

**TYNAGH ENERGY
L I M I T E D**

James McSherry
Commission for Energy Regulation
The Exchange
Belgard Square North
Tallaght
Dublin 24

REF: TEL/DV/13/129

15th July 2013

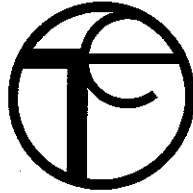
Re: Access Tariffs and Financing the Gas Transmission System

Dear Mr McSherry,

Tynagh Energy Limited (TEL) welcomes the opportunity to respond to the consultation paper on Access Tariffs and Financing the Gas Transmission System (CER/13/122) that was published on the 31st May 2013.

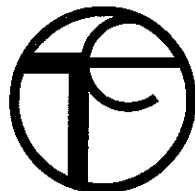
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1. Introduction

TEL acknowledges that the gas network needs to be paid for to ensure safe and secure supplies of gas. TEL acknowledges that annual capacity bookings are reducing. It is clear that, under the current methodology, continued reductions in capacity bookings will lead to increases in gas tariffs but TEL does not agree with either proposal put forward by the CER. These proposals seek to increase primary capacity booking by removing flexibility but fail to address the underlying issues which have impacted on the revenue base of the transmission system.

TEL believes that there is a more fundamental shift in the market and that reducing flexibility alone is not the answer. This fundamental shift is due to both greater existing and planned generation from wind and electricity interconnector imports, and the long term impact of these changes has not been analysed or quantified. In effect, the CER is asking the gas-fired power sector to underwrite the financial consequences of more renewable electricity on the system, which compete with gas.

TEL contends that circumscribing the European gas model is not a policy response that is legally available to the CER. Even if it were legally possible, as a policy response it is not appropriate. TEL believes that implementing either of these proposals without further analysis of their impact would be unwise. Neither proposal will restore the revenue base in the long term nor will they be equitable and may lead to unintended consequences that have not been identified.

TEL argues that the consultation is too narrow and a more intensive market engagement is required to ensure a sustainable long term solution to restore the transmission system revenue base. Factors such as increasing wind generation, and the associated impact on gas fired power plants running times, as well as the operation of the interconnector and the merit order of coal and peat fired power stations will continue to impact the capacity bookings of power generators.

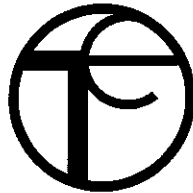
TEL believes that any further engagement should include a review of the suitability of products and their prices/profiles given a fundamentally changing market. In addition TEL believes that regulatory instructions to book minimum levels undermine a market driven by price signals and commercial need. This review of the gas market has to include the power markets due to the interdependency of both, ensuring that the energy consumer is not adversely affected by pricing products in the gas market that send the wrong investment or trading signals.

Reductions in primary capacity bookings are an inevitable consequence of the policy of increased renewable electricity generation. Gas generators should not be required to cross-subsidise renewable generators.

2. Detailed Comments on Issues Raised

The CER has raised five issues which TEL will address in turn. These are:

- a. Reduction in primary bookings
- b. Increased tariffs are of detriment to consumers
- c. Inequity of financial burden
- d. Economic inefficiency
- e. Flexibility pushes financial burden on those unable to avail of flexibility



2.1 Reduction in primary bookings

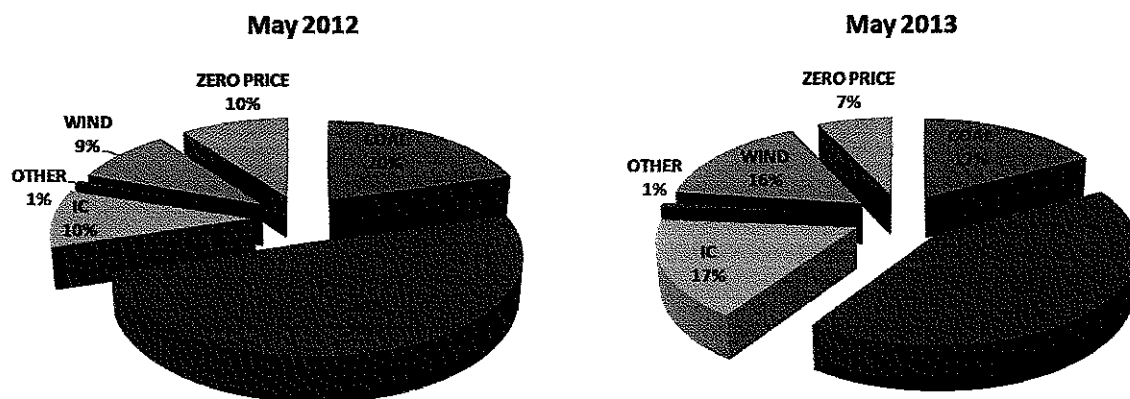
ROI annual gas demand contracted by 4.6% in 2010/11 compared to 2009/10 and peak day gas demand fell by 14.1% in 2011/12 compared to the peak of 2010/11¹. Power generation peak demand reduced by 10% from the peak in 2010/11. As annual capacity bookings are based on peak day gas usage any reduction of peak day demand will result in a reduction in annual capacity bookings.

