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Jill Murray
Commission for Energy Regulation
The Exchange
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2 July 2008

Dear Jill,

COMMON ARRANGEMENTS FOR GAS (CAG) – DISCUSSION PAPER ON THE OPTIONS FOR THE GAS OPERATIONAL REGIME

Thank you for this opportunity to contribute to the above consultation. Please note a copy of our response has also been issued to Rosin McLaughlin (NIAUR).

Ireland (RoI) and Northern Ireland (NI) are facing a period of unprecedented energy market volatility – the challenges are formidable. The key to helping both jurisdictions meet these challenges is by getting the market fundamentals right, across both jurisdictions.

The Transmission System Operator (TSO) and Distribution System Operator (DSO) roles must therefore provide a market 'backbone'. As such they are fundamental components in the delivery of efficient and effective networks, but to do this they must be capable of service delivery in a manner that is beyond question in terms transparency, confidentiality and strategic intent.

Within the electricity industry, both Eirgrid and Soni (soon to be divested) are wholly distinct legal entities - an approach embraced by both the Commission and NIAUR. It therefore makes no sense to have a different outcome for gas in either Ireland or Northern Ireland - especially when both are seeking to help deliver similar security of supply objectives, and their interrelationship (via generation) demands a coherent policy approach.

The consultation notes that under the EU Directive 2003/55/EC, the transmission and distribution system operators as part of a vertically integrated undertaking, are required to be independent at least in terms of the legal form, organisation and decision making from other activities not related to transmission. It should be noted this represents a minimum EU

requirement, stemming from 2003, and the RAs (under the auspices of ERGEG) have recently reiterated their support for the Parliament's position on ownership unbundling of "transmission system operators".

Further, as Europe prepares for greater EU wide harmonisation[1], including greater transparency, investment, capacity and interoperability, it just makes good sense to ensure the all-island TSO/DSO framework is able to put forward a single coherent voice, capable of pressing for RoI and NI network interests from an all-island perspective.

Increasingly, gas network investment is taking an all-island energy perspective (for example construction of the South-North pipeline). Ensuring the management of these increasingly integrated networks requires strong independent and coordinated oversight.

For us, these issues serve to reinforce the criticality of getting the gas operational regime right. Consequently, the TSO/DSO should understand and anticipate market needs, unhindered by vertically integrated conflicts of interest. It must be capable of responding in ways that considers the betterment of the market as a whole, such as the development of new transmission related products (e.g. day ahead products), and networks that are more responsive to network usage charging structures – user pay principle. Indeed, it will have a strong role in market transparency, helping to generate the right market investment signals, including the need for sufficient reserve of conventional generation to be called upon in support of renewable development. Finally, it would be capable of putting forward a coherent all-island TSO/DSO 'voice' to promote all-island gas network interests for the benefit of customers.

Ideally, this would spring from one TSO/DSO and one governing network code covering both jurisdictions. However, we accept the challenges of moving to this model would be significant and a more measured approach is called for. Our starting position with regard the gas operational regime is thus three fold.

1. Fundamentally we believe that securing a wholly independent transmission and distribution system operator(s) is a key requisite to a well functioning market – this approach has been adopted for electricity, and there is no good reason why gas should not follow suit.

2. The safety, security of supply, and optimal network management of the gas system is best delivered under a properly constructed TSO/DSO all-island regime, including making the most of the increasing gas network interdependence between south and north and adopting a Single Balancing Point.

3. The regime must be capable of delivering market transformation and a transmission charging approach that is responsive to market needs. As such, the approach must set the

[1] GTE is moving forward with the creation of ENTSOG (European Network of Transmission System Operators) and a work plan in anticipation of the EU 3rd package.

foundation for delivery of an effective harmonised, possibly single, transmission charging methodology.

Our response focuses on three aspects:

- an examination of the market issues from an all-island perspective;
- how these issues should be resolved, and under what structure; and
- how should it be implemented.

