



To:

Gas transportation licensees, gas interconnector licensees, gas shipper licensees, the Uniform Network Code Modification Panel and all other interested stakeholders

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Dear Colleague,

Next steps for Great Britain's (GB's) implementation of the first European Union (EU) network code for gas on Congestion Management Procedures (CMPs)

The Third Package of European Energy reforms (including the Gas Regulation¹) created a new legal framework to promote cross border trade in response to the European Commission's inquiry into competition in gas and electricity markets, published in January 2007. The inquiry found that there was too little integration between Member States' markets and highlighted that insufficient or unavailable cross-border transmission capacity and different market designs were hampering market integration.

A number of legally binding network codes (which are going to take the form of Guidelines annexed to the Third Package Regulations including the Gas Regulation), designed to promote the creation of liquid markets and the efficient use of interconnectors, are being established in response to the inquiry and in an effort to ensure integration between Member States' gas markets. For GB, the main impact from network codes will be to the way capacity is allocated and energy is nominated at GB cross-border points to introduce the following:

- More efficient use of interconnection capacity, such that market participants are offered unused capacity on a firm basis, as opposed to the current arrangements where the unused capacity is offered to others on an interruptible basis;
- Bundled capacity products that allow for shippers to buy a single GB to neighbouring market and neighbouring market to GB capacity removing the need for separate procurement of GB entry/exit capacity, interconnector capacity and entry/exit capacity in the neighbouring market;

¹ Regulation 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

- Auctions for this capacity in standardised products, which include annual, quarterly, monthly, daily and within-day capacity, which is a change to the current arrangements where capacity on GB interconnectors is sold under long-term contracts;
- A single European platform for cross-border capacity allocation;
- A harmonised approach to charges, including setting reserve prices in auctions for cross-border capacity; the network code has still to be developed but according to the guidelines set by national regulatory authorities (NRAs), the rules are likely to require costs to be recovered through the reserve prices in capacity auctions; this may require removing the transmission system operator (TSO) commodity charge at interconnection points at Bacton and Moffat; and
- A single nomination of gas flows between the neighbouring markets removing the need for separate nomination and matching processes.

These changes will require significant cooperation between National Grid Transmission (NG), interconnectors and neighbouring TSOs. Along with neighbouring NRAs, we are considering how these future network codes can be implemented, including GB's interaction with the capacity platform PRISMA (which is utilised by a number of GB neighbouring TSOs) and the required governance arrangements to implement these new rules. We anticipate setting out more on this in the follow-up to our joint review on the gas flows across the GB gas interconnectors². The network codes will also bring changes to GB's current arrangements, which we have already asked NG to consider. These include:

- A harmonised European gas day with gas flowing from 05:00 to 05:00³ GMT; this will require;
- Identification of cross-border capacity at Bacton for the purposes of bundling, which may affect the current market arrangements.

Ofgem would welcome views from industry participants and stakeholders on how the change to the gas day could impact the GB gas system. Submissions on this subject should be sent to Clement.Perry@ofgem.gov.uk by 29 April.

The rest of this letter sets out our approach to implementing the first of these network codes, which relates to Congestion Management Procedures (the CMP Guidelines); which is annexed to the Gas Regulation and which must be implemented by Member States by 1 October 2013. Ofgem, as the NRA for GB, has the obligation, under Article 24 of the Gas Regulation, to ensure compliance of gas undertakings with the Gas Regulation, including the network codes (which are Guidelines annexed to the Gas Regulation). Meanwhile, the UK Department of Energy and Climate Change (DECC) is responsible for implementation.

Our views on the minimum steps we expect relevant parties to take to comply with the CMP Guidelines are set out below. We expect all gas shippers to co-

² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=123&refer=Europe> - this review does not cover interconnectors at Moffat, but only those at Bacton.

³ <http://www.gasgovernance.co.uk/tx/070213>

operate with NG and the other gas TSOs so as not to unreasonably withhold any agreement necessary to implement the CMP Guidelines into the GB regulatory framework.

CMP Guidelines procedures

The CMP Guidelines aim to maximise the efficiency of cross-border gas transmission networks by making capacity that is booked but underused (so-called contractual congestion) available to third parties.

The CMP Guidelines will apply to all interconnection points between adjacent TSOs, between two or more Member States or between different TSOs within the same Member State. As such, the CMP Guidelines apply to BBL⁴ (GB-Netherlands), IUK (GB-Belgium), IC1 and IC2 (GB-Republic of Ireland) and SNIP (GB-Northern Ireland). The CMP Guidelines also apply to the two parts of NG's network that relate to these interconnection points: Moffat and Bacton. This letter refers to interconnector licensees BBL, IUK and NG. We are in discussions with the Irish NRAs about the application on cross-border interconnectors IC1, IC2 and SNIP. Collectively, BBL, IUK and NG are referred to as GB TSOs in the remainder of this letter.