This has largely been attributed to a fall in power sector gas demand as a consequence of higher wind powered generation and reduced electricity demands. The recession has been the main driver in this drop in electricity demand in recent years. A relatively slow recovery has been forecast² and demand is not expected to return to 2008 levels until 2018.

The proportion of this demand that will be served by gas fired generation will also decrease as gas generation is displaced by peat, coal, wind and electricity interconnector imports in the merit order. BGN has stated that electricity generated from gas decreased from 55% in 2011 to 51% in 2012³. The CER have stated that the fuel mix for 2012 was 47.7% gas⁴. This trend is set to continue.

The government has set ambitious renewable targets to source 40% of electricity demand from renewable sources by 2020. To achieve this, the System Non-Synchronous Penetration of renewable electricity on the system will increase to 75% of Irish demand plus electricity interconnector exports by 2020. The capacity of interconnection has also increased with the addition of the East West Interconnector which entered full commercial operation in May 2013. Structural problems with the Emission Trading Scheme have resulted in low carbon prices which significantly favour coal generation over gas.

As illustrated in the below chart, gas generation as a proportion of electricity generated has fallen further year on year from 50% in May 2012 to 42% in May 2013⁵.



TEL's load factor (excluding periods of major maintenance) has reduced from 35% in 2011 to 25% in 2012. Year to date TEL's load factor has reduced further to 19%. If this load factor were to continue for the remainder of the year TEL would run for only 70 days this year but TEL's peak day gas usage so far in 2013 has been 85% of the maximum capacity available at the exit point.

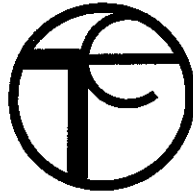
¹ Joint Gas Capacity Statement 2012

² All-Island Generation Capacity Statement 2013-2022

³ BGN Submission CER/13/034a

⁴ Fuel Mix Disclosure 2012 Information Document CER/13/148

⁵ Metered Generation by Units EP2 as published www.sem-o.com



BGN has acknowledged that increased wind has resulted in a number of base load CCGTs becoming mid merit. A combination of low load factors, with high peak day demand, will be experienced by a greater proportion of the CCGT fleet as wind generation approaches 40% to meet the renewable targets. The 24% increase in wind generation, compared to May 2013, required to meet the 2020 target will directly displace gas generation as it has the flexibility to support wind.

Annual gas capacity bookings are a significant fixed cost that cannot be recouped by generators through the electricity market. Neither are they funded through the capacity payment mechanism as the technology of choice has consistently been gasoil fired and therefore does not require payment for gas capacity. It is economically rational for gas fired generators who have become mid merit or peak plant to seek to minimise these fixed costs and move toward short-term products. The high cost of short term gas capacity products relative to the annual product ensures that only the daily product, as opposed to the monthly product, has been of value to generators. This is only purchased within day once actual gas capacity requirement is known and secondary capacity is not available.

While removing flexibility may on the face of it appear to resolve the issue of reduced primary bookings, it may in fact lead to unintended consequences. The CER has already reconfirmed the decision to restrict secondary capacity transfer within category which will significantly reduce the availability of secondary capacity for sale at exit. Removing the ability to trade secondary capacity may in fact exacerbate trend of falling primary bookings, as mid merit gas fired generators with low load factors would no longer book annual capacity as they would not be able to recoup a portion of this sunk cost through sales of surplus gas capacity. This will further reduce annual capacity bookings and further increase the unit cost for the remaining capacity bookings.

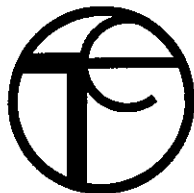
Likewise restricting the latest time for the purchase and transfers of capacity will require gas generators to make decisions on gas capacity holding prior to knowing their actual gas requirement for the day. Instead of making annual gas capacity a more attractive product to low load factor gas generators, this restriction could actually lead to a significant reduction in gas capacity demand from these generators, for the following reasons.

Annual gas capacity costs for the average 400MW CCGT, assuming a peak day load factor of 75%, would be in the region of €13.4 million. This is a significant annual fixed cost for a generator with low load factor to absorb. These gas capacity costs cannot be recovered directly through either the energy market or capacity payments. In fact the generator reducing load factor will result in reduced energy revenue. It may actually lead to low merit gas fired generators deciding to purchase no annual capacity and pursue liquid fuel operation or early closure. Peak plant will be forced to fire on liquid fuel thereby reducing gas demand further.

The existing restriction on secondary capacity transfers within market categories will already increase primary capacity bookings in both power and I&C sectors, as the majority of surplus capacity is currently available from the NDM sector. It is clear that neither of the further proposals to reduce flexibility, as set out in CER/13/122, will do anything to halt the trend toward a reduction in annual capacity bookings in the power sector in the longer term. Both proposals could in fact have significant negative impacts on annual bookings which would lead to further increases in gas capacity tariffs.

