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for energy consumers

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

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Dear Sir/Madam,

Modification of Special Conditions 1A and 5F of National Grid Gas plc's Gas Transporter Licence to facilitate implementation of the Capacity Allocation Mechanisms Network Code

We are notifying you that we are making changes to the special conditions of National Grid Gas plc's (NGG's) gas transporter licence in respect of the National Transmission System (NTS). These changes are to facilitate the implementation of certain aspects of the European Union (EU) Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems (CAM)¹ in Great Britain (GB).

Background to the licence modification

The final report of the European Commission's sector inquiry into competition in gas and electricity markets (published in January 2007) noted (amongst other things) the lack of effective competition in European gas and electricity markets.²

In response, a suite of legally binding EU legislation, referred to as the Third Package, on European electricity and gas markets was introduced and adopted on 13 July 2009.³ The Third Package was transposed into GB law by Regulations that came into force on 10 November 2011.⁴

The Third Package created a new legal framework to promote cross-border trade in gas and electricity. It requires a number of legally binding Guidelines and 'Network Codes' to be established and implemented.⁵ Taken together, these aim to promote liquidity, improve integration between Member States' gas and electricity markets and promote the efficient use of interconnectors to ensure that gas and electricity flows according to price signals, ie. to where it is valued most.⁶ These EU legislative requirements take priority over GB

¹ Commission Regulation (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council.

² <http://ec.europa.eu/competition/sectors/energy/inquiry/>

³ In relation to gas, the Third Package includes 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 (the "Gas Directive") and 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 (the "Gas Regulation").

⁴ The Electricity and Gas (Internal Markets) Regulations 2011 (SI 2011/2704):
<http://www.legislation.gov.uk/uksi/2011/2704/contents/made>

⁵ Article 6 (Establishment of network codes) of the Gas Regulation sets out the process for establishing EU wide network codes for gas.

⁶ See Article 8(6) of the Gas Regulation for the areas required to be covered by network codes.

domestic legislation and associated regulations and codes, including the Uniform Network Code (UNC) and licences.

One of these Network Codes, CAM, seeks to support access to cross-border capacity for shippers at Interconnection Points (IPs), one of which is Bacton. Bacton is unique within GB in that gas enters the GB gas transmission system both from domestic production and from interconnectors with mainland Europe. CAM does not apply to entry points from domestic production so we consider that it is necessary to split the current Bacton entry point into two new entry points to NGG's system. These two new points will be called Bacton UKCS and Bacton IP, effective from 1 November 2015 (or such other date as the Authority may direct in writing). As a result of splitting Bacton we also have to split the current baseline capacity in order to set out what amounts of capacity NGG will be obliged to offer at the two new entry points. We will do this by making modifications to NGG's licence, as set out below.

These modifications will:

- Rename the current Table 4 in Special Condition 5F to be Table 4A. Table 4A will list NTS Entry Points and their baseline capacities⁷ effective for processes on Gas Days prior to 1 November 2015 (or such other date as the Authority may direct in writing). Table 4A will otherwise be the same as the current Table 4.
- Insert a new table 4B in Special Condition 5F. Table 4B will be the same as the current table 4 except for the following changes:
 - It will list the NTS Entry Points and their baseline capacities effective for processes on Gas Days from 1 November 2015 (or such other date as the Authority may direct in writing).
 - The existing Bacton Aggregated System Entry Point (ASEP) will be split into two new ASEPs – Bacton UKCS and Bacton IP.
 - The baseline capacity for the Bacton IP ASEP will be set at the sum of the maximum technical capacities of the two interconnectors connected to the Bacton IP ASEP (1297.8 GWh/day), with the remaining baseline capacity of the current Bacton ASEP assigned to the Bacton UKCS ASEP (485.6 GWh/day).
 - A new column will be inserted in order to indicate the type of ASEP within NGG's licence for all entry points. This column is only needed in table 4B since the ASEP type is only relevant for the processes on Gas Days from 1 November 2015 (or such other date as the Authority may direct in writing).
- Amend the definition of 'Off Peak Exit Capacity' at IPs within Special Condition 1A. This is to reflect the terminology used in CAM in the licence when describing interruptible capacity at IPs.

