Initial Modification Report

Code Modification A069:

'Back-up Capacity Arrangements Under New Tariffing Regime'

2 December 2015

Issued for Industry Consultation

Consultation Details

Consultation Closes:	**16 December 2015**
Comments to:	**Aidan Hogan**
	aidan.hogan@gasnetworks.ie; and
	marketdevelopment@gasnetworks.ie

Gas Networks Ireland

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1 Introduction & Background

1.1 Introduction

The purpose of this Initial Modification Report is to aid the CER in deciding whether this modification proposal should be progressed further, and if so, in what manner. It also serves as a summary document of the modification process to date. In doing so, this report includes the following:

- Background to the modification and the timeline of events to date;
- Summary of written consultations, Industry responses, and forum discussions to date; and
- Transporter's assessment of the proposal.

A two week consultation period applies to the report, with Industry comments invited by close of business on 16 December 2015. Discussions regarding the modification to date have concentrated predominantly on the general principles and rationale underpinning the proposal, with substantially less discussion devoted to specific implementation mechanisms. It is therefore expected that the CER's decision at this point in the modification process would provide a determination as to whether or not the modification should be progressed further. If the CER approves further progression of the modification, the next phase of development would focus on the more detailed mechanics required to apply the proposal in practice.

1.2 Background

1.2.1 Current Code Modification Process

Code Modification Proposal A069 was submitted by the Irish Offshore Operators Association (IOOA) on 31 July 2015, proposing:

> *'that where a shipper at one entry point has booked entry capacity and where that shipper has a requirement to access a short term entry product at another entry point (back up capacity) due to a reduction / cessation of gas supplies at its primary entry point that the short term tariff payable by the shipper at the secondary entry point will be the daily / monthly / quarterly multiplier of the primary entry tariff for that entry point calculated under the matrix methodology and not the aggregate tariff (primary and adjustment / smeared)'*

The proposer cites changes to the transmission tariff methodology (See Decision Paper CER/15/140 *'Gas Entry/Exit Tariff Methodology'*), in particular the application of a 'matrix methodology' in setting the tariffs, as the primary driver for the proposal. The full modification proposal form can be found in Annex 1 of this Initial Modification Report.

Written responses to the proposal were sought and received from Industry in August 2015 and a number of Code Modification Forum discussions were held on the topic from August through to November 2015, as per the timeline below:

	Date	Reference Document
CER Decision Paper CER/15/140 published	23 July 2015	Paper
Code Modification Proposal Form issued	31 July 2015	Proposal Form
Proposer presented proposal to CMF	19 August 2015	Minutes
Industry consultation on proposal form	19 Aug–2 Sep 2015	Responses
Proposal discussed at CMF	16 September 2015	Minutes
Proposal discussed at offline workshop	6 Oct 2015	Workshop Notes
Proposal discussed at CMF	4 November 2015	Minutes

1.2.2 History of Back-up Capacity in the Code of Operations

A back-up capacity product was first introduced to the Code of Operations at a point in time when annual capacity was the shortest duration of capacity available. Given the absence of short-term capacity products, the back-up capacity product allowed Shippers to apply for capacity at an alternative entry point for the duration of an outage at its primary entry point. The product comprised an advance reservation fee and, in the event of the back-up capacity actually being used during an outage, a utilisation charge which applied seasonal multipliers to the annual tariff. Shippers were required to provide details of the outage to the Transporter in order to verify the validity of the outage and the quantity of back-up capacity utilised.

As of 1 October 2015, the Back-Up product is no longer a feature of the Code. When developing proposals for the implementation of the Capacity Allocation Mechanisms (CAM) Network Code (Regulation 984/2013) in 2014, the Transporter proposed (via Code Modification A062) removing the product from the Code on the grounds that, since 2007, short term capacity products were available to meet back-up requirements, and the existing product was incompatible with the introduction of bundled capacity auctions at Interconnection Points.

