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Dear Clive

Common Arrangements for Gas - Transmission Tariff Methodology and Regulation in Ireland and Northern Ireland

Bord Gáis Energy Supply & Trading (BGES) welcomes the opportunity to comment on the Common Arrangements for Gas "CAG" Tariff Methodology Consultation Document (issued by the Regulatory Authorities (RA's) on June 27th, 2008. Following consideration, BGES would like to make the following comments with regard to the consultation and requests that the CER take this response into account before making its final decision on the CAG Tariff Methodology.

Bord Gáis Observation / Additional Comments

We would like to make the following comments and observations in addition to the questions posed. With high world wide energy costs and a recent down turn in the global economy we believe that the interests of consumers must be given the highest priority in the response to this consultation. We should, wherever possible, look to ensure that we provide a competitive platform for industry, avoid fuel poverty and ensure that gas remains competitive to higher carbon fuel alternatives.

In particular we must ensure that the Moffat Tariff is not disproportionately disadvantaged as a result of increased indigenous production. We believe that current energy prices and the taxation regimes in the Island already provide a strong incentive to maximise hydrocarbon recovery and future exploration. We do not believe that viability of recovery or location choices are going to be greatly influenced by the smaller differences between tariff alternatives for onshore transportation within a clear revenue recovery framework.

Indeed, it is difficult to anticipate a development where the economic viability will be subject to the outcome of a Moffat Tariff determination. Furthermore we must recognise that Indigenous Producers have the opportunity to adjust their hydrocarbon price to ensure they are more competitive with the prevailing marginal cost of gas at other locations, whereas this benefit is not available at the Interconnector which will source gas on a price taker basis from the UK NBP.

Our favoured Tariff approach is a Combined Moffat entry tariff, Individual tariffs for other entry points (Separate others) and Single Exit. A Combined Moffat eliminates any differentiation as to which Interconnector is being booked and used, while providing both jurisdictions the benefit of security of supply provided by the Entry points. It will also allow Moffat Entry Trading between

Shippers in both jurisdictions. It also provides the correct signals at the other entry points for their projects.

Single Exit provides an efficient platform permitting Shippers to continue to Trade Secondary Capacity without jurisdictional restrictions.

Tariff Smoothing specifically within a price control period, as currently in operation in the ROI, is an essential element of a properly functioning market and provides the stability required for markets and helps to encourage competition as it minimises risks of year on year price changes.

Response

Question **1. Have we adequately described the difference/commonalities between the two markets?**

1. We agree with the description of the Tariff's currently applied in each jurisdiction

Question **2. Do you feel that all the relevant criteria have been covered in this document and are there other criteria you feel should be included?** **3. Do you have a view in relation to the priority of criteria and whether some criteria should be considered more important than others?**

2. The principle of Cost Recovery is a fundamental principle underpinning the tariff options, we take this as a given rather than a priority criteria per se. Full cost recovery of bona fide investments must be delivered to provide investor confidence in the regulatory regime. .

3. Thereafter, the criteria which should be given highest priority are;

> 1. Protecting Customers – with the exceptionally high energy prices currently being experienced we believe that it is imperative that the proposals prioritise customers and seek to avoid any increased risk of fuel poverty for smaller customers and reduced competitiveness for business. Changes must be stress tested against this requirement and need to be carefully managed.
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> 2. Impact on the marginal cost signals - marginal costs have a significant impact on final costs to customers and it is therefore vital that they are minimised in order to protect customers. Furthermore we must recognise that the Interconnectors will not just be the source of marginal gas to the Irish market but in addition to top up gas the Interconnectors provide back up, competition and supply security (see point 3 below) through diversity. Whilst it is important that the marginal cost provides clear price signals to indigenous suppliers we believe the pricing regime here must reflect the important role played by the interconnectors in building and maintaining the all Island gas market.
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> 3. Security of Supply - with Ireland continuing to be dependent on UK imports for the foreseeable future it is essential that the transmission pricing regime reflects the benefits the Interconnectors provide to both customer and indigenous producers. In the short term the Interconnectors ensure that indigenous producers can offer buyers continuity of supply and they balance the supply needs of the Island. In the longer term clearly the Interconnectors are a strategic asset which facilitate the development

of a successful all-Island gas market. Appropriate mechanisms rewarding the Interconnectors for these benefits need to be put in place.

