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Making a positive difference for energy consumers

To:

Gas transportation licensees, gas interconnector licensees, gas shipper licensees, the Uniform Network Code Modification Panel, IUK and BBL shippers and the Dutch and Belgian TSOs and all other interested stakeholders

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Dear Colleague

Options for implementation of the European Union Network Code on Congestion Management Procedures on BBL Company

The CMP Guidelines[1] were published in the Official Journal of the European Union on 28 August 2012 and entered into force 20 days later. The majority of their provisions were required to be implemented by 1 October 2013.

Gas Transport Services (GTS), the Dutch gas transmission system operator (TSO) and National Grid Gas (NGG), the Great British (GB) TSO, have both taken steps to implement the requirements of the CMP Guidelines. However, further work is needed in respect of both of the two European gas interconnectors – Interconnector UK (IUK) and BBL Company (BBL) – to make them compliant. This letter focuses specifically on implementation of the CMP Guidelines on BBL, the gas interconnector between GB and the Netherlands. It focuses solely on whether oversubscription and buy back (OSBB) or firm day-ahead use it or lose it (FDA UIOLI) should be the primary CMP mechanism implemented. In the interests of finding the optimum solution which delivers flexibility and encourages efficient flows of gas between NBP and TTF (the two most liquid hubs in Europe) we seek stakeholder input into which mechanism delivers best across the interconnector.

This document (i) briefly sets out the mechanics of each of these congestion management mechanisms, illustrated by some examples; (ii) explores the advantages and disadvantages of each option; (iii) summarises next steps. **We invite views from stakeholders on these proposals.**

Background

The CMP Guidelines set out certain provisions to be applied to counter and prevent contractual congestion. Contractual congestion is a situation where network users cannot

[1] Commission Decision of 24 August 2012 on amending Annex I to Regulation (EC) No 715/2009 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:231:0016:0020:EN:PDF

gain access to gas transmission systems in spite of the physical availability of the capacity.

In implementing the CMP Guidelines, our aim is to make a positive difference for energy consumers by stimulating the efficient use of infrastructure. This is done by enabling the reallocation of unused capacity to those market participants who wish to make use of it, allowing more efficient and competitive use of the gas networks.

We note that there is currently no contractual congestion on BBL: there is still firm capacity on offer. However, we also note that implementation of the CMP Guidelines is a legal requirement under European law and that the mechanisms to deal with contractual congestion must be in place before any congestion actually occurs.

Implementation Issues

The CMP Guidelines apply to all interconnection points between adjacent entry-exit systems, between two or more Member States or within the same Member State in so far as the points are subject to booking procedures by users. The Guidelines consist of four measures: (i) OSBB[2]; (ii) FDA UIOLI[3]; (iii) surrender of contracted capacity[4]; and, (iv) long-term UIOLI[5],[6]. Whilst BBL is required to implement the CMP Guidelines, it should be noted that the exempt capacity is not subject to certain provisions contained within the Regulation.

As stated above, this letter seeks stakeholder views on whether BBL should implement the OSBB or FDA UIOLI mechanisms. Below, we briefly set out how we envisage each of these options working, along with potential advantages and disadvantages. We would welcome the views of stakeholders regarding these options.

Option 1: Oversubscription and Buy Back

The OSBB mechanism should aim to incentivise TSOs to offer firm capacity in excess of their technical capability where they expect this capacity not to be used. Where users then signal that they intend to flow more gas than the system can carry, TSOs will need to buy-back capacity to reduce flows on the system.

In order for OSBB to achieve its aims, TSOs must strike an effective balance between offering meaningful volumes of additional or oversubscription capacity whilst taking proportionate buy-back risks. This requires them to use their experience of network flows and shipper behaviour to calculate likely quantities of unused capacity.

However, some of the instances which might trigger a buy back event are outside of a TSO's control. For example, an outage on another piece of gas infrastructure could result in a spike in capacity demand, which in turn could lead to a very high market spread between the European mainland and GB. Where BBL has oversold capacity and has to buy capacity back under such conditions, this could potentially result in extremely high costs.

