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Mr. Jerry MacEvilly,
Commission for Energy Regulation,
The Exchange,
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Dublin 24.

6 July 2012

Re: CER Consultation on "South-North Gas Pipeline and Compliance with EU Law: Tariffing Arrangements for flows to and from the Gaslink System", CER/12/066

Dear Jerry,

We are writing with respect to the above referenced consultation published by the CER on the 6th of June 2012. In the consultation, the CER asks for comments on five tariff issues which it raised on 23rd March, and repeats here with its proposed approach to each. Shannon LNG addresses each in the order presented.

1. Interconnector (IC) Entry Tariff

Section 2.2 "Interaction with the CER Proposed Decision on Regulatory Treatment of the BGE Gas Interconnectors"

Shannon LNG requests that the CER take account of all the submissions Shannon LNG has made on the CER's consultation process entitled *The Regulatory Treatment of the BGÉ Interconnectors*[1] ("IC Consultation") which commenced in January 2011 as part of our response to this consultation paper. We would also note that at the time of submission of this response Shannon LNG has not yet fully reviewed the Decision Paper CER/12/087 issued on 29th June 2012. As such, we may submit further comments on this consultation once we have fully analysed the IC Decision Paper.

In summary, the consultation paper is proposing that the exit tariff for flows from the Gaslink System[2] into the South-North Gas Pipeline (SNP) be calculated on the basis of the required revenues associated with a share of the regulated asset base (RAB) of the BGÉ Interconnectors. In this case the required revenues are estimated to be circa €4.8 million

[1] CER/11/002, CER/11/112 and CER/12/013
[2] As defined by CER in this consultation paper

for so called “standby costs” associated with IC2, based on the theory that IC2 provides security of supply[3] to Northern Ireland as described in the IC Consultation.

The proposed approach appears to follow a tariff setting methodology which conflicts with the methodology (and supporting theories) laid out by the CER in the IC Consultation, including the Proposed Decision issued in February 2012. **In this consultation the CER is proposing to design tariffs based on perceived actual costs of providing the service, but the CER ruled out using actual costs as a valid methodology in its Final Decision on the IC Consultation process.**

The IC consultation has produced a Final Decision[4] in which the CER has indicated *inter alia* that it will (i) eliminate any distinction between the BGN onshore and offshore regulated assets; and (ii) move to an LRMC methodology from a regulated asset base methodology for setting entry tariffs. In addition the Final Decision dropped all references to security of supply, standby costs, or diversity. The CER has also indicated it is minded to split the required revenues of the BGN system 50/50 between entry and exit tariffs, with any shortfall from entry tariff collection to be recovered by a common charge to all entry points. This SNP consultation proposes an approach which is completely at odds with each of these decisions or indications. Nowhere does the CER attempt to reconcile the differences between this consultation and the February 2012 draft decision on the Interconnectors, let alone the Final Decision on the IC consultation, beyond a passing reference at the top of page 7.

Furthermore, Shannon LNG believes that the justification the CER is using to allocate up to circa €4.8 million of “standby capacity” costs of the Interconnectors to the calculation of the exit tariff for flows from the Gaslink System into the SNP appears to be completely at odds with the contents of the letter sent by the European Commission (EC) to the CER which was appended to the SNP consultation paper.

Shannon LNG requests that the CER clarify this point with the EC and inform industry of the EC’s response.

The consultation paper states on page 6:

> While shippers might only utilise capacity on the SNP, and by extension IC2 and the onshore Scotland system, for short periods, those shippers will still benefit from the availability of such assets throughout the year. This benefit would essentially accrue to shippers and customers.

The mandatory introduction of short term capacity products at all entry points means that the above point is true of all entry infrastructure. For instance, if a shipper booked entry capacity for one day or one month at the Inch entry, they would still benefit from the availability of the Inch assets throughout the year. The approach the CER is taking to this issue is clearly discriminatory in treating the Interconnector assets differently to other entry points, and essentially frustrating EU guidelines on the development of short term capacity products.

[3] The consultation is confusing in that the CER appears to use the terms “security of supply” and “standby” interchangeably without explaining the difference between the two terms. Shannon LNG has assumed for purposes of its comments that the two terms mean the same thing.
[4] CER/12/087

The consultation paper states on page 6:

> In the recent Proposed Decision Paper, *The Regulatory Treatment of the BGÉ Interconnectors* (CER/12/013), the CER noted that it does not propose to 'strand' any part of the Interconnector assets as part of its preferred methodology. Therefore, it is envisaged that end-users of the Gaslink transmission system will continue to support the ongoing availability and operation of the BGE Interconnectors, as well as associated security of supply benefits, whether or not they use them.

The recent Proposed Decision Paper and the Final Decision carried no reference to allocating revenues and costs associated with security of supply and instead concluded that the stranded costs of the Interconnectors will be smeared across users of entry points, not "end-users of the Gaslink transmission system"[5].

