



## **Common Arrangements for Gas (CAG)**

**Gaslink response to 'Draft Conclusions on the Options for the Gas Operational Regime'.**

**28<sup>th</sup> November 2008**

## **Introduction**

Gaslink welcomes the opportunity to respond to the recent ‘Draft Conclusions on the options for the Gas Operational Regime’ which was published on 20 October 2008 by the Regulatory Authorities (RAs). In the main section of this paper we present our views for consideration by the RAs. In the appendix we provide responses to the specific questions posed by the RAs.

## **General Comments**

Gaslink is the independent system operator for the Republic of Ireland (RoI). Gaslink has responsibility for the operation, maintenance and development of both the BGE transmission and distribution systems serving RoI. In addition, Gaslink has responsibility for development and publication of The Code of Operations.

As we stated in our response to the Discussion Paper on the options for the Gas Operational Regime’ which was published by the RAs in May 2008, Gaslink is supportive of the Common Arrangements for Gas (CAG) project and is committed to working with the RAs and other participants to ensure the success of the project. Our response to the Discussion Paper highlighted a number of key points which we again summarise as follows<sup>1</sup>:

- Ease of operation and improved service to consumers and simplification of market arrangements should rank as key deliverables of the CAG project;
- Safety, reliability and integrity must be central to any operational arrangements;
- Operational arrangements should result in improved efficiency and cost effectiveness resulting in benefits to shippers and consumers;
- Certainty and stability of the operational arrangements and industry structure should be a key criteria against which to evaluate options;
- A single Code and single shipper interface should increase efficiencies for existing shippers and help to encourage new entrants;
- The obligations of asset owners under law and licence must be acknowledged and accommodated in any revised operational arrangements, particularly with regard to safety and integrity of the networks;
- Any complexity of arrangements that cannot be avoided should be focussed at the TSO/TO and RA level rather than at the shipper and consumer level; and
- European initiatives relating to cross jurisdictional co-operation between TSOs and regulators should inform the CAG process.

With regard to the Draft Conclusions document, we note that the RAs refer to a single TSO throughout. It appears that in most references in the paper the context would suggest that the more correct term is an Independent System Operator rather than a

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<sup>1</sup> The Gaslink response to the Discussion Paper made further key points but these are expanded on elsewhere in this document and reflect the development of thinking within Gaslink on these issues.

Transmission System Operator. We have in our response, continued with the use the TSO terminology as the RA's have used.

## **Impact of the Third Package**

In Appendix 2 of the Draft Conclusions paper, the RAs recognise that the Third Package raises issues that should be addressed in terms of:

- whether the single TSO and the SSP models would comply with the Third Package; and
- what would be the implications of the unbundling proposals in the Third Package for the structure of the single TSO and SSP models.

The Draft Conclusions paper considers that either the single TSO or the SSP models can be structured to be compliant with the Third Package. However, the Draft Conclusions paper does not appear to consider that the structures of the main companies themselves may change as a result of implementation of the Third Package. The options presented in the paper appear to assume that there would be a split in the functions of asset ownership and operation. Whilst this is currently the case in RoI, it is not so in NI. Further, there is no guarantee that once the Third Package is implemented that this situation would prevail in RoI.

Of the three options for unbundling considered by the Third Package, only one involves the full separation of the system operation function (ISO). A second option involves full unbundling from supply while the third option would result in an Independent Transmission Operator (ITO). Both of these two latter options envisage the ownership and operation of transmission assets residing within the same company. Specifically for the ITO option, the transmission network would be owned by the transmission system operator<sup>2</sup>.

We suggest that due consideration of the finalised text of the Third Package will need to be undertaken by governments, RAs and industry participants before any decisions are made on the most appropriate structures of transmission ownership and operation in RoI and NI.

Whilst there is uncertainty, not only on the final text of the Third Package, but also as to how it will be implemented in RoI and NI, Gaslink question whether it is prudent to make decisions on structural changes to the industry at this stage. Any decisions made on structural changes under the CAG project may not be consistent with potential outcomes under the Third Package and may not, therefore, be in the overall interests of the all-island gas market and consumers.

The ownership and structure of Gaslink Independent System Operator Ltd cannot be determined until after the implementation of the Third Package. This will ultimately be a decision for the shareholder.

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<sup>2</sup> Paragraph 1(a), article 17, Chapter IV Independent Transmission Operator. Council of the European Union 15 October 2008.