(A response to each of the consultation questions are listed in the attached Annex)

1. An examination of the market challenges from an all-island perspective

We enter a period of unprecedented global change, as the EU and indeed the world, faces the harsh reality of volatile wholesale gas costs. Ireland and Northern Ireland will be much stronger to confront these challenges where energy and market costs are efficiently optimised across the Island of Ireland.

Both Ireland and Northern Ireland have common market interests, e.g. dependency on Great Britain's (GB) wholesale energy markets, similar security of supply issues, exposure to high wholesale energy costs, and dealing with climate change - to name a few. The benefits of increasing gas connectivity between the two jurisdictions cannot be optimised without a corresponding market structure that supports issues such as: balancing optimisation, planning and development, and transmission and distribution charging. Measures that address and improve these issues must be embraced, especially if markets are to work effectively and efficiently.

There is no doubt that market complexity also harms smaller suppliers the most, and dissuades new entrants, particularly where markets are relatively small scale. Ireland and Northern Ireland have much to gain under an integrated gas operational regime (especially Northern Ireland where the gas market is smaller, and fragmentation greater). For example, multiple balancing points adds complexity and potentially detracts from optimal market liquidity.

Shippers operating across these markets must also contend with double their operational risks and management time when dealing with both jurisdictions, including handling dual systems, different market processes, and exposure to different market risks.

2. How these issues should be resolved, and under what structure

The consultation considers principally two components: the construction of the TSO and the development of Network Codes on an all-island basis.

We deal with each of these in turn, noting that, whilst the constructs of both can evolve independently of each, the consolidation of TSOs may also mean the eventual consolidation of network codes.

Independent system operation:

The present inherent complexities of having four TSOs and effectively three DSOs on an all-island basis potentially means there are significant opportunities to be had. We comment on each of the three options as follows:

- Option 1, which is essentially the 'no change' approach, simply ignores the present market challenges and, more importantly, does not prepare Ireland and Northern Ireland for what is undoubtedly a challenging time for energy markets and consumers. It meets none of the workstream objectives, and allows the existing fragmented basis to persist in NI. More specifically, we argue it will not be consistent with future EU legislation under the 3rd package. We therefore discount Option 1.

- Option 2 (Single Service Provider), could create a defined operational centre where predefined market processes can be performed and managed, presenting a single operational system interface for Shippers stretching across jurisdictional boundaries. If legally distinct and constructed correctly, with clearly defined responsibilities and accountabilities, it will help deliver a better coordinated and transparent market based approach, but avoids the obvious and significant institutional merger upheaval that Option 3 entails.

  However, an SSP in itself is insufficient to meet all the requirements. This needs to be reinforced by TSO/DSO structures that are ultimately ownership unbundled away from their existing vertically integrated host companies (i.e. consistent with the thrust and sentiment of the EU's 3rd package). Taken together, the SSP (shipper interface), and TSO/DSO independence, will secure market confidence through improved operational management and tariff transparency. As legally distinct entities, they will have sufficient viries to manage their responsibilities, including the SSP overseeing an all-island single market gas balancing point. This is therefore our preferred approach.

- Option 3 (the single TSO), would be our preferred starting position if starting from a blank sheet (which we are not). This approach delivers maximum coordination, transparency and accountability (via a reduced number of parties contracting with Shippers). However, the institutional upheaval would be just too great for the energy markets at this time. It will need to be independent, i.e. fully unbundled, and to be effective, it is also likely to require a single Network Code, which also adds further complexity. This remains an aspirational goal.

- Option 4 (Dual TSOs), improves coordination, accountability and transparency. It maintains jurisdictional independence, but still faces the institutional complexity challenge as noted for Option 3. This is not our preferred starting point.

  It is possible that, by creating wholly independent TSO/DSO structures (see Option 2 above), that market necessity will then drive the most optimal balance across the two Jurisdictions, e.g. further TSO/DSO consolidation. In time, this could evolve into two TSOs. As such, Options 2 & 4 could be a considered as a future steps towards a single TSO, albeit subject to market drivers rather than regulatory intervention.

