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Common Arrangements for Gas: Transmission Tariff Methodology and Regulation in Ireland and Northern Ireland Consultation Paper dated 27 June 2008 (the “Consultation Paper”)

Manx Electricity Authority (“MEA”) Response

General Comments

The Consultation Paper does not consider the impact on the Isle of Man of the alternative tariff methodology options. The Isle of Man is a separate jurisdiction and we consider that a change in tariff methodology or a reduction in capacity bookings on IC1/IC2 could potentially have a bigger impact on natural gas users in the Isle of Man than gas users in Ireland or Northern Ireland. We therefore consider that the future tariff arrangements under the Common Arrangements for Gas (“CAG”) should take account of the Isle of Man’s unique situation, so that the use of natural gas on the Isle of Man remains economically viable.

The MEA is a shipper on the IC1/IC2 interconnector and has reserved capacity in order to bring natural gas to Isle of Man. The MEA acts as the Isle of Man gas ‘wholesaler’ on behalf of the Isle of Man Government and as part of Government’s long-term energy strategy for the Isle of Man. Currently, MEA acquires IC1/IC2 capacity under a bilateral contract with Bord Gais Eireann (“BGE”). However, once Code Modification A030 has been implemented, the MEA will acquire IC1/IC2 capacity in accordance with the Irish Gas Code of Operations and under the tariff structure in Ireland, except that MEA will to pay Isle of Man IC Offtake charges under a bilateral agreement with BGE rather than an Exit tariff. As a result, following the implementation of the Modification, any change to the IC1/IC2 tariff methodology will have a direct impact on gas users in the Isle of Man.

In addition, the Isle of Man is also likely to be significantly affected if capacity bookings on IC1/IC2 are reduced due to the development of new indigenous gas fields and LNG import facilities on Ireland. This is due to:

- the Isle of Man’s position on the IC2 interconnector;
- the IC1/IC2 interconnector being the only source of natural gas for the Isle of Man;
- the lack of any indigenous gas fields or other energy supplies on the Isle of Man;
- the prohibitively high cost of building an alternative gas interconnector to either UK or Ireland; and
- the relatively small number of gas users on the Isle of Man able to absorb cost increases.

There is a risk that if capacity bookings on IC1/IC2 are reduced significantly and in the absence of any arrangements for reverse of flow, either virtual or physical, from Ireland to Moffat, the Isle of Man may be obliged to bear a disproportionate share of IC1/IC2 interconnector system charges to obtain natural gas supplies. In this situation, we consider that IC1/IC2 interconnector system charges should reflect the security of supply benefits which gas users in Ireland obtain from the IC1/IC2 interconnector.

Finally, we would wish to highlight the Isle of Man's rights to obtain capacity on the gas interconnector between UK and Ireland under the terms of the 1993 and 2004 Inter-Governmental Treaties between Ireland and the United Kingdom. Under the Treaties, the Irish Government has agreed to facilitate the transit of gas *'..on terms as if the Council Directive 91/296/EEC and any other relevant EC gas transit legislation (as amended or replaced from time to time) applied to the Isle of Man..'*. The Directive was adopted in May 1991 and our understanding is that it obliges EU Member States to take measures necessary to facilitate the transit of natural gas between transmission grids.

The MEA is the IOM Competent Authority under the Inter-Governmental Treaties and the requirements of the 2004 Treaty in relation to obtaining IC capacity have been included in the Code Modification A030.

Specific Comments

Q1: Have we adequately described the differences/commonalities between the two markets?

The Isle of Man is a separate jurisdiction and therefore represents an additional market which has not been included. However, following the implementation of Code Modification A030, the MEA will acquire IC1/IC2 capacity for Isle of Man gas users in accordance with the Irish Gas Code of Operations. The tariff structure in Ireland will therefore also apply to the Isle of Man, except that MEA will pay Isle of Man IC Offtake charges under a bilateral agreement with BGE rather than an Exit tariff.