However, Gaslink is keen to see the objectives of CAG in place as soon as possible and consider therefore whether an interim arrangement may be appropriate. Under an interim arrangement it may be possible to deliver the benefits of an all-island gas market whilst minimising any structural changes until the Third Package is implemented in both RoI and NI. We consider that this change is possible and set out a potential interim arrangement later in this paper (see page 10 question 7).

## **Responses to specific questions**

Gaslink offers views on the specific questions posed by the RAs in the Draft Conclusions paper. However, as we have stressed, elsewhere in this response, Gaslink believes that the best interests of the industry will be served by implementing an interim solution that requires minimal change to the current industry structure. An enduring solution can be designed and implemented once the detail of Third Package has been transposed into legislation. The following views are presented, therefore, on the basis of the enduring solution i.e. post implementation of the 3<sup>rd</sup> Package requirements.

### **Section 2. Goals of CAG Operations**

Gaslink supports the criteria initially proposed by the RAs and especially the statement that safety, reliability and integrity of the gas systems will be enshrined in CAG operational arrangements. Furthermore, we support the inclusion of additional criteria, especially that arrangements will need to be appropriately stable and provide certainty and clarity. Gaslink also supports arrangements that are flexible, adaptable and customer friendly and considers that this can best be delivered by a single IT interface underpinned by a single Code.

### **Section 3. All-island system operation functions**

#### ***Q1. Do you have any views on the draft conclusions outlined in this section?***

Gaslink is broadly supportive of the draft conclusions as outlined in the relevant section. We have the following comments which we wish to be taken into consideration.

We agree with the RAs that long-term management of the system should include management of the Code modification process and the development of new transportation services. We also agree that a single interface and single IT system are crucial elements of the CAG project and that these functions should be the responsibility of the CAG SO.

With respect to single billing we consider that, although not essential to the success of the project, synergies should be incorporated wherever possible and that consistency in the format and layout of bills should be achieved as a minimum. Further

consideration will need to be given to VAT and currency issues and we look forward to further discussion on these issues in the near future.

Gaslink believes that the CAG SO should be responsible for meter maintenance, standards of meter maintenance and meter specification. The asset owners should continue to own the meters and undertake maintenance (although it is acceptable for the maintenance of these meters to be outsourced). Co-ordination between the asset owners and the CAG SO would be required so that the CAG SO has appropriate access to meter read consumption data to be able to manage the day-to-day operation of the system and provide accurate and timely shipper allocations. Meter read and consumption data are critical to the CAG SO function and key to shippers' ability to manage day-to-day risks.

We agree with the RAs that emergencies require in depth consideration given the overriding CAG goal that the safety and reliability of the network will be paramount. Looking forward we consider that the CAG SO would have a role to play in the planning for and management of emergencies, although the precise nature of this involvement would need to be determined. We are confident that agreement can be reached in RoI and NI as to which parties would be responsible for the relevant safety cases. Gaslink will engage with the sub group as the process is taken forward.

Planning and development of the network would be a key consideration of the CAG SO and asset owners. Gaslink considers that it is important that the CAG SO is responsible for identifying where development of the network is required. On a practical level we consider that the CAG SO should be responsible for the development of supply and demand scenarios and for any associated network modelling. We would expect this process to identify any network investments that are required and then for a dialogue to take place that includes the CAG SO, the asset owners and the RAs concerning the provision of the required infrastructure. From the perspective of the asset owners, we would expect them to be responsible for the physical development of the network following agreement with the RAs on which investments are to be made and included in the regulatory asset base.

Gaslink agrees that the CAG SO should be responsible for the standards and co-ordination of maintenance in order to minimise the impact on an all-island basis. The asset owners should continue to undertake the physical maintenance of the network and should either carry this out themselves or outsource to an appropriate company.

A single Connection Policy should be established for the all-island market to ensure that there is a level playing field and that there are no commercial disadvantages to connection in one jurisdiction as compared to the other. The CAG SO should be responsible for the implementation of the single Connection Policy and should provide the interface for potential connectees to the network. The asset owners should continue to have responsibility for the physical connection to the network.

Gaslink supports the draft conclusions of the RAs for the remaining functions:

- A single shipper IT interface;
- An all-island Code modification panel;
- Consolidated market information;
- Streamlining of gas quality and safety which are progressing in independent workstreams; and
- A single financial security policy.

