BORD GAIS ENERGY SUPPLY'S COMMENTS ON THE PROPOSALS AND ISSUES SET OUT IN THE CONSULTATION DOCUMENT.

For the purpose of conformity, the numbering used in our response below tracks that used by the Commission's submission, hence Sections 1- 4.2.1 have been omitted, so that our response begins by referencing 4.2.2.

4 NEW GAS MARKET FRAMEWORK

4.2.2 Separation (or "unbundling") of Gas Trading from Gas Transportation

CER Issue: Whether BGÉ's transportation activities should be legally separate from BGÉ's competitive activities.

Bord Gáis Energy Supply accepts the principle of Business Separation of Supply from Transportation. It is not entirely clear the nature of the legal separation that the Commission is considering. We would welcome the opportunity to clarify this matter further. Full legal separation of Energy Supply from the asset-holding Transportation business may be complex and costly. In general, the smaller energy trading arms of integrated businesses, such as Bord Gáis Supply, are dependent on the security provided by the assets of the integrated business in order to command the best available terms in the market place. Without this security, the terms secured may be less favourable, leading to higher prices for Irish consumers. Such an outcome can occur either directly, through Bord Gáis Energy Supply paying more for inputs, or indirectly, through Bord Gáis Energy Supply's competitive position being diminished. Bord Gáis Energy Supply needs to maintain a strong competitive position to ensure that both it and its competitors deliver genuine benefits to Irish energy consumers.

Bearing in mind the Commission's comments on Licensing, particularly in relation to the ring-fencing of assets, we request that note is taken of the following points: (that apply equally to Separation and Licensing)

(i) The cost base incurred by a supply business is directly related to the strength of its guarantee to the transacting counter-party. Without access to an asset base, the vendor's perception will be that it is incurring greater market risk than would otherwise be the case. Given the low level of competitive margins that exists this might well preclude a supplier without recourse to an asset base from competing in the eligible market. This will not be in the interest of Irish consumers.

Rigid ring fencing of assets may also impact the credit rating of energy supply businesses and would impede its ability to enter into appropriate energy purchase contracts. This would be discriminatory to Bord Gáis Energy Supply and disadvantage it in the market, as other market operators will have a more direct access to an asset base.

Bord Gáis Energy Supply strongly believes that the "Chinese Wall" mechanism of separation has already proved effective in other regulatory environments and with the use of separate accounts would provide a mechanism that is easy to monitor.

Energy Supply welcomes the Commission's intention to create a 'level playing field' and looks forward to the implementation of the necessary measures.

Thus in summary, Energy Supply does not believe that it is in the best interest of the industry and especially of consumers to have transportation separated legally from Supply. There are alternative methods that have been applied successfully to ensure the same objective. Ring fencing and separation into distinct business units provides a relevant example.

4.2.3 Contract Carriage and Common Carriage for Open Access Transmission

CER Issue: The appropriate high-level approach for allowing open access to transmission pipelines – common carriage or contract carriage.

A common carriage approach to open access is the appropriate approach in the case of the Irish market. There are many benefits which end users receive from network investment. It is difficult to envisage small volume users (or their suppliers) entering long-term contracts for capacity. In the present changing environment of gas and electricity, shippers and/or end users can not take the long-term risks associated with mains construction. It is also likely that smaller volume users (or their suppliers) would be unable or unwilling to commit to a long-term contract. This could prejudice the required system planning and investment. A strict regulatory approval mechanism is required to provide appropriate criteria for approval.

4.2.4 Network Expansion: Section 39A Consents and Section 2(1) Orders

The Commission has the opportunity to introduce competition into new gas network extensions.

Energy Supply seeks only to ensure that any owners or operators of connected distribution networks are required to comply unconditionally with future extensions of consumer eligibility.

4.2.5 Interruptible Transportation Service

CER Issue: The appropriate pricing policy for interruptible services.

