



Energia House
62 New Forge Lane
Belfast
BT9 5NF

Tel: +44(0)28 9068 5941
Fax: +44(0)28 9068 5935

Richard Hume
Utility Regulator
Gas Branch
Queens House
14 Queens Street
Belfast
BT1 6ER

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Dear Richard

GAS STORAGE REGULATORY FRAMEWORK (CONSULTATION & DRAFT LICENCE)

Thank you for the opportunity to comment on the draft licence provisions for gas storage in Northern Ireland.

Before we comment upon the nature of the licence, it is important first to set the context within which the licence(s) will be expected to operate and which set the tone of the measures that will be required.

Global energy supply markets continue to be volatile and supply diversity is therefore important including the provision of storage as part of this mix. But this can be expensive and therefore optimising the benefits that could flow from dependence on Great Britain (GB)¹ storage and those flowing from the harmonisation of market arrangements on an all-island basis under the Common Arrangements for Gas (CAG), will provide cheaper alternatives for Northern Ireland's security of supply requirements. Nonetheless, we accept additional all-island storage is likely to be commercially viable at some point in the future, and by encouraging investment and market based solutions, customers will avoid having to bear these substantial costs.

Island specific storage is likely to therefore play an important role within the competitive market dynamic, probably responding more to all-island market signals, which may not always be aligned with market signals from GB. This reflects the unique market nature of these jurisdictions and other future supply considerations, such as gas flows from Corrib and Shannon LNG. We should also be cognisant of the company structural differences North and South, the relative state of competition within NI, and the materially different

¹ Signalled investment in Great Britain (GB) for security of supply measures - £10 billion in gas imports and storage facilities

transportation charging arrangements that exist compared with GB, all of which will impact on market decisions of where and when to store natural gas. It is therefore likely that natural gas storage in either RoI and/or NI, would in fact respond (at least in part) to either NI or all-island specific market signals.

Thus, taking a too wide relevant geographic perspective for competition analysis (i.e. including GB) could be misleading. However, we are reassured the Utility Regulator aims to ensure the regulatory framework for Northern Ireland will reflect the Third Package requirements and we suggest that, in accordance with this sentiment, it is quite probable that storage access will be necessary in order to provide efficient access for the supply of customers in Northern Ireland. Negotiated Third Party Access (nTPA) should not therefore be the default position.

Set against this backdrop, our concerns are further reinforced when vertically integrated energy undertakings take on commercially based storage as part of an integrated supply and/or network business strategy, especially when also operating as a natural monopoly - i.e. the potential to exercise market power. It is important this does not confer any market advantage that would affect the development of competition; for example, on access terms and/or information advantage. The provisions of 2009/73/EC, and in particular Article 15 (unbundling of transmission system owners and storage system operators), clearly sets the tone for what now needs to be rigorously enforced at the outset, as part of the regulatory framework for gas storage in Northern Ireland. We suggest that NIAUR does not wait until the third package has been finally transposed into Northern Ireland law.

Absolute transparency is thus a key prerequisite going forward and this needs to be a strong feature of the regulatory framework. Arrangements that include:

- Use-it-or-lose capacity management
- Utilisation performance
- Non-discriminatory access terms
- Transparent capacity auctions of all (or most) of the capacity

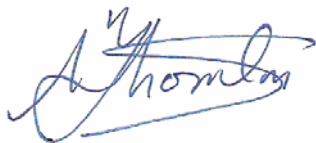
We therefore make the following points to strengthen the draft licence:

- Ring-fencing provisions should be unequivocal and specifically set out. These should follow similar obligations as those attached to Phoenix Natural Gas and NIEE.
- A compliance regime building on a strengthened ring-fencing provision (including a compliance officer) must be installed to ensure the regulatory arrangements are robust and accountable.
- Capacity auctions may be necessary, and provisions within the licence should ensure the Utility regulator's ability to issue directions to this effect are not frustrated.

- Access terms, products, and tariffs should be published on a regular basis. We therefore lean towards an rTPA² model. However, irrespective of the approach finally adopted (i.e. nTPA or rTPA), this information should be made a licence requirement.
- Condition 2.1, in respect security, reliability and efficiency, seems at first flush a little light. For example, we would expect gas storage to meet NI gas quality market specifications at the point of withdrawal, and performance measures may be necessary to ensure reliability.
- Market transparency would be assisted by publication of withdrawal and injection rates, as well as regular updates on available capacity and prices. We recommend a requirement to publish this, as well as maintenance schedules that affect performance.
- Connected systems agreements should be complied with wherever these are necessary, and enforced via a licence obligation.

We trust these comments are helpful and as always, please do not hesitate to contact us with any specific questions. Our specific comments to the consultation response can be found in the attached Appendix.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Tony Thornton', with a stylized flourish underneath.

Tony Thornton
Regulation Advisor

Mob: 07769 64 59 50

email: tony.thornton@energia.ie

² rTPA: Regulated Third Party Access requires the publication of tariffs, whereas a negotiated third party access (nTPA) requires just the main commercial conditions.

Appendix – Consultation Questions

1. The Utility Regulator seeks industry views on the concept draft gas storage licence presented as part of the gas storage regulation framework for Northern Ireland.