***Q2. Division of responsibility for the functions to be co-ordinated?***

We have answered this question on the relevant functions in our response to Q1. We summarise our views here for completeness in the following table.

<b>Function</b>	<b>CAG SO responsibility</b>	<b>Asset owner responsibility</b>
Planning and development	<ul style="list-style-type: none"> <li>• Identification of network development priorities</li> <li>• Supply and demand scenarios</li> <li>• Network modelling</li> </ul>	<ul style="list-style-type: none"> <li>• Physical works</li> <li>• Agreement of investment with RAs</li> </ul>
Scheduling and maintenance	<ul style="list-style-type: none"> <li>• Co-ordination and scheduling to minimise disruption</li> </ul>	<ul style="list-style-type: none"> <li>• Physical works</li> </ul>
Connection policy and standards	<ul style="list-style-type: none"> <li>• Interface with potential connectees</li> <li>• Formulation of Connection Policy and standards</li> </ul>	<ul style="list-style-type: none"> <li>• Physical works</li> </ul>
Consolidated market reports	<ul style="list-style-type: none"> <li>• Production of all-island transportation development statement</li> <li>• Information relating to transparency requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Provision of data as required by the SO</li> </ul>

***Q3. Do you have any further views or suggestions?***

Where functions are to be co-ordinated either between the CAG SO and asset owners or between TSOs then there must be sufficient clarity and certainty of roles. This clarity may be contained in licences and/or operational agreements between the CAG SO and asset owners.

One further issue that Gaslink would wish to raise concerns the interaction of tariffs and the optimisation of system operation on an all-island basis. If separate tariffs are introduced for the Moffat Entry Point and the SNIP Entry Point then shippers would book capacity at these distinct entry points and nominate accordingly resulting in gas

flows along the specified routes, SNIP to NI and Moffat to RoI. This may then result in reduced discretion for the CAG SO in determining the optimal scheduling of gas flows to the all-island market in order to minimise compressor fuel costs and potentially balancing gas. Gaslink urges, therefore, that interactions between tariff structure and day-to-day operation of the network be considered.

#### **Section 4. Options for System Operation**

***Q1. Which option for the CAG SO delivers the objectives of the CAG most effectively?***

***Q2. Of the remaining options, the single TSO and SSP, which do you prefer?***

***Q3. Which of the remaining options best meets the criteria set in Section 2?***

The first three questions contained in this section of the Draft Conclusions paper essentially refer to the same issue and therefore we present our comments on these questions together.

We note that the RAs propose to discard the co-ordination between multiple TSOs and the dual TSO options, largely on the basis that co-ordination is required between two or more parties. However, it is worth pointing out that the remaining options still require co-ordination and co-operation between asset owners and system operators, especially under the SSP model. The option that would minimise the co-ordination is the single TSO option but this would still require considerable interaction with the asset owners as noted in the draft conclusions on system operation functions. The single TSO model based on a corporate JV would also envisage extensive co-ordination across the various equity holders.

After careful consideration of the options set out in the Draft Conclusions document, Gaslink considers that the single TSO model may offer the more efficient solution. Decision making within a single TSO may be more effective and co-ordination and liaison with the asset owners may be easier to achieve than in either the SSP or JV models. However, we accept that the single TSO model may not be achievable given the existing rights and obligations of the current licence holders. In addition, the creation of a single TSO may involve significant costs which could make this model less attractive.

We note the SSP model as outlined by the RAs is based on multiple TSO's contracting with an unlicensed SSP. We believe that for the SSP model to be most effective, it should be based on a regulated SSP entity. We do not believe that outsourcing of the scale of services which the SSP could potentially undertake solely in a commercial basis is appropriate.

#### ***Control Room Arrangements***

Under the current arrangements the grid control room for both RoI and NI operations is owned and staffed by Bord Gáis Networks (BGN). In RoI the BGN control room

operates under an Operating Agreement between BGN and Gaslink that has been approved by the CER. In NI the control room is subject to a commercial arrangement between BGN and PTL and BGE (UK). We believe these arrangements have worked well and suggest that given the costs involved in relocating grid control, that any changes to the current service be carefully considered. We consider that the grid control function is crucial to the safety and operational integrity of the network and that this function should be a regulated activity under the CAG operational arrangements.

