

**Gaslink Response**  
**CEER Call for Evidence on Conceptual Model for European Gas Market**

**1. Executive Summary**

In the response set out below, Gaslink highlights the specific nature of the Irish gas market and recommends that a Gas Target Model for Europe takes into account and provides for the characteristics of individual gas systems across member states.

In relation to capacity, Gaslink recommends that auctions should only be required where congestion exists at an interconnection point and that the pricing of capacity products should reflect the long-term nature of the underlying investment made by the TSO. While recognising the provisions set out in the CAM Framework Guidelines for a standard set of products, we are strongly of the view that if there are other products that could benefit individual markets, these should not be prohibited. We welcome the introduction of bundled products and hub-to-hub trading but note our view that shippers should have the right to be registered at one side of the flange only to enable smaller players to take an active part in the market.

With respect to the balancing aspects of the Gas Target Model, we highlight Gaslink's concern about the 'one size fits all' approach as currently set out ERGEG's Framework Guideline on Gas Balancing Rules, given the regional specificities that exist across member states. We also note that the requirement for TSOs to publish the amount of gas in the transmission system at the start of each day and the forecast amount of gas in the transmission system at the end of each day could lead to potential abuse by network users resulting in TSOs and end users paying higher prices for balancing gas and gas respectively. Gaslink advocates that the Gas Target Model be reflective of the requirements of some TSOs that may not require the same frequency of balancing activity. We also recommend that rules regarding the manner in which shippers nominate gas flows and a mechanism for the allocation of gas are included in the Gas Target Model to ensure that consistent arrangements are in place at all interconnection points.

On the subject of tariffing, Gaslink recommends that the proposed Tariff Framework Guidelines be published in sufficient time to ensure that member states can analyse and debate the potential impacts of same and to ensure that the Tariff and Capacity Framework Guidelines, and indeed all other Framework Guidelines, are not developed in isolation from one another and that the interdependencies between all areas are fully provided for in the European network code.

As regards regional cooperation, in order to achieve the single market objective, Gaslink strongly identifies with the ENTSG view that appropriate regional structures need to be established. We further believe that it is important to allow sufficient time to learn from the strengths and weaknesses of each regional market before moving to create an effective European gas market.

## **2. Introduction**

Gaslink welcomes the opportunity to respond to CEER's call for evidence on a conceptual model for the European Gas Market. We agree with the conclusion of the 18th Madrid Forum that a Gas Target Model is necessary in order to appropriately guide the work of the European Commission, CEER, and ENTSOG in developing a new European network code. The interactions and interdependencies between the different elements of such a network code require careful consideration and management if the overall code development process is to successfully deliver a code which meets the European Commission's high-level policy objectives.

Gaslink is an active member of ENTSOG and participates in all active code development work streams. Our experience of being involved in this process over the past year has underlined our view that there is a need for overarching market architecture to inform and better align the various stakeholder contributions to the new code.

In making this response, Gaslink wishes in particular to highlight the specific nature of the Irish gas market in terms of its peripheral location at the western edge of Europe, its small market size, and its interconnectivity with and independence on UK gas due to the relatively small scale of its indigenous gas resources. In our view, the Gas Target Model for Europe should take into account the various specificities within the EU gas market and, in particular, those of countries like Ireland whose specific market characteristics mean that they may not be immediately positioned to implement and benefit from all of the changes envisaged by new legislation.

Therefore, while Gaslink recognises that the purpose of the Third Gas Package and previous directives/regulations is to break down barriers to market entry and encourage competition, we believe that a one-size-fits-all approach to implementing the Third Gas Package would be inconsistent and incompatible with the various market structures currently existing across the different EU member states. Whilst some of these structural differences are correctly targeted by the Third Gas Package, others are present for sound evolutionary reasons and it would be sub-optimal and ultimately to the detriment of some countries if their particular national or regional specificities were not recognized. The Gas Target Model should therefore take into account and provide for the characteristics of individual gas systems where reasonable and consistent with the spirit of the legislation.

We further believe that the policy choices made in the Gas Target Model should be consistent with the Third Gas Package and should not in any way purport to push beyond its limits. It has taken considerable effort and compromise to bring this package of gas legislation to a conclusion. The same focus now needs to be applied to ensuring the implementation of the legislation strictly within the confines of what has been agreed by the European Parliament and Council.

