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

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Dear Aidan,

Approval of Bilateral Agreements under the Gas Interconnector Licence

Background

Bord Gais Eireann ("BGE") (UK) Ltd holds a gas interconnector licence authorising it to operate the gas interconnector between Moffat, in South West Scotland, and the Republic of Ireland.

Standard condition 3 of the gas interconnector licence requires that the Authority¹ approves such bilateral agreements that BGE (UK) Ltd may be reasonably required to enter into by any relevant gas transporter, as well as any amendments to an approved bilateral agreement.

One such bilateral agreement is the Transportation Agreement ("TA"). The TA is a bilateral agreement between BGE (UK) Ltd and Premier Transmission Limited ("PTL"), which holds an interconnector licence allowing it to operate the gas interconnector between Twynholm, in Scotland, and Northern Ireland. In order to carry out this function, PTL must use the interconnector pipeline between Moffat and Twynholm, which is operated by BGE (UK) Ltd.

Article 16(1) of the Third Package Gas Regulation² 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 another TSO. Both of these obligations under the Third Package Gas Regulation are relevant requirements with which BGE (UK) Ltd 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 on an interconnector, it is still possible to offer capacity as a 'counter flow' on an

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this letter. 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

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 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.

interruptible and virtual basis. This virtual reverse flow (VRF) service works by netting off VRF 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.

BGE (UK) Ltd have therefore investigated ways to better achieve compliance with the obligation to make maximum capacity on its system available to market participants under Article 16(1) of the Third Package Gas Regulation. We note that under standard licence condition 3 of its licence, BGE (UK) Ltd 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 amendments to the TA

On 11 September 2012, BGE (UK) Ltd and PTL submitted a proposal to amend the TA to the Authority for approval to better achieve compliance with Article 16(1) of the Third Package Gas Regulation. The amendments were made to introduce interim arrangements relating to interruptible VRF (the "Arrangements"). These Arrangements were to facilitate provisions for an interruptible VRF service for Northern Irish shippers to Moffat.

Ofgem rejected this proposed amendment to the TA on 26 October 2012 as Ofgem had concerns that the amount of VRF proposed in the Arrangements did not maximise the amount of capacity made available for VRF as required by the Third Package Gas Regulation.

Another reason for the rejection was that interruptible VRF would not be offered until another subsidiary document, called a Locational Operational Procedure ("LOP"), was agreed between PTL and BGE (UK) Ltd and approved by the Authority, in accordance with the provisions of BGE (UK) Ltd's gas interconnector licence. Ofgem considered the LOP was not necessary to offer the interruptible VRF service and this conditionality would further delay the implementation of the VRF. The LOP was not necessary in order to implement the interruptible VRF as it contained supplementary details – it mapped out the procedures surrounding the submission, acceptance and rejection of daily profiles⁵, specifically day-ahead nominations and renominations.

On 7 February 2013, BGE (UK) Ltd and PTL submitted a revised set of amendments to the TA setting out the revised Arrangements ("the Revised Arrangements") in line with the comments made in the Authority's letter dated 26 October 2012. The Revised Arrangements specify the conditions under which an interruptible VRF service will be offered. These are summarised below:

- For the first usage of VRF, PTL will give 20 business days' notice period to BGE (UK) Ltd that the VRF service will be used;
- PTL will pay BGE (UK) Ltd an annual administrative charge of £25,000 for each year the VRF service is used;
- PTL will pay BGE (UK) Ltd a one-off fee of £50,000 towards interim arrangement transaction costs; and
- The amount of VRF capacity offered to shippers is increased to 4,100MWh in any single gas flow day.

The Revised Arrangements set out that the VRF service is currently offered by manual and not electronic systems and that if both PTL and BGE (UK) Ltd agree that the demand for

⁵ A daily profile is a document which shows how much gas is required in respect of each gas flow day. This is calculated by subtracting virtual reverse flow quantities from forward flow nominations.

VRF merits that the process to offer VRF should be systemised then this is to be done within one year. Furthermore, if after one year of approval of the Revised Arrangements, BGE (UK) Ltd, as a reasonable and prudent operator, considers that the amount of VRF offered cannot be maintained without electronic systems in place (and if no such systems are in place) it can only reduce the amount of VRF offered to as low as 1,228MWh after it receives written consent from all three national regulatory authorities concerned⁶.

BGE (UK) Ltd and PTL have failed to reach agreement so far over the amount of forward flow capacity which PTL owns the right to offer VRF on BGE (UK) Ltd's pipe between Moffat and Twynholm under the TA. The Revised Arrangements commit BGE (UK) Ltd and PTL to establish a programme of discussion and negotiation within one month of VRF capacity being offered, which will aim to resolve these differences.

The Revised Arrangements note that they become effective once changes to the exit flow profile methodology are approved 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 for each hour in the day. The exit flow profile methodology was approved by the CER on 7 December 2012.

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 Directive⁷. 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.

Ofgem considers that the Revised Arrangements submitted for approval will improve the efficiency of cross-border flows and improve the efficiency of gas trade between Northern Ireland and GB by providing for VRF.

Ofgem notes that the LOP condition has now been removed and the value of the VRF capacity increased from 1,228 MWh to 4,100 MWh. We welcome this amendment, which makes the volume of VRF comparable to that currently being offered between the Republic of Ireland and GB. Furthermore, given that Northern Ireland is dependent on GB for gas and currently has no domestic sources of gas, it is unlikely that there will be a demand for significant volumes of VRF. However, if there are new sources of gas in Northern Ireland in the future, the demand for VRF capacity may increase, therefore, we reserve the right to request the interconnector licensee to increase the volume of VRF available at Moffat.

We note that should BGE (UK) Ltd and PTL jointly wish to revise the amount of VRF offered, in general, they will need to agree to revise the TA and then they will need to obtain Ofgem approval in respect of amendments to the TA to implement such a revision as required by licence condition 3 of the gas interconnector licence. Whereas if BGE (UK) Ltd wish to revise this figure down (to a minimum of 1,228 MWh) for the specific reason that it considers, as a reasonable and prudent operator, that the level of VRF at 4,100 MWh

⁶ These are the Authority in Great Britain, the Commission for Energy Regulation in the Republic of Ireland and the Northern Ireland Authority for Utility Regulation in Northern Ireland

⁷ 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

cannot be maintained without electronic systems in place then it needs to receive written consent from all three national regulatory authorities concerned.

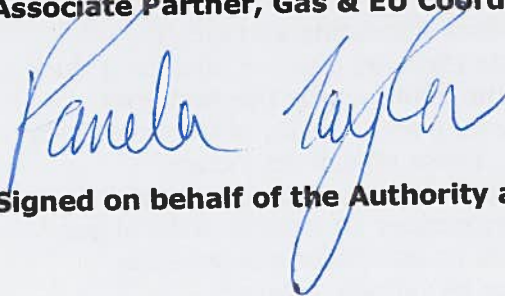
The Authority's decision

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 to approve the changes to the TA, in accordance with the provisions of BGE (UK) Ltd's gas interconnector licence, subject to the following conditions:

BGE (UK) Ltd and PTL will do the following:

- obtain Ofgem's approval of any revision to the amount of interruptible VRF offered under the TA and consequential to making the amendments to the TA as approved by this letter establish a programme to address the differences relating to what rights the TA gives PTL to offer VRF from Northern Ireland; and
- update the Authority on a monthly basis as to the developments taking place to resolve the differences relating to what rights the TA gives PTL to offer VRF from Northern Ireland.

Pamela Taylor
Associate Partner, Gas & EU Coordination



Signed on behalf of the Authority and authorised for that purpose