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Mr. Barry Hussey,
The Commission for Energy Regulation,
The Exchange, Belgard Square North,
Tallaght, Dublin 24.

30 January 2015

Twinning of the Southwest Scotland Onshore System in light of potential Connecting Europe Facility grant funding

Dear Barry,

Shannon LNG does not support the twinning proposal because it is not needed, does not have the support of users and potential users of the gas network[1] and would increase the cost of energy to Irish consumers.

Before the CER considers approving the unnecessary expenditure of circa €100 million, and commits gas consumers in Ireland to pay an extra annual cost of about €4.3 million per annum, the prudent and sensible approach would be to wait and see if demand materialises in the 2020s to justify it.

Problems caused by building speculative capacity

Building speculative capacity that is not underwritten by customer contracts has massive negative implications for regulated markets, competition and consumer prices, particularly in a small market like Irelands. For instance, the CER has taken over 4 years to address the question of who bears the stranded capacity costs of the second interconnector. The time taken to address how this stranded capacity is dealt with has foreclosed competition from new supply sources such as Shannon LNG.

Twinning would compound the problems associated with the over building of infrastructure and would increase that part of a consumer's gas bill that is directly under the CER's control.

The CER were vindicated in rejecting the twinning project in 2012

The CER's reasons for rejecting the twinning proposal in 2012 are even more compelling today: the Corrib project is just about to come on-line and natural gas demand growth has not increased in line with the forecasts in the Joint Gas Capacity Statement 2011. Had the twinning proposal been approved in 2012, it would have exacerbated Ireland's already high natural gas prices (e.g. 13% higher than British gas prices for residential customers[2]).

The CER consultation paper includes an extract from the 2012 Decision (CER/12/196) rejecting the twinning proposal which discusses what events might expedite the need for reinforcement including: '*a cessation of supplies from the Inch Entry Point and/or delayed flows from the Corrib facility'* and *'increasing renewable electricity generation' and 'the absence of other large-scale supply projects in the medium term'.* The 'wait and see' approach adopted by the CER in the 2012 Decision was the

[1] For instance see Section 9.3.2 of CER/12/196: "*Decision on October 2012 to September 2017 transmission revenue for Bord Gáis Networks*".
[2] http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Half-yearly_electricity_and_gas_prices_2014s1.png

right approach and has been vindicated by the facts. The short-term capacity constraints forecast for the 2013/14 Gas Year, used to justify the twinning proposal in 2011, simply never materialised.

The approach of creating a looming gas supply/demand crisis if infrastructure is not approved by the regulatory authorities, was used to justify building the second interconnector and this has had adverse consequences for consumers and competing sources of supply as discussed above. This 'cry wolf' approach to decision making does not lead to good economic and regulatory decisions for the gas consumer.

What security of supply policy is the CER trying to achieve?
The consultation states that the twinning proposal would improve Ireland's security of supply but the paper does not discuss what security of supply policy measure the CER is trying to achieve.

The European Union defined the key criteria that Member States should meet for security of gas supply in Regulation EU 994/2010, namely the Article 6 N-1 Infrastructure Standard test and the Article 8 Supply Standard test. The twinning proposal will not allow Ireland to pass either of these key security of supply tests.

If the CER wishes to justify the approval based on security of supply, we respectfully suggest it should first define what it means by security of supply, set a threshold that it wants the gas system in Ireland to meet and then have a competition for all infrastructure providers to meet this standard. Approving the twinning project, to be underwritten by gas consumers, under the banner of improving 'security of supply' would undermine the integrity of the regulatory process in Ireland.

The International Energy Agency recommended Ireland diversity its gas supply
It is worth considering what the International Energy Agency (IEA) said about Ireland's security of gas supply in its 2012 review:

"Ireland's gas market is characterised by its very high dependence on gas imports and the specificities of its geographical location. The island of Ireland is vulnerable to a supply disruption, as all gas supplies from Great Britain, accounting for 93% of demand, transit through a single point in Scotland, Moffat. <u>Accordingly, Ireland would benefit significantly if there were a greater diversification and flexibility of supply both in terms of entry points and in terms of sources of gas</u>. In this regard, the development of upstream gas fields, such as Corrib, and the proposal to build an LNG terminal in the Shannon Estuary, would be beneficial to Ireland's security of supply." [emphasis added]

There is no recommendation or even reference in the IEA's 2012 Review to the twinning proposal. On the contrary, the IEA recognise that Ireland has an over reliance on gas imports from Great Britain and recommends that Ireland diversify its gas supply away from Great Britain. The latest forecasts from National Grid indicate that Britain will be importing between 50% and 60% of its own gas requirements by 2020[3].

The twinning proposal is directly counter to the IEA's recommendations as it would increase Ireland's reliance on Britain for natural gas supply and would effectively chill investment from competing supply sources (such as LNG) which the IEA specifically recommend. Diversifying Ireland's gas supply away from Britain would put energy policy control back in the hands of Dublin rather than Whitehall.

Assumption of future capacity constraints at Moffat is highly speculative
The consultation states that Gaslink is of the view that the twinning proposal will resolve future capacity constraints at Moffat. This view is not supported by customer capacity bookings at Moffat.