VP&E Response: we agree with the general thrust, although we make a number of recommendations designed to improve transparency and accountability. These include:

- Ring-fencing provisions should be unequivocal and specifically set out. These should follow similar obligations as those attached to Phoenix Natural Gas and NIEE.
- A compliance regime (building on a strengthened ring-fencing provision) (including a compliance officer) must be installed to ensure the regulatory arrangements are robust and accountable.
- Capacity auctions may be necessary, and provisions within the licence should ensure the Utility regulator's ability to issue directions to this effect are not frustrated.
- Access terms, products, and tariffs should be published on a regular basis. We therefore lean towards an rTPA³ model. However, irrespective of the approach finally adopted (i.e. nTPA or rTPA), this information should be made a licence requirement.
- Condition 2.1, in respect security, reliability and efficiency, seems at first flush a little light. For example, we would expect gas storage to meet NI gas quality market specifications at the point of withdrawal, and performance measures may be necessary to ensure reliability.
- Market transparency would be assisted by publication of withdrawal and injection rates, as well as regular updates on available capacity and prices. We recommend a requirement to publish this, as well as maintenance schedules that affect performance.
- Connected systems agreements should be complied with wherever these are necessary, and enforced via a licence obligation.

Finally, if action by the licensee on storage matters is likely to affect consumers, then the obligation to consult with the Consumer Council should also include all supply licensees.

³ rTPA: Regulated Third Party Access requires the publication of tariffs, whereas a negotiated third party access (nTPA) requires just the main commercial conditions.

2. Are there any further aspects of the Third Package legislation that should be considered for the future regulatory framework of gas storage in Northern Ireland?

VP&E Response: the question of vertically integrated entities taking on storage businesses needs significant attention from NIAUR, and as a minimum the licence needs a number of changes to ensure constancy with third package measures, including our recommendations noted in response to Question 1.

The provisions of 2009/73/EC, and in particular Article 15 (unbundling of transmission system owners and storage system operators), clearly sets the tone for what now needs to be rigorously enforced at the outset, as part of the regulatory framework for gas storage in Northern Ireland. We suggest that NIAUR does not wait until the third package has been finally transposed into Northern Ireland law.

3. The Utility Regulator seeks industry views on the relevant geographic and product markets applicable to a gas storage facility in Northern Ireland.

VP&E Response: we agree the market for storage should embrace an all-island approach, however we question whether this should be extended to include GB.

Island specific storage is likely to play a key role within the competitive market dynamic, probably responding more to all-island market signals, than those flowing necessarily from GB. This reflects the unique market nature of these jurisdictions and other future supply considerations, such as gas flows from Corrib and Shannon LNG. We should also be cognisant of the company structural differences North and South, the relative state of competition within NI, and the materially different transportation charging arrangements that exist compared with GB, all of which will impact on market decisions of where and when to store natural gas. It is therefore likely that natural gas storage in either RoI and/or NI, would in fact respond (at least in part) to either NI or all-island specific market signals.

We understand the NBP driver and marginal price issue for NI, however the re-injection periods (by way of example) could nonetheless follow a slightly different set of market dynamics to those of GB, responding more to market signals specific to NI and on an all-island basis. Consequently, our view is that NI storage may have different market characteristics compared to GB storage, and suggest this therefore needs further consideration.

4. The Utility Regulator seeks industry views on the discussions on market power in relation to a storage facility in Northern Ireland and its influence on selecting the most appropriate TPA regime.

VP&E Response: we are reassured the Utility Regulator aims to ensure the regulatory framework for Northern Ireland will reflect the Third Package requirements and we suggest that, in accordance with this sentiment, it is quite probable that storage access will be necessary in order to provide efficient access for the supply of customers in Northern Ireland. Negotiated Third Party Access (nTPA) should not therefore be the default position.

Set against this backdrop, our concerns are further reinforced when vertically integrated energy undertakings take on commercially based storage as part of an integrated supply and/or network business strategy, especially when also operating as a natural monopoly - i.e. the potential to exercise market power. It is important this does not confer any market advantage that would affect the development of competition; for example, on access terms and/or information advantage.

Absolute transparency is thus a key perquisite going forward and this needs to be a strong feature of the regulatory framework. Arrangements that include:

- *Use-it-or-lose capacity management*
- *Utilisation performance*
- *Non-discriminatory access terms*
- *Transparent capacity auctions of all (or most) of the capacity*

5. The Utility Regulator seeks industry views on the application of the technically and/or economically necessary assessment regarding access to a gas storage facility in Northern Ireland.

VP&E Response: in our cover letter and the above responses, we query whether the GB market can be included for market definitional purposes and cannot therefore agree (at least not at this stage) that a gas storage facility in Northern Ireland can be considered to be functioning within a fully competitive and flexible market.

However, in principle we agree with the application of “the technically and/or economically necessary assessment” criteria as per CEER guidelines and as good basis to move forward, albeit we argue that natural gas storage in either RoI and/or NI, would in fact respond (at least in part) to either NI or all–island specific market signals.

It is quite probable that access to storage will be necessary in order to provide efficient access for the supply of customers in Northern Ireland. Negotiated Third Party Access (nTPA) should not therefore be the default position.

- 6. The Utility Regulator seeks industry views on the appropriateness of each regime (negotiated and regulated) as a framework for access to gas storage facilities in Northern Ireland.**

VP& Response: 'rTPA' should be used as a minimum for all storage facilities that constitute part of a vertical undertaking that is engaged in (or will be engaged in) the energy market for the supply and/or ownership of network assets. The licence may need to make clear that where storage facilities are transferred to a vertical undertaking that the move from 'nTPA' to 'rTPA' will be a requirement.

- 7. The Utility Regulator seeks industry views on the suitability of applying exemptions to the TPA requirements for a gas storage facility in Northern Ireland.**

VP&E Response: exemptions should be discussed on a case by cases basis and consulted upon as and when exemption requests are made.