We set out below a brief overview of the Irish gas market, focusing in particular on the specificities of our market as referred to above. We then identify the key issues for Gaslink

with respect to the creation of a European Gas Target Model, referencing relevant Framework Guidelines where published.

### **3. Brief overview of the Irish Gas market**

The natural gas transmission system in Ireland, of which Gaslink is currently the operator, was developed by Gaslink's parent company Bord Gais Eireann (BGE). The system initially comprised the onshore transmission pipelines within the island of Ireland which were developed to transport indigenous natural gas from the Kinsale and Seven Heads gas fields located off the coast south of Ireland. BGE subsequently developed two sub-sea interconnector pipelines. These sub-sea interconnector pipelines link the onshore system on the island of Ireland with a single onshore pipeline in Scotland (also developed by BGE and operated by Gaslink) to form a single point of interconnection with the British transmission system operated by National Grid.

Demand for natural gas in Ireland is currently met by way of natural gas sourced from:

- the British market via the Moffat Entry Point (the point of interconnection between the Irish and British transmission systems ) and the interconnector pipelines, supplying **93%** of demand;
- indigenous sources (the Kinsale and Seven Heads gas fields) delivered to the system at the Inch Entry Point, supplying the remaining **7%** of demand in Ireland.

The interconnectors were developed to meet the growing demand for natural gas in Ireland and having regard to the fact the indigenous supplies of gas were not adequate to meet this demand. The interconnectors were also designed to facilitate the transmission of natural gas to Northern Ireland and to the Isle of Man.

The Kinsale and Seven Heads gas fields have been substantially depleted and accordingly, facilities have now been developed within these fields for storage purposes, whereby gas can be injected from the onshore system for storage offshore and subsequently re-delivered to the system. A further source of indigenous natural gas will be the Corrib gas field. It is currently anticipated that this field will around 50% of natural gas demand in Ireland when it comes on stream, although this will reduce to around 24% within five years, with a continuing decline in contribution to demand thereafter<sup>1</sup>.

Gaslink, the Irish Transmission System Operator (TSO), and Bord Gais Networks (BGN), the Irish Transmission Asset Owner (TAO), are regulated by the Commission for Energy Regulation (CER). The CER, as Ireland's national regulatory authority, sets TSO and TAO revenues and tariffs. Once approved, Gaslink's costs are treated as a pass-through and collected via transportation tariffs. Revenue regulation is applied to BGN revenues via a revenue cap, recognising that the costs associated with BGN's transmission activities are largely invariant to demand. Some elements are treated as a direct pass-through. Any over-

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<sup>1</sup> Gaslink Transmission Development Statement 2009/10-2018/19

or under-recoveries are carried forward to subsequent years, subject to certain constraints set by the regulator.

Given Ireland's dependence on Britain for the majority of its natural gas as outlined above, any regulatory changes affecting the arrangements between National Grid and Gaslink at Moffat therefore have the potential to create a significant impact on the Irish gas market. Whilst Gaslink is fully supportive of the European Commission's drive to further enhance competition, we are also keen to ensure that the Gas Target Model enhances, rather than undermines, the existing market arrangements at the Moffat interconnection point, which have been developed with the specific nature of the Irish gas market in mind.

#### **4. Capacity**

In Ireland, capacity is sold on a first come first served basis using an entry and exit system. Available entry products are annual, monthly, daily and back-up entry, with an inventory storage product also available. The rules applying to these products are detailed in the Irish Code of Operations. Capacity is sold with daily nominations rights.

Gaslink has a number of concerns with certain elements of ERGEG's Capacity Allocation Mechanism (CAM) Framework Guidelines and the proposed target model described therein. These concerns are outlined below:

##### Auctions

Gaslink agrees that auctions are an efficient and market driven method of capacity allocation and are effective in finding the true value of capacity in congested markets. However, the most recent draft of the CAM Framework Guidelines states that all capacity products (except for a within-day product) shall be allocated via auctions, irrespective of the scarcity, or lack thereof, of network capacity. Gaslink's view is that where no congestion exists it is unnecessary and inefficient to apply a market based allocation mechanism such as an auction to allocate a resource that is not scarce. In the absence of congestion, the auction process will not act as an efficient price discovery mechanism. This will create an environment where the price of capacity is bid down by shippers and is inconsistent with its fundamental value from an investment perspective.

