

Marcel Neef
BBL Company VOF
Postbus 225
9700 AE Groningen
The Netherlands
4A 1AB

Direct Dial: 0141 263 0532
Email: Michael.Wagner@ofgem.gov.uk

Date: 18 January 2019

Dear Marcel

Authority decision to derogate BBL Company (BBL) from certain Articles of Commission Regulation (EU) 2017/460

Summary

On the 4 October 2018, BBL submitted an application for derogation from several articles of Commission Regulation (EU) 2017/460, establishing a network code on harmonised tariff structures for gas ('TAR')¹, to Ofgem for review, pursuant to Article 37 of TAR. This letter outlines our decision granting BBL derogation from certain articles of TAR and our reasons for doing so in line with the criteria set out in Article 37 (a-e).

Background

TAR came into force on 5 April 2017. TAR aims to contribute to European market integration, enhance security of supply and promote interconnection between gas markets. It does this by introducing a number of requirements for transmission system operators (TSOs).² In particular, it sets out how TSOs must design reference price methodologies³ and how corresponding reserve prices are calculated. There are also requirements in TAR that aim to increase the transparency of tariffs. These relate to requirements to publish and consult on various pieces of information.

TAR recognises that its requirements could jeopardise the efficient operation of some interconnectors. Accordingly, Article 37 of TAR states that National Regulatory Authorities (NRAs) may, at the request of an entity which operates an interconnector and has benefited from certain exemptions⁴, grant a derogation from one or more articles in TAR. NRAs may grant a derogation if the application of those particular articles would have one or several of the following negative consequences:

- a. not facilitate efficient gas trade and competition;
- b. not provide incentives for investment for new capacity or to maintain existing levels of capacity;
- c. unreasonably distort cross-border trade;

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0460&from=EN>.

² Note that interconnectors are considered to be TSOs and certified as TSOs.

³ TAR defines reference price methodology as the methodology applied to the part of the transmission services revenue to be recovered from capacity-based transmission tariffs with the aim of deriving reference prices.

⁴ To be eligible for a derogation, an interconnector must have benefited from an exemption from Article 41(6), (8) and (10) of Directive 2009/73/EC in accordance with Article 36 of that Directive or a similar exemption.

- d. distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;
- e. not be implementable when taking into account the specific nature of interconnectors.

On the 4 October 2018, BBL submitted an application for derogation from certain articles of TAR to Ofgem for review. BBL is also proposing changes to its Charging Methodology.⁵ The proposed Charging Methodology aims to facilitate compliance with TAR, excluding the requirements in TAR from which BBL is seeking derogation.

We will consider the proposed changes to BBL's Charging Methodology in a separate decision. Our views on BBL's derogation proposal in this letter do not imply any position on BBL's Charging Methodology.

BBL's proposal

BBL's overarching reason for applying for derogation from certain articles of TAR is that it is a merchant asset without a regulated allowed revenue. In its application, BBL noted it relies exclusively on market demand and capacity bookings for its revenues. BBL has no captive demand and competes in the market with other flexibility assets such as storage and LNG. As such, BBL's view is that a derogation from certain aspects of TAR is necessary for its ongoing business viability and to ensure it can compete with other flexibility sources.

In particular, BBL argues that derogation is required for the following three categories of articles that:

- 1) restrict tariff flexibility and BBL's ability to compete in the market
- 2) require the publication of information that is commercially sensitive for BBL as a merchant interconnector
- 3) relate to TSOs with a regulated asset base, captive customers and multiple network points and are therefore not relevant to BBL as a merchant interconnector.

The table in **Appendix 1** summarises which parts of TAR BBL is seeking derogation from and, in BBL's view, which of the negative consequences listed in Article 37 each article would cause if applied. BBL's arguments for each category of articles have also been summarised below.

Articles that restrict tariff setting flexibility

Applicable articles: 12.3, 13.1, 13.3, 15, 28, 29(a), 29(b)(i), 31.2(a)

In its application, BBL argues it needs flexibility to set its tariffs as it is a merchant asset that competes with other sources of gas flexibility.

- Article 12.3 requires that reserve prices for quarterly, monthly, daily and within day capacity are set in advance of the relevant gas year and fixed throughout that gas year.
- Article 13.1 and 13.3 require that multipliers, which are applied to the reference price, to calculate the reserve price of non-yearly capacity products, must be set within a range.
- Where seasonal factors are applied to the reference price to reflect changing demand within the year, Article 15 sets out how the reserve price for non-yearly standard capacity products are calculated based on that projected demand.
- Articles 28, 29(a), 29(b)(i) and 31.2(a) require the publication of information relating to the above articles.

