To: Pamela Taylor (Ofgem), Robert Spencer (NMa) and Dominique Woitrin (CREG)

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Our reference
BBL V.O.F. 12.056

Your reference

Subject
RE: Open letter: Call for evidence on the use of the gas interconnectors on Great Britain's (GB's) borders and on possible barriers to trade

Dear Pamela, Robert, Dominique,

BBL Company V.O.F. ("BBLC") welcomes this opportunity to comment on the use of gas interconnectors and on the evidence presented by Ofgem, CREG and NMa (hereafter "the regulators").

In this response we will:

in Section 1 – explain the background to capacity sold by BBLC;
in Section 2 – outline our response to the evidence presented by the regulators;
in Section 3 – address specifically the questions asked by the regulators; and
in Annex A – outline (for reference) the current regulatory position of BBLC.

In summary, BBLC believes that all arrangements relating to capacity availability on the BBL interconnector are transparent, objective and non-discriminatory. BBLC believes that the current arrangements are efficient, offer shippers the ability to respond to short-term price signals and that there are no barriers to trade between the Netherlands and Great Britain (GB).

Should you require any further details on the contents of this response, please contact my Manager Regulatory Affairs, David Bakker, as he would be happy to discuss the matter with you.

Yours sincerely,

Willem Faber
Managing Director
BBL Company V.O.F.

1. BBLC offers capacity in a transparent, market-oriented manner

BBL Company V.O.F. (BBLC) was established in 2004 to design, construct and operate an interconnector for the transportation of gas from Balgzand in the Netherlands, to Bacton in the UK. The BBL interconnector provides services to flow gas physically from the Netherlands to GB and non-physical interruptible reverse flow services from GB to the Netherlands.

BBLC has allocated its forward flow capacity through two open seasons, which were regarded as fully transparent, objective, non-discriminatory processes which resulted in 7 shippers obtaining capacity. It should be noted that not all of the additional firm forward flow capacity which became available after the installation of an additional fourth compressor in April 2011 has been sold and this unsold capacity is available to any interested party. The approved terms and conditions related to this available capacity are in the public domain and are published on our website.

Interruptible reverse flow (IRF) capacity is made available to all shippers on a transparent and non-discriminatory manner via regular auctions at which capacity can be booked for quarterly, monthly and daily products. Since the introduction of the IRF services so far 18 shippers have registered as IRF-shippers. IRF-shippers are able to participate in the auction process in order to obtain interruptible reverse flow capacity.

Reverse flow is interruptible as physical flows from GB to the Netherlands are not possible, and so we can only honour the nominations for reverse flow to the extent that there is a greater, or equal, nomination for forward flow. If forward flow nominations are less than the reverse flow nominations, then reverse flows would be interrupted. BBLC flows gas as directed by the aggregate net nominations of our customers for forward and reverse flow.

BBLC supports the economically efficient flow through the BBL pipeline in a number of ways, including:

- Offering firm forward flow capacity in a transparent and market oriented manner for a range of durations;
- Offering interruptible forward flow capacity in a transparent, objective and non-discriminatory manner if firm forward flow capacity is sold out;
- Facilitating transfer and / or assignment of forward flow capacity through the bulletin board;
- Frequent auctions offering IRF products for a range of durations;
- All IRF capacity is offered for sale via auctions with zero reserve prices;
- Anti-hoarding measures to reallocate forward flow capacity from shippers which hold but do not use their capacity; and
- Shippers using IRF face no transportation charges levied by BBLC (no "T2" charges). Any savings in compressor fuel usage are passed on to those shippers nominating forward flow so BBLC does not benefit from offsetting nominations.

2. Assessment of the price responsiveness of gas flows on the interconnectors and of possible barriers to trade

In order to help us to answer some of the questions posed by the regulators, we have undertaken an independent analysis of BBL flows and price spreads.

We have approached our analysis to determine the efficiency of interconnector flows in a similar manner to the regulators. We have calculated the price spreads[1] assuming the full marginal costs that will be incurred by shippers to move gas between markets including:

- offer price in the market where gas is bought;
- bid price in the market where gas is sold;
- brokerage costs/exchange fees on both trades;
- TTF variable charge applied to trades at TTF by GTS;
- National Grid Gas entry and exit commodity charges; and
- BBL variable energy (T2) charges levied on forward flows.

We have assumed that parties will not incur marginal exit and entry capacity costs as this is either a sunk cost, or is available for zero reserve price.