We note that single-pipe interconnectors have considerably less flexibility than meshed, national gas transmission networks in responding to such events. In order to strike a reasonable risk-reward balance and incentivise BBL to offer OS capacity, we would therefore consider it reasonable to limit BBL's buy back exposure in some way.

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[2] Point 2.2.2 of Annex I to the Gas Regulation
[3] Point 2.2.3 of Annex I to the Gas Regulation
[4] Point 2.2.4 of Annex I to the Gas Regulation
[5] Point 2.2.5 of Annex I to the Gas Regulation
[6] Procedures (i), (iii) and (iv) must be implemented by 1 October 2013. Procedure (ii) applies as of 1 July 2016, but can be introduced earlier as an alternative to OSBB

Ofgem, ACM and BBL have held a number of discussions about how to achieve the aims of the CMP Guidelines in practice on the BBL pipeline. We have also taken into account the regimes being implemented or already in place on other pieces of comparable infrastructure e.g. Interconnector UK (IUK) and Britned (the GB-Netherlands electricity interconnector).

Key Features

Based on these discussions, we consider the following key principles to be relevant to implementation of the OSBB mechanism on the BBL pipeline:

- OS capacity would be offered on forward flow capacity on a day-ahead basis. It would be sold via auctions and allocated on a 'pay as bid' basis via a bidding ladder, with the highest bid getting allocated first;
- BBL would decide on the quantities of OS capacity to be offered;
- All revenues from OS capacity sales would go into a 'pot';
- In case nominations exceed technical capacity, thereby endangering system integrity, BBL would issue a 'call for orders', stipulating the quantity of capacity that BBL wished to buy back;
- Where insufficient offers were received, BBL would move to a forced buy back, meaning that all nominations of non-exempt capacity (including OS capacity) would be pro-rated downwards. Affected shippers would receive the NBP-TTF price-differential;
- BBL's total exposure would be capped by an annual downside 'pot';
- Any costs / revenues at the end of each gas year would be split between BBL and shippers (with the distribution being decided by NRAs) on a rolling basis;

Advantages and Disadvantages

We consider that an OSBB mechanism based on the above principles would have two main advantages. It would:

- Incentivise BBL both to offer OS capacity and to accurately calculate the quantities of the OS capacity it should offer, given that it would face financial risk if buy-back costs exceed OS revenues;
- Be consistent with the mechanisms of the TSOs on either side of BBL and with other GB interconnectors.

However, implementing the OSBB mechanism could also give rise to a disadvantage:

- The existence of a pot would limit the exposure of BBL and give rise to the possibility of capacity being forcibly restricted. Whilst the likelihood of such a curtailment depends on the exact design of the OSBB scheme and the conduct of BBL, NRA analysis suggests that the pot could be set at a level which only marginally compromises the firmness of the product – especially given the financial incentives for a TSO to accurately calculate OS offerings.

Option 2: Firm Day-Ahead Use it or Lose it

The OSBB mechanism outlined above is considered to be the basic instrument to prevent contractual congestion. However, in the case of BBL, a single pipe interconnector, there is a strong case for limiting the TSO's downside exposure, which in turn affects the firmness of the capacity for shippers. This leads to the question of whether FDA UIOLI is possibly a more suitable option for BBL.

FDA UIOLI is a mechanism that enables the TSO to offer contracted but unused capacity as firm day-ahead capacity to the market. After the initial nomination deadline, the mechanism limits the ability to renominate within-day, thus providing a flow commitment to the TSO. The cumulative flow commitments in turn provide the TSO with

a minimum and a maximum of the total flow via an interconnection point, which it can use to offer firm day-ahead capacity in either direction.