We would recommend as an alternative that the European network code includes a provision whereby auctions are required to be utilised only where congestion exists at an interconnection point. At all other interconnection points, capacity would be sold on a 'first come/first serve' basis at the regulated tariff.

Gaslink also believes that the pricing of capacity products should reflect the long-term nature of the underlying investment made by the TSO. An appropriate pricing regime should apply to shorter-term products reflecting the risk profile of the investment made by the TSO. With regard to the appropriate reserve price for capacity auctions, our view is that the reserve price should equal the regulated tariff. A lower reserve price would result in revenue being recovered through other means (such as commodity charges) and long term products would become less attractive for shippers, leading to increased risk for TSOs.

### Standard Products

Gaslink agrees in principle with the provisions set out in the CAM Framework Guidelines for a standard set of products which will bring uniformity to the European gas market. However, we are strongly of the view that if there are other products that could benefit individual markets, these should not be prohibited. We envisage that these products would be defined in individual TSOs Network Codes as approved by their National Regulatory Authority.

### Bundled Products

Gaslink welcomes the introduction of bundled products and hub-to-hub trading. However, we believe that shippers should have the right to be registered at one side of the flange only. Trading at the flange enables smaller players to take an active part in the market.

### TSO to TSO co-operation

Gaslink welcomes the requirement that TSOs determine the firm and interruptible capacity they jointly offer at each interconnection point.

## **5. Balancing**

With respect to the balancing aspects of the Gas Target Model, Gaslink notes ERGEG's Framework Guideline on Gas Balancing Rules and is concerned about the 'one size fits all' approach set out therein. As previously noted above, we strongly advocate the need for sufficient flexibility within the Gas Target Model to accommodate the specific characteristics of smaller TSOs, and to account for regional and system differences between the networks of different TSOs.

Ireland currently has a daily balancing regime where network users are cashed-out for any positive or negative imbalances at the end of that period. Network users are charged/credited with a market-based price for their imbalances, and competitive tenders are offered to the market for the buying and selling of balancing gas.

There is a requirement in the Framework Guideline for 'network users to have access to a liquid short-term wholesale gas market'. There are extensive arrangements in place between Irish and British Shippers regarding the trading of gas at the Moffat interconnection point and Irish Network Users already have access to a liquid market in Britain. Consequently we would consider that arrangements such as these would be consistent with the Gas Target Model and the underlying Framework Guideline.

With respect to the requirement for TSOs to publish 'the amount of gas in the transmission system at the start of each day and the forecast amount of gas in the transmission system at the end of each day', as set out in the balancing Framework Guidelines, Gaslink is concerned that this requirement could lead to potential abuse by network users resulting in TSOs and end users paying higher prices for balancing gas and gas respectively. Gaslink would also

question how a national regulatory authority would satisfy itself that the provision of this information does not give room to potential abuse by network users.

The Balancing Framework Guidelines appear to assume that balancing actions are taken on a daily basis and linked to a shipper's daily imbalance position. But balancing actions may be required as a result of a long period of accumulated daily system imbalances. Furthermore, we believe that it would be inefficient and costly for TSO's to take balancing actions on a daily basis where it is not necessary. Where balancing actions are taken on a daily basis, we are concerned that this may have a disproportionate effect on new and smaller network users. Although it may be necessary for some TSO's to take balancing actions on a daily basis, we would urge that the Gas Target Model be reflective of the requirements of other TSOs that may not require the same frequency of balancing activity.

In respect of system balancing, the Gas Target Model needs to take account of the overall operation and technical capability of the natural gas transmission system(s). Rules regarding the manner in which shippers nominate gas flows and a mechanism for the allocation of gas are not currently included in the Gas Target Model. We believe that these rules are required in order to ensure that consistent arrangements are in place at all Interconnection Points.

