



G&WM Generation & Wholesale Markets

**Response to: Interim Review of BGN Allowed Revenues and Gas
Transmission Tariffs for 2012/13**

February 22nd 2013

Part One: Introduction

ESB Generation and Wholesale Markets (G&WM) welcomes the opportunity to respond to the consultation paper on the Interim Review of BGN Allowed Revenues and Gas Transmission Tariffs (CER/13/034) that was published on the 8th February 2013.

G&WM acknowledges the revenue under recovery which BGN has experienced to date for the 2012/13 gas year, however we do not agree with the proposed mid-year (April 2013) tariff increase by the CER.

G&WM believes that there is a more fundamental shift in the market and that a tariff increase alone is not the answer. This fundamental shift is due to the both greater wind and interconnector power penetration. G&WM believes that implementing a tariff increase of 13% within a four to six week time frame does not address this fundamental issue nor does it provide market participants with sufficient time to assess and manage their exposure to this unforeseen tariff increase. There is also no reference on the impact in the commodity price of this shortfall.

G&WM believes that if the revenue under recovery is as drastic as outlined by BGN that a wider consultation is required which seeks to provide a long term solution to the revenue under recovery. Factors such as increasing wind generation and the associated impact on gas fired power plants running times as well the operation of the interconnector and the merit order of coal and peat fired power stations will continue to impact the capacity bookings of power generators and the revenue recovered by BGN.

G&WM believes that any further consultations should review the suitability of products and their prices/profiles given a fundamentally changing market.

In addition G&WM believes that regulatory instructions to book minimum levels undermine a market driven by price signals and commercial need.

Finally G&WM does not support the cessation of secondary capacity trading nor the limits placed on the transfers between LDM and NDM markets.

G&WM would recommend a fundamental review of the gas market in relation to the power markets as a whole ensuring that the energy consumer is not adversely affected by pricing products in the gas market that send the wrong investment or trading signals.

Part Two: Detailed Comments

G&WM believes that BGN's revenue recovery for the 2012/13 gas year is underestimated as it is based on reductions in winter demand. The recent CER decision (CER12/033) reducing short term capacity rates in the summer should result in increased bookings for BGN and an associated increase in revenue for BGN over the summer period. This will lead to a greater revenue recovery for BGN over the 2012/13 period and will reduce the amount of revenue under recovery forecast by BGN.

G&WM agrees with the CER's position of not supporting any of the three options proposed by BGN. BGN's proposed options consist of tariff increases between 25%-45% being implemented by the 1st of April. As already discussed, the timeframes involved are not adequate for market participants to assess the impact of such significant tariff increases.

The impact on commodity charges due to an increase in capacity charges is not detailed in this proposed decision paper. G&WM would request clarity on this process and recommends that a consultation process occurs to ensure market participants can assess any potential impacts and provide relevant inputs.

G&WM fundamentally disagrees with the BGN proposal of removing secondary trading at the exit completely. We believe that there should be no restriction on secondary trading between LDM and NDM as this restrictions result in a more illiquid market.

Section 3 of the proposed decision paper outlines structural changes on the demand side such as the removal of secondary capacity trading at the exit points, consideration of the short term tariff with enhanced incentives for long term bookings and requiring the power sector to book firm capacity. G&WM strongly disagree with their implementation as it results in restricting market choice and a less competitive market. For example, with increasing electricity generation from wind, power companies must have access to reasonably priced short term products to support the intermittency of wind generation.

Restricting access to secondary capacity will increase gas capacity costs and lead to increased electricity prices. This will encourage increasing imports of electricity due to false market signals and may send inappropriate price signals for the potential investment in a new power interconnector. This in itself will prove uneconomic and inefficient. Pricing and product design should be such that it makes the most economic and efficient use of existing infrastructure.

The Short Term Daily product is provided to the market by Bord Gáis Networks on behalf of Gaslink. The Short Term product is highly flexible and can be booked within-day with the booking window closing at 03:00 on day D, thereby offering good alignment between the gas market and the SEM. The product is available to Shippers at both Entry & Exit Points. These daily products are priced at a factor of the annual price, so there is good advance price visibility. Updates of availability of short term services (day ahead and week-ahead) based, inter alia, on nominations and prevailing contractual commitments are also available on the following web page: <http://web1.bgegtms.ie/index.html>.