Four mechanisms, summarised below, must be applied: (i) oversubscription and buy-back; (ii) firm day-ahead use-it-or-lose-it (UIOLI); (iii) surrender of contracted capacity; and, (iv) long-term UIOLI⁵. Collectively, these will require capacity that has been sold but is underused to be made available to third parties, with the purpose of maximising the efficiency in the use of cross-border transmission capacity.

1. Oversubscription and buy-back⁶

GB TSOs must implement a scheme offering shippers (on a firm basis) more capacity than the physical capability of the network. If shippers then tell the relevant GB TSO that they intend to use all of the physical capacity and some of the additional capacity, the GB TSO may need to 'buy-back' some of the capacity to balance the system. The procedure for shippers to offer capacity for the GB TSO to 'buy-back' must be market based. TSOs cannot implement an oversubscription and buy-back scheme without the Authority's⁷ approval⁸.

We will monitor GB TSOs' oversubscription and buy-back schemes⁹ and, where appropriate request GB TSOs to make revisions. We will also monitor the extent to which shippers' contracted capacity has been used or subject to licensees' UIOLI mechanisms¹⁰.

2. Firm day-ahead UIOLI¹¹

⁴ All non-exempt capacity

⁵ Procedures (i), (iii) and (iv) must be implemented by 1 October 2013 (Article 23 of the Gas Regulation refers to the power of the Commission to adopt guidelines). Procedure (ii) applies as of 1 July 2016.

⁶ Point 2.2.2 of Annex I to the Gas Regulation.

⁷ The terms "the Authority", "Ofgem" and "we" are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets.

⁸ Point 2.2.2(1) of Annex I to the Gas Regulation.

⁹ Pursuant to point 2.2.2(8) of Annex I to the Gas Regulation.

¹⁰ Pursuant to point 2.2.5(4) of Annex I to the Gas Regulation.

¹¹ Point 2.2.3 of Annex I to the Gas Regulation.

This is an alternative method of freeing up unused portions of capacity bought by shippers, which would then be made available as firm capacity in the day-ahead allocation. However, this optional measure will only be required in 2016 if the oversubscription and buy-back procedure is not functioning efficiently (in the Authority's opinion, following consultation with other relevant NRAs).

3. Surrender of contracted capacity¹²

GB TSOs must have a system whereby shippers can voluntarily surrender unused capacity to the relevant GB TSO. The GB TSO can then offer that surrendered capacity to the market after all available primary capacity has been allocated.

4. Long-term UIOLI¹³

The CMP Guidelines state that NRAs shall require TSOs to partially or fully remove what the CMP Guidelines refer to as a shipper's 'systematically underutilised contracted capacity'. The criteria for such capacity are set out in point 2.2.5(1) of the CMP Guidelines. This mechanism must be used if capacity hoarding is occurring and a shipper is not offering its unused capacity to the market despite its availability.

Summary of expectations for CMP Guidelines

In order to achieve the CMP Guidelines' stated aims, Ofgem expects any implementation proposals to meet a number of conditions. For example, interconnectors must seek to maximise the volume of oversubscription capacity made available whilst still retaining some flexibility to respond to changes in price signals. Therefore, we expect no restrictions on the volumes of available capacity being offered as oversubscription or any barriers to this capacity being sold to other users.

In the event that a GB TSO sells additional capacity and the expected flows are greater than the physical capability of the network, the TSO may need to buy capacity back from shippers. The Authority expects any proposed buy-back regime to ensure that the value of this capacity is priced appropriately, using market-based mechanisms wherever possible.

Regarding the surrender mechanism, Ofgem notes that NG, IUK and BBL operate bulletin boards which allow shippers to notify the market of unwanted capacity or requests for capacity. These arrangements must provide for shippers surrendering capacity to be compensated accordingly once it has been resold.

The long-term UIOLI mechanism should provide the appropriate level of unused capacity to be taken from shippers and to be resold. Our preference is that GB TSOs determine which market participants' capacity is being systematically underused and when the test for applying long-term UIOLI is met and notify the participant of their intention to apply this mechanism. We will consider whether a process for dispute resolution is required and will consult and co-operate with other NRAs on this.

Implementation work streams

We consider there to be two parallel work streams for implementing the CMP Guidelines in GB. The first will be NRA led, in order to ensure that there are appropriate enforcement powers for Ofgem. The second will be industry led, in order to enable

¹² Point 2.2.4 of Annex I to the Gas Regulation.

