Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

6th May 2014

Mr Aidan O'Sullivan
General Manager
Gaslink
Gasworks Road
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Our Ref: D/14/10276

Mr Padraic O'Connell
Head of Regulation
Bord Gais Networks
Gasworks Road
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Re: Cross-border Cost Allocation agreement – CER decision

Dear Aidan\Padraic,

Article 12(4) of Regulation 347/2013 (the 'Regulation') requires National Regulatory Authorities (NRAs) to allocate investment costs across borders within 6 months of the date of which the last investment request for a Project of Common Interest was received.

In light of this, the Commission for Energy Regulation, as coordinating regulator, the Northem Irish Authority for Utility Regulation and the Office for Gas and Electricity Markets (the NRAs) have reached an agreement on cost allocation in respect of your project, having assessed the contents of the

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application submitted by Gaslink, subsequent information received in response to requests by the NRAs, and the outcome of the meeting held with the project promoter on February 21st, 2014.

The Cross Border Cost Allocation (CBCA) decision, attached to this letter, sets out the NRAs' agreement that there should be no allocation of costs in respect of this request. This letter sets out the CER's detailed reasons for reaching this decision.

Introduction

The CER's position is predicated on the consideration of the allocation of the potential benefits of the project; foremost in this decision is a recognition of the uncertainty over the allocation of the benefits accruing over the time-horizon of the project. As provided for by the Regulation under Article 12 (4) d, the Project Promoter proposed a cost allocation of 88% to Ireland and 12% to Northern Ireland. While the Project Promoter's application provides detailed information on the allocation of benefits under a number of reasonable scenarios in support of this substantiated cost allocation, due to the uncertainty over flows from the Corrib gas field once on-stream, the benefits accruing from the construction of the project could be distributed quite differently. Other contingencies include commercial decisions that may be made by the operators of Inch Storage facility, and potential Final Investment Decisions made by the promoters of Shannon LNG and Islandmagee Storage facilities.

In light of this uncertainty, and through no fault of the Project Promoter, the CER accepts that the dispersion of benefits accruing from the construction of the project is unclear. The benefits could potentially be greater or smaller than the Project Promoter's CBA indicates, and also, the magnitude of the benefits monetised in the Project Promoter's CBA may also vary as a result of the external variables set out above.

Due to the uncertainty of the allocation of benefits, the CER also notes there is a reasonable possibility that the material benefits accruing to Northern Ireland could be below or near the significance threshold of 10% of aggregate positive net benefits, referred to in the Regulation under Article 12(3) and developed in Section 2.3 of ACER Recommendation 07/2013.

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In light of the uncertainty with regard to the allocation of benefits, and the additional possibility that the significance threshold may not be met in the case of Northern Ireland in some scenarios, it is agreed the appropriate cost allocation at this time is 100% of costs to Ireland, with 0% of costs allocated to Northern Ireland and Great Britain.

Notwithstanding the cost allocation agreement reached which places all costs on Ireland, the benefits this project would bring if constructed are recognised, including:

- the positive impact on security of supply that the twinning project would have for both Ireland and Northern Ireland
- the increased operational flexibility that twinning the pipes would allow, most notably facilitating further integration of the Ireland, Northern Ireland and Great Britain gas markets
- construction of a twinned pipeline in this part of the Irish network is considered a prerequisite by the CER, prior to permitting physical reverse flow on the interconnectors. Twinning of this stretch of pipeline would also significantly reduce the cost of implementing physical reverse flow between Ireland, Northern Ireland and Great Britain. The Project Promoter suggests that this reduction could be in the realm of 40% of the capital cost of a physical reverse flow project.
- the increased entry capacity from Great Britain to Ireland and Northern Ireland, which is likely to be required to meet demand in the next 7-8 years
- the reduced compressor fuel consumption in instances of both high and low demand on the interconnectors, including the reduced associated CO_2 emissions

The CER notes that Article 12 (5) of the Regulation requires that the coordinated decision, as set out above, shall contain detailed reasons on the basis of which costs were allocated among Member States such as the following;

1. An evaluation of the impact, including concerning network tariffs, on each Member State concerned

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2. An evaluation of the project's business plan, submitted as part of the CBCA application

3. Regional or Union-wide positive externalities

4. The result of the consultation of the project promoters

Before setting out this information, the CER provides an overview of the project and the process undertaken in reaching this CBCA decision.

Project Overview

This project involves the twinning of an existing 50km stretch of 85barg pipeline running between Cluden and Brighouse Bay. While the project is physically located in Southwest Scotland, the existing asset is part of the Irish transmission system. Both Gaslink and Bord Gais Eireann are licensed with respect to this system. The project would increase the current entry capacity from Moffat by about 10%, from 31mcm to 34.1mcm per day. The project cost is €93.8 million.

