



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

**THE COMMISSION FOR ENERGY REGULATION
AN COIMISIÚN UM RIALÁIL FUINNIMH**

**FINAL PROPOSALS ON MARKET ARRANGEMENT
PRINCIPLES**

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1. INTRODUCTION

The Commission for Energy Regulation (the “Commission”) began its review of market arrangements principles with the publication of its Consultation Document on Market Arrangement Principles on 28th of August 2002.¹ This document proposed principles to be applied in the review of the gas market arrangements in Ireland. An advisory group (the Gas Market Advisory Group or “GMAG”) representing the views of the gas industry was established to discuss the proposed principles.

Following on from the original Consultation Document, and from discussions at GMAG, the Commission published its Proposals on Market Arrangement Principles (“Proposals Document”) on the 19th of June 2003.² This document proposed the final principles upon which business rules governing gas market arrangements in Ireland would be based. Following consideration of the responses received to this document, the Commission has agreed a number of high-level principles upon which the new market arrangements in the Irish gas market will be based.

The following document describes the Commission’s decisions on the various principles to be applied in the review of the existing Transmission Code of Operations³ and the gas market arrangements in general. These principles are final, although some minor changes may be necessary to ensure consistency with market arrangements arising from changes to the capacity regime. Where possible, the Commission has responded to any additional arguments put forward in relation to individual issues. However, and in general, this document is limited to a statement of the Commission’s final position concerning individual market arrangement issues. For previous documents concerning market arrangements see the Commission’s website.⁴

¹ Consultation Document on Market Arrangement Principles. CER/02/117. 28 August 2002.

² Proposals on Market Arrangement Principles. CER/03/147. 19 June 2003.

³ It would also apply to the Distribution Code of Operations where relevant.

⁴ Available at <http://www.cer.ie>

2. CAPACITY

2.1. Definition of Capacity Rights

Under the current Code of Operations shippers are required to book capacity on a point-to-point basis. In a generic point-to-point system, capacity is defined with respect to specified lengths of pipeline (i.e. from an entry point to an exit point), and gas must follow that assigned path. However, under the Irish system, shippers are allowed some further flexibility, such as, for example, the ability, subject to some conditions, to *transfer* all or part of its capacity from one exit point to another exit point provided that the total volume and rate of natural gas being supplied to the two exit points do not, in aggregate, exceed the reserved capacity of that shipper.

On the 30th of July 2003, the Commission announced its decision, in principle, to advocate a move to an entry-exit capacity definition. This capacity definition will break the physical link between gas that is entered into and off taken from the gas system. This will constitute a significant change in the operation of the Irish market and will require a thorough review of business rules concerning, in particular, capacity, balancing and nominations. The Commission has commenced discussions with the Transporter concerning the programme for implementation of the entry-exit regime. It is proposed that the entry-exit regime should be put in place by the 1st of October 2004.

2.2. Electronic System for Capacity Trading

Irish gas shippers currently trade capacity rights bilaterally over the phone or by fax, on an over-the-counter basis. While the current system may be appropriate for current market participants, the Commission is concerned that it may not provide equal opportunity for new entrants. The Commission believes that the introduction of an electronic system for capacity trading would ensure that *all (i.e. current and new)* shippers would have available *all (and the same)* relevant information concerning the current and expected usage of capacity by shippers themselves and of the pipeline system as a whole. Such an electronic system would help to ensure a more transparent capacity trading regime that would be available to all.

Four respondents supported the Commission's proposals concerning an electronic system for capacity trading. Two respondents did not support an electronic system, while a further two respondents suggested that the GTMS system should be leveraged to provide this facility. Finally one respondent suggested a web-based bulletin board be adopted.

In discussions at GMAG, participants raised a concern over the cost of introducing an electronic trading mechanism given the size of the Irish market and the limited potential for capacity trading. The Commission recognises this concern, and that any facility proposed should be fit for purpose. As such the Commission has

determined that a GTMS-based electronic bulletin board should be developed, on which shippers would post the volume and location of their available (required) capacity, with prices to be posted where possible.⁵ This bulletin board would be mandatory, with prices to be agreed off-line and then posted on an ex-post basis.

