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*Promoting choice and value for
all gas and electricity customers*

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Dear Emma Jane,

Re: Approval of Bilateral Agreements under the Gas Interconnector Licence

Background

Premier Transmission Limited (PTL) holds a gas interconnector licence authorising it to participate in the operation of the gas interconnector between Twynholm, in South West Scotland, and Northern Ireland.

Standard condition 3 of the gas interconnector licence requires that the Authority¹ approves such bilateral agreements as may reasonably be required to be entered into by PTL and any relevant gas transporter, as well as any amendment to an approved bilateral agreement.

Standard licence condition 3 of the gas interconnector licence also requires the licensee to take all steps within its power to make such changes to those agreements as may be necessary from time to time to comply with the Third Package Gas Regulation² and to give full and timely effect to any relevant legally binding decisions of the Agency or the European Commission.

One such bilateral agreement is the Transportation Agreement (TA). The TA is an agreement between PTL and Bord Gais Eireann (BGE) (UK) Ltd, which holds an interconnector licence authorising it to participate in the operation of the gas interconnector between Moffat, in South West Scotland, and the Republic of Ireland.

Article 16(1) of the Third Package Gas Regulation requires a transmission system operator (TSO) to make maximum capacity on its system available to market participants³. The obligation to offer maximum capacity, combined with the obligation to provide firm and interruptible third party access services under Article 14(1)(b)⁴ of the Third Package Gas Regulation, means that a TSO has to offer capacity in both directions at a connection with

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) no 1775/2005, see www.eurlex.europa.eu.

³ Article 5(1) of the Second Package Gas Regulation (Regulation (EC) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks) also required a Transmission System Operator (TSO) to make maximum capacity in its gas transmission system available to market participants. The Second Package Gas Regulation was repealed by the Third Package Gas Regulation on 3 March 2011 and the Third Package Regulation applies from 3 March 2011.

⁴ Article 4(1) of the Second Package Gas Regulation also required a TSO to provide both firm and interruptible third party access services.

another TSO. Both of these obligations under the Third Package Gas Regulation are relevant requirements with which PTL is required to comply under the Gas Act 1986.

In those cases where it is technically not possible to have physical flows in both directions, it is still possible to offer capacity as a 'counter flow' on an interruptible and virtual basis. This virtual reverse flow service works by netting off virtual reverse flow from commercial forward flows to give the physical flow.

Under current arrangements, gas can flow physically from GB to Northern Ireland, with shippers purchasing GB exit capacity at the Moffat interconnection and Northern Irish entry capacity. However, there is no commercial interruptible reverse flow service offered to transport gas in the reverse direction from Northern Ireland to GB.

The obligation under Articles 14(1) and Article 16(1) of the Third Package Gas Regulation are relevant requirements with which PTL is required to comply under the Gas Act 1986. PTL is not currently fully compliant with the obligation to make maximum capacity on its system available to market participants under Article 16(1) of the Third Package Gas Regulation. Under standard licence condition 3 of its licence, PTL therefore has an obligation to take all steps within its power to make such changes to the TA, as may be necessary from time to time to comply fully with the Third Package Gas Regulation.

Proposed modifications to the TA

On 11 September 2012, PTL and BGE (UK) Ltd submitted a proposal to the Authority to introduce interim arrangements in respect of the TA (the "Arrangements"). These Arrangements, introduced as a subsidiary document and requiring Ofgem approval, facilitate provisions for an interruptible virtual reverse flow service for Northern Irish shippers to Moffat.

The Arrangements proposed specify the conditions under which an interruptible virtual reverse flow service will be offered. For the first usage of virtual reverse flow, it is proposed that:

- The interested shipper will give 20 business days' notice to PTL prior to submitting a daily profile;
- PTL will then give exactly the same 20 business days' notice period to BGE (which can be done in parallel with the shipper notification period to PTL);
- PTL will pay BGE (UK) Ltd an annual administrative charge of £25,000;
- PTL will pay BGE (UK) Ltd £50,000 towards interim arrangement transaction costs.

Thereafter, the interested shipper will pay a £5,000 registration fee (valid for one gas year), and nominate desired day-ahead virtual reverse flow capacity by 10:00 on D-1.

The amount of virtual reverse flow capacity offered to shippers is capped at 1228MWh (around 0.1 MSCMD) in any single gas flow day. This compares with 8.08 MSCMD of permitted forward flow nominations.

However, PTL and BGE (UK) Ltd have failed to reach agreement over the amount of forward flow which PTL owns the right to on BGE (UK) Ltd's pipe between Moffat and Twynholm and so can offer as virtual reverse flow. The Arrangements commit PTL and BGE (UK) Ltd to resolve this difference at the earliest practicable date.

The Arrangements will become effective once certain conditions are met. We describe the two main conditions below. One such condition is for another subsidiary document, called a Locational Operational Procedure (LOP), to be agreed between PTL and BGE (UK) Ltd. The current version of the LOP⁵ maps out the procedures surrounding the submission, acceptance and rejection of daily profiles, specifically day-ahead nominations and

⁵ This has version number 1.9.8 which BGE (UK) Ltd sent to Ofgem on 15 October 2012.

renominations. It also contains information on the agreed nomination (forward and virtual reverse flow) and EODQ limits.

