ESB Comments on CER Proposed Decision regarding "The Regulatory Treatment of BGÉ Interconnectors"

Introduction

ESB has a number of comments on CER's proposed decision paper, which focus on:

- Stranding of Interconnector assets;
- Impact of new sources of supply on wholesale pricing; and
- Long Run Marginal Costs as a basis for setting the regulated entry tariff;

Stranding of Interconnector Assets

ESB agrees with the CER proposal not to strand any of the BGE Interconnector assets. Any regulatory decision to strand part of the existing gas interconnector infrastructure would have widespread consequences across the wider regulated utility sector.

The second gas interconnector does, to a significant degree, contribute to security of gas supplies and as such its costs must be recoverable. Stranding of the second BGE interconnector costs would send a very negative signal to the capital markets for all future regulated utilities' infrastructure projects. Financing costs would increase and access to scarce capital would become more difficult arising from the regulatory uncertainty that the principle of stranding would introduce for all regulated infrastructure assets.

At a time when access to capital for major infrastructure projects is limited, the recognition of the principle that cost recovery is guaranteed (provided those costs are properly and efficiently incurred) for all regulated infrastructure assets, would be a welcome one.

Impact of Increased Supply on Pricing

ESB agrees with CER proposed decision that the Interconnectors will be deemed to be as much a part of the transmission system as other transmission assets. ESB also supports CER thinking that the LRMC of transporting gas could be used as the basis for calculating the regulated entry tariff (subject to comments later in the response).

ESB believes that this approach will reduce the risk of a perverse wholesale price outcome following new entry points becoming effective on the system. This situation could arise where a reduction in gas volumes being transported through the interconnector, due to a marginally cheaper pricing strategy at new supply entry points, would necessitate an increase in the IC transmission tariff, in order for BGÉ's total interconnector costs to be recovered. An increased transmission tariff would as a consequence increase the wholesale gas price for Ireland.

Such an eventuality would not be a rational economic outcome, in that an increase in the overall level of supply would perversely lead to higher prices, whereas conventional economic thinking would assume that an increase in supply competition would lead to a reduction in price.

Long Run Marginal Costs as a basis for setting the regulated entry tariff

ESB has some comments on the proposal to use Long Run Average Incremental Cost (LRAIC) methodology to calculate the LRMC:

- ESB would welcome further detail be provided and that the proposed methodology be fully consulted upon before implementation;
- ESB would agree that LRAIC looks a more stable basis for determining LRMC when compared with LRIC;
- Based on previous experience of LRMC based charging in electricity, ESB would have concerns regarding any charging methodology that gives locational signals. In addition to the objectives of efficiency and cost recovery it is imperative that any such signals be stable, equitable, transparent and predictable;
- In the event that the marginal signal over/under recovers it is imperative that the means of ensuring the correct recovery of revenues does not exaggerate the locational signal. ESB considers that it may be better to under-state than over-state a locational signal, given the impact that it could have on market participants;