2.3. Time Periods for Which Capacity is Traded

Under the Transmission Code of Operations, the minimum period for capacity transfers is a balancing period and the maximum period is the remaining duration over which a shipper holds his capacity right. This applies to all capacity transfers, with the exception of within day capacity transfers that are limited to a maximum of a balancing period.

The Commission does not propose any change to the time periods for which capacity is traded.

2.4. Capacity Overruns

Under the current Code of Operations, all overruns are unauthorised overruns and, in principle, attract a penal charge (i.e. a price higher than the cost imposed on the system by the capacity overrun). Having incurred such an overrun, shippers have no means of mitigating their exposure to the overrun charge, with the exception of a facility put in place under Modification 13 of the Code of Operations. Under Modification 13 if two shippers take gas at the same exit point in a particular balancing period and one shipper exceeds its booked capacity while the other takes transportation quantities below its booked capacity, the first shipper does not pay overrun charges and the second shipper is not compensated for its unused capacity provided the physical gas flows at the exit point do not exceed the exit point aggregate capacity.⁶

In its Proposals Document the Commission advocated the rescinding of Modification 13 to the Code of Operations as it was felt that this Modification was inconsistent with the objectives of the review of market arrangements, including the encouragement of competition and capacity trading. The Commission considered that to allow ex-post trading of overruns would provide a more appropriate means of minimising shippers' overrun charges.

Three respondents supported the Commission's view concerning capacity overruns. One respondent supported overrun trading, while another did not support overrun trading. Three respondents did not believe Modification 13 to be inconsistent with the Commission's objectives for market arrangements.

⁵ For the avoidance of doubt, Shippers will be required to post the capacity they wish to sell only, and not all spare capacity.

⁶ This is subject to the prior agreement of the Shippers at that Entry Point.

The Commission has considered the views put forward by interested parties concerning Modification 13. It acknowledges the convenience of Modification 13 for sites using more than one shipper. However the Commission remains to be convinced that Modification 13 is the most appropriate means of mitigating the risk associated with capacity overruns in the long term. In the view of the Commission, shippers should be required to pay for the capacity they use, and should not be permitted to make use of another shipper's capacity without compensating them for the use of that capacity. It is the Commission's decision that Modification 13 should be rescinded, and that ex-post trading of capacity overruns be introduced.

3. TRANSMISSION SERVICES

Under the current Code of Operations the Transporter only offers a firm transmission service, and shippers are required to book this service for no less than 12 months. In order to provide more flexibility to shippers the Commission questioned whether the Transporter should provide the following *additional* services:

- One month firm service;
- Interruptible service; and
- Authorised overruns.

Each of these services is discussed below.

3.1. One Month Firm Service

In its Proposals Document, the Commission proposed that, although the current firm transportation service may not provide enough flexibility to shippers, the introduction of a monthly service at this point would have an adverse affect on the annual transmission tariffs. The Commission also proposed that a more transparent secondary market for capacity trading and the introduction of authorised overruns (see discussion in Section 3.2) would provide sufficient additional flexibility to shippers such that a short-term firm service should not be offered at this stage.

Five respondents to the Proposals Document supported the Commission's view that short-term service may not be appropriate for the Irish market at this point. Three respondents maintained their support for a short-term firm service. Of these, one respondent proposed that a short-term capacity service may be appropriate in particular situations, such as for commissioning gas, where it would not result in a transfer from longer term capacity booking. The Commission acknowledges the use that could be made of short-term bookings for some purposes, and would welcome any proposals for Modifications to the Code of Operations in this regard.

In general, however, the Commission has not been persuaded of the need to introduce a short-term firm service at this point. The Commission will review this decision at the end of the transmission tariff regulatory period, once it has had opportunity to assess whether the changes proposed on capacity trading and the introduction of authorised overruns provide the necessary flexibility to shippers in Ireland.

3.2. Authorised Overrun

In its Proposals Document, the Commission sought to examine the desirability of the Transporter offering *authorised* overruns. It was proposed that overruns could be authorised in advance if they cause no operational constraints to the Transporter for a period of one day at a time. The Commission highlighted that this service should be priced such that this service would not undermine the firm service capacity product offered by the Transporter and so as to discourage shippers from persistently seeking authorised overruns rather than purchasing capacity.

