BG GROUP

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Dear Pamela

Call for evidence on the use of gas interconnectors on GB's borders and on possible barriers to trade

Thank you for the opportunity to respond to the call for evidence on gas interconnectors. BG International Limited (BG) has been a primary capacity holder on the Interconnector (IUK) since its inception in 1998 and became a reverse flow shipper on the BBL in February 2012.

NBP, TTF and Zeebrugge are the most efficient and liquid gas markets in Europe. BG believes that the increasing price correlation between the three hubs is evidence of the efficiency of the interconnectors. Without the utilisation of IUK and BBL capacity the UK gas market would demonstrate much greater price volatility and security of supply problems.

BG is disappointed that the initial analysis conducted by the regulators does not properly reflect market prices or costs of flowing gas and was not reconciled with the interconnector operators prior to the publication of the open letter of 1st October. BG endorses the analysis and conclusions of the Interconnector (UK) Limited, presented at the public workshop on 21st November, which demonstrates the economic efficiency of cross-border flows between the UK and Belgium.

BG considers it misleading for the regulators to include both the IUK and BBL interconnectors in a single study given their fundamental differences:

- IUK was financed and built to export gas production from the UK whereas BBL was financed and built to export Dutch gas production to the UK;
- IUK is now an arbitrage interconnector, but BBL remains an export pipeline for Dutch gas production and is arguably more akin to Langeled than to IUK;
- IUK is physically bi-directional, BBL is not;
- IUK has more capacity holders and less concentration of capacity than BBL.

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BG recommends that Ofgem, CREG and NMA take full account of what the interconnectors and their shippers have to say in response to the call for evidence. Furthermore BG recommends that the regulators avoid interconnector specific reforms and focus on ensuring that National Grid, Fluxys and Gasunie Transport Services implement the various elements of the Third Energy Directive. This would allow for co-ordinated and consistent solutions to be implemented in each market that do not directly or indirectly discriminate against interconnectors. For example, reforming GB commodity charges and short-haul tariffs just to encourage greater interconnector utilisation may have damaging knock-on effects such as higher costs for end-users. It may also encourage greater use of non-National Transmission System (NTS) pipelines, such as SILK, that short haul tariffs were originally designed to discourage.

What should be of much greater concern to the regulators than the occasional flow against price differential (FAPD) is ensuring that interconnector capacity is attractive to potential shippers in the second half of the decade and beyond. According to BBL's website, the majority of BBL capacity becomes available in 2016 and all of it by 2022. All IUK capacity will be available in 2018 when the original 20 year capacity contracts expire. Given increasing UK import dependence, BG encourages the regulators to start addressing how they plan to incentivise the market to book BBL and IUK capacity after 2016 and 2018 respectively.

In summary, BG does not believe that there are fundamental problems concerning the use of GB interconnectors, or a case for the regulators to pursue interconnector specific reforms. BG recommends the regulators avoid discriminating against interconnectors when implementing the Third Directive. In addition, the regulators should ensure interconnector capacities are booked after 2016 and 2018.

In response to the specific questions in the call for evidence :

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?

As stated above, BG regards the economic efficiency of cross border flows between the GB and Belgium to be high. BG is not a forward flow, physical BBL shipper, so is not in such a strong position to comment on BBL flows. However, BG played a part in the growth of BBL reverse flow activity in 2012 (virtual UK exports). This arbitrage demonstrates a rational market response to the export of Dutch gas production to the UK at times when the NBP price was lower than TTF less the costs of accessing capacity and flowing gas.

BG does not consider this review into cross-border flows to be important at this time. The wholesale gas markets in the three countries are efficient and liquid (and evidently the most efficient and liquid in Europe).

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?

BG has been a shipper on IUK since 1998 and BBL since 2012 (reverse flow only). Of the ten potential causes of FAPDs referred to in the open letter[1], BG wishes to highlight the following issues:

Barriers to obtaining short-term capacity
With regards to access to IUK capacity, BG has been an active seller and marketer of secondary IUK capacity. In response to BG's question at the public workshop the regulators acknowledged that they do not receive complaints from the market about access to interconnectors.

Charging arrangements
As pointed out by the IUK in their presentation at the public workshop, the current GB Commodity Charges for entering the NTS incentivise the use of cheaper short haul arrangements. This use of Bacton rather than NBP gas makes UK exports economic when the Zeebrugge price is marginally less than the NBP price. However the regulators should recognise that those who hold IUK capacity and those that import gas at Bacton from the UKCS or BBL are generally not the same entities. As such there is an active market for Bacton gas to match buyers with sellers, who share the avoided GB Commodity Charges to enter or exit the NTS between them. This Bacton market does lead to gas that was imported via the BBL regularly being exported back to Continental Europe via IUK, again highlighting the efficient use of IUK.