Q2: Do you feel that all the relevant criteria have been covered in this document and are there other criteria you feel should be included?

No comments

Q3: Do you have a view in relation to the priority of the criteria and whether some criteria should be considered more important than others?

The important criteria for the Isle of Man are:

- Protecting consumers by ensuring that prices are as low and as stable as possible.
- Development of the gas industry on the Island through the roll out of the natural gas network to consumers on the Island.

Q4: Do you feel we have adequately represented the appropriate reform options at Entry and Exit? What further reform options do you feel warrant further investigation?

No comments

Q5: In relation to mitigating the effect of declining interconnector utilisation, have all the viable options been set out? What option do you feel is missing? What level of price incentive, if any, do you feel is an adequate signal to incentivise indigenous gas production/storage?

We have no comments in relation to the options set out for reducing the annual revenue requirement and reducing the effect of the decline in utilisation.

In relation to incentives for investment in Ireland, we consider that in practice it may be difficult to establish a price level which provides an adequate signal to incentivise investment. We also recall comments of a producer at the recent workshop that the relationship between interconnector tariffs and the price at IBP is not as simple as that set out in the Consultation Paper. As a result, it is likely to be difficult to establish the price level required by producers with any certainty. This could mean that the initial price level may need to be adjusted in the short-term which would create volatility in IC tariff charges.

Although tariffs clearly have a role as an incentive, we consider that it may not be practical to rely only on the price level at IBP to encourage indigenous gas production and storage in Ireland. We consider that other measures may provide a more efficient and economic way of incentivising investment. These are likely to be Government-level initiatives and are therefore probably outside the scope of CAG.

Q6: Do you think we should harmonise the capacity/ commodity split?

We agree that it would be logical to harmonise the proportions allocated between capacity and commodity.

Q7: Do you think we should aim to harmonise non-annual gas capacity products? What products do you feel should be available?

We consider that it is sensible to aim for harmonisation and that the short-term products currently available under the Irish Code and the products currently being considered for development would be an adequate starting point.

Q8: Do you feel that we have adequately described Postalisation under the selected criteria?

Q9: Do you feel that Postalisation is a viable option for the harmonisation of transmission tariffs in the two jurisdictions?

Q10: How should we deal with revenue transfer between the two jurisdictions under postalisation?

Q11: How should we deal with currency risk arising from the Postalisation option?

We consider that postalisation would be a potentially viable option for Ireland and Northern Ireland. However, the position of the Isle of Man would need to be considered, particularly in relation to costs which are currently charged by an Exit tariff.

Modification proposal A030 requires a shipper to the Isle of Man to pay for capacity at entry, but there is no capacity charge at offtake (i.e. the Onshore Tariff does not apply, although an overrun charge is, rightly, applicable). Costs relating to the Isle of Man IC Offtake will be charged under the terms of a bilateral agreement with BGE. In addition, there are significant infrastructure costs for the onshore system on the Isle of Man (downstream of the Isle of Man IC Offtake) that are paid for by users of capacity in the Isle of Man.

It follows that under postalisation gas users in the Isle of Man would pay a proportion of costs relating to the onshore system in Ireland and also be obliged to pay Isle of Man IC Offtake charges. This would create a 'double charge' for Isle of Man gas users. It may be possible to deal with this using some form of revenue transfer back to MEA in respect of onshore transmission system costs in Ireland. However, we consider that this complication would undermine the simplicity of postalisation.

We note that a postalised capacity charge would be beneficial for consumers, at least in the short to medium term, due to lower and less volatile prices. As the Isle of Man has no indigenous gas sources the potential impact on security of supply has less relevance.

In relation to currency risk, MEA currently pays for IC capacity in Euros and manages the associated currency risk against Sterling. We would continue to manage this currency risk if capacity continued to be charged in Euros.

Q12: Do you feel that we have adequately described the entry options under the selected criteria?

Q13: How should we deal with revenue transfer between the two jurisdictions under the relevant options?

Q14: How should we deal with currency risk arising from the above options?

