

Gas transporter licensees, gas
shipper licensees, gas
interconnector licensees and
other interested parties

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Date: 15 December 2014

Dear Sir/Madam,

Statutory consultation on proposed licence modifications to facilitate the implementation of the Capacity Allocation Mechanisms Network Code in Great Britain

This letter seeks views on our proposals to modify Special Condition 1A and Special Condition 5F of the Gas Transporter Licence held by National Grid Gas Plc (NGG) in respect of the National Transmission System (NTS).

We consider that these modifications are necessary to facilitate the implementation of certain aspects of European Regulation 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems (CAM) in Great Britain (GB). These aspects include the introduction of standardised auctions and bundled capacity products at Interconnection Points (IPs). CAM is to be implemented from 1 November 2015.

Alongside this letter we are publishing a statutory consultation notice on the proposed modifications to Special Conditions 1A and 5F of the Gas Transporter Licence held by NGG in respect of the NTS. This follows the consideration of responses to our open letter in October 2013¹, consultation in June 2014² and extensive discussions with stakeholders.

Our proposed changes are:

- Amending Table 3 of Special Condition 5F to split the existing Bacton Aggregated System Entry Point (ASEP) into two new ASEPs – Bacton UKCS and Bacton IP.
- Inserting a new Table 6B in Special Condition 5F which lists the NTS Entry Points effective for processes on Gas Days from 1 November 2015 (or such other date as the Authority may direct in writing). Table 6B is the same as the current table 6A except for the following:
 - the existing Bacton ASEP is split into two new ASEPs – Bacton UKCS and Bacton IP,
 - the baseline capacity (capacity is the right to flow gas on or off a network) for the Bacton IP ASEP is set at the sum of the maximum technical capacities of the two interconnectors (1297.8 GWh/day), with the remaining baseline

¹ <https://www.ofgem.gov.uk/publications-and-updates/options-great-britain%E2%80%99s-implementation-european-union-network-code-capacity-allocation-mechanisms-gas-transmission-systems-regulation-9842013-bacton-entry-point-0>

² <https://www.ofgem.gov.uk/publications-and-updates/facilitating-implementation-aspects-capacity-allocation-mechanisms-network-code-great-britain>

- capacity of the current Bacton ASEP assigned to the Bacton UKCS entry point (485.6 GWh/day), and
 - o a new column is inserted in order to indicate the type of Entry Point within NGG's licence for all entry points.
- Amending the definition of Off Peak Exit Capacity at IPs within Special Condition 1A.

We think these changes are necessary to implement our proposals and are seeking stakeholders' views. Responses should be sent to david.mccrone@ofgem.gov.uk by **16 January 2015**.

Background

The Third Package of European energy reforms created a new legal framework to promote cross-border trade. CAM, which has an implementation date of 1 November 2015, was established under this framework, and seeks to support access to cross-border capacity for shippers at IPs. This will be achieved through measures including:

- Capacity being bundled at both sides of an IP so shippers need to buy fewer products to move gas from one market to another.
- Auctions selling yearly, quarterly, monthly, daily and within-day standard capacity products.
- The sale of capacity via pan-European web-based booking platforms.
- The ability for a shipper to make a single nomination (a declaration of how much gas a shipper intends to flow against the capacity it holds) against an associated bundled capacity quantity.

In October 2013, we published an open letter setting out our initial thoughts on how CAM should be implemented within GB. The key elements of the letter were that:

- CAM should be implemented in GB at IPs only.
- The existing ASEP should be split to enable CAM to be implemented effectively at Bacton. This is because NGG currently makes no differentiation from a capacity perspective between supply entering Bacton via the two interconnectors (IUK and BBL) and the three UKCS sub-terminals.
- The split should create two new ASEPs – Bacton UKCS and Bacton IP. There was no need to further split the Bacton IP between IUK and BBL.
- The baseline capacity for the Bacton IP entry point should be set at the sum of the maximum technical capacities of the two interconnectors. We considered this would achieve compliance with Article 6 of the CAM Regulation to make the maximum technical capacity available. It also furthers the interests of consumers by promoting competition and eliminating restrictions on trade in natural gas between Member States through making the maximum capacity at interconnectors available.
- The remainder of the current Bacton baseline capacity is assigned to Bacton UKCS entry point.

Responses generally supported our proposal to implement CAM at IPs only and to split the Bacton ASEP into two. However there were some concerns raised over the possible consequences of such a split and the treatment of existing capacity bookings.

