Airtricity Response to

Draft Conclusions on Transmission Tariff Harmonisation in Ireland and Northern Ireland

(A CAG Consultation)

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Scottish and Southern Energy

Airtricity Ltd, Airtricity House, Ravenscourt Office Park, Sandyford. Dublin 18

Introduction

The draft conclusions on transmission tariff harmonisation in Ireland and Northern Ireland has gone a long way in reducing the scope of issues under consideration to enable a more considered analysis. This however has not been the case on the vexing issue of the tariff implications of IC2 underutilisation. If anything the difficulty of tackling it is made even more evident with further suggestions of possible solutions thrown into the mix. While the IC2 issue is not necessarily a CAG issue, it portends grave issues for it if not properly addressed.

Airtricity welcomes the opportunity to respond to these draft conclusions and have below provided our comments to a number of the specific areas as requested by the regulatory authorities.

RAs Preferred Approach to Implementing an Entry-Exit Regime

In their September 2002 European Commission commissioned report, The Brattle Group recommended '…a presumption in favour of entry-exit tariffs…'[1] Since then the preference for the principle of entry-exit systems for European gas networks has been validated at the 6th Madrid Forum.[2] Furthermore this methodology of transmission tariffs for gas networks has been included as a proposal in the European Commission's COM(2007)0532[3], part of the 'Third legislative package'.

Given the prevailing above, it would seem that a decision for entry-exit as the substantive transmission tariff regime for gas networks in Europe is *fait accompli*. This position has been stated variously, both in the consultation papers and the workshops, by the regulatory authorities.

With this being the case, unless a compelling argument can be advanced otherwise, it is hard to see the adoption of a transmission regime other than entry-exit. While a fully postalised regime offers some benefits as identified in the consultation paper, such as average cost pricing and reduced financial risk, the significant impact it poses to Northern Ireland customers in terms of increased tariffs reduces considerably any attractiveness to it. The additional aspect that it will essentially eliminate any market signals further puts it at a disadvantage.

In light of the foregoing we do not see any objections to the regulatory authorities' stated preference to implement an entry-exit transmission regime.

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[1] Lapuerta C., Moselle B.: Convergence of non-discriminatory tariff and congestion management systems in the European gas sector, p. 8.

[2] Conclusions of the 6th meeting of the European Gas Regulatory Forum Madrid, 30-31 October 2002, para. 8.

[3] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks.

Entry Asset Configuration

Essentially two options for the configuration of entry points have been left for active consideration by the regulatory authorities – Combined Moffat with all other entries separate and Separate Moffat with all other entries separate. In effect then the issue in point is whether the ICs connected to the Republic of Ireland should be combined with SNIP in making tariff determinations or not.

While the ICs and SNIP land in different jurisdictions and are owned and financed differently, consideration under point (or source) geometry implies a single entry point – located at Moffat. Equally while in principle we would support an entry configuration that mapped the logical architecture to the physical layout, i.e. a tariff entry point per actual pipeline, in this case the physical reality does not support a great deal of differentiation.

Given that differences exists, as those alluded to above with respect to ownership and financing, the first stated objective in the CAG Memorandum of Understanding refers to the operation of 'the natural gas market north and south of the border *effectively*[4] on an all-island basis.'[5] In other words, while not smearing out jurisdictional differences, a key aim is to attain operations *minimising* those differences.

In our initial response to the consultation preceding the current one, we laid out the principle of adopting 'a solution that is sized appropriately to the island of Ireland'.[6] In contributing to such a solution it is inevitable that the two jurisdictions of Ireland and Northern Ireland will offer upsides and downsides. Along those lines we have attempted an analysis of the two remaining entry point options. Our analysis of the weigh offs considered the 'persistence' of these advantages and disadvantages. By 'persistence' we refer to an enduring quality to the factor under consideration. The options presented in the consultation, the Combined Moffat and the Separate SNIP, Combined ICs options, are considered in the Annexes to this document.