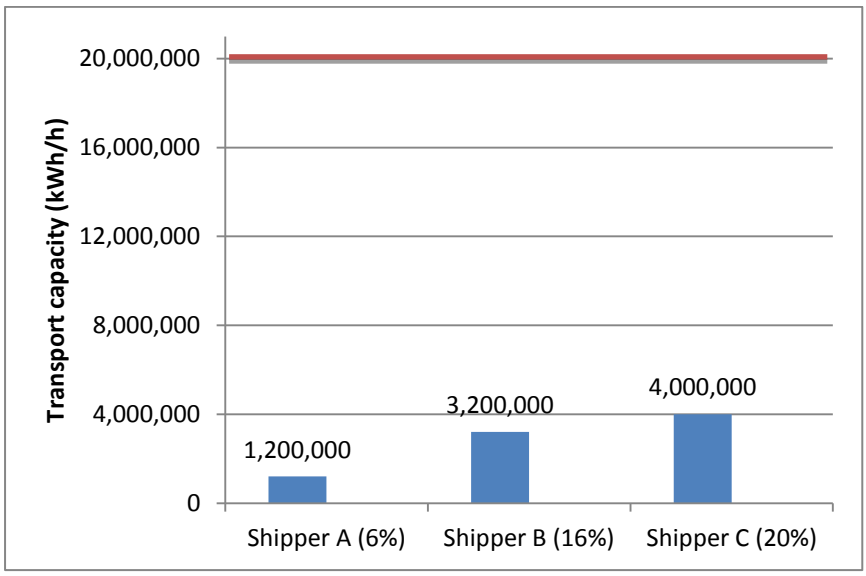
Key features

- The mechanism only applies to network users who hold 10% or more of the technical capacity on that interconnection point;
- The initial capacity holder keeps the right to renominate on an interruptible basis. This means that in a situation without contractual congestion the mechanism has no material effect;
- All shippers may buy the capacity offered at the Day Ahead stage;
- BBL is not revenue regulated, so is entitled to keep any additional revenues.

Examples

For clarity of this mechanism we worked out some examples for FDA UIOLI.

Shipper A has a contracted capacity on BBL (firm forward) of 1.200.000 kWh/h.
Shipper B has a contracted capacity on BBL (firm forward) of 3.200.000 kWh/h.
Shipper C has a contracted capacity on BBL (firm forward) of 4.000.000 kWh/h.



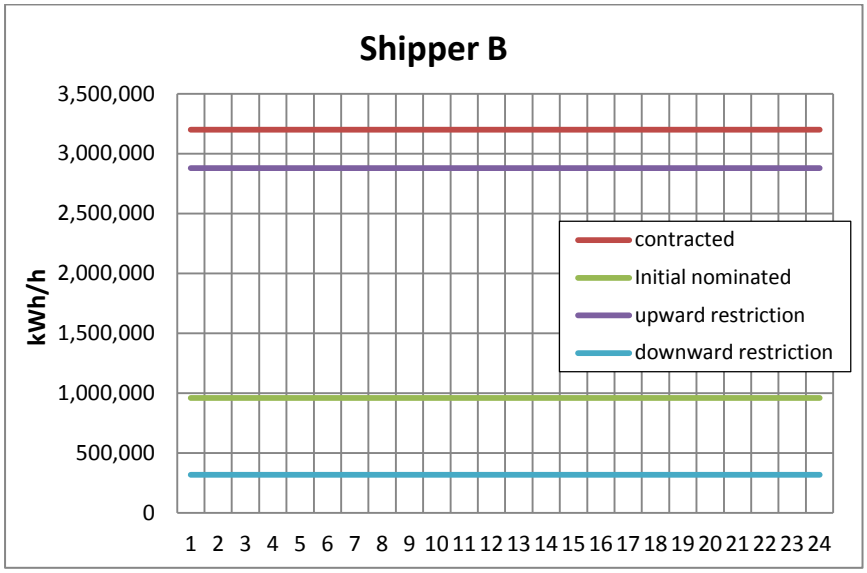
Contracted capacity for shipper A, B and C in relation to the technical capacity on BBL

In each of these cases the following happens:

Shipper A
This shipper does not face any restriction of renomination because it holds less than 10% of the total technical capacity on the BBL.

Shipper B
This shipper sends an initial nomination to BBL of 960.000 kWh (=30% of contracted capacity) for each hour of the next gas day. After initial nomination, Shipper B keeps the firm right to renominate up to 90% of its contracted capacity (2.880.000 kWh/h) and down to 10% of its contracted capacity (320.000 kWh/h). This shipper may renominate further upwards and downwards but faces (for that part) a chance of interruption.