We have plotted the physical flows as a percentage of the capacity sold. Since there is firm forward flow capacity available in the market, analysing the flows compared to the capacity sold provides a better indication of the usage of the capacity by shippers than comparing the flows to the full pipeline capacity.

Taking into account the full cost of moving gas across borders results in a different picture from the initial assessment drawn by the regulators. Including the marginal cost of transporting gas has an impact on the periods which the regulators highlighted as having low utilisation and the days on which there are flows against price differentials (FAPDs).

We sought further information from the regulators regarding the particular examples they were interested to understand; both those periods when they viewed utilisation to be low, and periods when in their opinion there were FAPDs. These periods are commented on in the analysis below and are shown as 'days of interest'.[2]

In the analysis that follows, we illustrate the days when there was an opportunity to flow gas profitably from one market to the other using the revenues and costs detailed in the bullet points above, ensuring that the spread is large enough to cover the full marginal costs incurred. The days when physical flows from the Netherlands to GB would be profitable are illustrated by the square red markers. The days when flows from GB to the Netherlands were profitable, using interruptible reverse flow (if available) are illustrated by the round

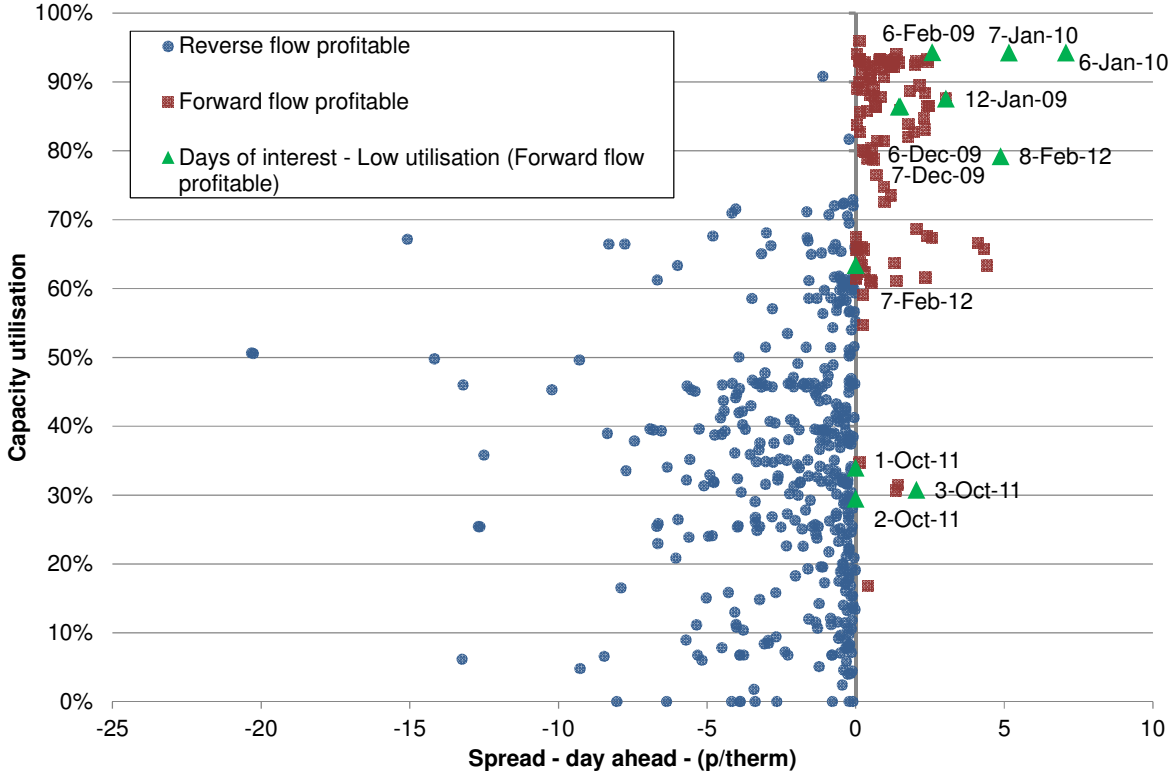
[1] Using data from the ICIS Heren European Spot Gas Market reports

[2] We have conducted our analysis on the basis of the day on which gas flowed and applied the appropriate day ahead or weekend contract to each gas flow day. For example Monday 1 October 2012 would show the gas flow which occurred on gas day 1 October 2012, and the price as published for day ahead in the ICIS Heren publication from Friday 28 September 2012.

blue markers. The charts also depict certain days of interest that were highlighted in discussion with the regulators as triangles (green for low utilisation, pink for FAPDs).