The Combined Moffat option presents benefits which make it particularly attractive. On a stakeholder basis, it appears to offer substantive benefits all round – operational efficiencies to the TSO, which potentially could 'trickle down; reduced IBP and volatility which benefits supplier offerings to customers; maintains some production incentives even if at lower levels. While Northern Ireland gas users may appear to be disadvantaged under this option, as has already being pointed out this could be remedied with the design of exit tariffs.

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[4] Emphasis intended.

[5] Memorandum of Understanding between CER and NIAUR in relation to Common Arrangements for Gas (CAG) under the All-island Energy Market Development Framework.

[6] Airtricity Initial Response to Transmission Tariff Methodology and Regulation in Ireland and Northern Ireland.

For these reasons we recommend the Combined Moffat with all other entry points separate option.

Exit Asset Configuration

As we noted in our response to the initial consultation on this issue, Airtricity advocates for jurisdictional exit points. In other words two exit zones, with one each in the Republic of Ireland and Northern Ireland. The benefits have already being listed in the consultation but to complete the stakeholder analysis we alluded to above in considering the entry asset configuration, jurisdictional exit points in conjunction with Combined Moffat entry configuration helps redistribute tariffs between north and south and thus minimise any adverse impacts to gas users in Northern Ireland.

In our previous response also, we suggested a possible 'virtual' exit point for gas-fired generation plants in SEM. Since generators in SEM are required to only bid in their short-run marginal costs, essentially fuel costs, varying exit point transmission costs between the two jurisdictions does not necessarily lead to a distortion in the SEM. But we note here an argument made by VP&E for the recovery of fixed gas transportation costs in the SEM. While this may not be the avenue for advancing this position, in principle we support such a position but note the potential for distortion between north and south were this the case. In such an event then a common but distinct exit point just for gas-fired generating plants may be necessary.

To summarise then, our preference would be for a two exit zone configuration.

Mitigating the Effects of Low IC Utilisation

This issue of IC underutilisation has been correctly identified as an issue that poses immense difficulty to the industry, irrespective of CAG. The various ramifications of this situation have already been documented elsewhere, but it will bear pointing out that the potential drastic escalation of transmission tariffs thus making landed gas very costly could result in a feedback loop mechanism whereby fuel substitution occurs both for space heating and electricity generation pressuring demand downwards, and thereby putting further upward strain on transmission tariffs. This could do untold damage to the gas industry in Ireland, if it allowed to play out to the full extent.

CER in Annex 1 of the consultation stated its position against stranding IC2 investment costs as a means of mitigating any tariff implications of expected reduced throughput on the interconnector. CER also made pains to stress that this situation has not been created by any of the indigenous gas developers. Be that as it may, the implication of substantial tariff increases should not be allowed to fall in any substantial way on gas end users either.

An essential element of the decision made to invest in IC2 was considerations for security of gas supply. While this consideration was made with Republic of Ireland customers primarily, as the paper notes customers in Northern Ireland also share in this benefit. On this basis IC2 has value which is offered to the market, value which may be more evident for instance if at any time during the period of low utilisation another entry point encounters an outage for any reason.

In light of this then Airtricity would strongly argue that this benefit of security of supply should be carefully assessed, quantified and then levied in such a manner to reduce the tariff implications of IC2 underutilisation. What that value is we cannot assume to know, but presumably it does not exactly dovetail with the investment cost of IC2.

While we advocate for a security of supply levy we do not advance it as a singular, or even as a primary solution. Various options have been advanced to mitigate the expected underutilisation and while each in its own right has merit, we are of the opinion that staged application of a combination of the options, with each contributing to the mitigation, may be preferable to a single option solution.

As the RA paper noted, combining the interconnectors into a single entry point at Moffat will result in lower transmission tariffs. While not the primary objective of this entry configuration, if adopted it contributes its share to the mitigation effort.

