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CER/13/122

Access Tariffs and Financing the Gas Transmission System

15th July 2013

I am responding on behalf of SSE to the CER's consultation paper on Access Tariffs and Financing the Gas Transmission System. As Airtricity, SSE supplies each of the market segments that will be affected by this change, and as SSE, we will be purchasing gas products to meet the requirements of a new CCGT from 2014 onwards.

Executive Summary

The stated aim of this consultation is addressing the situation that led to a significant under-recovery in Bord Gais Networks (BGN) 2012/13 allowed revenues, primarily due to a significant decrease in primary firm bookings made by the Power and Daily Metered sectors. The CER seeks to avoid a repeat of the significant (mid-year) increases in transmission tariffs, introduced in Decision Paper CER/13/080.

We would note that significant changes are already taking place with a modification to the Gaslink Code of Operations on Secondary Capacity Transfers introduced from October 2013, reflecting CER/10/089. **In combination with the code modification introduced, the second option proposed in the paper would represent a radical restriction in market flexibility.** A single, standard product would be the only viable option for a majority of customers.

Any customers with significant variations in usage would be required to book products far in advance of knowing what that usage is likely to be. Flexibility should, and could, be paid for by those who require it. **However, an operationally flexible system with an inflexible tariff structure will mean only those customers whose requirements match the single preferred product offered (annual firm capacity bookings) will be properly served.**

Imposing a booking regime that reflects the historic rather than actual usage of the gas transmission system on all of its customers applies a temporary fix to a deeper structural issue. This may disguise the symptoms for a year or two, but will actually exacerbate the underlying revenue recovery issues BGN faces. **A broad customer base¹ will become a**

¹ This demand destruction could be a result of fuel switching, mothballing or permanent closure of facilities.

narrow customer base, as customers who require any form of flexibility are forced to consider their commercial position in Ireland.

Demand destruction has not been assumed in any of the modelling provided by the Commission at the workshops that have taken place. **Customers are also assumed to have perfect foresight with regard to their purchasing strategy.** As a customers demand for flexibility increases, these assumptions become increasingly unrealistic. For power generation in particular, the error is compounded as assumed load factors drop over time, with an increasing penetration of renewables.

The CER needs additional time to comprehensively consider the structural changes required to exit tariffs and products, having full regard to the interactions between the natural gas market, and other sectors of the economy. The paper includes no substantive analysis of the changes to the electricity and I&C sectors that have led to these issues. We are also particularly surprised that the consultation paper makes no reference to the SEM Committee's guidance to market participants on the inclusion of Gas Transportation Capacity Costs in bids.

We believe that a number of the issues that resulted in the requirement to revisit access tariffs could have been realistically foreseen, and that the submissions by Bord Gais Networks (BGN) toward the beginning of the new price control period should have prompted a CER project that looked at the financing of the gas transmission network holistically.

SSE urges the CER to withdraw the two proposals outlined in the consultation paper, and in coordination with BGN begin a project to look at how the PC3 revenue requirement can be recovered from a customer base with increasingly broad requirements for flexibility. Structural tariff changes, underlined by detailed research and analysis, adequately signalled and consulted upon could resolve the issues without significant damage to the customer base of the gas transmission system.

The current consultation paper does not make those proposals, or follow that process. The customers of the gas transmission system could and should be better served.

Our detailed response set out below looks at causes, symptoms and potential solutions to the issue outlined in the consultation paper. If you have any queries regarding SSE's response, please do not hesitate to contact me directly on +4428 9043 6864.

Changing usage of the gas transmission system

NDM

Actual NDM customer usage patterns have not dramatically changed over the period in question. Actual 1 in 50 day peak requirements on a seasonally adjusted per customer have been partially dampened by energy efficiency improvements to Ireland's housing stock, but despite the focus on 'equity' in the paper, there is no analysis looking at whether annual usage has changed relative to peak use.

As the shipper is required to book sufficient capacity to meet the 1 in 50 peak day demand, booking behaviour is fixed, and predictable.

DM and LDM

The paper acknowledges DM and LDM profiles can vary significantly, and that the facility to transfer transmission exit capacity was originally implemented to facilitate demand from customers with non-typical loads.

"The facility to transfer transmission exit capacity was implemented in 1998 as part of the first transmission code of operations and there have been significant changes in the sector since then. [.....] Some of the customers had loads that peaked outside of the winter such as the sugar processing plants and the facility to transfer exit capacity was considered appropriate for those customers' specific needs"

The demands of those specific customers have not shifted substantively towards a regular profile. If anything, usage has actually fragmented further, with LDM and DM customers seeing increased variation in the usage of their production capacity, coupled with increasing response to price signals.