In June 2014, we published a consultation on implementing parts of CAM in GB. This re-stated our approach proposed in October 2013. In addition to the above we considered that a change to the definition of Off Peak Exit Capacity contained in Special Condition 1A of the Gas Transporter Licence was required as a result of CAM. Furthermore, we set out transitional arrangements that would be required to manage existing industry processes before and after implementation of CAM.

Overview of consultation responses and our views

We received ten non confidential responses to our June 2014 consultation. These have been published on our website.³

In general, our proposed approach to facilitating implementation was viewed as the most appropriate way forward. However respondents recognised that this may have consequences, especially at Bacton.

Facilitating the implementation of aspects of CAM on the NTS in GB

In our June 2014 consultation we described our view that CAM should be implemented in GB at IPs only. This is because we did not think the benefits of implementing CAM would be increased by implementing CAM at all entry and exit points and implementing CAM at all capacity at the current Bacton ASEP could be discriminatory.

All responses to our June 2014 consultation supported our proposals that CAM should be implemented at IPs only.

One respondent said that this approach raised concerns with the possibility of discriminatory treatment between different points on the NTS. They also sought clarity on whether substitution of capacity from an IP would be more or less likely than at a non IP system point.

We recognise that our approach will result in different mechanisms for selling capacity at IPs compared to non-IP system points. We do not consider this would have a material impact on consumers whereas it is unclear how bundling could occur where there was no transmission system operator (TSO) on the 'other side' of the system point. Furthermore, we said in our consultation that, with all other things being equal, the only way to address this would be to implement CAM at all entry and exit points. This would likely lead to higher costs, greater complexity and possible delays in implementation with no significant increase in benefits.

The same entry capacity substitution rules currently apply for IP and non-IP capacity, as set out in the Entry Capacity Substitution Methodology (ECSM) approved by Ofgem in Oct 2013, so both are subject to the same drivers.⁴ When we approved NGG's current ECSM, we recognised that substitution of exit capacity is treated separately at IPs, and stated our view that this differential treatment of exit and entry capacity at IPs is appropriate.⁵ These rules may change in the future through NGG's regular reviews and parties will have opportunities to comment through this process.

Under the current rules, and, in the event of a future scenario where there is a signal for further capacity at the Bacton UKCS ASEP and capacity at the Bacton IP ASEP is unsold, then capacity could be substituted from Bacton IP to Bacton UKCS. We note that NGG intend to review the capacity methodologies and parties will have the opportunity to comment on these rules.

Our proposals

For the reasons set out in this document and having carefully considered the responses received in relation to our previous consultations we still consider that CAM should only be

³ <https://www.ofgem.gov.uk/publications-and-updates/facilitating-implementation-aspects-capacity-allocation-mechanisms-network-code-great-britain>

⁴ Capacity substitution is the movement of unsold Non-incremental Obligated Entry or Exit Capacity from one system point to another in response to demand for Incremental Obligated Entry or exit Capacity. The methodologies by which this is done are available on National Grid's website:

(<http://www2.nationalgrid.com/UK/Industry-information/Gas-capacity-methodologies/>)

⁵ <https://www.ofgem.gov.uk/publications-and-updates/approval-entry-capacity-substitution-methodology-statement>

implemented at IPs. At this time, these are Bacton (specifically the Bacton ASEP, Bacton IUK exit point and Bacton BBL exit point) and Moffat (specifically the Moffat exit point and Moffat entry point).⁶

Facilitating the implementation of aspects of CAM at entry points to the NTS

Bacton is currently the only IP where firm entry capacity onto the NTS can be purchased. Our consultation noted that Bacton was also unique in that it is the only GB entry point where gas enters from the UKCS as well as interconnectors with mainland Europe. Our proposal to only implement CAM at IPs would mean that after implementation entry capacity for gas could be sold at the Bacton entry point either under the current rules defined in the Uniform Network Code or by the rules described in CAM, depending on the route into GB (ie. whether from the UKCS or via the interconnectors).

We proposed to manage this by splitting the existing Bacton ASEP in two – creating two new ASEPs, Bacton UKCS and Bacton IP. We came to this conclusion after considering other implementation options as described in more detail in our consultation. We said that options that did not split the ASEP would increase risks, costs and have several unintended consequences.

We also proposed that the amount of entry capacity available at the Bacton IP ASEP would be equal to the sum of the technical capacities of the two interconnectors. This was confirmed in our consultation as 1297.8 GWh/day. The remainder of the current Bacton baseline capacity would be assigned to the Bacton UKCS ASEP (485.6 GWh/day).

