

**Response to SEM-12-089, CER/Utility Regulator
Consultation on Single Electricity Market
Treatment of Gas Transportation Capacity Costs**

For the attention of:

**Kenny Dane, Northern Ireland Utility Regulator, Queens House,
14 Queen Street, Belfast, BT1 6ED**

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Prepared by:

**Ger Fullam
Managing Director
Kore Energy
Unit 4, Ballisk Business Park
Donabate, County Dublin
Ireland**

Tel: +353 (0)1 808 5555

Fax: +353 (0)1 808 5554

Website: www.kore.ie

Registered Number 403186 (Ireland)

Registered for VAT: IE6423186E

Introduction

Kore Energy welcomes the opportunity to respond to the CER/Utility Regulator consultation on the treatment of gas capacity costs within the Single Electricity Market (SEM). Kore Energy is the largest provider of energy procurement and energy price risk management services in the Irish Energy Market. It provides services to a broad spectrum of industrial and commercial energy users in Ireland, including 5 of the Country's 10 largest energy users.

During the current difficult economic conditions in Ireland and, indeed, globally, we are particularly concerned at the prospect of implementing any changes to the SEM that would have the impact of increasing electricity prices and impacting adversely on the competitiveness of Irish Industry. We note that the consultation document does not provide an analysis of the cost impact of any decision to allow the inclusion of gas transportation capacity costs. Based on the gas Transmission Capacity rates implemented from 1 October 2012, which are 20% higher than those referred to in the consultation document, table 1 below provides an illustration of the potential cost impact on electricity prices in Ireland, arising from the inclusion of gas capacity costs in Commercial Offer data or Short Run Marginal Cost (SRMC) bids submitted by gas fired power generators.

Table 1: Impact on electricity prices as a result of including gas transmission capacity costs in electricity Commercial Offer data

	2012/13 gas capacity charges		Impact on electricity price: €/MWh	
	€/annum/peak day MWh	€/day/peak day MWh	55% efficiency, 15 hours/day	35% efficiency, 2 hours/day
Annual	€ 754.80	€ 2.07	€ 0.25	€ 2.95
Monthly	€ 1,169.95	€ 3.21	€ 0.39	€ 4.58
Daily	€ 2,180.36	€ 5.97	€ 0.72	€ 8.53

As an alternative to considering the inclusion of gas capacity costs in Commercial Offer Data, it may well be more appropriate for the Regulatory Authorities to consider amending the Bidding Code of Practice to specifically disallow the inclusion of gas capacity costs, given that these costs are already captured with the Best New Entrant (BNE) calculation which determines the amount of the Annual Capacity Payment to power generators. With the Capacity Payment set at €529 million for 2013, it hardly seems credible that power generators should be seeking further revenues from the SEM, most likely linked to a notional cost for gas capacity that they are not actually incurring. As there is no reference in the consultation document to power generators failing to recover actual costs or being disadvantaged, competitively, as a result of the exclusion of gas capacity costs from Commercial Offer Data, it would appear that the only notable outcome as a result of including the costs will be to increase electricity prices to consumers, thereby increasing power generator's profits. On that basis, we urge the Regulatory Authorities to ensure that this change is not implemented.

In relation to the specific questions raised by the Regulators in the consultation document, our responses are detailed as follows:

Q1 *Has there been sufficient development on the trading of gas transportation capacity since the publication of the Bidding Code of Practice to allow the cost of such to be included in Commercial Offer Data? If so, why? Is this situation different between Northern Ireland and ROI?*

Kore Energy Response

In relation to secondary gas capacity, we do not believe that its inclusion in Commercial Offer Data is appropriate, primarily as there is no transparent market for the trading of secondary capacity but also because a generator relying on secondary capacity cannot fully commit to being available for dispatch due to the interruptible nature of that capacity.

Short term monthly and daily capacity products can only be sold as firm capacity products by Gas Link and cannot be subject to further trade by the purchasing Shipper. On that basis, we believe the purchase of these products does not constitute trading to the extent that the prices for those short term products should be included in Commercial Offer Data.

In respect of Northern Ireland, given that short term capacity products are sold on a 12 day forward basis, these costs could not be allowable as part of the SRMC bid.

Q2 *Should the cost of gas transportation capacity be included in the Commercial Offer Data of units in Northern Ireland?*

Kore Energy Response

No, for the reasons stated in response to question 1 above and also as the cost of gas transportation capacity has already been included in the cost structure of the Best New Entrant (BNE) power generator for 2012/13 with the result that the cost is already recovered by generators via the Capacity Payment Mechanism.

Q3 *Should the cost of gas transportation capacity be included in the Commercial Offer Data of units in the Republic of Ireland? Is there any good cause why the principles within paragraphs 8(i) and 8(ii) of the Bidding Code of Practice should not be applied?*

Kore Energy Response

For various reasons outlined below, we believe that the cost of gas transportation capacity should not be included in Commercial Offer data. These reasons are:

In the first instance, the cost of annual gas capacity should not be included in SRMC bids as it clearly does not fall within the classification of a short run marginal cost under the Bidding Code

of Practice (BCOP) and it is already included within the cost of BNE and, hence, the Capacity Payment Mechanism.