Low utilisation

Figure 1 – Physical gas flows through BBL



Source: BBLC

From Figure 1 it can be seen that there are high levels of utilisation on the days when there were profitable opportunities to deliver gas from the Netherlands to GB. On days when we calculate a profitable opportunity to bring gas to the NBP, utilisation is on average 79% of sold capacities, which indicates that shippers are responding to high price signals in GB.

We do not find it surprising that flows are not exactly 100% of sold capacity on days when there NBP prices exceed TTF prices by more than the full marginal costs, since this would require all holders of forward capacity to nominate their full capacity for every hour of the gas day, and require that all holders of IRF capacity nominate exactly zero for every hour of the day. BBLC has a diverse range of customers; each of which is free to use their BBL capacity to support their commercial aims and their portfolio position in both the UK and Netherlands. As a result, 100% use of capacity is seldom experienced.

Three days highlighted by the regulators as days of low utilisation would be unprofitable if shippers are incurring the full cost of transporting gas between the hubs and so this explains the lower utilisation on these days (1 and 2 October 2011, and 7 Feb 2012).

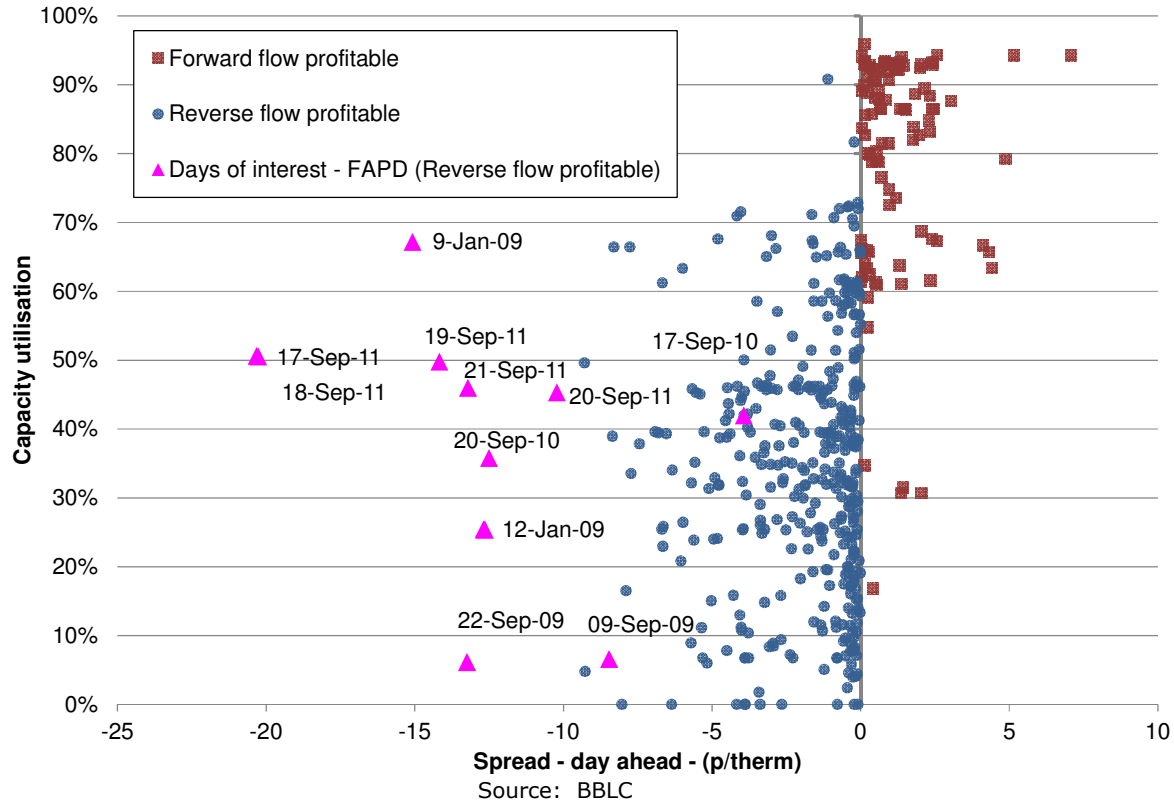
Of the other days highlighted as being of particular interest by the regulators, Figure 1 illustrates that most have utilisation of more than 80%. In our view, this is a very strong indication that flows are responding to price signals. There are two days of interest that have utilisation of less than 80%; 8 February 2012 when utilisation was 79% and 3 October 2011 when utilisation was 31%. Both were periods of high price volatility which would mean that scheduling flows between markets would have been difficult:

