Mrs. Fay Geitona
Secretary General
CEER
Rue le Titien 28
1000 Brussels
Belgium

17 January 2007

Dear Mrs. Geitona

**BG International Response to ERGEG Public Consultation on Cost and Tariff Principles.**

BG International welcomes the opportunity to comment on ERGEG's Principles on calculating tariffs for access to Gas Transmission Networks. BG International ("BG") is a subsidiary of BG Group which is active in gas exploration and production in both the UK and Norwegian sectors of the North Sea. BG supplies approximately 6% of UK gas demand, and is an active participant in the UK wholesale market, and at the Zeebrugge and TTF hubs. BG is also active in the LNG market with shares in various upstream liquefaction plants, as well as equity and capacity in the Dragon LNG terminal currently being built in the UK.

Overall the document is a reasonable reflection of the principles that should be included in the calculation of tariffs. There has been considerable work on these issues in liberalised markets and by academics, and regulators should be able to draw on this work when setting tariffs.

We have the following comments on certain aspects of the document.

<u>6. Criteria to assess effective pipe to pipe competition.</u>

We welcome the fact that ERGEG recognises that there needs to be a rigorous test before allowing TSOs to charge market based tariffs. We would question if the existence of two TSOs in a market will lead to pipe to pipe competition given the oligopolistic nature of most European gas markets, and therefore welcome ERGEG's statement that such a situation is a necessary but not sufficient condition for pipe to pipe competition.

Our view is that market based tariffs, or a benchmarking approach, are wholly inappropriate at this time for downstream European transmission pipelines. The current situation, where many TSOs are part of vertically integrated incumbents who often are the dominant players in their respective markets, means that any approach other than a regulated approach to tariff setting will only benefit the incumbent players by keeping other players out of the market. Incumbents with captive markets will be able to absorb high transportation costs by passing them onto consumers, whilst new entrants will frequently be at a disadvantage. An example of this is imbalance charges where lack of liquid markets make new entrants much more vulnerable to imbalance charges than incumbents. Where such charges are set very high this can adversely impact the viability of potential deals.

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Another issue is the lack of willingness of TSOs to invest in new capacity or to maximise utilisation of existing capacity where there is contractual but not physical congestion. The EU Commission Sectoral Enquiry identified many examples of contractual congestion, even when there is not physical congestion. Such a situation, combined with market based tariffs, will simply lead to higher transmission costs than can be justified. Proper regulation of TSOs' tariffs would ensure that they had the right incentives to maximise their revenues by maximising availability of capacity on a transparent, fair and non-discriminatory basis.

4.6 Imbalance Charges.

As noted above we believe this should be regulated to ensure that they reflect costs incurred and are properly targeted on to those who create the costs. To achieve this imbalance charges should be based on a market price for gas where there is a reliable liquid market (as is the case in the UK) or should be set in a way that reflects costs expected to be incurred where such a liquid market does not exist. A benchmarking approach could lead to TSOs charging unnecessarily penal rates simply because other TSOs charge such rates.

We welcome the proposal to establish Operational Balancing Agreements between TSOs to minimise interruptions or reductions to shippers. We have experience of situations where lack of such an agreement, and penal balancing charges in one TSO system, have hindered cross border flows to the detriment of European gas trade and ultimately consumers.

4.4 Short term capacity.

We do not agree that short term capacity contracts necessarily mean higher risk for the TSO and should therefore mean higher charges. This depends on the level of certainty that the TSO has about its allowed revenue, and the cost of capital that it is allowed overall, which of course should reflect its risk. TSOs should be obliged to maximise the release of capacity to the market, whether this is on a long term or short term basis. It may be appropriate to have a framework whereby short term capacity is sold on a pay as bid basis to allow efficient allocation between players. However this should be coupled with measures to ensure that there is not unnecessary contractual congestion and thereby ensure that utilisation of pipelines can be maximised. Long term capacity should of course be sold on a regulated price basis as the quantity of capacity is not fixed and TSOs should meet demand where it is economic to do so. It should be noted that it is usually better to have a little too much capacity, rather than too little because of the way capacity constraints impede trade in gas.

General comment.

TSOs and Regulators need to recognise the importance of setting tariffs in a way that is consistent with other aspects of the regulatory framework, for example the methods of capacity release. If this is not done it may result in poor investment signals to the TSO or distortion of competition between shippers, for example by distorting the buying decision between long term and short term capacity.

Should you have any queries please do not hesitate to contact me on ++ 44 118 929 3442 or at alex.barnes@bg-group.com.

Yours sincerely

**Alex Barnes**
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