultation[3] has so far demonstrated[4], there is no expectation of congestion in the Irish transmission system, particularly at Moffat. The Proposed Decision uses a hypothetical expansion of the Moffat entry point developed by Bord Gais Networks (BGN) to illustrate the application of LRMC to the Interconnector tariff. But the theoretical and practical underpinning of the LRMC tariff methodology, which requires congested entry points and long term contracts, collapses when the entry point is uncongested.

Stated differently, when the CER wants to cause other entry points (competing suppliers) to subsidise BGN, it presents a case for loss of throughput on the Interconnectors. Yet at the same time, the CER launches a consultation predicated on the inadequacy of capacity on the Interconnectors. Notwithstanding the very clear rejection of the proposed Interconnector expansion by the market, the CER now intends to apply the tariff methodology developed for a congested pipeline system(CER/11/206) to an uncongested one (CER/12/013).

It appears that the CER's primary concern is to maintain the current level of revenues for BGE at all costs, even when they arise from poor investments, unsupported by the market. Indeed the potential expansion of the Moffat entry point is just such a possible investment. If unsupported by market demand, and if the CER follows its current thinking, "Moffat twinning" will chill competition to BGE in Ireland. The expansion will be underutilised and under the CER's new theory of "regulatory compact", gas prices in Ireland will inevitably rise as the CER allows BGE to recover its additional revenues from the "market". In the present Proposed Decision, the CER proposes such un-recovered revenues be extracted from BGE's competitors, to the ostensible benefit of the Irish consumer. But if competitors are frozen out of the market by poor regulatory decisions, the only source of revenues to cover such unnecessary investments will be the Irish consumers, and prices will have to rise to meet those increased revenue needs.

Finally, Shannon LNG would note that at each step of this process, the CER has introduced new proposals, never previously discussed, while simultaneously proposing to discard the prior proposals on grounds that "*there are significant shortcomings to each option, with any advantages likely outweighed by their disadvantages*"[5]. One has to wonder what is preventing the CER from carrying out the analysis it uses to reject its prior proposals before it includes them in its consultations. This problem could be solved if the CER required BGN and the system operator to present options for solving the issues which the CER has identified, accept comments from third parties on those proposals, then, acting as an

[3] Mitigation Measures to address Potential Capacity Constraints at the Moffat Entry Point in 2013/14 – CER/11/206

[4] Code Mod Forum Responses to Mitigation Measures Consultation - CER presentation cer12011.pdf , 20th January 2012

[5] Proposed Decision Paper, CER/12/013, page 3

independent regulator, adjudicate between the options presented to it or propose a compromise. Instead, by presenting the proposals itself, then adjudicating on them, the CER has created an environment where it has a stake in defending its own positions and acts as prosecutor, judge, jury and executioner. This is not an example of independent, reasoned and balanced decision making.

Shannon LNG will now address the Proposed Decision in detail.

2. Introduction

Given the lengthy history of this consultation process, Shannon LNG expects and requests that the CER move swiftly to make a decision that is consistent with the requirements of Irish and European law and that will allow Shannon LNG and other suppliers who wish to compete on the Irish gas market to make a reasonable assessment of the commercial and regulatory conditions that will be applied to their entry points and gas sales in the country.

The CER's Proposed Decision is economically inefficient, greatly increases regulatory uncertainty, is not cost reflective, protects the state owned pipeline company from commercial realities, has not been shown to be in the consumer's interests and discriminates against non-Great Britain (GB) suppliers of gas to Ireland, who do not use the Interconnectors, by forcing them to pay part of their competitors' transportation costs.

There are real capital and operating costs involved in transporting natural gas from Scotland to Ireland using the BGN Interconnectors. Article 13 of Regulation (EC) 715 of 2009 states that tariffs must "*reflect the actual costs incurred*" and that there must be no cross subsidies between network users. Any interpretation of Article 13, using the normal and ordinary meaning of words, would conclude that the tariff to transport gas from Scotland to Ireland must reflect the actual costs incurred, not some inappropriate methodology relying on speculative future costs and volumes associated with expanding the Interconnectors. Indeed, the industry response to the CER consultation on expanding the Interconnectors (CER/11/206) demonstrate that there is no need to speculate on future expansion – there is no such interest, and there will be no future volumes.

Shannon LNG has made a number of proposals to the CER where the Interconnector tariff would be set at a level that reflects actual costs incurred, as it has been historically, but does not increase if Interconnector throughput declines. The proposals put forward by Shannon LNG, if adopted, would mean gas prices would be lower than they would otherwise be due to the benefits of bringing real competition to the Irish market.

Process to date

The CER initiated this consultation process in January 2011 and proposed that, due to the security of supply benefits of the Interconnectors, €21.25 million of the costs of the Interconnectors should be recovered through either (i) a transfer of part of the rate-base of IC1 to the onshore regulatory asset base (ii) a back-up booking requirement on all shippers or (iii) the payment of a levy at all entry points akin to a public service obligation levy.

Shannon LNG wrote to the CER on the 1st of February requesting that the CER answer a list of questions we had on the January Consultation Paper. Shannon LNG has not received a written response to these questions. Shannon LNG respectfully requests written answers to these questions.

Shannon LNG responded comprehensively to the January 2011 consultation paper and proposed a pragmatic solution to address the CER's concerns on the Interconnector tariff, which would effectively involve capping the tariff at essentially its historic average.

Shannon LNG wrote to the CER on the 15th of June 2011 outlining how supplies from new entry points would actually lower gas prices in Ireland if a **proportionate** solution such as the one proposed by Shannon LNG was adopted.

Shannon LNG also wrote to the CER on the 13th of July 2011 calling for greater transparency on the publication of information in this consultation process.

The CER published a second consultation paper on this subject in July 2011 which appeared to set aside the January 2011 consultation paper. The July consultation paper outlined four options for dealing with the regulatory treatment of the Interconnectors, two of which the CER proposed to dismiss outright. Shannon LNG provided a comprehensive response to this consultation paper including reports from our legal advisors, Matheson Ormsby Prentice and our economic advisors, the Brattle Group. The Brattle Group's submission proposed an "amended Option 3" of the CER's July 2011 Consultation Paper as a solution "*that if it is amended to respect certain principles, would best balance the interests of Irish consumers, gas producers and investors in the gas industry".*

In December 2011, Shannon LNG submitted a report by Dr. Colm McCarthy of UCD to the CER on the regulatory treatment of the Interconnectors (Appendix 1). Based on "*considerations of overall economic competitiveness"*[6], Dr McCarthy proposed a solution involving a combination of Option 2 and Option 3 of the CER's July 2011 consultation paper.