- Early February 2012 was a period when there was cold weather across Europe and there were widespread concerns that Russian flows were not sufficient to fulfil contractual obligations. There were security of supply concerns in Eastern Europe, whilst the GB market appeared well supplied; indeed IUK exported gas from GB to Belgium through this period. As a consequence of the situation in continental Europe, prices were very volatile and it might not have been obvious to all shippers that the day-ahead closing price would indicate a profitable opportunity to move gas from the Netherlands to GB.
- 3 October 2011 was a period of exceptionally mild weather, and the TTF price dropped by 9ppt compared to the previous day. Consequently, the spread changed from unprofitable to profitable for a short period of time. The spread the previous day did not send the same signal when the marginal costs of moving gas are taken into account.

Flows against price differential

Figure 2 below shows the analysis from Figure 1, but with the days of interest as indicated by the regulators for flows against price differentials highlighted.

Figure 2– Physical gas flows through BBL



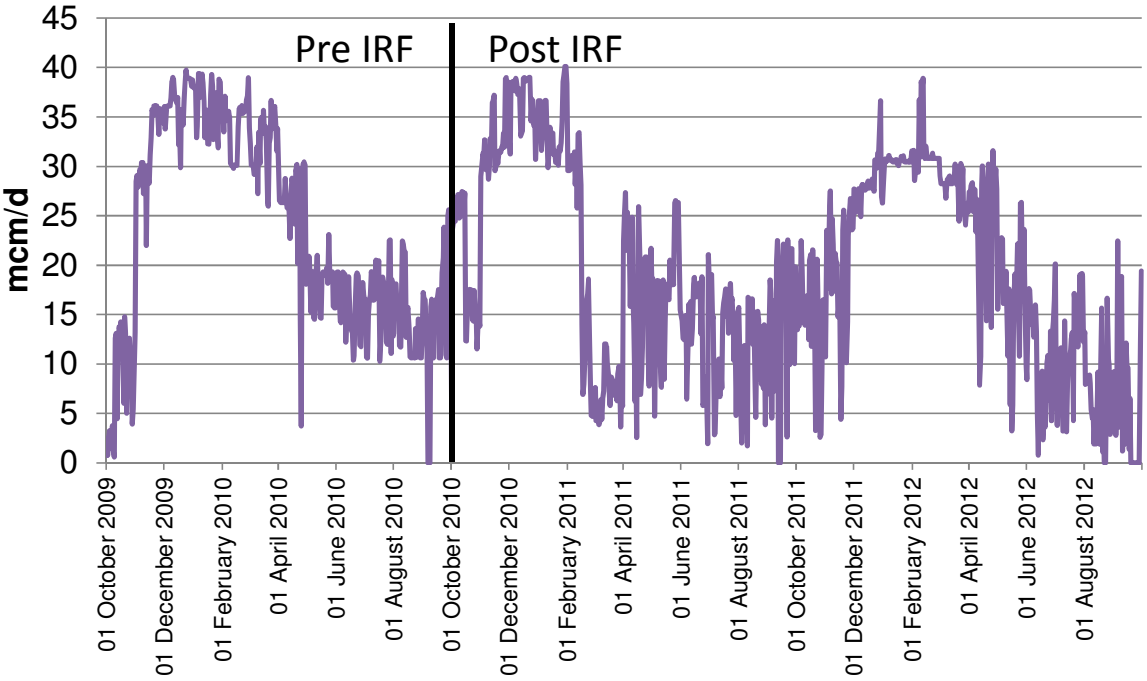
Source: BBLC

The introduction of Interruptible Reverse Flow (IRF) in October 2010 has made the BBL flows more responsive to short-term price signals. Most of the days of interest as indicated by the regulators for FAPDs fell in the period before IRF services were introduced. The days of interest as indicated by the regulators for FAPDs after the introduction of IRF services are 17 until 21 September 2011. These days coincided with the annual maintenance period of IUK in 2011. During this period, all the BBL shippers with IRF capacity made use of this capacity on all of the indicated days.