Network Codes

As mentioned above, to some extent the structural approach adopted for the TSO(s) will in part dictate the most optimal outcome for the different network codes that currently persist. One point we can be very clear upon: we would not like to lose the advantages already gained in having a single transmission and distribution code (Code of Operations) in RoI.

Multiple Network Codes

The multiple code option (four in Northern Ireland and one in Ireland), the 'no change' approach, simply ignores the present market challenges. It does not prepare Ireland and Northern Ireland for what is undoubtedly a challenging time for both energy markets (e.g. providing strong network governance on an all-island basis). It also reduces market transparency and does not provide the best possible operational backdrop for a new SSP to manage (would increase complexity and costs). We do not support this option.

Dual Network Codes

In Ireland, the single Code of Operations, has significantly improved the transparency and management of transmission and distribution arrangements. Under one governance approach, it provides a single change mechanism that enables smaller suppliers to better engage with the process. It would be important not to lose these benefits.

In Northern Ireland, the code position is more fragmented. We believe there are benefits in bringing this closer to the model in Ireland. This would help with transparency, coordination and engagement on industry change from all market players, however small. It also facilitates jurisdictional regulatory policy differences and helps create a degree of market stability during a period of tremendous change. We submit this should be targeted at the Transmission level, and coupled with delivery of a single all-island balancing point as a first step.

Further harmonisation of the codes across the two jurisdictions will be challenging especially at the distribution level). Nonetheless, there are benefits to be had from sharing and adopting best practice, and alignment where the all-island gas market interest will be best served. Bringing together the NI Transmission and Distribution Codes would be a future consideration.

The Dual Network Code approach would better facilitate this dialogue, will enable any future change. We therefore support this approach.

Single Network Codes

A single unified network code can be achieved, as evidenced in GB. Whilst this represents our ideal solution, we note this took over two years to achieve (across one jurisdiction) and its driver was essentially concerns arising from the sale of four distribution networks. The benefits under CAG at this stage are therefore questionable, and more likely lead to further complications, particularly jurisdictional policy differences. We do not recommend this approach (at least not at this stage).

3. How should it be implemented

As mentioned above, the Island of Ireland is facing unprecedented times. The "do nothing" option simply ignores the benefits to be gained from greater co-operation on an all-island energy policy and market operation basis.

It is likely that models which drive 'full on' jurisdictional harmonisation (i.e. a single TSO and single Network Code), will require significant effort and take years to complete. Too much too soon, and either smaller suppliers will be effectively frozen out of the process due to resource constraints, and/or the market becomes destabilised with a plethora of new market rules to contend with.

The greatest efficiencies and market benefits are likely to come from a middle road approach.

Concluding, we therefore recommend the following:

a. **Option 2 – adoption of a Single Service Provider (SSP) -** legally distinct, its roles and responsibilities (once clearly defined), will create a single Shipper interface. However, this must be coupled with ownership unbundling of the TSO/DSO from their vertically integrated host companies. Collectively, this will aid market transparency and optimise network balancing efficiency. Market barriers would be reduced and, subject to the right regulatory obligations, incentives and independence of the TSOs, would drive transparency and reduce costs.

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b. **Dual Codes** – this will retain the benefits of an integrated code for Ireland, whilst reducing complexity in Northern Ireland. It improves market accessibility for new entrants and facilitates greater harmonisation and best practice. It is simple to understand, reduces governance complexity and costs, and enables jurisdictional differences to be facilitated where they are beneficial due either to: institutional, geographical, or wider policy constructs. As such, this means bringing together the Transmission Codes in NI as a first step, together with the creation of a single all-island balancing point.

c. **Independent TSO/DSO** – market confidence and transparency can only be assured if there is ownership unbundling of the TSO/DSOs from their host companies. Consolidation of TSOs, i.e. in Northern Ireland, should be driven from competition/market drivers as the markets evolve further.

A Single Service Provider approach (the Shipper interface) in itself will not deliver all the workstream benefits, unless this is coupled with full ownership unbundling of the TSO/DSO structures. A Dual Network Code model will help underpin the measures and provide the best possible platform going forward, and should as a first step deliver a single all-island balancing point.

