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Dear Mr Regan

Cross-Border Cost Allocation application submitted by Shannon LNG: Final decision

I am writing with details of the final decision of the Gas and Electricity Markets Authority[1], the National Regulatory Authority for Great Britain, on a cross-border cost allocation application (the "CBCA application") made by Shannon LNG. The letter sets out the context and our analysis of the CBCA application as well as the reasons for our decision.

Based on this final decision we intend to enter into a coordinated decision (the "Coordinated CBCA decision") on the CBCA application. The other parties to the Coordinated CBCA decision are the Commission for Energy Regulation (CER) and the Utility Regulator of Northern Ireland (URNI). The Coordinated CBCA decision is attached to this letter in Annex 1. We, CER and URNI are collectively referred to in this letter as "NRAs".

Our decision is that we have agreed to allocate all costs to Ireland.

Background

On 6 November 2013, Shannon LNG submitted its CBCA application to the NRAs under Regulation (EU) No 347/2013 (the "Regulation").[2]

The Regulation lays down the rules for the timely development and interoperability of trans-European energy networks. This is to achieve the energy policy objectives of the Treaty on the Functioning of the European Union. In particular this is to ensure the functioning of the internal energy market and security of supply in the European Union, to promote energy efficiency and energy saving and the development of new and renewable forms of energy, and to promote the interconnection of networks. The Regulation sets out the framework for identifying and prioritising projects necessary to implement the energy infrastructure priority corridors across Europe. These Projects are defined under the Regulation as "projects of common interest" ("PCIs"). The entities developing PCIs are defined under the Regulation, as "project promoters". The first list of PCIs determined under the Regulation was adopted by the European Commission on 14 October 2013 (the "first Union list").[3]

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[1] The Authority is supported by the Office of Gas and Electricity Markets (Ofgem). The terms "we", "Ofgem" and "Authority" are used interchangeably in this letter.
[2] Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009.
[3] Commission Delegated Regulation (EU) No 1391/2013 of 14 October 2013 amending Regulation (EU) No 347/2013 of the European Parliament and of the Council on guidelines for trans-European energy infrastructure as regards the Union list of projects of common interest

For the purposes of the Regulation and the submitted CBCA application, you act as the project promoter in relation to your proposed PCI (the "Shannon Pipeline Project"), which has been included in the first Union list.

Your CBCA application is an investment request, pursuant to Article 12 of the Regulation, for allocation of investment costs associated with the Shannon Pipeline Project to the countries you consider to be beneficiaries of this PCI, ie Republic of Ireland (RoI) and the United Kingdom, including Great Britain (GB) and Northern Ireland (NI). The CBCA application does not contain any specific proposal for allocation of investment costs between GB, NI and RoI.

You also stated in your CBCA application that you intend to seek EU financial assistance for the Shannon Pipeline Project under the Connecting Europe Facility (the "CEF"). [4] To be eligible for this EU financial assistance, you need to fulfil the requirements of Article 14 of the Regulation, including submitting your CBCA application to, and obtaining a coordinated decision from, the relevant NRAs in respect of this CBCA application.

The Agency for the Cooperation of Energy Regulators (ACER) has published a recommendation on CBCA (the "ACER Recommendation")[5] that sets out in more detail the process for CBCA, including the required content of CBCA requests and how they are to be evaluated by relevant National Regulatory Authorities. Of particular relevance is the ACER interpretation of when investment costs shall be allocated between relevant countries in respect of individual CBCA requests. The ACER Recommendation (paragraph 2.2) states:

"Therefore the Agency recommends that, unless the NRAs agree otherwise, compensations are provided only if at least one country hosting the project is deemed to have a negative net benefit. In such cases, the aim should be to compensate as much as possible the negative net benefit in the relevant countries."

The cost benefit analysis is undertaken to determine the net benefit, including externalities[6], in each country.[7] A "negative net benefit" arises when the costs outweigh the benefits. Similarly, a "positive net benefit" is where benefits outweigh costs.

The Shannon Pipeline Project proposal

You have proposed the construction of an LNG terminal on the Shannon estuary together with a 26km 30 inch pipeline to the Irish national pipeline network. The pipeline element includes additional spur lines to connect the facility and the Irish grid, to a power station and to new consumers in County Kerry. You have submitted a CBCA application for the pipeline, together with the associated spur lines. The LNG terminal itself is not subject to this CBCA application.

