In addition to day-to-day regulation of the market, key work carried out during 2010 by the Regulatory Authorities, the CER and the Utility Regulator, included:

- *Capacity Payment Mechanism (CPM) Medium Term Review:* The main purpose of this review is to examine whether the current design of the CPM can be improved. Two consultation papers on different aspects of the CPM were published in 2010, with a final one due in early 2011 followed by an overall CPM decision paper. It is intended that any changes to the CPM will be effective from October 2012.
- *Regional Integration:* In line with a decision paper published in March 2010, the Regulatory Authorities are progressing the integration of the SEM with its neighbouring markets and the harmonisation of cross-border interconnector rules as appropriate, whilst ensuring that the SEM design remains robust. This aims to maximise the efficient use of existing and planned interconnectors to/from SEM and neighbouring markets.
- *Market Power and Contract Liquidity:* This review examines the current and likely future presence of market power in the SEM and the liquidity of wholesale electricity contracting. An information paper was published in August 2010 and a consultation paper on the matter is planned for December, with a view to a final decision in Q2 2011.
- *Scheduling & Dispatch:* Following earlier papers, in September 2010 the Regulatory Authorities published a proposed position paper regarding principles for the dispatch of generation in the SEM and rules regarding remuneration under the Trading and Settlement Code. A decision paper is planned for Q1 2011.
- *SEMO Regulation:* Following consultation, a decision paper was published in December 2010 on the form of regulation for SEMO (the Single Electricity Market Operator), its allowed revenue and associated tariffs for the tariff period from October 2010 to September 2013. This provides strong incentives for SEMO to make efficiency gains.

For more information on SEM please visit **www.allislandproject.org**.

Merry Christmas & Happy New Year!

The CER would like to take this opportunity to wish all our stakeholders a Merry Christmas and a Happy New Year. We look forward to continuing to working with you throughout 2011.

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Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

December 2010

Newsletter

The Commission for Energy Regulation (CER) is the independent body responsible for regulating the natural gas and electricity sectors in Ireland.

The CER is pleased to publish this newsletter, which provides an overview of some of the key Irish energy developments and CER work carried out during the 2nd half of 2010. It follows on from a CER newsletter published in August and is part of our commitment to publish a newsletter for our stakeholders bi-annually.

There are also other aspects of the CER's work in recent months which are not detailed in this newsletter - further information can be found on our website at www.cer.ie.

1. Retail Competition & Consumer Protection

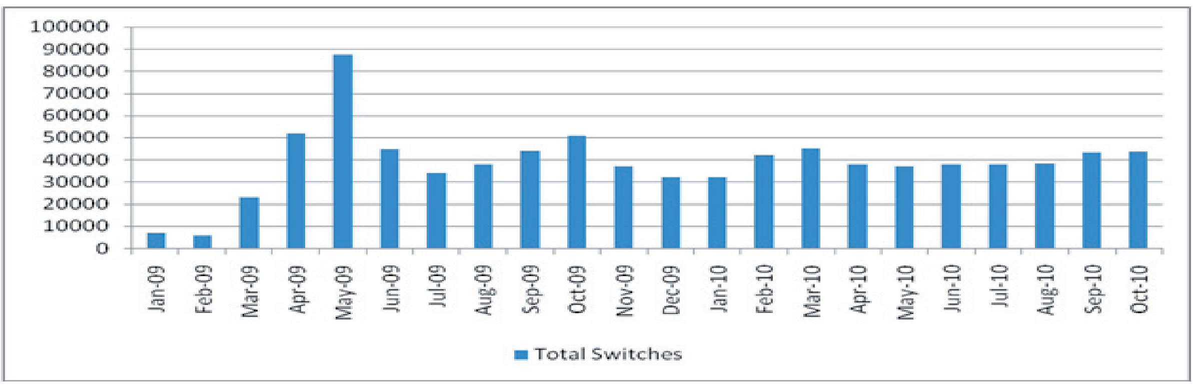
Retail Competition

Strong competition has developed in the retail electricity market since early 2009, with over 850,000 business and domestic customers having switched supplier since then. In other words, over the last two years approximately 38% of all Irish electricity customers switched supplier, one of the highest supplier switching rates ever seen in Europe.