The project has all necessary consents in place and the Project Promoter has indicated strong confidence about the expected costs of the project. In light of this, the CER notes the project meets the 'sufficient maturity' criterion for assessment for a CBCA decision.

Process Overview

The NRAs received the relevant application documents on November 7th, 2013. Using ACER Recommendation 07/2013 as a template, the NRAs assessed the completeness of the application file. In light of this undertaking, the NRAs requested further information on a number of areas to ensure the completeness of the application file on December 19th, 2013. The Project Promoter provided detailed responses to these queries on January 10th, 2014.

The NRAs hosted a meeting with the Project Promoter on February 21st, 2014 in the CER offices in Dublin. At this meeting, the Project Promoter made a presentation on the project, and on the outcome and findings of the CBA provided to the NRAs as part of the CBCA application. There followed a question and answer session with the Project Promoter and in response to the issues raised in this session, the NRAs issued a number of follow-up questions to the Project Promoter. These follow-up questions were issued to the project promoters on March 6th, 2014 with a clarification of one question issued on March 21st, 2014 by the CER. Responses to these questions were received by the NRAs on April 1st, 2014.

Detailed Information

1. An evaluation of the impact, including on network tariffs, on each Member State concerned

The Twinning project would have no significant impact on Great Britain in the short term. There could be longer term benefits if gas were to physically reverse flow to Great Britain from Ireland or Northern Ireland in the future e.g. if there was additional storage, production or LNG on the island.

The project would have an impact on Northern Ireland and Ireland by improving security of supply, increasing available capacity and improving the flexibility of the system to better respond to new patterns of demand caused by the increase in renewable power generation on the Irish power systems. In addition, the project could also progress the integration of the Ireland, Northern Ireland and Great Britain markets as a first step to physical reverse flows on the interconnectors. Forecasts indicate that additional capacity may be required in by 2020-21 to meet demand in Northern Ireland and Ireland as output from Corrib declines.

As it has been decided that the cross-border allocation will be zero to Northern Ireland and Great Britain, the full cost of the project would be borne by Irish consumers were the project to proceed. According to calculations provided by the Project Promoter, approval of the full cost of the infrastructure by the CER would increase transmission tariffs by approximately 10%. The CER's view, in light of the recent decline in throughput on the Irish interconnectors, is that this increase in tariffs could not be sustained at present.

During the course of the consultation with the Project Promoter as part of the CBCA assessment, the CER requested Gaslink to consider the results of the financial analysis provided in the CBA using the TSO's Weighted Average Cost of Capital (5.2%) in place of the 10% financial discount rate used. This indicated that in the most likely scenario used in the CBA (Scenario 1) the project would be NPV negative of approximately €45.9 million.

The CER is of the view that the project is desirable but not essential in the short term, particularly in light of the expected security of supply that will arise from the Corrib field on connection in 2015. Calculations provided by the Project Promoter suggest that were the CER to approve funding up to €47.9 this would have no impact on tariffs in the long term. In the event the CER approved funding of €47.9 million in respect of this infrastructure, the balance of the capital cost would need to be provided by direct funding.

2. An evaluation of the project's business plan, submitted as part of the CBCA application, including the results of market testing

In the course of the consultation with the Project Promoter, the NRAs requested clarification from the Project Promoter on the requirement for a binding or non-binding market test contained in the Regulation. In its response, the Project Promoter pointed to the work undertaken in developing the Gaslink Network Development Plan. This document is consulted on with market participants to assess future supply and demand on the Irish market in the short term, and to develop long-term (10-year) forecasts used to assess the ability of the existing gas infrastructure to meet gas demand.

3. Regional or Union wide externalities

The externalities provided by the project include improved security of supply for Ireland and Northern Ireland. The project will facilitate the operation of the gas network as more renewable power generation comes onto the Irish and Northern Irish electricity markets. The project is also considered a prerequisite for physical reverse flow on the interconnectors by the CER.

4. Result of consultation with project promoters

The CER notes that productive consultation occurred with the Project Promoter throughout the CBCA assessment process. In two iterations, the NRAs identified areas that they felt required further development in addition to the information provided by the CBCA application documents received on November 7th, 2013. On each occasion, Gaslink provided responses which assisted the CER in its consideration of the CBA and the CBCA application.

The outcome of the consultation with the Project Promoters is that a CBCA decision of 100% to Ireland and 0% to Northern Ireland and Great Britain is agreed by the NRAs.

The CER intends to publish this decision and therefore if you could identify any areas of the letter which you consider confidential and your reason for doing so by Wednesday May 14th, 2014.

Yours sincerely,

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Director – Energy Networks and Legal

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