Power Generation

The power generation sector has seen the most dramatic shift in usage. The relative position of gas-fired generators in the merit order has shifted, with baseload plant moving to mid-merit and some mid-merit plant shifting to a peaking position. The load factors of gas-fired generators have dropped substantially, as has the predictability of dispatch.

This process has been accelerated by current global and local market conditions, with cheap coal imports, low CO² prices, increasing levels of renewable penetration and the East West Interconnector leading to the displacement of gas-fired capacity. While some of the global conditions may be temporary, the local conditions are not. Load factors for CCGT plant will not return to the levels referenced by the CER in the workshops held on this consultation.

The paper partially references CER/10/089, which made reference to the shift in operating hours that was being seen at the time, and comments on the efficiency of exit capacity transfers:

*"It is recognised that generating stations may be increasingly called upon to ramp up and down on account of the large amount of electricity made available from wind generation over the coming years. **The transfer of exit capacity between gas-fired generating stations,***

where one plant in effect ‘replaces’ another plant that has come off load and makes use of the available capacity, could be regarded as an efficient process of allocation. It is also noted that, as increasing amounts of wind generation comes on to the electricity system, gas-fired plants are likely to be able to offer greater amounts of spare exit capacity.”

Best regulatory practice, signalling and forecasting

Timelines and signalling

The consultation paper implies that it represents the beginning of a process to address structural issues on the demand side.

“This paper commences a consultation process which addresses potential structural changes on the demand side.”

However, the consultation also implies that any conclusions from this consultation paper would be in place for the October 2013 gas tariff year. Substantial market changes are being proposed, with a 6 week period of consultation for market participants. The normal Code Modification process would be circumvented through the Gas (Interim) Regulation Act 2002:

“Should the CER conclude from this consultation exercise that secondary capacity transfers at the exit should no longer be permitted, it would issue a direction to Gaslink pursuant Section 14 of the Gas (Interim) Regulation Act 2002. The Gas Code of Operations would have to be amended to reflect such a direction.”

This means that the consultation paper is in effect a proposed decision paper, albeit one without any substantive analysis outside of a brief examination of actual and expected 1-in-50 year peak demand across different customer segments. The impact on customers with variable loads, or impact on overall demand has not been considered.

Transfers and Trading

The paper distinguishes between shippers transferring primary exit capacity from one geographic location to another geographic location, and capacity trading where shippers trade capacity at a single geographic location.

The paper does not provide any detail on how any changes could be implemented through the Code of Operations, and how the ability to ‘trade’ would be preserved, and distinguished from the ability to ‘transfer’ capacity. We would note that Ireland maintains a single price zone, rather than applying zonal pricing.

Forecasting

Not even six months into the first period of PC3, CER was proposing to review BGN’s allowed revenues and the gas transmission tariffs in CER/13/034. The current consultation paper describes a recent unprecedented drop off in primary capacity bookings, leading to the symptoms described in the paper.

“BGN forecasted a significant drop in exit capacity bookings in 2012/2013, falling by 18.5% on 2011/2012 levels at the Moffat Entry point. BGN noted that the decrease in bookings was directly related to the Power and Daily Metered (DM) sectors radically reducing their firm bookings”

However, the changes in the DM and LDM sector that have led to a change in primary capacity bookings have not been sudden. Their drivers were well known and communicated to the CER by market participants. The initial volume forecasts provided by BGN in April 2012 should have been treated as working estimates, particularly as the PC3 process extended beyond the start of the relevant period.

Despite the mid-year tariff review being finalised in February, the consultation paper still includes no updated medium to long term forecasts for primary capacity bookings under the different options proposed. The Commission stated in CER/13/080:

“The CER acknowledges there are issues regarding how the gas network is remunerated. The CER is committed to extensive consultation on tackling the structural issues in the gas market and will consult in the near future on such issues.”

This paper does not represent extensive consultation, nor does it attempt to tackle the structural issues in the gas market. SSE believes that the signalling, forecasting and overall process for this review could and should have been far better. Sudden changes, backed by little to no analysis, are bad for every customer of the gas transmission system.

