



**GASLINK RESPONSE TO CAG
TRANSMISSION TARIFF METHODOLOGY
CONSULTATION PAPER**

Aug 2008

- 1. Introduction**
- 2. Regulatory Context**
- 3. Gaslink Objectives**
- 4. Assessment Criteria**
- 5. Assessment of Options**

1. INTRODUCTION

Gaslink welcomes the opportunity of responding to this important consultation paper on the transmission tariff methodology aspects of the Common Arrangements for Gas Programme. We fully support the Memorandum of Understanding (MoU) signed by the two Regulatory Authorities (RAs) in February of this year and look forward to making a positive contribution to this process.

Gaslink is the new Independent System Operator for the Irish gas transportation network and was awarded operator licences for the Transmission and Distribution systems in ROI on 04 Jul 2008. Its primary function is to ensure the secure, reliable and efficient operation of the gas transmission and distribution systems under economic conditions and with due regard to the environment. Gaslink also has an important role in ensuring non-discriminatory access to the natural gas network.

Gaslink was established in response to the second EU Directive on unbundling of vertically integrated gas utilities. It operates the gas network owned by Bord Gais Eireann but has no interest in the ownership of those assets. This is an important consideration which informs our response to this paper – in that Gaslink's interests in future tariff methodologies may differ from those that one would typically find in a traditional asset owner/operator. Gaslink's priorities with respect to the harmonisation of transmission tariffs are therefore focussed more on the high level principles of tariff design.

In many instances Gaslink identifies with the proposals of the RAs in relation to the principles underpinning the design of a harmonised tariff. From the independent system operator perspective, harmonised system charges that (1) are transparent and non-discriminatory, (2) encourage efficient and optimal use of the system, (3) provide appropriate levels of security of supply,

will provide the necessary conditions required to support competition in the all island gas market and best serve the customers' interests.

We recognise that given the evolving nature of the gas markets on the island and the various stakeholders that are involved, there will be inevitable tensions between these competing objectives. Gaslink is pleased to be able to contribute to the consultation process and hopes that the final decision on this workstream reconciles the different stakeholder interests whilst not compromising the conditions set out above and discussed below.

2. REGULATORY CONTEXT

The RAs will want to provide a solution that meets with European and local regulatory mandates. Similarly, Gaslink's response to this consultation paper is driven primarily by the regulatory framework including:

- Directive 2003/55/EC of the European Parliament and of the Council (the 2nd Directive);
- Statutory Instruments 760 of 2005 and 377 of 2007 (SIs);
- Regulation (EC) 1775/2005 of the European Parliament and of the Council (EC 1775); and
- The transmission licence issued by CER.

We have considered the requirements of existing European and Irish legislation to the extent that these relate to transmission use of system tariffs and the role of a gas system operator and we have used this to guide our response. In particular the following recital from the 2nd Directive is relevant: "For competition to function, network access must be non-discriminatory, transparent and fairly priced." [recital 7]

3. GASLINK OBJECTIVES

In responding to the consultation paper we have identified below the outcomes that Gaslink believes should be achieved by any changes to the tariff regime:

3.1. The resultant tariff structure should be:

- transparent so that suppliers, end-users and producers have sufficient information to enable users to access the system;
- cost reflective; EC1775 Article 3(1) states that the methodologies used to calculate tariffs should "reflect actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator", cost reflective tariffs should promote the efficient and appropriate development of the network;
- stable, so that efficient investment and commercial decisions can be made with clarity over the level and direction of tariffs over the medium/long term

3.2. The tariff structure should be objective and non-discriminatory. The tariff structure should not discriminate between suppliers so that irrespective of the tariff that is selected this should not prohibit the all island operation of the network or put financial obstacles on physical flow.

3.3. The tariff structure should ensure that the tariff regime facilitates the efficient transportation of gas around the island of Ireland. For example the tariff structure and the connection policy should combine to create a framework which avoids uneconomic bypass of the Transmission system.

- 3.4.** Security of supply investment decisions should receive the appropriate signals from the agreed tariff structure. Therefore it is important that the tariffs are based on a methodology that sends these investment signals clearly and unambiguously. In this regard Gaslink feel that the development of a security of supply standard is vital and we look forward to contributing to discussions on the relevant CAG workstream dealing with this.
- 3.5.** The workstream should be compatible with other workstreams in the project. For example, the development of tariff for products should be done in line with the development of a code of operations for the provision of those products.

As outlined in our response to the Consultation on the CAG Operational Regime , Gaslink believe an entry/exit regime is more consistent with European legislation and regulation.

It is noted that CAG is yet to decide on the appropriate transportation regime (i.e. entry/exit, point to point or a combination) for the all-island market and also how this decision is to be made pursuant to the Operational Regime workstream. It is important therefore that a consistent approach to product definition and tariff design is adopted across the two workstreams.

While it is possible to have an entry/exit tariff and a fully point to point capacity product, this does not enable different amounts of entry and exit capacity to be booked and Gaslink believes that this does not offer sufficient flexibility in the booking regime.