## **6. Tariffs**

As outlined above, in Ireland capacity is sold on a first come first served basis using an entry and exit system. As there is currently excess capacity on the Irish system, there are no restrictions on market access. Annual, monthly and daily capacity products are available, with tariffs published on the Gaslink website. The same tariffs apply to all Shippers. Tariff regulation is implemented by way of a "revenue cap" and any over/under recoveries are passed back to customers through the allowed revenue by adjusting tariffs in subsequent years.

Ireland is broadly compliant with the provisions of EC Regulation 715 and there are no tariffing principles set out therein that are of immediate concern to the Irish gas market. However, these tariff principles are quite vague and, depending on their final interpretation as set out in European network codes, they could potentially have a significant impact on our market.

For example, with regard to the entry-exit split, the final determination on the proportion of revenue to be recovered through the entry and through the exit systems could cause change to our current arrangements. Similarly, the principles set out in the network code may impact on our current capacity/commodity split. Depending on the approach adopted, standardised multipliers/pricing mechanisms for short-term tariffs may be set which would vary from the current tariffs in the Republic of Ireland and introduce great volatility to the annual tariffs and also the short-term tariffs as a result. In addition, the final interpretation of the objectives of EC Regulation 715 will have an impact on cross-border tariffs and on the pricing rules introduced for different products e.g. storage, LNG.

Therefore, we would recommend that the proposed Tariff Framework Guidelines setting out ERGEG's interpretation of these principles be published in sufficient time to ensure that member states can analyse and debate the potential impacts of same. In addition, as regards capacity auctions, the introduction of auctions will cause significant change in the types of products available, how capacity is procured and the prices it is procured at. Much of the work on this area is being referred to the ENTSOG Tariff Working Group, which will have to conclude on pricing/tariff issues that result from the mechanisms finalised by the Capacity Working Group. These interdependences between the Tariff and Capacity Working Groups further support our recommendation that the publication of the Tariff Framework Guidelines be progressed, to ensure that the Tariff and Capacity Framework Guidelines are not developed in isolation from one another and that the interdependencies between various Framework Guidelines are recognised.

## **7. Interoperability**

Interoperability is a key component of the Target Model. We recommend that Framework Guidelines on Interoperability be developed in parallel with network code development in other areas.

## **8. Framework Guideline Development Process**

Gaslink is concerned with the timing of Framework Guideline publication and Network Code development. For example, it is proposed that the Capacity elements of the Network Code be developed during 2011 although the Tariff Framework Guidelines are not due to be published until March 2011. It is difficult to envisage how capacity products can be fully developed and provided for within a Capacity Network Code in the absence of agreed Tariff Framework Guidelines. Therefore, we would recommend that the Gas Target Model is designed to ensure that Framework Guidelines are not developed in isolation from one another and that interdependencies between various Framework Guidelines are recognised.

## **9. Investment**

The Gas Target Model as proposed focuses on the above areas outlined above (e.g. capacity, balancing, tariffing etc) and is driven by the need for a market based model. This is not always consistent with the need for long term investment and the reward of such investment.

## **10. Retail**

In relation to the retail market, Gaslink believes that the Gas Target Model should support the fundamental provisions of the Third Gas Package in relation to public service requirements, common minimum standards, consumer interests, quality of service, consumer rights and transparency, allowing for requirements to be defined at a national level in order to take into account national circumstances.

## **11. Regional Co-operation**

Gaslink believes that the Gas Target Model should reflect the regional co-operation responsibilities of Member States, National Regulatory Authorities, and TSOs. These responsibilities should be focused firstly on moving individual member state gas markets towards regional integration, while continuing to recognise and, where appropriate, allow for, the specific nature of individual markets. Once shown to function effectively, the emphasis should switch towards integrating these regional markets at a pan-European level.

We believe that it is important to allow sufficient time to learn from the strengths and weaknesses of each regional market before moving to create an effective European gas market. All stakeholders appreciate the considerable complexities of creating a single gas market. Moving too quickly towards full integration means that valuable experience of operating regional markets would not feature in the development of the single market, potentially to its detriment.

In order to achieve the single market objective Gaslink strongly identifies with the ENTSOG view that appropriate regional structures need to be established. A joint regional co-operation governance structure should be set up with representation on an equal basis by member states, national regulatory authorities, and TSOs.