



**Response to Commission for Energy  
Regulation Consultation Paper CER/13/122**

***Access Tariffs and Financing the Gas  
Transmission System***

**15 July 2013**

### Introduction

The question of how to finance the gas transmission system in a sustainable and equitable way is not a trivial one. Designing the right system requires detailed analysis to allow for evidence based decision making that support the achievement of the stated objectives. The achievement of a sustainable, secure and competitive transmission system is critical to Irish energy and industrial policy. Proposals to introduce rudimentary change without any supporting analysis risks trivialising the issue to the ultimate detriment of all.

### The Issues

A radical decline in annual capacity bookings and the availability of improved flexibility, through the secondary market and within day products, reflect the changing demand for gas in Ireland. This change, as driven largely by European and Irish energy policy, is a long term trend. While these long term trends may pose a short term problem, treating the trends as the problem misrepresents the issues to be addressed and seriously risks undermining the objectives to be achieved in this consultation. The need for comprehensive analysis of the perceived issues and of possible solutions cannot be overstated.

### Power Generation & the Gas Transportation System

The Connections Policy differentiates between customers and places different contractual and financial burdens on different customer groups. Power stations pay the full cost of their connection to the gas system (shallow and deep costs), make substantial continued contributions to general network costs and are expected to remain the single greatest consumers of gas in Ireland. Fair and equitable tariffs are central to the achievement of the overall objectives but the equity issue is a complex one requiring careful analysis and is erroneously simplified in the current consultation.

### Assessment of the Proposals and Previous CER Decision

In presenting “(initial) updated views” in this consultation, the CER have proposed contradicting evidence based conclusions from their 2010 decision paper on secondary capacity transfer restriction with mere conjecture. Robust regulatory decisions should not be arrived at without proper supporting analysis or by statements such as, “*it could be argued that...*”<sup>1</sup>, particularly where such arguments are overly simplistic and narrow in scope. An assessment of the consultation by Oxera found that in the absence of any analysis, “*there is neither certainty nor likelihood that these measures will provide a sustainable remedy*”.

### Legal review

An assessment of the consultation paper by Arthur Cox identified a number of legal issues relating to both domestic and European legislation, and how these have been interpreted by CER. While there is disagreement between Arthur Cox and CER on the correct legal interpretation of the Articles referred to in the consultation paper, it is the considered view of Arthur Cox that, “*the better interpretation of the Directive and Regulation is that the proposals in the Consultation Paper are not permissible as a matter of law*”.

### Better Regulation

The recently stated Government position on economic regulation in Ireland is that good regulation should continue to be governed by the 6 Principles of Better Regulation first published in 2004. In a consultation paper of such fundamental importance as this, it is expected, at a minimum, that these principles would be followed. There is no evidence that these principles have been followed in the paper.

### Conclusions & Next Steps

This consultation sets an unwelcome precedent for drastic change being unsupported by evidence. Unquestionably certain issues raised in this paper need to be addressed through comprehensive analysis. It is recommended that CER set-aside these current proposals and immediately convene an appropriately resourced workstream to undertake the necessary analysis, in conjunction with the relevant stakeholders. The outcomes of this workstream should be capable of implementation in the market for October 2014.

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<sup>1</sup> CER/13/122 at 17

## **1. Introduction**

Energia welcomes this opportunity to respond to this Commission for Energy Regulation (CER) consultation on Access Tariffs and Financing the Gas Transmission System (CER/13/122). This consultation attempts, in just 28 pages, to deal with one of the most significant energy issues that the CER has consulted on. The conundrum posed by the changing electricity generation mix on the island is one of systemic long term change which is likely to require a fundamental rethink.

In the recent Price Control (PC3), the CER approved a required revenue of €857m, Net Present Value (NPV), for Bord Gáis Networks (BGN), to recover through transmission tariffs over the period between 01 October 2012 and 30 September 2018. In order to achieve this, CER set annual transmission tariffs based off capacity and commodity forecasts from BGN. Transmission tariffs are simply based off a profile of revenue to be recovered in each year of PC3 and the relevant BGN forecasts. Some under/over recovery in any one year is therefore expected as forecasts are statistically unlikely to perfectly reflect outturn and the impact on customers will be dependent on the relative size of this divergence. The focus of CER/13/122 is however not how to improve forecasting accuracy, or to mitigate potentially significant tariff increases as a result of inaccurate forecasts by reviewing the overall required revenue, but rather to attempt to force the realisation of BGN's forecasts, or at least to minimise the differential between their forecasts and real outturn.

From this brief introduction, the fundamental importance of this consultation should be apparent. Its outcome will have a defining impact on the security, sustainability and competitiveness of Irish energy and industrial policy. The continued remuneration of BGN investments in gas infrastructure in Ireland that is designed to meet varying demands from various different customers is best achieved through the maximisation of gas consumption through products that are appropriately tariffed and designed to meet the demands of its customers. Under the current tariff regime this outcome must be delivered at both entry and exit but as this consultation deals only with the latter, comments are confined to exit capacity.

The remainder of this response considers first the issues as presented in the consultation paper, as well as other relevant issues from those relied upon by CER. A brief overview of power generation customers and the gas transmission system follows, before an examination of the proposals and their impact on power generation customers. Included in this examination is a comparative analysis of the rationale forwarded by CER in support of the current proposals and the previous CER decision to restrict secondary capacity transfers, due to come into force this October 2013. The rationale forwarded in the consultation paper has also been assessed externally by Oxera and the conclusions from their work are stated herein.

Energia have also benefited from a further external review, undertaken by Arthur Cox, of the relevant legal position adopted by CER with respect to potential European compliance issues arising from the proposals. A number of areas of divergence emerge from this review and are stated in this submission.

The penultimate section considers the extent to which this consultation paper, which is possibly the most significant gas consultation issued by CER both in terms of the issues being considered and the proposals forwarded, complies with the Government commitment to the Six Principles of Better Regulation. It should be expected that for a consultation of this magnitude that the appropriate process is adopted, at a minimum one can reasonably expect there to be adherence to these six principles.

Finally a number of conclusions are drawn together and some next steps, differing from those in the paper, are proposed in light of the conclusions and material contained elsewhere in the submission.

## **2. The Issue(s)**

In February 2013 the CER first indicated to the market that capacity bookings were expected to deviate significantly from their forecast levels used to determine gas capacity tariffs for 2012/13. The information submitted by BGN to CER gave rise to an unusual interim review of transmission tariffs to reduce BGN's forecasted under-recovery of tariff revenue. A radical decline in power generation bookings and an increasing availability of restricted secondary capacity, from both within and across customer categories, were identified as key drivers of this divergence, and hence of the revenue shortfall.

### **2.1 *The issues CER are seeking to address***

The key issues according to CER to be addressed by this consultation paper are the decline in annual capacity bookings and the erosion of BGN's core revenue base, and the availability of too much flexibility for shippers. These changes are seen to give rise to an equity issue which the paper consequently seeks to address and is premised on an understanding that, through the regulated tariffs, the network is not being remunerated by all customers in a fair and equitable way. There is however no assessment or analysis of the equity issue in the consultation paper, rendering it mere conjecture and contrary to a previously stated CER position that has its basis in analysis<sup>2</sup>.