Within the next 12-18 months, both CER and NIAUR should be pressing for full ownership unbundling of the TSO/DSO structures. Until this happens, the TSO/DSOs will continue to struggle to meet a common all-island agenda due to their vertically integrated nature with incumbents. In ROI there is an urgent need for re-examination of SI 760 of 2005 which forces the parent company Bord Gáis Éireann (BGE) to retain a controlling stake in Gaslink, in contradiction with EU Policy.

We would be very willing to meet to discuss further the points we have made. In the meantime, please do not hesitate to contact us if we can provide further information in support of this response.

Yours sincerely,

Tony Thornton
Consultant – Energy Regulation
(for VPE/Emergia)

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Annex – Key questions for interested parties

Please refer to our supporting cover letter.

Section 2 – CAG Vision and goals

Q1. Are there any other criteria against which to evaluate the options for common operation?

VPE Response: we would add market responsiveness and innovation to the criteria. For example, we believe the constructs of the TSO/DSO should be such that it independently anticipates and drives future transmission tariff changes for the betterment of the whole market, and on a coherent all-island basis (e.g. balancing).

Q2. Do you have a view on whether any criteria should be prioritised over others?

VPE Response: all the criteria are important, since they complement each other. For example, the regime should be incentivised to deliver optimal efficiency ("Cost Effective"), but this requires full cost transparency ("Transparency"). That said, three criteria in particular warrant the closest attention: "Efficient", "Transparent" and market responsiveness / innovation (see above).

Q3: What is your initial view of the costs/benefits of common operational arrangements for shippers/suppliers?

VPE Response: there is no doubt the present arrangements serve to frustrate market transparency and competition. Retail margins are already very low and becoming increasingly strained as wholesale energy costs spiral. Against this backdrop, measures that take out costs will always be welcome. However, the benefits that ultimately flow will be wider than those directly attributed to the reform of the gas operational regime - this is more than just 'taking out costs', but creating the foundation to deliver much more, e.g. information transparency and transmission tariff reform.

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Section 3 – All-Island system operation functions:

Q4: Which functions should be performed on an all-island basis?

VPE Response: all those listed under Section 3. However, we would remove single billing as a requirement - this is not a fundamental cost issue for Shippers. We would also include a single market balancing point, consolidated market reports (e.g. capacity availability), development and consultation on new products & services etc.

For the record, the functions currently listed within the consultation are:

- *Long term management of transportation arrangements, including products;*
- *day to day operation;*
- *Single billing*
- *balancing;*
- *procurement of fuel;*
- *emergencies;*
- *planning & development;*
- *measurement and end to day settlement and allocations;*
- *capacity trading;*
- *connections to transmission system;*
- *maintenance (but carried out by asset owner);*
- *Congestion management; collection & disbursement of transportation charges*

Q5: What is your preliminary view of how transportation charges should be collected and distributed?

VPE Response: the consultation notes the sensitivity with one operator collecting monies and therefore suggests collecting monies under a 'PoT' system as used in NI (via a trustee). In our view, the very presence of a 'PoT' approach is evidence of potential market structural inadequacies, which would be unnecessary if TSO/DSO independence can be absolutely assured. The design going forward must secure proper TSO/DSO independence via ownership unbundling, and if this can be secured within the next 18 months, the requirement for a PoT and the additional administration this entails would be short lived.

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Section 4 – Options for system operation:

Q6: How complex would it be to create a single IT interface for nominations with multiple TSO'?

VPE Response: from a design stance, this need not be overtly complex at all. For example, an existing platform could be simply modified, or possibly a move to a system of open standard protocols with an interface/communications layer that every participant's system then 'talks to'.

Under Option 2 (multiple TSO's with a contracted SSP), we envisage this would be part of the tendered solution with inputs from Shippers to help limit system impacts across the whole market. As such, it would seek to accommodate the management of market participants' internal system changes with minimal system design impact. Ultimately, we would expect the Commission and the Authority to be the final arbiter of the design and costs.