While Industry did not object to the proposed discontinuance of back-up entry capacity during the consultation process, 2 respondents requested that the Transporter and CER consider future proposals to mitigate the impact of the withdrawal of back-up capacity. The CER approved the business rules in October 2014, with the approved modification taking effect from 1 October 2015.

1.2.3 Decision Paper CER/15/140

The CER published Decision Paper CER/15/140 '*Gas Entry/Exit Tariff Methodology*' in July 2015 on the back of a 5 year tariff reform process which began in 2011, including substantial industry consultation and involvement through the Network Tariff Liaison Group. The paper established a new transmission tariff methodology, the 'matrix' methodology, which results in the derivation of a separate and distinct tariff for each entry point. In deriving a given entry point tariff, the methodology aggregates two elements:

- a *primary tariff* specific to that particular entry point; and
- a *secondary adjustment*, to achieve the required revenue recovery.

The Transporter calculated and published transmission tariffs for 2015/16 on the basis of this methodology.

2 Summary of Written Consultations & Forum Discussions

This section summarises both the written responses received form Industry and the discussions held at Code Modification Forum meetings.

Note that the views expressed in this Section 2 are representations of Industry respondent's views expressed in written responses and discussions at Code Modification Forum meetings and should not be construed as the views of the Transporter. While every effort has been made to fairly and accurately represent these views, please refer to the Transporter's website where both written responses and Code Modification Forum meeting minutes can be accessed in their original form.

2.1 Written Consultation re Modification Proposal Form

Following publication of the proposal form and the proposer's presentation at the Code Modification Forum in August, written responses were invited to the proposed modification. The Transporter received 8 responses from:

1. Bord Gais Energy
2. ESB
3. Kinsale Energy Ltd. (IOOA)
4. Shell Energy Europe Ltd. (IOOA)
5. SSE Airtricity
6. Statoil (UK) Ltd. (IOOA)
7. Sunningdale Oils (Ireland) Ltd. (IOOA)
8. Vermillion Energy (IOOA)

The responses can be broadly categorised as follows:

- 5 respondents ***fully supported*** the proposal;
- 2 respondents ***broadly supported*** the proposal, while listing a number of concerns and requesting further information regarding the nature and detail of the proposal; and
- 1 respondent ***reserved its position*** pending receipt of further detail, while conditionally highlighting a number of queries and concerns.

2.1.1 Benefits:

A number of benefits were outlined by Industry respondents as follows:

- ***Bellanaboy Perspective:*** A respondent highlighted that, as there is an expectation of variances in daily deliveries at the Bellanaboy Entry Point, Shippers at the point may need to purchase capacity at an alternative entry point to meet its customers' needs. The proposal could avoid situations whereby a Shipper using an indigenous entry point pays more (by virtue of paying the secondary adjustment twice) than a Shipper with an identical customer profile using only the Moffat Entry Point.

- ***Inch Perspective - Inferior Inch service not reflected in tariff methodology:*** A respondent asserted that the quality of service at Inch is inferior to that offered at Moffat, due to restrictions of flow at Inch and periodic maintenance at the point and that the cost/value of these differences are not recognised in the tariff methodology. Neither does the tariff methodology recognise the cost borne by Inch Shippers in accessing 'back-up' capacity at

Moffat, which is effectively provided for free at Moffat due to the availability of surplus Moffat capacity. The proposal could have a positive impact on these issues.

- ***IBP Perspective:*** One respondent stated that IBP liquidity may benefit from more Shippers entering into firm contracts with indigenous producers as a result of the proposal.

2.1.2 Concerns:

A number of concerns were raised by Industry respondents in relation to the proposal:

- ***General - more detail required:*** A number of respondents to the written consultation requested further detail in terms of the proposal, including the following queries:
    - o How is it proposed to identify the amount of capacity eligible for a 'discount'?
    - o How is it proposed that a Shipper demonstrates what proportion of its capacity it would have used if an outage had not occurred?
    - o Is it proposed that the 'discount' be applied only to back-up capacity acquired after the outage occurs, or is it proposed to also apply to back-up capacity acquired before the outage occurs?