Question **4. Do you feel we have adequately represented the appropriate reform options at the Entry and Exit? What further reform options do you feel warrant further investigation?** **5. In relation to mitigating the effect of declining interconnector utilisation, have all the viable options been set out? What options do you feel is missing? What level of price incentive, if any, do you feel is an adequate signal to incentivise indigenous producers?** **6. Do you think we should harmonise the capacity/commodity split?** **7. Do you think we should aim to harmonise non annual gas capacity products? What products do you feel should be available?**

4. The suggested options outlined seem adequate.

5. There are a number of ways in which the decline in Interconnector utilisation could be addressed. It is imperative that the Interconnector Tariff's do not escalate to such an extent that the price of gas in Ireland is uncompetitive with alternative fuels. It also needs to be recognised that all parties benefit from the strategic nature of the Interconnector. There are three approaches which could be employed and in order of our preference these are:

- a long run marginal pricing regime which recognises and rewards the long term contribution of the Interconnectors as an asset, or
- a specific discount applied to the Interconnector which reflects the security of supply benefit therein, or
- a surcharge applied at other entry and exit points which recover the Interconnector benefit.

The Price control periods have proved beneficial in providing stability to Tariffs.
We believe that with this stability, current market prices and the tax regimes in both jurisdictions already provide sufficient incentives to producers. It is simply not the case that the producer behaviour will be influenced by variability in the downstream transportation regime of the kind contemplated herein. We believe that the options under discussion are a very marginal issue to producers and will neither change the landing point of any discovered hydrocarbons, nor change the rate at which they are developed.

6. The Northern Ireland regime moved to 75:25 in 2008. Whilst we believe that the ROI structure of 90:10 provides the best capacity: commodity split we would understand a compromise between these points if it is important that each jurisdiction is seen to be willing and able to move.

7. We would support the current range of Non Annual products as available in ROI, Month Ahead, Day Ahead and Within Day, Inventory and Storage Tariff's. Our view is that Interruptible Products should only be made available once firm capacity is no longer available, under EU guidelines, for Congestion management. Regarding the introduction of Back Haul while this product may prove beneficial, implementation could prove challenging as it will require the universal support of National Grid, Ofgem and the UK Shipping community to convert Moffat to a 'Virtual Entry Point' into the UK. Clearly this support would not be required if the Interconnector has the physical capability to reverse flow. We would support the required capital investment in the event that under a competitive market regime players were unable to discharge their contractual positions

due to market illiquidity, or in the event that further significant hydrocarbons discoveries are announced.

We do not currently see the necessity for, or benefits of, capacity auctions. The UK experience does not promote auctions as an efficient or competitive means of capacity allocation and the impact on consumers there was negative. Our analysis of the UK experience is that auctions were introduced when capacity at St Fergus was in high demand. This resulted in a very large over-recovery of revenue requirements to National Grid which had the knock on effect of increasing gas prices to end-users. While attempts were made to recycle the over recovery amounts to end users, this was not achieved. We therefore question the overall benefit of auctions and our strong preference is to continue with the status quo.

Question
8. Do you feel that we have adequately described Postalisation under the selected criteria?

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

10. How should we deal with revenue transfer between the two jurisdictions under postalisation?

11. How should we deal with currency risk arising from the Postalisation options?

8. We believe the description of Postalisation appears to be similar to the Point-to-Point regime in existence prior to the introduction of the Entry Exit Code in April 2005. We would welcome further clarity as to how Postalisation would work, and an analysis setting out the similarities and differences between Postalisation and Point-to-Point to assure ourselves it is not Point to Point that is intended.

9. We would not support a Fully Postalised system as this is effectively a Point-to-Point system which is a regime no longer supported by the EU.

10. The centralised approach with a sharing based on approved allowable revenues, as currently employed in Northern Ireland, may seem the most appropriate mechanism.

11. It would seem prudent that parties in each jurisdiction pay for Tariffs in their respective currencies, with the balance being calculated on an agreed rate. The daily rate is applicable in the Single Electricity Market “SEM” due to the fact that there is Daily Bidding and it is needed for the comparison of prices between Generators. This is not the case with gas, as the UK based NBP traded market is in Sterling. Since Tariff’s will be set annually the agreed time for the annual Tariff may set an appropriate currency movement review point.

Question
12. Do you feel that we have adequately described the entry options under the selected criteria?

13. How should we deal with revenue transfer between the two jurisdictions under the relevant options?

14. How should we deal with currency risk arising from the above options?

12. Yes. Of the options provided we support a Combined Moffat which will allow Capacity Trading between all shippers. It also provides all Moffat Shippers from both jurisdictions a transparent and easy way to implement and understand the Tariff, not to mention security of supply. This Combined Tariff will ensure that Shippers would not restrict capacity at Moffat which might otherwise be the case in one Interconnector has a price advantage over another.

13. Again as per our comments in 10 above, a centralised pot may prove the most effective.

14. See comments on 11 above

Question
15. Do you feel that we have adequately described the exit options under the selected criteria?