### **2.2 *The issues with the issues CER are seeking to address***

- **A short term fix to a long term problem?**

Comparing this consultation with the short term requirements of the interim tariff review, one notes that the issues are common which suggests an underlying change in the demand for gas capacity as opposed to any short term issue with the forecasts. CER are similarly of the view that is unlikely to be a short term issue. Therefore, to the extent that the forecasts for 2012/13 created a significant under-recovery issue for BGN and whether this is unrelated to the use of secondary capacity from NDM in the DM and LDM segments, this effect will have implications for the subsequent years of PC3. Consequently, this may further contribute to

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<sup>2</sup> CER/10/089 at 30

significant tariff increases already forecast in the PC3 model to meet the approved revenue for BGN.

It is not possible to design a solution to the issue presented without first correctly defining the problem and in doing so it is necessary to differentiate between genuine problems that exist with the market and underlying structural changes that may give rise to apparent problems. A failure to differentiate between these two possibilities will likely have detrimental effects on the design of any proposed solution. Markets, including regulated markets, should adjust to structural changes in demand, where possible, with (further) regulation required only to address residual or complete market failure.

It is therefore important to correctly characterise the changes in the demand for gas and gas capacity products that have precipitated the current situation.

- **The quantum of PC3**

One obvious additional factor of significant importance is the overall level of required revenue approved by CER for PC3 and the necessary acceptance that must accompany this decision to allow €857m (NPV) to be recovered over just five years, that Ireland has a relatively new and expensive gas transmission system. In approving these revenues, CER committed gas customers in Ireland to meet this requirement through a significant projected tariff increase, before any realisation that BGN capacity booking forecasts were diverging significantly from outturn bookings and thus increasing the requirement for even greater increases.

- **The role & (undue?) importance of capacity forecasts**

An important example of the role of capacity bookings in this discussion can be seen if one considers the first year of PC3 tariffs (2012/13). First it is important to recognise that the tariffs for this year were set before the finalisation of PC3 and are therefore merely index-linked to PC2 tariffs with forecasted capacity bookings from April 2012. Implicit in this approach is a deferral of revenue to the remaining four years of PC3, thus delaying the required tariff increase of PC3, and capacity booking forecast from BGN that had been updated. If based on the forecasts finally used by CER in PC3 for year 1, the expected tariff would have been 19.6%<sup>3</sup> higher than that set for the year and which was subsequently adjusted by just 9% in the interim review<sup>4</sup>. As we will come to discuss, the fact that BGN's forecasts of capacity bookings on a year-ahead basis were out by c.20% is perhaps indicative of a lack of awareness and understanding of the electricity market and the potential impacts of changes to the demand from a relatively small number of power generation customers who represent c.50% of BGN's tariff base. This may also indicate the absence of an effective incentive mechanism on BGN with respect to forecasting, particularly where all of their required revenue is guaranteed by its customers who implicitly carry the costs associated with these forecasts.

Alternatively, it may be appropriate for the CER to consider a change in the structure of tariffs to accommodate BGN's superior forecasting accuracy record with respect to

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<sup>3</sup> Analysis based on the published PC3 model.

<sup>4</sup> CER/13/034

commodity. If, properly defined, the problem is one of revenue and tariff certainty for BGN and CER respectively, then such an approach may be preferable. By placing a greater weighting on commodity in the capacity/commodity split it would not remove the need for tariff increases but through their forecasts, it would stabilise revenue and tariffs. It must therefore be accepted, that despite the merits of the approach which are argued for by CER elsewhere, the current capacity/commodity split is contributing to the current issues in the gas market through the issues already identified with respect to BGN's forecasting of capacity bookings.

- **Gas demand & the power sector**

Of structural importance to the overall question of what issues need to be considered in this consultation is the demand for gas and gas capacity products. At a macroeconomic level the continuing recession in Ireland has had an adverse impact on gas demand. In the power generation sector, the introduction of the East-West Interconnector (EWIC) and the substantial investments in onshore wind to assist in the achievement of an ambitious Government target of 40% renewable consumption by 2020, has reduced demand for gas in the sector as increasingly CCGTs are being forced to operate as mid-merit or peaking units in the system. This trend is further exacerbated by the relatively cheap price of coal and the historic lows being recorded in the carbon market. While none of these factors can be properly regarded as sudden or unanticipated changes in the demand for gas, they appear for the most part to be sustained changes for the medium to long term, as opposed to temporary phenomena.

In the wider economy it is expected that an economic recovery, or at least an end to recession, will begin to emerge in the short to medium term but this is unlikely to arrest the structural, long-term changes in the demand for gas from the power generation sector. Notwithstanding the growth in gas-fired CCGT's as a proportion of the installed capacity in the electricity system, it is possible that this is further contributing to the issue of revenue and tariff stability, particularly as recent investments by the two semi-State energy companies (ESB and Bord Gáis Energy) in over 800MW of CCGT capacity in Cork did not appear, at least for the second unit, to reflect underlying market fundamentals and commercial signals in the market. Further to this, while it was not expected that these plant would have a material impact on gas throughput, certainly in the current market environment, the impact of their introduction has been far more pronounced for capacity bookings and presumably for forecasts of the capacity bookings.

- **The focus on annual capacity products – a luxury that can no longer be afforded?**

As a result of these identified drivers of changes in gas demand for power generation customers, there is concomitant change in their demand for gas capacity products. Increasingly variable running profiles for CCGTs and a shift to operate as peaking units for some dilutes, and in some places removes, the incentive to book long term (annual) capacity products with the transporter. The power sector has a growing demand for flexible products and such products are likely to be required if the overall energy policy goals being pursued by the Government are to be achieved. While this

change has clear implications for the current model of revenue certainty preferred by BGN (annual products), it is reasonably foreseeable that such fundamental change in the electricity market would necessitate change in the gas market to reflect the new demand for gas and gas products. Conversely, it is difficult to see how a sustainable approach can be achieved without such change, or without imposing unnecessary costs on consumers of both gas and electricity.

While no attempt is being made to overstate this point, it is undeniable that BGN's preference for annual products and the incentivisation of these products by CER, is contributing, at least in part, to the issues with secondary capacity identified by CER in the consultation paper. Put another way, the incentives are inducing certain customers to book excess capacity, thus increasing the availability of secondary capacity; the increased supply of secondary capacity induces other customers to increase their reliance on it. While some of these supposed issues will be resolved following the implementation of secondary capacity restrictions (CER/10/089) in October 2013, properly characterised the issue may not be with the availability of secondary capacity but rather the incentive offered by the CER to shippers to book capacity that is likely to be in excess of their projected needs. Similarly for a different type of shipper, the CER decision to incentivise short term products, through a recent reduction in tariff multipliers, is likely to have reduced the overall demand for annual products and consequently the supply of secondary capacity.