CAM applies from 1 November 2015. Subject to any appeal, these licence modifications will take effect from 8 April 2015. We consider that this will allow sufficient time for the necessary industry processes to be completed in time for the implementation date of 1 November 2015.

We published an open letter on 31 October 2013⁸, and consultation on 13 June 2014⁹ which set out the rationale for our policy.

Our statutory consultation and covering letter, published on 15 December 2014, set out our proposed modifications to NGG's licence.¹⁰ These documents explained our reasons for

⁷ Capacity is the right to flow gas on or off the NTS. An entry point's baseline capacity is the amount of firm capacity NGG are obligated to make available as defined by NGG's gas transporter licence.

⁸ The open letter can be found here: <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>.

⁹ The consultation can be found here: <https://www.ofgem.gov.uk/publications-and-updates/facilitating-implementation-aspects-capacity-allocation-mechanisms-network-code-great-britain>.

¹⁰ These can be found here: <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-proposed-licence-modifications-facilitate-implementation-capacity-allocation-mechanisms-network-code-great-britain>.

proposing changes to NGG's licence and sought views from stakeholders. The deadline for representations on the proposed modifications was 16 January 2015.

Summary of responses to statutory consultation and our views

We received seven responses to the statutory consultation. Respondents included NGG, gas shippers, interconnectors and storage operators. All responses were non confidential and are published alongside the statutory consultation on our website.

Respondents supported our proposed licence modifications. One respondent said it was a pragmatic and transparent solution. Another agreed with our proposals and believed it was the only way to implement CAM. A further respondent said our proposals were necessary to allow bundled capacity products to be sold.

Respondents also commented on:

- the proposed baselines
- any further split of the Bacton IP ASEP
- existing capacity contracts
- flexible use of existing capacity bookings
- substitution of baseline capacity between ASEPs
- trade and transfer.

We set out our current views, where appropriate, on each of these below.

A UNC modification and three alternate proposals have been raised that propose different ways of treating existing capacity holdings at Bacton after the Bacton ASEP is split into two entry points (Bacton IP ASEP and Bacton UKCS ASEP).¹¹ A number of the comments received in response to the statutory consultation on the proposed licence modifications relate to these UNC modifications, rather than the proposed licence modifications.

The UNC modification process is ongoing and the UNC Panel is expected to make a recommendation in February 2015. Assuming our licence modifications are implemented, we expect to publish our decision on the UNC modifications, taking into consideration these comments, in April 2015.¹² Our comments below reflect that points made in responses that relate to the issues that are being addressed by the UNC modifications are more appropriately considered through the UNC modification process.

Proposed baselines

One respondent said it remains to be seen whether the proposed baselines would be fully compliant with Article 6 of CAM. The respondent said in the event that immediate demand for capacity at the UKCS ASEP exceeds the baseline capacity level then arguably the setting of the new IP ASEP baseline as proposed may be "*detrimental to the offer of capacity at other relevant points*".

The baseline capacity for the Bacton IP ASEP will provide the maximum technical capacity to network users and so we consider that it is compliant with Article 6(1) of CAM. CAM also requires that this allocation of capacity to the IPs should not be detrimental to the offer of capacity at other relevant points. As we set out in our June 2014 consultation, the proposed baseline capacity for Bacton UKCS and Bacton IP were calculated based on data of recent historical flows at Bacton. Without firm evidence that UKCS flows will increase above the proposed baseline in the near future, we do not consider that it is appropriate to use any

¹¹ 501 501A 501B 501C - Treatment of Existing Entry Capacity Rights at the Bacton ASEP to comply with EU Capacity Regulations - are available at: <http://www.gasgovernance.co.uk/0501>.