Now, without any advance notice or discussion, the CER proposes to introduce a new option for setting entry tariffs, including the Interconnector tariff **("the BGN LRMC Proposal**") first proposed by BGN to the CER in August 2008. Neither the January 2011 Consultation Paper nor the July 2011 Consultation Paper referenced the long run marginal cost (LRMC) methodology as an option the CER was considering in the consultation process. This in the face of BGN's comments on the January 2011 consultation to the effect that the CER should consider "Application of the LRMC (Long-run marginal cost) concept to the Interconnector charges"[7]. Having missed that signal the first time around BGÉ further developed the concept in their response to the July consultation. It now appears that the CER has heard and heeded them, and is proposing to adopt BGN's LRMC approach without question.

The Proposed Decision states that the Interconnectors will no longer be Interconnectors but will be included in the general transmission system and be reimbursed through tariffs collected from users of the system. The CER did not consult on or even mention it was considering this approach in either the January 2011 or July 2011 Consultation Papers.

[6] Report entitled "Interconnector Tariffs and Competition in the Irish Gas Market", Report for Shannon LNG, December 2011, Colm McCarthy, School of Economics, University College Dublin, page 26.
[7] Bord Gais Networks submission to the CER, regarding CER/11/002, 4th March 2011

The Interconnectors are no longer Interconnectors but part of the general RAB
Shannon LNG is disturbed that the CER is proposing to make this fundamental change to the Irish regulatory structure as it has not been subject to prior consultation. The CER has failed to explain why the merger of the regulatory asset bases (RABs) of the onshore system and the Interconnectors is required, or the legal and regulatory rationale for such a merger.

The CER does state the ICs are clearly an essential part of the Irish transmission system on the grounds of "*Historical evidence*" and "t*he definition of "transmission" in Regulation 715/2009/EC".* These assertions alone are not sufficient to support the merger of the two systems.

The two systems perform distinct functions, and until now have been treated independently for tariff setting purposes, reflecting these separate functions. The onshore system has been established as a postalised exit system which permits the transport of gas from any entry point (such entry point being subject to an entry tariff) to any exit point on the system for a single tariff. These multiple exit points throughout Ireland are either directly attached to large consumers of gas or to the low pressure distribution systems which serve smaller consumers.

In contrast, the Interconnectors provide a transit service from the UK to Ireland, with lateral connections which provide transit services to Northern Ireland (via the SNIP pipeline) and the Isle of Man. As transit services the tariffs charged to the SNIP shippers and the Isle of Man are not the same as those charged to shippers using the Interconnectors to deliver gas to the Irish consumers[8]. And with only one entry point and three exit points, the tariffs are not designed around an entry/exit system. In contrast to the onshore system, the Interconnectors are not connected to end consumers of gas or to low pressure distribution systems. They simply move gas from one high pressure onshore system (National Grid in the UK) to other high pressure systems (the Irish onshore system, SNIP and the Isle of Man). They are also subject to a Government treaty between Ireland and the UK. Since 2001, the entry tariff for capacity at the Moffat entry point has been calculated based on the capital and operating costs of the Interconnectors with the entry point being physically located at Moffat.

BGE (UK) holds an Interconnector licence for the pipelines running between Scotland and Ireland from Ofgem in the UK. The Interconnectors have been defined extensively as Interconnectors by the regulatory authorities in Ireland and the UK since they were built. The definition of an "Interconnector" is given in Directive 2009/73/EC:

"'interconnector' means a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States;

It is clear that the BGÉ Interconnectors meet the definition of an interconnector under Directive 2009/73/EC. Indeed the Interconnectors not only cross state borders, but also traverse international waters.

---

[8] Shannon LNG notes that the CER has refused to disclose the tariffs paid or payable by either the SNIP shippers or the Isle of Man shippers, but we understand them to be lower than those charged to shippers transiting to the Republic.

When the Government approved IC2 it was on the express understanding that IC1 and IC2 would have a stand-alone tariff associated with them for the delivery of gas from Scotland to Ireland. The CER's Proposed Decision would involve Shannon LNG paying a tariff which will, in part or in totality, defray the capital and operating costs of the Interconnectors. It is not clear on what basis the CER has the statutory authority to change the long standing Irish government policy that the Interconnectors are designated as "interconnectors", and are separate and distinct from the onshore system.

The Interconnectors are used for flowing molecules of natural gas from Scotland to Ireland. The Interconnectors are not a "common asset" to which Shannon LNG Energy Limited[9] has access. As set out in Shannon LNG's regulated third party access (RTPA) exemption, Shannon LNG Energy Limited will be flowing gas through the Shannon LNG entry point. The CER's Proposed Decision would involve Shannon LNG Energy Limited making a tariff payment for a facility (the Interconnectors) to which it does not have access and it is therefore not clear on what basis the CER has the statutory authority to direct the imposition of a levy on Shannon LNG Energy Limited in respect of access to the Interconnectors. This point is referred to at section 4(j) below.

The unexpected, unexplained and prospective designation of the Interconnectors as part of the general BGÉ Regulated Asset Base (RAB) is a significant change in the rules of the game to the benefit of BGÉ and GB suppliers of gas to Ireland and introduces major uncertainty into the decisions of private investors.

Impact of Proposed Decision

From the limited information available the following is Shannon LNG's preliminary understanding of the impact of the CER's Proposed Decision:

(i) The CER indicates that the Interconnector tariff may be set at less than half the level that it has averaged over the last ten years.

(ii) The entry tariffs for each entry point will be determined by auctions with a reserve price whose calculation methodology remains uncertain but appears likely to be based on LRMC. There does not appear to be a ceiling on entry auction prices. It is unclear whether the auction price will apply to all suppliers at the entry point, or whether incremental suppliers only will pay the auction price, or whether some other regime will apply.

(iii) Cumulated over all entry points suppliers would have to pay half the total required revenue on the basis of BGN's total regulated assets (which includes the onshore network and the Interconnectors) using the CER's proposed 50/50 split of the total required revenue between entry and exit. We estimate this to be in the region of €85 million per annum assuming a revenue requirement of €170 million[10] on the BGN

[9] Under the Shannon LNG RTPA exemption, the capacity holder of the Shannon LNG Terminal is identified as TradeCo. Shannon LNG Energy Limited has been incorporated in Ireland to ultimately undertake the role of TradeCo. Shannon LNG Energy Limited will hold the capacity in the LNG terminal and will also be responsible for shipping gas in the BGÉ transmission network.