Given this strong retail competition, in April 2010 the CER published a "Roadmap" decision paper on the de-regulation of ESB Customer Supply's retail electricity prices. This Roadmap set out the criteria for deregulation of the retail business and domestic (i.e. residential) markets.

The business markets were accordingly deregulated on 1st October 2010, given that ESB Customer Supply's market share has fallen dramatically, marking a significant milestone in the history of electricity market liberalisation. Since then, ESB has been free to develop its own tariff offerings for business customers. ESB Customer Supply's domestic tariff remains regulated (see section 2). The CER's latest market monitoring does, however, indicate that the high levels of customer switching is continuing, as shown in the chart below. This means that ESB's market share is likely to reach the 60% market share threshold in the near future. Reaching this threshold will allow for de-regulation

Monthly Numbers of Electricity Customers Switching Supplier



in the domestic market in Q2 2011, assuming ESB has provided a satisfactory commitment to rebrand its supply business.

In the gas market, following the de-regulation of the RTF sector (Regulated Tariff Formula, comprising the large energy users sector) in June 2010, in late November the CER published for consultation a Roadmap for possible retail de-regulation in the Non Daily Metered (NDM) gas market. This includes small business and residential customers. A decision on this is likely in Q2 2011.

The CER also notes Airtricity's recent entry into the domestic gas market, providing more choice to energy customers.

Customer Protection

With the transition to a deregulated market, the CER is placing further emphasis on customer protection measures to ensure that consumers are fully benefitting from retail competition. In December 2010, the CER will publish a consultation on Customer Protection in the Deregulated Market, which will consider what additional measures may be required to ensure that customers are protected. In 2011, the CER will also consult on a range of enhanced retail market indicators which will be used to assess the development of competition in the market, and if consumers are benefiting.

Due to the difficult economic climate the CER recently consulted on the issue of energy customer disconnection costs and on additional customer protection measures that could be included in a supplier's Code of Practice. Following this, in late November 2010, the CER decided that:

- We will review the level of disconnection and reconnection charges for gas and electricity, effective from January 2011.
- Where an electricity or gas supplier initiates a disconnection/reconnection of a domestic customer for reason of non-payment of account, only 50% of the total charge is recoverable (including of any new rate set from 1st January) from the customer. This is effective for the 12 months from 22nd December and will be reviewed again in December 2011.
- A revised supplier Code of Practice for disconnections is effective from January 2011. This includes additional measures to assist domestic customers in managing their bills and reducing disconnection rates, such as requirements on suppliers to:
  - Provide customers a written confirmation of payment plans;
  - Provide customers with a minimum of 4 contacts, at least two of which should be in writing, before a disconnection occurs;
  - Increase notice of supplier disconnection of customers from 7 days to 10 business days;
  - Highlight on the bill, any administrative costs separate to the published network cost of disconnection/ reconnection costs and to highlight any cancellation fee that may apply;
  - Maintain a record of all steps taken and considerations made when reaching the decision to disconnect a customer and to report to the CER on a monthly basis;
  - Use "plain English" in all correspondence to customers.

The CER likewise welcomes the responsible decision taken by electricity suppliers not to disconnect any customers during the recent cold weather.

The CER also published its decision on the use of prepayment equipment, known as budget controllers, to reduce the number of disconnections in the electricity market for customers in financial hardship. This decision paper noted the limitations of the budget controllers currently in place, in terms of technology and availability. The CER is also working with industry to deliver a more technically robust and widely available prepayment solution for electricity customers in financial hardship, as an interim solution in advance of the roll out of smart meters.

2. Regulated Retail Tariffs

Gas

Given that the wholesale price of gas constitutes almost 50% of the cost to the gas consumer, changes in international wholesale gas prices have a very significant effect on prices paid by gas consumers. Compared to the same period last year international gas prices have increased.