The provision of Interruptible services by the transporter would tend to encourage end users to reduce their bookings of firm capacity and to supplement their capacity requirements on an interruptible basis. This would adversely affect the tariffs and destabilise the setting of tariffs. The development of an interruptible (or short term) market between shippers would be the preferred mechanism. The Code of Operations includes provisions to authorise the capacity transfers in support of such a market. This trading of capacity allows consumers (and their suppliers) to match their day-to day and locational capacity bookings to their requirements. However, they are required to book firm capacity to match their annual requirements. This is necessary to ensure regulated cost recovery by the transporter
Since Ireland is a small market with a few players bilateral arrangements between these players is the preferred and easiest mechanism for the trading of this capacity. If the transporter offered an interruptible service smaller volume users and their suppliers could be placed at a financial disadvantage to the larger volume consumers and shippers.

It is not in any user's interest to purchase a greater amount of capacity than is required. Consumers and their suppliers will always actively attempt to minimise capacity costs through either demand management at the plant or the sale of any excess capacity in this capacity transfer market. It is essential that shippers booking firm capacity have the ability to trade on this market without impediment. Most if not all traded markets are transacted either bilaterally or through emerging communication tools. These mechanisms will further develop as the number of participants increases. It is very possible that these players through various marketing tools (such as Electronic Bulletin Boards) would offer short-term capacity products in addition to the bilateral arrangement presently being operated.

Ultimately, it is the net cost to shippers which matters and further discussions will be required to establish the mechanism that achieves the lowest net cost.

CER Issue: Whether shippers should, even in conditions of excess capacity, be able to contract for short-term services from the transporter at regulated prices.

This proposal would severely undermine the development of a stable market in primary firm capacity in Ireland, as well as the development of a secondary market in capacity. Whilst such an arrangement might suit the larger volume consumers, the smaller volume consumers and their shippers would suffer greatly from the availability of such a service due to its negative effect on tariffs. Parties purchasing annual or longer-term capacity would have the value of their product greatly undermined.

While it is accepted that surplus capacity arises in the low demand periods, consumers still derive the same system benefits during this period. The sale of a short-term service by the transporter (less than one year) undermines the value they obtain. The option of purchasing capacity on the secondary market would continue to be available for those requiring capacity on such terms. Transportation booking periods shorter than one year could lead to under-recovery of transporters costs, which will inevitably increase tariffs over the longer period. It could also potentially destabilise tariffs, damaging the predictability for all shippers and consumers.

4.2.6 Shrinkage

CER Issue: The suggestion of transferring the responsibility for replacing shrinkage gas to shippers.

Once the following conditions apply: 1) the transporter can be incentivised to minimise the use of gas, and 2) the management of the price risk by the transporter takes account of shippers preference, then it is a more efficient solution to allow the transporter to tender for both balancing and shrinkage gas. This is due to economies of scale and to the forecasting ability that the transporter possesses.

4.2.7 Connections Policy

CER Issue: Whether connection policy should be based on the principles of "deep" or "shallow" charging.

As outlined in the consultation paper, this issue is bound up with the issue of Common Carriage or Contract Carriage. However, the complexities of "Deep" connection charges, particularly with regard to charging other users for "surplus" benefits arising from "Deep" reinforcement would suggest that a Common Carriage regime, with "Shallow" connection charges and contract durations up to 10 years is the most suitable for a small market, as in Ireland.

Energy Supply is supportive of a "shallow" connection charging policy as it supports the development of an economically efficient network. A shallow policy would encourage and enable the maximum number of consumers to connect to the network.

A shallow connection policy has the advantage of being simple and transparent in terms of the consumer's understanding of the connection costs, as well as being administratively easier for the transportation business units. In the longer term, an increased number of users using the network assets will mean a decreased cost per customer of operating and maintaining the assets. Of course, even shallow connections need to be subject to an economic test against average costs to ensure that benefits accrue to existing consumers.

4.3 Market Operation

4.3.1 Gas Trading

CER Issue: Whether a gas spot market is likely to be viable in the near future.

Given the operation of a large liquid market at the British NBP, it is difficult to see a *raison d'être* for a similar market in Ireland. This is particularly so if a regime that can facilitate bilateral trades, (preferably on a post-event basis), is developed in Ireland. If demand for a spot market emerges, then shippers and suppliers, in conjunction with the appropriate market operations experts (such as the IPE) would be best suited to fill the need.