The quantum of the tariff also impacts significantly on capacity booking irrespective of whether the quantum can be compensated for in the price of delivered gas. In the event of capacity tariffs at a point being

extremely cheap or zero, Gaslink believe this would increase the likelihood of improper behaviour in the market including the possibility of hoarding of capacity.

The existence of a zero tariff would, in particular, be a concern, as the current rules of the Code (ROI only) are based on Shippers being penalised for under-booking using a multiple of the cost of capacity.

Gaslink believe that the existence of a robust capacity over-run regime based on cost reflective tariffs is an important attribute of any competitive gas market. We trust that CAG will deliver this in both jurisdictions.

Finally Gaslink believe that it is important that the network should be able to physically deliver products that are developed and for which a tariff methodology is agreed. In this regard, Gaslink understand that further analysis may be necessary to determine the requirements to facilitate certain flows.

- 3.6.** Proposed changes in the tariff methodology should avoid discrimination between users or classes of such users. EC1775 Article 3 (1) states that the tariff methodology should avoid “cross-subsidies between network users”. In addition a stated objective of the MoU is to work to encourage a single market approach that “does not create incentives to differentiate between different parts of the market”.

In this regard Gaslink is mindful that these objectives relate to all users of the system and has identified three broad groups to which these objectives apply:

User	Objective
Shippers	<ul style="list-style-type: none"> - Non discriminatory access; - Sufficient transparent information; - Security of supply; - Facilitation of transportation of gas on an all island basis;
Producers	<ul style="list-style-type: none"> - Incentivise security and diversity of supply;
End users	<ul style="list-style-type: none"> - Minimise undue discrimination between users and classes of users; - Security of supply; - Price stability.

4. ASSESSMENT CRITERIA

While we believe the assessment options outlined in the consultation paper provide good guidance on how the various options are assessed, Gaslink would make the following comments under each:

4.1. Development of industry

The Consultation Paper refers to developing a viable gas industry. While in principle this criterion should be supported it requires more detailed definition. Assessing the various tariff options against the criterion of developing the industry could have varying implications for different constituents whose objectives will likely be conflicting:

Asset owner	Extending the network to bring gas to more end users
Producers	A tariff that incentivises exploration
System operator	A tariff that encourages efficient use of the existing network and promotes efficient development;
Suppliers	A tariff that will encourage new suppliers to the market or encourage existing suppliers into new market segments.
Customers	A tariff that provides lower stable prices and security of supply.

As natural gas is the cleanest of the fossil fuels Gaslink would support its increased use. The extension of the network, when it is economically appropriate and efficient, is important in achieving this.

However, in relation to the extension of the network there are many other factors that will influence the decision in addition to transportation charges.

In the NDM and smaller DM segments it is likely that network extension will be driven primarily by customer demand for gas which in turn will be driven by the overall price of delivered gas of which the transportation costs are one element. Costs of connection and (potentially) conversion are also likely to influence domestic customers' decision to connect to the network.

For larger end users, the absolute level of transmission tariffs is more significant and a tariff structure that reduces these costs is likely to have a significant impact.

4.2. Protecting customers

The objective of ensuring that prices are kept as low and stable as possible is noted as being key to delivering this criterion. The tariff harmonisation process should focus on developing the appropriate methodology to achieve the right price to deliver SOS, stability and efficient development.

In addition, stability of prices will be a significant concern to end users.

Costs of implementation 3.2.3 – costs of implementation should be assessed on the system changes that would be required under the various methodologies. Our view is that this should be a separate assessment criterion.

4.3. Security of Supply

We agree that a key role for tariffs is to send the appropriate signals regarding investment in transmission, production and storage facilities in order to achieve security of supply objectives.

In addition to its role in providing required capacity and inventory product to the network, security of supply benefits are also provided by IC2. However, we are also cognisant that producers and storage operators have put forward that their facilities offer security and diversity of supply. With these competing views, it is imperative that a security of supply standard is developed and agreed. We welcome the fact that a stated objective of the MoU is to work to develop a single approach to security of supply.

4.4. Promotion of competition

We recognise that NBP is the basis for pricing delivered gas on the island given that the market in GB has such significant liquidity and is currently the sole alternative to indigenous gas. The tariff(s) at Mofatt will therefore have a critical role to play here and it is important that the chosen tariff regime delivers the appropriate charges at Mofatt in order to encourage competition in the market place.

4.5. Gaslink would also support the addition of the following criteria:

Ease of implementation

Even though this is included as a sub criterion under Protection of Customers, Gaslink believe that this should be a criterion in its own right both in terms of the actual implementation (legislative or system changes) and the ongoing clarity and comprehension of the proposed methodology.

Flexibility

The methodology should be robust enough to cater for new scenarios that develop, that are unforeseen at this stage, or for the outcomes of the scenarios been outlined to differ significantly from the assumptions. It would not be appropriate to implement a methodology that would require an additional process such as this one in the event of an unforeseen structural change on the system. The introduction of new entry points onto the system may not lead to the desired outcome of lower prices on the market.

5. ASSESMENT OF VARIOUS OPTIONS

Gaslink believe that the various options set out in the consultation paper are comprehensive and that the agreed methodology will probably arise out of one or a combination of the options set out in the paper.