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Ms Elaine Wallace
Commission for Energy Regulation
Plaza House
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By EMail

Dear Ms Wallace

Consultation on Market Arrangement Principles

Innogy welcome the opportunity to respond to your consultation. We are generally supportive of your proposals to expand competition in gas supply and to restructure and reform the gas industry.

In our view, a key principle is to implement enduring market arrangements that prevent the incumbent from frustrating the development of competition and new entrants from entering the market. The unbundling and transparent pricing of monopoly transportation services, together with clearer price signals for balancing and the allocation of capacity rights are vitally important. We believe that legal separation of supply, distribution and transportation is the most effective way to introduce competition. The very least that should be done is for the activities to be separately licensed. Another key area is to ensure that any new storage capacity be made available on equal and non-discriminatory terms. This is vital to ensure supply resilience and flexibility. We believe that separate licensing and operation of storage and transportation is necessary, but that ownership of storage facilities by the Transporter may be acceptable.

We endorse your position that any gas market arrangements should not conflict with those in the electricity market, although the precise arrangements can differ, reflecting the inherently different market characteristics. Efficient interactions between both markets are important, particularly given the dominance of gas-fired generation in the Irish gas market.

We have a number of specific comments under each of the following headings:

Capacity: Investment and Trading

We would support moving to an entry/exit system, as this should provide a better framework for a liquid capacity (and gas) market to develop. The Transporter should develop systems to facilitate capacity trading. Shipper-to-shipper trading needs to be supported, as do trades with the Transporter as counter-party. This is important as the

Transporter will need to manage constraints and potentially optimise its trade-off between financial and physical capacity rights as the regime develops.

Although there are reasons to support retention of contract carriage in a developing market, our preference is for the common carriage approach, together with appropriate incentives to invest in efficient levels of capacity. In the case of networks we believe that, while a market based approach is appropriate for balancing and in certain circumstances for allocation of short term capacity rights, long term investment signals are better provided by a transport model to provide economic signals on investment timescales. We recognise that moving to this type of regime will require consideration of the appropriate exposure to the costs of any excess capacity that will be faced by the Transporter. It may be helpful to develop transitional arrangements.

Secondary trading is an important feature of the capacity regime. Under a common carriage regime, trading will be shorter-term allowing shippers to fine tune their positions closer to gas flow. Although secondary trading provides a useful signal of the value of incremental capacity, experience in the UK suggests that its low intrinsic value, when compared to the commodity, has restricted the emergence of a liquid market.

Transportation Services
For the pipeline operator there are clearly advantages in shippers booking transmission capacity in twelve month tranches. Our preference would be for the introduction of shorter duration services to complement the annual service and provide additional flexibility. This would improve day-to-day operational security of supply, as shippers would be able to potentially contract for a diversity of back-up supply to cover both planned and unplanned supply outages. We do recognise that a shorter duration service would attract a premium and would agree that the service should be priced such that it does not undermine the long-term product. We would make a similar argument for interruptible capacity. Interruptible capacity will always be a feature of a network designed to meet peak demand. It should be made readily available at prices that reflect its value to the Transporter, in terms of avoided pipeline investment, and the probability of interruption. It should be priced at levels that do not allow it to become a substitute for firm capacity.

Our view of overruns is that the cost of overrunning should reflect the Transporter's costs of managing the system. We support the "ticket to ride" principle, where it should always be cheaper to procure capacity ahead of flowing gas. Structurally, the charge could be based upon a multiple of the daily traded firm rate or a fixed market price. A more penal charge that included the cost of gas on the day would provide stronger incentives not to overrun. Care needs to be exercised when establishing the overrun regime, as it should not discourage additional gas onto the network when that is appropriate. Where overruns can be netted off, we would support both ex ante and ex post trading.

Nominations and Balancing
In our view the balancing period should be consistent with the physical characteristics of the network and that the adoption of an NBP-type approach will encourage liquidity and trading by bringing in non-physical market players. This will provide

both shippers and the system operator with access to balancing gas. We agree that shippers should face incentives to balance their own positions and believe that the system operator should have a residual balancing role. The costs faced by out of balance shippers should be reflective of the costs that they impose on the system. While incentives on the system operator to minimise balancing costs are superficially attractive, our experience in the UK market suggests that the any incentive needs to be carefully designed to avoid any behavioural inefficiency by the system operator. The position where the system operator is incentivised to take trading positions against shippers should be avoided.

The nominations regime should be designed to enable the provision of accurate information on gas flows in a timely manner. We agree that charges for scheduling errors beyond tolerance should reflect the real costs rather than attracting penalties. In general, our view is that however the balancing mechanism is structured it should effectively provide as much flexibility for new entrants as for incumbents.

Shrinkage gas and linepack
We agree that all system line-pack should all be initially allocated to the Transporter for system operation purposes. Regarding shrinkage, we would support a regime that encouraged the Transporter to minimise the level of shrinkage as the costs inevitably feed through into end-user charges.

In conclusion, we are broadly supportive of the market arrangement principles set out in the consultation document. We are in favour of arrangements that encourage flexibility and permit both ex ante and ex post trading. The principle that charges should be reflective of the costs imposed on the network is also something that we support. In view of the relative stage of development of the Irish gas market, we would caution against introducing overly complex arrangements in the first instance.

We hope that these views are constructive and would be happy to discuss the issues further.

Yours sincerely

Charles Ruffell
Economic Regulation