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Dear Tom,

Call for Evidence: Change to Existing Arrangements for Accessing Licence Baseline Exit Capacity on the National Transmission System at Bacton Interconnection Point

We refer to your Call for Evidence (CFE) dated 26 July 2019 seeking views regarding whether or not existing arrangements at the Bacton Interconnection Points (IPs) need modification.

Although the CFE is primarily concerned with access to capacity at Bacton, it also covers a wide range of topics including consideration of LNG, storage, transmission and transit flows of gas, market liquidity and security of supply. Rather than respond to all the questions posed in the CFE, IUK limits its response to a number of key issues we have identified in the CFE.

Key Messages

Our key messages are that:

- Statutory processes for assessing market demand for capacity outlined in the CAM Network Code¹ (NC CAM) and EU Gas Security of Supply Regulation (SofS Reg)² must be followed in considering obligated capacity needs at the Bacton (BBL) exit point.
- 2. The current allocation of National Transmission System (NTS) capacity at the Bacton (IUK) exit point meets legal obligations.
- 3. The current allocation of NTS capacity at the Bacton (IUK) exit point is appropriate.

We conclude that the introduction of competing capacity, as has been suggested by BBL, is not a robust solution.

To protect the interests of existing and future consumers the RIIO-2 process affords Ofgem with an opportunity to consider additional investments in the infrastructure at Bacton.

¹ <u>Commission Regulation (EU) 2017/459 of 16 March 2017 establishing a network code on capacity allocation</u> mechanisms in gas transmission systems and repealing Regulation (EU) No 984/2013

² <u>Regulation (EU) 2017/1938 concerning measures to safeguard the security of gas supply</u>

<u>Statutory processes for assessing market demand for capacity must be followed in considering obligated capacity needs at the Bacton (BBL) exit point</u>

It is unclear to us why you are seeking views on whether and how exit arrangements on the National Grid (NG) at the Bacton IPs need modification. Clear statutory processes already exist to assess market demand for capacity at IPs. These statutory processes ensure efficient investment, coordination and alignment of the offered capacity levels at IPs and across transmission points. The processes include the need for a positive market demand assessment and the requirement to pass an economic test before capacity is made available. The relevant rules are outlined in the NC CAM (Articles 22-31) and, for the NTS, in the NG IP Planning and Advance Reservation of Capacity Agreement process (IP PARCA)³ and the Exit Capacity Release Methodology⁴. It is mandatory that these rules are followed when considering the allocation of capacity. We are surprised there is no mention of these processes in the CFE and cannot ascertain from the letter how the CFE fits into these processes.

When a NC CAM market assessment was conducted by BBL and National Grid (NG) in 2017 there was no signal for incremental capacity at the Bacton (BBL) exit point. The market demand assessment report, published in July 2017 jointly by NG and BBL⁵, said:

"The indicative demand is too low to pass even the most favorable economic test. Hence for the entryexit systems addressed by this report, no incremental capacity project/process nor technical studies will be initiated based on this market demand assessment report. BBL Company will, however, continue to investigate the possibilities to install physical reverse capability on the BBL-interconnector at its own expense and risk".

The current offering and allocation of NTS exit capacity to the Bacton (BBL) exit point with interruptible or non-obligated capacity is consistent with this.

Furthermore, there is no information in the public domain why the BBL investment created 184.78 GWh/d of available capacity when the market demand signal it received was far less than that⁶. That 2017 market demand assessment showed an initial demand signal for only 12 GWh/d received by BBL, 15 times less than the incremental capacity it has built. To date we understand BBL has not made any IP PARCA application for NTS capacity⁷. As such we fail to understand why, as suggested in the CFE, BBL considers it does not have equal and transparent access to capacity when due process has not even been initiated.

As required by the NC CAM, a 2019 IP market demand assessment across Europe, including the Bacton (BBL) exit point, was recently concluded. This provided another opportunity to signal additional capacity needs⁸. The assessment window requesting non-binding demand indications closed on 26th August. NG again received no positive market demand for Bacton (BBL) exit capacity⁹.

It is clearly noted in both the CFE and its appendix that expressions of interest in Bacton (BBL) exit would not be considered firm commitments but merely as stakeholder views and opinions, so it is important for Ofgem to explain its intentions and how these fit within the statutory processes. We

³ National Grid process for reserving NTS capacity for new investment (PARCA and NC CAM)

⁴ The NG Exit capacity release methodology statement

⁵ See: <u>https://www.bblcompany.com/about-bbl/consultations-implementation-information</u>

⁶ This is greater than the 170GWh/d mentioned in the CFE. The figure of 184.78 GWh/d is in the BBL

Interconnection Agreement and now used by NG on PRISMA to offer daily interruptible NTS exit capacity for the BBL offtake.

