



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

Operating Agreement between Gaslink and Bord Gáis Éireann

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QUERIES TO:	jmelvin@cer.ie



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*The Commission for Energy Regulation,
The Exchange,
Belgard Square North,
Tallaght,
Dublin 24.*

www.cer.ie

Table of Contents

1.0 Introduction	3
1.1 The Commission for Energy Regulation	3
1.2 Purpose of this paper.....	3
1.3 Comments Received	3
1.4 Background Information.....	3
1.5 Structure of this paper	4
1.5 Other Relevant Information.....	4
2.0 Commission Decision	5
2.1 Introduction.....	5
2.2 Background	5
2.3 Commission Decision	7
3.0 Response to Comments Received.....	9
3.1 Response to individual comments	9
4.0 Conclusions and Next Steps.....	12
4.1 Summary	12

1.0 Introduction

1.1 *The Commission for Energy Regulation*

The Commission for Energy Regulation ('the Commission') is the independent body responsible for overseeing the regulation of Ireland's electricity and gas sector's. The Commission was initially established and granted regulatory powers over the electricity market under the Electricity Regulation Act, 1999. The enactment of the Gas (Interim) (Regulation) Act, 2002 expanded the Commission's jurisdiction to include regulation of the natural gas market, while the Energy (Miscellaneous Provisions) Act 2006 granted the Commission additional powers in relation to gas and electricity safety. The Commission is working to ensure that consumers benefit from regulation and the introduction of competition in the energy sector.

1.2 *Purpose of this paper*

The purpose of this paper is to outline and describe the Commission's decision with regard to *the proposed **Operating Agreement between Gaslink and Bord Gáis Éireann (BGE)***. In April 2008, the Commission consulted on the proposed Operating Agreement.

1.3 *Comments Received*

The Commission received two responses to the consultation (CER/08/072). Both respondents have requested that their responses remain confidential and not be published.

1.4 *Background Information*

It is required, under European Communities (Internal Market in Natural Gas) (BGE) Regulations 2005, S.I. No 760 of 2005 to establish an independent system operator for the BGE Transportation System to facilitate competition in supply activities.

Pursuant to the Regulations, Gaslink has been established as the Independent System Operator (ISO) for the Bord Gáis transmission and distribution systems. The Minister has approved its memorandum and articles of association and a transfer plan is currently being finalised. Gaslink will commence in its role as ISO

following the Commission's approval of the Operating Agreement and the Minister's approval of the Transfer Plan. The Commission has recently consulted upon the proposed licences¹ for the Gaslink as system operator and for Bord Gáis as asset owner.

The Operating Agreement is designed to enable Gaslink discharge the functions of independent transmission and distribution system operators as provided for in Directive 2003/55/EC.

1.5 Structure of this paper

The rest of this paper is set out as follows:

- **Sections 2.** sets out the Commission's Decision on the Operating Agreement;
- **Section 3.** sets out the Commission's Response to the key issues raised by the respondents to the consultation
- **Section 4** outlines the next steps in relation to the Operating Agreement and Gaslink's commencement as ISO.

1.5 Other Relevant Information

For further information on this paper contact John Melvin (jmelvin@cer.ie) at the Commission

¹ CER/08/078, CER/08/079, CER/08/080 and CER/08/081

2.0 Commission Decision

2.1 Introduction

The Commission for Energy Regulation is today publishing the Revised Operating Agreement reached between BGE and its newly established subsidiary company, Gaslink, which the companies have submitted to the Commission for approval. Since the consultation version (CER 08/073), a significant number of minor legal drafting changes and clarifications have been made to the Operating Agreement. These amendments, while important do not change substantively the basic model of ISO separation and division of functions set out in the earlier version.

The Operating Agreement is designed to enable Gaslink discharge the functions of independent transmission and distribution system operators as provided for in Directive 2003/55/EC

2.2 Background

The legal and *de facto* independence of the system operator is a key principle of EU liberalisation of both the electricity and gas industries. This principle applies to both the transmission and distribution networks.

It does not mean that the system need necessarily be *owned* by the system operator. This is evidenced in Ireland, for example, where EirGrid is the operator of the electricity transmission system but not the owner. The principle does mean, however, that where the system is owned by an incumbent player who also trades in a related contestable market - e.g. gas supply – the system operator function is discharged by a distinct legal entity (such as a subsidiary undertaking) who “shall be independent at least in terms of its legal form, organisation and decision making” from other activities not relating to system operation.

In Ireland’s case **Directive 2003/55/EC** has been transposed into domestic law by **S.I. No. 760 of 2005** as amended by **S.I. 377 of 2007**. These Regulations provide, among other things, that

- BGE shall establish an independent subsidiary company (Gaslink) to discharge the functions of TSO and DSO in a manner consistent with the 2003 Directive and the Minister will approve the memorandum and articles of association of Gaslink.