We would highlight the fact that the existing position of separate entry points could be seriously detrimental to the Isle of Man if there is a significant drop in IC capacity bookings. We believe that this would lead to Isle of Man gas users paying a disproportionate share of IC costs: effectively the Isle of Man would become a stranded user on a stranded asset. We therefore consider that the option to retain the existing position is not a 'viable option' for the Isle of Man.

Q15: Do you feel that we have adequately described the exit options under the selected criteria?

Q16: How should we deal with revenue transfer between the two jurisdictions under the single exit option?

Q17: How should we deal with currency risk arising under the existing exit option?

We consider that there should be no change to the tariff arrangements in respect of the proposed Isle of Man IC Offtake under CAG. The effect of this would be that MEA would not pay an Exit tariff.

Q18: Should there be any attempt to mitigate the effect of declining utilisation of the interconnectors?

Q19: Do you feel that we have adequately described the relevant options under the selected criteria?

As noted previously, this is a key issue for MEA and the Isle of Man.

We consider that it would be appropriate, and in the long-term interests of gas users in the three jurisdictions, to mitigate the effect of declining utilisation of the interconnectors. We also consider that it would ultimately benefit producers, storage and LNG terminal owner/operators in Ireland as mitigation would support the development of the gas market Ireland and Northern Ireland.

We consider that the IC transmission system will always have an important strategic role for Ireland as an alternative supply of natural gas. This provides essential security of supply for gas users in Ireland and also CAG, even if natural gas is provided from either indigenous sources or the Shannon LNG terminal. We consider that it would not be reasonable to expect the entire cost of the interconnector to be met those shippers who continue to use the interconnector during a period of declining utilisation.

As there is no viable economic alternative, the Isle of Man could be obliged to pay a disproportionate share of these costs.

In relation to the minimum booking level we would like to see more detail in relation to who books and pays for the guaranteed capacity.

Q20: Do you feel that we have adequately described the option of harmonising capacity and commodity charges under the selected criteria?

Q21: What is an appropriate level at which to harmonise?

We consider 80% would be acceptable

Q22: Do you agree with our analysis of the applicability of auctions?

We consider that the use of auctions would not be appropriate at this stage of market development.

Q23: Do you agree with our selection of viable options for further analysis? What additional options should be included for further analysis and why. What options should be excluded from further analysis and why?

Q24: What is your preferred option for entry/ exit?

We consider that postalisation would benefit Isle of Man gas users and achieve the best possible match with the priorities for the Isle of Man (protecting consumers and development of the gas industry). However, it may not be practical to implement across the three jurisdictions.

A single entry point tariff would be worth further analysis. We assume that MEA would continue to pay the Isle of Man IC offtake charge under a bilateral arrangement rather than an exit tariff. This charging basis would also meet the priorities for the Isle of Man. However, we are aware of the need for CAG to balance the development and incentivisation of the market on the one hand, against the protection of consumers. A single entry point would have advantages for the development of the natural gas market under CAG as it would be simple to regulate and provide sufficient price signals for the development of more import gas capacity.

Q25: Which is your preferred option for mitigating the effect of declining interconnector utilisation?

We consider that some form of mitigation is essential both for MEA, Isle of Man gas users and the other shippers who will continue to use the interconnectors. We consider that establishing a PSO levy and buying down some of the costs by moving the Regulated Asset Base would be worth further consideration. Our expectation is that these options would effectively transfer costs from IC to the onshore transmission system. A transfer of costs would be appropriate when considering the Isle of Man charges as it would reflect the security of supply benefits for Ireland and Northern Ireland gas users from the interconnectors.

In addition, guaranteed minimum capacity bookings may also be worth further consideration if this also effectively transferred costs from IC to the onshore transmission system.

We consider that reprofiling linked with some cost reductions would simply defer costs to future periods.

Due to the high importance of this issue for the Isle of Man we would like the opportunity to consider the mitigation options in more detail as the consultation process moves forward.

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