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Stuart Coleman
Commission for Energy Regulation
The Exchange
Belgard Square North
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24 August 2009

Dear Stuart

GAS TARIFF REVIEW 2009 – 2010, BORD GAIS ENERGY'S RESIDENTIAL AND SMALLER INDUSTRIAL AND COMMERCIAL CUSTOMERS (CER/09/124)

Thank you for this opportunity to respond on the proposed gas tariff reductions effective from October 2009.

We also thank the Commission for the opportunity to debate the costs and tariffs at the Tariff Open Day on 10th August. As we mentioned at that forum (and echoed also in our response for the electricity tariff announcements), whilst we may have been disappointed in the process leading up to that session, this should not be allowed to detract from the importance of market transparency and how these events can help in this regard.

We would therefore encourage both ESB PES and Bord Gáis Energy Supply (BGE) to be a great deal more forthcoming in terms of the underlying facts and how the tariffs have been arrived at, and also at giving participants sufficient time to review the detail. We believe this would facilitate a more productive discussion.

That said, we do appreciate the approach for BGE seems to be now following a more consistent regulatory process, including how the K-Factor is managed. This will provide a welcome respite from the previous 12 months of a challenging regulatory approach, which injected some risk to the market. Providing this is maintained, it should lead to an increase in market confidence in the regulatory tariff setting process for gas.

However, we have a number of points to make with respect to these proposals.

- the inadequacies of the gas purchasing benchmark information;
- lack of transparency in the allocation of costs across sectors;
- the calculation of secondary capacity discounts; and

- the effective management of regulated tariff announcements.

Gas Purchasing Benchmark

The issue of gas purchase benchmark hedging information has been the subject of detailed discussion between ourselves and the Commission for some time, and we have appreciated the opportunity to have these debates. However, the underlying concern still remains and we have yet to be convinced by the rationale to maintain the status quo.

The gas benchmark data should provide market participants with a sufficient level of detail that enables them to understand how the regulated prices have been derived. It therefore seems logical this should be as helpful as possible. However, by relying on the quarterly gas benchmark data, market participants are left exposed unable to establish the extent of their risk. Currently, the only participant that has full knowledge of the construction of the benchmark is BGE - this unequal insight into a key element of gas regulation must be ended immediately.

Without more information, assumptions must be made on how the benchmark data has been determined. For example, if different assumptions are used, the spread between the maximum and minimum benchmark price can be as high as 9.47p/therm – this figure is obviously extremely significant relative to supply business margins. Similar issues also arise when trying to apply an appropriate currency exchange rate. Both add in risk to our modelling when interpreting the benchmark data and unnecessarily increase the risk of supplying these customers.

The Benchmark data is therefore still too broad, and ideally we require monthly benchmarked data. Failing this, and in order to narrow the information gap, we recommend at the very least providing the market with more information, such as:

- Identifying the limited days (or day) of the month that form the construct of the benchmark.
- Explaining how the benchmark calculation has been made over the relevant quarter(s) (e.g. averaging approach).
- Regular 'snap shot' publications of the benchmark gas prices for each quarter throughout the year for the future tariff period.
- Publication of the actual gas price that went into the gas tariff formula.

It has been suggested, if more information (e.g. monthly data) were provided and if BGE were to map their tariffs to the benchmark information, this could leave them commercially exposed. This is clearly not the case:

- BGE's trading activity is confidential and its performance relative to the benchmark is therefore unknown. This provides sufficient protection for BGE's

commercial interests and, notwithstanding our additional suggestions above, should at least resolve any concern there might be.

- The purpose of the benchmark model is to assist all market participants in understanding how the regulated tariffs have been determined. It therefore seems odd to argue the information needs to be sufficiently obtuse in order to avoid accurate determination of how regulated tariffs have been arrived at by all participants, except BGE.

We therefore ask the Commission to reconsider our request for more market transparency with respect gas hedging data, and which would also enable market participants to sensibly comment on BGE's regulated tariffs as and when consulted upon.

Transparency in the allocation of costs

BGE has proposed a reduction of 9.3% for domestic and 13.6% for small industrial and commercial customers. However, there has been no backup data to qualify how the costs have been allocated across these customer sectors that might warrant such a wide disparity between domestic and business.

This lack of information makes it difficult for us to penetrate how the decision was arrived at. Our analysis suggests that at best we might expect a reduction of between 9-10%, suggesting that these tariff proposals are not fully cost reflective.

We would appreciate a further explanation on how costs have been allocated between these two customer groups. Analysis based on the profiles published by BGE shows that shape alone is insufficient to explain the discrepancy.

Secondary Capacity Discounts

Energia is an active trader in secondary capacity products, and yet, we have had significant difficulty arriving at the 10% discount that is internally transferred by BGE from the residential and smaller industrial and commercial customer sector, to benefit the FVT sector (i.e. Medium Business Units). We just cannot get to their figures.

More recently (9 July 2009), we have written expressing this concern, not only in the lack of transparency in how this is arrived at, but questioning whether the approach is even justified.

Assuming the numbers stack up, we have also offered an alternative so that all customers would benefit. We have suggested the discount could be distributed via the network charge (UoS) to also help mitigate the effects on competition.

We understand the Commission is undertaking a detailed critique of the discount value and we look forward to your response in due course, hopefully supported by sufficient data and information to at least enable us to understand the figures.

Regulated Tariff Announcements

We understand the gas tariff announcements may have been delayed to align with the electricity announcements. In principle, we have no objection, providing the result is a consistent and solid regulatory process for these announcements.

However, we were surprised by the early announcement in the press¹ on the Wednesday 5 August, of the BGE tariff reduction. Steps were taken by the Commission to help manage this amongst market participants, which was appreciated. Indeed, the announcement was closely followed by the Commission's supporting paper the following day (6 August 2009).

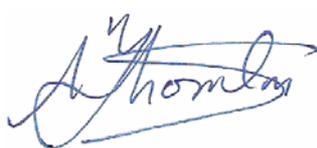
Nonetheless, we wonder who initiated this and hope the Commission had fully reviewed and tacitly approved the tariff reductions before this was leaked to the press.

Far better, would have been a joint press release statement made on 6 August to coincide with the consultation paper. This would have enabled the message to be managed and so avoid compromising regulatory due process. Once a statement such as this has been made public, it is very difficult to retract or modify, even if the grounds for doing so are justified.

We therefore recommend an inquiry into how and why this announcement was made, what can be done to manage such announcements in future, and how the regulatory tariff announcement approach can be improved.

We look forward to your response on the points made above, and please do not hesitate to contact us if we can provide any further information.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Tony Thornton', with a stylized flourish above the name.

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¹ Irish Examiner, Wednesday 5 August 2009.