### **2.3 Summary**

In summary, it is undeniable that the issues CER are looking to address in this consultation paper are far wider than a decline in annual firm capacity bookings from the transporter and a perception of too much flexibility for shippers. Undoubtedly the revenue and tariff certainty objectives could be achieved through addressing these perceived issues but to do so would be to ignore the drivers of these changes and to wrongly identify the issue(s) to be addressed. The implication of this is to undermine the sustainability of network remuneration and of their customers' ability to make a fair and proportionate contribution to the service provided. Flexibility cannot be regarded as an issue in any enduring solution, rather it should form the basis of such a solution. Acceptance of this needs to come through a shared understanding of the gas and electricity systems, as this is not solely a gas issue but rather an issue for the energy market in Ireland.

## **3. Power Generation & the Gas Transportation System**

In identifying some of the issues and the relevant drivers of change in the previous section, significant focus was placed, as it is in the consultation paper, on the power generation sector. It is therefore important to be clear on the role and duties of the power generation sector in the wider gas transportation system and how these might differ from those of other customers. To the extent that there are differences, it is important to further consider the implications of any such differences.

- **The Connections Policy – an unequal treatment**

It is useful to start with the connections policy, the policy which governs how all customers connect to the gas system and any obligations that arise from the policy. Despite a number of revisions to the connections policy document in the last 10 years or so, the underlying high-level principles have remained largely unchanged. Prior to connection to the network LDM customers (including power generation) are required to pay up front, or through a capacity agreement/contract, for both the shallow and deep connection costs associated with their connection. Contrary to the position forwarded by CER in the consultation paper<sup>5</sup>, this is equivalent to the payment made by an oil fired power station for an oil tank; or a coal fired station for a coal bunker. Interestingly, neither of these generators are required to make contributions to the general development of the roads or shipping facilities on an ongoing basis. However in the case of a gas fired generator, given the up-front commitment to pay the shallow and deep connection costs, all primary gas capacity tariff revenue goes to general development of the gas network either immediately upon payment of the first invoice or after the expiration of an agreed period of capacity bookings.

- **LDM contribution to general network development & consistency in the current regime**

Comparing the connections policy's approach to LDM and NDM customers also indicates a consistency in the current tariffing approach. As discussed LDM customers pay the shallow and deep costs associated with their connection, therefore they are afforded the flexibility to book their own capacity levels as no contribution is required to be made to the Long Run Marginal Cost (LRMC) associated with their connection. In fact all of the tariff revenue goes to long run network development (primary capacity) and with secondary capacity purchases from BGE going to subsidising the cost of NDM capacity. For NDM customers, their requirement to book for a 1-in-50 peak demand is consistent with the connections policy for NDM customers where the costs of connection are postalisised and domestic customers are only required to pay a nominal amount towards the cost of connection. By having a peak booking requirement placed on them, domestic customers are forced to make a contribution to the LRMC of their connection. Over time these customers are likely to be making contributions to general network development but it is at a far later stage than LDM customers who begin with their first invoice or upon expiration of their capacity agreement.

- **The Equity Issue – a complex issue**

In terms of the so-called 'equity issue' identified in the consultation paper and which was previously considered by CER in 2010<sup>6</sup>, where the CER arrived at the opposite conclusion to that suggested in the current consultation, namely that LDM and DM were subsidising NDM customers based on analysis of the relative burden borne by each customer category, it is unclear whether due consideration is given to the

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<sup>5</sup> CER/13/122 at 24

<sup>6</sup> CER/10/089

expected life cycle of customers in different customer categories. Again it may be instructive to consider power generation and domestic customers. A new gas fired CCGT power station is expected, in accordance with the assumptions for similar units the SEM BNE calculation, to have an asset life of 20 years.<sup>7</sup> Over the duration of its existence, a new 400MW CCGT is conservatively expected to contribute in excess of €100m, at today's tariff rates, to general network development. It is thought that a domestic customer is accurately characterised as an enduring connection; that is once they are connected to the gas network they will continue to consume gas indefinitely.

In any proper assessment of the equity question it would seem unavoidable that one should give due consideration to the differences in what these different customers are contributing to, in terms of any monies paid to general network development. On the face of it, it would appear that different customers benefit to a different extent from the investments made in the network, with those connected for an enduring period benefiting the most from their contributions. Again, the mandated booking requirement for the NDM sector can be seen to be consistent with this argument.

- **Flexibility**

Finally, it must be accepted that power generation shipper's demand for gas has recently changed in a fundamental and enduring way, due largely to energy policy developments and the introduction of increased interconnection and renewable generation capacity. In light of the stated dependence this new system is to have on gas-fired CCGTs to support renewable generation, it is foreseen that the power generation sector of the gas market will exhibit a sustained demand for gas. In theory, this should represent an undoubted positive for both gas and electricity customers, however for this demand to provide these potential benefits it must be met by relevant gas market products and be tarified such the cost of these products are proportionate with the service they provide. To achieve this, it should also be accepted that some change from the current regime may be required.

#### **4. Assessment of the Proposals and Previous CER Decision**

The consultation paper puts forward two substantive proposals to effect so called structural reform of the demand side. Both proposals concern exit only. The first proposal is to remove secondary capacity trading. This proposal is to go beyond the forthcoming introduction of the CER decision (CER/10/089) restricting eligible secondary capacity transfers to customers in the same customer category by banning all transfers at exit. The second proposal, independent of the first, is to remove the ability to buy/transfer capacity within day at the exit.

Before moving to properly consider these proposals, it is first instructive to examine the current stated approach of the CER to matters arising under these proposals.

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<sup>7</sup> AIP/SEM/12/078 at 26

#### 4.1 CER Decision CER/10/089

In CER/10/089 the CER issued a decision restricting secondary capacity transfers at exit to within customer categories. This decision is to be implemented on 01 October 2013 and its expected impacts have already been taken into account in the PC3 decision (CER/12/145). At this point it will suffice to quote the relevant sections of the decision appropriate to this consultation.

- **Basis for 1-in-50 NDM booking requirement**

*“If the capacity to satisfy this demand is to be built and made available to the NDM sector then it would seem reasonable that the NDM sector should pay for it.”<sup>8</sup>*

- **Cross-subsidy from LDM/DM to NDM**

*“[A]ll DMs & LDMs are to some extent subsidising all NDMs and some DMs and LDMs are subsidising all other users.”<sup>9</sup>*

- **Cross-subsidy, efficiency and effective competition**

*“The above process (cross-subsidy) could arguably be said to be discriminatory practice which fundamentally fails to promote effective competition and an efficient market.”<sup>10</sup>*

- **Fair & Equitable**

*“[T]he Commission has decided that modifications to secondary capacity sales are necessary in order to ensure that the transmission system is remunerated fairly and to ensure that network tariffs are cost reflective for all customers.”<sup>11</sup>*

- **Transfers within categories are efficient**

*“The Commission is mindful that exit capacity sales are not economically inefficient in all cases. The direct substitution of one capacity purchaser by another does, however, provide flexibility and does ensure that the system is fairly remunerated.”<sup>12</sup>*

- **Short term tariffs**

*“This consultation will focus on potential for reducing short-term prices in order to provide greater flexibility to shippers, while also ensuring that sufficient incentives remain for the booking of annual firm capacity.”<sup>13</sup>*

- **Evidence based decision making**

*“In light of the analysis undertaken, the Commission has decided...”<sup>14</sup>*

<sup>8</sup> CER/10/089 at 28

<sup>9</sup> CER/10/089 at 30

<sup>10</sup> CER/10/089 at 30-31

<sup>11</sup> CER/10/089 at 32

<sup>12</sup> CER/10/089 at 33

<sup>13</sup> CER/10/089 at 34

<sup>14</sup> CER/10/089 at 32

It has been suggested in the current consultation paper that there may in fact be “(initial) updated CER views”<sup>15</sup> on a number of the points contained in the 2010 decision paper. It is somewhat unclear as to what importance should be given to these initial updates, particularly as they are not supported by any evidence or analysis. In this context it is difficult to understand how the CER can support any (initial) new positions that are contrary to those previously stated in its 2010 evidence based decision on restricting secondary capacity transfers.