In general, there are occasions when gas appears to flow against the price differential (as shown in the Figure 1 and Figure 2) but these are far more limited in number than the original analysis presented by the regulators. It is notable that many of the days with the largest spreads are days when there is IUK maintenance and so particularly low prices in GB.

Figure 3 illustrates that the flows during 2011 and 2012 have been more volatile than the previous period which followed a more stable, seasonal profile.

Figure 3 – BBL flows pre and post IRF



Source: BBLC

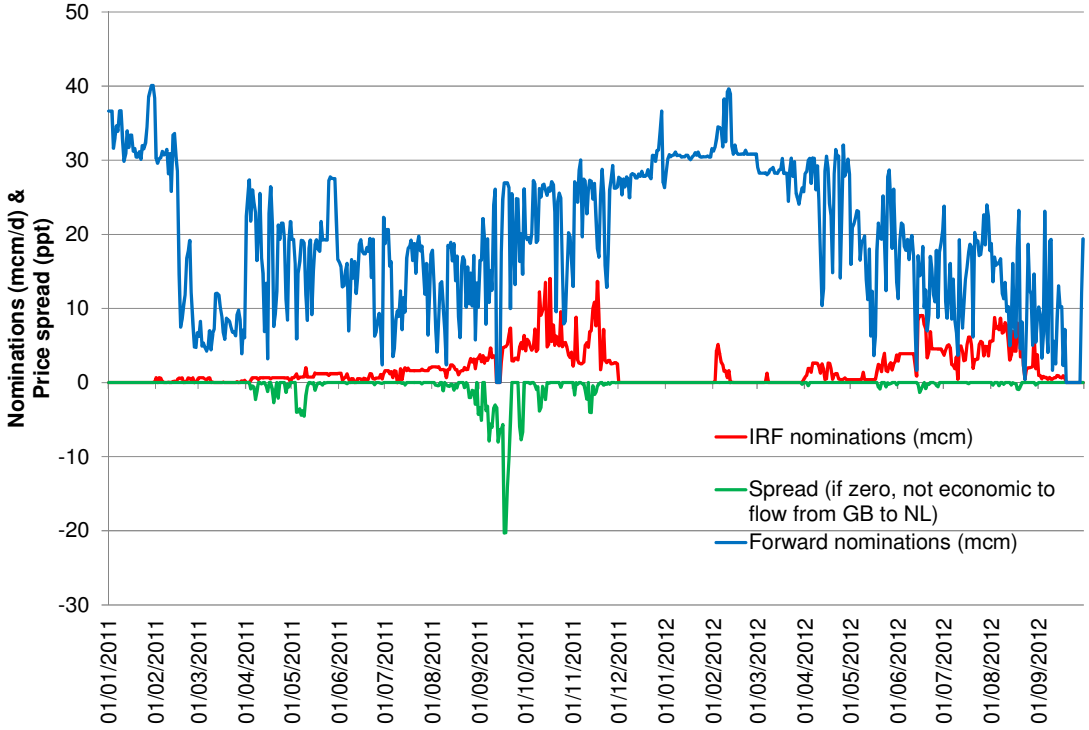
Figure 3 illustrates that the flows became more volatile a little while after IRF was first introduced, suggesting that the shippers have become more familiar with the product, the processes and the risks involved with using the capacity.

There have been 18 different shippers registered as IRF-shipper in the two years that it has been operational. IRF-shippers are able to participate in auctions and respond to price signals to flow gas from GB to the Netherlands. Sales of IRF have averaged 83% of available capacity during gas year 2011 which illustrates that the arrangements put in place by BBLC have released the capacity in an effective way to the shipping community.

Usage of IRF is limited by the forward flow nominations. There have been occasions (for example 22 and 23 August 2012) when forward flow nominations were entirely matched by reverse flow nominations and thus resulted in zero physical flows. However, these are examples based on a daily total. Since the introduction of IRF services there have been approximately 50 occasions when some IRF has been interrupted as forward flow nominations have not exceeded IRF nominations on an hourly basis, again illustrating that shippers have often used IRF to the maximum degree possible.

Figure 4 illustrates that there is a strong relationship between the IRF nominations and the days on which we calculate profitable opportunities to flow gas from GB to the Netherlands, indicating that shippers are generally responding to the market signals.