2.2 Increased tariffs are of detriment to consumers

The Consultation Paper has a strong focus on tariffs rising "to the detriment of consumers". TEL does not agree with this assertion. BGN are allowed to recover their revenue entitlement each year, or to the extent that there is a shortfall to recover it in a subsequent year. The



aggregate amount recovered from consumers will be the same irrespective of the volume of primary capacity bookings. This assertion is therefore *prima facie* incorrect.

It is true that if capacity bookings drop, the amount that needs to be recovered from each remaining consumer will increase, but this is because of the need to recover BGN revenue entitlement.

The fact that BGN's revenue sources become more opaque as different system users pay different tariffs for different capacity products is irrelevant to this issue. BGN ultimately recover their revenue entitlement and therefore have absolute certainty in relation to their ultimate revenues.

In these circumstances, abolishing flexibility for the convenience of BGN is indefensible.

2.3 Inequity in financial burden

The CER has indicated that a key consideration in carrying out this review is ensuring that the gas network system is remunerated in a fair and equitable manner. As stated by the CER, the financial burden placed on the customer should be commensurate with the level of service being provided:

Data from BGN has demonstrated that shippers are increasingly booking 1kWh at the exit for their customers (and it is presumed booking secondary capacity and/or short term capacity at exit...[T]his practice is pushing up the overall transmission tariff for everybody else as fewer firm bookings are made.

The CER's previous decision to restrict capacity transfers at exit to within a customer category will, as it stands, significantly reduce the amount of secondary capacity available for transfer. Shippers will increasingly be required to rely on firm primary capacity (whether annual or short term) from the transporter. Short term primary capacity products are priced at the cost of providing the capacity with seasonal scalars to encourage annual capacity bookings. It has not been made clear how the proposal to remove gas capacity transfers will improve equity.

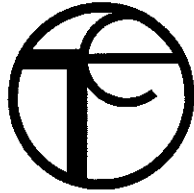
NDM customers are required to book gas capacity for the "1 in 50" winter. The CER has argued⁶ that allowing this capacity to be sold to DM and LDM customers was inequitable as these customers were, in effect, paying for the security of supply benefits that NDM customers receive by booking this capacity. The power sector has underwritten this security of supply benefit for NDM customers through the secondary fuel obligation contained in the Grid Code.

All gas fired generators are required, under the Grid Code, to be able to fire on an alternative fuel and hold stock of that fuel on site for use in a gas emergency such as a "1 in 50" winter. The cost of complying with the obligation to maintain this capability is significant and cannot be recovered through the electricity market.

With the current seasonal scalars, the cost of purchasing daily capacity every day would be 289% of the equivalent annual capacity. It is not economically rational to purchase capacity in this way. The second proposal proffered by the CER, which requires generators to purchase capacity before knowing whether it is required, would make booking annual capacity the rational decision.

The punitive nature of capacity overrun costs would lead generators to be conservative in their capacity bookings. This, in effect, would require low load factor gas fired generators to

⁶ CER/10/089



book annual capacity equal to their peak day requirement. The capacity would be available for every day of the year but low load factor gas generators, as demonstrated above, require gas for only a fraction of this time. This cost would not appear to be reflective of the service provided.

TEL believes that any inequity in the distribution of the cost burden cannot be attributed to the fact that flexible products are available, nor can it be attributed to the fact that some system users avail of them. Any inequity must be due to the fact that the tariffs that are charged for different services do not equitably apportion the burden. If the CER is correct in this assertion then they are arguably in breach of their obligation under both the Directive and the Regulation to avoid cross subsidies in tariff setting. The solution to any such inequity (and indeed the obligation under the Directive and the Regulation) is to recalibrate the tariffs, not to prevent parties from availing of more flexible services which they require.

Increases in tariffs are an inevitable consequence of a decrease in the volume of firm bookings, but this is not a justification for requiring shippers to book firm capacity if they do not require it. It may, however, be a justification for charging system users differently if they avail of different products.

The CER further argues that by reducing the amount of flexibility available it will be "restoring the transmission system revenue base on an equitable basis", however it is hard to see how forcing shippers to purchase capacity products which they do not want could be considered "equitable". Rather, this seems to be specifically discriminatory toward a class of system users – a breach of both the Directive and the Regulation.

The CER are particularly concerned that "if the power sector is booking less capacity then the burden of this will fall on the Industrial and Commercial (I&C) and residential sectors". However this is entirely appropriate. 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 the Directive and the Regulation.

TEL firmly believes that the CER must reassess the equity issue to ensure that all customers, both electricity and gas, who benefit from having access to the gas transmission network, either directly or through the flexibility that the gas generation provides, pay their fair share of the cost of the network.

2.4 Economic inefficiency

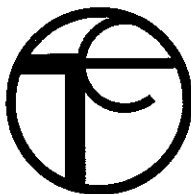
The Consultation paper states:

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.

However, it is not clear why this is economically inefficient. It seems far more economically inefficient to require shippers to book capacity which they know they will not use and then prohibit them from transferring this excess capacity to someone who is able to use it.