⁵ <https://www.bblcompany.com/news/consultation-of-proposed-modifications-to-the-gb-charging-methodology>

BBL noted that, as a merchant asset, it needs to be able to respond to changing market conditions in order set competitive prices in the short term. The application of these articles, in BBL's view, would impose constraints that are not applied to its competitors.

Articles that would expose commercially sensitive information

Applicable articles: 7(a), 26.1(a)(iii), 26.2, 30.1(b)(iii)(2-5)

BBL argue that the application of these articles would force BBL to release commercially sensitive information to its competitors:

- Article 7(a) of TAR requires TSOs to choose a reference price methodology that enables network users to reproduce the calculation of reference prices and their accurate forecast.
- Under Article 26 of TAR, GB interconnectors must consult periodically on charging information prior to charges coming into effect.
 - This includes the indicative reference price as required by 26.1(a)(iii).
 - Article 26.2 also requires that the final consultation should be open for two months.
- Article 30.1(b)(iii)(2-5) includes information that TAR requires TSOs to publish before the tariff period, for example capital and operating expenditures.

BBL argue that complying with the above articles would force BBL to reveal commercially sensitive information that would give an unfair advantage to its competitors.

Articles not relevant to merchant interconnectors

Applicable articles: 5, 26.1(a)(iv)(vi), 30.1(b)(i)(ii), 30.1(b)(iii)(1), 30.1(b)(iv)(v), 30.2, 30.1(a)(ii)(iii),

BBL noted in its application that, since it has no regulated asset base, captive customers or multiple network points, certain articles that relate to these characteristics would not be relevant to BBL as a merchant interconnector:

- Article 5 of TAR requires TSOs to perform cost allocation assessments in order to identify cross subsidisation between network users by comparing transmission services revenue recovery in relation to domestic end users.
- Article 26.1(a)(iv) requires TSOs to publish the results of the cost allocation assessments. BBL noted in its application that as all its revenues are collected through capacity sales, it would not be relevant to perform a cost allocation assessment and has therefore sought derogation for the above articles.
- Article 26.1(a)(vi) of TAR requires TSO to publish a comparison of the reference price methodology compared to an equivalent methodology using capacity weighted distance. BBL argue the capacity weighted distance approach is a methodology relevant to a TSO with multiple network points and therefore it would not be possible for it to carry out this comparison.
- Articles 30.1(b)(i)(ii), 30.1(b)(iii)(1), 30.1(b)(iv)(v), 30.2 and 30.1(a)(ii)(iii), make reference to a regulated asset base and transmission services revenue, which BBL do not consider relevant, as they do not have either.

Charging Methodology Consultation

On 8 August 2017, BBL consulted on changes to its Charging Methodology pursuant to Standard Licence Condition (SLC) 10 of its Gas Interconnector Licence. At the same time, it published its proposed derogation application. Whilst it did not seek responses on the derogation application, the changes to the Charging Methodology aimed at facilitating compliance with TAR, apart from those articles from which it is seeking derogation from.

Where a respondent commented on aspects of the Charging Methodology that relate to articles in TAR from which BBL has sought a derogation, we have considered these in coming to our decision on BBL's derogation application.

There were three responses to BBL's Charging Methodology consultation. One respondent argued (in relation to a request for derogation from Article 13.2) that flexibility in setting seasonal factors should not be required if BBL are granted flexibility in how it sets its multipliers. In response, BBL have removed Article 13.2 from its derogation application, therefore it will not be considered in our decision. This respondent also noted that there was a risk that, over time, BBL could use the multipliers proposed in the Charging Methodology to accrue excess profit, and that this behaviour should be monitored. The other two respondents did not comment on aspects of the Charging Methodology that relate to BBL's derogation application.

The Authority's decision

Eligibility for derogation

Article 37 of TAR allows the Authority to grant derogation from articles in TAR for an interconnector that has benefited from an exemption from Article 41(6), (8) and (10) of Directive 2009/73/EC or a similar exemption. Shortly after it was commissioned, BBL received an exemption from third party access under Article 22 of Directive 2003/55/EC⁶. When Directive 2009/73/EC entered into force it repealed Directive 2003/55/EC. Given that BBL came into operation prior to the 2009 Directive, we consider that the exemption it received is a similar exemption to that set out in Article 41(6), (8) and (10) of Directive 2009/73/EC and that BBL is eligible to apply for derogation under Article 37 of TAR.