Equity, efficiency and access tariffs

Energy markets are moving toward increasing levels of price response, which facilitates and rewards flexibility. In the long run, the energy systems designed around those markets will increasingly reflect the least cost capacity requirements of the customers they serve. **Sunk costs must be recovered by BGN, but the signals for efficient network planning should not be blunted entirely by imposing an arbitrary cost allocation on every customer of the gas transmission system, underpinned by assumptions that do not reflect the actual usage of the gas transmission system.**

The paper focuses on the concept of ‘equity’ at the demand side, without considering the what effect an unrealistic picture of actual 1-in-50 peak day usage has on long-term network development, and the makeup of Bord Gais Networks customer base.

Equity and efficiency across market segments

The Commission’s current view as outlined in CER/10/089 is that the transfer of secondary exit capacity is efficient.

“The transfer of exit capacity between gas-fired generating stations, where one plant in effect ‘replaces’ another plant that has come off load and makes use of the available capacity, could be regarded as an efficient process of allocation.”

This proposed decision paper suggests that the Commission has entirely reversed this view, and considers that efficient allocation of flexibility pushes the payment for infrastructure onto customers who are not offered any flexibility (**NDM customers**) or customers who are not in a position to avail of this degree of flexibility (**customers who don't require flexibility**).

“Continuing to ensure there is generally “surplus” capacity at the exit, while at the same time allowing surplus exit capacity to be transferred, reduces bookings on the exit and leads to higher tariffs and is (prima facie at least) economically inefficient.”

“It is important that those who benefit from having access to the network pay their fair share of the cost of the network. It could be argued that the current levels of flexibility push the payment for infrastructure on to those who are either not offered any flexibility or who are not in a position to avail of this degree of flexibility.”

We believe that the reasoning around ‘equity’ is flawed:

- NDM customers have already benefited from pipelines that have that have been fully paid for by power generation². SSE Generation Ireland has connected the Great Island power plant through a 44.5 km spur line from the Cork Dublin pipeline. This pipeline should make new connection projects in the Waterford and Wexford area viable, and give new customers an opportunity to connect to the network.
- Any Gas Units with over 10MW of generation capacity are required to be capable of running on a secondary fuel, and are also required to hold stocks of that secondary fuel equivalent to 3 to 5 days continuous running. The 1-in-50 peak day is less applicable to Power Generation³, or any DM/LDM customers with the capacity to fuel-switch.
- Customers who do not require any flexibility are already incentivised through the pricing structure for short term products and the penal overrun charges in place. With Code Modification 046 on ‘Secondary Capacity’ drafted and accepted, booking behaviour will adjust. The cost of variable usage will still be substantially higher than predictable usage on a per unit basis.

Secondary (interruptible) capacity is currently priced at a level that doesn't necessarily reflect the possibility of interruption, as a result of the mandated booking placed on the NDM sector. With Code Modification 046 on ‘Secondary Capacity Transfers’ the distortion created by mandated bookings for one market sector will be removed.

Therefore, we cannot see how ‘equity’ can be referenced as the key driver for an about-turn in the Commission's view on secondary capacity transfers without any analysis of booking behaviour post Code Modification 046, a detailed examination of the charging regime for short term products and an examination of the existing Connections Policy.

SSE would also suggest that reducing primary annual bookings at the exit is not the same as reducing overall bookings at the exit. There is demand for primary bookings of short-term

² Power generation pays for its deep connection costs upfront.

products that reflect actual customer demands but their usage would require an appropriate charging regime. This does not appear to have been considered in this consultation paper.

The draft ACER framework guidelines⁴ on harmonised transmission tariff structures provide some guidance on reserve prices for Quarterly, Monthly, Daily and Within-Day firm standard products:

*“The Network Code on Tariffs shall set out that the reserve prices for daily and within-day firm standard capacity products be on average over the gas year less than or equal to the price set proportionately to the yearly reference price. **The Network Code on Tariffs shall set out that, in determining the reserve prices for daily and within-day firm standard capacity products, NRAs may also apply multipliers and that these multipliers may be higher than one, but not higher than 1.5 on average over the gas year at the respective entry or exit point in the absence of congestion.**”*

Without substantial changes to the Draft Framework Guidelines, it is difficult to imagine how the Commission’s vision for tariffs will meet the framework guidelines, or be compliant with the finalised network code on harmonised transmission tariff structures. This will mean further, radical changes to gas transmission tariffs will be required in the short to medium term.

Equity market within segments

An issue that has been overlooked within the consultation paper is the effect of the proposals on ‘equity’ within the different market segments.

The paper appears to suggest that power generators (and by extension, LDM customers) should potentially be booking an arbitrary or mandated level of primary capacity, closer to the 1 in 50 day peak requirements of the site. This also means that

“Illustrating this point by an analogy; an oil fired power station needs an oil tank and must pay for it, whether or not it runs; a coal fired power station needs a coal bunker and must pay for it, whether or not it runs. It can be said that a gas fired power station needs gas capacity to be available whether or not it runs.”