Notwithstanding the absence of evidence or analysis to support any new (initial) views of the CER, it can be shown that a number of these views can have little or no bearing on the previously stated conclusions of the CER as they become irrelevant under proper scrutiny. We consider this in the following section along with a stymied economic assessment of the proposals due to the absence of any quantitative analysis in the consultation paper.

Energia commissioned Oxera to complete an assessment of the consultation paper, a summary of which is contained in the Annex of this response. Oxera’s principal finding is that the equity and distributional effects of the proposal, along with the ability of the proposals to address the revenue shortfall issue cannot be determined without appropriate quantitative analysis to support the arguments forwarded. Without due consideration of the likely impacts of the proposals it neither certain nor likely that these measures will provide a sustainable remedy.

#### **4.2 Economic assessment of the proposals**

In accordance with the approach taken in the consultation paper, the proposals are to be considered separately with conclusions from the work undertaken by Oxera included where relevant.

##### **Proposal 1: Removal of All Secondary Transfers at Exit**

The CER decision paper CER/10/089 introduced restrictions on secondary capacity transfers to permit only DM/DM and LDM/LDM transfers. The decision, for a number of the reasons already outlined, as well as acknowledging the need to retain flexibility, did not remove secondary transfers at exit. Utilising the categories contained in the consultation paper, the (initial) updated views of the CER to now implement the removal of secondary capacity transfers are considered.

- **Developments in Electricity Power Generation**

CER previously found that secondary capacity transfers between power stations were economically efficient and that the “*direct substitution of one capacity purchaser by another does,....,provide flexibility and does ensure that the system is fairly remunerated.*”<sup>16</sup>

CER’s updated thinking appears to be based on an assessment of projected power generation bookings and actual historic peak bookings. This attempted comparison is wholly inappropriate and risks misinforming the debate on this issue. On a peak day power generation will have booked a level of capacity commensurate with the

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<sup>15</sup> CER/13/122 at 16

<sup>16</sup> CER/10/089 at 33

demand. Comparing actual historic outturn with projected future bookings is an erroneous and potentially misleading exercise. Additionally, the comparison fails to account for the introduction of the CER/10/089, the delayed implementation of which has been managed by the CER.

The CER also contend that, “it could be argued that providing for the current levels of flexibility simply pushes the payment for infrastructure to those who are either not offered any flexibility (NDM customers in particular) or to those who cannot profit from using the flexibility.” A number of points can be made in respect of this update.

1. Regulatory decisions should be based on analysis and not unsubstantiated arguments.
2. In CER/10/089 the CER concluded that it would seem reasonable that NDM customers would pay for the security provided to them and by the 1-in-50 requirement.
3. In CER/10/089 the CER found, based on analysis, that the NDM customer was being subsidised by DM & LDM customers; i.e. they benefited from the flexibility as opposed to being disproportionately burdened by it.
4. There is no analysis in the consultation paper of what may constitute a fair and equitable remuneration for the system across customer categories. Previously the CER decided that a system of restricted capacity transfers ensured “the transmission system is remunerated fairly and to ensure that network tariffs are cost reflective for all customers.”<sup>17</sup>

There is considered to be nothing in the (initial) updated views of CER that would justify a change from the previous evidence based decision of CER/10/089. While it is accepted that CER may have raised a number of issues to be further investigated, it is important both to undertake such analysis and to do so as part of a comprehensive process and not focussing on any one category of customer.

- **Barrier to entry**

Consideration of this issue in both the 2010 paper and in this current consultation appears to focus on the retail market and while retail market issues were a principal driver of the decision to restrict capacity transfers in CER/10/089, all customer categories were considered. Put simply, transfers of secondary capacity between power stations is efficient (up to the point’s technical capacity); removing it creates an inefficiency with further possible implications for introduction of inefficient market entry and exit signals, thus constituting a unnecessary barrier to entry.

Before any decision on removing secondary capacity transfers, all of these issues must be fully considered and supported by appropriate quantitative analysis.

- **Use of Excess Exit Capacity**

In CER/10/089 the CER, in agreement with BGN, held that secondary capacity transfers between power stations were economically efficient (up to the point’s

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<sup>17</sup> CER/10/089 at 32

technical capacity) and acceptable. There is nothing in CER's (initial) updated thinking that either addresses this issue or contradicts it.

It must therefore be the case that CER's views on this matter have not changed and as such the proposal to remove secondary capacity transfers where "one gas-fired generation station replaces another that has come offline"<sup>18</sup> is a proposal to implement an inefficient regime at exit. The "rucksack rule" is a separate, albeit important, matter which indicates a focus exclusively on the retail gas market and not the entire gas market as is required by such a consultation.

- **Impact of Secondary Capacity regime on the Connections Policy**

The CER previously stated that their view on Connections Policy was that "it is not considered that modifications to the Connections Policy would in themselves resolve all of the inefficiencies associated with secondary capacity"<sup>19</sup>. Also from CER/10/089 we know that secondary capacity transfers between power stations are economically efficient. Therefore, it cannot be the case that LDM/LDM transfers are contained in the inefficiencies to be addressed and as such consideration of the proposed amendments to the Connections Policy cannot be related to the continuation of restricted secondary capacity transfers.

The updated view of the CER offers nothing to contradict their previous position. It also ignores the Connections Policy treatment of LDM connections already outlined and by appearing to focus on particular connections, risks introducing adverse impacts for the wider market. As part of a necessary and comprehensive review of gas tariffing, it would be important to consider the role of the Connections Policy and the impact it may have in light of the different obligations placed on different connections.

- **Restrictions on Within Portfolio Capacity Transfers**

In CER/10/089 the CER determined that "restrictions on secondary capacity sales was the minimum required changes at the time and constituted the fairest approach in modifying the current regime"<sup>20</sup>. CER have now proposed removal of secondary capacity transfers as an appropriate response to "significant changes in the market for transmission capacity, including significant declines in bookings"<sup>21</sup>.

As already stated, the 2010 decision was focussed on removing the cross-subsidisation of NDM customers by DM/LDM customers, and to address certain retail market issues. There is no analysis in the current consultation paper that removal of secondary capacity transfers is an appropriate, effective, necessary or proportionate response to a decline in capacity bookings. The issue CER are looking to address in this consultation is fundamentally different from that decided in 2010.