¹² These modifications (as well as UNC modifications 493 and 500) make reference to the Bacton UKCS ASEP and Bacton IP ASEP. The Authority is unable to publish its decision on these modifications until these ASEPs are set out in NGG's licence.

alternative baseline capacity figure at this time. The baseline capacity figures in our proposed licence modifications therefore remain unchanged.

Further split of Bacton IP

One respondent suggested that, once existing long-term NTS Bacton ASEP capacity holdings expire, it may be appropriate to disaggregate the Bacton IP further. They said this would be consistent with the exit points at Bacton.

The advantage of a single Bacton IP ASEP is that those users who hold capacity at the Bacton IP will be able to use it interchangeably between IUK and BBL (and vice versa), maintaining some flexibility, which shippers have indicated is desirable.¹³ We do not think therefore that there would be a net benefit to further disaggregation of Bacton IP ASEP at this time.

We have therefore noted the comments made but not made any changes to our proposed licence modifications as a result.

Existing capacity contracts

Several respondents called for the opportunity to terminate existing capacity contracts. We note that three of the four UNC 501 modification proposals currently being considered by the industry seek to provide some form of capacity return.

This issue relates to the terms of the capacity booking contracts between NGG and shippers, which are governed by the UNC. It does not influence whether the licence modification to split the Bacton ASEP should go ahead or not. We therefore consider that the issue of how existing capacity contracts are dealt with is most appropriately considered through the UNC modification process. The relevant UNC modification proposals will ultimately come to the Authority for a decision. The Authority will judge the proposals against the UNC relevant objectives and its wider statutory duties.

We have therefore noted the comments made but not made any changes to our proposed licence modifications as a result.

Flexible use of existing capacity bookings

Some respondents made comments about the loss of flexibility as a result of the proposed modifications. That is because existing capacity already sold and assigned at either the Bacton UKCS ASEP or Bacton IP ASEP will not be interchangeable with the other new Bacton entry point resulting from the split.

We consider that splitting the ASEP is the most appropriate method of facilitating the implementation of CAM at Bacton. Our reasons for using this method, and for discounting alternative solutions, are set out in our June 2014 consultation and December 2014 statutory consultation. Our proposed approach was supported by the responses to our statutory consultation and our reasons for choosing this method remain unchanged.

We recognise the impact this proposal has on the use of capacity at Bacton and have encouraged industry throughout this process to consider ways in which flexibility might be facilitated. We note that ENI UK raised UNC 501C on 7 November 2014 to address this issue.

As with the other UNC 501 modification proposals, the Authority will assess UNC 501C against the UNC relevant objectives and its wider statutory duties when making our decision on whether to approve any of the UNC modification proposals.

¹³ IUK is a bi-directional gas interconnector between Great Britain and Belgium. The Balgzand Bacton Leiding (BBL) gas interconnector physically flows gas in one direction from the Netherlands to Great Britain.

We have therefore noted the comments made but have not made any changes to our proposed licence modifications in this respect.

Substitution of baseline capacity between ASEPs

We received submissions reflecting mixed views on substitution of capacity¹⁴ between the Bacton UKCS and IP ASEPs. One respondent stated it was important that capacity can be accessed efficiently. They stated any arrangements should seek to avoid baseline capacity being unnecessarily prevented from being substituted from an entry point where there is no demand to another where demand exists (referred to in their response as "sterilisation"). The respondent also stated NGG should not be forced to build new incremental capacity at an ASEP when another means such as substitution might be more efficient. Another expressed concern that the proposed baselines and current substitution methodology provided interconnectors and their users with an advantage over existing long-term capacity holders. Two respondents recommended that Bacton IP ASEP baseline entry capacity should be protected from the possibility of substitution.

In our statutory consultation, we stated that under the current rules, where in future there is a signal for incremental capacity at the Bacton UKCS ASEP and baseline capacity at the Bacton IP ASEP is unsold, baseline capacity could be substituted from Bacton IP to Bacton UKCS (or vice versa). We remain of the view that it would not be in the interests of GB consumers, or an efficient use of the network, if NGG was forced to consider building new capacity at one of the Bacton entry points if there was unsold baseline capacity available at Bacton in aggregate.