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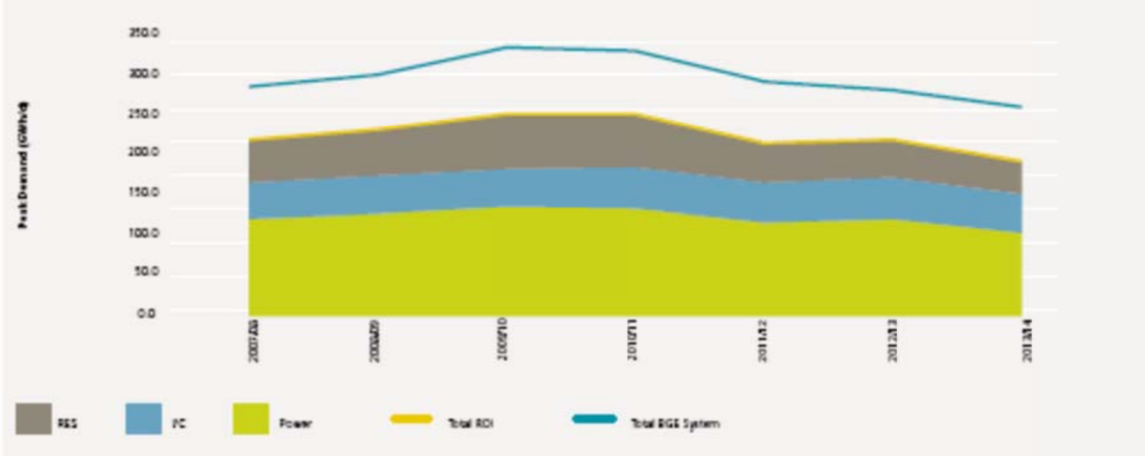
[3] See Figure 2.5A and 2.5B of the National Grid 10 Year Statement 2014.

Based on the current evidence of declining peak day gas demand, there is nothing to suggest that there will be a capacity constraint at Moffat in the 2020s.

Figure 3.4 below is extracted from the Gaslink Network Development Plan 2014 and shows that peak day gas demand has decreased materially over the last 3 to 4 years. The recent historical data showing declining peak day gas demand does not support the case that gas demand in the 2020s will increase to such a level as to justify the twinning proposal.

Gaslink graph showing decline in historic peak day gas demand

Figure 3.4: Historic ROI Peak Day Gas Demand



In the unlikely event a capacity constraint did occur in the 2020s, there are a number of much lower cost commercial solutions available to the market compared to spending circa €100 million on twinning the pipeline[4].

The CER would unnecessarily increase gas prices if it approves the twinning project
The assertion by the project promoter that the twinning of the Interconnector "*would have no impact on tariffs in the long term*" is highly dubious. According to the spreadsheet which formed part of the consultation documents, the Irish gas consumer would have to pay circa €4.3 million per annum to pay for the twinning project which may never be needed. There is a high probability that the twinning project would never be required to meet gas demand in Ireland due to a multiplicity of factors (e.g. no growth in gas demand, greater electricity imports, additional indigenous discoveries etc.).

Approval of the twinning by the CER would destroy and prevent investment in competing energy supply infrastructure that, as recognised by the IEA, would have a much superior impact on security and diversity of supply, at no risk to the consumer.

The NPV analysis showing a benefit from twinning is flawed
Approval of the capital expenditure associated with the twinning project is a highly risky proposition as the likelihood is that the incremental capacity will never be used and will be a stranded asset. Based on the risky nature of the proposition, a much higher discount factor than the regulated discount factor of 5.2% should be used when calculating the NPV of the cash flows. Gas Networks Ireland (GNI) used a 10% discount factor when discussing the twinning project as a merchant type project in their Cross Border Cost Allocation application (see page 19 of CER14/795(b)). A discount factor of 10% or higher better reflects the riskiness of the venture.

[4] See Shannon LNG letter to CER dated 16 December 2011 in response to CER consultation CER/11/206.

If the cash flows are discounted using a 10% discount factor, then there is no NPV benefit in proceeding with the twinning project today.

Physical reverse flow is a red herring
The consultation states that "*The project is also considered a prerequisite to any potential physical reverse flow project at the Moffat Entry Point.*" Almost all of Ireland's gas is imported from Great Britain. Thus there is no gas available in Ireland for physical reverse flow. Hence, there is no need to twin the pipeline as a prerequisite for physical reverse flow.

The CER must be consistent to avoid double standards
Shannon LNG had extensive discussions in 2009 and 2010 with the CER regarding an early build of the 26 km Shannon Pipeline to facilitate the extension of the gas grid to a major power generation customer in Kerry. The central issue in the discussions was the level of risk the CER would allow the general gas consumer to take in the event that the capacity on the pipeline became stranded. Shannon LNG was willing to contribute the €6 million it had invested in the pipeline to the early build project.

Even though the Shannon LNG project would provide much greater security of supply than the twinning proposal and the early build of the pipeline would have been a concrete sign of support for the LNG project from the regulatory authorities, the CER decided it did not wish to impose the risk of any potential stranded costs of this lower cost pipeline project on the general consumer.

It is critical that the CER is not now seen to be applying double standards in dealing with private companies and State owned companies who are both providing competing gas import infrastructure.

Vanity Projects and Empire Building
In summary, we believe the CER will unnecessarily increase the price of gas and electricity in Ireland, if they approve the twinning project, for infrastructure that is not needed and is a good example of a "Vanity Project and Empire Building".

Yours sincerely,

Mort Reg

Martin Regan
Commercial Manager