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RE: Access Tariffs and Financing the Gas Transmission System, CER/13/122

Dear James,

Bord Gáis Energy (“BG Energy”) welcomes the opportunity to respond to the Commission for Energy Regulation’s (“CER”) consultation on Access Tariffs and Financing the Gas Transmission System. BG Energy accepts that some changes to the current revenue recovery mechanism are necessary to ensure that both BGN’s allowed revenue is recovered while ensuring that gas remains competitive as a fuel source for its different customer segments.

However while BG Energy agrees that some remedial action is required, we disagree with the current form of action proposed. In particular, we consider that the CER’s proposal to remove within day flexibility runs counter intuitive to wider developments in the power generation sector, which could render gas uncompetitive as a fuel in the electricity market, thereby affecting gas demand in the long-term. At a policy level, BG Energy believes that implementation of this proposal could ultimately act to stymie Ireland’s attempts to meet mandated 2020 renewable energy targets (on the basis of the generally accepted principle that natural gas technologies are best suited to support wind power¹) and further increase gas tariffs for all customers.

To be explicit, as more wind and interconnection is brought onto the electricity system, there will be an increasing need for gas generators to vary their generation within the day to compensate for continuous changes in output and flows respectively. At the recent Gas and Electricity Workshop, hosted by the CER on the 3rd July 2013, BGN recognised this change in operations and acknowledged that it can be facilitated, as long as system users communicate effectively with the System Operator to enable them to plan and change operations accordingly and in a timely manner.

¹ “While the push to develop renewable energies is commendable, the IEA warns, it will result in an increased reliance on natural gas, as gas-fired power plants will be required to provide flexibility in electricity supply when wind power is unavailable. The country (Ireland) must successfully develop a range of gas and electricity infrastructure projects and market solutions while continuing to integrate its energy markets with regional neighbours” (International Energy Agency, Report on Ireland, July 2012)

The current proposal to remove within day capacity bookings contradicts this assertion and perversely tries to mandate a level of certainty from power generators which they are not in a position to give in an electricity market environment with such high levels of variable generation. The proposal is also in complete contradiction to another ongoing work-stream by the CER, in conjunction with the Utility Regulator, on DS3 which aims to incentivise flexibility and investment in flexible generation to allow the electricity system to operate securely with the increasing levels of wind penetration necessary to meet 2020 renewable targets. To that extent, the CER's proposal could inhibit the security of the electricity system and electricity supplies on the island of Ireland.

This will also have a knock on impact on gas market demand given that gas fired power generation accounts for approximately 50% of overall gas demand in Ireland. Certain gas generators will not be able to compete in the electricity market in the absence of flexibility in the gas market and as such may have to exit both markets. In addition to that investors looking to invest in gas fired flexible generation will be dis-incentivised from entering the market due to the higher and increasing relative costs of gas. This will inevitably reduce overall throughput in the gas system, potentially exacerbating the current revenue recovery shortfall and causing further increases in gas transportation tariffs in the long-term.

In short, reducing the flexibility available to the power sector may ultimately prove detrimental to long term strategic objectives of the electricity market and act contrary to the CER's current objectives for the gas market.

In terms of the approach taken to the consultation, BG Energy considers that the CER has taken too narrow an outlook in its proposals, focusing almost exclusively on forcing long term capacity bookings as a means of stabilising gas network revenue recovery without properly attempting to understand the implications to the overall energy market. The proposals are not accompanied by any assessments as to its long term impact on the electricity power generation sector and/or actual gas demand. To propose implementing such a proposal without first comprehensively considering its full implications is ill conceived and we therefore strongly urge the CER to re-consider its approach.

BG Energy acknowledges that arriving at a solution which satisfactorily meets key energy wide objectives is challenging and is of the view that a more considered approach should be undertaken which properly considers both the current proposals and potential alternatives and thoroughly evaluates their short and long term implications. It is our view that the current consultation does not provide such fundamental considerations. BG Energy believes that a more measured, consultative, industry wide approach encompassing key participants in the gas and electricity sectors needs to be undertaken to better understand and assess the issues and potential solutions within the context of:

- ✓ Ensuring Bord Gais Networks recover their allowed network revenue requirement;
- ✓ Retaining the competitiveness of gas as a fuel source, and
- ✓ Providing a holistic energy market focused solution which best meets the strategic objectives of both the gas **and** electricity market.