Whilst the current GB Commodity Charges help increase IUK exports they also acts as a disincentive to import gas to the UK during the winter if the NBP less Zeebrugge differential is less than 2p/therm.

The regulators should also be aware of the variability of GB Commodity Charges and GB Exit Capacity Charges. For example Bacton exit capacity for 2012/13 is 0.0011 p/pdkWh/day and National Grid's indications for the next three gas years are 0.0067, then 0.0001 and then 0.0084. This volatility and unpredictability is unhelpful to the market. BG would encourage Ofgem to introduce more stable cost reflective pricing as is evident in the new Fluxys tariffs for 2012-15 endorsed by CREG.

The current variability in costs creates a disincentive to own long-term capacity. To encourage long-term capacity bookings and associated contractual obligations, shippers need to have certainty that related charges will remain stable. Stability would help incentivise long-term capacity booking (and thus security of supply) and stimulate arbitrage opportunities and liquidity beyond the current gas year.

[1] Lack of stable and robust price signals; Long-term contracts; Balancing rules; Security of supply rules; Barriers to obtaining short-term capacity; Nomination rules; Technical issues; Charging arrangements; Other costs faced by network users and Lack of co-ordination between market arrangements.

The Framework Guideline on Transmission Tariff Structures may lead to a review of GB Commodity Charges, short-haul tariffs and entry and exit charges. However, the regulators should recognise that any changes may have unintended consequences for the utilisation of the interconnectors and increased costs for end-users.

With regard to BBL reverse flow, Annex 2 of the open letter implies that BBL reverse flow capacity is “typically near zero”. However, this was not the case during summer 2012 for buyers of the least interruptible capacity.

Gasunie Transport Services’ entry capacity at Julianadorp (the Dutch end of the BBL) is very expensive given it is interruptible back-haul (counter flow) capacity which we assume has negative or very limited operational costs. In summer 2012, monthly capacity cost 0.6 p/therm and daily capacity cost 1.2 p/therm. Given this is back-haul capacity these summer tariffs are unacceptably high, particularly as monthly and daily firm exit capacity at Julianadorp (for exports to UK via BBL) were only 0.3 p/therm and 0.6 p/therm respectively. In France GRTgaz’s back-haul capacity is only 20% of its firm equivalent, yet in the Netherlands it is 200%. BG would welcome a changed approach to the Dutch capacity charging mechanism that does not penalise short term bookings and impede short term trading and flow efficiency, especially at back-haul points.

Other costs faced by network users
The open letter fails to acknowledge that interconnector primary shippers face very substantial costs for their primary capacity in these pipelines. The high cost of BG’s IUK capacity provides every incentive for the capacity to be fully optimised.

Question3: 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 security of supply?

The elimination of all FAPDs would require there to be no variable or fixed costs for interconnector capacity, equal liquidity in TTF and Zeebrugge to the NBP, identical market rules in each of the three markets and no long term gas contracts or inter-company portfolio optimisation between the markets. BG assumes that the regulators’ cannot address all of the above.

BG recommends that the regulators avoid tinkering with specific issues associated with the interconnectors in advance of implementation of the Third Directive. However, BG would strongly encourage the regulators to consider the implementation consequences of the Third Directive on the interconnectors. By way of example the sanction by CREG of a second Belgian trading point by Fluxys, ‘ZTP’, could have a detrimental impact on Zeebrugge liquidity and thus IUK flow efficiency.

As the regulators seek to implement the Third Directive they must ensure market liquidity in the NBP, TTF and Zeebrugge is encouraged and not undermined. The growth of liquidity must be the primary objective of the Third Directive.

With regards to the specific issue of security of supply, the central issue for regulators will be ensuring that interconnector capacity is attractive for shippers to book from 2016 in the BBL and from 2018 in the IUK when the vast majority of existing primary capacity contracts expire. The second half of the decade is likely to see increased import dependence in the UK and the interconnector capacities will be vital in fulfilling demand. However, the price differentials between NBP and Zeebrugge over the last few years would not incentivise shippers to book new capacity at the IUK's current tariff. The regulators should also recognise that the capacity needs to be attractive to a potentially different group of shippers than many of the existing IUK capacity holders whose motivation to sanction the construction of the pipeline was to export excess UKCS gas production to the continent – a problem that no longer exists.

Ofgem also needs to ensure that any substitution of entry capacity by National Grid for new LNG capacity or offshore storage projects does not impact entry capacity for IUK, BBL and any possible expansion of BBL.

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?

As stated above BG recommends that regulators avoid interconnector specific initiatives and focus on the implementation of the Third Directive.

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?

BG recommends that the regulators focus on implementation of the Third Directive and start addressing the post 2016 and 2018 regulatory framework for interconnectors to incentivise new capacity bookings.

Please do not hesitate to contact me should you wish to discuss any of the points raised in this response in more detail.

Yours sincerely,

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