- BGE, as owner, and Gaslink, as operator, shall negotiate and enter into an **Operating Agreement** providing for the terms on which each will fulfill its respective functions regarding the BGE transportation system (i.e. the transmission and distribution networks). This Operating Agreement will then be submitted to the Commission for approval.

Since these Regulations were made, Gaslink has been established and the Minister has approved its memorandum and articles of association. The two companies negotiated and agreed an Operating Agreement and submitted it to CER for approval. This Original Operating Agreement² was published for consultation on 23rd May 2008. The Revised Operating Agreement³ issued in conjunction with this decision reflects the changes agreed between the parties and the Commission since the consultation paper was issued.

In considering the request to approve the Revised Operating Agreement, the key questions for the Commission were (i) whether the Agreement is compatible with the letter and the spirit of the Regulations and (ii) whether it provides the basis for an efficient and sustainable relationship between the two companies for discharging their obligations and meeting the needs of the Irish gas industry in the coming years.

The Respective Functions of System Operator and Owner

The core provisions in the Regulations on the respective functions of Gaslink and its parent BGÉ can be summarised as follows for the present purpose:

Regulation 11 provides that responsibility for the operation of the BGÉ transportation system is vested in Gaslink, who shall operate that system in a manner consistent with Article 8 of the Directive 2003/55/EC. That responsibility includes (but is not limited to) identifying works necessary for the effective operation of the BGÉ transportation system. As soon as practicable after identifying works necessary for the effective operation of the BGÉ transportation system, Gaslink shall give directions to BGÉ with respect to carrying out those works. BGÉ shall take all practicable steps to ensure that these directions are complied with by the date, or within the period, specified in those directions or by such later date as Gaslink may allow.

Regulation 12 provides that Gaslink is declared to be independent of BGÉ as regards its organisation and its power to make decisions with respect to carrying out its responsibility for operating the BGÉ Transportation System and that Gaslink is entitled to make decisions, independently of BGÉ, for the operation, maintenance and development of the BGÉ Transportation System. It also provides that BGÉ shall not engage in any conduct that interferes with or is likely

² CER 08/073

³ CER 08/110

to prejudice Gaslink as regards its responsibility for the day-to-day operation, maintenance and development of the BGÉ Transportation System nor make any decision about the construction or improvement of the BGÉ Transportation System that is within the ambit of the annual plan prepared or approved by BGÉ.

Regulation 12 further provides that nothing in that Regulation affects the right of BGÉ to take appropriate steps to ensure the protection of the economic and management supervision rights of BGÉ with respect to securing a return on assets, whether owned by BGÉ or Gaslink. It also allows BGÉ to require that Gaslink complies with an annual financial plan prepared or approved by BGÉ for the purposes of the Regulations and to impose global limits on the amount of debt that Gaslink may incur at any specified time or during any specified period.

2.3 Commission Decision

The Commission has approved the attached revised version of the Operating Agreement⁴ published on 23rd May 2008 pursuant to Regulation 8 of S.I. No. 760 of 2005 (as amended).

The Commission believes that the revised Operating Agreement meets both the letter and the spirit of the Regulations and also that it provides the basis for an efficient and sustainable relationship between the two companies for discharging their obligations and meeting the needs of the Irish gas industry in the coming years.

While the arrangements described in the Agreement, and indeed in the Regulations themselves, may appear to have adopted what might be termed a relatively “light” ISO model, it is important to bear in mind that many of the “owner” functions charged to BGE will be in fact discharged by BG Networks which will continue to act as a separate division within BGE whose staff will be bound by strict ring fencing licence rules regarding non-disclosure of information etc. Examples of such functions include carrying out Gaslink’s Development Programme, managing all contracts with subcontractors etc. Even allowing for this, the Agreement also makes it clear that legal responsibility for the key statutory function of planning, developing and operating the gas network systems will rest exclusively with Gaslink.

This Operating Agreement has been amended from that proposed operating agreement published in CER 08/073, this is to reflect changes agreed between the parties and the Commission since the consultation paper was issued and takes into account the comments received during the consultation.

⁴ CER/08/110

In a separate but related development, the Commission is also publishing transmission and distribution operator and owner licences⁵ for Gaslink and BGE respectively following a separate public consultation exercise. This was as required by the Regulations. These licences confine themselves to providing that, with regard to the Operating Agreement, the parties shall comply with its terms.

⁵ CER/08/102

3.0 Response to Comments Received

The Commission received two responses to the Consultation. Both of the respondents have requested that their submission remain confidential and not be published. The main issues raised by the respondents are addressed below. The Commission response is set out in italics after each individual issue.