[10] Decision on BGN Allowed Revenues and Gas Transmission Tariffs for 2011/12, CER/11/170, 1 September 2011

total regulated asset base .The justification for this split appears to be "that is what they do in the UK".

(iv) If BGN fail to collect the €85 million from all entry points, "common charging" would be applied to all entry points to meet the total required revenue. We note that the term "common charging" is not defined nor can we find it used anywhere else in the literature of regulatory application or theory.

(v) Since none of these elements are fixed, but appear to reflect the current thinking of the CER and BGN, there is no way for an investor to know what tariff regime might apply and when one might expect to know this.

(vi) The "position of the Isle of Man is not unduly affected". Since we do not know what this position, nor what it is expected to be under the Proposed Decision, we cannot be expected to come to the same conclusion. The position of Northern Ireland is totally unexplained.

The net effect of the Proposed Decision is that the CER is proposing that shippers such as Shannon LNG Energy Limited, who do not use the Interconnectors, will pay the unrecovered costs of the Interconnectors and so cross-subsidise the cost of transporting gas from Scotland to Ireland.

If the Interconnector tariff is set at the postulated level of €137.6 per peak day MWh and capacity reservations remain at today's levels, the most revenue that can be collected for the Interconnectors, assuming there is no congestion on the system, is approximately €30 million. The resulting shortfall of €55 million will be collected across all entry points, of which €20 million will cross-subsidise the annual revenue requirement of the Interconnectors and those shippers using it. If the throughput on the Interconnectors drops below today's levels (and that has been the basis for the consultations since January 2011), the revenues collected from the Interconnector shippers will be even lower and the subsidies correspondingly higher. Not only does this proposal shift the playing field in favour of the Interconnector shippers, it does so to a much greater extent than any of the proposals which preceded it.

3. Substance of the CER's Proposed Decision is still the same

(a) In this new Proposed Decision Paper, the CER continues to facilitate payments to BGN from users of the three potentially competing entry points, Corrib, Shannon LNG and Kinsale resulting from under-utilisation of the Interconnectors.

(b) Accordingly, the Proposed Decision is similar in <u>substance</u> to Options 3 and 4 of the July 2011 Proposal and the options tabled in January 2011, though in a different guise and with a greater subsidy, in that it forces competitors to pay a subsidy to BGN to compensate for the lack of use of the Interconnectors due to competition.

(c) The payment is still designed to compensate BGN for the Interconnectors' inability to compete if the current system of cost-reflective tariffs set per entry point were to continue when gas begins to enter the Irish system from new sources of supply in large volumes.

(d) Not only does the BGN LRMC Proposal provide for payments to BGN for non-use of the Interconnectors as the previous (and now purportedly discarded) Options 3 and 4, but the new BGN LRMC Proposal potentially increases the payment to BGN from competing entry points as follows:

Under the current tariff regime, to enter the BGÉ owned transmission system, Shannon LNG would pay:

(i) the costs of the 26 km Shannon LNG owned pipeline from the LNG terminal to Foynes in County Limerick, which we estimate to be approximately €60 million; plus

(ii) the Shannon LNG entry tariff which reflects the capital and operating costs associated with the infrastructure to enter the BGN owned system at Foynes which BGN estimated in 2008 to be €15 per peak day MWh on average[11].

Under the proposed tariff regime, Shannon LNG would have to pay:

(i) the costs of the 26 km Shannon LNG owned pipeline from the LNG terminal to Foynes in County Limerick; plus

(ii) the cost of the Shannon LNG entry tariff calculated using the LRMC approach which has not been disclosed by the CER; plus

(iii) a share (which could be as much as 100%) of any shortfall in revenue associated with the 50% of the total BGÉ transmission RAB allocated to entry points which will not be known for any given year until it has occurred and which could be up to €85 million per annum.

The CER's Proposed Decision makes establishing a new natural gas import business in Ireland close to impossible, as two major cost components are not known and one of these cost components will only be known at the end of every Gas Year - i.e. long after the investment decision is taken. This position is untenable and represents a major barrier to entry.

4. The BGN LRMC Proposal fails for the same reasons as previous Options

The BGN LRMC Proposal fails for the same reasons as the previous options proposed in the January 2011 and July 2011 consultation papers. **For this reason, Shannon LNG requests that the CER take account of all previous submissions from Shannon LNG on this consultation process, when reviewing our response to this consultation paper.**

(a) *Tariff structures that will give rise to a cross-subsidy*

[11] Bord Gais Networks, Common Arrangements for Gas (CAG) – Transmission Tariff Methodology and Regulation, Consultation Response, 15th August 2008.

Article 13 of Regulation (EC) No 715/2009[12] (the "Regulation") requires that any tariff arrangement avoids cross-subsidies between network users.

By contrast, the tariff and subsidy arrangement set out in the Proposed Decision contemplates that all Irish shippers will fund the costs of the Interconnectors, despite the fact that not all these shippers use or can get access to the Interconnectors to bring their gas to the Irish market.

This arrangement will effectively involve the payment, by the shippers who do not use the Interconnectors (such as Shannon LNG Energy Limited), of a cross-subsidy of up to €50 million per annum (compared to today's tariff regime) **to the shippers who use the Interconnectors**. This cross-subsidisation is contrary to the requirements of the Regulation.

Under the policy decision made by Government in 2001, only users of the Interconnector were liable to pay for the Interconnectors. The CER's Proposed Decision means that users of other entry points such as Shannon LNG Energy Limited will now also pay part of the costs of the Interconnectors.

We would also remind the CER of its duty, pursuant to Article 41(1)(f) of Directive 2009/73/EC, to ensure that "*there are no cross-subsidies between transmission … [and] LNG … activities*". The Proposed Decision, if made by the CER in its current form, will establish precisely such a cross-subsidy.

(b) *Tariff Structures that are not cost reflective*

Article 13 of the Regulation requires that tariffs reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent.

In the Proposed Decision Paper, the CER indicates the total revenue required by BGN is to be split on a "50/50" basis between entry and exit. The required tariffs for entry points would be established by auction with a reserve price calculated using LRMC methodology. But tariffs in this case calculated using LRMC are not capable of reflecting the actual costs incurred, because (among other things):

- The LRMC methodology is, by its nature, forward-looking, and applicable in circumstances where the entry to the network is congested. In the absence of congestion (which is clearly the case here as the CER undertook this consultation to address long term under-utilisation of the Interconnectors), the use of LRMC is inappropriate and perverse and the tariffs should reflect historical actual costs incurred.

- At the Moffat entry point, the cost of transporting gas from Scotland to Ireland is the sum of the capital and operating costs of the Interconnectors. The new LRMC tariff will not reflect the actual costs incurred in transporting gas from Scotland to Ireland as the CER's example clearly demonstrates.