Our view is that an electricity and gas industry wide grouping constituted and established along the lines of the 2012 gas network tariff liaison group² is the appropriate forum to consider and critically analyse issues of such fundamental importance to overall energy policy in Ireland. Such a stakeholder forum must encompass the key participants from the electricity and gas sectors to allow comprehensive consideration of the complex issues involved and attempt to arrive at conclusions which will deliver solutions to the benefit of overall energy market objectives.

A proposal which BG Energy believes should be examined in more detail as part of this forum is to revise the capacity – commodity split currently applied in the gas market. As the analysis below shows, BG Energy believes that this would be a more proportionate approach in both addressing the revenue requirements for the gas network, while retaining and even enhancing the flexibility provided to gas fired generators in the electricity market.

➤ **Apply a revised Capacity/Commodity weighting for the Power Generation sector:**

The CER's consultation does not consider the option of revising the capacity/commodity split as an option for rectifying the issues with respect to allowed network revenue recovery. BG Energy believes that the reduction in capacity bookings warrants a re-examination of the suitability of the current split for the different sectors in the gas market.

A 90:10 split was implemented on the basis that the majority of the network revenue requirement is to recover the cost of physical pipes which is a fixed long-run cost. Although this may be the case for the retail customer segments, this is not true for the power generation segment.

The connection policy for the power generation sector obliges connecting power generators to pay a large proportion of their fixed costs upfront via their connection charge (70% of gas power generation deep and shallow connection costs must be paid over the first 7 years following connection). In this regard power generation pay the majority of their Long Run Marginal Costs (LRMC) of connection over their first seven years of connection to the network, whereas the retail sectors are not required to make the same upfront contribution to the cost of connection. On that basis, it is questionable why a 90:10 split has been applied to the power generation sector, even though it was not an issue when power generation usage was more predictable and stable in the past.

The changing profile of gas usage amongst power generation and consequent reduction in firm capacity bookings and variability in transmission tariffs is, in BG Energy's view, good reason to review the 90:10 split.

² 2012 Gas Network Tariff Group established to discuss and facilitate the progress of the development of an LRMC methodology for calculating entry tariffs to the Irish gas transmission system as provided for in CER Decision CER/12/087 published 29th June 2012

Firstly, while there is a trend towards reducing capacity bookings amongst power generation, gas volume commodity throughput has not reduced to the same degree. Indeed the 2012 Gas Capacity Statement³ is forecasting annual power sector gas demand to rise by 33% between the period 2011/12 to 2020/21 which suggests increased gas commodity throughput in the coming years. This suggests a recalibration of the capacity/commodity towards an increased commodity component would be a successful long term measure from the point of view of stabilising network revenue recovery from the power generation sector.

Secondly, given the connection policy for power generators connecting to the network, a revised capacity : commodity split, for the power generation sector at least, would more appropriately allocate the long run costs of the system proportionately to the different sectors.

Thirdly, stabilising the transmission revenues while retaining the level of flexibility, which BGN is able to operationally facilitate, will better allow the gas market to respond to and accommodate changes in the electricity market. Given the changing dynamics of the electricity system towards more renewable and gas generation, this should ultimately increase gas demand in the long term, thereby decreasing long run fixed costs for all customers of the system.

BG Energy considers the merits of adopting such an approach are worth considering in the context of meeting key energy market strategic objectives. In a previous Common Arrangements for Gas (CAG) consultation⁴, the Regulatory Authorities (RAs) assessed the impact of reducing the capacity component in Ireland and found positives both in relation to incentivising peaking plant and encouraging a more efficient use of the gas network. Furthermore, examination of international precedence in the UK and Denmark, whereby the commodity component within gas transmission tariffs has recently increased provides good context and evidence for change.

i. United Kingdom:

The UK is experiencing issues similar to Ireland whereby, in recent years, falling capacity bookings has led to a declining trend in revenues raised from capacity sales. The UK changed its capacity tariffing regime to provide more favourable pricing of alternative capacity products, namely short-term capacity products, which has led to a reduction in long term capacity bookings and a consequent revenue under-recovery. The UK response to date has tended towards increasing the commodity element of transmission tariffs rather than remove short-term capacity discounts whose availability OFGEM believes is in the UK's best strategic interests⁵. BG Energy considers that the UK experience, with respect to increasing the commodity element of the tariff in order to solve a revenue under recovery issue, is instructive from an Irish perspective.