2.5 Flexibility pushes financial burden on those unable to avail of flexibility

It is clear that the CER has designed both proposals to reduce flexibility due to the concern that the current level of flexibility is pushing the costs of the network on those who are unable to avail of this flexibility. This concern is misguided. Flexibility allows open cycle power plant



to source gas capacity within day, as required, from either capacity transfers within a portfolio, purchases from the secondary market or purchases of primary capacity from the transporter. If this flexibility were to be removed, open cycle power plant would not be able to source gas capacity within day. These generators would also not purchase short term capacity as they would have no way of forecasting gas capacity requirements. There would also be no economic rationale for purchasing annual gas capacity. The cost of annual capacity for one open cycle turbine, assuming a peak day load factor of 65%, would be in excess of €3.5 million. This fixed cost would not be recoverable from the electricity market or through the capacity payment mechanism due to technology choice for the BNE.

This would in effect result in the open cycle turbine becoming distillate plant and bidding in accordingly. The price differential between gas and distillate bids for an open cycle turbine at current fuel prices, assuming an efficiency of 35%, is €120/MWh. The increased fuel cost per start based on a heat requirement of 63 GJ is €720.

The three combustion turbines at Aghada were included in the market schedule for 35 trading periods in 2012 and they were scheduled on average for 2.5 hours per start. If these units were to set the price on distillate for these 35 trading periods rather than gas this would result in an increase in SMP of €408/MWh. This would equate to potential additional costs in excess of €42 million to electricity consumers due to gas shippers being unable to avail of flexible services - a significantly higher cost than the supposed "under-recovery" forecast by BGN in the current gas year.⁷

The current flexibility provisions also facilitate the development of trading at IBP. This is crucial not only for Corrib but is necessary to make any storage commercially viable. If shippers cannot purchase exit capacity within day at a reasonable price then it will be impossible to capitalise on low summer gas prices for injection into storage. BGN has already identified that increased storage at Inch would mitigate the risk of a potential gas supply shortfall this coming winter, if a "1 in 50" winter were to occur, due to the delay in Corrib.⁸ It was due to this potential risk that the seasonal multipliers for gas capacity during the summer were reduced.⁹ It would seem unwise to remove this flexibility if it were to threaten security of supply in the coming winter.

3. Compatibility of the Proposals with the Directive and Regulation

TEL has a number of serious reservations about the view of the CER on the provisions of the Directive and Regulation that are relevant to this issue. TEL also disagrees with the conclusions reached by the CER in relation to this. These reservations are set out below.

The CER's analysis is premised on the assumption that their only obligations under the Directive or the Regulation are to comply with the minimum requirements for flexibility and liquidity in capacity markets set out in Articles 16.3(b) and 22¹⁰, notwithstanding those minimum requirements are significantly exceeded in Ireland and have been for many years.

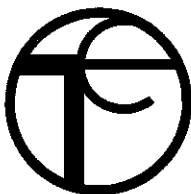
In TEL's view this fundamentally misunderstands the requirements of the Directive and Regulation. While it is clear that the Directive and the Regulation establish minimum standards which must be complied with by all Member States in relation to liquidity and flexibility in capacity markets, it is equally clear that the obligations of Member States are not limited to compliance with such minimum standards.

⁷ BGN Submission CER/13/034a

⁸ Joint Gas Capacity Statement 2012

⁹ CER/12/143

¹⁰ The CER does not address why they believe that the proposals are consistent with Article 22.



Rather the Directive and Regulation impose expressed obligations to strive to exceed these minimum standards, such as an obligation to achieve “maximum use of technical capacity”¹¹ and to increase liquidity¹² by facilitating “trading of primary capacity”¹³. These obligations are not limited by the minimum requirements quoted by the CER in the Consultation Paper. Rather, these are independent obligations which are binding upon the Member State in their own right.

Even if the proposals in the Consultation Paper were consistent with the minimum requirements specified in the Directive and Regulation (which for the reasons set out below, TEL do not believe that they are), in TEL’s view insofar as it reduced the liquidity and flexibility in Ireland’s gas capacity market, the implementation of those proposals would fly in direct contravention of the spirit and principles behind the Directive and the Regulation and would put the CER in breach of its other obligations to maximise liquidity and use of technical capacity.

Set out below are TEL’s views in relation to the relevant requirements of the Directive and Regulation in relation to the specific proposals included in the consultation.

3.1 Proposal 1: “the potential removal of secondary capacity at the exit from the gas transmission system”

3.1.1 Article 16(3)

Article 16(3) provides materially that:

“The transmission system operator shall implement and publish non-discriminatory and transparent congestion-management procedures which facilitate cross-border exchanges in natural gas on a non-discriminatory basis and which shall be based on the following principles:

- (a) in the event of contractual congestion, the transmission system operator shall offer unused capacity on the primary market at least on a day-ahead and interruptible basis; and*
- (b) network users who wish to re-sell or sublet their unused contracted capacity on the secondary market shall be entitled to do so.”*

The CER proposes in CER/13/122 to remove the ability of holders of secondary exit capacity (i.e. exit capacity that has been purchased from another shipper) to transfer such exit capacity from one geographic location to another geographic location.