3.1 Response to individual comments

One respondent questioned the model being employed to set up Gaslink as Independent System Operator. Gaslink are an independent subsidiary of BGE. They pointed to the model used in electricity transmission as being preferable where EirGrid were set up as an entirely independent company while the Electricity Supply Board (ESB) retained asset ownership.

The set-up of the ISO was directed through Part 2 of SI NO. 760 of 2005 and so is outside the remit of this consultation and the jurisdiction of the Commission.

The same respondent asserted that Gaslink's independence should be without question at all times and some aspects of the model being employed may be questionable. They claim the majority of the Gaslink Board members are senior members of BGE. They believe that at the very least there should be an independent representative from Irish Gas Shippers on the Gaslink board. They note that appointments to the board of Gaslink are only effective with the approval of the Minister.

The Commission appreciates that the decision on the appointment of the Gaslink board is a critical aspect of the implementation of the unbundling provisions of Directive 2003/54/EC and ensuring the de facto independence of Gaslink. The Commission will bring these comments to the attention of the Minister who has exclusive competence on this issue.

One respondent raised the point that the legislation at the centre of the establishment of the ISO is currently under review at European level. They suggest that the changes being proposed would require that a more effective unbundling of the ISO take place and that the Commission should be cognisant of such.

The Commission will continue to monitor events at European level. The Commission will facilitate any further changes, should they be so mandated by future legislation.

Many of the operation functions are carried out by BGE for Gaslink. One respondent felt that there should be a clear migration plan set out to show how

the responsibilities for these functions will move across to Gaslink from BGE. They also felt that the non transportation assets should move to Gaslink also.

The decision on what responsibilities should be carried out by BGE and Gaslink is one for the Minister. The transfer plan will contain these details. The decision to move any responsibilities (or non transportation assets) in the future will remain with the Minister.

One of the respondents feels that the Operating Agreement gives BGE too much power to overturn Gaslink decisions, most notably where the Gaslink decision will adversely affect BGE's ability to make a return on its assets. The respondent feels that in such instances BGE should only be allowed to overturn the Gaslink decision with the Commission's approval.

Clause 4.4 (a) of the Operating Agreement has been further clarified since consultation to make it clear that either party may meet the Commission at any time it sees fit to discuss any issues they may have. The Commission feels that this offers an open door to either party to discuss any issues it may have and that this clause caters for the scenario outlines by the respondent.

One respondent questioned Clause 4.3 which deals with the use of transportation assets for use other than that of the transportation of natural gas. They would like clarification on what this non energy use is and whether it includes inventory product.

It is not possible to specify what this non energy use is (it is simply specified what it is NOT). For the avoidance of doubt it is not any gas transportation operation and it is not inventory product.

One of the respondents felt that all siteworks should be carried out and invoiced in Gaslinks name as not to do so will cause confusion. They feel that carrying out the work as Gaslinks agent is not going far enough and that BGN livery should be changed to reflect that the work is being carried out on behalf of gaslink.

Rebranding all site works as Gaslink would cost significant monies (changing vans etc). As the work is being essentially being carried out by BGN on behalf of Gaslink in any case, this would only serve put more costs on the customer.

One respondent felt that Gaslink should collect all monies from shippers and just pay BGE their share rather than BGE collecting the money and giving Gaslink their share.

BGN (part of BGE) are currently equipped to handle all of the monies and have complex systems in place to do so. The move away from this at present would be costly and is not warranted by the overall "light" ISO model envisaged in the Regulations.

One respondent would like to see more of the documents referenced in Operating Agreement in the public domain. They feel that these documents should be available at the same time as the Operating Agreement.

The Commission is publishing the Confidential Information Protocol as a schedule to the Operating Agreement. We believe it is appropriate to publish this Protocol so that external parties may examine the arrangements in place to maintain confidentiality of information collated and processed by BGN on behalf of Gaslink. The Commission believes that the main body of the Operating Agreement clearly outlines the functions and roles of the parties.

Some of the other documents will remain subject to change, and others contain details of confidential commercial arrangements; the Commission believes that their absence from the consultation does not alter the ability of interested parties to comment on the substantive issue.

One respondent felt that the timelines in the Dispute Resolution process need to be tightened and that the Commission should be allowed intervene at an early stage if invited.

As with an earlier point, Section 4.4 (a) of the Operating Agreement has been further clarified since consultation to make it clear that either party may meet the Commission at any time it sees fit to discuss any issues they may have. This will also be the case in any dispute between the parties. Any third party affected by a dispute may also contact the commission should they so chose.

4.0 Conclusions and Next Steps

4.1 Summary

The Operating Agreement has now been approved by the Commission. Gaslink will take over responsibility for the operation of the BGE transportation system following the Commission's approval of the BGE and Gaslink licences and the Minister's approval of the Transfer Plan.