- ***General - Compliance with EU Regulations at IPs:*** Respondents queried whether EU Regulations allowed for IP Capacity to be acquired at two different tariffs and whether restrictions would apply to the trading of 'discounted' IP capacity on the secondary market.

- ***Short Term Market Distortion:*** A respondent queried whether the proposal could create distortion in the market given that a Shipper which knows that it is eligible for a subsequent rebate, may be able to bid higher in an IP auction than a Shipper not eligible for a rebate. This may result in a Shipper which is not eligible for a rebate either a) paying a higher auction premium than would otherwise have been the case, or b) being priced out of the auction and incurring overrun charges as a result.

- ***Discrimination towards certain Shippers:*** A respondent noted that one of the principles underpinning this proposal is that a Shipper receives a form of financial redress in the event of a 'trip' at a production facility. In the interest on non-discrimination among Shippers, the respondent suggested that similar redress be applied in the event of a 'trip' at a power generation facility.

- ***Reduced producer incentive to maintain supply:*** A respondent suggested that it may be the case that bilateral contracts between Shippers and indigenous producers include provisions whereby the producer provides a form of redress to the Shipper in the event of a production outage. It was also noted that only the two parties to these contracts have sight of the arrangements within. Should this modification proposal be adopted, the redress will be provided through the contract between the Shipper and the Transporter, thus reducing the producer's risk in the event of a production outage. This could reduce a producer's incentive to maintain a reliable gas supply at the entry point.

- ***Potential for gaming:*** A respondent pointed out that difficulties in accurately defining certain elements of this modification (e.g. how is an outage defined, declared or verified?) may offer opportunities for manipulation of the process for financial gain.

2.1.3 Suggestions

A number of suggestions were put forward in terms of how the proposal might be applied:

- ***Disaggregation of Tariff:*** One respondent suggested that disaggregating the aggregated tariff to its constituent parts (primary tariff and secondary adjustment) was a potential means to give effect to the intent of the proposal. Where a Shipper is booking capacity at its primary entry point, it would be required to book and pay separately for the primary tariff and the secondary adjustment. Where a Shipper is booking capacity at a 'back-up' entry point, it is only required to book and pay the primary tariff.
- ***Apply time limit to back-up arrangements:*** One respondent proposed that the application of any proposed back-up arrangements be time limited to a period of X days/weeks. This could mitigate a number of the concerns listed above, while simultaneously recognising that the secondary adjustment element of the tariff has already been paid.
- ***Apply discount only to unused capacity holding:*** In an effort to mitigate some of the aforementioned concerns, a respondent proposed that any 'discount' only be applied to the unused portion of the capacity at the primary entry point as opposed to the entire booking at the back-up entry point.

2.2 Forum Discussions

The modification was discussed at Code Modification Forum Meetings in August, September and November 2015, as well as at an additional offline workshop in October. While many forum representatives reiterated the points raised in the written consultations, the main discussion topics were as follows:

1. Clarification regarding the general intent, rationale and principles underpinning the proposal;
2. Clarification of which specific scenarios are proposed for application of back-up arrangements;
3. The new transmission tariff methodology as set out in Decision Paper CER/15/140; and
4. The mechanisms to be used to give effect to any such back-up arrangements.

The principles and rationale behind the proposal (items 1 & 2 above) were to the forefront of discussions, rather than the particular mechanics which might be used to apply it. It was agreed that it was appropriate to focus on these aspects as a means to inform a CER decision on the progression of the modification at this stage in the process. Should the CER decide to progress this modification further, the focus will shift to the more practical elements of implementing the modification.

2.2.1 Modification Intent & Rationale:

- The proposer clarified its intention for the proposal to address both offshore outages and onshore network issues (i.e. a reduction in capacity at an entry point arising from issues with the Transporter's network).
    - In response, an Industry representative stated that in the case of an onshore issue, effectively caused by the Transporter, it would not be appropriate for any charge to be applied for back-up capacity.
- Furthermore, the proposer stated that the fundamental principle underpinning the proposal was that, in any circumstances (not limited to onshore or offshore outages), a Shipper should not

have to pay the secondary adjustment element of the tariff twice, noting that this would not be an issue if the tariff methodology recovered the secondary adjustment via a commodity charge.