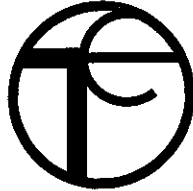
“Contracted capacity” is defined in Regulation 715/2009 as “capacity that the transmission system operator has allocated to a network user by means of a transport contract”, and “capacity” is, in turn, defined as “the maximum flow, expressed in normal cubic meters per time unit or in energy unit per time unit, to which the network user is entitled in accordance with the provisions of the transport contract”. These definitions clearly include exit capacity.

It is fundamental to the nature of exit capacity (insofar as this capacity applies to exit points to final consumers or distribution systems) that its “re-sale” or “sub-letting” will have a geographic component. The restriction of the geographic transfer of secondary exit capacity, in the manner proposed in CER/13/122, will therefore deprive the holders of such unused capacity of an entitlement, protected by Article 16(3)(b), to re-sell or sublet such capacity.

¹¹ See for example Article 2.5, Article 16.2 and Paragraph 2.1(4) of Annex 1 of the Regulation

¹² See for example Recital (36) of the Directive and Recital (29) of the Regulation

¹³ See for example Recital (29) of the Regulation.



The CER argue, at page 14 in CER/13/122, that Article 16 does not apply to the CER proposal because it “deals with cross border trades”. This is not the case. Article 16 requires that a TSO’s congestion-management procedures both (i) facilitate cross-border exchanges in natural gas; and (ii) are based on the principles set out in Article 16(3)(a) and (b). Nothing in Article 16 suggests that the obligation to allow network-users to re-sell capacity on the secondary market is limited to cross border capacity. The fact that the congestion-management procedures must facilitate cross-border exchanges in natural gas is an entirely separate obligation. TEL is therefore of the view that abolition of the ability to re-sell or sublet unused contracted exit capacity on the secondary market breaches Article 16.

This is also consistent with other provisions of the Regulation which require increased liquidity in the natural gas market and secondary trading of capacity without limitation. These include:

- *Tariffs for network access shall neither restrict market liquidity nor distort trade across borders of different transmission systems.*¹⁴
- *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**.....*¹⁵
- *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.*¹⁶
- ***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.*¹⁷
- *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.*¹⁸
- *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.*¹⁹

This being the case, there remains a requirement pursuant to Article 16(3)(b) that Irish network users are able to re-sell or sublet any unused capacity, including exit capacity, on a secondary market. The proposed restriction will effectively deprive certain network users of this ability, and the proposal is not compatible with the requirements of Article 16(3)(b), and is therefore contrary to European law.

¹⁴ Article 13.2 of the Regulation

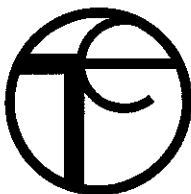
¹⁵ Recital (36) of the Directive.

¹⁶ Recital (21) of the Regulation.

¹⁷ Recital (29) of the Regulation.

¹⁸ Paragraph 1(2) of Annex 1 of the Regulation.

¹⁹ Paragraph 2.1(1) of Annex 1: of the Regulation.



3.1.2 Article 22

Article 22 provides materially that:

"Each transmission ... 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 ... 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.

The harmonised transport, LNG facility and storage contracts and procedures shall be notified to the regulatory authorities."

Clearly, exit capacity is a "capacity right" within the contemplation of Regulation 715/2009. The concepts of entry and exit capacity rights are distinguished in other parts of Regulation 715/2009, but Article 22 does not make any such distinction and therefore applies to entry and exit capacity.

As mentioned above, it is fundamental to the nature of exit capacity (insofar as this capacity applies to exit points to final consumers or distribution systems) that its trade will have a geographic component. The restriction of the geographic transfer of secondary exit capacity, in the manner proposed in CER/13/122, is therefore a clear curtailment of an exit capacity holder's ability to "freely trade" such capacity. The proposed restriction is not compatible with the requirements of Article 22, and is therefore contrary to European law.

Article 22 is cited at page 14 of CER/13/122, but the CER makes no attempt to explain how it applies to, or permits, the proposal. We submit that the proposal is in fact contrary to Article 22.

The proposal also runs counter to the CER's function, set out in section 9(1)(l) of the Electricity Regulation Act 1999, to "ensure compliance by ... gas undertakings, including transmission system operators, ... with their obligations under the Natural Gas Market Directive..."

3.2 Proposal 2: "the potential removal of within day purchases/transfers of short term (including within day) capacity at the exit"

3.2.1 Regulation 715/2009

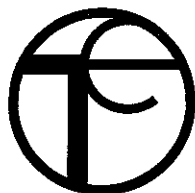
The CER relies on Paragraph 1.1 of Annex 1 of the Regulation as authority for the proposition that they are entitled to abolish the availability of within-day capacity products. Paragraph 1.1 of Annex 1 of the Regulation provides:

Transmission system operators shall offer firm and interruptible services down to a minimum period of one day.

While TEL agrees that this is the minimum requirement set by the Regulation, for the reasons outlined in section 3 above, TEL does not agree that this is the only relevant provision of the Regulation.

