

Ms. Catherine O'Hara
Commission for Energy Regulation
Plaza House
Belgrad Road
Tallaght
Dublin 24

London, 28 June 2002

Dear Ms O'Hara

Re: Consultation on Natural Gas Policy Framework

Duke Energy Intl. (Europe) Ltd welcomes the consultation opened by CER on the Gas Policy Framework, and acknowledges the need to address a number of key questions surrounding the development of a competitive environment for the gas industry in Ireland.

1. Legal unbundling is key to ensure effective TPA

We regard legal unbundling of regulated and competitive activities within BGÉ as critical to ensure transparent, non-discriminatory and cost-reflective TPA terms and conditions. This requirement is in line with the Good Practice recommendations elaborated within the Madrid Gas Forum, and it has also been adopted by the EU Commission in their latest drafts of the amended directives. Experience in the UK and elsewhere demonstrates that competitive gas markets come associated with an independent TSO. Legal separation thus becomes the minimum level of unbundling to achieve these objectives.

However, we see no reason why this unbundling could go even further, that is, to ownership separation. Trends in the US but also in Europe (UK, The Netherlands, Spain) suggest that ensuring the independence of the management and operation of essential facilities is better achieved by separating totally (or partially) ownership of regulated and competitive activities.

2. Common carriage and shallow entry are appropriate for the Irish market

Common carriage should continue to be the basis for the development of gas infrastructures and reservation of capacity, and this requires CER to lay down a

regulatory framework that provides the TSO with the right incentives to adequately forecast demand growth and to build the necessary and optimal amount of infrastructure.

Alternatively, at present, a long-term contract carriage system will undoubtedly inhibit entrants, given the uncertainties surrounding the development of the gas market in Ireland. We consider that long-term contract carriage could be more appropriate when there are a considerable large number of shippers and suppliers, and also, where there is room for pipe-to-pipe competition. Currently, those conditions are not met in Ireland.

Finally, a shallow connection policy is fully compatible with the postalised structure of exit charging.

3. Interruptible and short-term capacity reservation services happen to be critical instruments to promote entry and spur competition

Entrants, in order to meet customers' requirements and compete, need to have access to any flexibility mechanism available in the market, either in the form of imports, storage facilities, back-up services (provided by the TSO), spot liquid markets and hubs, etc...

Currently in Ireland, these flexibility mechanisms are either inexistent, underdeveloped or on the sole hands of BGÉ. Therefore, interruptible services or short-term capacity reservations should not simply be linked with the lack of sufficient transportation capacity, but also with the ability of entrants and shippers to obtain the necessary flexibility to compete. Given the absence of a liquid spot gas market and/or a properly regulated, non-discriminatory and cost-reflective back-up service, short-term reservation of entry capacity and interruptible services become an essential feature for gas marketing in Ireland.

Typically, shippers will book long-term firm capacity at different entry points to wheel their supplies into the market, but at certain occasions (gas production outages or unexpected increases in demand) they may need additional supplies onshore for a limited period of time. If this requires shippers to book a minimum of 1-year firm additional capacity for these contingencies, the system will simply become too onerous and inefficient, and will discourage entry, since secondary capacity markets are still not well developed, and any booked but unused capacity (as it will be most of the time in the example above) will be difficult to trade. In fact, an efficient operation of the system requires that reservations and capacity utilisation become as closer as possible (but also to prevent capacity hoarding especially by incumbents). Consequently, short-term reservation of capacity and interruptible

services should be available and regulated since this will facilitate shippers to procure the flexibility and back up products they require to participate competitively in the market.

We see short-term reservations of capacity, the institution of use-it or lose-it principle, and the ability to contract interruptible services as the pre-conditions for the development of both spot gas markets and secondary trading of capacity, otherwise the inherent rigidities of the current arrangement will remain and preclude any further development in the desired direction.

4. The responsibility of shrinkage gas needs to be born by both shippers and transporters

We accept the principle that shrinkage gas needs to be replaced at the least cost, and shippers and traders are better placed to do so. However, the amount of shrinkage largely remains a responsibility of the transporter's efficient operation of the system, and adequate thresholds and incentives to minimise these levels need to be put in place.

5. The development of the spot gas market depends on how accessible the market is for entrants

The medium and long-term attractiveness of the Irish gas market critically depends on the development of sufficient liquidity and competition. The present situation is still very far from meeting these conditions. As the consultation document indicates, a spot and liquid market hinges on the existence of a sufficient number of competitors and shippers, and an independent and efficient carrier that facilitates this marketplace. The question goes beyond establishing a "formal or official" organised market or hub, but setting up the conditions for competition: once these conditions are met, the creation of a centrally organised trading function becomes a matter of choice.