The volumes of gas capacity available on a daily basis represent a significant portion of the overall daily gas flows and this combination of sufficient volume, published prices and flexible trading ensures a highly-liquid market. G&WM believe that greater transparency around the volumes traded by all parties in the market would provide a greater understanding of product availability and would request that this information is made publically available. Since the introduction of the within-day Short Term product in June 2008, we believe a liquid market has now materialised with several participants engaging in the market.

The above two paragraphs clearly emphasises the flexibility and usefulness of the Short Term Products offered in the Republic of Ireland; however, there is one main flaw to the products and that problem is price.

Ultimately, it is important for the regulator to ensure that the Short Term Capacity product pricing matches the commercial requirements that generators in the SEM must deal with. G&WM, if asked, would propose as an example changing the price of Within Day/Day Ahead Short Term Firm Capacity to a flat profile i.e. 1/365 of the annual price. At present, the prices are not sending the correct signals to the market. This proposed flat pricing structure reflects the pricing structure outlined in ACER's "Draft Framework Guidelines on Rules Regarding Harmonised Transmission Tariff Structures for Gas", published on the 4th September 2012 which states that "The daily, monthly and quarterly reserve prices are lower than, or equal to, the product of the annual reserve price and the ratio of their duration (in days) divided by 365"¹.

G&WM would welcome further discussion on this matter.

Redesigning the pricing of the product provides the correct incentives for shippers to book the correct products, however it will not in total address the impact of wind or interconnector generation displacement on capacity bookings.

G&WM would like to take this opportunity to once again point out that it believes that this Daily Capacity product is currently prohibitively expensive. Power demand forms a significant portion of ROI demand and product pricing should send the correct market signals. Ultimately, it is important for the regulator to ensure that the Short Term Capacity product offering matches the commercial requirements and timeframes that generators in the SEM must deal with. Pricing a product in such a way that it is not bought undermines the viability of that product itself.

We believe that a forum is urgently needed where the Regulatory Authorities (RAs) for both gas and electricity are available to meet with market participants. The revenue under recovery as detailed by BGN is symptomatic of a changing market where increased wind generation and interconnector power imports is resulting in changing running patterns for thermal generators. At present the electricity and gas RAs have conflicting messages for participants in the power sector such as the requirement for increased flexibility from the conventional generation fleet to accommodate increasing level of wind generation whereas gas renominations must be tightened despite increasing difficulty for power participants to accurately forecast running regimes.

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http://www.acer.europa.eu/Official_documents/Public_consultations/PC_2012_G_14/PC_2012_G_14_FG_Tariff_Draft.pdf

In all of the discussions to achieve a sustainable energy portfolio, the related need to maintain backup power fuelled by gas as well as the need for a clear means for a RAB based revenue of BGN the needs and impact on the ability to recover these increasing costs by those who incur them has been omitted.

Those who are impacted must have some means by which to recover this increasing cost. Cost recovery by both BGN and market participants must be clearly recognised and where possible solutions sought.

Approaches that may need to be examined, given the likelihood that this issue will be continuous and only spiral in an upwards direction, are market design, product pricing and structure as well as potential policy issues to manage the recovery of long life RAB assets through possible alternative cost recovery mechanisms.

G&WM believes that this is a fundamental issue, one that will only grow as market supply and demand conditions change, and one which requires a deep examination. G&WM recommends a new project to consider this and are willing to meet to discuss any initial thoughts on how this may be done.

Conclusion

G&WM does not support a mid year tariff increase.

G&WM believes that a longer term view is required for capacity bookings due to the increased penetration of imported power and renewable energy combined with a potential additional supply of gas in ROI due to Corrib and Shannon LNG.

G&WM would therefore ask the regulators to immediately review the current offering with the aim to providing a product that is appropriate for participants of both the Irish Gas Market and the SEM.

G&WM would request that the CER should consult with industry to develop a long term solution which will be effective over the duration of PC3.

G&WM is happy to discuss any of the above matters and would welcome the opportunity to meet to consider the issue in more detail and review potential solutions.

I look forward to speaking to you getting in touch.

Kind regards,

Karol O'Kane

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