¹³ Point 2.2.5 of Annex I to the Gas Regulation.

adjustments to contractual arrangements such that they achieve compliance with the CMP Guidelines:

Regulatory-led work stream

On the regulatory side, we have considered two options for enabling enforcement of the CMP Guidelines by Ofgem as the NRA:

The first, which is our preferred option (following the joint Ofgem/DECC stakeholder meeting on 7 February 2013), is for the Secretary of State for DECC to use powers under section 2(2) of the European Communities Act 1972¹⁴ (section 2(2) powers) to bring the provisions of the CMP Guidelines within the definition of "relevant requirements" under section 28(8) of the Gas Act 1986 (the Gas Act) for gas shippers, gas transporters and on gas interconnectors. Sections 28-30 and Schedule 4B Gas Act set out the Authority's powers of enforcement in relation to "relevant requirements".

The second option is for the Authority (using its licence modification power), or for the Secretary of State for DECC (using the section 2(2) powers), to insert new licence conditions into relevant licences (e.g. the gas transporter and gas interconnector licences and, if appropriate, also in the gas shipper licence). The licence modifications would reflect the requirements of the CMP Guidelines so that failure to comply with them would be enforceable as a breach of licence.

Industry led work stream

We expect this work-stream to progress concurrently with the NRA led work-stream.

NG

For NG this will involve proposing changes to the Uniform Network Code (UNC), which sets out the detailed rules governing GB market operation, and any other necessary contracts to ensure compliance with the CMP Guidelines.

We note that NG's view is that it already has an oversubscription and buy-back regime and that minimal changes to the current arrangements are needed to make it compliant with the CMP Guidelines (NG is incentivised to release OS capacity). However, further changes to the UNC are needed to introduce a long-term UIOLI framework and to create a process for shippers to surrender any unused capacity back to NG. This process will need to provide clear timelines for shippers to voluntarily surrender capacity ahead of the auctions, determine which requests can be satisfied and determine the process for passing any revenues from the sale back to the shipper.

We therefore expect NG to raise UNC code modification proposals covering the changes necessary to bring the current regimes into compliance with the CMP Guidelines.

Due to time considerations with respect to the implementation deadline of 1 October 2013, we may issue a direction(s) under Standard Special Condition A11(9)(j) of the gas transporter licence covering all or any of the following:

- (i) requiring NG to raise the modification proposal(s); and/or,

¹⁴ Section 2(2) European Communities Act 1972 empowers the designated Minister or government department to make regulations for the purpose of implementing any EU obligation or dealing with matters arising out of EU obligations or rights.

- (ii) setting or amending the timetable for completing each of the relevant procedural steps within the UNC modification process, to the extent that they are relevant; and/or,
- (iii) setting the timetable for implementation, if the modification proposal(s) are approved.

Gas Interconnector Licensees

GB gas interconnector licensees need to ensure that their own contractual arrangements comply with the CMP Guidelines. Under standard licence condition 11A of the gas interconnector licence, the Authority may direct interconnector licensees to submit access rules covering (but not limited to) arrangements for maximising available interconnector capacity and for managing congestion for capacity which is not included by existing access rules. The Authority can issue direction for the access rules to be amended to comply with the Gas Regulation, without delay and in any event within three months. We consider that compliance with the CMP Guidelines is part of the access rules, referred to in standard licence condition 11A. **We therefore expect interconnector licensees to publicly consult on their compliance proposals prior to formal submission to the Authority, and other relevant NRAs, for approval as appropriate. We also expect interconnector licensees to comply with any directions by the Authority to amend the access rules to ensure compliance with the CMP Guidelines.**

Should shippers, in our view, seek to unreasonably block any detailed changes necessary for gas interconnector licensees to comply with the CMP Guidelines, we may need to take formal action. For example, we could consider making changes to the gas shipper licence requiring gas shippers to co-operate with gas interconnector licensees and not to unreasonably withhold any necessary consents or we could take action under the Gas Act as compliance with the CMP Guidelines will be made into a relevant requirement on interconnector licensees.

We note that the oversubscription and buy-back arrangements proposed by gas interconnector licensees will need to be approved by the Authority in co-operation with the relevant NRAs¹⁵. We are currently holding discussions with relevant NRAs and TSOs to this end, and propose issuing our views on licensees' proposals jointly with other relevant NRAs wherever reasonably practicable.

Next steps

We will co-operate closely with DECC on its work to make the provisions of the CMP Guidelines relevant requirements in the Gas Act. We will also work closely with industry and other relevant NRAs on their detailed implementation of the CMP requirements.

We expect NG to raise the appropriate UNC code modification proposal(s) and for any subsequent Authority direction (if issued) concerning the procedural timetable to be adhered to. We understand that NG intends to raise a UNC modification proposal prior to the next UNC modification panel on 21 March 2013.

We expect gas interconnector licensees to submit the congestion management arrangements on which they propose to publicly consult to the Authority (and

¹⁵ Point 2.2.2(1) of the CMP Guidelines.

other relevant NRAs) for discussion by 27 March 2013 and for public consultations to start in spring/ early summer.

Yours sincerely,



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