The CER stated at the 1st of March public meeting that the IC Consultation Proposed Decision Paper is merely a draft decision paper, subject to change. The CER has now issued the Final Decision in the IC consultation and it is fair to state that it appears not to have deviated in any material respect (especially insofar as it might impact this SNP consultation) from the Proposed Decision.

The consultation paper states on page 6:

> The importance of IC2 was also in part addressed in the context of the CER's consultation process on the regulatory treatment of the Interconnectors. It was noted that the Interconnectors provide a back-up source of gas for users of other Entry Points in the event of an outage. Clearly, there are significant capital and operational costs associated with the development, maintenance and operation of IC2 and other relevant assets in onshore Scotland. These costs arise from the ongoing availability of IC2 throughout the year and do not constitute one-off costs for a particular service at a given time.

The CER did put forward a justification for a so called security of supply payment to BGN for the non-use of the Interconnectors based on its January 2011 consultation paper. The CER's July 2011 consultation paper moved away from a security of supply payment to BGN and acknowledged "*it is worth noting that new supply sources can also provide security of supply and perhaps even more importantly diversity of supply*". The CER appears to be arbitrarily drawing on incomplete arguments and proposals in other consultation papers (rather than decisions) to make the case that users of the exit capacity at Gormanston to flow gas from the Gaslink System into SNP should be forced to pay part of the claimed security of supply (standby) cost of the Interconnectors. It is clear from the Final Decision in the IC consultation, as described above, that the CER has moved entirely away from this line of argument. To return to it in another parallel consultation is evidence of arbitrary and capricious decision making, not well reasoned.

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[5] Extract from pages 46/67 of the CER's Proposed Decision Paper, CER/12/035: "Where entry capacity auctions under recover this 50% of revenues, common charging will be applied at all entry points to meet the total required revenue for entry"

As Shannon LNG has pointed out in numerous responses to the CER's consultations on *The Regulatory Treatment of the BGÉ Interconnectors*, it is an illegal state aid to attempt to recover the costs of the Interconnectors from non-users of the Interconnectors. In the Final Decision on the IC consultation, the CER has clearly moved away from any attempt to assess non-users under "security of supply" (or standby) cost recovery theories, in favour of a "common charging" approach by which any shortfall in the required entry point revenues is met through a process of common charging across all entry points. Without commenting on the legality of this approach, it is quite clear that the CER is here proposing something different, and as such appears to be proposing discriminatory treatment of one entry-exit point combination (or pair) on the BGN system over all the others.

As the CER's final decision on the BGÉ Interconnectors (CER/12/087, page 27) states that *"The ICs will be treated as an integral part of the transmission system no different to other assets"*, can the CER clarify as a matter of urgency, how exit charges from the transmission system at Twynholm and the Isle of Man offtake will now be treated given they are now connected to the general transmission system?

Section 2.3 "Exit Tariff from the Gaslink System; Cost Allocation"

The consultation paper states on page 7:

> The CER proposes to set a methodology for calculating the tariff for exit from the Gaslink System (into the SNP) in a manner consistent with the views put forward by the European Commission. The CER therefore intends to put in place a methodology which would recover a fair proportion of the costs associated with ensuring the ongoing availability of IC2 for SNP shippers, and which reflect ongoing security of supply benefits. The CER does not propose to apply such costs as an ongoing charge, i.e. an ongoing charge will not be placed on relevant shippers who have not booked capacity on the IC2. Given that the EC's views are based on relevant requirements of the Third Energy Package, the CER considers this approach to be in accordance with relevant EU legislation.

The CER's tariff proposals put forward by the CER appear to be completely at odds with the advice offered by the EC. An extract from the conclusion of the EC's 19th of October 2011 letter is inserted below.

> In answer to the joint question set out in your letter, and based on the information since provided by the two regulatory authorities, DG Energy considers that it is not possible for the Irish national regulatory authority to approve a regulatory framework which would require Northern Ireland entities to pay an ongoing security of supply charge in order to have access to the Irish transmission system and to deny access to the Irish transmission system to Northern Ireland entities who have not paid this charge.

The CER's proposal would require users of exit capacity at Gormanston **(i.e. Northern Ireland entities)** to pay an ongoing security of supply charge of circa €4.8 million in order to have access to the Irish transmission system, plus the associated cost of securing the equivalent entry capacity at Moffat. Without Moffat entry capacity there can be no secure supply of gas to the SNP pipeline.

Section 3.0 "Calculation of Required Revenue"

The SNP consultation paper justifies the CER's approach for allocating the so called "Standby Costs" of the Interconnectors to users of exit capacity at Gormanston, through a security of supply benefit argument. The same argument was raised upon by the CER in January 2011 but was dropped in its July 2011 IC consultation paper. It is bizarre that a proposal made by the CER in January 2011, then dropped, now turns up in a consultation process for tariffs for the SNP regarding the use of the same pipeline(s) in a similar context to that considered and finally rejected in the IC consultation.