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<sup>18</sup> CER/13/122 at 19

<sup>19</sup> CER/13/122 at 20

<sup>20</sup> CER/13/122 at 21

<sup>21</sup> CER/13/122 at 21

## **Proposal 2: Removal of the Ability to Buy/Transfer Capacity Within Day at Exit**

Proposal 2 represents a new proposal put forward by CER and has no direct link to the secondary capacity issues considered in CER/10/089. As a corollary of the efficiency finding in respect of secondary capacity transfers between power stations, it would seem reasonable to conclude that within day capacity bookings are also efficient.

Notwithstanding this point, there is no assessment of the efficiency, or any other aspect, of the proposal contained in the paper and we are thus restricted to commenting on a series of statements and questionable arguments put forward in the paper. As a number of these points are addressed elsewhere in the submission, this section merely summarises them.

- **Flexibility**

Within day flexibility was introduced, as is noted in the consultation paper, in response to shipper requests. First in 2008 following Code Mod(A)027, and again to accommodate additional flexibility in 2010 Code Mod (A)042. Shippers, particularly power generation shippers, demand for flexibility in the gas system, for reasons largely outside of their control, is increasingly needed to ensure their ability to support wider energy policy objectives.

The consultation paper states; “[T]he flexibility of within day purchases was considered useful in the light of the expected movement of CCGTs to mid merit as wind penetration increased”<sup>22</sup>. If this was important in the past, it is even more important for the future. Instead of acknowledging this fundamental change in demand for gas, the CER are proposing to remove the products and thus remove a significant area of demand growth for gas. The implications of this are likely to be inefficiency, increased costs for power generation in return for a reduced service and increased costs overall. Such a fundamental about-turn by the CER is premised on an outdated belief that the gas system can only be properly and fairly remunerated through annual products.

Where mention has been made to symptom/cause type effects, it is plausible to argue that the availability of within day capacity and secondary market transfers are merely a symptom of the changing demand for gas and the cause of the current shortfall issue is the CER and BGN’s insistence on ignoring this long term trend and mandating that BGN revenue be recovered predominantly through annual products.

- **Removal of a disproportionate amount of flexibility**

The CER’s claim that the current proposal avoids removing a disproportionate amount of flexibility from the system is considered to be either disingenuous, or it highlights a fundamental misunderstanding or lack of understanding of the SEM and the role of central dispatch in that market. The potential consequences of this proposal are far-reaching, deleterious and short-sighted.

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<sup>22</sup> CER/13/122 at 22

- **The gas system and power stations**

Elsewhere in this paper we have already addressed the erroneous argument advanced in the consultation paper that in some way gas fired power stations are different from coal and oil fired units, with respect to the costs of their construction (connection). The Connections Policy undermines the argument advanced by CER.

On the long term issues identified in the paper, these fail to acknowledge the inefficient exit signals these proposals are likely to introduce for power generation customers and the long term impacts of this consequence on both remaining gas customers (tariffs, investment, security of supply) and electricity customers (security of supply). In light of the importance placed on security of supply within CER's statutory obligations under the 1999 Act, it is expected that all proposals from the CER would give full consideration to these statutory objectives before coming to a decision. The arguments advanced in the paper are too simplistic and limited to constitute being well reasoned and likely outcomes.

### **4.3 Summary of the Proposals**

In summarising the proposals and Energia's submissions in respect of them, it is useful to consider the intention of the CER with respect to both proposals and contrast these with the conclusions reached by Oxera in their review of the paper.

- **CER's intended outcome from Proposal 1:**

*"[i]f secondary capacity transfers at the exit were removed, primary capacity bookings could be expected to increase. This in turn would help to lower the unit tariff for gas transportation from what it would otherwise be. It would go some way to address the equity issue as described in section 2."*<sup>23</sup>

- **CER's intended outcome from Proposal 2:**

*"The objective of removing 'within day' products at the exit is to increase primary bookings at the exit. It is undeniable that the removal of these within day products would reduce flexibility with respect to capacity at the exit, but it may be that the cost of this current flexibility is tariffs that are higher than they would otherwise would be."*

<sup>24</sup>

- **Oxera's conclusions on the proposals in CER/13/122**

In the absence of empirical analysis, the effects of the removal of secondary capacity transfers and within-day volumes on each customer category and sector cannot be quantified. Hence, the equitability cannot be assessed. For the same reason, it is unclear what extent of volume increases of primary bookings can be expected from these measures. Furthermore, the CER has not provided any analysis on potential adverse effects of each of the proposed measures, or any joint effects of their simultaneous implementation, on the different customer categories or downstream markets.

<sup>23</sup> CER/13/122 at 16

<sup>24</sup> CER/13/122 at 22

The CER intends to implement a remedy to a regulatory issue that it does not consider to be a short-term phenomenon. Absent any quantitative analysis and empirical evidence on the effects of these measures, there is neither certainty nor likelihood that these measures will provide a sustainable remedy.

Finally, any implementation of measures that would only partially remove booking-related revenue shortfalls would require additional measures at a later stage, or possibly a more structural reform of the economic regulation of the gas transmission system altogether.

It is clear from this brief comparison that despite the intentions of the CER, it is not possible to examine or comment in a meaningful way on the proposals or the extent to which they can or would address the issue they are intended to address. One important conclusion to note is that absent such certainty, additional measures may be required, including *“possibly a more structural reform of the economic regulation of the gas transmission system altogether”*. In light of the systemic nature of the issues facing both the gas and electricity industries and the interdependencies between the two, it is important that a fundamental review is undertaken before the market is exposed to unquantifiable regulatory risk, and that decisions taken by the CER are evidence based and follow good regulatory practice.

#### **4.4 Other Proposals**

The CER have put forward three additional (alternative) proposals in the current consultation paper. These are not considered in any detail for the purpose of this response as they would appear to be unworkable (mandatory bookings); inconsistent with the objective of the paper and contrary to general gas market policy (Removal of Mandatory Bookings for NDM), and; legally questionable (Long Term Booking Incentives). We do however note that the Long Term Booking Incentive approach is a tariff based approach involving no regulatory restrictions on the products currently available in the market.

#### **4.5 Conclusion**

In respect of any regulatory proposals to change to the market, it is essential that good process is followed. Recommending the implementation of a specific proposal in the absence of comprehensive analysis and supporting evidence is folly and, is detrimental to the regulatory process and to all regulated entities. In this instance it is incumbent upon CER to first analyse the cause of the issue they are looking to address and the impact this issue is having on all customers in the market. Only after this stage can recommendations for change be developed, the full impact of which should also be subject to a full Regulatory Impact Assessment (RIA), or at the very least a comprehensive quantitative assessment to determine the most suitable proposal for change, including the option of no change.

## 5. The Proposals – Legal Review

The CER have sought to justify the proposals in the consultation paper on the economic grounds of efficiency, equity, and market development. While we query these justifications, ultimately these considerations are only relevant within the range of lawful decisions that the CER may make pursuant to domestic and European requirements. Energia have engaged Arthur Cox to undertake a review of the consultation paper and advise on whether the proposals are compatible with European law. For the reasons set out below, Arthur Cox have advised that they are of the view that the consultation paper does not consider all relevant obligations under European Law and, having regard to such other obligations, the better view is that the proposals may not be lawfully implemented.

