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Stuart Coleman
Commission for Energy Regulation
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Dear Stuart

PROPOSED REDUCTIONS IN GAS TARIFFS 2009 (CER/09/039)

Thank you for this opportunity to respond on the proposed gas tariff reductions for May 09.

Continual market disruptions to the tariff setting process, places independent suppliers in a very difficult position. It is therefore a concern that we are just two months into the current tariff period and we are once again reviewing gas tariffs. Especially as competition in the NDM market is only now just starting to make some headway.

Regulatory intervention on this scale and frequency potentially undermines market confidence and increases risks for independent suppliers. In fact, the very existence of the option by the Commission to intervene in this manner, acts as a barrier to competition and a disincentive for independent suppliers to adopt hedging strategies.

However, we appreciate the uniquely difficult economic conditions that Ireland's consumers are facing, and in this respect we understand the need to take action.

We therefore make the following points on the proposed 12% reduction from 1st May 2009.

- **K Factor:** the approach could be construed as an abuse of the K-Factor mechanism. We also challenge whether the time has now come for its removal altogether.

- **Wholesale markets:** these remain volatile and implementing an interim reduction from May 09 is not without some risk.

- **Competition effects**: competition for SME customers has only just started to take a serious step forward, and any interim tariff measures must take account of these effects. We therefore recommend a reduction in the network components of tariffs, from which all customers might benefit.

- **Market confidence**: restoring market confidence is essential going forward, and this requires regulatory processes that are proportionate, consistent, transparent and in support of competition.

K Factor

It is no secret that we are not advocates of the K-factor and have long argued for its removal, however it did at least serve one purpose, namely to balance out the gas procurement exposure from one year to the next – its primary purpose within the Price Control mechanism is not meant as an interim mid-term reapportionment. This is not how it is intended to work, and merely reinforces the need for its removal altogether.

Tariff adjustments in a pro-competitive market should reflect sound commercial risk based judgements. The presence of ‘K’ dispenses with this commercial judgement for BGES, whilst leaving independent suppliers exposed to these risks. Its presence therefore confers an unfair market advantage for BGES and the use of the K-factor mechanism in this manner, serves to reinforce this advantage.

The K–factor should not be used to effect mid-term price reductions from May 09, and we explain below in more detail our preference for an alternative approach to achieve the tariff reduction of 12%.

Wholesale market volatility

The past year has seen unprecedented volatility in the wholesale energy market, and the future outlook remains challenging. This is due in part to geopolitical events and the present economic climate. Indeed, analyst reports vary, with some predicting wholesale prices could rise again, as early as 2010.

There is no doubt we are sailing through unchartered waters during this present economic downturn and we therefore suspect these volatile market conditions are to remain with us for some considerable time to come. The danger however, is to unduly pre-empt significant tariff reductions, to then months later have to retract them. Whilst customers invariably need the lowest possible energy prices, they also require some price stability.

The proposed 12% reduction from May 09 is reasonable given the circumstances. It is also consistent with the proposed reduction for electricity, as well as protecting against possible adverse repercussions for consumers should wholesale gas commodity prices not move as anticipated. Come October 2009, markets will then be better informed on wholesale commodity price movements for 2009/2010.

Competition Effects

The Commission has been mindful of the possible negative effects on competition when making previous decisions with respect to tariffs for both electricity and gas. For example, measures have been directed through the network charging mechanisms to ensure that all customers benefit, no matter their supplier. Indeed, we note that even for the latest proposed decision for ESB PES Tariffs, the effect on competition has been mitigated via use of the Transmission and Distribution charges to provide a 10% rebate (i.e. network based).

However, there is a significant dilemma now facing the market with the proposed interim gas tariff reductions from May 09. How should the proposed reduction be implemented in line with the Commission's key market principles, including that reductions do not negatively impact on competition?

There are steps that can be taken to lessen the impact on competition. More specifically, we recommend the 12% reduction be managed via a reduced network component, an approach suggested and then seemingly dismissed by the Commission. The network reduction could be applied in the same manner as that implemented for the January 09 and May 09 electricity tariff reductions, i.e. network based and therefore applied to all customers irrespective of their supplier.

The benefit of such an approach would be to leave the K-Factor unadulterated, reduces the impact on competition, and yet still enable a reduction to be passed on to customers. BGES would then properly recoup and rebalance its wholesale gas costs from October 2009 as designed under its price control and with full insight to wholesale commodity cost movements for 2010.

Restoring Market Confidence.

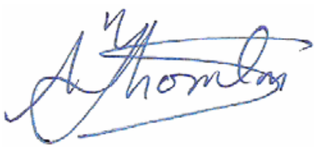
We remain deeply concerned regarding the commercial consequences for competing suppliers faced with such regulatory uncertainty and unpredictability. The need to restore market confidence is therefore critical - the scale and frequency of the continuing regulatory and political intervention does not help matters, nor does the Commission's commitment to continue doing so.

Whilst we may not be certain of the regulatory process going forward, we do however appreciate the Commission's commitment towards the development of effective competitive markets. We would like to reiterate the primary importance of pro-competitive market pricing reflectivity, market transparency and regulatory certainty as fundamental market principles in support of competition.

Concluding, we hope the Commission reevaluates its position to ensure that any tariff reduction is delivered in a manner that benefits all customers, irrespective of their supplier, i.e. via the network component.

Please do not hesitate to contact us if we can provide any further information.

Yours sincerely



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