

CONSULTATION ON NATURAL GAS POLICY FRAMEWORK

Please find attached Viridian's response to the above and specifically our attempt to respond to the specific questions set out in the document. We would like to commend the CER on a well considered and comprehensive document and hope that this is an early indicator of the evolution of a vibrant competitive gas market in Ireland. Our responses here are by their nature a result of the text and questions posed in the consultation document; if we have further gas policy issues that are not addressed here we shall forward these at a later date.

Section 4.2

?? ***Whether BGEs transportations activities should be legally separate from BGEs competitive activities.***

Viridian is in favour of legal separation between BGE transmission and the BGE competitive activities; we suggest that when the two entities become legally separate that they should be based in different physical locations.

?? ***The appropriate high-level approach for allowing open access to transmission pipelines – common carriage or contract carriage.***

The difficulty with common carriage is that the transporter is incentivised to overestimate demand requirements and thus over invest in order to achieve higher growth of regulated returns. A review of existing BGE investment commitments comparing actual demand growth to the original investment assumptions may help to understand whether the right balance is currently being met. We suggest that a system where the transporter takes the risk of stranded assets and cannot pass through this cost to shippers or other customers. With appropriate safe guards the common carriage system could work. We suggest that even though the regulator has agreed a given investment this approval was made on the basis of the rational and figures provided by the transporter and to the extent that this rational of the figures used are incorrect then the transporter should take the risk not the customer. The common carriage system currently operated will work efficiently if improved by the allowing more flexible trading of gas capacity on a day ahead and within day basis.

Contract carriage imposes higher risks on shippers and assumes a fully liquid market in gas transportation capacity, not easily achievable in a small market such as Ireland. It may not be realistic to introduce such a system at the moment but this may need to be considered in the future if common carriage does not demonstrate value to shippers and customers.

?? ***The Appropriate pricing policy for interruptible services.***

The value of interruptible services will not be large in a system with excess capacity and thus the discussion maybe somewhat academic. We our concerned at the current ability of BGE to impose interruptibility on shippers at prices that they dictate. The criteria for interruption and the conditions of interruption are currently solely at the transporter's discretion where this imposes significant risk to large users, particularly gas fired generators.

In principle "Interruptible Capacity" should be encouraged as it promotes the efficient use of capacity in the system particularly during times of capacity shortage and fluctuating demand.

As interruptible capacity is in effect a "Firm" right of one party who is willing to "rent" to another party with the condition that if they need it back they can "interrupt" the other party and take it. As the party who has the "Firm" right to the capacity has already paid the Transporter for that capacity it could be argued that the price paid by the party wishing to purchase "interruptible" capacity should not have to pay anything to the transporter and that anything they do pay will be (i) agreed bi-laterally between the parties and (ii) paid directly to the Party owning the "Firm" right to the capacity.

Thus in an "Open" market Interruptible capacity should be priced by "the Market" by allowing parties to trade it among themselves at whatever rate they agree, and should not be a regulated price. Safeguards may need to be considered to stop dominant shippers (eg. ESB or BDCP) from excluding smaller shippers from the market.

Section 4.3

?? ***Whether Shippers should, even in conditions of excess capacity, be able to contract for short term services from the Transporter at regulated prices.***

Shippers should always be allowed to contract for short term "Firm" capacity services from the Transporter as to prevent it would (i) unduly restrict the market players (ii) prevent Shippers and the Transporter from taking full advantage of all available capacity. However it is clear that an RPO Transporter should encourage Shippers from booking the capacity they reasonably think they will need and discourage Shippers from constantly relying of Short Term capacity. To do this Short Term capacity should be priced at a level above the cost of daily annualised capacity charge. Thus the charge could be some multiple of the daily annualised capacity charge and this multiple should be seasonally adjusted to reflect the Summer, Shoulder and Winter periods to reflect the different "Value" of capacity during the periods. A suggestion would be to use multiples of 1.25, 1.50 and 2.00

for the Summer, Shoulder and Winter periods respectively, or such other values as players in the market agree are reflective of the value of the capacity.

?? ***The suggestion of transferring the responsibility for replacing shrinkage gas to shippers.***

Shrinkage gas is a loss from the gas system which the transporter designed, installed and operates. If the transporter designed, installed and operates an inefficient system, as in any other business walk of life, the transporter should bear the full cost of the inefficiency. It is understood that this is the case in the UK.

Viridian agree with the CERs comment that the existing system “does not give BGE any incentive to minimise the total cost that is passed on to Shippers”. This has to change.