However, despite this increase, on 1st September the CER announced that there would be no increase in Bord Gáis Energy's (BG Energy's) gas tariffs for residential and smaller industrial / commercial customers from 1st October. This was for three reasons:

- As approved by the CER, BG Energy purchased gas using a benchmark (or laddered) approach which spreads the purchases of gas over a period of time. Thus some of the gas for the year ahead would have been purchased when prices were lower;
- The margin earned by EG Energy from higher than predicted gas sales during the cold winter period of early 2010 was returned to the customer; and,
- Savings achieved by BG Energy beating the "benchmark" price have been included.

Electricity

On 1st September the CER announced ESB Customer Supply's regulated tariffs to apply for domestic customers from October 2010 (business market tariffs have been deregulated - see section 1). With the exception of the Public Service Obligation (PSO) levy, ESB Customer Supply's regulated domestic tariffs remained unchanged because of the following two key factors cancelling each other out:

1 There was a slight increase in the cost of generation, which makes up about 60% of the end price of electricity, due to an increase in international fossil fuel prices from last year.

2 There was been an overall fall in network-related charges (see section 3).

However, there was an increase in the PSO levy. The PSO is Government policy designed to support security of energy supply, the use of indigenous fuels (i.e. peat) and the use of renewable energy (especially wind). The PSO levy was zero in previous years because PSO-related generation earned enough money from the market. Now that fuel prices have fallen from their record highs, PSO-related generation is no longer "in the money" and so requires a subsidy.

The result of this PSO levy was a 4.9% increase in ESB Customer Supplier's domestic tariffs from October. This is equivalent to a monthly charge of €2.73.

3. Electricity Network Charges

The costs of operating and developing the Irish electricity network, a natural monopoly, make up about one-third of the final price of electricity to Irish homes and businesses. As regulator, the CER is responsible for setting the allowed network costs/ revenues and charges for EirGrid and ESB Networks Ltd., the operators of the transmission (high voltage) and distribution (lower voltage) networks respectively.

Following public consultation, in November of this year the CER announced its final decisions on the electricity network revenues for the years 2011 to 2015. This project was called "Price Review 3" or "PR3". These revenue decisions are designed to cover the cost for EirGrid and ESB Networks Ltd to efficiently operate and expand the transmission and distribution network to 2015. When determining the revenue amounts, the CER's emphasis was on value for money and on developing a high quality network.

This 5-year allowed revenues feed into Transmission Use of System (TUoS) and Distribution Use of System (DUoS) tariffs - these are the charges, based on the CER's approved revenue, that electricity generators and suppliers pay EirGrid and ESB Networks Ltd. to transport electricity across the network. Overall, the TUoS and DUoS charges, making up 1/3 of the final electricity price, combined fell by about 5% last October, with a gradual increase anticipated for the remainder of PR3. The TUoS and DUoS charges are discussed below.

Transmission

Regarding the high voltage transmission network, the CER approved an increase in TUoS tariffs over the five years such that they rose by circa 3% last October and are estimated to rise by 7% per annum thereafter to 2015. Transmission costs make up a very small element of the final end user bill at present (approx. 7%).

The key driver behind the increase in TUoS charges is the major transmission investment programme required for the next five years. EirGrid had requested an investment allowance of €2.1 billion but, conscious of the need for value for money, the CER decided that the transmission investment programme can be delivered for €1.45 billion through efficient and optimal management of the network. This investment will provide Ireland with a high-quality electricity supply and enable the country increase the proportion of its electricity consumption coming from renewable generation from about 15% currently to 40% by 2020. Another driver for TUoS charges over the PR3 period is the East-West interconnector - see section 4.

Distribution

The distribution network consists of lower voltage wires used typically to distribute electricity from the grid and small generators to our homes, shops and businesses.

The CER approved a 6.5% cut in the average DUoS tariffs in October, with increases of 4.8% per annum for the remaining lifetime of PR3. A €2.31 billion distribution network investment programme has been approved - ESB Networks Ltd. requested a €2.66 billion investment programme over the next five years but the CER believes that the significant distribution network upgrade can also be achieved at a reduced cost through the implementation of productivity and efficiency improvements. The PR3 project also includes incentives for ESB Networks Ltd. to improve the quality of its service to customers.