Article 12(3) of EU Regulation 347/2013 requires a CBCA application to include: a) a project-specific cost-benefit analysis, b) a business plan, and c) (optional) a substantiated proposal for a CBCA. A cost-benefit analysis (the "CBA") was included within the CBCA application.

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[4] The Connecting Europe Facility is a funding instrument for the trans-European networks in the transport, energy and telecommunications sectors. It has been established under Regulation (EU) 1316/2013 of the European Parliament and of the Council of 11 December 2013 establishing the Connecting Europe Facility, amending Regulation (EU) 913/2010 and repealing Regulations (EC) 680/2007 and (EC) 67/2010

[5] Recommendation of ACER No 07/2013 of 25 September 2013 regarding the CBCA requests submitted in the framework of the first Union list of electricity and PCIs

[6] Externalities include (but are not limited to) the costs and benefits associated with: the environment, society, competition, security of supply, sustainability, disaster resilience, and impact on congestion.

[7] The evaluation of costs and benefits is undertaken through a Net Present Value (NPV) cost-benefit analysis (CBA) that includes short and long term costs and benefits where such costs and benefits are monetised as far as possible. Some benefits, however, cannot be monetised and although excluded from the analysis they are still reported qualitatively in the CBA.

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The CBA's monetised benefit from the LNG terminal is an anticipated reduction in the wholesale gas price across the UK (GB and NI) and RoI resulting from increased competition. The CBA allocates a share (5-10%) of this benefit to the Shannon Pipeline Project on the assumption that the construction of the pipeline will increase the probability of the LNG terminal being developed. The CBA estimates the Net Present Value (NPV) of this share of the benefit as EUR 548 million for the UK (GB and NI) and RoI consumers.

In the CBCA application, you have not made any specific request for investment costs to be allocated to GB, NI and RoI. You have included in your CBCA application a request for EU financial assistance under the CEF. You proposed an investment cost allocation to GB, NI and RoI at a workshop held at the Commission of Energy Regulation (CER) office on 21 February 2014. This was:

RoI contribution	100%
NI contribution	0%
GB contribution	0%

In considering the project proposal, we have been engaged in discussions with CER, URNI and Shannon LNG. The process to date comprised:

6 Nov 2013	Submission of CBCA application by Shannon LNG to NRAs
19 Dec 2013	NRAs' further information request to Shannon LNG
10 Jan 2014	Further information received by NRAs from Shannon LNG
21 Feb 2014	Workshop delivered by Shannon LNG and attended by Ofgem, URNI and CER
6 Mar 2014	Further information request to Shannon LNG following the workshop
20 Mar 2014	Further information received by NRAs from Shannon LNG
May 2014	Ofgem's consultation with Shannon LNG on the decision it is minded to take on the CBCA application
16 June 2014	Ofgem's final decision on the CBCA application and NRAs' final Coordinated CBCA decision.

Throughout this period the NRAs have communicated with each other on a regular basis.

Our analysis of the CBCA application

In undertaking our analysis we have given due regard to our principal objective to protect the interests of existing and future consumers in Great Britain and our general duties including our functions as the UK National Regulatory Authority under the EU Third Energy Package.[8] In particular, due consideration has been given to ensuring that consumers in GB do not contribute financially to projects where the benefits do not justify such financial contribution.

Analysis

The CBA within the CBCA application is detailed. It shows that the project provides a positive net benefit taking the effect on all the relevant countries, RoI and the UK (including GB and NI). The CBA also states that none of these countries, individually, experiences a net negative benefit. The ACER Recommendation specifies the need for a negative net

[8] The term "EU Third Energy Package" refers to Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (Electricity Directive); Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/203 (Electricity Regulation); Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (Gas Directive); Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 (Gas Regulation); and Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

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benefit in at least one member state. While exceptions are allowed where the NRAs agree, we think that it is important to comply with this condition. This is in part because in the context of this first Union list of PCIs, there have been and will be further developments to the CBA that underpins the list. This helps to ensure that consumers in GB contribute to PCIs only where necessary and where wider benefits are achievable.

While secondary to this reason and without ruling out possible long-term benefits to GB, we make the following points about the analysis contained in your CBCA application. We consider that:

1. The CBA's monetised benefits to GB consumers can only be realised once the related Shannon LNG terminal is developed. In Shannon LNG's CBCA application the increased probability of the LNG terminal being developed if the pipeline is built is relatively small.
2. If the LNG terminal were developed we would remain unconvinced that there would, in fact, be the expected benefits to GB consumers as stated in the CBA. Based on our understanding of the GB gas market, network congestion from existing GB LNG terminals is not likely in the near future.