The Commission has received general support for the introduction of authorised overruns in predetermined and strictly limited circumstances, subject to appropriate structure and design. Only one respondent objected to the introduction of authorised overruns under any circumstances. The Commission has determined that authorised overruns should be allowed in very limited circumstances, and will consult with the Transporter and interested industry participants on setting the conditions under which such overruns might apply.

3.3. Interruptible Service

In its Proposals Document, the Commission proposed that an interruptible service should only be provided when there is a good probability of actual interruption at peak. The Commission has received widespread support from respondents for this view, and, as such, its position remains unchanged.

4. NOMINATIONS AND BALANCING

4.1. Gas Nominations

The Commission considers that given the level of satisfaction with the current nomination procedures for the Moffat entry point, the existing nomination arrangements should be retained for that entry point. Regarding the Inch entry point, Marathon and the Transporter are developing proposals on nomination rules for Inch, which will be largely based on those arrangements in place at Moffat. While the Commission would wish for these arrangements to be as flexible as possible for shippers at the Inch entry point, the Commission accepts that the mirroring of Moffat arrangements may be more practical in the short to medium term.

In light of the adoption of the entry/exit regime for the definition of gas capacity rights, it should be noted that it will be necessary to develop separate nomination procedures for gas to be delivered into and gas to be off taken from the transmission system.

4.2. Point-to-Point or Entry/Exit Balancing

In light of the adoption of an entry/exit system for capacity rights, the Commission has determined that balancing should also be done on an entry/exit basis under which all entry and exit points are considered equivalent and are aggregated for balancing purposes.

4.3. The Balancing Period

Ireland currently has a daily balancing period. Given the universal support of respondents for daily balancing, the Commission has determined that this should remain unchanged.

4.4. Imbalance Arrangements and Tolerances

Under the current Code of Operations all imbalances falling outside of a tolerance level are charged at a penalty price (i.e. a price higher than the costs that the imbalance creates on the system). That is, the tolerance represents the level of imbalance at which cash-out provisions change.

In the Proposals Document the Commission recommended the adoption of a *different* imbalance tolerance system in which the imbalance tolerance determines the amount that shippers can carry forward *without any charge* from one balancing period to another. Under this tolerance system the shipper can either offset any such imbalance within tolerance in a future balancing period prior to settlement or (to the extent not offset) have it cashed out at settlement. Therefore under this

arrangement, the tolerance represents the amount by which a shipper can be out of balance in any balancing period within a settlement period and not face imbalance charges, *as long as the imbalance is offset within the settlement period* (e.g. a month).

This type of imbalance tolerance arrangement allows shippers the flexibility to run imbalances that do not compromise system security. The existence of an imbalance tolerance can be justified as an efficient use of the available physical flexibility in the system (i.e. the available line-pack above the amount needed by the Transporter for system security purposes). However, the Commission would like to highlight that under this imbalance system *all* imbalances that are not traded are paid for (either via an opposite imbalance in the next balancing period or cash-out) by the end of the settlement period. Therefore, the regime does not give rise to gaming opportunities. Equally, the Commission proposes that under this imbalance mechanism the amount of a shipper's cumulative imbalance should be limited. This limit deters shippers from seeking to utilise their full imbalance tolerance in every balancing period, by placing a cap on the total cumulative imbalance that can be accrued before the shipper faces a penalty. However, provided that a shipper remains within this cumulative limit, the shipper is able to carry forward an imbalance relating to that balancing period. The shipper can then offset the carried forward imbalance in a future balancing period prior to settlement or (to the extent the imbalance has not been offset) trade the imbalance or have it cashed out at settlement.

Four respondents supported the Commission's proposals concerning imbalance arrangements and tolerances. Another respondent supported a more flexible approach to imbalance arrangements, although subject to the proviso that system security should not be compromised. Two respondents raised concerns that this regime may create incentives to be out of balance. It was also suggested that full trading of imbalances should be permitted and that charges should relate to the real costs of physical balancing actions taken. Finally, a concern was raised by one party that the service proposed is a form of linepack service, and that it should be charged for as such.

