

**Response from AES**

**Common Arrangements for Gas**

**Transmission Tariff Methodology and Regulation in  
Ireland and Northern Ireland**

**15<sup>th</sup> August 2008**

1. AES welcomes the opportunity to comment on this consultation. Whilst we found the earlier workshop on these issues very helpful, we were somewhat concerned by the comment from the regulatory panel that decisions had to be made before year-end because of two other key investment decisions in the RoI. This left us with the impression that decisions may already have been made and that we were simply “going through the motions” with this consultation process. We hope that this is not the case.
2. Generally networks (either gas or electricity) are considered natural monopolies irrespective of ownership. The thrust of EU legislation is that networks should facilitate competition in the production and final supply of either gas or electricity.
3. The existing networks (North and South, on shore and off shore) are sunk costs which have to be paid for by consumers irrespective of utilisation. In such circumstances tariffs should be designed to (i) encourage full utilisation and (ii) to facilitate and promote competition in the production and final supply of both electricity and gas.
4. It is our view that the high entry tariff for IC1+2, reflecting low utilisation, distorts competition unnecessarily. As we have said already, consumers have to pay the full cost of the IC1+2 investments irrespective of utilisation. The problem becomes circular; if regulated tariffs remain high, utilisation will remain low. Setting a relatively high tariff for IC1+2 is likely to result in producers and suppliers of gas at other entry/exit points earning increased margins, because they will price to consumer avoided costs. Therefore consumers will see no advantage whatsoever from competition in the production and supply of gas.
5. If we stick with the existing entry/exit tariff arrangement, the solution to the problem above rests in setting network tariffs at a notional level of utilisation, perhaps 80%. In the short term, there may be a revenue under-recovery but this could be catered for by either a PSO charge across all consumers or by extending the revenue recovery period for the asset to allow for improved utilisation over time. An alternative solution is to move to a postalised arrangement similar to that in place in NI.
6. Gas entering from Corrib or Shannon LNG can attract higher margins if the tariff on IC1+2 remains in its current form. This will clearly be attractive to the investors and to Government given the potential for increased security of supply. However we must be careful not to deliver security of supply using “hidden” subsidies which distort competition. EU legislation permits PSO levies for investments to deliver security of supply. Such a mechanism would be more appropriate than subsidies which distort competition. If we are to use the

PSO vehicle for security of supply investments however, there clearly needs to be an upfront competition for this provision. The two departments commissioned a study some time ago in regard to options for enhancing security of supply but we are unaware of any decisions that have flowed from this work to date.

7. At present network tariffs are split into fixed and variable components. Presently the split is 90:10 in RoI and 75:25 in NI. We are unaware of any economic rationale for these splits. They appear to be somewhat arbitrary. In our view the different splits create an unnecessary distortion between the electricity and gas markets in NI and the RoI. Tariffs should be set to promote competition in the production and supply of gas and electricity. To create the maximum day-to-day competition tariffs should be 100% variable in both jurisdictions. Having to book and pay for network capacity for a year ahead creates an unnecessary barrier to competition. Moving to 100% variable charges may slightly reduce predictability of revenue recovery but this can be addressed by tariff correction factors.
8. We see no compelling economic rationale for differentiating transmission network charges between existing gas producers or consumers for each jurisdiction on the basis of location. For existing sunk costs, postalised tariffs are economically efficient.
9. The cost of new connections to the existing transmission networks should also be postalised if this makes economic sense. We suggest that an objective Network Investment Test (NIT) should be conducted for each application<sup>1</sup>. This test might, for example, consider the incremental capital costs and the resulting reduction in overall unit costs to all consumers. Clearly the test needs to encourage new connections at locations where incremental capex is minimised.
10. The remaining big question is; should we have one single postalised transmission tariff across the entire island? The objective is to create a single all-island energy market. We consider this to mean, amongst other things, minimising regulatory distortions between the jurisdictions such that competition can prevail across the island in the production and supply of energy. Given that the transmission of gas is a natural monopoly, this might point to single postalised tariff across the island.
11. At present all customers on the island pay the same price for energy in the SEM, namely the system marginal price. However, whilst the electricity transmission tariffs are postalised for customers in each jurisdiction, a differential remains in net tariff charges between the jurisdictions.

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<sup>1</sup> This approach is used in some electricity networks. We can forward a reference for this later if requested.

12. Existing transmission network assets (and production assets) in each jurisdiction are owned by the asset owners. They are not owned by consumers. Whilst it is essential that network owners continue to get the regulated return they anticipated at the time of investment, maintenance of tariff differentials on the basis of jurisdiction may not be consistent with the notion of a single energy market.