First, with regard to relevant domestic legislation, the Electricity Regulation Act 1999 (as amended) (the 1999 Act), as produced in the consultation paper requires that CER have regard to eliminating restrictions on trade when carrying out its duties. It is difficult to align this objective with proposals that are explicitly designed to restrict trading such that trade that is currently possible is to be prohibited by a direct act of the CER. While it is considered to be at least strongly arguable that this obligation would preclude CER from implementing either proposal, it should be at least be demonstrated by the CER how they had regard to this objective but further determined that it was appropriate to disregard it. No justification is contained in the consultation paper as to why CER believe that the relevant section of s.9(5) of the 1999 Act does not apply, or why, having considered it, it held in this instance that it ought not to apply. Therefore with regard to domestic law there is a regarded to at least a procedural deficiency with the CER's approach, but it is also strongly arguable that requirement in the 1999 Act prevents the introduction of these proposals to restrict trade by regulating to prohibit trade that is presently feasible and permissible.

With regard to European Union law, specifically Regulation No. 715/2009 EC that is referenced in the paper, the CER offer a number of definitive statements;

1. *“European legislation imposes requirements to facilitate trading of capacity at interconnection points...[T]ransfer of capacity at exit is not covered under this legislation.”*<sup>25</sup>
2. *“Article 16 deals with cross borders trades. Article 16 does not, therefore, apply to this CER proposal to remove secondary capacity transfers at the exit.”*<sup>26</sup>
3. The CER considers that the proposal to remove the ability to buy/transfer capacity “within day” at the exit does not contravene this” (i.e. the requirement in Annex 1 of the Regulation on TSOs to offer firm and interruptible services down to a minimum period of one day).

While this relatively brief but decisive discussion in the consultation paper may be presented as a definitive view of the Regulation, the legal review undertaken by Arthur Cox identifies a number of reservations with respect to both the limited

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<sup>25</sup> CER/13/122 at 13

<sup>26</sup> CER/13/122 at 14

number of Articles from the Directive and Regulation that have been considered in relation to the proposals, and the conclusions reached by CER in respect of them. These reservations are presented separately herein.

### **5.1 Minimum requirements for flexibility and liquidity in Articles 16.3(b) & 22**

While it is clear that the Directive and Regulation establish minimum standards which must be complied with by all Member States in relation to liquidity and flexibility in capacity markets, it would seem equally clear that the obligations of Member States are not limited to compliance with such minimum standards. Arguments to the contrary misunderstand the requirements of both the Directive and Regulation. Consideration of a number of other legally binding obligations on Member States contained in the Regulation such as an obligation to achieve “*maximum use of technical capacity*”<sup>27</sup> and to increase liquidity<sup>28</sup> by facilitating “*trading of primary capacity*”<sup>29</sup>, would appear to seriously undermine the implicit conclusion in the consultation paper that the minimum requirements in the Regulation represent the extent of the obligations to which the Member State is subject. It is our view that these obligations are not limited by the minimum requirements quoted by the CER in the Consultation Paper. Rather, these are independently obligations which are binding upon the Member State in their own right.

Based on the advice that we have received, we believe that even if the proposals in the Consultation Paper were consistent with the minimum requirements specified in the Directive and Regulation (which they are not determined to be), the implementation of the proposals would put the CER in breach of its other obligations in the Directive and Regulation to maximise liquidity and use of technical capacity. Importantly, any such breach would be brought about as a result of a Member States failure to maximise liquidity and flexibility by taking deliberate steps to reduce that which is already available in the market, and not a failure to satisfy the minimum standards for liquidity and flexibility. In light of the foregoing, it is the considered view of Arthur Cox that, “the better interpretation of the Directive and Regulation is that the proposals in the Consultation Paper are not permissible as a matter of law.”

### **5.2 Secondary Gas Transfers between Exit Points**

Following a review of Article 16.3 of the Regulation and the conclusion reached by CER that this Regulation is limited in scope to cross border trade, it is the view of our external legal advice that such an interpretation is incorrect for the following reasons;

1. There is nothing in the title of Article 16 or anywhere else in Article 16 which can be relied upon to support the CER’s assertion;
2. The fact that the congestion management procedures must facilitate cross-border exchanges in natural gas is an entirely separate obligation to the obligation to allow network users to re-sell capacity on the secondary market; and

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<sup>27</sup> See for example Article 2.5, Article 16.2 and Paragraph 2.1(4) of Annex 1 of the Regulation

<sup>28</sup> See for example Recital (36) of the Directive and Recital (29) of the Regulation

<sup>29</sup> See for example Recital (29) of the Regulation.

3. There is nothing in Article 16 which suggests that the obligation to allow network users to re-sell capacity on the secondary market is limited to cross border capacity.

The consequence of rejecting the CER's stated but largely unsubstantiated approach in favour of the plain words of the Regulation is to conclude that the abolition of the ability to re-sell or sublet unused contracted exit capacity on the secondary market breaches Article 16. This view is considered to be consistent with a range of other provisions of the Directive and Regulation which require increased liquidity in natural gas market and secondary trading of capacity without limitation. These include;

*"The internal market in natural gas suffers from a lack of liquidity and transparency hindering the efficient allocation of resources, risk hedging and new entry. Trust in the market, its liquidity and the number of market participants needs to increase....."*<sup>30</sup>

*"There is substantial contractual congestion in the gas networks. The congestion-management and capacity-allocation principles for new or newly negotiated contracts are therefore based on the freeing-up of unused capacity by enabling network users to sublet or resell their contracted capacities and the obligation of transmission system operators to offer unused capacity to the market, at least on a day-ahead and interruptible basis. Given the large proportion of existing contracts and the need to create a true level playing field between users of new and existing capacity, those principles should be applied to all contracted capacity, including existing contracts."*<sup>31</sup>

*"The trading of primary capacity rights is an important part of developing a competitive market and creating liquidity. This Regulation should therefore lay down basic rules relating to such trading."*<sup>32</sup>

*"Each transmission, storage and LNG system operator shall take reasonable steps to allow capacity rights to be freely tradable and to facilitate such trade in a transparent and non-discriminatory manner. Every such operator shall develop harmonised transport, LNG facility and storage contracts and procedures on the primary market to facilitate secondary trade of capacity and shall recognise the transfer of primary capacity rights where notified by system users."*<sup>33</sup>

*"Harmonised transport contracts and common network codes shall be designed in a manner that facilitates trading and re-utilisation of capacity contracted by network users without hampering capacity release."*<sup>34</sup>

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<sup>30</sup> Recital (36) of the Directive.

<sup>31</sup> Recital (21) of the Regulation.

<sup>32</sup> Recital (29) of the Regulation.

<sup>33</sup> Article 22 of the Regulation. Note that the CER quote this Article in the Consultation Paper but it is not at all clear why it is believed that this does not require secondary trading of exit capacity. The proposals clearly result in a decrease in the extent to which capacity is tradable, and is therefore it cannot be said that by reducing the ability to trade capacity that reasonable steps are being taken to allow capacity rights to be freely tradable.