Having considered all responses received to this consultation, the Commission is of the view that its proposals concerning imbalance arrangements and tolerances should be implemented as outlined. The Commission is of the view that these arrangements will not create perverse incentives for Shippers in carrying forward their imbalances, but rather will allow them to the opportunity to optimise their balancing arrangements. The Commission notes however, that other jurisdictions have mechanisms in place to avoid gaming of the system where high gas prices on a day may encourage users to abuse the flexibility system. The Commission would reiterate that the rationale for the balancing service lies in the fact that there is a level of flexibility in the system that could be made available to shippers without imposing costs on the system or resulting in balancing actions. It is not the intention of this system to allow shippers to avoid costs that they have imposed on the system.

4.5. Trading of Imbalances

4.5.1. Time allowed for trading of imbalances

In the Proposals document, the Commission proposed an increase in the time allowed for the trading of imbalances from the current level of six days following the balancing period (D+6). In line with responses to the Proposals document, and, in particular as agreed at the GMAG of the 9th of July 2003, the Commission has determined that shippers should be allowed to trade imbalances for *any* balancing period in a calendar month until the 6th day following the end of the calendar month in which the balancing period occurs (M+6).

4.5.2. Trading of imbalances outside of tolerance

The Commission, in its Proposals Document, proposed that the restriction on the trading of imbalances outside the first tier should be removed, as it has not been shown how this is related to the mitigation of constraints on the transmission system. The Commission has received no objections to this position, and so has determined that this restriction should be removed.

4.5.3. System to facilitate trading of imbalances

In its Proposals Document, the Commission proposed the introduction of an electronic system to facilitate the trading of imbalances between shippers. The Commission received limited support for this proposal from shippers, who believe that this is not necessary for the Irish system at present. Consequently, the Commission is withdrawing its proposal to introduce an electronic system for imbalance trading.

In the absence of such a system however, the Commission has proposed that the Transporter provide further information concerning system imbalances. In its Proposals Document, the Commission proposed the Transporter provide shippers with information regarding: (1) the shipper's own imbalance; (2) the overall system imbalance; and (3) the identity of shippers with whom trade may be undertaken. This information would increase transparency, with the likely consequence that more imbalance trading would occur than absent the information. Moreover, this is information that the Transporter already possesses and could be processed into an appropriate form and sent to shippers at relatively little cost. Greater transparency will be of particular benefit to new market entrants. The proposal will ensure that new entrants have access to the same information regarding imbalances as incumbents, thereby enhancing the potential for effective competition. The Commission has decided that the Transporter should provide such information on imbalances to shippers.

4.6. Mechanism for Obtaining Imbalance Gas for System Security

Currently, the Transporter obtains imbalance gas via an annual contract. The contract is awarded following a tender process.

In its Proposals Document the Commission proposed a bid-based mechanism (“BBM”) for the provision of balancing gas. Under the bid-based mechanism parties could (but would not be required to) submit bids to increase or decrease gas on the system that the Transporter could call on in order to maintain system security. Such a mechanism would aim to provide balancing prices that would reflect the costs incurred by other shippers willingly providing the imbalance gas required whenever the Transporter needs to take physical action.

In addition to the efficient provision of imbalance gas, the benefits of a BBM include:

1. The revelation of a market based imbalance price for each period in which a balancing action is taken. This provides a cost-reflective price at which imbalances can be cashed-out. Absent such a price, it will be necessary to assume a regulated price that will not (necessarily) be cost-reflective and which, therefore, will provide less appropriate incentives; and
2. A short-term market for gas (and the only such market in Ireland until a spot market develops). It is new entrants with smaller portfolios of customers that are most likely to take advantage of this mechanism. Therefore, this mechanism will provide more encouragement for entry into the market than would exist absent the mechanism. This mechanism is particularly important if there is to be no additional facilitation of imbalance trading.

Five respondents to the Proposals Document were in favour of the Commission’s proposal, while three respondents believed that such a mechanism was not appropriate for the Irish market.

