



2 July 2008

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Dear John, Sarah,

RE Consultation on Transmission Use of System Charging Methodology for All-Island Generation Tariffs (SEM-08-067)

EirGrid welcomes the opportunity to respond to the SEM Committee's consultation on the methodology for calculating all-island generation tariffs. EirGrid believes that the introduction of all-island locational tariffs has the potential to support the efficient development of the coordinated electricity system on the island of Ireland, and has been working closely with SONI with a view to achieving the best methodology for use in calculating all-island tariffs.

As the consultation paper notes, high-level design decisions and some detailed methodological decisions have already been made through previous consultations. The outstanding decisions, which form the basis of the consultation paper and/or this response, include:

- the appropriate basis for network costs;
- the method for calculating the monies to transfer between the System Operators; and
- the treatment of lightly-loaded lines.

Network costs

Basis for network costs

The consultation paper states that the RAs' current preferred option for network costing is to use 20% forward-looking costs and 80% historic regulatory asset values as per the ERGEG Draft Proposal on Guidelines on Inter TSO Compensation. EirGrid does not consider that a costing approach based upon historic regulatory asset values accords with the objective of locational tariffs to provide marginal locational signals for entry/exit

onto the transmission system. Indeed, while it may seem logical to treat transit flows on a similar basis to domestic flows, it is not clear that the European ITC mechanism is seeking to achieve the objective of influencing generator location decisions.

Replacement costs have been used as the basis for locational tariffs in the Republic of Ireland to date and EirGrid continues to believe that replacement costs are the most appropriate basis for valuing assets for use in locational tariffs. Replacement costs provide the best proxy for the incremental network cost imposed by a generator in a given location. That is, by providing an estimate of the cost required to replace an asset today, replacement costs provide a forward-looking signal of the cost of expanding the network to facilitate a generator connecting at a given point on the network. This is combined with postalisation to ensure adequate revenue recovery of any non attributable costs.

Notwithstanding this, it may be desirable to smooth cost volatility if such volatility is at odds with the philosophy for using replacement costs. However, EirGrid would also like to note that, in deriving replacement costs, estimates would likely be taken from a number of recent projects undertaken over more than one year. It is therefore unlikely that replacement costs would be overly influenced by short-term volatility, rather than by longer-term trends – a concern raised in the consultation paper.

If the RAs are nonetheless of the view that it is appropriate to undertake smoothing to ensure that costs are not unduly influenced by short-term volatility, then EirGrid believes it is appropriate that any smoothing be applied to replacement costs, and does not understand the principle behind using historic regulatory asset values in this context. The consultation paper includes an option of applying a rolling average of replacement costs which EirGrid believes would be preferable.

If the RAs do decide that regulated values are to be employed, EirGrid seeks further information on what exactly is proposed, including how the “regulated values” are defined and calculated. This is required such that the necessary arrangements can be put in place, for example with ESB Networks, to ensure that the appropriate network costing data is available to EirGrid, both this year and in subsequent years.

More generally, it is important that the final decision provides for consistent treatment of costs in both jurisdictions and that any solution is enduring. EirGrid considers the statement in the consultation paper that “the details of this approach will be kept under review in subsequent tariff years should better information become available” to be very unsatisfactory and to give rise to further regulatory uncertainty both to EirGrid and participants.

Annualising factor

The consultation paper briefly discusses the factors used to convert costs into annualised costs. To avoid creating a distortion between jurisdictions, it is important that the annualising factors applied to Northern Ireland and Republic of Ireland costs are derived on the same basis, but bearing in mind that the factors themselves may be different in the

two jurisdictions. It is not clear to EirGrid that the 7.55% quoted as the Northern Ireland annualising factor was derived on the same basis as that for the Republic of Ireland.

Cross-border revenue adjustment

While not addressed in the consultation paper, an important methodological consideration is the approach to calculating the settlement of revenue on an all-island basis to ensure that each system operator is kept financially whole. As stated in the RAs' July 2006 consultation paper "a combined all-island tariff... will not [necessarily] recover from the users in either jurisdiction, the costs incurred by the transmission companies in that jurisdiction. Consequently there will be a need for a financial transfer between the transmission companies in order to ensure that each company receives the appropriate revenue". EirGrid agrees that, in moving to an all-island model, it is appropriate that tariffs are not differentiated on a jurisdictional basis. And, indeed, it follows that if generators in one jurisdiction are making more use of the all-island networks there will need to be a transfer between the System Operators.

However, the RAs have proposed that the transfer between SOs be adjusted in order to offset an effect on Northern Ireland customers. In particular, in their March 2007 decision paper, the RAs stated that "in order to offset any increase in costs to NI consumers relative to consumers in ROI, the Regulatory Authorities consider it appropriate to make an adjustment, up until the first of the cancellation dates in the PPB contracts, calculated each year as part of derivation of the annual TUoS tariffs and taking into account the locational generation TUoS tariff".

EirGrid is not convinced that seeking to mitigate the impact on a specific customer class is the most appropriate means to decide the transfer between SOs and the utility costs in one or other jurisdiction. Furthermore, the rationale behind the decision by the RAs to specifically mitigate the effect of PPB contracts on Northern Ireland customers is unclear. Indeed, in moving to an all-island tariff model, there are various factors which mean that different groups of customers are affected differently. For example, any additional constraints costs resulting from all-island access rights – including congested North-South tie-lines – will be shared across the entire island. As another example, there may be different planning standards in the two jurisdictions. To the extent that one jurisdiction plans to a higher level of contingency, that cost is being shared on an all-island basis.

While EirGrid recognises that the RAs have previously decided that Moyle will not be charged TUoS, any cross jurisdictional revenue flow should be calculated on the *basis* that Moyle would be charged consistent with its inclusion in the dispatch model. This is important given that interconnectors are a driver of network costs which TUoS seeks to recover.

Finally, regardless of the approach that is adopted, EirGrid assumes and seeks assurance from the RAs that both System Operators will be kept financially whole.

Lightly-Loaded Lines

The consultation paper proposes that lightly-loaded lines continue to be excluded from the calculation of tariffs, as per the existing EirGrid methodology. The philosophy behind removing the costs of lightly loaded lines is that flows on such lines are not driving the need for investment or eliminating the requirement for investment to the same extent. It follows that generators should not be rewarded or charged for flows on such lines.

The RAs' consultation paper discusses the removal of lightly loaded lines as a means to reduce tariff volatility. However, EirGrid notes that the volatility effects of removing lightly loaded lines are uncertain. On one hand, the flow on lightly-loaded lines can reverse more easily as a result of year-on-year changes in generation and demand and therefore the removal of such lines could be expected to reduce volatility. On the other hand, a line which is lightly-loaded in one year may not be in the following year, and hence the removal of lightly loaded lines could potentially increase year-on-year tariff volatility.

It is important that no cross jurisdictional distortion is created in continuing with the removal of lightly-loaded lines given the differences in transmission planning standards in the two jurisdictions. Equally, in terms of its continued application, it must be considered whether the removal of lightly loaded lines is equally applicable, and on the same basis, to all dispatch scenarios. Finally, in the application of a locational tariff it is important to ensure sufficient network is included within the model to ensure that tariff is meaningful in terms of its locational properties. These potential issues should be taken into account in the decision on whether or not lightly-loaded lines should be included, both this year and in subsequent years.

Please do not hesitate to contact us if you have any queries in relation to this response.

Yours sincerely

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