⁷ No notifications indicated on NG PARCA page

⁸ NGG Expression of Interest for Incremental Capacity at Interconnection Points Market Demand Indication

Assessment starting 1st July 2019

⁹ NG 2019 confirmation of no demand indication for incremental capacity at GB IPs

would welcome assurances from Ofgem that the CFE will not interfere with or undermine the mandatory process prescribed for assessment of capacity demand.

If changes to the NTS exit capacity arrangements are being considered for security of supply reasons, then a separate prescribed process exists under the SofS Reg. This requires a market demand assessment to be conducted that comprises (amongst other things) assessment of the possible economic impact on existing infrastructure and a cost benefit analysis (CBA)¹⁰. If there is a positive CBA, the beneficiaries of the improved security of supply should also contribute to the cost of any required enhancement.

The current allocation of capacity at the Bacton (IUK) exit point meets legal obligations

There are a number of separate offtakes from the NTS system at Bacton as noted in Table 8 of the NG's Gas Transporter Licence Special Conditions¹¹. The Bacton (IUK) exit point is physically separate from the Bacton (BBL) exit point, and holds 651.67694 GWh/day of Baseline Exit Capacity as stipulated in the NTS Licence¹².

The exit capacity at the Bacton (IUK) exit point fully matches IUK's entry capacity at its Bacton terminal. The associated 651.67694 GWh/day of IUK's exit capacity at the Zeebrugge IP is furthermore matched with Fluxys Belgium's entry capacity. Likewise, in the other direction, from the continent to GB, the technical capacity is fully matched at either side of the Bacton and Zeebrugge IPs.

These current arrangements are consistent and fully compliant with the obligations outlined in the NC CAM¹³ and SofS Reg. The arrangements ensure a harmonised and coordinated maximisation of technical capacity. Consistent with the these obligations, the technical capacities at both the Moffat and Bacton (IUK) exit points are ring fenced from capacity substitution under NG's Exit Capacity Substitution methodology¹⁴.

The current allocation of capacity at the Bacton (IUK) exit point is appropriate

(a) At peak times, the NTS Bacton (IUK) exit point capacity is needed now and in the future

The CFE suggests that the expiry of IUK's long term contracts has structurally changed flow patterns, interconnector utilisation rates and NBP v TTF price dynamics. The CFE however provides no analysis to support these statements. IUK disagrees with these assertions.

It has only been a few months into the first summer since those initial contracts expired, which is not enough time to see a changing trend for GB export. As Ofgem will be aware, IUK flows are highly responsive and dependent on price differentials, supply/demand fundamentals, maintenance programs and disruptions on the UK Continental Shelf and Norwegian Continental Shelf, as well as competition in the flexibility market. This gas year has witnessed high LNG imports into both GB and continental markets unlike past years. Another year could be different depending on global demand and supply conditions.

The graph below shows actual GB export flows via the Bacton (IUK) exit point¹⁵ and evidences that the current pattern of gas flows remains similar to past summers when IUK still had long-term contracts

¹⁰ As outlined in Article 5 of the EU Gas Security of Supply Regulation.

¹¹ National Grid System Gas Transporter Licence Part C Special Licence Conditions

¹² 623.58 GWh/day as outlined in Table 8 plus 28.096940 GWh/day at outlined in Table 10 (Legacy TO Exit Capacity) of NG's Gas Transporter Licence Part C equals 651 67694 GWh/day

of NG's Gas Transporter Licence Part C equals 651.67694 GWh/day.

¹³ See Article 6.

¹⁴ <u>NG Exit Capacity Substitution and Revision Methodology Statement</u>

¹⁵ Data up to August 2019, source <u>https://transparency.entsog.eu</u>

in place. It also shows periods of high flows at or near peak capacity, which is certainly a lot more frequent than the 1 in 20 demand which infrastructure is typically designed to meet.