³ Joint Gas Capacity Statement 2012, CER & NIAUR

⁴ Consultation Paper on the Harmonisation of Network Tariff Capacity Commodity Ratios, Interruptible and Short Term Products and the introduction of an Entry Exit Hub, 20th July 2011, CAG/11/018

⁵ ACER Impact Assessment of Network Tariff Structures, page 16,

ii. Denmark:

Previously, Denmark set capacity tariffs so that they accounted for at least 75% of total income, while commodity payments accounted for the remaining 25%. The reason for the 75:25 split was to ensure that tariffing essentially reflected the network cost structure. However, Denmark is moving to a higher commodity weighting with the ultimate objective of *'increasing customer access to and utilisation of the capacity in the transmission system, and to support a more flexible use of gas in the future market'*⁶.

The Danish Gas Transmission System Operator (TSO)⁷ has opted to increase the commodity weighting collected through transmission tariffs with the intention of ensuring that gas fired power generation remains competitive in the electricity sector. Energinet as the single TSO for gas and electricity in Denmark understands that flexibility of the gas power sector is key to the stability of the electricity system. That is not to say that the power sector in Denmark will not pay their allocated share of associated system costs, on the contrary, the intention is to recalibrate the payment mechanism in a way that provides the sector with the necessary flexibility, while ensuring that it pays its proportionate share of the costs of the system. The ability of flexible gas fired generation to act as a natural complement to wind generation has been a key policy consideration for Denmark in changing its approach. This consideration appears consistent with international analysis⁸:

'Natural gas technologies seem to be best suited to support wind power in the future, due to their relatively low investment costs and technical capabilities to deliver flexibility. This makes it likely that, as the market share of wind increases, the role of natural gas as a flexible fuel supporting wind output increases'.

It is within this context that we consider the Danish experience worth examining from an Irish perspective. Denmark appears to have broad similarities to Ireland both with respect to the structure of its gas transmission system and strategic objectives in its power generation sector:

- Denmark applies a regulated entry-exit tariff system for gas transmission;
- Both countries are broadly similar with respect to population size, overall installed generation capacity and formulated 2020 wind energy targets⁹ (Denmark - 3,960 MW and Ireland – 4,649 MW);
- Denmark is similarly grappling with issues related to the impacts and challenges associated with accommodating the increased share of wind generation in its electricity fuel mix necessary to meet 2020 renewable;
- In Denmark, as in Ireland, natural gas is widely viewed as the most effective bridge to cleaner forms of energy; and
- The catalysts to review the gas transmission tariffing structure in Denmark are equally applicable to the changing profile of gas usage amongst the power generation sector in Ireland, in our view: *'optimum use of gas in the coming*

⁶ <http://www.energinet.dk/EN/GAS/Udfordringer-for-gassen-i-fremtiden/Tariffer/Sider/Transporttariffer.aspx>

⁷ Energinet, Danish TSO for both gas and electricity, www.energinet.dk

⁸ The impact of wind power on European Natural Gas Markets, The International Energy Agency, January 2012

⁹ Wind targets as published in the National Renewable Action Plans (EU27), Source: European Commission

years requires that the tariffs be adapted to new requirements’ and ‘a review of the tariffs is required as gas consumers increasingly go from using the gas all year round to more varied uses¹⁰’.

It is worth noting that the approved structural changes to the Danish gas transmission system are the result of the TSO’s interaction with its customers via stakeholder forums over a two year period. This process contrasts with the development of the CER’s current proposed solutions which are the result of minimal consultation with key stakeholders and which lack critical underlying analysis. Also, using the available information from the PC3 process, a high level impact analysis would suggest that moving towards the Danish model would significantly reduce revenue shortfalls and improve the stability of gas tariffs during the PC3 timeframe. The high level analysis undertaken is detailed in Appendix 1 attached.

iii. Assumed impact of revised capacity-commodity split on revenues & tariffs:

Given that its gas throughput is predicted to increase in the coming years, recovery of an increased proportion of gas transmission system costs via commodity tariffs could serve to negate falling revenues associated with identified reduced capacity bookings. The extent of the extra revenues garnered would depend on the revised capacity : commodity allocation chosen. BG Energy has modelled the potential impact of amending the capacity : commodity percentage split for the power generation sector only and measured the impact on expected revenues over the course of the 2012 – 2017 period for the 3 following scenarios:

- Status Quo – 90% Capacity : 10% Commodity split;
- 75% Capacity : 25% Commodity split; and
- 60% Capacity : 40% Commodity split.