Therefore, we would like to recommend the regulator to put special emphasis in implementing those measures (within the range of CER's duties and responsibilities) that could bring more competitors into the market. In addition to the features we described above in relation to short-term reservations of capacity and interruptible transportation services, gas regulation in Ireland should consider, along the lines of the conclusions of the 5th Madrid Gas Forum, some form of transparent and public gas release programme:

"While recognising the importance which long-term contracts have played in securing gas supplies for Europe and recognising in principle the legal

acceptance of long-term contracts, the Forum stressed that the existence of multiple gas suppliers and real supply-side gas-to-gas competition are essential preconditions for providing real benefits to consumers from market opening. Where necessary and legally possible, gas release programmes implemented at national level may help enhance such gas-to-gas competition and may in certain cases even be necessary to achieve real supply-side competition.”

6. Capacity trading requires an improvement of system information and the application of the use-it or lose-it principle

Trading of secondary capacity is an important feature of well-developed competitive markets, and the CER is committed to lay down the principles to achieve these aims.

The first principle is the existence of transparent, usable and non-discriminatory information on system flows, physical capacities and its utilisation, while respecting reasonable terms for confidentiality. In fact, CER shall have the powers to refuse the confidential treatment of aggregate data. A minimum amount of data should be published by the TSO on its websites such as

- ~~the~~the physical flows: annual average and annual peak at entry points;
- ~~the~~the total contracted firm and interruptible capacity, specifying the capacity reserved for the non-eligible market;
- ~~the~~the available capacity on the primary market;
- ~~(in real time)~~(in real time) the aggregate amount of nominations at each entry point;
- ~~for storage facilities,~~for storage facilities, the volume and flow (injection and off-take) capacities;
- ~~reasons and circumstances for eventual interruptions;~~and
- ~~an account of works planned on its facilities,~~an account of works planned on its facilities, for maintenance or development of the installations, and which will affect the amount of capacity available.

We believe CER should play a critical role in monitoring and encouraging the TSO meets these standards with the view of facilitating the operation of the system, enhancing their regulatory supervision of the market and promoting entry. In fact, the availability of this information should minimise the ability of undue refusal of access to third parties.

The next principle is to establish regulations that prevent capacity hoarding, so shippers are encouraged to trade (bilaterally or centrally through bulletin boards) unused capacity. Therefore, prior to any discussion about congestion mechanisms, the principle of use-it or lose-it should be included in the gas regulation, both to day-ahead nominations (as compared to reservations), but also if CER detects a persistent under-utilisation of booked capacities (a typical practice of vertically integrated incumbent suppliers).

7. Entry/exit balancing is more coherent with the short-term contractual flexibility

Along with our recommendations for common carriage and short-term transportation services, gas balancing is better measured at a NBP, irrespective of the actual route taken by the deliveries. It will also add a great deal of simplicity and will spur trading between shippers at the balancing point, ie, imbalances become more commoditised.

We do not consider necessary a balancing period below the day, even for gas-fired generators and large loads. This will come associated with hourly gas nominations, which we do not regard as a practical solution at present. However, it is important to accept the possibility of intra-day re-nominations in order to facilitate shippers' balancing.

Also, at this earlier stage of the development of the gas market, it is advisable to allow for some balancing tolerance in order to make entrants to familiarise with the system. We consider that current scheduling tolerances and charges are too high, and entail a penalty element that should be removed.

Balancing costs should at any time reflect market conditions, but where sufficiently liquid markets do not yet exist (as it is the case of Ireland), balancing costs must be regulated in order to ensure they reflect the real costs incurred.

Therefore, any trading arrangement relative to balancing must be proportionate and in line with the market realities, and it will not be advisable to expect market forces to yield superior market-based prices, when these market forces do not yet exist.

Since BGÉ trading currently retains a *de facto* monopoly position on the provision of balancing services, CER should regulate, until competitive conditions mature, the provision of these services such as they are offered in a transparent, non-discriminatory and cost-reflective basis. Within this context, and bearing in mind

that administratively determined balancing prices may not convey adequate time signals (ie, if based on average costs), charges should only be applied to net aggregate shippers' imbalances.

8. Storage facilities should be open to regulated TPA

Similar to the previous arguments used above, we strongly recommend storage to be open to be subject to regulated TPA. The lack of sufficient flexibility mechanisms in the Irish gas market makes storage a more essential facility and therefore the need to ensure transparent and non-discriminatory TPA.

Finally, we would regard more appropriate if the title of the line pack-gas remains the shipper's, and this should not affect the operation of the system.

Kind regards,

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