3rd September 2010

Mr. Jean Pierre Miura
The Utility Regulator
Queens House
14 Queen Street
Belfast
BT 16ER

RE: SEMO Revenue Review and Tariffs: October 2010 – September 2013

Dear Jean Pierre,

Bord Gáis Energy (BG Energy) appreciates the role of the Regulatory Authorities (RAs) in setting revenue controls which are cost reflective while also incentivising efficiencies. Also of importance in the design of any such regulatory formula is that the formula provides for future change in the market and does not impede on the ability of the regulated entity to finance its business and to facilitate changes and developments in the market.

With this in mind, BG Energy has certain concerns relating to the RAs proposals for the regulation of SEMO over the coming three-year period. These concerns largely relate to the inconsistency in the RAs proposals relative to the proposals recently suggested for the system operators, the implications of the proposals for the sustainability of SEMO and consequently the implications for the future development of the Single Electricity Market (SEM).

Form of Regulation

In keeping with the regulatory principles outlined by the RAs in section 4 of the paper, BG Energy is of the view that the most important principles in regulating an entity are; stability, sustainability, transparency, predictability and cost-effectiveness. Policy based on these principles will ensure that a business is sustainable, while also providing a level of flexibility for the market and delivering value for money for customers. BG Energy does not believe that the RAs proposals to recover capital expenditure through a revenue cap regime is appropriate or in keeping with these principles.

Firstly, the proposal will create tariff volatility and uncertainty year-on-year as capital expenditure arises. This is unpalatable both for customers and also SEMO from a financing point of view. The current rate-of-return approach smoothes the impact of capital expenditure across a number of years, which is a more appropriate formula for a regulated monopoly than a risk/return orientated formula.

Secondly, the revenue cap regime would not replicate the market realities faced by SEMO in developing and financing capital expenditure projects. It would be unreasonable to require SEMO to accost projects in a manner which diverges from accounting and tax laws which ultimately dictate how projects are accounted for and depreciated in commercial practice.

Finally, the RAs proposal to introduce a revenue cap regime is inconsistent with the regulatory formulas applied to the parent companies of SEMO, both of whom are regulated by a rate-of-return formula. BG Energy considers that the RAs should be consistent in their treatment of the regulated monopolies and does not see merit in either the principle of diverging regulatory policies or the suggested formula itself in providing the correct incentives for SEMO.

Capital Expenditure

BG Energy recognises the RAs initiative to reduce the level of information asymmetries between the regulated entity and the regulatory authority while also ensuring projects are delivered in a timely and cost effective manner. However, BG Energy does not believe that the suggested menu regulation proposal is appropriate for the regulation of SEMO.

SEMO is charged with facilitating market change and development as determined by the SEM Committee through the Modifications Committee process. The type of development implemented by SEMO is ultimately decided by the market, which in taking any decision takes the cost of implementation into account. It is therefore largely not within SEMOs remit to diverge from the agreed proposal and to choose between different cost alternatives.

In short, the theory of menu regulation is directed more at those companies who have scope for cost reductions or a choice between different cost options. This can provide appropriate incentives for certain regulated entities but given the role of the market operator, BG Energy does not believe it is an appropriate regulatory mechanism for SEMO. BG Energy suggests that incentives on SEMO should be more directly related to service delivery, akin to the KPI proposals.

Payroll

BG Energy was surprised at the RAs assertion in 9.1.4 that the pace of market change is expected to decrease in the coming years. Considering the ongoing regional integration developments at a European level and the related changes to the market in terms of delivering intra-day trading arrangements and day-ahead market coupling, BG Energy is of the view that there will be significant change and development over the coming years.

To accommodate these changes and provide for a more dynamic market, BG Energy would suggest that SEMO will need extra staff resources over the coming years. With this in mind, BG Energy does not believe that the RAs proposed decrease in payroll costs are achievable if the market is to continue its development and integration.

Incentives

As stated above, BG Energy agrees with the provision of incentives on SEMO both in terms of service delivery and time and cost delivery of projects (i.e. within the timelines and budgets as agreed with the RAs and the Mods Committee). BG Energy welcomes the addition of further incentives on SEMO and would suggest further incentives around the timing of query responses, the number of resettlements and the publication of market reports. The latter will become more important with the introduction of intra-day trading and further gate closures.

In summary, SEMO has an integral part in the credibility and sustainability of the SEM. It is therefore essential that it has the resources (labour, capital and financial) to meet the current and future needs of the market and its participants. For this reason, BG Energy would suggest that it is important that the regulatory formula pertaining to SEMO is stable, predictable, transparent and cost-reflective. This will in the long term deliver benefits in terms of costs and market sustainability. To this end, BG Energy suggests that the regulatory formula currently applied to SEMO and the system operators in both jurisdictions would be a more appropriate regulatory formula than that proposed by the RAs in its latest consultation paper.

Yours sincerely

Jill Murray
Commercial Regulation
Bord Gáis Energy