Figure 4 – Forward and reverse nominations compared to TTF minus NBP price spread (including marginal costs)



Source: BBLC analysis, ICIS Heren

Besides the IUK maintenance there are further reasons which might prevent shippers from responding fully in the way that short-term price signals might suggest.

Some shippers might schedule their flows based upon their commitments under long-term gas contracts or for other reasons associated with the overall management of their portfolios. During the public workshop on 21 November 2012 in London about the call for evidence on the use of gas interconnectors on GB's borders and on possible barriers to trade it became clear that other reasons could include short haul tariffs, different balancing regimes in the UK and the Netherlands and the Dutch (reverse) quality conversion mechanism.

Due to the physical configuration of the pipeline, BBLC can only offer interruptible reverse flow and not a firm service. Consequently, shippers are likely to take a risk-adjusted view of whether the spread between the two hubs offers a profitable opportunity, given the risk that the IRF may be interrupted.

The risk-adjustment that the shippers make is likely to include the potential for being out of balance in two markets which have different arrangements; a daily imbalance system in GB and one with within-day obligations in the Netherlands.

Many of the days of interest highlighted by the regulators covered weekend periods. In order to amend nominations for these periods, a shipper would need to have access to a 24

hour operations service. This may not be the case for all shippers. Consequently, shippers may use a higher degree of caution when scheduling IRF flows over a weekend since they might incur imbalance penalties should the IRF be interrupted.

Conclusion

We have undertaken an independent analysis of the flows through BBL which includes the marginal cost of transporting gas both to and from GB.

We consider that utilisation of the pipeline is generally responding well to strong price signals which indicate that gas should be transported to GB. This position was supported by the presentation given by the European Commission at the public meeting in London on 21 November 2012.

There are a small number of examples when utilisation is lower than is generally the case, but it is arguable that the price signals were not strong due to price volatility at the time.

The release of interruptible reverse flow capacity allows BBL shippers to respond to short-term market signals when there are opportunities to move gas from GB to the Netherlands. The IRF capacity is auctioned with a zero reserve price and has proved popular. Moreover, there is a strong relationship between the IRF nominations and the days on which we calculate profitable opportunities to flow gas from GB to the Netherlands, indicating that shippers are generally responding to the market signals.

BBLC believes that all arrangements relating to capacity availability on the BBL interconnector are transparent, objective and non-discriminatory. BBLC believes that the current arrangements are efficient, offer shippers the ability to respond to short-term price signals and that there are no barriers to trade between the Netherlands and GB.

3. Response to the questions asked by the regulators

Question 1: *What are your views on the economic efficiency of cross-border gas flows between GB, Belgium and the Netherlands? How important do you consider this review into cross-border flows to be?*

BBLC's business is built on enabling shippers to move gas between the Netherlands and GB. BBLC offers the opportunity to shippers to move gas physically from the Netherlands to GB, and has put in place arrangements which allow commercial movement of gas from GB to the Netherlands through Interruptible Reverse Flow.

BBLC offers a range of products and services. We are in regular contact with existing and potential customers to ensure capacity can be booked in a manner that suits a range of business models; from those looking for long-term certainty to those responding to short-term market signals.

We believe that the products we sell to the market on transparent and non-discriminatory basis are fit for purpose.

Question 2*: What is your experience with cross-border gas trading between GB, the Netherlands and Belgium? What, if any, are the key barriers to economically efficient gas trades happening across our borders? Please provide any evidence or analysis that would contribute to our understanding of the observed behaviour of cross-border gas flows.*

BBLC is a provider of cross-border capacity and so has relevant experience with designing and marketing products to allow cross-border trade. We flow gas as directed by the aggregate nominations of our customers. We do not trade gas on our own account.

We are in regular discussion with existing and potential shippers, and none have expressed dissatisfaction with the way that BBL offers capacity. We therefore believe that the arrangements put in place by BBLC are no barrier to economically efficient gas trading.

We have outlined in the body of our response the analysis which explains the observed behaviour of cross-border gas flows.

Question 3: *How could current market arrangements be improved so that they better promote the objectives of promoting a competitive internal market, eliminating restrictions on cross-border trade in gas and enhancing the integration of national markets as well as security of supply? In your response, please specifically refer to a) IUK, b) BBL, c) the adjacent market arrangements and d) whether more common arrangements are needed where relevant and possible.*

We are of the opinion that the existing arrangements are working well and allow shippers to respond to price signals. This view is supported by the analysis presented in this letter and the presentation of the European Commission at the public meeting to discuss the issue.