[12] Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005.

- The 50/50 split of the total revenue required by BGE between entry and exit is arbitrary (as was acknowledged by the CER at the public meeting on 1 March), and was not calculated so as to reflect the relative costs associated with these assets. The 50/50 split of the total revenue required by BGN between entry and exit does not reflect the actual asset bases as presently used by the CER. Under the CER's current transmission tariff methodology, the current split of the total revenue requirement between entry and exit is about 28/72.

- We are not aware of any proposal by the CER to assess the extent to which the costs incurred in the construction and operation of the Interconnectors reflect the equivalent costs that would be incurred by an efficient and structurally comparable network operator; and

- Where entry capacity auctions under-recover the required 50% of revenues, the deficit will be imposed on and recovered at other entry points through a term which is unexplained and not in common usage within the industry.

For these reasons, the tariffs proposed in the Proposed Decision are clearly contrary to the requirements of the Regulation.

(c) *Tariff structures that will distort intra-state trade*

Article 13 of the Regulation requires that tariffs do not distort trade across borders.

However, the arrangements contemplated in the Proposed Decision will distort the cross-border trade in gas, in the sense that – relative to a situation in which only the users of the Interconnectors pay the costs associated with the Interconnectors – they will artificially and arbitrarily lower the tariffs that will apply to the use of the Interconnectors, and will therefore result in a greater movement of gas from the UK to Ireland via the Interconnectors than would otherwise have been the case.

This distortion will occur at the expense of the other entry points to the Irish transmission system, and the supply chains upstream of such entry points (including the owners of the relevant infrastructure).

The proposed tariff structure will also distort the flow of LNG to member states within the EU. As LNG is the marginal source of supply of natural gas in Western Europe, LNG cargoes should go to member states with the highest prices. Extra supply in a member state should put downward pressure on gas prices in that member state[13]. However, the CER's Proposed Decision will have a perverse effect that when additional LNG volumes are imported into Ireland, the Interconnector throughput will fall, and Shannon LNG will be required to subsidise BGN for the shortfall, thereby raising its own costs and not permitting it to compete on a level playing field with other LNG importers.

Existing LNG import terminals in Europe, primarily Zeebrugge and the Spanish terminals are increasingly <u>loading</u> LNG cargoes for delivery to other markets where

[13] Except perhaps in Ireland where the CER has argued that competition from additional supplies (unless delivered through the Interconnector) will **raise** prices.

prices are higher. There is no reason why LNG could not be shipped to Ireland from Zeebrugge or Spain. However, under the CER's Proposed Decision, Shannon LNG will certainly have to pay a portion of the Interconnector costs through the subsidy which BGN will receive under the CER's Proposed Direction. Thus LNG which is being sent from one European state to Ireland would be subject to a surcharge to cover the costs of a pipeline it is not using, while LNG delivered to Ireland via the UK (for example) will be subsidised by SLNG's payments to subsidise the Interconnectors, thereby distorting trade between Member States.

(d) *Tariff structures that are discriminatory*

Article 13 of the Regulation requires that tariffs for network users be non-discriminatory, and that they be applied in a non-discriminatory manner. Similarly, section 9(3)(b) of the Electricity Regulation Act 1999 requires that the CER carries out its functions and exercises its powers in a manner which does not discriminate unfairly between holders of licences, consents and BGÉ or between applicants for consents or licences. By contrast, the arrangements contemplated in the Proposed Decision:

- Discriminate against Shannon LNG, Corrib and others as producers and suppliers of upstream gas (relative to sources of upstream gas that lie on the GB side of the Interconnectors) because the net effect will be to force users of non-Interconnector entry points to pay part of the costs of their competitors importing gas from GB to Ireland.

- Discriminate specifically against the Shannon LNG project, to the extent that the Shannon LNG business model, as approved by the CER in the context of its issuance of the RTPA Exemption, contemplates that the project will include an affiliated shipping business that will use the entry point associated with the LNG terminal. This affiliated shipping business will be the sole capacity holder of the LNG terminal. By issuing the RTPA Exemption to Shannon LNG, the CER acknowledged that these arrangements are justified due to the positive benefits (such as increased competition and security of supply) conferred by the project upon the Irish gas market.

  The Proposed Decision is therefore discriminatory in that it levies upon Shannon LNG Energy Limited costs that are associated with assets that it will not use for its transportation activities, whereas from the perspective of shippers that do use the Interconnectors, the tariff reflects costs associated with assets that are used for the transport of gas.

- Discriminate against Shannon LNG as a developer, owner and operator of an onshore pipeline in Ireland (between the Shannon LNG terminal and the BGN network at Foynes) which will not benefit from the scheme that is now proposed by the CER to apply solely to the funding of the BGN transmission system.

- A CER representative stated at the 1 March 2012 public meeting that a specific class of *network users* of the Interconnectors delivering gas to the Isle of Man and Northern Ireland will not be subject to the CER's Proposed

Decision and that there will be a special "carve out" for these *network users*. On this topic, it is also stated at page 47 of the Proposed Decision that:

> "the planned changes to the IC tariff structure will ensure that the position of the Isle of Man is not unduly affected."

Even though the network users delivering gas to the Isle of Man and Northern Ireland will clearly use the BGN Interconnectors, special arrangements are to be put in place for them. The CER is clearly preparing to discriminate in favour of these network users against other network users including Shannon LNG Energy Limited.

As the CER notes in footnote 1 (page 6), other factors will also put downward competitive pressure on Irish gas demand and the Interconnector throughput, including increased wind generation and the East West Electricity Interconnector, which will reduce the demand for gas-fired electricity generation (the primary source of gas demand in Ireland). Yet the CER is not proposing to surcharge either the wind generators or the electricity interconnector users for the drop in the BGE Interconnector throughput which will cause the same upward pressure on Interconnector tariffs and Irish retail gas prices as competing gas suppliers allegedly will. Indeed, any throughput drop attributable to these competing sources of electricity will also be subsidised by BGE's competitors, including Shannon LNG, through the CER's proposal.

(e) *Tariff structures that constitute a barrier to entry*

The CER is required, pursuant to Article 40(e) of the Regulation, to take all reasonable measures in pursuit of an objective (among others) to remove barriers that could prevent access for new market entrants.

However, were the CER to implement the Proposed Decision, it would be erecting substantial barriers to the entry of new supplies of gas to the Irish market via new infrastructure. These barriers would take the form of imposing on the developers of such infrastructure (or their shipper customers) payments to BGN far in excess of any costs arising from their access to the network, which would then be used to cross-subsidise the users of the Interconnectors.