However, if the RAs determine that real benefits can be realised by either a single TSO taking ownership of grid control or a single TSO directly employing grid control staff, then Gaslink is happy to work with the RAs to fulfil this requirement. Under such an arrangement the control room would continue to fall under regulatory oversight which we believe to be a positive outcome for the all-island gas market.

### *Contestability*

Gaslink considers that the position of the existing licence holders must be respected. Existing licence holders should have a right to a role in the new structure unless the licence holder voluntarily relinquishes its licence in agreement with the RAs. We are concerned at the suggestion in the Draft Conclusions paper that a competition for licences may be held as we consider that this would undermine existing rights of the licence holders.

Gaslink does not believe that a single TSO should be subject to contestability. A single TSO should be appointed as a licenced entity which would then be subject to RA scrutiny in terms of costs and services. Gaslink disagrees with the suggestion that contestability may provide a further governance element in terms of cost and maintenance of operational integrity and believes that the opposite may, in fact, be true. Gaslink also considers that contestability of single TSO services would undermine two of the goals of the CAG project. Firstly, potential periodic changes in a single TSO would undermine the criteria that the arrangements would need to be appropriately stable and provide certainty and stability. Secondly, we do not consider that contestability would increase the safety, reliability and integrity of the gas networks.

Whilst, in principle, Gaslink agrees that contestability may lead to more efficient costs, this is only true in a competitive market for services. For instance, there is only currently one party that owns a gas control room in Rio or NI and we have serious doubts that a competitive market for control room services would emerge. We feel that it is unlikely that new entrants would be able to compete on price with the established control room as they would undoubtedly incur significant set-up costs. New entrants would also need to factor in the risk that they would lose any subsequent tender. This could lead the incumbent to factor in expectation of higher competitor costs into its bid this leading to an upward pressure on the cost of



providing the service. Gaslink considers that it may be far more cost effective for the existing control room subject to the cost/benefit test as outlined above, to continue in its function and be subject to RA scrutiny on costs and service.

Our view on the issue of contestability under the SSP approach is similar to that under a single TSO. Gaslink does not support contestability as we consider that it would be counter to the requirements of certainty, stability and reliability and safety of the gas networks together with efficiency of operation.

#### *Joint Venture*

With regard to the creation of a corporate JV, Gaslink has the following points to raise. Firstly, we consider that it may be possible, given discussion between the existing licence holders, to reduce the number of equity partners. This would create a simpler JV structure and may lead to a more streamlined and effective JV.

Secondly, we consider that any JV should consist of equity partners that are similar in structure and function and represent similar interests. Due to the uncertainty over both the Third Package itself and its implementation in RoI and NI it is possible that the JV equity partners may not be structurally consistent. The potential exists that one equity partner may represent the interests of asset ownership as well as operation and we feel that this would undermine the independence of the JV and complicate its decision making process. We consider that the JV approach can operate most efficiently if the equity partners are equal in terms of status and the interests that they represent.

Our third point concerns the suggestion that the TSOs would be given licence conditions to enter into a JV, which itself would be a licenced entity. We are not sure that it is necessary for the TSOs to be given a licence condition to create the JV company. Gaslink consider that it is more appropriate that the relevant parties are requested by the RAs to establish the JV. If the TSOs failed to do this then it may be appropriate for licence conditions to be put in place.

Creation of a JV through negotiation would be particularly appropriate where the equity partners are of a different scale in terms of size of operation. The JV could be set up with due regard to the size of the equity holders, especially with respect to liabilities.

#### ***Q4. Which of the remaining options best:***

- ***Provides stability and certainty of market structure?***
- ***Allows flexibility for changing customer needs and market environment?***
- ***Allows for sufficient regulatory control over costs and services?***

Gaslink considers that a single TSO may best deliver stability, flexibility and regulatory control. However, we accept that in order to retain the rights of the existing licencees that this may not be achievable.

Furthermore, a single TSO would provide certainty and stability if appointed on a non-contestable basis and would be able to react to the requirements of the market and take a long-term view of transportation development.

Regulatory control over costs and services would best be achieved by having direct regulatory oversight by the RAs. This would be best achieved by the single TSO approach since there is direct regulatory scrutiny, especially if a single TSO was established as a company in both jurisdictions.