As a result of our proposals, we said that for existing holders of capacity to use their capacity at the Bacton ASEP from 1 November 2015 they will need to confirm how they wish these bookings to be treated. We invited shippers who hold capacity at the existing Bacton entry point to provide information on how they might assign their current holding between the two new entry points. This was to determine whether our proposed split was appropriate, and give shippers the opportunity to input into the final decision on the baseline capacities at each ASEP.

We received comments on our proposals along two main themes – flexibility of existing contracts and substitution and competition.

Treatment of existing entry capacity contracts and flexibility

We said in our June 2014 consultation that the CAM Regulation applies to existing contracts. Article 20 of the CAM Regulation sets out the obligations in respect of existing contracts.

In respect of the possibility of terminating capacity contracts as a result of CAM we said in our June 2014 consultation that parties should seek their own legal advice on contractual issues. All parties to the main contract between NGG and shippers (the Uniform Network Code (UNC)) are free to raise modifications to the UNC arrangements, including in respect of capacity already purchased.

Some respondents raised concerns that splitting the Bacton ASEP reduces the flexibility of entry capacity that has already been purchased. This is because a Bacton ASEP capacity holder can currently choose to bring gas into GB from UKCS or via the interconnectors. Under our proposals, shippers will need to make a one off decision about how they wish existing bookings to be treated from 1 November 2015. Four modifications to the UNC have been raised that propose different ways of managing this.⁷ We encourage industry to continue examining the proposals in order to fully address the concerns that have been

⁶ Commercially interruptible reverse flow is available from the island of Ireland onto the NTS at the Moffat IP. The BBL exit point is also only for virtual reverse flow.

⁷ 0501 0501A 0501B 0501C - Treatment of Existing Entry Capacity Rights at the Bacton ASEP to comply with EU Capacity Regulations <http://www.gasgovernance.co.uk/0501>

raised. After considering responses to the modification consultation and the UNC Panel's recommendation, the Authority will decide which (if any) modification best facilitates the UNC relevant objectives and its wider statutory duties. As each modification depends on the new ASEPs proposed in our statutory consultation, the Authority will make this decision if and when the licence changes take effect.

We also worked with industry to determine how flexibility might be maintained prior to publishing our June 2014 consultation. We hosted an industry workshop on 28 January 2014 where a number of objectives were identified by shippers:

- capacity should be fungible (as far as practically possible within the bounds of being CAM compliant)
- avoid unnecessary artificial constraints
- honour existing contracts (subject to changes necessary to be CAM network code compliant)
- be free to allocate capacity as shippers wish and
- implementation should be at minimal cost.

The lead option emerging from the workgroup to address the fungibility objective was a possible change to the overrun regime at Bacton. An entry capacity overrun charge is applied where the amount of gas flowed by a shipper exceeds their entry capacity entitlement. A proposal has recently been made to do this as part of UNC0501C.

Some stakeholders have expressed a view that splitting Bacton should provide an opportunity to terminate existing contracts without penalty as splitting the current Bacton ASEP into two ASEPs "frustrates" existing entry capacity contracts. This has been raised in both responses to our consultation and at the working group for UNC modification 0501 and its alternatives.

We noted above that four modifications have been raised to manage existing contracts once the current Bacton ASEP has been split. Three out of the four modifications include a means for existing capacity holders to return some or all of their contracts whilst one modification (UNC 0501C) also seeks to maintain flexibility for existing contracts at Bacton.

We have expressed our concerns with terminating or handing back entry capacity contracts during the development of these modifications. The consequences of handing back or terminating capacity contracts without penalty are significant. We encourage industry to continue developing these modifications to determine whether they resolve all the issues discussed during development. The Authority will then consider all the proposals against the UNC relevant objectives and its wider statutory duties.

In discussions with stakeholders since our June 2014 consultation we considered the possibility of creating a third 'historical' ASEP at Bacton and whether this could provide an alternative means of maintaining flexibility. Existing bookings could be assigned to this and enjoy the interchangeability that exists today. Future capacity bookings would be made at the Bacton UKCS and Bacton IP ASEP. We do not consider this is appropriate as NGG would have uncertainty in determining the amount of capacity available to offer for sale at Bacton IP and Bacton UKCS without knowing whether holders of 'historical' Bacton capacity would use it at Bacton IP or Bacton UKCS. It is also unclear which rules would apply to capacity at the historical ASEP (eg. the existing rules for GB entry points or those introduced at IPs by the European network codes).