  - In response, a number of Industry representatives expressed concern at the prospect of back-up arrangements being applied in situations other than legitimate and verifiable outage situations.

- Notwithstanding the concerns raised and requests for further information, there was general agreement within Industry that, in principle, it was appropriate to facilitate back-up arrangements in the instance of legitimate and verifiable outage situations, provided that those situations were clearly and appropriately defined.
  - The CER noted that, while Industry may hold this view, the CER reserved its position until it gave full consideration to all aspects of the proposal, ensuring that it was fair and equitable in all circumstances. The CER noted that issues such has potential cross-subsidisation would have to be fully considered.
  - The CER also requested the Transporter to review whether the proposal presented any EU Network Code compliance issues.

2.2.2 Additional Concerns

While concerns raised in the written responses were reiterated verbally, an additional item was added:

- ***Impact on secondary market:*** Where 'discounted' primary capacity could be requested under back-up arrangements at an entry point, an Industry representative argued that the value of entry capacity offered for sale on the secondary market could be negatively affected.

2.2.3 Potential Implementation Mechanisms

Although not discussed in detail, the following represents a list of potential mechanisms suggested:

- ***Distinct Back-up Capacity Product:*** A distinct back-up capacity product with a distinct tariff which would be booked by Shippers in advance of use (via PRISMA auction at IPs, via GTMS at non-IPs).
- ***Disaggregated Tariff:*** The aggregated capacity tariff is disaggregated to its constituent parts (primary tariff and secondary adjustment). Where a Shipper is booking capacity at its primary entry point, it would be required to book and pay separately for the primary tariff and the secondary adjustment. Where a Shipper is booking capacity at a 'back-up' entry point, it is only required to book and pay the primary tariff.
- ***Retrospective Rebate:*** Rather than booking a distinct 'back-up' capacity product, the Shipper would acquire standard short term capacity at the alternative entry point. The Shipper would then verify that an outage had occurred, and would be entitled to a rebate on a portion of the short term capacity it acquired, based on an agreed calculation.
- ***Capacity Substitution:*** A model whereby, in the case of an outage, a Shipper could request an amount of capacity at the alternative entry point in substitution for (applying an appropriate adjustment to reflect differences in tariff price between two points) the capacity which is rendered unavailable at the primary entry point.

3 Estimated System Impacts, Costs, Implementation Timelines

Discussions regarding the modification to date have concentrated predominantly on the general principles and rationale underpinning the proposal, with substantially less discussion devoted to the specific mechanisms which might be applied in implementing the proposal. In this context, the Transporter is not in a position to provide a meaningful assessment of system impacts, costs or implementation timelines and proposes that this exercise be carried out in the next phase of the development process, should the modification be progressed further.

4 Transporter's Assessment of the Proposed Modification

4.1 EU Network Code Compliance Review

The Transporter has conducted an initial review of current EU Network Codes and associated Regulations and Directives in order to assess whether any compliance issues arise. For the purpose of this exercise, two potential implementation models were considered:

1. A dedicated back-up capacity product incorporated in Interconnection Point auctions and with a dedicated 'back-up' tariff distinct from the standard capacity product tariff; and
2. A rebate applied to standard capacity products bought in Interconnection Point auctions at the regulated standard capacity product tariff.

In the case of 1 above, while Regulation EU 984/2013 (CAM Network Code) does not appear to explicitly preclude a back-up capacity product, neither does it specifically provide for one. Were such a product to be proposed, a range of challenges would arise in terms of incorporating the product while maintaining consistency with the standard capacity products and joint capacity booking platform as prescribed in the Regulation, including the following:

- Restricting access to a back-up capacity auction to which only certain parties would be considered eligible;
- How to determine an appropriate level of available back-up capacity to auction, particularly given the impact this may have on the available capacity auctioned for the standard product of the same duration; and
- Incorporating an additional non-standard product, auction and tariff on the PRISMA platform and into the contractual arrangements (tri-partite agreements) with adjacent TSOs.