<sup>34</sup> Paragraph 1(2) of Annex 1 of the Regulation.

*“Capacity-allocation mechanisms and congestion-management procedures shall facilitate the development of competition and liquid trading of capacity and shall be compatible with market mechanisms including spot markets and trading hubs. They shall be flexible and capable of adapting to evolving market circumstances.”<sup>35</sup>*

This view of the correct legal requirements around secondary capacity is also consistent with other provisions of the Regulation, such as those in relation to tariffs which require that liquidity is not restricted. For example Article 13.2 of the Regulation provides, amongst other things that “[T]ariffs for network access shall neither restrict market liquidity nor distort trade across borders of different transmission systems”.

Notwithstanding the foregoing interpretation of Article 16.3(b), the fact that congestion-management procedures must facilitate cross-border exchanges in natural gas means that it is not sufficient that secondary-trading is only permitted at cross border entry points. The reasons for this is that if a person cannot acquire capacity at exit, then the congestion-management procures may prevent rather than facilitate cross-border exchanges in natural gas.

### **5.3 Availability of Within Day Products**

For many of the reasons already stated with regard to minimum requirements and the existence of parallel legal obligation on Member States with regard to liquidity and maximum use of technical capacity, it is the view of Arthur Cox that it is strongly arguable that the proposal to remove within day products is contrary to the obligations in the Regulation to make maximum use of technical capacity. This obligation is independent of the minimum requirements and binding on Member States.

### **5.4 Other legal issues**

While the assessment presented so far has focussed on the specific legal provisions referenced in the consultation paper, the review of the paper undertaken by Arthur Cox has given rise to further points capable of giving rise to legal problems, arising in relation to both proposals. These points can be summarised as;

1. On the point of equity raised by CER, if the power sector requires less capacity, they should be booking less capacity, otherwise the risk of contractual congestion is increased. If the power sector is booking different types of capacity, it is not only open to the CER to tariff such capacity bookings differently to ensure that the burden is spread in an equitable and non-discriminatory way which avoids cross-subsidies, but it is required to do so by Article 13 of the Regulation.
2. It would appear to be economically inefficient to require shippers to book capacity which they know they will not use and then prohibit them from transferring to someone who is able to use it.

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<sup>35</sup> Paragraph 2.1(1) of Annex 1: of the Regulation.

3. The general approach in the paper would appear to be inconsistent with the general direction of travel elsewhere in Europe and previously embraced by CER to ensure increased flexibility in the gas market was provided. This is separate from the potential legal implications of the permissibility of the retrograde steps proposed.
4. The proposals are also inconsistent with the High Level Principles for CAG to which we assume both regulators and Government Departments remain committed to. This would suggest that the implementation of these proposals would require a change to the High Level Principles for the design of CAG which would presumably bring it within the remit of both CER and UR, as well as the Joint Steering Group containing both DCENR and DETINI.

### **5.5 Summary of the legal review**

Drawing together the key messages from the legal review of this consultation paper allows one to put forward the following conclusions on what is understood to be the correct legal interpretation of the relevant domestic and European legislation, as they relate to the proposals. Importantly this review differs in both its scope and its conclusions from that undertaken by CER for reasons primarily related to the unnecessarily restricted list of Articles considered by CER and an interpretation of these articles that would appear to be inconsistent with the wording of the relevant Articles. It is understood that the CER have, both through the consultation paper and in the proposals, significantly departed from a correct legal interpretation of the following;

1. The minimum requirements contained in the Directive and Regulation with respect to flexibility and liquidity are not the sole standards by which compliance is to be assessed and/or achieved.
2. Additional independent obligations exist that are binding on Member States, including the obligations to achieve maximum use of technical capacity and to increase liquidity by facilitating trading of primary capacity. This implies that any steps to implement retrograde changes to flexibility or liquidity, that otherwise remain technically feasible, would not be consistent with the obligations under the Directive and Regulation.
3. There is nothing in the title of Article 16 or anywhere else in Article 16 which can be relied on to support the assertion that it is only applicable to cross-border trade. The facilitation of cross-border trade is a separate and distinct requirement from the requirement to permit within day trading of capacity.
4. In respect of domestic legislation (1999 Act), it is at the very least unclear how the proposals to restrict flexibility and trade, are consistent with the obligation on CER to have regard to the need to eliminate restrictions on trade.

To the extent that the Directive and Regulation are breached, Ireland may be subject to enforcement proceedings and it would appear to be contrary to the significant efforts of the CER to ensure compliance with the relevant provisions of both the

Electricity and Gas Third Package. It is equally important for the CER to fully consider proposals for retrograde changes from a situation of compliance, as it is for them to consider means by which the markets can comply with the provisions in the first place. The latter would appear to be the only one of these receiving the due attention.

Finally, it is important to note that while there is ongoing litigation between Shannon LNG and CER in respect of a proposed new tariff regime for gas transmission in Ireland, it is not our belief that these proceedings bear materially on the present consultation. Clearly the outcome of the proceedings will be important for CER and market participants in their understanding of tariffing requirements in the gas market. However, based on our understanding of those proceedings, the central legal arguments advanced in respect of within day products and trading in this response are not the issues subject to the ongoing litigation. Furthermore, to the extent that cross-subsidisation may be an issue in both, this is not a point of contention as the Regulation clearly requires CER to avoid any such subsidisation once it has been identified. Conversely, if it is CER's view that the decision in the ongoing litigation with Shannon LNG is material to the issues in this consultation, it would appear to be ill-advised for them to make any proposals for change while the proceedings are extant.

## **6. Better Regulation**

In January 2004 the Government of the day publish a White Paper entitled *Regulating Better* which set down six principles of Better Regulation. The principles were designed to ensure a more rigorous assessment of new regulations was to take place to contribute to improving national competitiveness. Since this time a number of reviews of regulation and specifically economic regulation have been commissioned by the Government<sup>36</sup> and current the Government, through a number of commitments in their Programme for Government (PfG), have recently reiterated their intention to retain the six principles of Better Regulation as part of a refocussing on the role of economic regulation in economic recovery and job creation<sup>37</sup>.

The role of economic regulation in the economy has recently been correctly characterised as;

- Safeguarding the interests of customers to ensure fair, reliable and sustainable services are delivered.
- An important enabler of necessary infrastructure investment.
- Balancing the challenge of efficient delivery of infrastructure investment which is vital to the long term interests of customers who ultimately pay the costs, and other important and competing national policy objectives.

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<sup>36</sup> These include; Economist Intelligence Unit (2009); Government Statement on Economic Regulation (2009); Forfás (2012).

<sup>37</sup> Department of An Taoiseach (2013) Government Policy Statement on Economic Regulation, Consultation Paper.