Substitution and competition

In our June 2014 consultation, we proposed setting the baseline of the IP ASEP at the sum of the maximum technical capacity of the two interconnectors. We consider this proposal to be compliant with Article 6 of the CAM Regulation. Article 6 states that the maximum technical capacity shall be made available to network users, taking into account system integrity, safety and efficient network operation and so far as it is not detrimental to the

offer of capacity at other relevant points. It also furthers the interests of consumers by promoting competition and eliminating restrictions on trade in natural gas between Member States by making the maximum capacity at interconnectors available.

Some stakeholders have raised concerns with the impact of our proposals on the competition between shippers primarily active at what would be the Bacton UKCS vis-a-vis those at Bacton IP. That is, by setting the IP ASEP baseline at the sum of the maximum technical capacity of the two interconnectors, the long term availability of entry capacity has been guaranteed without a market signal being received.

We note the concerns that this may lead to constraints at the UKCS ASEP. However our June 2014 consultation explained that our proposed UKCS baseline would be sufficient to meet historical flows. In the event of flows from UKCS increasing in the future, NGG have a number of tools to manage this situation. This could include substitution of entry capacity from the IP ASEP to the UKCS ASEP as we described earlier in this letter.

Our proposals

Having carefully considered the consultation responses received and further discussions with interested parties, we consider that our proposals are the most appropriate approach to facilitating the implementation of aspects of CAM at entry points to the NTS. These proposals are that we will:

- Amend Table 3 of Special Condition 5F to split the existing Bacton Aggregated System Entry Point (ASEP) into two new ASEPs – Bacton UKCS and Bacton IP.
- Insert a new Table 6B to Special Condition 5F which lists the NTS Entry Points effective for processes on Gas Days from 1 November 2015 (or such other date as the Authority may direct in writing). Table 6B is the same as the current table 6A except for the following:
 - the existing Bacton Aggregated System Entry Point (ASEP) is split into two new ASEPs – Bacton UKCS and Bacton IP, and
 - the baseline capacity for the Bacton IP ASEP is set at the sum of the maximum technical capacities of the two interconnectors (1297.8 GWh/day), with the remaining baseline capacity of the current Bacton ASEP being made available at the Bacton UKCS entry point (485.6 GWh/day).
- Insert a new column in order to indicate the type of Entry Point within the NGG's licence for all entry points.

Facilitating the implementation of aspects of CAM at exit points from the NTS

We said in our June 2014 consultation that no material licence changes were required to implement CAM at exit points from the NTS. This is because there are already distinct exit points at Bacton for BBL and IUK. Similarly, the exit point referred to in the licence at Moffat specifically relates to the interconnector. We maintain our views as set out in the June 2014 consultation that no material changes were required to implement CAM at exit points from the NTS.

We did, however, think a change would be necessary to apply an end date to enduring exit capacity contracts. This was because the contracts did not comply with the capacity products described in Article 9 of CAM. We noted that NGG had raised a modification to this effect, which the industry was considering.⁸ The draft modification report for this proposal has been published and industry is invited to submit comments to the Joint Office of Gas Transporters by 19 December 2014. We also said that the definition of Off Peak Exit Capacity would need to be revised to reflect CAM terminology.

⁸ 0500 – EU Capacity Regulations – Capacity Allocation Mechanisms with Congestion Management Procedures (<http://www.gasgovernance.co.uk/0500>)

Respondents to our consultation generally agreed with our proposals. One respondent noted that the current licence definition of an entry and exit point included IPs. They felt this might mean that the current capacity methodologies may be contrary to CAM. As with all methodologies and statements, we invite NGG to review these with industry and make changes as appropriate.

Another respondent suggested that the BBL and IUK exit points should be combined into a single exit point. It was claimed this would 'future proof' capacity arrangements under CAM and mirror the single IP ASEP. While consistency is often desirable, we are unconvinced of what additional benefits would be achieved by combining the BBL and IUK exit points. Indeed, it may be more appropriate to keep the separate exit points given that physical exit capacity is available at the IUK exit point only. We do not therefore propose making such a change at this time.

Our proposals

We still consider that enduring exit capacity is not compliant with CAM and therefore it is appropriate to provide an end date for these contracts in this instance and await the proposals being developed in UNC0500. We also propose to:

- Amend the definition of Off Peak Exit Capacity at IPs within Special Condition 1A.

Responses to the licence drafting

In our June 2014 consultation, we provided draft amended licence text for how our proposals might be implemented. We also described transitional arrangements that might be necessary to allow shippers to purchase entry capacity at the new ASEPs before CAM is implemented on 1 November 2015.⁹ We invited comments on the drafting and proposed implementation approach.