***Q5. Do the different options ensure that the relevant Health and Safety authorities can enforce their health and safety obligations?***

Safety Cases will be required in each jurisdiction and for any effective co-ordination on an all-island basis, clarity of responsibility will be key. We consider that appropriate arrangements can be put in place under either the single TSO or JV approach. Gaslink believe that in the SSP model, the licensing of the SSP entity would aid the provision of clarity and therefore is more likely to result in a consensus approach to safety rather than if the SSP was not licensed.

Emergency planning would require further consideration so RoI and NI emergency co-ordinators are required to co-operate together on an all-island basis. It would be particularly important that arrangements are consistent across both jurisdictions particularly with respect to the equality of any interruptions required to classifications of customers. In particular domestic customers should have equal priority across both jurisdictions.

***Q6. Are there variations of the options that could work better?***

Gaslink has two points to raise in relation to this question.

Firstly, as we have stated throughout this response, we consider that day-to-day activities of system operation should be carried out by a licenced entity. The grid control function is central to the safe and reliable operation of the network and commercial arrangements should not be relied upon to deliver this.

Secondly, it may be preferable that in order for a single TSO to be regulated effectively by the RAs that it has a company registered in each jurisdiction.

***Q7. Is there anything in the CAG model that has been missed, or that is material and requires further consideration by the RAs?***

*Interim Arrangements*

As we have pointed out in this response we feel that the Third Package may have a significant impact on the design of the CAG SO. Whilst there is still uncertainty we request that the RAs consider an interim solution that would minimise structural change.

Some of the most significant benefits of the CAG are likely to arise from co-ordinated and consolidated operation of the all-island transmission network on a day-to-day basis and simplified arrangements for shippers in terms of a single point of contact, Code and IT system. Gaslink considers that these can be achieved through co-ordination and co-operation between the existing TSOs without the need for structural change in advance of Third Package implementation.

Whilst it may be true that either the single TSO or SSP options as described in the paper may deliver the full range of CAG benefits more completely than any interim solution, Gaslink considers that an interim arrangement may provide a pragmatic solution until Third Package issues are resolved. The interim arrangements would therefore avoid any unnecessary expenditure that may not provide value on an enduring basis following the implementation of the Third Package.

Under the option for an interim solution, one option is for increased cooperation and coordination between existing licence holders potentially by way of a contractual JV. Alternatively, in order to simplify the structure of the JV, it may be possible to form a contractual JV consisting of PTL (representing PTL and BGTL) and a new company Gaslink (NI) which will be a subsidiary of Gaslink, Independent System Operator Ltd. which would undertake the operational responsibilities relating to the BGE (UK) assets in N/I. This proposal would be subject to Board and Shareholder approval.

The contractual JV in NI and Gaslink as the current operator in ROI would be obliged to co-operate in the development of market rules, a single point of contact, code & IT System. We believe this can be done without delay to any workstreams which are already underway. Any JV and co-operation agreements would be created with the purpose of delivering the CAG until an enduring solution could be implemented. The enduring solution would be designed once the industry structure has been finalised following Third Package implementation.

Under the interim solution the existing day-to-day functions could continue to be carried out by the BGN owned control room under amended operating agreements with Gaslink and the NI JV. Amendments to the relevant agreements would be made in light of the requirement to operate the transmission systems on an all-island basis.

### *Distribution issues*

The Draft Conclusions paper does not consider, in any detail, the distribution and retail arrangements on an all-island basis. We understand that this is being progressed on a different timetable and is being consulted upon separately. However, Gaslink would request that the RAs consider the provisions of Article 15 of the Second Directive that enables transmission and distribution assets to be held within the same company structure. Gaslink considers that unwarranted costs and complexity may arise as a result of the separation of transmission and distribution assets and operation.

### **Section 5. Network Codes**

Gaslink supports the draft conclusion of the RAs to proceed with the single Code option. The single Code should be owned by a single TSO and should be governed jointly by the RAs. A single TSO should have the responsibility for the development of the Code and the management of the Code modification process with implementation being subject to joint RA approval.

Whilst we accept that distribution and retail arrangements are being considered separately, Gaslink believes that it is important to consider the interface between transmission and distribution and the booking of transmission exit capacity. In RoI this is booked by shippers but in NI it is booked by the DSO on behalf of shippers. This and other interface issues that may emerge would require consideration so that consistency between RoI and NI arrangements can be achieved.