Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

6th May 2014

Mr Martin Regan
Commercial Manager
Shannon LNG
15 Windsor Terrace
Sandycove
Co. Dublin

Our Ref: D/14/10275

Re: Cross-border Cost Allocation agreement – CER decision

Dear Martin,

Article 12(4) of Regulation 347/2013 (the 'Regulation') requires National Regulatory Authorities (NRAs) to allocate investment costs across borders within 6 months of the date of which the last investment request for a Project of Common Interest was received.

In light of this, the Commission for Energy Regulation, as coordinating regulator, the Northern Irish Authority for Utility Regulation and the Office for Gas and Electricity Markets (the NRAs) have reached an agreement on cost allocation in respect of your project, having assessed the contents of the application submitted by Shannon LNG, subsequent information received in response to requests by the NRAs, and the outcome of the meeting held with the project promoter on February 21st, 2014.

The Cross Border Cost Allocation (CBCA) decision attached to this letter sets out the NRAs' agreement that there should be no allocation of costs in respect of this request. This letter sets out the CER's detailed reasons for reaching this decision.

Introduction

The CER's position is that it is not, and would not be, appropriate that the risk of the facility not proceeding after the pipeline has been commissioned, should be borne by gas users in Member States outside the hosting country. Notwithstanding the cost allocation which places all costs on Ireland, the CER recognises:

- the benefits Shannon LNG could provide to Irish, Northern Irish and European security of supply by facilitating West-East flows of gas, freeing up capacity on the Irish interconnectors with GB, and also interconnectors between GB and continental Europe. The avoided flows from East to West have a positive security of supply impact on all transit countries. This is of particular importance considering renewed concerns over gas-supplies to the EU from Russia via Ukraine. Shannon LNG would be ideally situated at the Western periphery of Europe to accept imports of US LNG. This would provide time and cost advantages over other European LNG facilities (1 day time saving).
- should towns in Kerry be connected to the natural gas grid, the construction of the Shannon LNG pipe would provide carbon and financial savings via fuel-switching which might occur
- the marginal reduction in gas prices at NBP that could follow from the construction of the facility as a result of increased competition in gas sources in the area of impact (IE, NI & GB)
- the amelioration of congestion in South to North flows in Great Britain, to meet Irish demand, that could be achieved from the construction of the facility
- the reduction in possible congestion in existing GB LNG terminals at some point in future were the project to proceed

The CER notes that Article 12 (5) of the Regulation requires that the coordinated decision, as set out above, shall contain detailed reasons on the basis of which costs were allocated among Member States such as the following;

1. An evaluation of the impact, including concerning network tariffs, on each Member State concerned
2. An evaluation of the project's business plan, submitted as part of the CBCA application
3. Regional or Union-wide positive externalities
4. The result of the consultation of the project promoters

Before setting out this information, the CER provides an overview of the project and the process undertaken in reaching this CBCA decision.

Project Overview

Shannon LNG, a merchant project with a proposed send out capacity of 10.7 Nm^3/d at commissioning and $26.8Nm^3/d$ at full build-out, was designated a PCI under Commission Delegated Regulation (EU) 1391\2013 on October 14th, 2013. The initial application for PCI status submitted by Shannon LNG in July 2012 made clear that the project consisted of two parts – the LNG facility and the 26km 30 inch pipeline which will connect the terminal to the national grid. As the facility itself has an exemption from Third Party Access, it is not eligible for a cross-border cost allocation or grant funding. The Shannon Pipeline connecting the existing Bord Gais Networks transmission system at Foynes, Co. Limerick to the Shannon LNG facility has no such exemption, and is the subject of this cross-border cost allocation application.

The Shannon LNG Cost Benefit Analysis (CBA) indicated that the total cost of the pipeline was €69 million. Shannon LNG has already invested €6 million in the pipeline project and intends to seek €56 million in grant funding under the Connecting Europe Fund. The Shannon LNG CBA proposes that the balance of the capital cost, €7 million, will be paid by Bord Gais Networks in respect of future receipts of transmission tariffs from new gas consumers in Co. Kerry who will be connected to the pipeline.

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Shannon LNG has to date received all necessary consents for both the facility and the Shannon Pipeline. The CER notes that strong confidence about the expected costs of the project, and good knowledge of the factors affecting expected costs and benefits of the project are displayed in the CBCA application prepared by Shannon LNG. In light of this, the CER notes the project meets the 'sufficient maturity' criterion for assessment for a CBCA decision.

Process Overview

The NRAs received the relevant application documents on November 6th, 2013. Using ACER Recommendation 07/2013[1] as a template, the NRAs assessed the completeness of the application file. In light of this undertaking, the NRAs, coordinated by the CER, requested further information in relation to the 'substantial and consistent evidence about the progress achieved in the development of the project', on December 19th, 2013. The Project Promoter provided a detailed implementation plan to the NRAs on January 10th, 2014.

The NRAs hosted a meeting with the Project Promoter on February 21st, 2014 in the CER offices in Dublin. At this meeting, Shannon LNG made a presentation on the project and on the outcome and findings of the CBA provided to the NRAs as part of the CBCA application. There followed a question and answer session and in response to the issues raised in this session, the NRAs issued a number of follow-up questions to the project promoter. These follow-up questions were issued to the project promoters on March 6th, 2014. Responses were received by the NRAs on March 20th, 2014.