16. How should we deal with revenue transfer between the two jurisdictions under the single exit options?

17. How should we deal with currency risk arising from the existing exit option?

15. Yes. We favour a Single Exit as this will allow Capacity Trading without jurisdictional restriction providing for efficient use of the overall network both North and South and encouraging competition between all Suppliers on the Island.

16. See comments 13 and 10 above

17. See comments 11

Question
18. Should there be any attempt to mitigate the effect of declining utilisation of the interconnectors?

19. Do you feel that we have adequately described the relevant options under the selected criteria?

18. Yes. Our greatest concern is the effect that a high Interconnector tariff will have on the costs of gas across the Island and the stimulus or impediment to competition that the tariff signal creates. We strongly urge the Regulator to try to resolve this issue and believe that the criteria we have set out under point 3 above would provide useful guidance. It is imperative that the Island of Ireland does not create a regime which could increase cost to consumers, reduce the competitiveness of gas relative to higher carbon alternative fuels or which undermines the worth of strategic assets required for the long term development of the gas industry on the Island.

19. No. The description places too much emphasis on the benefit Producers may obtain from Entry point differentials. Producers already have the ability to adjust their gas price to ensure they retain their overall price differential with UK Imports. The Interconnector does not have this benefit. Producers will always sell their gas at the most favourable price and will adjust their delivered gas price in line with Market prices. We do not foresee much competition between entry points as long as the Irish market remains dependent on Imports. It is only when Ireland becomes a net exporter that competition between Indigenous Producers emerge. We believe there should be greater emphasis on the impact on consumers.

Question
20. Do you feel that we have adequately described the relevant option of harmonising capacity & commodity charges under the selected criteria?

21. What is the appropriate level at which to harmonise?

20. Yes.

21. The current splitting approach of Capex:Opex seem to be universally accepted as an appropriate approach. We believe that 90:10 best reflects the need to recover network costs and make suitable customer commitments but if it is important to encourage movement in each jurisdiction then we would support harmonisation at an 85:15 Capacity:Commodity split.

Question
22. Do you agree with our analysis of the applicability of auctions?

22. Our understanding of the GB experience is that the thinking behind capacity auctions, i.e. that they provide good investment signals to network operator, has significant practical limitations at best and can be fundamentally flawed. The introduction of Auctions in GB, in response to an indicated over requirement for capacity at St Fergus, provided a very crude means whereby parties could try to obtain capacity. The panic caused by concerns about existing high value hydrocarbons being shut-in, resulted in huge over subscriptions and an increase in wholesale gas prices and domestic prices. As is now well known, even following the rush for capacity and the detrimental impact this caused on prices, Transco did not invest at St Fergus as this investment would not have been economic. Auctions have proved a continuous issue in GB with only Ofgem supporting this mechanism, as can be evidenced by the very strong opposition by both Suppliers and end-users to the attempted introduction of Exit Auctions. Ireland does not have the need for further significant speculative investment at Entry points and investment should be on a case-by-case basis, and we do not need the uncertainty likely to result from unnecessary auctions.

Question
23. 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?**

24. What is your preferred option for entry/exit?

25. Which is your preferred option for mitigating the effect of the declining Interconnector utilisation?

23. We note with interest that a Single Exit zone is excluded and believe this deserves further analysis. If the CAG is to develop as an all Island market then a single tariff across both jurisdictions is a necessity at some point and we should be progressing to this point. We again would like to stress the point that if indigenous projects are dependent on entry tariff benefits to be viable in the current climate of high energy costs then these projects will be in danger of being abandoned should energy prices retract from their current highs.

24. We would like to see Single Exit Tariff included and assumed that inclusion of Combined Moffat means Combined Moffat, Separate others. We would also like to see recognition for existing Entry points i.e. Inch, which has significantly contributed to the overall development of the Irish gas market. This Entry point has provided security of supply for many years to the Irish market and most recently through Storage. With respect to Postalisation, we would welcome clarity on how this proposal would work but our interpretation is that this is Point to Point and not favoured by the EU.

As mentioned at the beginning of our comments and throughout this response we strongly favour Combined Moffat, Separate Entry and a Single Exit. We would propose that steps be taken, whether in the form of a PSO or a Security of Supply levy at other Entry and Exit points be adopted to minimise any increase in the Interconnector Tariff in the event that this is not the result of an application of a long run marginal cost philosophy. We should not burden needed imported gas unnecessarily since this will increase consumer costs and reduce competition from diverse supply sources. The Non-Annual products should continue in line with EU requirements, with some of these products contributing to the overall revenue recovery of the Interconnectors. We believe that Entry Point differentials are incidental to hydrocarbon investment or recovery decisions.

We would again like to thank you for the opportunity to comment on this consultation. Please do not hesitate to contact us if you require further clarity, or in the event that you would like to discuss our position further.

Yours sincerely

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