Standard licence condition 3 of the gas interconnector licence requires the Authority to approve such bilateral agreements as may be reasonably required by any relevant gas transporter. Therefore the TA and its subsidiary documents need to be approved by the Authority.

The Arrangements also require approved changes to the exit flow profile methodology by the Commission for Energy Regulation (CER) in the Republic of Ireland. The exit flow profile methodology explains how BGE (UK) Ltd develop 'exit flow profiles', which essentially show how much gas is going to be physically taken from the National Grid system and delivered to the BGE (UK) Ltd system at Moffat. The exit flow profile methodology is now with the CER for approval.

Ofgem View

The Authority's principal objective is to protect the interests of existing and future consumers. The interests of consumers are their interests taken as a whole, including their interests in the security of supply and their interests in the fulfilment by the Authority, when carrying out its functions as designated regulatory authority for GB, of the objectives set out in Article 40 of the Third Package Gas Directive⁶. Those objectives include promoting a competitive internal market in natural gas, developing competitive and properly functioning regional markets and eliminating restrictions on trade in natural gas between Member States, including developing appropriate cross-border transmission capacities to meet demand and enhancing the integration of national markets.

The Arrangements proposed are subject to a number of conditions, which undermine the potential benefits of introducing virtual reverse flow. The purpose of a virtual reverse flow is to maximise the efficiency of cross-border flows and improve the efficiency of gas trade between Northern Ireland and GB. This is achieved by shippers nominating virtual flows between Northern Ireland and GB (i.e. in the opposite direction to the physical flow), which the TSO then nets off against the forward flow (from GB to Northern Ireland).

Firstly, your proposal is that virtual reverse flow will only become operational once the LOP is agreed between PTL and BGE. We are of the view that this is not consistent with your obligations under the Gas Act and the Third Package Gas Regulation to make maximum capacity available. To make the virtual reverse flow arrangements contingent upon a further subsidiary agreement which has not been concluded effectively means that there is no obligation on PTL to provide maximum capacity through virtual reverse flow until this agreement has been signed.

Under standard licence condition 3 of its licence, PTL has an obligation to take all steps within its power to make such changes to the TA as may be necessary from time to time to comply with the Third Package Gas Regulation. PTL therefore has to make such changes to the TA and any subsidiary documents as may be necessary to comply with the Third Package Gas Regulation. Our assessment of the most recent version of the LOP is that it is not a necessary requirement for virtual reverse flow to be offered from Northern Ireland. As such, the TA does not need to be amended so as to contain this LOP subsidiary agreement in order to comply with the Third Package Gas Regulation.

Secondly, Ofgem considers that the amount of virtual reverse flow capacity offered in the Arrangements – 1228 MWh, or around 1% of forward flow capacity in any single gas flow day – is not fully compliant with the requirement of maximising capacity, as required by the

⁶ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC

Third Package Gas Regulation⁷. Virtual reverse flow is designed to allow for forward flows to be netted. Restricting this to 1% will have very limited impact and is unlikely to be worth shippers using. As such, we may consider PTL to be in breach of the relevant requirement under the Gas Act to make maximum capacity available and also in breach of its licence obligation under standard condition 3(2) to take all steps within its power to make such changes to the TA as may be necessary from time to time to comply with the Third Package Gas Regulation (i.e. the requirement to make maximum capacity available) unless additional virtual reverse flow capacity is offered.

We note that any future approval of the TA is without prejudice to the Authority's rights to take formal enforcement action against PTL should the arrangements in which only 1% of capacity is being offered mean that the licensee continues not to comply fully with its obligations under the Third Package Gas Regulation to make maximum capacity on its system available to market participants.

Way Forward

Ofgem expects PTL to do the following:

- Remove the condition on LOP from the TA and resubmit to Ofgem for approval, as soon as practicable
- In mutual agreement with BGE (UK) Ltd, Ofgem, CER and any other relevant regulators, offer a higher figure of virtual reverse flow capacity and propose an amendment to the Arrangements to reflect this to Ofgem for approval. This should be done within three months of the date of this letter.

Ofgem also encourages PTL to agree the LOP with BGE (UK) Ltd and submit it to Ofgem for consideration in due course as this may further refine interactions between PTL and BGE (UK) Ltd (though as noted above, we do not see it as a necessary condition to be able to offer virtual reverse flow or to comply with the Third Package Gas Regulation).

The Authority's decision

Following consideration of the documentation provided and having regard to the Authority's principal objective and statutory duties and for the reasons set out above, the Authority has decided not to approve the changes to the TA with the TA containing the condition that the LOP must be approved, in accordance with the provisions of PTL's gas interconnector licence.

Pamela Taylor
Associate Partner, European Wholesale

Signed on behalf of the Authority and authorised for that purpose

⁷ The requirement to maximise available capacity was also contained in the Second Package Gas Regulation (EC) No 1775/2005