Detailed Information

1. *An evaluation of the impact, including on network tariffs, on each Member State concerned*

[1] Recommendation of ACER No 07/2013 of September 25th, 2013 regarding the cross-border cost-allocation requests submitted in the framework of the First Union list of electricity and gas projects of common interest

The CER notes that the CBA provided by the Project Promoter splits the benefits of the project between the benefit of the pipeline's construction and also the facility's construction. The benefits of the pipeline's construction are entirely yielded in Ireland. Shannon LNG suggests that the likelihood of the project's construction is increased by between 5-10% with the construction of the pipeline.

The CBA prepared by Shannon LNG captures this increase in the likelihood of the facility's construction by including a portion of the benefits of the ***facility's*** construction in the CBA for consideration for the CBCA. The NRAs queried the use of this approach in the workshop of February 21st, 2014 and subsequently requested further information in support of such an approach in the information request issued on March 6th, 2014. The CER accepts, based on the information received on March 20th, 2014, that there are precedents of the use of such an approach.

The construction of the pipeline impacts only Ireland. Shannon LNG's CBA foresees a capital contribution of €7 million from the Irish TSO in respect of future capacity bookings facilitated by the pipeline if it were to go ahead. The CER having reviewed the supporting data provided in the CBA and CBCA application in respect of this capital contribution, notes this calculation seems reasonable. The CBA indicates that a €7 million capital contribution would have no impact on tariffs in the long term. Any contribution by the Irish TSO would require approval by the CER. The CER notes that under the CBCA agreement, there would be no impact on either Northern Irish or Great British tariffs.

The impact of the pipeline's construction would be –

- An economic saving for new gas customers connected to natural gas for the first time as a result of the ability to connect new towns to the grid. This saving is calculated at approximately €142 million over the time-horizon of the CBA (23 years)
- A reduction in CO_2 emissions due to fuel substitution. This saving is calculated at approximately €28 million over the time period of the CBA.

The construction of the facility would have an impact on the three jurisdictions. Notably, the LNG facility could bring:

- Significant improvement in Ireland's security of supply directly, and indirectly to all Member States in the region of impact due to the displacing of flows from East to West to meet Irish demand. This could be of particular significance in light of renewed concerns over the stability of gas supplies from outside of the EU's borders.
- A potential marginal drop in prices at NBP by between 0.4 and 0.7% through increased competition in gas sources, which could yield benefits for all three jurisdictions. This potential benefit is calculated at approximately €1,368 million over the time-horizon of the CBA
- A reduction in the import dependence index of Ireland by 30%
- The potential reduction in congestion in South to North flows in Great Britain, to meet Irish demand

In light of the direct impact of the pipeline project on Ireland and the potential increase in the likelihood of the LNG facility's construction in response to the construction of the pipeline, it was agreed that a cost-allocation based on the benefits accruing from the construction of the pipeline rather than the terminal is appropriate. Therefore, the cost-allocation decision agreed places all costs of the pipeline project on Ireland. Notwithstanding this, the CER notes that the construction of the pipeline in advance of the terminal will have quantitative and qualitative positive impact on the likelihood of the LNG terminal proceeding.

2. *An evaluation of the project's business plan, submitted as part of the CBCA application, including the results of market testing*

The business plan submitted as part of the CBCA application shows that the pipeline project is not economically viable without support (Section III.B.1). With a financial contribution of € 7 million from Gaslink\BGN, the project has a funding shortfall of €56 million. The results of the CBA performed by the Brattle Group on Shannon LNG's behalf indicate that the pipeline is not, in and of itself, viable as the capacity on the pipeline from the new gas consumers in Co. Kerry will only account for a fraction of the pipeline's full capacity as it will be sized for use by the LNG terminal. The revenues from the pipeline are therefore low relative to the total cost and therefore non-viable. The CER understands that the project promoter will seek this full amount (€56 million) from the Connecting Europe Fund. According to the CBA prepared by

Brattle, receipt of this funding would make the pipeline project financially sustainable.

As the Shannon Pipeline falls under the Category of projects referred to under Annex II.2 of the Regulation (concerning gas), consideration of the results of market testing must also be considered. The NRAs received notification of a market test in the original CBCA application documents which was performed as part of the facility's TPA exemption application. However, in the original application pack, there was no indication of the outcome of this report. This issue was raised with Shannon LNG at the workshop on February 21st, 2014 and a copy of the close-out report was provided to the NRAs on March 20th, 2014. There were no non-binding requests for capacity in response to the market test.

3. *Regional or Union wide externalities*

The CER notes that the regional and Union-wide positive externality provided by the Shannon LNG facility is the improvement Shannon LNG could provide to Irish, Northern Irish and European security of supply. This would be done by facilitating West-East flows of gas, freeing up capacity on the Irish interconnectors with Great Britain, and also interconnectors between GB and Continental Europe. The avoided flows from East to West have a positive security of supply impact on all transit countries. This is of particular importance considering renewed concerns over gas-supplies to the EU from Russia via Ukraine. Shannon LNG would be ideally situated at the Western periphery of Europe to accept imports of US gas, with a 1 day advantage over other European LNG facilities.

4. *Result of consultation with project promoters*

The CER notes that productive consultation occurred with Shannon LNG throughout the CBCA assessment process. In two instances the NRAs identified areas that they felt required further development in addition to the information provided by the CBCA application documents received on November 6th, 2013. In each case Shannon LNG provided responses which assisted the CER in its consideration of the CBCA application. The outcome of the consultation with the project promoters is that the CBCA proposed by the Project Promoter of 100% to Ireland and 0% to Northern Ireland and Great Britain is agreed by the NRAs.

The CER intends to publish this decision and therefore if you could identify any areas of this letter which you consider confidential and your reason for doing so by Wednesday May 14th, 2014.

Yours sincerely,

Denis Cagney
Director – Energy Networks and Legal