With reference to clause 7 of the BCOP for SRMC bids, it is our view that the Opportunity Cost of Short Term Capacity cannot be valued on the basis of published Gas Link prices as Shippers are not entitled to re-sell Short Term capacity products on a firm basis. Also, the pricing of that capacity “by reference to the most valuable realisable alternative use of that cost-item for purposes other than electricity generation” is not possible on a transparent basis due to the opaque nature of secondary trading in gas capacity.

With reference to clause 8(i) of the BCOP the requirement for a “generally accessible trading market” has not been met on a number of grounds for the reasons stated in the previous paragraph.

As outlined in Table 1 in the introduction section of this response, given that it is clearly not economic for a mid-merit CCGT plant to purchase any significant quantity of its gas capacity requirements on a short term basis, we find it difficult to see the rationale behind the inclusion of these costs in Commercial Offer Data. Similarly, we find it difficult to see how even a low load factor peaking plant could justify the purchase of short term capacity over annual capacity, while any interruptible capacity purchased would not be traded on a suitably transparent market.

Q4 *If the cost of gas transportation capacity is to be included in the Commercial Offer Data (of the units in the Republic of Ireland) is there a recognised and generally accessible trading market in short-term gas transportation capacity? Is this recognised and generally accessible trading market in secondary capacity or regulated daily capacity?*

Kore Energy Response

As short term capacity products can only be sold, on a firm basis, by Gas Link, we do not believe that this constitutes a generally accessible trading market, specifically as there is effectively a single seller and the buyer or Shipper is not permitted to re-sell the product as firm capacity. Also, there has been no information provided with this document, detailing the volume of gas capacity purchased by gas-fired generators on a short term basis, relative to the purchase of annual capacity. Due to the high cost of short term capacity relative to annual capacity, it is difficult to see how any significant percentage of capacity would be purchased on a short term basis and on this basis, it is unlikely that any significant market currently exists. In relation to secondary capacity, we do not believe that any transparent and therefore, generally accessible, market exists.

Q5 *If the cost of gas transportation capacity is to be included in the Commercial Offer Data (of the units in the Republic of Ireland) and there is no recognised and generally accessible trading market in short-term gas transportation capacity, what is the replacement cost?*

Kore Energy Response

We hold a strong view that if a generator has declared its availability to generate power for a given period, resulting in it receiving a payment via the Capacity Payment Mechanism, then it should have firm gas transportation capacity available to it for that period. On that basis, we do not see how anything other than the annual cost of firm capacity (for high load factor plant) and the cost of daily short term capacity (for very low load factor peaking plant) can be used to establish the replacement cost.

Q6 **If the cost of gas transportation capacity is included in the Commercial Offer Data (of units in the republic of Ireland), should the price of the BNE be recalculated?**

Kore Energy Response

Yes, clearly generators should not receive a payment for gas capacity via the capacity payment mechanism and the System Marginal Price for electricity. This would only serve to artificially increase the price of electricity in Ireland to the detriment of Ireland's cost competitiveness.

Q7 **Which methods outlined in Section 3 is the most appropriate for accounting for the cost of short term gas transportation capacity?**

Kore Energy Response

We believe that none of the methods outlined are appropriate as the booking of annual gas capacity should provide the most economical solution, in which case this cost is already included in the capacity Payment Mechanism.

Q8 **Are there any other methods for valuing gas transportation capacity which have not been included in Section 3?**

Kore Energy Response

As the price of short term gas capacity currently substantially outweighs the cost of annual gas capacity, with the annual cost of daily capacity amounting to 289% of the annual cost of capacity, it is difficult to see how gas transportation costs can be included in Commercial Offer Data at any value other than the value of annual capacity. However, if there was to be a fundamental shift in the pricing of short term gas capacity in the future, the inclusion of gas capacity costs in Commercial Offer Data in the SEM might make sense. Currently, the price of short term gas capacity is designed, in part at least, to discourage the booking of short term capacity. If the price of short term capacity was more reflective of the actual monthly and daily value of capacity, then its inclusion might be appropriate.

Summary

We believe that the inclusion of gas capacity costs within Commercial Offer Data for electricity is inappropriate as the booking of annual gas capacity is the most economic option for the sourcing of capacity for the majority of, if not all, gas fired generators and the cost of annual gas capacity is already included within the Capacity Payment Mechanism. For a small minority of gas fired generators who may be able to prove an economic case in favour of booking short term capacity or interruptible capacity, we believe that no generally accessible trading market exists for the trading of short term capacity and secondary capacity.

While the above arguments against the inclusion of gas capacity costs in Commercial Offer Data are technical in nature, as is the Regulatory Authorities consultation document on the issue, we believe that this issue needs to be looked at from an efficiency perspective.

In particular, we urge the Regulatory Authorities to consider this issue in the context of the potential adverse impact on electricity prices in Ireland, the impact on the competitiveness of Irish industry and, of course, on householders who are already struggling to meet the cost of ever increasing energy bills.

We look forward to hearing from you in due course.

Yours sincerely,

Ger Fullam
Managing Director