Figure 1: Actual GB Export Flows (GWh/day) via Bacton (IUK) exit point – no evidence of structural change in flow patterns



🗢 National Grid Gas – Bacton (IUK) (exit) Physical Flow 🛛 🔶 National Grid Gas – Bacton (IUK) (exit) Firm Technical

NG's Future Energy Scenarios (FES) 2019 suggests interconnector export flows will be steady until at least 2040. This is used as justification by NG for its Bacton Terminal redevelopment proposal plan as part of its RIIO-2 draft business plan proposals. The proposals are to maintain at least the existing capacity¹⁶. We note that this Bacton redevelopment report suggest a range of forecasts for Bacton exit flows which include a scenario greater than the existing capacity levels¹⁷.

In terms of bookings, it is important to note first that only 90% of technical capacity is made available long term as 10% is required under the NC CAM to be offered short term for the next gas year. The Bacton (IUK) exit point does actually see a high level of capacity bookings in certain periods. As shown in Figure 1, utilisation has been as high as 100% of technical capacity for periods in the gas year 2016/2017, greater than 90% in the gas year 2017/18 and thus far as high as 93% for periods of 2019/20. Looking at the suite of NTS products available to shippers a lot of these flows are with short term and/or interruptible bookings. This is hardly surprising given the market and pricing incentives have driven the whole GB market more towards short term bookings when there is the opportunity to do so. This compares favourably with other exit points such as the Moffat exit point which does not see as much peak utilisation: no one is suggesting that the Moffat exit capacity is no longer needed for exports to the Irish Market. Another consideration is that future/longer term bookings have been impacted by the ongoing uncertainty about future transmission charges on the NTS pending the conclusion of the NTS charging review with Ofgem's decision on UNC modification 678 and its alternatives¹⁸.

¹⁶NG Future Energy Scenarios

¹⁷ This capacity need includes local distribution as outlined in paragraph 4.11 of NG Annex A22.02 Bacton Terminal Redevelopment Justification Report – July 2019. See National Grid website for further details on its draft RIIO-2 proposals: <u>https://www.nationalgridgas.com/about-us/business-planning-riio/have-your-say-our-future-businessplans/we-have-developed-our-draft-plan-with-you</u>

¹⁸ <u>https://www.gasgovernance.co.uk/0678</u>

NG in its RIIO-2 Bacton redevelopment plan¹⁹ justification also cautions against looking just at longer term product bookings saying "It is clear through stakeholder engagement, that there is a long-term future at Bacton. However, the volatility of the market is reducing the amount of long-term capacity bookings in favour of short-term. The long-term capacity bookings do not reflect the true future need, and we should no(t) base decisions on capacity booking data in isolation."

Overall, it is impossible for Ofgem or any other stakeholder to confidently consider that NTS capacity is no longer needed to be matched with IUK at the Bacton (IUK) exit point. On the contrary, the outlook for export flows through IUK is positive.

(b) NTS entry and exit arrangements are consistent

The CFE refers to the NTS entry arrangement at the Bacton IP, and seems to indicate that there is an inconsistency between the entry and exit arrangements, and/or that the entry arrangements should be mirrored into the exit provisions. We do not believe there is an inconsistency between the current entry and exit arrangements.

Whilst Bacton is commercially an aggregated entry point, as Ofgem note in the CFE the technical capacity of both BBL and IUK are fully matched by NG at the Bacton (IP) entry point, in line with the NC CAM obligations. The obligation to fully match the technical capacity of the interconnectors was noted by Ofgem and both BBL and IUK when the Bacton ASEP was split in 2015. The equivalent for a Bacton (IP) aggregated exit point, if it was considered, would require the technical capacity of both BBL and IUK to be fully matched on the NTS side. NG would therefore need to increase the obligated capacity by 184.78 GWh/d.

The key reason for keeping the 2 IPs together in a Bacton IP ASEP when the NC CAM was implemented was due to historical NG unbundled capacity contracts. Whilst splitting the Bacton ASEP was needed for NC CAM compliance, historical capacity contracts could no longer be used flexibly with any of the 5 entry points at Bacton. Creating a Bacton IP ASEP at least allowed historical NG contract users to use this capacity flexibility with either IUK or BBL. At the time BBL did not support creating the Bacton IP ASEP arguing individual points were better and raised concerns about competing auctions²⁰. IUK also preferred individual entry points but recognised the challenge for NG shippers with historical contracts. There was no such issue on the exit side, as contracts were linked to individual offtakes consistent with the exit regime as a whole, therefore there was no reason to create an aggregated exit point.