At present about 80% of Ireland's gas needs are sourced through Britain. Britain will continue to be the main source of supply even when the Corrib field begins commercial flows. The British wholesale market will continue to provide the main source of gas commodity pricing to the Irish market. A spot market is only likely to emerge if either demand or supply is restricted in some way. However, as long as Ireland is dependent on the British market for supplies, then the British wholesale market will be the primary pricing reference.

It is also necessary to consider the liquidity requirements of a spot market. A spot market would probably be unfeasible in economic terms due to the small scale of the total eligible volumes (less than €200m pa). It is unlikely that the number of players or the turnover base will emerge to sustain an indigenous spot market.

CER Issue: Whether gas trading arrangements, and in particular the creation of a spot market should be the responsibility of shippers and suppliers as opposed to the Commission.

There are a relatively small number of players in the Irish gas market and as such any spot market could be easily dealt with through direct bilateral arrangements. The development of "Electronic Bulletin Board" should be left to individual shippers as a marketing tool. The developments of markets, even when assisted by regulators, have traditionally been based on shipper and supplier agreements. Markets developed by regulators are viewed in a sceptical light and often prove illiquid, as the principle requirement of any market is freedom from external interference.

4.3.2 Capacity Trading

CER Issue: Ways in which the trading of capacity rights might be improved and which role, if any, the Commission may play in capacity trading.

(a) Role of Commission
To oversee transporter's rules for capacity trading

End users with excess capacity will always endeavour to trade out this excess as a cost minimising exercise. This is best achieved through a market in short-term capacity transfers or bilateral agreements. Mechanisms have already been developed since the introduction of the Code of Operations. Companies with excess capacity have access to appropriate market tools e.g. Internet, to market their unused capacity at any time. The Commission may wish to review the operational aspects contained within the Code of Operations for the secondary capacity market but further intervention could stifle the growth of the market.

4.4 System Operation

4.4.2 System Operator

Energy Supply notes the regulator's view on pipeline ownership and restates its interest in ensuring all consumers (in accordance with their eligibility status) have access to the competitive market.

4.4.3 Daily vs. Shorter-term Balancing

CER Issue: Whether a balancing period of less than a day would be appropriate for the Irish natural gas market over the longer term.

Daily balancing is appropriate in a transmission system where capacity availability is adequate to meet market needs.

This issue of balancing regimes and particularly a move to shorter term balancing has been extensively debated in Britain. A move away from daily balancing has met with vehement objection from consumers, shippers, suppliers and other interested parties in Britain. The estimated costs for renegotiation~~s~~ of contracts, administrative process and technology changes amount to between Stg £1bn and £2bn. The EU has expressed concern that balancing periods shorter than one day would result in a barrier to entry. In Britain the need for a shorter balancing period is being reviewed with the objective of reaching an alternative solution to proposals by both Transco and Ofgem. It is anticipated that an alternative solution will emerge eventually.

4.4.4 Point-to-Point or Entry/Exit Balancing

CER Issue: The appropriate approach for balancing – on a point-to-point basis or entry/exit basis.

Energy Supply has no strong views as to either approach. The entry/exit basis as used in Britain *does* facilitate the wholesale marketing of gas and may possibly be of assistance, in the event that shippers/suppliers should ever wish to set up a spot market in Ireland. The use of either mechanism is acceptable, subject to the most favourable costs to shippers/suppliers.

4.4.5 Gas Nominations

CER Issue: Whether the current nominations process needs to be changed, and, if so, how.

The present system seems to be operating satisfactorily and is consistent with the British mechanism for imports. Any fundamental change from the present mechanism would only create the same complexities as a shorter balancing period.

4.4.6 Gas Balancing

CER Issue: Whether a real-time market mechanism for increasing and/or decreasing gas on the system should be created.

Again due to the nature and size of the Irish system and the dependence on Britain for imports, a real-time system is already available through the wholesale market in Britain. The creation of a real-time market in Ireland would only result in the same complications that a spot market creates. This real-time market should be at the behest of shippers/suppliers to develop, or encourage to be developed, independent of the Commission.

4.4.7 Scheduling Charges

CER Issue: Whether current scheduling tolerances and charges reflect the costs imposed on the system by nomination divergences.