Question 4: *Should we try to proceed with minimum necessary changes or should the regulators be looking more holistically at a wider review of arrangements that may present barriers? Should we be considering piloting some deeper regional integration or joining initiatives that are already going on in Europe?*

The analysis and supporting arguments within this response illustrate that the arrangements put in place by BBLC support the efficient flow of gas between the Netherlands and GB. As a consequence we believe there would be little benefit in undertaking a wider review of current arrangements since the evidence so far available suggests that inefficiencies or barriers to trade are negligible. Consequently from BBLC's perspective, no changes to the current arrangements are necessary. It would, however, be appropriate to keep these matters under review.

Question 5: *What process may help us to achieve the best outcome? What role should regulators, market parties and TSOs have in this process? How would it interact with pan-European policy initiatives?*

The analysis and supporting arguments within this response suggest that the arrangements currently in place support the efficient flow of gas between the Netherlands and GB; a position we believe was supported at the public meeting on this issue in London on 21 November. We believe the regulators should make recommendations for changes to the current arrangements only if a cost/benefit analysis indicates that any proposed changes would be worthwhile.

Annex A –Current regulatory position of BBLC

Background – BBL Company

BBL Company (BBLC) was established on 9 July 2004 to design, construct and operate an interconnector for the transportation of gas from Balgzand, in the Netherlands, to Bacton, in the UK. The BBL interconnector provides services to flow gas physically from the Netherlands to the UK and non-physical interruptible reverse flow services from the UK to the Netherlands. The initial capacity for gas flow from the Netherlands to the UK was 1.75 million cubic metres per hour. On 8 April 2005, Ofgem granted BBLC a gas interconnector licence under section 7ZA of the Gas Act 1986 and issued an exemption order with this licence (see below).

After the signing of the three initial contracts commercial transportation of gas to the UK, via the BBL interconnector, started on 1 December 2006. After the installation of an additional fourth compressor, the total forward capacity of BBLC as of 15th April 2011 was increased to 2.11 million cubic metres per hour. From 1st October 2010 BBLC introduced non-physical interruptible reverse flow (IRF) services. These IRF services make it possible for shippers to book IRF capacity from the UK to the Netherlands.

Exemptions

Ofgem granted the BBL interconnector an initial exemption on 8 April 2005.[3] Subsequently the European Commission requested the Authority to amend the initial exemption and as a result the exemption was amended on 9 August 2005 [4] to give the BBL interconnector an exemption from SLCs 10 and 11 pursuant to SLC 12 until:
2 December 2016 with respect to approximately 1.15 mcm/hour of capacity for the physical forward flow of gas from the Netherlands to the UK;
2 December 2022 with respect to approximately 0.6 mcm/hour of capacity for the physical forward flow of gas from the Netherlands to the UK.

This exempted BBLC from publishing an approved charging methodology and allowing TPA to its interconnector, subject to the capacity and time limits given.

In addition, in order to prevent potential problems in running parallel regulated and exempted regimes on the same pipeline, it was decided that after the expiration of the first initial contract (i.e. 2 December 2016) the capacity yielded by that expiration would be regulated until 2 December 2022 as follows: BBLC has to develop a market oriented, non-discriminatory and transparent mechanism (approved by the Dutch and UK authorities) for the allocation of the available capacity, in which BBLC, in setting it's tariffs, is entitled to take into account the tariffs and conditions that are applied to the initial contracts.[5]

[3] See http://epr.ofgem.gov.uk/document_fetch.php?documentid=11562
[4] See http://epr.ofgem.gov.uk/document_fetch.php?documentid=11561
[5] As decided in the amended exemption decision of MEA, published 2 September 2005 in 'de Staatscourant'.

Uniform regulatory regime

After discussions with all relevant authorities (EC, Ofgem, DECC, Dutch MEA and NMa) in 2008, it was decided that the regulatory regime which would be effective after the expiration of the first initial contract, should similarly be applicable to the extra capacity that became available with the additional fourth compressor expansion project. This means that the same rules apply for the capacity that becomes available after expiration of the first initial contract. Therefore, BBLC developed a market oriented, non-discriminatory and transparent mechanism for the allocation of such capacity, in which the tariffs and conditions that apply to the three initial contracts were taken into account. This mechanism was approved by the Dutch, the UK and the European authorities and is published on the BBL website.[6]

It was stated in the decision letter of MEA of 19 March 2008 that a different regulatory framework for the capacity related to the installation of the fourth compressor, would bring large risks for the economic viability of the BBL project. This would contradict the aim of the original exemption. In addition, the non-discriminatory application of one regulatory framework for the entire technical capacity of the BBL interconnector ensures that parties can compete on a similar basis for the transport capacity between the Netherlands and the UK.