In the case of 2 above, there are a number of more general obligations regarding objective and non-discriminatory access to the network (See Art. 32 of the Directive 2009/73/EC and Articles 13& 14 of Regulation EC 715/2009). The question of cross-subsidisation also arises and the CER has already noted that it is cognisant of such considerations and will evaluate this modification proposal accordingly.

4.2 Modification Intent & Rationale:

The Transporter makes the following observations regarding the intent and rationale underpinning the proposed modification:

1. ***Scope of Proposal:*** During the various forum discussions, the proposer clarified that the fundamental driver behind the modification proposal was that the secondary adjustment element on the tariff should not be paid twice by a Shipper in any circumstance. The Transporter therefore interprets the proposal as not solely driven by specific outage (be they offshore or onshore) events where 'back-up' capacity' is required, but as a more fundamental commentary on the new transmission tariff methodology in general. Accordingly, it may be necessary for the CER to consider the proposal separately in respect of the two distinct items below:
    a. In limited circumstances of offshore or onshore outages, where a Shipper requires 'back-up' capacity at a secondary entry point; and

b. In more general scenarios of a Shipper holding capacity at more than one entry point.

In the case of b) above, further development of the proposal may be required to better understand how this might be applied. For instance, is it proposed that the secondary adjustment element of the tariff be applied as a commodity charge?

Given the disconnect from outage scenarios, the Transporter considers b) to be a 'tariff methodology' issue rather than a Code issue. The Transporter notes that considerable consultation has been conducted over the past number of years in relation to tariff reform culminating in the publication of Decision Paper CER/15/140 in July 2015. The Transporter does not therefore believe it appropriate to reopen this decision at this point in time.

2. ***Access to back-up capacity:*** The Transporter proposes that, should this modification be progressed, it is unnecessary to create a dedicated back-up capacity product offered and booked (on PRISMA & GTMS) in advance of use. Instead, Shippers should utilise the existing suite of short term capacity products to acquire capacity at a back-up entry point. This proposal is based on the following reasoning:

   a. During the forum discussions, references were made to the Back-up Capacity product which was previously included in the Code. One of the principal drivers behind the original product was access to short term capacity in the event of an outage, at a time when only annual products were offered in the Code. Given that monthly and daily capacity products are now accessible at all entry points, as well as secondary capacity and access to the IBP, the Transporter suggests that access to capacity is no longer an issue which needs to be addressed.

   b. There are substantial legal and practical challenges presented in terms of incorporating a new 'back-up' capacity product at Interconnection Points, as set out in section 4.1 above.

3. ***Price of back-up capacity:*** As access to back-up capacity is no longer an issue, the price to be paid for capacity acquired to address an outage at another point becomes the focus. There are a few points to note in this regard:

   a. Consistent with the Transporter's suggestion in 2 above, The Transporter believes that when booking a standard capacity product, all Shippers (regardless of whether they are affected by an outage or not) should do so at the regulated tariff for that standard capacity product. Pending the outcome of this code modification process, a rebate may or may not be applied subsequently.

The Transporter echoes the concerns raised by Industry respondents (see 2.1.2) in respect of the potential downsides of applying a rebate or otherwise 'discounting' capacity in back-up situations. In particular, the Transporter has concerns regarding the potential consequences for the clearing price of auctions at IPs as a result of a Shipper being able to bid higher than would otherwise be the case in the knowledge that he will subsequently receive a rebate. Similarly, the application of a rebate/discount may detract from the value of capacity on the secondary market and raise potential discrimination, anti-competitive and cross-subsidisation issues in terms of applying two different prices to an identical service, depending on which party acquires the product.