There was general agreement with our proposed transitional arrangements. This will be monitored as we approach 1 November 2015 and may be reviewed if additional issues arise.

A respondent said that the use of 'Interconnector Capacity' in the proposed licence drafting may cause confusion with capacity purchased for use on IUK or BBL. We agree this could be the case so have amended the licence drafting to use 'Interconnection Point / IP'.

Another respondent said that the new UKCS and IP ASEPs should be recognised as Relevant Points. NGG is required to make information about capacity available to the public for entry points classified as relevant points. We previously decided that all entry points with the exception of entry points linked directly to a production facility of a single final producer located within the EU be considered as relevant points.¹⁰ Information for entry points connected to single final producers can be published in aggregate format to protect commercial confidentiality at these sites.

Currently Bacton is recognised as a relevant entry point. This classification shall continue at the new ASEPs if our proposals are implemented as neither is connected to a production facility of a single final producer.

One response noted that the definition of "Regulation" within the licence refers to the main Regulation (EC) No 715/2009 and makes reference to the 2010 Amending Decision (2010/685/EU). However, the definitions do not include references to any changes beyond this point (such as the introduction of Network Codes concerning CAM, Congestion

⁹ There may also be a need for some processes to refer to the pre 1 November 2015 ASEP (eg, in respect of reconciliation).

¹⁰ <https://www.ofgem.gov.uk/ofgem-publications/53032/relevantpointsdecisionletter.pdf>

Management Procedures or Balancing). They recommended updating the definitions to include these changes.

We have noted these comments and will continue to look at the definition of the Electricity and Gas Regulations across all licences and may consult on any changes we feel are necessary to ensure the correct definitions are used.

A further respondent suggested that NGG should face a licence obligation to ensure the contractual arrangements at Bacton allow for the same level of fungibility as now. We consider that such an arrangement is already available to shippers to explore via the UNC modification process and does not require a licence obligation.

Since we issued our consultation we have also published a decision on changes to NGG's licence to implement new incremental gas transmission capacity arrangements ('PARCAs').¹¹ The PARCA licence changes will come into effect on 31 January 2015. We have also issued a consultation on terminating the use of Permit Arrangements from National Grid Gas Transmission's Licence and adjust the revenue earned from Permit Arrangements for the period 1 April 2013 to 31 March 2015.¹²

These changes affect the same licence conditions as we are changing under our CAM proposals. There is no policy interaction between both sets of proposals – both will amend different parts of each Special Condition. However, the PARCA licence modifications will insert additional definitions to Special Condition 1A and change the numbering and structure of Special Condition 5F. Respondents should be aware of these modifications as the final changes to the Special Conditions will depend on implementing the PARCA licence text and the outcome of this consultation.

Next steps

Alongside this letter we have published a statutory consultation notice under section 23(2) of the Gas Act 1986 that we propose to modify the gas transporter licence held by NGG in respect of the NTS.

We welcome comments on the proposed drafting. Responses should be received by **16 January 2015**. We prefer electronic responses, sent to david.mccrone@ofgem.gov.uk, but you can also post them to:

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Unless marked confidential, all responses will be published on our website, www.ofgem.gov.uk. You can ask us to keep your response confidential. We'll respect this request, subject to any obligations to disclose information, for example under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

If you'd like your response to remain confidential you should clearly mark the document to that effect and include the reasons for confidentiality. Please restrict any confidential material to the appendices to your response.

After considering your views, we may issue a direction to modify the licence. If we proceed in this way, we expect it to be published in February 2015. Licence holders, trade bodies

¹¹ [Decision on Licence changes to implement Planning and Advanced Reservation of Capacity Agreements](#)

¹² <https://www.ofgem.gov.uk/publications-and-updates/proposal-terminate-use-permits-arrangements-national-grid-gas-transmission%E2%80%99s-licence-and-adjust-revenue-earned-permit-arrangements-period-1-april-2013-%E2%80%93-31-march-2015>

representing licence holders and Citizens Advice and/or Citizens Advice Scotland will then have 20 working days to decide (from the first working day after our decision is published) if they want to appeal against the reforms to the Competition and Markets Authority. Subject to any appeal, the licence changes will be effective 56 days after our decision is published. We anticipate this would be in April 2015.

Any questions about this letter should initially be directed to David McCrone (david.mccrone@ofgem.gov.uk or 0141 341 3993).

Yours sincerely,

Rob Mills
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