- Ensuring that end users (business and residential) have access to quality services at the least cost, both now and in the future.<sup>38</sup>

Although general principles, these bear a remarkable resemblance to the issues CER are seeking to address in the current consultation. Furthermore, as the current consultation is addressing a systemic issue of long term importance to the sector, it is of added importance that the CER adopt the correct process for analysis of any new regulation, this is obviously provided by Better Regulation. It is important to note that properly considered, regulatory certainty does not imply a failure or reluctance of the regulator to affect change but rather adherence to a proper regulatory process wherein that process and the decision making is well reasoned and predictable. Issues of regulatory certainty, stability and predictability properly refer to the regulatory process as opposed to regulatory outcomes, as adherence to the former will deliver the latter. Prioritisation of stable, unchanging outcomes over process will conversely lead to a perceived increase in regulatory risk and is likely to give rise to additional costs for market participants and ultimately final consumers.

Therefore, a good process around a consultation of such systemic importance and magnitude as the one being considered should be a paramount consideration and as a minimum the 6 Principles of Better Regulation should be used to guide the CER to achieve the intended effects of good economic regulation. It is briefly worth considering the extent to which the current consultation adheres to these principles and to use this to reflect on the overall process and its implications for regulatory risk.

### **6.1 6 Principles of Better Regulation**

The six core principles considered in the recent Department of An Taoiseach consultation paper to underpin good regulation are: necessity; effectiveness; proportionality; transparency; accountability and consistency. Each of these core principles are considered in turn and how they apply to the current consultation.

- **Necessity**

While it is generally accepted that some change is required to ensure the continued and sustainable remuneration of the network, the question as to whether the specific proposals forwarded are necessary is not addressed. The question cannot therefore be answered.

Should this question be addressed in a future consultation, it will be important to consider whether the current approach to network remuneration remains valid and whether in this context, proposals based on a potentially out of date approach are a valid approach to take. This would appear to be of fundamental importance to the long term sustainability of what is trying to be achieved.

- **Effectiveness**

While there is no question that the proposals are targeted, it remains an open question from the consultation whether the proposals are properly targeted and whether through their introduction they can be effective at bringing about the

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<sup>38</sup> Department of An Taoiseach (2013) Government Policy Statement on Economic Regulation, Consultation Paper at 3.

objectives to be achieved. In the event that the proposals are poorly targeted, this is likely to impinge on their effectiveness and in the context of this consultation exacerbate a number of the issues identified by CER.

As there is no analysis to accompany the consultation paper it is not possible to conclude on the effectiveness of the proposals, nevertheless one should be aware of the potential for demand destruction arising from the proposals and the more dangerous this is for remaining gas customers where the proposals are poorly targeted.

- **Proportionality**

In the absence of any analysis it cannot be determined whether the proposals in the paper are proportionate. The proposals are targeted to give rise to a historic booking profile in power generation based on a inflexible approach to revenue recovery through annual products, despite the significant decline in demand for annual products. In respect of whether there is a smarter way to achieve the same outcome, this would require analysis of which there is none contained in the paper or advanced as a basis for supporting any of the proposals.

- **Transparency**

Once again the absence of any analysis or back-up explanatory material for the proposals forwarded makes it impossible to conclude on the issue of transparency. Despite the consultation process inviting stakeholder comments, the proposals appear to be based on mere conjecture and are therefore not transparently arrived at or justified.

- **Accountability**

It is again not possible to determine with any certainty who is accountable for the proposals as Proposal 1 appears to have been taken from BGN submissions, while Proposal 2 appears to have come from CER. Notwithstanding this, the absence of any analysis of the proposals mean that while CER may be accountable for the proposals forwarded in the paper, it is unclear why they have been put forward in the absence of any analysis of arguments received from BGN. There is no effective appeals process.

- **Consistency**

While there are numerous references to CER/10/089 in the current consultation paper, no attempt has been made to address the inconsistencies already highlighted herein between the evidence based conclusions drawn in that paper and the contradictory positions the CER is now attempting to adopt.

Furthermore, the proposals would appear to be inconsistent with wider energy policy in Ireland and across Europe. At a time when increased flexibility in electricity and gas is demanded to support the achievement of Ireland's renewable energy target, the CER's proposals are to restrict flexibility in the gas market thus potentially destroying a feasible revenue base for the gas networks and putting the security and sustainability of both electricity and gas markets at unnecessary risk.

## 7. Conclusions & Proposed Next Steps

This consultation paper seeks to address a matter of utmost importance, possible shortcomings in the financing of the gas transmission system. A failure to address this issue could have serious implications for the gas system and consequently for the wider energy market. While it is undeniable that the paper raises some important questions that must be addressed, it gives rise to further complex issues that require comprehensive analysis if the wider objectives of this paper are to be achieved. The implication of this for the consultation paper is that it wrongly identifies a long term and substantial change in the profile of gas demand in Ireland, as a problem. This approach wrongly characterises the “issue(s)” to be addressed and fundamentally undermines the prospect of a sustainable solution capable of fostering and benefiting from future gas demand growth.

The approach adopted by CER in the current consultation paper is inadequate and represents an unwelcome precedent for drastic change that is unsupported by evidence. In fact the CER propose, on the basis of speculative arguments, to contradict their own stated, evidence based views with respect to secondary capacity transfers from a 2010 decision paper on that issue. In the view of Oxera, the absence of any quantitative analysis by the CER means that, “*there is neither certainty nor likelihood that these measures will provide a sustainable remedy*”. The arguments that are forwarded in the consultation paper in support of the proposals therefore amount to mere conjecture.

Notwithstanding the absence of a robust, evidence based economic justification for the proposals, it is the considered view of Arthur Cox that, “*the better interpretation of the Directive and Regulation is that the proposals in the Consultation Paper are not permissible as a matter of law*”. Furthermore, as we understand the ongoing litigation between Shannon LNG and the CER, this is concerned with important issues that are outside of the scope of this consultation.

In summary, it is Energia’s submission that certain issues identified with respect to the financing of the gas transmission system require further assessment. The current consultation paper does not do this and instead seeks to apply a quick fix of unquantified benefit or harm in a manner that is legally unsound and contrary to good regulatory practice. Energia requests that having initiated an important discussion on these issues, this consultation paper is set-aside and immediately replaced by an appropriately resourced workstream to undertake the necessary analysis on both the issue and potential remedies, in conjunction with the relevant stakeholders.

### 7.1 Proposed Next Steps

In light of the foregoing Energia is calling for the CER to publish its decision paper on 2013/14 Transmission tariffs in the coming weeks by taking account of the decision in CER/10/089 as the only change to be implemented in the exit regime. Appropriate changes in respect of the cost of capital (WACC) and the entry system should still be considered, and supported by robust evidence where applied.

Furthermore, we urge the CER to immediately convene an appropriately resourced workstream to undertake the necessary analysis on both the issue(s) and potential

remedies, in conjunction with the relevant stakeholders. The outputs of this workstream should be capable of implementation in October 2014. To ensure a degree of tariff stability for all customers over this period, the CER could also consider a reprofiling of required revenues at exit for the gas year 2013/14, to mitigate the effects on customers of potentially inequitable tariff increases, until such time as these issues can be properly determined.

Finally, it is Energia's view that a decision by the CER to implement any of the proposals contained in the current consultation paper would seriously undermine the regulatory regime and be open to challenge on a number of grounds.

# APPENDIX

## **A.1 Summary of Oxera Report**