Summary of Transporter's Assessment:	
Scope:	The scope of the proposal has two distinct elements: 1. Back-up Capacity scenarios (i.e. where an outage occurs) 2. Wider tariff methodology issues (where an outage has not occurred) Fundamental issues relating to the tariff methodology outlined in Decision Paper CER/15/140 should be addressed separate to the Code modification process.
Access:	Shippers have sufficient means (short term capacity, secondary capacity, IBP) to acquire capacity at alternative entry points in back-up scenarios. The Transporter does not support the introduction of a dedicated 'back-up' capacity product and suggests that existing short term products are sufficient.
Price:	The Transporter is concerned that application of a rebate / discount may have discriminatory anti-competitive and cross-subsidisation implications. Short term capacity products should be priced at the regulated tariff in all circumstances.

ANNEX 1:

CODE MODIFICATION PROPOSAL FORM

CODE OF OPERATIONS MODIFICATION PROPOSAL

MODIFICATION DETAILS				
Modification Number: A069	**Modification Title:** Back-up Capacity Arrangements under new tariffing regime			
Modification Proposer:	**Modification Representative:**	**Modification Representative Contact Details (email address):**	**Date Submitted**:	**Proposed Implementation Date:**
Irish Offshore Operator's Association	Brian McGlinchey	bmcglinchey@kinsale-energy.ie	31 July 2015	1 October 2015

Proposal (including rationale):

Substantial changes are occurring to the GNI tariffing regime from 1 October 2015 - GNI is adopting a new tariffing regime using the matrix methodology. From the matrix methodology the entry tariff at each entry point will consist of a primary entry tariff that is linked to that specific entry point and an adjustment / smeared tariff that is common to all entry points - aggregated together the primary and the adjustment / smeared tariffs give the overall entry tariff at a specific entry point.

IOOA proposes that where a shipper at one entry point has booked entry capacity and where that shipper has a requirement to access a short term entry product at another entry point (back up capacity) due to a reduction / cessation of gas supplies at its primary entry point that the short term tariff payable by the shipper at the secondary entry point will be the daily / monthly / quarterly multiplier of the primary entry tariff for that entry point calculated under the matrix methodology and not the aggregate tariff (primary and adjustment / smeared).

Proposed Implementation Date:

1 October 2015

Proposed section of the Code to be modified:

Part C

MODIFICATION MOTIVATION

Intended Outcome of the Proposed Modification:

Shippers with an entry capacity booking pay an entry point tariff which consists of a primary entry tariff and an adjustment / smeared entry tariff. Since shippers have already paid the adjustment / smeared entry tariff which is a common charge across all entry points when booking its entry point capacity, in the event that this shipper requires access to short term entry capacity at another entry point for back up reasons, this shipper should not have to pay the adjustment / smeared entry tariff twice since it has already been paid for through shipper's original entry point booking.

Benefits of implementing this Modification:

Entry capacity costs for shippers at Corrib and Inch are increasing substantially due to the new tariffing regime and the cost of accessing back-up capacity at Moffat is rising. Shippers who have booked entry capacity at one entry point should not have to pay the smearing charge twice when accessing back-up capacity at another entry point. This modification will prevent shippers paying the adjustment / smeared entry tariff twice and reduces the costs of accessing back-up entry capacity at other entry points.

Consequences of not making this Modification:

Shippers at production entry points accessing other entry points for back-up reasons will end up paying the adjustment / smeared tariff twice and paying higher price for accessing short term capacity.

Illustrative Example (Please enter a scenario where the issue and solution are illustrated):
A shipper has booked entry capacity at a production entry point – A supply outage at this production entry point means that the shipper needs to access short term capacity at another entry point for a day. Since the shipper is committed to paying for its production capacity, for that day it can access the short term capacity booking at Moffat based on the primary tariff. If for example the Moffat tariff is €448/MWh with €198/MWh being the primary tariff and €250/MWh being the adjustment / smeared tariff. Based on the above the shipper will be able to purchase short term Moffat capacity for back-up reasons at 44% of the published short term tariff for Moffat (198/448).