Provisions of the Regulation which impose an additional level of obligation to the minimum requirements include:

- *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.²⁰

- 'congestion management' means management of the capacity portfolio of the transmission system operator with a view to **optimal and maximum use of the technical capacity** and the timely detection of future congestion and saturation points;²¹
- The transmission system operator shall implement and publish non-discriminatory and transparent capacity-allocation mechanisms, which shall...provide appropriate economic signals for **the efficient and maximum use of technical capacity**, facilitate investment in new infrastructure and facilitate cross-border exchanges in natural gas;²²
- Those mechanisms and procedures [Capacity-allocation mechanisms and congestion-management procedures] shall provide appropriate economic signals for **efficient and maximum use of technical capacity** and facilitate investment in new infrastructure.²³

Shippers in Ireland can currently purchase capacity within day if they require it. If the proposals were implemented, shippers could no longer do this. This would reduce the ability of such shippers to make use of the technical capacity of the system. TEL argues that this is contrary to the obligations in the Regulation to make maximum use of technical capacity.

3.2.2 Regulation 715/2009 – Network Code

On a similar point, the current near-final version of the Network Code on Capacity Allocation Mechanisms in Gas Transmission²⁴, as contemplated under Article 8(6)(g) of Regulation 715/2009, requires (among other things) the establishment of a system of auctions for a suite of capacity products at the Irish entry point, including rolling day-ahead capacity auctions (see Article 14) and within-day capacity auctions (see Article 15).

The CER is proposing to require all gas generators to purchase exit capacity before 9:00 D-1. This will be 5½ hours before the bidding round opens for the day-ahead capacity auctions. Irish gas network users will at the time have to make a decision on the maximum gas capacity that they will require on the day. If the actual gas required on the day changes the Irish gas user will not be able to revise their exit booking.

Irish gas network users will only be able to purchase entry capacity in these auctions up to the level of exit capacity that has been purchased. Where an Irish gas network user has not purchased exit capacity the availability of short-term capacity products will be worthless as they are prevented by the proposed CER decision from purchasing corresponding exit capacity on a similar timescale. The European Commission cannot have intended that its detailed auction framework in this regard should be deprived of any commercial purpose by the downstream decision of a national regulator.

²⁰ Recital (21) of the Regulation.

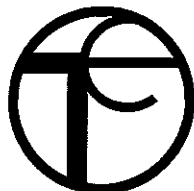
²¹ Article 2(15) of the Regulation.

²² Article 16.2(a) of the Regulation.

²³ Paragraph 2.1(4) of Annex 1 of the Regulation.

²⁴ See

<http://ec.europa.eu/transparency/regcomitology/index.cfm?do=search.documentdetail&FJbot9ZJPkHln6HXXHdTPBNyUUQ6RM+foDTWPcbnmvthxbx1TISJ2Mfg5DtxY23N>



This commercial outcome runs entirely counter to the principles enshrined in Regulation 715/2009, and the CER proposal that gives rise to it is therefore fundamentally inconsistent with the Regulation.

4. Compatibility with EU Policy

Were a similar regime to be adopted in Great Britain, a UK shipper wishing to source natural gas at short notice would face difficulties obtaining gas at the GB National Balancing Point unless it had previously obtained GB exit capacity. This would significantly reduce liquidity in the gas market in the UK, a key European gas hub, and thereby have a direct impact on liquidity across Europe – a result that is contrary to the liquid trading arrangements contemplated by Regulation 1775/2005.

Furthermore, from a policy perspective the proposals in the Consultation Paper are also a retrograde step which runs contrary to the move toward greater liquidity and flexibility in capacity trading and purchasing by European gas regulation. TEL believes that reducing liquidity of capacity markets is contrary to the spirit and intention of the European Parliament and Council in making the Directive and Regulation and that a court would give greater weight to this in the context of European legislative instruments.

For the various reasons set out above, the proposals in CER/13/122 are not permitted under European energy law on account of their impact upon natural gas transmission in Ireland.

In addition to their effect upon the Irish energy market, the wider European effect of the proposals needs to be considered. Were the proposals to stand as binding and enduring regulatory decisions in Ireland, a precedent of non-compliance with European law would be established that may encourage other European national regulators, with natural gas transmission systems facing similar issues to those that apparently prompted the issuance of CER/13/122, to adopt similar measures. A proliferation of similar measures across Europe could be anticipated to have serious detrimental effects upon cross border exchanges in natural gas.

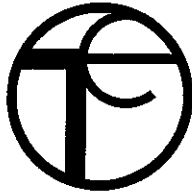
5. Compatibility with High Level Design for CAG

The proposals are also inconsistent with the High Level Principles for the design of the Common Arrangements for Gas²⁵. In particular:

5.1 Paragraph 4.7.1.3 of the High Level Principles for the design of the CAG provides that "Shippers will only be allowed to transfer LDM Exit Capacity to another Shipper at an LDM Offtake or to another LDM offtake within their own portfolio or to another DM Shipper or to its own DM Portfolio."

5.2 Paragraph 4.6.4.3 of the High Level Principles for the design of the CAG provides that "The Daily Capacity Booking Window is the period commencing at 06:00 hours on the Day which is 7 days prior to the requested Capacity Booking Effective Date specified in a request for short term daily capacity and ending at 03:00 hours on the requested Capacity Booking Effective Date."