Q7. What level of IT investment might be needed to create such an interface?

VPE Response: estimates are likely to be inaccurate until a conceptual design is in place (e.g. proposed IT platform) and agreed, and from which each market participant (including Shippers) can then undertake an impact assessment.

Section 4.2.2 – Multiple TSO/TOs with a single service provider

Q8. Should new transporters coming into the market be required to contract with the SSP?

VPE Response: absolutely, otherwise the overall integrity and benefits will drain away. This is largely no different to what market participants must do today by acceding to other industry agreements in order to operate within the market.

Q9. Would any other steps be required to implement this option?

VPE Response: it will require careful coordination in order to optimise the SSP model for the benefit of the whole market, and not merely to 'tick' the SSP box by the TSO/DSOs. We would expect Shipper input and strong regulatory oversight (by both regulators) in its design and selection. We would also expect it to be legally distinct, capable of evolving as the market needs adjust, and to be a driver of change and innovation. However, this will happen only if the TSO/DSOs are freed from their vested integrated interests and thus allowed to centre

themselves on delivering the TSO/DSO functions and objectives, unhindered by being vertically integrated with their host companies.

Section 4.2.3 – Single TSO

Q10. Other that the options outlined, how else might a single TSO be appointed?

VPE Response: in the event this option is chosen, the single TSO would have to be appointed under licence, with a licence requirement placed upon all Asset providers to contract with the TSO.

Q11. Would any other steps be required to implement this option?

VPE Response: potentially, this could require some form of change to all Shipper licences and industry agreements in order the recognise the new licensed entity.

Section 4.2.4 – Dual TSOs

Q12. Would any other steps be required to implement this option?

VPE Response: this would have a knock on effect to Shipper licences and a range of industry agreements.

Section 4.3 – Other Market Structure Issues

Q13. What investment will be needed to support single system operation?

VPE Response: unable to comment

Q14. How should emergencies be managed under each option?

VPE Response: emergency arrangements can be developed under any of the options, although the single TSO approach which transcends both jurisdictions would be the most complex. For reasons such as these, we have recommended Option 2 which allows jurisdictional differences to be maintained; at least until such time as there is evidence for greater consolidation.

Under the SSP (Option 2) approach, initially each TSO could retain their particular emergency obligations and operational arrangements. Over time, we would expect the independent TSO/DSOs to be incentivised to reduce costs and secure best practices. We believe this would lead to consolidation of the TSOs and therefore services, such as the emergency arrangements.

Section 4.4 – Assessment of Options

Q15. What is your view of how each option meets the goal?

VPE Response:

- Option 1, which is essentially the 'no change' approach, simply ignores the present market challenges and, more importantly, does not prepare Ireland and Northern Ireland for what is undoubtedly a challenging time for energy markets and consumers. It meets none of the workstream objectives, and allows the existing fragmented basis to persist in NI. More specifically, we argue it will not be consistent with future EU legislation under the 3rd package. We therefore discount Option 1.

- Option 2 (Single Service Provider), could create a defined operational centre where predefined market processes can be performed and managed, presenting a single operational system interface for Shippers stretching across jurisdictional boundaries. If legally distinct and constructed correctly, with clearly defined responsibilities and accountabilities, it will help deliver a better coordinated and transparent market based approach, but avoids the obvious and significant institutional merger upheaval that Option 3 entails.

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effective, it is also likely to require a single Network Code, which also adds further complexity. This remains an aspirational goal.

- Option 4 (Dual TSOs), improves coordination, accountability and transparency. It maintains jurisdictional independence, but still faces the institutional complexity challenge as noted for Option 3. This is not our preferred starting point.

  It is possible that, by creating wholly independent TSO/DSO structures (see Option 2 above), that market necessity will then drive the most optimal balance across the two Jurisdictions, e.g. further TSO/DSO consolidation. In time, this could evolve into two TSOs. As such, Options 2 & 4 could be a considered as a future steps towards a single TSO, albeit subject to market drivers rather than regulatory intervention.

Q16. Are there any other costs which will need to be taken into account?