National Grid has stated that in the longer-term there would be benefits to the UK (including GB). We are not at this stage denying the possibility of such wider benefits. However, this is insufficiently certain at this point to affect our CBCA decision.

We recognise from CER's analysis that the project does provide significant benefits to RoI, including fuel substitution effects for existing off-grid customers. These benefits are more certain and have a higher degree of confidence than benefits to GB consumers.

<u>Conclusions</u>

The CBCA application of 100% of the cost to be borne by RoI is consistent with our assessment of the benefit distribution.

The Shannon Pipeline Project delivers an overall net benefit and none of the countries involved, ie RoI and the UK (including GB and NI) experience a net negative benefit.

While secondary in determining our decision, we feel that our consideration of the suggested benefit to GB, conditional on the LNG terminal itself rather than the Shannon Pipeline Project, has to take account of the relatively small increase in likelihood of the terminal being built, from your CBCA application. Longer term benefits might be present but do not affect our CBCA decision.

Final decision

Following our consideration and discussion with the other NRAs, we have reached the decision that the cost allocation of 100% to RoI and 0% to both Great Britain and NI is appropriate.

<u>Reasons for the decision</u>

None of the countries experience a net negative benefit as a result of this project. This is sufficient on its own to support no allocation of the investment costs to GB. We agree with your assessment that while some benefits in the long-term might accrue to the UK and potentially to GB, these are insufficiently certain to justify a CBCA of anything other than 100% costs to RoI, 0% to NI and 0% to GB.

Our view is that although we agree with your assessment of the cost allocation between the countries, we have to take a decision not on whether we agree but on the appropriate CBCA. It is reasonable to take the ACER Recommendation into account here. Had we failed

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to do so and not reached agreement with the other NRAs, ACER would have followed its own Recommendation in considering any appeal.

While secondary, the likelihood of some of the benefits in the assessment is small (following your own analysis). This does not seek to downplay the potential benefits. Instead this suggests, as you appear to recognise in your own assessment, that even if the net negative benefit test is not applied, the appropriate CBCA is as in our decision.

If you have any queries on this letter please contact Iain Morgan at iain.morgan@ofgem.gov.uk.

Yours sincerely,

Andrew Burgess
Associate Partner, Transmission and Distribution Policy

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Annex 1

Coordinated decision under Article 12 of Regulation 347/2013 on the cross-border cost allocation request submitted by Shannon LNG (PCI 5.3)

On November 6th, 2013, Shannon LNG (the "Project Promoter") applied for a cross-border cost allocation (CBCA) in accordance with Article 12(3) of Regulation (EU) 347/2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009 (the "Regulation"). This CBCA application, along with all further information received from the Project Promoter by the NRAs, was transmitted for information without delay to the Agency for the Cooperation of Energy Regulators (the "Agency"), as per Article 12(3) of the Regulation.

The Commission for Energy Regulation, the Northern Ireland Authority for Utility Regulation and the Gas and Electricity Markets Authority (hereon the "NRAs"), having:

- evaluated the contents of the cross-border cost allocation proposal;
- reviewed the contents of the application in light of the Regulation and the Agency's Recommendation No 07/2013;
- considered the meeting held with the Project Promoter on February 21st, 2014;
- appraised all additional information provided in response to information requests forwarded to the Project Promoter on December 19th, 2013 and March 6th, 2014, and responded to on January 10th, 2014 and March 20th, 2014 respectively,

have concluded their consideration of the CBCA application and have agreed to allocate 100% costs to Ireland and 0% costs to Northern Ireland and Great Britain.

This decision has been taken pursuant to Article 12(4) and in consideration of Article 12(1) of the Regulation. This decision is in line with the cost allocation proposed by the Project Promoter of 100% to Ireland and 0% to Northern Ireland and Great Britain. This decision will have no tariff impact on either Northern Ireland or Great Britain. The Commission for Energy Regulation has set out in its individual decision letter the impact on tariffs if it were to approve an up-front payment from the Irish Transmission System Operator.

Attached to this decision are letters setting out the detailed reasons and basis for the NRAs' individual decisions in respect of this CBCA application, as required by Article 12(5) of the Regulation.

This decision is agreed on:

By:

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