Our Decision

Following consideration of BBL's derogation application, the responses to BBL's Charging Methodology consultation, and the criteria for granting a derogation under Article 37 of TAR we have decided to grant BBL derogation from the articles listed in **Appendix 2**.

Reasons for our decision

BBL is a merchant asset that competes with alternative providers of flexible gas supply.

Taking into consideration this competitive environment, it is our view that the application of some articles that restrict BBL's tariff setting flexibility and the application of articles that would force BBL to reveal commercially sensitive information would distort competition with other infrastructure operators that offer services of a similar nature.⁷

Furthermore, it is our view that some articles in TAR that relate to TSOs with a regulated asset base, captive customers and multiple network points are not implementable given the specific nature of BBL as a merchant interconnector.⁸

Articles that restrict tariff flexibility and BBL's ability to compete in the market

We agree that Articles 12.3, 13.1, 13.3 and 15 would inhibit BBL's ability to optimise the price of its short-term products and therefore we consider that the application of these articles would distort competition with other operators that offer services of similar nature to BBL. For example, some storage and LNG facilities have the ability to adjust their pricing dynamically in response to market conditions. Given the competitive environment, we think

⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003L0055&from=IT>

⁷ TAR Article 37, criteria (d)

⁸ TAR Article 37, criteria (e)

it is appropriate for BBL, as a merchant interconnector operator, to have more tariff setting flexibility than allowed for under TAR.

The same considerations can be made in relation to Articles 28, 29(a), 29(b)(i) and 31.2 (a) that require BBL to publish and consult on information related to the specific tariff setting process in TAR.

For the above reasons, we derogate BBL from the following articles in TAR: 12.3, 13.1, 13.3, 15, 28, 29(a), 29(b)(i), 31.2(a).

With regards to the response to BBL's Charging Methodology consultation about monitoring BBL, we will continue to monitor the market to ensure that it remains competitive.⁹

BBL's tariff setting regime is set out in its Charging Methodology. We approve any changes to the Charging Methodology under SLC 10 of the gas interconnector licence. Although, in this decision, we are granting BBL derogation from the requirements of TAR for the articles listed above, BBL will be required to continue to review its Charging Methodology annually and must ensure it meets the relevant Charging Methodology objectives. That is, that the Charging Methodology be transparent, objective, non-discriminatory and compliant with the Regulation¹⁰, and any relevant legally binding decision of the European Commission and/or Agency.

Articles that require the publication of information that is commercially sensitive for BBL as a merchant interconnector.

We also consider that where TAR requires the publication of information that is commercially sensitive for BBL as a merchant interconnector operator, the application of such articles will distort competition. Articles 7(a), 26.1(a)(iii) and 26.2 would require BBL to reveal its pricing strategy, while 30.1(b)(ii), 30.1(b)(iii)(2-5) would reveal sensitive information relating to its commercial operations. We agree with BBL that these articles would require BBL to publish information that is commercially sensitive and in doing so would distort competition with other operators that offer services of a similar nature.

For the above reasons, we derogate BBL from the following articles in TAR: 7(a), 26.1(a)(iii), 26.2, 30.1(b)(ii), 30.1(b)(iii),(2-5)

Articles that relate to TSOs with a regulated asset base, captive customers and multiple network points and are therefore not relevant to BBL as a merchant interconnector

We also consider that certain articles in TAR are not implementable for BBL as a merchant interconnector. Articles 5, 26(a)(vi), 30.1(a)(ii)(iii), 30.1(b)(i)(ii), 30.1(b)(iii)(1), 30.1(b)(iv)(v), and 30.2 relate to TSOs with a regulated asset base, captive customers and multiple network points. BBL does not have these characteristics. We therefore agree that these articles would not be implementable when taking in to account the specific nature of BBL as a merchant interconnector.

However, it is our view that if derogation is granted for Article 5, then Article 26a(iv), which requires the publication of the results of Article 5, will not have effect. We therefore do not think there is sufficient justification to grant derogation for Article 26a(iv).