Having considered each of the points raised in relation to a bid-based balancing mechanism, the Commission has determined that a bid based balancing mechanism is the most appropriate means of obtaining balancing gas. Such a mechanism may require back-up in the form of an annual tender to provide a balancing gas supplier of last resort to ensure system security.

The Commission also proposes the publication of further information relating to balancing gas. The level of information to be published was recently consulted upon in the context of the Commission’s consultation on Publication of Bord Gáis Éireann system information.⁷

⁷ Publication of Bord Gáis Éireann System Information – A Consultation Paper. CER/03/155. 3 July 2003.

4.7. Imbalance Prices

As explained in previous documents, the Commission believes that imbalance prices should be: (1) designed to give shippers an incentive to offset or trade out imbalances, wherever such opportunities exist, without being unduly penal and hence imposing undue risk on shippers; and (2) reflect the costs the imbalance imposes on the system.

Imbalances within a shipper's permitted tolerance will not impose significant costs on the system and the Commission proposes, therefore, that these imbalances are cashed out at a market-based price [such as the GB OCM]. In addition a small margin [of 10%] either side, to reflect positive or negative imbalances, should be added to the market-based price to avoid perverse incentives for shippers to run imbalances and encourage the trade out of imbalances.

Imbalances outside of a shipper's permitted tolerance may result in real costs being imposed on the system, if the Transporter is required to take a balancing action. The Commission proposes that such imbalances be cashed out at a price based on the actual marginal prices for incremental or decremental balancing gas as determined by the BBM.

4.8. Scheduling Charges

Although the current Transmission Code of Operations contains provisions relating to the levying of scheduling charges, to date the Transporter has not levied these charges. In its Proposals Document, the Commission proposed that these charges should either be removed from the Code or, alternatively, applied at the appropriate level. Several respondents supported the Commission's view in relation to scheduling charges.

The Commission believes that the fact that the Transporter has not levied scheduling charges to date may indicate that differences between actual flows and nominations have not imposed real costs on the transmission system. This would imply that the current tolerance level of 10% may be too low and does not reflect the physical characteristics of the system. In light of this fact, and given that the adoption of an entry-exit regime will necessitate the application of scheduling charges for both gas injections and off-takes, the Commission has directed that although scheduling charges *should* be imposed, they should not be imposed before a full review of the appropriate level and tolerances takes place.

5. SHRINKAGE GAS AND LINE-PACK

5.1. Shrinkage Gas

5.1.1. Provision of shrinkage gas

Under the current system the Transporter is responsible for purchasing transmission shrinkage gas. To purchase the necessary gas the Transporter issues a competitive tender every year. In its Proposals Document, the Commission proposed that this method would be replaced by shrinkage factors, which would effectively see shippers purchasing their own shrinkage gas. The Commission received little support for this proposal from respondents however, with most respondents preferring to leave procurement of shrinkage gas to the Transporter. In line with the wishes of the industry, the Commission has decided to leave the provision of shrinkage gas unchanged. The Commission may, however, consider the introduction of financial incentives on the Transporter to reduce the cost of shrinkage gas.

5.1.2. Shrinkage incentive

The Commission proposes to set a target on the amount of shrinkage and appropriate sharing factors that provide rewards/penalties to the Transporter for bettering/exceeding the target. The target could be re-set each year (or as necessary within-year), taking into account previous experience including the end-period level of linepack. The Commission is currently assessing the current level of transmission shrinkage and characteristics of the Irish transmission system in order to define the initial target. The Commission received support for this proposal from all respondents.

5.2. Treatment of Line-pack

The Commission has proposed that *all* the line-pack should be allocated to the Transporter initially, but that shippers should have *indirect* access to any *additional* line-pack that is not required by the Transporter for system safety and security purposes.

6. NEXT STEPS

The Commission is currently in discussions with the Transporter concerning a timetable for the implementation of the measures outlined in this document. Following on from this, the Commission proposes to convene a number of meetings of GMAG at which the detailed business rules applying these principles will be devised. The first such meeting will take place at Commission offices on the 17th of October 2003.