Our analysis, outlined in Appendix 1, shows that, retaining the current level of flexibility, while changing the capacity : commodity split reduces the level of revenue shortfall throughout the period 2012 – 2017, thereby reducing the need for tariff changes year on year. Moving from a 90:10 to a 60:40 split, would reduce a forecasted revenue shortfall from the power generation sector of approximately €64 million into a revenue surplus of approximately €7 million¹¹.

BG Energy acknowledges that its impact assessment undertaken in Appendix 1 is a very high level analysis and may not appreciate certain subtleties of the tariffing process. However, as suggested earlier, BG Energy would welcome more detailed analysis of this proposal as part of a wider tariff liaison group with the CER, BGN, EirGrid and other interested stakeholders.

In **conclusion** BG Energy believes that the issues currently under consideration, the eventual solutions arrived at and their long term implications are of fundamental importance to the

¹⁰ Gas in Denmark 2011 – Security of Supply and development, Energinet.dk

¹¹ This assumes that the power generation sector still accounts for 50% of the overall PC 3 revenue requirement. Further discussion with respect to the proportions charged to the power generation sector may need to be revised within the context of the connection policy.

future direction of the energy market in Ireland. Therefore, it is vital that a holistic energy market approach is adopted rather than pursuing an isolated gas market focused approach. We acknowledge that arriving at a solution to the current issue that satisfies all participants is challenging and we believe a stakeholder forum encompassing the key participants in the electricity and gas sectors is the best option to consider the complex issues involved and assisting the CER in its attempts to arrive at a solution to the overall benefit of the energy market. As part of this process, BG Energy suggests that further consideration is given to examining the capacity : commodity split as a means of stabilising revenues, while retaining flexibility within the gas and electricity markets.

I hope you find the above comments useful. BG Energy is available to discuss the above issues at the earliest opportunity and looks forward to liaising with the CER on this very pertinent issue. Please do not hesitate to contact me should you require any further details on the points raised above.

Yours sincerely,

Dermot Lynch
Commercial Regulation
Bord Gáis Energy

{By email}

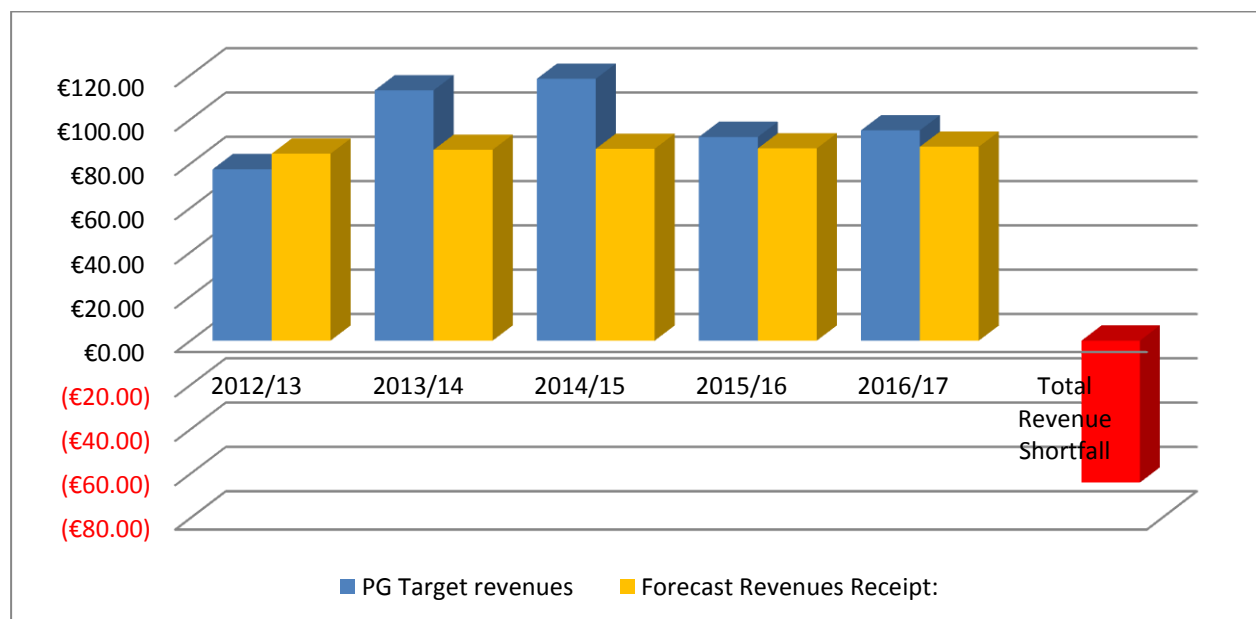
Appendix 1 Revenue impact of amending the PG Capacity Commodity split