NGG has published an informal consultation on changes to the capacity methodology statements as a result of UNC modification proposals 0500 and 0501/0501A/0501B/0501C.¹⁵ This consultation closes on 27 February 2015. We consider this is the most appropriate way to determine whether the capacity methodologies might need to be changed to ensure industry parties have access to NTS Entry Capacity in accordance with the provisions of NGG's statutory licence obligations.

We have therefore noted the comments made but not made any changes to our proposed licence modifications as a result.

Trade and transfer

One respondent expressed concerns that, as IPs will be covered by the same existing licence definition of NTS Entry Point and NTS Exit Point following our proposed changes to the licence, they will be subject to the same licence conditions as all other NTS Entry Points and NTS Exit Points. They did not consider it appropriate for IPs to be subject to the Entry Capacity Transfer and Entry Capacity Trade obligations in the licence.

Our current view is that it is NGG's responsibility under Special Condition 9 of their gas transporter licence to have in place capacity methodologies that facilitate the achievement of the objectives described in the licence. NGG should therefore review their capacity methodologies in light of CAM and other EU network codes and propose any changes that they consider appropriate. We do not consider that this affects our decision on whether to proceed with our currently proposed licence modifications in respect of Bacton but will continue to discuss this with NGG and determine whether any further changes to the licence, UNC or capacity methodologies are required.

We have therefore noted the comments made but not made any changes to our proposed licence modifications as a result.

¹⁴ Capacity substitution is the substitution of capacity from one entry (or exit) point to another entry (or exit) point where demand for capacity exceeds existing quantities.

¹⁵ The methodologies can be found here: <http://www2.nationalgrid.com/UK/Industry-information/Gas-capacity-methodologies/>

Licence drafting

One respondent noted that our recent decision on licence changes relating to PARCAs meant our proposed modification to Table 3 of Special Condition 5F was not necessary.

The licence changes relating to PARCAs came into effect on 31 January 2015. One of these changes deleted Table 3 of Special Condition 5F. We agree that this impacts our proposed licence modification and so we no longer propose to make this change.

The PARCA licence modification also changed the numbering of Special Condition 5F. In our statutory consultation we proposed changes to Special Condition 5F Table 6. The PARCA changes mean that Table 6 has been renumbered as Table 4. We have reflected this in the proposed licence text.

Since the publication of our statutory consultation we have also been informed by NGG that the description of the type of entry point for the Canonbie Entry Point (new Table 4B in Special Condition 5F) is incorrect. This should be correctly listed as an Offshore Field. We have updated our licence drafting to reflect this.

Our decision

Having carefully considered the responses to our statutory consultation, we have decided to proceed with the modifications to Special Licence Conditions 1A and 5F of NGG's licence that are set out in the statutory direction referred to below. These modifications will take effect from 8 April 2015.

A statutory direction modifying NGG's licence has today been issued to NGG. The statutory direction has also been published on our website.¹⁶

This letter and the statutory direction constitute our publication of our decision and the modification in accordance with the terms of section 23(7) of the Gas Act 1986.

Next steps

Licence holders, trade bodies representing licence holders and Citizens Advice/ Citizens Advice Scotland will have 20 working days (from the first working day after this letter is published) to decide if they want to appeal to the Competition and Markets Authority against any licence modifications. Barring any appeal, the licence modifications will have effect from the date set out above.

If you have any questions regarding the content of this letter, please contact David McCrone by email at david.mccrone@ofgem.gov.uk or on 0141 341 3993.

Yours sincerely

Frances Warburton
Partner, Wholesale Markets

¹⁶ The direction can be found here: <https://www.ofgem.gov.uk/publications-and-updates/modification-special-conditions-1a-and-5f-national-grid-gas-plc%E2%80%99s-gas-transporter-licence-facilitate-implementation-capacity-allocation-mechanisms-network-code>