Viridian understand that BGE did not deem it necessary to, and did not, charge Shippers for Shrinkage gas before the 2001/2002 gas year, the same year that two new IPP gas fired electricity generation power stations were coming on stream. Viridian would like to understand why BGE feel it is now necessary to charge for this.

Viridian would argue that as BGE did not need to charge for Shrinkage Gas before 2001/02 they should continue to not charge until they can demonstrate the detailed use of this shrinkage gas and methods that are being employed to minimize the cost. It is important to incentivise BGE to reduce the amount of Shrinkage gas.

If it has been accepted that shrinkage volumes can be clearly identified, isolated and shown to be wholly necessary, then the transporter should demonstrate that he is sourcing the shrinkage gas in the most cost efficient manner and bidding by shippers for this gas may help in demonstrating this.

?? ***Whether connection policy should be based on the principles of “deep” or “shallow” charging.***

The main aim of any policy, but in particular in this area, should be to encourage new users of gas. This is in the interest of the Transporter and all the shippers – the transporter gets more revenue and the Shippers pay less per therm of gas.

It must be the case that any new user pays for the Shallow connection costs as it cannot be disputed that they have caused the costs directly. However if any reinforcement work has to be performed to the upstream network to accommodate the new user on the system, then this should be paid for by all customers as (i) this

encourages new users by making it more economic (ii) all shippers will eventually pay less per therm due to the new load being in place.

Viridian support a “Shallow” connection charging policy with the proviso safeguards are put in place to ensure that connections are not made to the transportation system that are fundamentally uneconomic but the project is not affected as a result of smearing across all customers in the transportation system.

Whatever pricing policy is decided upon there must be complete 100% cost transparency from BGE (or other pipeline operator).

Section 4.3

?? Whether a gas spot market is likely to be viable in the near future.

?? 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.

We understand that the setting up of a separate market in Ireland will incur some cost and that a significant volume of traded gas (assuming that reasonably low spreads are charged) will be necessary to ensure viability of such an enterprise. We understand the argument that there is already a liquid market in the UK at NBP and it appears expensive to replicate one in Ireland if it is going to just track the price. There are however a number of reasons why a separate market in Ireland may be worth considering:

- (i) During low demand and significant indigenous gas production volumes a decoupling of the Irish market pricing will occur with respect to NBP where the price is set by NBP - transportation rather than NBP + transportation. In this scenario Irish gas consumers will be at a competitive advantage to our UK counterparts. If there is not a separate liquid market in Ireland then it will be more difficult for this price discovery to occur.
- (ii) The transporter currently imposes very large balancing charges on shippers. A liquid market would help shippers mitigate these risks. It could arguably be cheaper however to require the transporter to charge lower balancing charges. Arguably the ringmain system with storage should make balancing much easier for the transporter. A separate balancing system such as the OCM in the UK should be worthy of consideration as an alternative.

?? *Ways in which the trading of capacity rights might be improved and which role, if any, the commission may play in capacity trading.*

We argue that in the long term to have a truly open, cost reflective, market with market related prices the existing point-to-point system must be changed to a entry/exit regime (as in the UK). However bearing in mind that we have a point-to-point system currently capacity trading could be improved by (i) allowing within day capacity transfers to take place without an “approval” process with the Transporter as if the capacity is there it must be possible to use it without the necessity for approval (ii) allowing capacity transfers to take place at any hour of the day with the minimum of notice – ideally 30 minutes. This should be possible at all Entry points but must be possible at any Entry Point taking in indigenous Irish Gas.

Section 4.4

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

The period decided on for the balancing period in any gas system should be that period which the operator of the pipeline system is comfortable he can manage the pressures in the system within prudent tolerance bands. Also if all participants in the gas system nominate accurately and re-nominate punctually it makes the pipeline operators job much easier. In the case of the BGE system, to date the Transporter has stated at Gas Forum meetings that he has basically never had to take balancing action on a within day basis. With the addition of (i) three new sources of gas – namely Corrib, Seven Heads and IC2 and (ii) the Dublin-Galway-Limerick ring main pipeline (iii) the Mayo-Galway link line, the transmission system in Ireland will be even more robust than it has been to date.

With all this substantial additions to the gas pipeline system in ROI there cannot be a case to argue for shorter balancing periods as there is not currently, and will not in the foreseeable future, be a threat to the security and integrity of the system.

It should be noted that the decision on the balancing period is dependent on decisions in the UK which influence us as a result of connection at Moffat. The CER may have not play a role in influencing OFGEM that extra costs on all market players imposed by a shorter balancing period may not be worth the investment of participant’s time and cost.