On the basis of only the initial nomination of Shipper B, BBL should be able to offer 320.000 kWh/h firm day ahead forward flow and 320.000 kWh/h firm reverse flow.

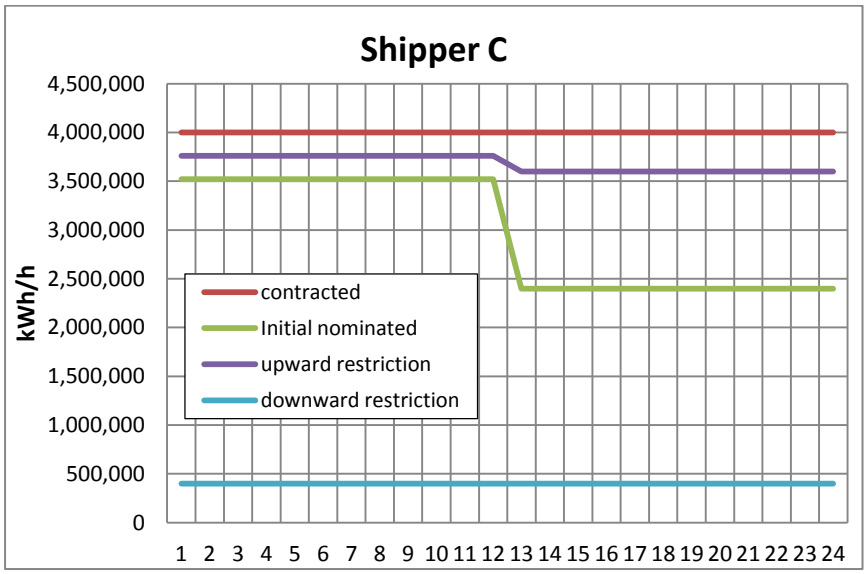


Consequences for Shipper B

Shipper C

This shipper sends an initial nomination to BBL of 3.520.000 kWh (=88% of contracted capacity) for the hours 1-12 and 2.400.000 kWh (=60% of contracted capacity) for the hours 12-24 of the next gas day. For the first 12 hours, shipper C keeps the firm right to renominate upwards half of the non-nominated capacity, which is up to 94% of the contracted capacity (3.760.000 kWh/h). For the other 12 hours, shipper C keeps the firm right to renominate upwards to 90% of its contracted capacity (3.600.000 kWh/h). Downwards is in both cases the same: 10% of the contracted capacity (400.000 kWh/h).

On the basis of only the initial nomination of Shipper C, BBL should be able to offer firm day ahead forward flow: 180.000 kWh/h and firm reverse flow: 240.000 kWh/h.



Consequences for Shipper C

Advantages and Disadvantages

We consider that the FDA UIOLI mechanism would have the following advantages:

- It would lead to a guaranteed offer of firm day-ahead capacity, providing the entire market with additional flexibility;
- The TSO would be neutral, meaning that the impact for shippers would not be dependent on an assessment by BBL.

However, implementing FDA UIOLI gives rise to the disadvantage that:

- Shipper renomination rights would be restricted, restraining flexibility for individual shippers. However, experience in Germany where the same mechanism applies to interconnection points between TSOs suggests that shippers' bookings are more profiled and efficient.

Next Steps

We invite stakeholder views on the relative merits of each option. Specifically, we would like to hear views on the following questions:

1. Which of the potential options – OSBB or FDA UIOLI – do you prefer? Why?
2. Which of the potential options discussed in this document would provide the greatest level of flexibility that you are seeking in flowing gas from the Netherlands to GB, subject to the requirements of the CMP Guidelines?
3. Do you agree with the advantages and disadvantages of each option as presented? Are there any further advantages or disadvantages to be considered?
4. How would you value the potential threat of curtailment under an OSBB mechanism with a pot, relative to the potential loss of flexibility due to restriction of renomination rights under the FDA UIOLI mechanism?

Responses should be received by 24 February 2014 and sent to:

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Should you wish to discuss any aspect of this letter please contact Clement Perry or Meinoud Hehenkamp.

Yours sincerely,

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