SSE believes that this argument is flawed. A power station or LDM customer pays upfront for their connection costs (including any associated deep reinforcements required). While the gas-fired generator’s deep connection requires a functioning gas transmission system, the oil tank is useless without the transportation (capacity) arrangements that deliver oil. Likewise, the coal bunker is useless without the transportation (capacity) arrangements that deliver coal.

We would also note that the charges for transportation arrangements are similar to the charges for the gas transmission network in that they primarily remunerate sunk costs (oil

⁴ ACER (2013), Draft Framework Guidelines on rules regarding harmonised transmission tariff structures for gas, available at: http://www.acer.europa.eu/Gas/Framework%20guidelines_and_network%20codes/Documents/outcome%20of%20BoR27-5%201_FG-GasTariffs_for_publication_clean.pdf

tankers, bulk carriers, origination ports, rail infrastructure). However, they are (and are considered) variable, short run and recoverable from the market.

Should an LDM customer with an annual capacity utilisation of 50%, and a daily capacity utilisation that significantly varies from 100% to 0% be paying for either an annual or day ahead product, as proposed in the consultation paper? That LDM customer should be paying for their required flexibility, but the CER doesn't appear to have considered what an 'equitable' payment for that capacity would be.

The only modelling done by the CER assumes a perfectly efficient purchasing strategy for every customer, which is unrealistic. If customers have to predict their requirements significantly in advance of real time, the probability of penal overrun costs being incurred becomes greater the more volatile those requirements are.

Looking for solutions

A quick fix

The two proposals considered in the paper represent a quick fix, the removal of all secondary transfers at the exit⁵ and the removal of 'within day' products at the exit. The paper notes that:

"The recent unprecedented drop off in primary capacity bookings is, in the CER's view, unlikely to be a short term phenomenon."

The solutions proposed are short term, and appear to consider only one outcome as being desirable, an increase in firm annual primary capacity bookings:

"Primary capacity bookings are the core revenue base for financing Ireland's gas transmission system and will continue to be for the foreseeable future."

Whether the firm annual primary product still reflects the requirements of gas transmission network customers is not considered, nor is the impact on those customers with variable usage or the medium to long term effects on Bord Gais Networks customer base. The paper briefly looks at mandatory bookings (imposition and removal) and long term booking incentives, but contains no analysis of alternatives.

A comprehensive solution

What could a comprehensive solution look like? There are a number of options and issues to consider:

- The capacity/commodity weighting in tariffs. The 90:10 weighting applied in the Irish system is probably closer to reflecting the actual cost of the transmission network than the charging arrangements applied in other European countries, but whether this is desirable has not been considered.

⁵ Without knowing, or even attempting to model what booking behaviour will look like after Code Modification 046.

- Whether the products available and multipliers applied accurately fit the changing demands of DM and LDM customers, in particular the power generation customers who have been singled out in the consultation.
- The interactions between gas and electricity, and the guidance note provided by the SEM Committee on the treatment of gas transportation costs in bids.
- The reprofiling of BGN revenues. This was acknowledged within the interim revenue on allowed revenues and gas transmission tariffs, but this consultation paper limits itself to 'structural changes on the demand side'
- The Connections Policy and whether or not the assumptions for primary annual capacity being booked are accurate for future network development.

These issues have not been considered in the current consultation paper, and therefore, a comprehensive long-term solution will not be reached. In particular, any further consultation should consider the following two questions:

1. If revenues for the gas transmission network are to be primarily raised through a single product, the customers whose requirements most closely match that product will be better off, relative to their current position. **Is this considered an 'equitable' position?**
2. In the medium to long term, as commercial decisions are taken by customers of the gas transmission system, a broad customer base (with significant variations in usage) will become a narrow customer base. **Is this considered a sensible outcome?**

SSE believes that the answer to both of these questions is negative. The Commission should withdraw the two proposals outlined in the consultation paper, and look at the issue in full.

Realistically, the underlying structural issues will not be resolved for the October 2013 gas year. The tariff structure created by the introduction of either proposal will be for the interim, and would be unlikely to meet ACER's framework guidelines or ENTSOG's network code on harmonised transmission tariff structures.

Attempting to meet an artificial deadline imposed by the October 2013 gas year will inevitably create greater medium term volatility, long term demand destruction and substantial difficulties for shippers and end consumers.