Balancing is an essential requirement of the Irish system. Without incentives to balance the actions of one party could potentially impact security of supply to the detriment of all other users. The present tolerances seem to fairly reflect the potential effect users have on the system. As the threshold drops the smaller volume consumers and their suppliers may require a different level of tolerance due to their particular size. Balancing and balancing charges need to be applied where users breach their permitted tolerance limits. This acts as an incentive to balance and to maintain the integrity of the system. A review of these charges is presently underway and any change in this regard would prove a more cost reflective incentive on system users to minimise imbalances. In summary, balancing charges should act as a "shield not a sword" in the protection of all users.

4.4.8 Overruns

CER Issue: Whether BGÉ, as a transporter, should authorise overruns when there is capacity available, and the appropriate charge for authorised overruns.

This would effectively stifle any developments of the secondary capacity market. It would also create an environment where system users would under-book firm requirements and seek authorised overruns on the day additional capacity is required. This under-booking would adversely effect the tariffs to end users and only favour the bigger system users to the detriment of all other smaller volume users. The transporter should only sell firm capacity, with the secondary capacity market supplying any shortfall requirements users may have on a day. Bord Gáis Energy Supply believes that authorised overruns would only equate to the subsidisation of large volume users by the smaller volume users.

4.5 Gas Storage

CER Issue: Whether storage facilities should be open access facilities.

Should a storage facility ever be developed in Ireland the owners of this asset would wish to have an input on how the facility is marketed. Access to any future storage facilities should be on an open basis to promote competition.

4.5.1 Storage Licensing

CER Issue: Whether the transporter should be allowed to undertake licensed storage activities.

If the use of storage by the transporter assists the management of risk (at reasonable cost) during the occurrence of "Difficult Days" or "Emergencies" then this should be allowed. However, transporters should not trade in Storage gas.

Should storage facilities be under the control of the transporter then these should be made available to the market. *System* assets should not be defined as storage facilities as these are essential to maintaining system integrity and security of supply.

4.5.2 Line-Pack Storage

CER Issue: The Code of Operation's current requirement regarding all line-pack passing into the possession of the transporter.

Linepack should not be identified as a storage facility. Linepack is an essential tool in managing system integrity in the interest of all users. Opening access to linepack would potentially lead to system security problems. It would also eliminate the existing flexibility that system users and the transporter obtain from linepack.

5 Regulatory Framework

5.2 Principal Regulatory Instruments

5.2.1 Functions of the Commission

5.2.2 Pipeline Consents: Section 39A of the Gas Act, 1976

CER Issues: The circumstances in which a competitive process for granting pipeline consents should be held.

In any competitive process, it is important that all parties (including suppliers) remain incentivised to maximise the connection of individual customers to the new pipeline. Options include a one-off cost, paid by the distributor to the appropriate party, to cover the necessary marketing and selling costs to convince customers to switch to gas. Beyond 2005, it is also fundamental that any consumers connected to any gas distribution network are permitted and enabled to change supplier.

The circumstances and criteria are likely to be significantly affected by the decision on Carriage (Common or Contract), but the following general comments apply:

The appropriate circumstances for a competitive process are where:
(i) there is an established need for the Project and
(ii) there is an unwillingness by the transporter to undertake a project or
(iii) Where the transporter is willing to take on the project but
1. There are competent competitors willing and able to take on the project
2. The use of a new Operator will not have a negative impact on Shippers costs and
3. The alternative developer can demonstrate a benefit to existing users over and above that offered by the incumbent.

CER Issue: The criteria, which should be used in that competitive process.

Energy Supply has no substantive comments to make other than stating the obvious criteria of safety, quality, cost and the ability and resources to meet all associated obligations. The process should also ensure a better outcome than that offered by the incumbent.

5.2.3 Third Party Access

CER Issue: The Commission's intention to have model clauses, etc. for TPA arrangements.

Model clauses and standard forms of agreement should help simplify the method of facilitating access by new system users to the network. These proposals should include menu connection charges to enable suppliers and customers to readily evaluate costs of connection.