The reason there could be competing auctions on the Bacton IP ASEP originates from the fact that there was, and still is, an amount of unbundled NG entry capacity sold on a long term basis. With NTS technical entry capacity equal to the sum of both BBL and IUK exit capacity, this means that the competing auctions only relate to requests for bundled capacity. To date there has never been a competing auction triggered for the Bacton IP ASEP. As the longer term NG unbundled entry capacity bookings tail off in the coming years, the potential need for competing auctions will disappear.

(c) Creating a technical mismatch and using competing auctions is not appropriate

We are aware BBL has suggested sharing the technical capacity currently allocated to the Bacton (IUK) exit point and using competing auctions for the allocation. We do not believe creating a mismatch of technical capacity in such a way is appropriate or compliant with legal obligations. We believe that the introduction of competing capacity at Bacton is not a robust solution.

¹⁹ Para 4.8 of Annex A22.02 Bacton Terminal Redevelopment Justification Report July 2019. See National Grid website for further details on its draft RIIO-2 proposals (link in footnote 17).

²⁰ BBL response to Ofgem consultation "Facilitating the implementation of aspects of the CAM NC in GB

BBL decided to invest in its reverse flow project at its own risk and expense and the EU and GB regulatory regime, in particular the type of capacity products NG could offer, were well known to BBL at the time. When making its investment decision, BBL had not concluded any capacity agreements for this reverse flow project, had not concluded an amended interconnection agreement with NG, nor had it obtained an increase in NTS exit capacity levels at the Bacton (BBL) exit point. In the circumstances, BBL has had equal and transparent access to NTS capacity. We note that since making its investment decision, BPL Aprocess.

Clearly, accessing capacity on the NTS is not a free for all. It requires defined rules to be respected. One cannot simply build a gas power generation plant, a direct industrial offtake, or storage facility near another offtake and then demand NTS capacity via competing auctions because the investment has already been made. This would set a dangerous precedent, allowing preferential treatment to be introduced undermining the NC CAM and the NTS PARCA regime.

Competing auctions are furthermore not an appropriate allocation mechanism for NTS exit capacity at Bacton as auctions would be continually triggered if there is technically mismatched exit capacity. Competing auctions could potentially sterilise over a quarter of IUK's Bacton capacity and would have a knock-on impact at the Zeebrugge IP, affecting not just IUK but also Fluxys Belgium given capacity matching and the fact that IUK operates on an *in equals out* balancing regime. From a regulatory point of view, we also refer to the NC CAM stipulating that technical capacity is to be maximised and matched across an IP, and that specific actions at a given IP should not be detrimental to the offer of capacity at other IPs. Similarly, in relation to competing capacities, the NC CAM specifies that competing auctions can only be put in place subject to the agreement of the directly involved transmission system operators.

Considering the wider and longer term arrangements at Bacton

IUK considers that the Bacton entry and exit arrangements should be regarded in a wider context and with a more long term perspective. Relevant factors that should be considered in relation to allocation of capacity at Bacton include:

- A continuing UKCS production and export, well into the 2040s, for which Bacton is a crucial landing point and a route to continental markets;
- A net zero CO₂ emissions policy by 2050 for the UK, which, together with the government policy of maximising economic oil and gas recovery, supports UK exports;
- A growing import gap in the UK and in North West Europe, based on declining indigenous production and coal-to-gas and nuclear-to-gas switching;
- A growing seasonality in UK demand and net export/import requirements;
- A growing volatility in capacity booking and utilisation, amongst others due to further exposure to global supply and demand dynamics, increasing commercial destination flexibility by LNG players and Norwegian gas production, combined with physical events like flow disruptions and unplanned maintenance.

For these reasons, IUK is of the opinion that the Bacton terminal will remain a crucial asset for the GB energy supply and exports. This means that there will be periods of high utilisation and a high demand for operational flexibility. This view is supported by NG's FES publication forecasting multiple scenarios with increasing or steady levels of GB export flows through Bacton.

As noted earlier, NG is proposing to redevelop the Bacton terminal as part of its draft RIIO-2 price control business plan. IUK is supportive of NG's proposals to rejuvenate the Bacton terminal for the reasons outlined above. To protect the interests of current and future consumers, we believe that RIIO-2 affords Ofgem with an opportunity to review wider and longer term objectives, and, subject to a positive market demand assessment and cost benefit analysis, expand the capability of the Bacton terminal.

We look forward to continuing to work with Ofgem to address the current and future challenges facing the NTS at Bacton.

Yours sincerely,

Steven De Ranter Managing Director