If this then is followed up by the application of an appropriately valued security of supply levy, a lower tariff shape will result which can then be re-profiled to flatten it further.

This regimen may not entirely remove tariff increases but it may well reduce such to level that is insignificant.

While this particular combined set of options may not provide the optimal solution, we will urge the RAs to consider using such an approach to minimise the wholesale impact of applying a single option on any one stakeholder in the market. Irrespective of the option or combination of options adopted, it is worth reiterating that unmitigated gas transmission tariff increases could lead to wholesale fuel substitution and consequently gas demand collapse.

Summary

In the discussion above we have aimed to balance off the various stakeholder interests that are affected by the issues under consideration. But at the end of the day the whole point of transporting gas is to provide end-users with a relatively safe, cost-effective and manageable fuel for various needs but primarily space heating and electricity generation. The energy required for these end uses can, with minimal effort in most cases, be obtained from other fuels. In light of this it cannot be overemphasised the CAG should aim to, and

actually deliver demonstrable benefits to end-users. Else the immense effort required may very well be conserved.

It is on this basis that we submit our comments on the draft conclusions on transmission tariff harmonisation in Ireland and Northern Ireland.

ANNEX 1A: Analysis of 'Persistence' of Combined Moffat Asset Configuration Option

Combined Moffat	Advantages	Operational Efficiency	Were substantial operational efficiencies to be identified under the option, it would be the case that the benefits will 'persist' so long as the arrangements were maintained.
		Reduced IBP	This would also be considered a 'persistent' benefit arising from the arrangements.
		Reduced Producer Incentives	This would be similar to the position above.
		Provisional mitigation of IC2 underutilisation	This has already been labelled 'provisional'. Hence this benefit is not by so labelling enduring and may be fleeting depending on the addition of new sources of gas.
		Reduced volatility	This benefit we see as 'persistent'.
	Disadvantages	Impact to NI	This may be considered a 'persistent' proposition, since even though NI is anticipated to start receiving gas from IC2 from 2011, the quantities if averaged out against lower cost SNIP gas may not necessarily result in substantial tariff increases. But since this can be mitigated by say a jurisdictional exit point we argue that this can be managed.
		Security of supply Aspects/Producer disincentive	This creates a 'persistent' downside if a relatively lower, stable tariff regime serves as a disincentive to producers. However this option does not entirely eliminate such incentives and may actually only eliminate 'super profits'.
		Implementation	This may require substantial effort upfront but once in place we anticipate that efforts addressed at administration will be minimal. Hence we do not regard it as 'persistent'.

ANNEX 1B: Analysis of 'Persistence' of Separate SNIP, Combined ICs Asset Configuration Option

Separate SNIP, Combined ICs	Advantages	NI transmission tariffs	A 'persistent' factor since SNIP in this case will be managed for the benefit of NI alone, eliminating the 'straying' of IC2 issues across the border.
		New production incentives	This potentially is 'persistent' but that depends on factors such as how deep and long IC2 emerges to be dependent on the production profile of Corrib, the shipment profile of Shannon LNG and the discovery, development and production of new gas fields. It also depends on how effective any IC2 underutilisation mitigation is. An additional counterargument is that production incentives do not, indeed should not, lie exclusively in transportation costs. Other factors such as the price of the commodity itself do serve as intrinsic incentives.
	Disadvantages	Operational limitation	This will remain 'persistent' with no means to obtain comparable efficiencies.
		Potential price increase in NI	Not exactly sure how this is the case, since moving to an entry exit for NI, under this configuration, is similar to the subsisting postalisation regime, with a mere splitting of the current transmission tariffs into a single entry (SNIP) and a single exit (onshore NI) – if a distinct single exit point is adopted for NI.
		Retain higher marginal pricing	This will be 'persistent' in so far as the marginal ICs are underutilised and this underutilisation is not mitigated substantially.