4. East West Interconnector

The East-West Interconnector (EWIC), currently under construction with a due operational date of 2012, will connect the electricity system in Ireland with the UK via a 260km subsea and underground cable. It will have a capacity of 500 MW and will be able to transport power in both directions. At a cost of €600 million, it is estimated to bring benefits to Ireland of over €1 billion over its 30 year economic life time. Some of the benefits are:

- Enhancing Ireland's Security of Supply. The EWIC will provide access to the significant generation capacity that is available in the UK;
- Assisting Ireland's national renewable electricity consumption target of 40% by 2020. This is because through EWIC we can use UK generation as a back-up for wind power during calm days in Ireland, Likewise, when we have excess wind it can be exported to the UK.
- Increased competition, by allowing generators in the UK to compete in the Irish market.

The contract to design, manufacture and install the EWIC has been awarded to Swedish engineering firm ABB following a competitive tendering process. The EWIC will be owned and operated by EirGrid. The CER is overseeing the project and is pleased to report that it is currently on target and ahead of budget for operation by the end of 2012. Some key recent developments include:

- The granting to EirGrid for the full notice to proceed with the construction of the EWIC on foot of Government approval;
- The securing of the necessary finance for funding of the project. Funding includes a grant of €110 million from the European Energy Program for Recovery fund and a loan from the European Investment Bank;
- The securing of all necessary planning consents and approvals for the project; and,

- The commencement of the installation of the cable ducting in Ireland and Britain with the installation nearly complete in Britain.

5. SAFETY

CER's Safety Enforcement

To ensure high safety standards, it is illegal for a person who is not registered with the Register of Gas Installers Ireland (RGII) to carry out domestic gas works. In November the CER successfully prosecuted a person for installing a gas boiler in a premise in Dublin whilst unregistered with RGII. The Court noted the severity of the offence, convicted the person and imposed a fine. This prosecution was the first of its kind by the CER and shows that the CER will use the law to enforce Safety Standards where necessary.

LPG Update

Legislation for the inclusion of Liquefied Petroleum Gas (LPG) installers into the regulatory safety scheme was enacted in June 2010. The CER will shortly consult with industry to define what LPG work will be regulated. Similarly to natural gas, LPG installers will be required to register with RGII in order to legally carry out LPG works. In preparation for registration, which will commence in mid 2011, LPG Installers should familiarise themselves with the registration process - see www.rgii.ie.

The CER is now working with the Department of Communication Energy and Natural Resources on the draft Phase 2 legislation for the regulation of LPG undertakings (rather than only installers). This legislation will provide for the safety regulation of LPG distribution networks, LPG appliance-related incident reporting in a domestic setting and the promotion of LPG safety by the CER. It is envisaged the publication of this legislation will take place in December 2010.

Natural Gas Safety Inspections

As part of its ongoing implementation of the Natural Gas Safety Regulatory Framework, the CER has initiated the development of a programme of inspections of natural gas network infrastructure assets and activities for 2011.

Independent inspection or monitoring activities are essential to assure the CER that the reported safety performance of the gas network is accurate and complete, to identify emergent reporting areas and to recognise any future hazard potential. The process of gathering and iterating information on risk is a fundamental requirement of continuous safety improvement.

It is intended that the inspection activity will be both planned and sporadic in nature. In the first instance it will focus on assets and activities where it is considered a higher level of potential risk may exist, either through increased likelihood or consequence. To this end the initial programme will focus on assets where mechanical failure would have high significance, as well as operational activities where previous learning has indicated a higher potential for unsafe acts or conditions.

6. SEM Update

The all-island Single Electricity Market (SEM) continued to work well in 2010. The market saw significant new entry of new renewable and thermal generation, with for example two new efficient power plants of over 400 MW each joining the market in the Cork region, helping to provide a healthy generation margin on the system. The System Marginal Price (SMP), shown below, continued to track movements in international fossil fuels prices, with the SEM providing for the cheapest generators to meet demand across the island at any one time.