BG Energy Assumptions:

- Network system required revenues are based upon figures in CER/12/196¹² and assumes 50% of total cost recovery is allocated to power generation;
- Revenue recovery for each year is based upon current tariffs, i.e. Revenue and demand figures used to derive tariff April increase amended to reflect each capacity and commodity weighting scenario;
- Capacity Revenue forecast assumes continuation of CER expectation that power generation will book 70% of its projected peak capacity in 2012/13 for full 5 year period;
- Commodity Revenue based upon forecast annual gas demand of power sector taken from Regulatory Authorities 2012 Joint Gas Capacity Statement.

Scenario 1 – Continuation of 90:10 split for Power Generation:

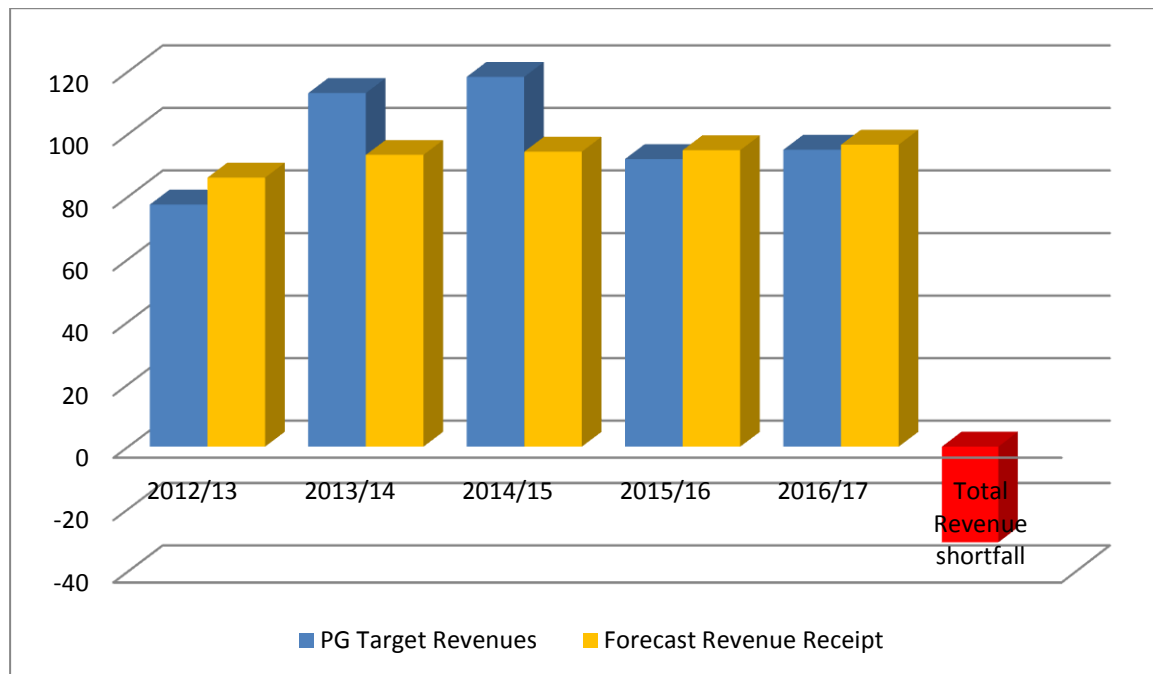
EURO €m



¹² Decision on October 2012 to September 2017 Transmission Revenue for Bord Gais Networks, CER/12/196

Scenario 2 – Impact of 75:25 split for Power Generation 2012/13 to 2016/17:

EURO €m



Scenario 3 – Impact of 60:40 split for Power Generation 2012/13 to 2016/17:

EURO €m