This cross-subsidy will impair the competitive position of new suppliers by simultaneously increasing their costs, and reducing the costs of their competitors.

(f) *Impact on competition and consumers*

Article 13 of the Regulation requires that tariffs for network users <u>facilitate</u> competition. The CER is required, pursuant to Article 40(e) of the Regulation, to take all reasonable measures in pursuit of an objective (among others) to ensure that customers benefit through the efficient functioning of their national market.

In its example on page 13, the CER demonstrates how the IC tariff might increase if it did nothing, the result being a price increase of 1.4% experienced by Irish consumers. Yet on page 11, the CER concedes (and Shannon LNG presented evidence to support this in its prior submissions) that “these producers may offer a marginal discount in order to maintain a competitive edge on IC gas imports, nevertheless the economically rational decision on their part would be to keep any such discount to the minimum necessary”. Taking these two positions together, the first only holds true if the new market entrants capture half the Irish market by exactly matching the prevailing price and offering no discounts, an assumption which defies both common sense and practical experience. The minute a new entrant offers any price discount greater than 1.3%, the CER’s rationale collapses. This erroneous analysis is repeated on page 39, where it is further compounded by discussion of the “theoretically maximum throughput” of the Interconnectors without any mention of the additional investment on the order of €270 million needed to achieve this theoretical (and apparently un-needed) throughput.

The arrangements contemplated in the Proposed Decision introduce, in a discriminatory manner, distortions to cross-border trade. Each of these discriminatory and distortionary effects can be regarded as inhibiting, rather than facilitating, competition in the Irish gas market.

An attendee at the 1 March public meeting asked if gas prices would increase compared to what they would otherwise be following the introduction of the Proposed Decision. The CER representative said that they were unable to give any assurance at the meeting that prices would not increase under the Proposed Decision. We find it very difficult to understand how the CER can dismiss an *amended Option 3*, yet support the Proposed Decision, given the above statement at the meeting.

The Shannon LNG terminal was granted an exemption from regulated third party access by the CER under Directive 2003/55/EC. The CER’s exemption decision was approved by the European Commission. Two of the criteria that must be met for the granting an exemption under Directive 2003/55/EC are:

(a) **the investment must enhance competition in gas supply and enhance security of supply;**

(e) **the exemption is not detrimental to competition** or the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.

In granting the Shannon LNG RTPA exemption, the CER agreed that the Shannon LNG terminal improved competition and security of supply. The European Commission also agreed that the SLNG terminal improved competition and security of supply, because they approved the exemption subject to the condition that SLNG hold an ‘open season’ process, which the Commission felt had the potential to improve competition further. The CER’s Proposed Decision will have the effect of creating additional hurdles for the Shannon LNG project to be built thus potentially diminishing competition.

Shannon LNG wrote to the CER on the 15th of June 2011 setting out three specific areas where gas from new sources such as Shannon LNG would reduce gas prices for Irish consumers, namely, the avoided cost of reinforcing the Interconnectors, savings in compressor fuel on the Irish gas network and savings due to gas-on-gas price competition. Shannon LNG used a model provided by the CER to assess this subject.

The Brattle Group stated in their 10th August 2011 report to Shannon LNG that if Shannon LNG were to cancel its project: "*We estimate this price increase would cost consumers in GB and Ireland between €130-200 million per year*. "

As BGN itself noted:

> "Any adverse amendment to a regulatory decision including the stranding of assets would adversely impact not only on the gas sector but also on electricity and other regulated sectors. It would lead to higher costs as developers would require a higher cost of capital to compensate for the risk of regulatory uncertainty. **This would increase costs to consumers, who in the end pay for all infrastructure**." (emphasis added)

Even BGN recognises that uncertainties being introduced by the CER will increase consumer costs, not lower them. And the CER cites this verbatim in the current proposal.

(g) *Legitimate expectation*

The CER states in the Proposed Decision Paper (at page 28) that it does not accept that "it has given a legitimate expectation that the prevailing interconnector tariff regime would remain unchanged, regardless of developments on the Irish gas market" and that in light of the evidence as presented by CER it is "very difficult" to see how the CER could be said to have given a legitimate expectation in the legal sense.

Shannon LNG believes that it is not at all difficult to see how representations and the actions of the Minister and the CER have given rise to legitimate expectations in the legal sense. Shannon LNG would draw CER's attention to our submissions through the consultation process on this issue and would request that the CER look at the totality of the evidence.

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 Separate Entry/Postalised Exit tariff structure, where all Interconnector costs are recovered from Interconnector capacity bookings (i.e. costs are paid for by users of the Interconnectors), would continue. In reliance on this representation Shannon LNG and its shareholders have undertaken and continue to undertake significant investment in Ireland based on the reasonable legitimate expectation that there would be no change to the broad policy set out by the Minister in 2001.

The CER make the point on page 25 of the Proposed Decision that the Government Tariff Directives of 2001 are moot because "*the 10 year time period covered by the directives themselves – 2001/02 to 2010/11 gas years - has now elapsed*." **Shannon LNG is surprised that the CER has confused a 10 year tariff**

derivation methodology with the general policy direction of the 2001 Government Tariff Directives. A defined timeframe is always used to set a tariff under normal regulatory practice (e.g. the CER's 5 year price control). There is nothing in the 2001 Tariff Directives that limit Government policy to a 10 year period. In fact the nature of gas infrastructure investment, involving infrastructure typically having a lifespan of 50 years plus, would preclude this type of approach.

The CER in the footnote on page 25 also notes:

> "Any question of the CER being bound by the Ministerial directives of 2001 themselves does not arise at this stage, in the CER's view. Even leaving aside the fact that the directives were never incorporated into the subsequent legislation giving CER regulatory powers on gas, the 10 year time period covered by the directives themselves – 2001/02 to 2010/11 gas years - has now elapsed. This also means that any potential issue of reconciling regulatory independence under EU law and compliance with the Ministerial directives is now a moot point."

This position stands in stark contrast to the CER's position on the matter of stranding of the Interconnectors. According to the CER it cannot strand the Interconnectors since they were the subject of a Government mandate or Government directive which it has failed to produce. Taking this claim at face value it is unclear why the CER feels that it is bound by this mandate which was never incorporated into the legislative powers establishing the CER or why it is not moot under the "regulatory independence" test, both of which the CER has no difficulty using to explain why it is not bound to follow prior policy on the tariffs themselves.