For above reasons, we derogate BBL from the following articles in TAR: 5, 26.1(a)(vi), 30.1(a)(ii) and (iii), 30.1(b)(i) and (ii), 30.1(b)(iii)(1), 30.1(b)(iv) and (v), 30.2.

⁹ Ofgem State of the energy market 2018 report

https://www.ofgem.gov.uk/system/files/docs/2018/10/state_of_the_energy_market_report_2018.pdf

¹⁰ Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks
<https://eurlex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32009R0715>

Next steps

Our decision to derogate BBL from the articles in TAR listed in **Appendix 2** is effective immediately, and those articles are hereby suspended from effect.

Under Article 37(5) of TAR, we may revoke any or all of the derogations granted in this letter if the circumstances or underlying reasons, or both, no longer apply or upon a reasoned recommendation of the Agency for Cooperation of Energy Regulators (ACER) or the European Commission to revoke a derogation due to a lack of justification.¹¹

The above derogations shall continue until the Authority decides to revoke the derogations granted. BBL must notify us in the event of any material changes to circumstances relating to its derogation application. In addition, BBL shall provide the Authority with an annual report by 31 December 2019 and then each calendar year thereafter. The report must explain whether the derogations granted continue to have sufficient justification as required in Article 37 TAR.

We will notify this decision to ACER and the European Commission.¹² If you have any questions relating to this decision, please contact Robin.Dunne@Ofgem.gov.uk.

Yours sincerely

Michael Wagner
Systems and Networks

¹¹ Article 37(5)

¹² Article 37(4)

Appendix 1 – Summary of Requested Derogations

The below table summarises which parts of TAR BBL is seeking derogation from and, in BBL's view, which of the negative consequences listed in Article 37 each article would cause if applied.

| Chapter | Description | Article applied for derogation | Criteria A.37 (a-e) |
|------------------------------------|-----------------------------------------------------------------------|------------------------------------------|----------------------------|
| I – General Provisions | Cost Allocation Assessments | 5 (entire article) | (a),(b),(c) |
| II – Reference Price Methodologies | Choice of a reference Price Methodology | 7 (a) | (d),(e) |
| III – Reserve Prices | General Provisions | 12.3 | (a),(b),(c),(d),(e) |
| | Level of Multipliers and Seasonality factors | 13.1, 13.3 and 15 | (a),(b),(c),(d),(e) |
| VII – Consultation Requirements | Periodic Consultation | 26.1(a)(iii),(iv),(vi) and 26.2 | (a),(b),(c),(d),(e) |
| | Consultation on discounts, multipliers and seasonal factors | 28 (entire article) | (a),(b),(c),(d),(e) |
| VIII – Publication Requirements | Information to be published before the annual yearly capacity auction | 29(a) and (b)(i) | (a),(b),(c),(d),(e) |
| | Information to be published before the tariff period | 30.1(a)(ii) and (iii), 30.1(b)(i-v) 30.2 | (a),(b),(c),(d),(e) |
| | Form of Publication | 31.2(a) | (a),(b),(c),(d),(e) |

Appendix 2 – Summary of Granted Derogations

The below table summarises which parts of TAR we have granted BBL derogation from.

| Chapter | Description | Articles from which BBL have been granted Derogation | Criteria A.37 (a-e) |
|------------------------------------|-----------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|----------------------------------------|
| I – General Provisions | Cost Allocation Assessments | 5 (entire article) | (e) |
| II – Reference Price Methodologies | Choice of a reference Price Methodology | 7 (a) | (d) |
| III – Reserve Prices | General Provisions | 12.3 | (d) |
| | Level of Multipliers and Seasonality factors | 13.1, 13.3 and 15 | (d) |
| VII – Consultation Requirements | Periodic Consultation | 26.1(a)(iii), 26.1(a)(vi) 26.2 | (d) (e) (d) |
| | Consultation on discounts, multipliers and seasonal factors | 28 (entire article) | (d) |
| VIII – Publication Requirements | Information to be published before the annual yearly capacity auction | 29(a) and (b)(i) | (d) |
| | Information to be published before the tariff period | 30.1(a)(ii) and (iii), 30.1(b)(i), 30.1(b)(ii) 30.1(b)(iii)(1) 30.1(b)(2-5) 30.1(b)(iv) and (v) 30.2 | (e) (e) (e) (d) (e) (e) |
| | Form of Publication | 31.2(a) | (d) |