?? *The appropriate approach for balancing – on a point-to-point basis or entry/exit basis.*

The only way to have a truly competitive gas market is to have one which is highly flexible, highly liquid with many players. The current point-to-point

system is highly restrictive with long notice periods and all subject ultimately to the transporters final approval. Due to the restrictive nature of the system (and the high costs of capacity booking) only players that must have firm access to capacity 365 days a year book capacity (through STAs) and they book as little capacity as possible. If it were possible to trade out capacity, existing players may be encouraged to book more capacity to prevent the possibility of overrun charges, and other players e.g. gas suppliers, may be encouraged to contract for capacity. Due to the point-to-point system and the other restrictions in an STA, and the restrictions in the Code of Operations, there is little or no flexibility for a shipper to sell surplus gas or buy surplus gas, as they cannot get or give access to capacity at alternative Exit/Entry points.

Viridian believe Ireland needs a Entry/Exit regime to give maximum flexibility to Shippers which may perhaps reduce the costs of capacity to players by allowing them to make full use of capacity by allowing it to be traded effectively.

?? ***Whether current nominations process needs to be changed, and if so how.***

The current gas nomination process does not “fit” the electricity regime and as such causes problems for electricity generators with gas fired power stations. For example (i) under the Code of operations one has to make nominations for the next day by 10.00 – under the TSC rules you have to submit your BILC and ANOM files by 10.00. However the SSA on the electricity side may take until 18:00 (or even longer – unfortunately they do not have an obligation to do this by a certain time or at all) to give an indicative running order for power stations for the next day. It is with this information in hand that the power station should be making its gas nominations (and executing its gas trades).

If this SSA instructions were given at say 13:00, and the gas nominations given by 14:30 then generators can then purchase gas to fill their nominations at a time when they can access the true market price in the UK (at NBP) as most gas players at NBP are in the offices. After 17:00 this is not the case - generators are exposed to fewer players and usually get worse prices. (ii) the cut-off time of 01.45 for final renominations is highly restrictive as there are over 4 hours left in the day.

For NBP gas Transco nomination system is down from 04:00 to 06:00 and thus final renominations should be allowed up to 03:45. However for indigenous Irish gas coming through Inch/Corrib renominations should be allowed up to 04.45.

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

If this means should there be a mechanism for accessing market related prices for balancing gas then a mechanism should be created if all players have a level playing field in which to make their offers.

The problem at present is that the balancing gas price bears no resemblance to market prices and in fact is highly penal. If the transporter can advise on a within day and day ahead basis how much balancing gas he needs to buy or sell, then players in the gas market in Ireland should be able to bid for this business by offering to supply gas to, or take gas from, the system. Ideally, in order to keep costs to a minimum, the transporter should be discouraged from taking within day actions unless absolutely necessary and to use line pack – in this way the gas can be supplied at lower cost and thus all parties benefit.

?? *Whether current scheduling tolerances and charges reflect the costs imposed on the system by nomination divergences.*

The current Scheduling tolerances and charges are thought to be acceptable.

?? *Whether BGE as a Transporter, should authorise overruns when there is capacity available, and the appropriate charge for authorised overruns.*

If there is the ability to book short term capacity then there would be no need to have overruns authorised. However authorisation of overruns should be available if there is no short term capacity booking possible, and it should be charged for at the rates suggested previously in this reply for short term capacity bookings i.e. the charge could be some seasonally adjusted multiple of the daily annualised capacity charge - a suggestion being multiples of 1.25, 1.50 and 2.00 for the Summer, Shoulder and Winter periods respectively.

Section 4.5

?? *Whether storage facilities should be open access facilities.*

In a gas market where the intention is to have it open and fair to all third party players and like transmission, distribution and supply, storage should definitely be operated on an open and transparent basis to all third parties otherwise there is the risk of giving advantage to one shipper over another.

?? *Whether the Transporter should be allowed to undertake licenced storage activities.*

If it can be proved beyond all reasonable doubt that the Transporter is operating in an open, transparent and fair way in dealing with all shippers then there is no reason for the transporter not to be allowed to undertake a storage licence. However this would be difficult to prove, and this set-up is not the ideal for an open market as you have the same entity (being the incumbent) having a position in 2 sections of the gas services chain and this may lead to monopolistic behaviour. It is important that if the transporter is to enter into a storage contract that he should be obliged to make available any storage not necessary for system operations to the market on an fair and equal basis to all shippers.

In general storage should be kept separate from the transporter who should concentrate on the proper operation of transmission and distribution pipelines.