The CER has an express statutory duty set out in section 9(6)(a) of the Electricity Regulation Act 1999, to act in as consistent a manner as practicable in the exercise of its functions. A departure now from the established and repeatedly confirmed Irish Separate Entry/Postalised Exit tariff structure, where all Interconnector costs are paid for by users of the Interconnectors), in circumstances where there has been no change in facts or circumstances, would constitute not only poor regulatory practice but would also be a material breach of the CER's statutory duty to act in as consistent a manner as practicable.

Shannon LNG does not expect that the current tariff arrangements will remain in place indefinitely. Indeed our submissions have repeatedly recognised that any tariff revisions should not have the perverse effect of raising gas prices in Ireland as the CER has hypothesised, and we have proposed reasoned solutions to address this concern. However, the terms, conditions and duration of the RPTA Exemption, that was granted to Shannon LNG by the CER on 19 November 2010, have given rise to the reasonable and legitimate expectation, on the part of Shannon LNG and its shareholders, that it will be treated by the CER in a manner consistent with the RTPA Exemption, at least until the RTPA Exemption ceases to have effect.

On the subject of legitimate expectations, we would also repeat the point made by the Brattle Group in their 10th of August report to Shannon LNG on this subject:

> *"SLNG and Corrib have committed considerable sums of money on the understanding that a basis differential between NBP and IBP would remain in*

place. SLNG has provided details of the history of this commitment in previous submissions to the CER. To honour a regulatory compact with BGN by rejecting Option 2, but not to respect a regulatory compact with SLNG and other investors would be discriminatory and inconsistent."

(h) *Constitutional Property Rights*

Shannon LNG's (and its shareholders') property rights are protected under Irish law in particular by Article 40.3 and Article 43 of the Irish Constitution, and by Article 1 of Protocol 1 of the European Convention of Human Rights ("ECHR") (now incorporated into Irish law in the European Convention on Human Rights Act 2003).[14]

Shannon LNG has incurred significant investment in Ireland to date, based on the legitimate expectation created initially by the Minister and confirmed in subsequent decisions by the CER (including the granting of the RTPA Exemption) that the regulatory regime was settled, and Shannon LNG relied on this to incur considerable expenditure.

Shannon LNG can show:

(1) the existence of its property rights as described above; and

(2) that the Proposed Decision would, if implemented, amount to an interference with those rights, and

(3) that the interference with Shannon LNG's property rights is not prescribed by law, because the CER is acting ultra vires, and

(4) that the interference cannot be justified as proportionate .

Thus, the Proposed Decision would, if implemented, constitute an infringement of Shannon LNG's (and its shareholders') property rights, as protected in particular by Article 40.3 and Article 43 of the Irish Constitution, and by Article 1 of Protocol 1 of the ECHR.

(i) *State Aid*

We note that the CER has provided input to the Irish authorities for the purpose of responding to the European Commission's queries in relation to a potentially illegal State aid arising from the Proposed Decision. The European Commission has an obligation to ensure State aid compliance by all Member States, including Ireland. Consistent with that obligation, the European Commission is empowered to direct queries to the State until it is entirely satisfied that a proposed measure does not constitute a State aid under Article 107.

[14] *Pine Valley Developments Limited & Others v. Ireland*, judgment of the ECtHR of 29 November 1991, Series A no. 222; and *Pressos Compania Naviera S.A. v. Belgium*, judgment of 20 November 1995, Series A no. 332, p.21.

At paragraph 5.3.2 of the Proposed Decision, the CER states that it is "not aware of any evidence being produced to date of State resources, within the meaning of Article 107 of the Treaty, planned or being made available to BGE or any other party".

We firmly believe that the proposed measure will satisfy each aspect of the test for State aid contained in Article 107, including the requirement that 'State resources' be involved. It is illegal for any Member State to introduce State aid without first notifying that aid to the European Commission.

(j) *No legislative authority*

It is not clear that the CER has the statutory power to make the Proposed Decision.

The relevant statutory power of the CER is its power, pursuant to section 10A(17)(b)(i) of the Gas (Interim) (Regulation) Act 2002, to "give directions to an operator from time to time in respect of the basis for charges for third party access to … a facility under the control of the operator."

This power only extends to the imposition of charges for "third party access", which is defined for the current purpose as "transportation of natural gas through a pipeline operator's pipeline".

Under the current design of the Interconnectors, which is not thought to be subject to any proposed change, Shannon LNG Energy Limited will not (given its relationship with the Shannon LNG entry point) have any access to the Interconnectors. Therefore, there is no basis in law for the CER to direct any entity to levy charges upon Shannon LNG Energy Limited in respect of such access.

This applies notwithstanding the proposed unilateral re-designation by the CER of the Interconnectors as forming part of the onshore transmission system.

5. Long Run Marginal Cost

We note as an initial point that the CER has failed to address in the Proposed Decision paper why it has abandoned the historical cost approach to setting transmission tariffs.

BGN first proposed a long run marginal cost approach to setting entry tariffs in its 15th of August 2008 consultation response to the Regulatory Authorities[15] (RAs) consultation entitled "Common Arrangements for Gas (CAG) – Transmission Tariff Methodology and Regulation". The RAs reviewed the BGN proposal and part of the draft conclusion the RAs gave on the LRMC methodology is set out below[16]:

[15] Note the Regulatory Authorities means the CER and the Northern Ireland energy regulator.
[16] Publication entitled "Common Arrangements for Gas Draft Conclusions on Transmission Tariff Harmonisation in Ireland and Northern Ireland" 17th October 2008.

"Where demand is not expected to exceed capacity in the foreseeable future and there is permanent and significant excess capacity such that cost recovery is the primary aim of the regulatory prices setting mechanism then backward looking approaches (such as average cost pricing) are likely to be more appropriate."

In other words, the CER recognised the shortcomings in the use of LRMC in circumstances where there is permanent and excess capacity on the system. The whole premise underlying the CER's consultation process on the Interconnectors is that there will be permanent and excess capacity on the Interconnector system. The CER also recognised in 2008 that the use of LRMC does not address the issue of cost recovery of the Interconnectors. The CER's Proposed Decision provides no analysis to describe why it has moved away from its well articulated 17th of October 2008 review of LRMC, or if adopting LRMC why it would not recover any shortfall through the imposition of exit charges as proposed by BGN.

It is interesting to note that the RAs Conclusion Paper from the 19th December 2008 does not even reference LRMC as an option for setting entry tariffs.