VPE Response: Shipper system costs, and those costs incurred whilst transitioning to the new arrangements (i.e. schema code freezes), for example delayed opportunity costs due to delayed industry change.

Section 5 – Network Codes

Q17. How can we ensure that codes do not diverge over time?

VPE Response: multiple code alignment will be down to effective governance and management control. The present difficulties regarding transparency in NI would continue.

Q18. Are there any other implementation issues to consider

VPE Response: inputs from Shippers and their impacts.

Section 5.2.2 – Dual Network Codes

Q19. Are there any clear advantages of having this option over multiple codes?

VPE Response: this will retain the benefits of an integrated code for Ireland, whilst reducing complexity in Northern Ireland. As such, it improves market accessibility for new entrants and facilitates greater harmonisation and best practice. It is simple to understand, reduces governance complexity and costs, and enables jurisdictional differences to be facilitated where they are beneficial due either to: institutional, geographical, or wider policy constructs.

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Q20. Are there any other implementation issues to consider.

VPE Response: none, other than those listed in this response, for example a move towards ownership unbundling of the TSO/DSO away from the vertically integrated incumbents.

Section 5.3 – Other implementation issues

Q21. Who should own the code?

VPE Response: This will depend on the final SSP responsibilities. If Option 2 (multi TSO/SSP model) is adopted, we recommend a joint ownership basis similar to the GB approach (under the Joint Office of Gas Transporters).

Q22. Is a single code feasible with multiple TSO's/TOs?

VPE Response: a single code would be possible, and whilst ideal, this is not recommended at this stage. We believe the jurisdictional differences would be just too great for it to be a worthwhile exercise. We therefore recommend a Dual Code approach.

Q23. Are there any other implementation issues to consider?

VPE Response: at this stage of design, it is difficult to comment further.

Section 5.4.3 – Single Code

Q24. What is your view of how each code option meets the goal

VPE Response: each of code option is capable of delivering the goal. However, the challenges have more to do with the complexity and proportionate benefits which flow. Multiple Codes merely maintain the status quo (and all the present difficulties, i.e. this option does not facilitate change). The Dual Code approach, encourages a rationalisation of the NI operational regime without the loss of benefits in ROI and would facilitate the development of a single balancing point. The Single Code approach would have to overcome material jurisdictional differences - some of which do need to be resolved just yet.

Better to put in place the building blocks for change under a Dual Code approach.

Q25. Are there any other issues we should consider in assessing which option best meet the goal?

VPE Response: we would factor in, the option which facilitates the most direct and responsive basis for market reform.

Section 6.1 – System operation at the distribution/retail level

Q26. Should the single TSO cover distribution?

VPE Response: ideally yes, but the priority (as a first stage) would be for NI to adopt a single Transmission System Operator model (as in RoI). It should them have a plan to assimilate the distribution operator role over an agreed time scale.

Q27. Can a single TSO operate distribution in one half of the island and only transmission on the other?

VPE Response: yes, but it makes it more difficult, and some of the benefits are inevitably lost. Whereas, for a Dual TSO approach, the NI model could initially adopt a 'Transmission only' approach, with an agreed transition to a TSO/DSO NI code over an agreed timescale.

Q28. Do we need an xoserve function in CAG?

VPE Response: not if we set up the SSP and independent TSO/DSOs with the correct mandate and regulatory oversight..

Section 6.2.3 – Unified Network Code with carve outs for certain distribution networks

Q29. What should the long term goal of CAG be in terms of code development?

VPE Response: If the TSO and DSO functions are truly independent, this will create the momentum for change which will seek to optimise market efficiencies. Over time, this may or may not result in one code.

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Q30. Should the UNC incorporate the distribution functions?

VPE Response: see comment above for Q29.

Q31. If the goal should be a combined Transmission and Distribution UNC, can this be achieved by 2010?

VPE Response: no, it cannot be achieved, the jurisdictional differences are too great. We are concerned that market participant resources would be stretched too thinly across many other market reform issues under CAG, and the solution could be seriously compromised.