The European Commission (EC) confirmed the decision of MEA by expressing the view that applying the same regulatory regime to the additional capacity as the regime that will apply between 2016 and 2022 was also in line with European internal energy market legislation. It is assumed by the EC services that the conditions set in the regulatory regime to be applied between 2016 and 2022 respect the requirements in Directive 2003/55/EC and Regulation 1775/2005, regarding tariff setting, third party access services and capacity allocation, as well as regulatory oversight over the tariff methodology and the terms and conditions for access to the capacity. Also assumed by the EC services is that BBLC will also respect the transparency and the trading of capacity rights requirements, and that the regulator ensures that the Regulation (1775/2005) is correctly applied.

BBLC has allocated its forward flow capacity through two open seasons, which were regarded as fully transparent, objective and non-discriminatory processes. It should be noted that not all of the additional firm forward flow capacity has been sold and this unsold capacity is available to any interested party. The approved terms and conditions related to this available capacity are in the public domain and are published on our website.

In summary, the current situation is that BBL interconnector has been granted an exemption from the third party access rules according to Article 22 of Directive 2003/55/EC. Part of the initial capacity is exempted to 2016, while the remaining initial capacity is exempted to 2022. The regulatory regime applicable to the other part of the initial capacity, in the period 2016-2022, is also defined in the exemption decision. BBLC is, for this capacity, allowed to take into account the tariffs as defined in the exempted capacity. The same regulatory regime is also applicable to the additional capacity following the installation of the fourth compressor. This regulatory regime, of which the terms and conditions are in line with the

[6] See http://www.bblcompany.com/commerce/agreements-for-forward-flow

terms and conditions applied to the exempted capacity, is already in place and approved by all authorities involved. Therefore, it can be concluded that this approved regulatory regime, including the tariff setting, which applies to both exempted and non-exempted capacity until 2 December 2022 is meeting all relevant requirements as set out in relevant European legislation.

IRF Services

It was decided in the amended exemption decision that BBLC should offer IRF services on a market oriented, non-discriminatory and transparent basis, and that charging methodology should be approved NRAs.[7]In order to meet this requirement of the exemption with regard to the IRF services, the tariff methodology was agreed by the Dutch and UK regulatory authorities in May 2010. Following discussions with the appropriate regulatory authorities and as a result of the responses received from market parties to the informal market consultation held at the beginning of 2010 BBLC decided to offer these services by auction.

IRF capacity is allocated through a pay as bid auction process with a zero reserve price and BBLC offers daily, monthly and quarterly IRF capacity. BBLC maintains continuous contact with its shippers in order to enable the services to be utilised in the most efficient way. As a result of this consultation process BBLC has introduced one or two minor changes within the charging methodology, e.g. the introduction of an additional decimal in the bidding screens. More details about the IRF services can be found on the website of BBLC.[8]

Conclusion

The BBL interconnector has been granted an exemption from SLCs 10 and 11 pursuant to SLC12 and all authorities involved have agreed upon the application of one regulatory regime for the total forward flow capacity until the expiry date of the longest running exemption (2 December 2022). The relevant mechanism develop by BBLC is approved by the Dutch and UK authorities as a market oriented, non-discriminatory and transparent mechanism for the allocation of the available capacity. Additionally, IRF services of BBLC are also marketed in a totally transparent, market oriented and non-discriminatory manner.

BBLC believes that all arrangements relating to capacity availability on the BBL interconnector are transparent, objective and non-discriminatory. Moreover, all relevant information can be found on our website. In addition, it should be noted that currently there are no issues surrounding the availability of capacity since BBLC still has forward flow capacity available and would be happy to allocate such capacity to any interested party. BBLC believes that the current arrangements are efficient and that there are no barriers to cross-border trade.

[7] As decided in the amended exemption decision of MEA, published 2 September 2005 in 'de Staatscourant'.

[8] See http://www.bblcompany.com/commerce/interruptible-reverse-flow