²⁵ CAG 2012 Code Development: High Level Principles dated June 14th 2011 (Revision 1.0). See http://www.allislandproject.org/en/to_decision_documents.aspx?article=98e6f402-336c-45eb-96a5-0505f502ef08



This therefore suggests that the implementation of the proposals would require a change to the High Level Principles for the design of the CAG. This presumably brings the proposals within the remit of both regulatory authorities on the island of Ireland, and not just the CER.

6. Compatibility of the Proposals with Irish Law

The CER identifies in the consultation paper that it is required to have regard to the need to “eliminate restrictions on trade”²⁶. By its own admission, the very purpose of the proposals is to impose restrictions on trade that is currently occurring.

If one accepts the CER's fundamental proposition that reforms are required, the CER must exercise discretion as to how to address the issue. It is possible for it to address this issue by modifying tariffs. The CER is in fact obliged to modify tariffs to the extent that the existing tariff regime is inequitably distributing any burden. TEL argues that this obligation would preclude the CER from implementing the proposals. At the very least, the CER must demonstrate how it had shown regard to this objective but subsequently determined that it was appropriate to disregard it.

7. Principles of competition and administrative law

7.1 No power to restrict competition in a cross-border market under EU law

The market for short term capacity products has been in operation for 6 years since 2007, and (due to the relationship between entry capacity and NTS exit capacity) is a cross-border market which is protected by Regulation 715/2009 and by EU competition law.

All of the Irish and EU energy legislation, and the exercise by the CER of its powers, are subject to compliance with EU Treaty provisions regarding the protection of competition in the EU internal market. The CER cannot unilaterally shut down or curtail an intra-EU Member State competitive market.

Article 4(3) of the EC Treaty requires EU Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings. That principle imposes obligations on national regulatory authorities such as the CER, to respect EU competition principles which has been upheld in *Deutsche Telekom AG v Commission*²⁷.

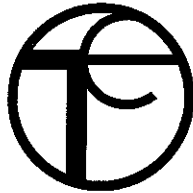
Secondary legislation such as Regulation 715/2009 must be interpreted consistently with EU Treaty provisions. The CER's claim that its proposal to curtail this cross-border market is permitted under Regulation 715/2009 is incorrect, ignores the purposes of the Regulation (a central one of which is to promote liquid gas markets²⁸) and contravenes the EU Treaty provisions which protect competition in the EU and which are superior to Regulation 715/2009.

It is also worth noting the CER's function, set out in section 9(1)(n) of the Electricity Regulation Act 1999, to “decide upon and impose effective and proportionate measures to promote effective competition”.

²⁶ Section 9(4)(b)(iii) Electricity Regulation Act 1999 (as amended by Regulation 40 of SI 630 of 2011)

²⁷ Case C-280/08P, *Deutsche Telekom AG v Commission* [2010] E.C.R. I-9555, para.91

²⁸ Recital 19 of Regulation 715/2009. Under EU law, the purpose set out in the Recitals governs the interpretation of the legislation.



7.2 Ability to change policy or set of rules on the basis of which parties have acted

Whether or not a regulator can change its rules, and on what terms any change could be made, involves consideration of the doctrine of legitimate expectation or promissory estoppel²⁹.

It is clear that Irish electricity generators have legitimate expectations, based on (i) the express continuation by the CER, since its inception, of the secondary market in unused exit capacity, and (ii) the establishment by the CER of the market for short term capacity products, that competition in those markets would not be removed, or would not be removed without overriding reasons. The CER has not demonstrated any such overriding reasons. No compelling evidence is advanced by the CER in CER/13/122 that supports its proposals.

It is clear that under Irish law, a court must ultimately carry out a balancing exercise between the interest to the affected party and the public interest in the unfettered exercise of the decision maker's discretion. Here, the level of interference with the property rights of gas-fired electricity generators, and the closure or curtailment of the capacity markets to which CER/13/122 relates, is unjust in the circumstances where the alleged "problem" identified by the CER is attributable to the priority given to renewable energy and the promotion of renewable energy projects.

In effect, the CER is asking the gas-fired power sector to underwrite the financial consequences of more renewable electricity on the system, which competes with gas. The proposals in CER/13/122 amount to the unlawful breach by the CER of the legitimate expectation of the gas network users that they could continue to participate in the secondary trading market and in the within-day market.

It should also be noted that the CER bears a statutory duty, pursuant to section 9(6) of the Electricity Regulation Act 1999, to act "in as consistent a manner as practicable". As well as frustrating the legitimate expectations of gas-fired electricity generators, TEL contends that on the basis of the historical operation of the relevant capacity markets and mechanisms, the CER's current proposals breach this statutory duty.

7.3 Ultra vires restriction on competition - closure of existing markets

The secondary trading market in transfers of surplus exit capacity has been in operation for 15 years, since 1998. There is no power in the Irish or EU legislation for the CER to completely close down a competitive secondary trading market, which the CER has admitted is growing³⁰. The growth in the market demonstrates the market/customer demand for this liquidity and flexibility.