Shannon LNG commissioned the Brattle Group to prepare a report giving its views on the CER's Proposed Decision Paper. The Brattle Group Report is attached as Appendix 2. The key findings of the Brattle Group Report are:

The CER assumes that tariffs should be based on the creation of future costs – a 'marginal cost' approach. But in a system that is not congested, tariffs that fairly allocate historic costs are a more valid policy objective. The CER has agreed with this principle for tariff setting as recently as 2008. Basing tariffs on forward looking costs will fail to allocate the large costs that have already been incurred to the parties that have benefited from the associated infrastructure.

The CER proposes tariffs based on marginal costs. But absent long-term contracts, marginal costs fail to allocate the actual costs incurred. Once an entry point is expanded, the marginal cost falls and shippers can buy short-term capacity at the new lower price. With short-term contracts, the marginal cost is a mirage which disappears from the tariff when it is incurred, and therefore remains unpaid.

The CER proposes that where the auction revenues fall short of the 50% cost recovery target, the difference will be made up by common charging at entry points. This means that producers, rather than consumers, will end up bearing the majority of the stranded IC costs. The decision on who should bear the stranded IC costs is an important one. If it is the CER's policy that producers, and not consumers, should bear the stranded IC costs then this should be stated explicitly.

Brattle make very similar points on the LRMC approach that the CER made in 2008 when dismissing BGÉ's LRMC Proposal.

The CER states on page 4 of the Proposed Decision that: *"The overall entry/exit system will be similar to the current GB system*". What the CER omits in the Proposed Decision Paper are the significant differences between how the LRMC system operates in GB and how the CER are proposing to adopt it. As Brattle point out, LRMC is only a valid option where there is congestion on the system and capacity bookings are underwritten by long term contracts. The whole point of the CER"s consultation process is that there will be significant excess capacity on the Interconnectors and that capacity will be stranded.

Based on the spreadsheets released by the CER on the 9th of March, BGN does not appear to share the CER's view of underutilisation. Indeed, through the Gas Capacity Statement of 2011, which is the basis for the CER's consultation on twinning the Interconnectors, and through the spreadsheets it prepared for the CER, BGN has demonstrated that there is a need for **more** capacity on the Interconnectors. The spreadsheets show the mechanics of calculating LRMC from the projected additional costs and incremental gas flows from new supplies and using these to set tariffs. But these spreadsheets illustrate the flaw in the methodology. If there is no incremental demand for Interconnector capacity (a basic premise of this consultation), there can be no denominator to apply to the equation used to set the LRMC tariff. The result is either that the tariff is meaningless or that it must be infinite (as a result of dividing required revenue by zero volume).

We find ourselves hopelessly confused as to whether it is BGN's position (which is very important as they are the owner of the Interconnectors and the beneficiary of the revenues at issue in this consultation) that the Interconnectors are congested or uncongested. If they are congested (as BGN suggest in the twinning consultation and in the spreadsheets now introduced here) then this consultation is moot, and we can quickly establish the LRMC tariff by auctioning off the needed extra capacity on a long term basis (as is done in the UK, although the CER also omits that detail) prior to expanding the Interconnectors. If the Interconnectors are going to be underutilised, then the LRMC calculations are meaningless and based purely on BGN speculation, illustrating the inapplicability of the LRMC methodology in this case. And as a corollary it would appear the twinning consultation is then also moot.

There are other practical problems. The CER has failed to describe what it means by "common charging", the mechanism it plans to use to collect the surcharges from BGE's competitors. Absent a description there is no way to assess the impact of this on BGE's competitors, including Shannon LNG. The description of the UK LRMC methodology (even if its applicability could be demonstrated which as we suggest the CER has failed to do) is incomplete and lacking significant details that have major impacts on the results it would generate if applied in Ireland. It is unclear whether the CER is proposing to adopt the UK's LRMC methodology, or adopt a modified (in some unspecified way) version, or simply include the reference as a superficial means of trying to establish the general legitimacy of the approach in the present context.

The CER's use of the BGN LRMC Proposal to set the regulated entry tariffs (for reserve prices) appears to be merely a "construct" to recover the historic costs of BGÉ, but it is proposed in such a way that it is contrary to Article 13 of Regulation (EC) 715 of 2009. It disguises where the true costs of service are found in the system and allows the CER to avoid confronting BGÉ or the Government on the possible stranding of the Interconnector assets.

Finally we would note that the CER also notes on page 40, when rejecting Option 3, that "*If there is a shortage of capacity then it is more efficient (in an economic sense) to invest in the cheapest increment of capacity."* Thus the incremental cost should be the "price to beat" in the market, rather than any "historic" cost." In other words, even the CER concedes LRMC is only preferred in a constrained system, a constraint that has clearly not been shown to exist in this consultation. It appears that the CER is having difficulty tracking which IC throughput assumptions are associated with which tariff theories, since we are engaged in this consultation on the grounds that the IC throughput is falling, not constrained.

6. Another changed position on security of supply

(a) In the January 2011 consultation paper, the CER put forward a justification for a so-called "*security of supply*" payment to BGN for the non-use of the Interconnectors based on no analysis but statements and assertions that the Interconnectors provided essential security of supply for Ireland. This security of supply was said to justify the payment. That paper proposed that there would be a further consultation paper on quantifying the security of supply value of the Interconnectors and a proposed mechanism for collecting this amount.

(b) In the July 2011 consultation paper, the CER moved away from a security of supply payment to BGN, instead introducing Options 1 to 4, (with emphasis on Options 3 and 4). In the July 2011 consultation paper the CER said that *"It is worth noting that new supply sources can also provide security of supply and perhaps even more importantly diversity of supply".* Accordingly, in July the CER changed the reason for the payment to BGN for non-use of the Interconnectors in Options 3 and 4 as being to offset a so-called "*diversity premium*".

(c) However, (and without any explanation) the February 2012 paper presenting the BGN LRMC Proposal reverts to the position in the January 2011 paper that a payment to BGN from competing entry points is underpinned by "*security of supply*" benefits, e.g.:

(i) "It could be argued that 17mcm/d "additional" capacity is being paid for as an insurance policy in case of a supply interruption. The Interconnectors were constructed at the then Government's behest to meet Ireland's security of supply needs as these were perceived at the time." (p9 of the February 2012 paper).

(ii) "Those shippers who decide to source their gas from somewhere other than the Interconnectors entry will still, arguably, benefit in terms of security of supply from the availability of the Interconnectors, as will their customers." (p13 of the February 2012 paper).