?? ***The Code of Operations current requirement regarding all Line-pack passing into the possession of the Transporter.***

By having access to all line pack the transporter has a huge advantage over other players in the gas market as he knows precisely at any moment in time the gas pressures in the system, he can bring in or take out gas as he sees fit. Due to the restrictions of the STA and the Code of Operations shippers have little or no such flexibility. The current set-up can only operate properly if (i) the Transporter is not in charge of buying balancing gas (ii) the Transporter makes spare line pack available to shippers through virtual storage or some other product that will allow shippers to use this facility for balancing.

Section 5.2.3

- ?? We believe that in general competitive processes should be held for a pipeline except where the transporter can demonstrate to the CER's satisfaction that this would cause insurmountable operational difficulties and/or give the new pipeline owner an unfair leverage over the existing system. Entry and exit spurs appear to be good examples of where competition would be attractive, whereas a section of a ring main may not be appropriate for competitive process for ownership. A pipeline should not be subject to competition if the sole end user is the owner of the pipeline
- ?? The key criteria for a pipeline connected to the transportation system should include; requirement to allow TPA, cost of build (fixed cost), time to build, level of liquidated damages for late delivery. The CER may wish to consider how a non-BGE entity would get wayleaves without a compulsory purchase order or could BGE's rights be transferred somehow?

Section 5.3.2

- ?? Viridian is in favour of model clauses in the contract as long as these clauses are not restrictive or place unnecessary risk with the shipper. The principle for risk should be that he/she who is better able to control the risk should take that risk. We refer to the numerous restrictive clauses in our STA offered as part of the gas allocation process (as evidenced in the associated dispute) as examples of where standard clauses of a restrictive nature are damaging to the promotion of new gas users.
- ?? We look forward to clear, measurable criteria for the framework for determining terms and conditions for TPA.

Section 5.2.4.2

- ?? Provision of a gas license on similar terms to the electricity license will help the certainty and bankability of projects.
- ?? The licence should mirror the electricity license but be careful of those clauses where the license could be revoked or place additional financial obligations as a result of a subjective view from the regulator. Banks are particularly concern about the regulator risk created by such clauses.
- ?? We believe that the current ringfencing process in BGE is insufficient and believe that complete legal separation of the businesses is required as a minimum.

Section 5.3

- ?? We are of the strong opinion that transportation charges should be developed as part of an open and transparent process where individual shippers can challenge the calculation of the charges based on detailed information provided by the transporter. The charges should be calculated on a five year rolling average with the next year binding and the following years to set an upper and lower boundary of potential charges. Certainty of transportation charges is very important for large gas customer planning requirement and investment decisions. We suggest that transportation tariffs should for the following gas year should be announced prior to the electricity tariff review (currently around September) to allow certainty for new generators to set prices in the electricity market.
- ?? We are in favour of a Uniform System of Accounts using Regulatory Accounting Guidelines (“RAGs”), consistent with those being developed for the electricity industry in Ireland, developed for BGÉ and any other regulated entity. We argue that the level of accounts detail available to the electricity industry player or customer is still insufficient particularly where separation between different areas in the business needs to occur. For example ESB PG and ESB PES have yet to provide separate accounts or have a legal separation.

Section 5.4

- ?? We suggest that it may be appropriate to use EU norms for the technical guidelines for consent as this will ensure a larger competitive field, increase the population of equipment that can be sourced, and reduce the cost of maintaining specialist national standards.

?? It would appear reasonable that the customer accepts responsibility and thus contribute to costs of action beyond the meter (on the customers side) to reduce the burden on the average gas customer. This should set the right incentives in place.

Other comments:

We note that figure A1 shows a profile from Corrib lower than the minimum gas demand in the system (as provided by that field operator). We are concerned that the CER may be accepting in faith figures from an interested party that has bearing on the commercial value of their product. We believe that Ireland may, under any circumstances, become a net exporter (or zero importer) of gas and this will have a significant impact on the price of indigenous gas. We would welcome further investigation and clarity in the industry on what constitutes reasonable gas demand assumptions for Ireland going forward.

Timing of tariffs is key to minimizing risks to independent generators and we suggest that the transportation tariffs increase for the following gas year should be announced in August so that both ESB and the independent sector can factor this in their calculations for electricity prices that occurs around the September electricity tariff announcement.

Code of Operations Policy matters:

Currently the Code of Operations discriminates against large users of gas for electricity generation and we suggest that this is considered as a matter of policy and changed so that all users are considered equally.

There are a number of areas of incongruence between the code of operations and the electricity Grid code, particularly in the area of ramp rates and primary operating reserves, this needs consideration.