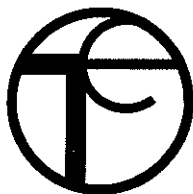
The market for short-term capacity is also thought by the CER to be growing.³¹

It is accepted by the courts without question that a regulator may not take on itself a power not otherwise given to it by statute. A decision by a statutory body such as a regulator may be outside the regulator's powers (or *ultra vires*) where: (a) the required power does not exist,

²⁹ This doctrine in Irish law is based primarily on the decision of the Supreme Court in *Glencar Explorations v. Mayo County Council* [2002] 1 I.R. 84 and the decisions of the High Court (Clarke J.) in *Lett & Co. v. Wexford Borough Council* [2007] IEHC 195 and *Atlantic Marine Supplies Ltd. and Rogers v. Minister for Transport* [2010] IEHC 104.

³⁰ See page 10 of the Consultation Paper: "There are significant volumes of exit capacity transfers executed within the gas market at present and the quantity has been increasing."

³¹ See page 22 of the Consultation Paper: "It is reasonable to conclude that the recent significant drop off in capacity bookings at the exit is facilitated by the presence of both within day primary and secondary capacity sales."



or (b) where a given power is exercised in excess of its statutory base, or (c) where such decision could never have been contemplated by the Oireachtas in enacting the legislation. A decision which is ultra vires cannot stand and must be struck down by the courts.

The key rule for any regulatory body is: "What the statute does not expressly or impliedly authorise is to be taken to be prohibited"³². Article 16 (3) of Regulation 715/2009 clearly contemplates the right of network users to participate in markets in unused capacity. This right is not restricted to entry capacity or to particular types of exit capacity.

Accordingly, the CER does not have the power to shut down or to significantly curtail competition in, or the competitive operation of, such markets. This is particularly the case in circumstances where more proportionate responses to the perceived problem exist.

7.4 Disproportionate infringement of property rights regarding secondary trading market

For the last 15 years, by purchasing annual exit capacity one has also purchased the right to transfer that capacity in a functioning secondary market. As with any tradable product or right, Irish network users that hold such capacity have intrinsic property rights. A fundamental aspect of property rights is the right to sell a product/right for a price in a competitive market. The right to transfer unused exit capacity in the secondary market is a property right that is protected by both EU law and our Constitution.

As set out elsewhere in this submission, the CER's attempt to exclude the secondary market in the transfer of exit capacity from the application of Article 16(3) of Regulation 715/2009 is not borne out by the express wording of that Article.

The CER's proposal, which effectively abolishes the competitive market for unused exit capacity, is at the extreme end of impairing the property rights of network users that hold such capacity. It is demonstrably not a measure that impairs the rights "as little as possible" – the property rights related to transfer are eliminated.

This amounts to regulatory expropriation or deprivation of property, which breaches the constitutional protection of property rights.

8. Connection Charging Policy

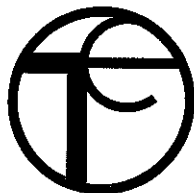
Under current connection policy³³ a CCGT would be subject to a deep connection charging policy and so would have had to pay for the full cost of all system reinforcements either up front (or in certain circumstances within seven years). The fact that LDMs are subject to a deep connection charging regime but have flexibility in their bookings is consistent with the fact that NDMs pay for 1 in 50 year capacity, but are not subject to deep reinforcement costs up front.

9. Conclusion

It is not clear why allowing the surplus exit capacity to be transferred is economically inefficient. It seems far more 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. Ireland would be in breach of the Directive and Regulation if it has failed to maximise liquidity and flexibility by taking deliberate steps to reduce that which is already

³² Halsbury textbook (4th Ed.) Vol. 9, para 133, Hamilton C.J. in *Keane v. An Bórd Pleanála and Commissioners of Irish Lights* [1997] 1 I.R. 184

³³ Gas Transmission Policy 2003 and Gas Connection Policy Document 2006



available in the market. It is clear that the ambit of Article 16 extends beyond "*cross border trade*".

The right to transfer unused exit capacity in the secondary market is a property right that is protected by both EU law and our Constitution. The CER has not demonstrated any overriding reasons why competition in either the market for short term capacity or the secondary capacity market should be withdrawn. In effect, the CER is asking the gas fired power sector to underwrite the financial consequences of more renewable electricity on the system, which competes with gas.

The CER has argued that by reducing the amount of flexibility available it will be "restoring the transmission system revenue base on an equitable basis", however it is hard to see how forcing shippers to purchase capacity products which they do not want could be considered "equitable". Rather, this seems to be specifically discriminatory toward a class of system users – a breach of both the Directive and the Regulation. TEL firmly believes that the CER must reassess the equity issue to ensure that all customers, both electricity and gas, who benefit from having access to the gas transmission network, either directly or through the flexibility the gas generation provides, pay their fair share of the cost of the network.

If reform is required the CER must not to introduce restrictions on trade. It is possible for the CER to address this issue by modifying tariffs alone.

Yours Sincerely,

David Vaughan
Business Analyst