(d) Shannon LNG disagrees with this second reversal of position by the CER. Shannon LNG agrees with the position of the CER in the July 2011 paper that new supply sources provide both security of supply and diversity of supply, which is more important. **Accordingly, there is no basis (and none is given) for discriminating in favour of the Interconnectors on "*security of supply*" grounds. Of more concern, however is the reversion by the CER to the security of supply argument to justify this new proposed approach.**

(e) The Proposed Decision (on page 9) also notes:

> "While customers are paying for 40mcm/d (17mcm/d + 23mcm/d) worth of assets, the current feasible throughput of IC1 & IC2 is limited to 23mcm/d, due to system constraints on the Scottish onshore side. It could be argued that 17mcm/d additional capacity is being paid for as insurance policy in case of a supply interruption."

This statement by the CER is misleading and inaccurate. There are no "system constraints" on the "*Scottish onshore side"* any more than there are system constraints on flights at Heathrow Airport due a limited number of runways. As the BGN spreadsheet clearly shows, to remove these constraints would require an investment of €270 million in Scotland. But this consultation is based on the premise that not only are there no constraints, but rather there is an excess of capacity in the Interconnectors which requires subsidy by BGE's competitors. If the system is "constrained", this consultation is moot, the twinning consultation is valid, and BGN should be able to support its hypothetical LRMC calculation through the sale of long term capacity at Moffat. This, of course, flies in the face of the declared total lack of interest on the part of the Irish gas market participants who participated in the CER's consultation on the possible twinning of the Interconnectors (CER/11/206).

7. Fair Procedures

The latest consultation paper makes a series of provisional findings which have serious adverse consequences for Shannon LNG. Having regard to this and to the express statutory provisions regarding the CER's obligations of transparency as mandated by Regulation (EC) 715/2009 and by Directive 2009/73/EC, the basis for, and data and analysis supporting, each of those provisional findings should have been made available by the CER. Despite requests by Shannon LNG and others at the public meeting and in writing, these have not been made available.

As set out in our previous submissions and above, comprehensive underlying data and analysis were not provided by the CER throughout this consultation, which detrimentally affects Shannon LNG's ability to understand and respond to the consultations.

Leaving aside the argument that the CER does not have the statutory power to make the Proposed Decision at all, Shannon LNG believes that:

- The CER has statutory obligations of transparency in fixing or approving tariffs or methodologies and in ensuring that the tariffs are transparent, as set out in our previous submission. If the CER had the power to make the Proposed Decision, then the CER would have to do so in a transparent manner and in accordance with transparent criteria.

- The Proposed Decision, if made, would have a fundamental negative effect on Shannon LNG including additional costs up to €85 million per year to the benefit of our competitors. As set out in our previous submissions in this case, fair procedures entails provision of the underlying data and analysis for the proposed addition, and would include transparency on all dealings with other participants in the consultation.

By way of example of the consequences of three fundamental failures to act transparently in the consultation process regarding the Proposed Decision:

(1) There is no explanation of the purpose nor the legal and factual rationale and analysis for the proposed decision to designate the Interconnectors as part of the onshore transmission system.

(2) The CER's Proposed Decision allocates the historic cost of the Interconnectors and the onshore system to the entry and exit points in an arbitrary fashion. No basis whatsoever is given for this allocation. Instead the CER decision focuses on an interim tariffing step based on another methodology such as LRMC. Again, this is not explained, in particular the staged nature of the tariff is not justified or reasoned.

(3) The CER does not explain why it has rejected the other Options with sufficient, or any, reasons such as to enable Shannon LNG to understand and comment.

The CER must, at a minimum:

- Ensure that the ultimate decision on tariffs for the Interconnectors is understandable to the industry participants, i.e. so that the industry participants are in a position to understand how and why the decision was made and assess how it affects them.

- Ensure that comprehensive data is made available to industry participants so that they are in a position to assess the full economic and financial impact of the CER's decision on their business.

- Provide justification for the decision; including the provision of adequate information as to why the matter was decided as it was and what conclusions were reached on the 'principal important controversial issues', disclosing how any issue of law or fact was resolved.

It is stated at page 47 of the Proposed Decision that:

> "the planned changes to the IC tariff structure will ensure that the position of the Isle of Man is not unduly affected."

This somewhat ambiguous statement suggests that the treatment of the "exit point" corresponding to the junction between the Isle of Man spur, and Interconnector 2 has yet to be finalised. As for the position of Northern Ireland, the Proposed Decision is entirely silent, even though this gas accounts for a significant percentage of the throughput of the Interconnectors. The Proposed Decision needs to be comprehensive, and accordingly the CER needs to make clear how this exit point is to be dealt with.

8. "Regulatory Compact"

It is noted in the Proposed Decision (at page 36) that:

> "The absence of an express letter of undertaking by the Government or CER in respect of individual components of these expenditure programmes does

> not take from their regulatory status for inclusion in the RAB. They form part of what can be termed the "regulatory compact" with the designated system operator/owner."

This "regulatory compact" was again referred to by Denis Cagney (CER) at the Public Meeting on 1 March 2012.

Shannon LNG is not sure what is meant by a "regulatory compact". The existence, powers and duties of the CER are set out in, and are governed by, Irish and European law – which is the basis upon which Shannon LNG is participating in this consultation process.

The existence of an additional, unpublished body of rules by which the CER considers itself bound to act (and to which the CER has referred in this instance as the "regulatory compact") would be fundamentally inconsistent with the regulatory structure of the Irish natural gas sector, as this is currently established in law and is understood to operate. Shannon LNG does not accept that it is open to the CER to seek to justify its behaviour by reference to a concept or arrangement that has not previously been consulted upon, documented or published.

9. Query on Regulatory Capture

At the Public Meeting on 1 March 2012, Mr Dermot Nolan of the CER stated categorically that the LRMC Proposal did not come from BGN only to be contradicted by a another representative of the CER, who clarified that it had indeed been put forward by BGN. Shannon LNG believes that the CER must not only act independently of market participants (including BGN) and the Government on this issue, it must also be seen to be so acting. Shannon LNG is deeply concerned that the CER is not acting independently in this instance. The similarities between the current CER proposal and the BGN submission of 10th August 2011 are striking and strongly suggest that the CER is not acting independently.

10. Conclusion

After 15 months of this consultation process, Shannon LNG believes that the industry now deserves a final decision on this matter from the CER.

Shannon LNG respectfully requests that the CER make this final decision no later than April 2012.

Yours sincerely,

Mark Regan

PP Paddy Power

Enclosures:

Appendix 1 - Report entitled “Interconnector Tariffs and Competition in the Irish Gas Market”, Report for Shannon LNG, December 2011, Colm McCarthy, School of Economics, University College Dublin

Appendix 2 - Brattle Report - Response to CER’s Draft Decision on the Treatment of the BGÉ Interconnectors, 15 March 2012