Suppliers and shippers (and the Commission) need to be involved in the drafting of model clauses for single and multiple site supplies.

CER Issue: The Commission's intention to set out in some detail the framework for determining terms and conditions for those requiring access to a licensed operator's network.

This intention is welcomed and it is expected that the opportunity for industry-wide contributions will be made available. It is also expected that any licensed operator will be subject to the same regulatory controls and reporting as other market players. These include, for example, price control mechanisms for tariffs and the application of service standards and obligations.

5.2.4 Licensing

CER Issue: Whether the gas licence should be of the same, or similar, duration as electricity licences (30 years minimum initial period, indefinite duration thereafter subject to minimum 15 years notice period).

Given the commercial arrangements between gas suppliers and electricity generators, it will be essential that parity exists between the licence periods for gas and electricity industry participants. Therefore 30 year licences are appropriate. Other details should be agreed in consultation with industry participants.

CER Issue: The broad outline of licence content bearing in mind the specific consultation on licences that is to follow.

To facilitate this next market opening it is envisaged that licences would be in a fairly simple form enabling shippers/suppliers enter *this* market. The licence should concentrate on the ability of shippers/suppliers to meet the key operating rules and to have the necessary financial and operating capability to participate.

CER Issue: Whether the ring-fencing arrangements and accompanying compliance regime proposed for integrated natural gas undertakings including BGÉ are likely to ensure adequate separation between its transportation and supply/shipping businesses.

(a) Ring-fencing of Information
Rather than attempting to restrict the flow of information within Bord Gáis, it might be simpler to specify which information (subject to agreement in particular with customers affected) Bord Gáis will be required to make available to *bona fide* interested parties, screened, if appropriate by a third party (for example, the Commission.

(b) Ring-fencing of Assets
See comments made on this earlier

(c) The proper set-up and operation of a Compliance Office should demonstrate adequately that appropriate separation mechanisms are being correctly adhered to.

Notwithstanding these observations Bord Gáis will ensure that required safeguards will be in place, e.g., separate accounting data, confidentiality and record retention.

5.3 Economic Regulation

5.3.1 Regulation of Gas Supply Prices to Smaller Customers

Bord Gais Energy Supply will shortly submit proposals for gas supply tariff prices to the Commission.

5.3.2 Principles of Good Regulatory Practice

No further comment at this stage

5.3.3 Form of Regulatory Control

No further comment at this stage

5.3.4 Regulation of Transmission and Distribution Charges

CER Issue: The steps to be taken in the review of transportation charges.

The process for determining the review of transportation charges must fully take account of the ability of suppliers to recover the charges from their customers. This is particularly important in gas where oil is the major fuel competitor.

There needs to be a public and open debate to consider what is the optimum solution to provide the lowest possible transportation costs to consumers.

5.3.5 Regulatory Accounts

CER Issue: Whether a Uniform System of Accounts using Regulatory Accounting Guidelines should be adopted.

It is sensible to have as much uniformity as possible in the gas and electricity regulatory accounts. It must be stressed that the different business may have differing cost-drivers and cost of sales that may make direct comparisons less meaningful.

The most favourable approach, should this be the Regulatory Accounting method (as used in Britain or some other appropriate method), is to ensure the avoidance of unnecessary interventions. The process should be designed to provide transparency for comparison purposes.

The use of Regulatory Accounting Guidelines - a detailed framework of principles supported in certain areas by detailed rules - will be an important step in introducing more consistency into regulatory accounts and into the understanding of how the information presented relates to the assumptions made by any member. Regulatory Accounting Guidelines would provide an objective framework for price control reviews.

5.4 Technical and Safety Regulation

5.4.1 Consents

CER Issue: The issues to be covered by the technical guidelines for consent.

The issue of system security and integrity should be the responsibility of the operator with the onus on the operator to use best practice in safeguarding the system.

5.4.2 Gas Safety

CER Issue: Whether the transporter should be allowed to recover the costs of action beyond the meter from the customer concerned.

Should action beyond the meter be required then in the majority of cases full costs should be recovered from the end user concerned. There may be exceptional cases where legally enforced entry on to private premises is necessary to ensure system safety. These costs may be recovered through the tariffs.