Even if one accepted the premise of a standby charge the analysis of the proposed revenue calculation appears to fall short. For example, the CER gives no acknowledgement to what level of service Northern Ireland might actually require for security of supply purposes, other than the apparently theoretical capacity of the SNP pipeline receiving gas from IC2 in an unconstrained manner. It may well be that Northern Ireland would be prepared to settle for much less than this capacity given a preponderance of dual-fuelled power plants on its gas network. Has the CER asked the Northern Ireland authorities what they require by way of security of supply and if the CER has, could they make this correspondence available to industry?

There are other practical considerations with the calculation which the CER appears to have overlooked or ignored. In the IC consultation[6], the CER stated that the capacity of the Interconnectors was approximately 23 mcm/d. Of this, 1 mcm/d was dedicated to the Isle of Man. Gas flows of 20.6 mscmd/d were recorded on the subsea Interconnectors on the 8th of December 2010[7] meaning there was significantly less than the 5 mscm/d of back-up capacity quoted by the CER available on the Interconnectors. In other words, when back-up is most critically needed, on the coldest days of the year, the Interconnectors are effectively fully utilised and not able to offer any back-up. On what basis can the CER charge for this back-up capacity of 5 mscm/d when it is actually not available when it is most needed?

This highlights another shortcoming of the CER's analysis. While the €4.8 million figure may be theoretically correct if considered in isolation, it does not account for the fact that in order to secure volumes of gas to flow from IC2 to SNP, the shipper would also have to hold and pay for a corresponding amount of entry capacity at Moffat. Without Moffat entry capacity it is not clear how a shipper wishing to move gas from IC2 to SNP could actually secure the needed volumes.

Section 4.0 "Calculation of Annual and Short-Term Capacity Tariffs"

The CER proposes a methodology for calculating the tariff for the exit capacity at Gormanston into the SNP that results in the standby charge of circa €4.8 million.

In its consultations on "*The Regulatory Treatment of the BGÉ Interconnectors*" of July 2011, the CER described its concerns that as throughput dropped in the Interconnectors due to competition from other entry points, the Interconnector tariff per unit would have to increase to provide BGN with its assured revenue[8]. The CER argue that this would increase the

[6] CER/11/002, Section 2.1, 2.4
[7] Gas Capacity Statement 2010, pg 28.
[8] See Section 5.0 of CER/11/112.

marginal price of gas in Ireland leading to increased gas prices for all consumers. Under a scenario where the Scotland to Northern Ireland Pipeline (SNIP) is capacity constrained, the tariff methodology proposed by the CER in the consultation paper will lead to exactly the type of scenario occurring in Northern Ireland that the CER states it is trying to avoid in Ireland. For instance, under the CER's proposed tariff methodology it is possible that the total revenue requirement of €4.8 million could be levied against a tiny volume of gas needed in the Northern Ireland market. Yet in this case, the need for the gas would be for system demand growth, not standby/security of supply. Nowhere does the CER explain how it would distinguish between charges to be assigned for "normal" capacity versus "standby/security of supply" capacity. This anomaly is further highlighted by the CER's silence as to whether any consumer connecting to the SNP in Ireland would be in turn assessed the €4.8 million (or any portion thereof) in respect of any gas purchased by that consumer in addition to the "normal" SNP charges and gas supply charges that the consumer would be obligated to pay.

In the event that Gaslink does not recover the proposed required revenue of circa €4.8 million per annum from users of the SNP, Section 4.2 of the consultation paper seeks responses on any over/under recoveries of the €4.8 million. As stated above, Shannon LNG cannot support the overall methodology the CER is proposing for tariffing of the SNP – we therefore believe that this question is moot. And, in any event, if it is not moot now, the CER Final Decision in the IC consultation renders it moot in October 2014.

3 Remuneration for use of the SNP in Ireland

As noted above, the CER is silent as to whether a party connecting to the SNP in Ireland would be required to remunerate the SNP owner in respect of all or even a portion of the "standby/security of supply" charges being proposed. If not, the CER fails to explain why and how this would avoid discriminating against Northern Ireland customers in favour of Irish customers of the SNP pipeline. The closing paragraph in this section strongly hints that the Irish consumers connected to SNP will not incur any of the standby/security of supply charges.

4 Charges for end-users in Ireland supplied through the SNP

See preceding comments. Shannon LNG has nothing to add to the EU's letter regarding any inter-TSO arrangements.

5. Northern Ireland to Ireland Flows (reverse flow)

Shannon LNG has no comments on this aspect of the consultation paper.

Shannon LNG also requests that the CER publishes copies of all correspondence between the CER, the Northern Ireland regulatory authorities and the EC as part of this consultation process, as this information would assist industry in formulating a more considered response to the consultation.

Yours sincerely,

Martin Regan