Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

Implications for Ireland of Planned Reforms of UK Gas Transmission Exit Regime

Consultation Paper
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Executive Summary

Significant reforms to offtake arrangements on the U.K. gas transmission network (NTS) are due to come into effect from July 2007. These reforms follow on from proposals by the U.K. energy regulator (OFGEM) and will be implemented by National Grid (NG NTS), the U.K. transmission system operator.

All exit points on the NTS will be impacted by these reforms, including the Moffat exit point, which is the central point for gas importation into the Republic of Ireland, Northern Ireland and the Isle of Man. The Commission for Energy Regulation (CER) in conjunction with the regulators in Northern of Ireland (OFREG) and the Isle of Man (MEA) have had extensive consultations with OFGEM and NG NTS to discuss how arrangements at Moffat can be adapted to accommodate the Exit Reforms. Central to these discussions have been the issues of security of supply and market foreclosure, which will become serious threats to the gas markets downstream of Moffat if appropriate arrangements are not established.

This paper is concerned with progressing the development and establishment of new operational, legal and regulatory arrangements at Moffat in light of the planned NTS reforms. The paper is constructed as follows;

- The introduction outlines the CER's security of supply and market foreclosure concerns
- Following from this, section 2 summarises the rationale for the Exit Reforms on the UK side and presents the main features of these reforms
- Section 3 highlights the impact these reforms will have on the three jurisdictions downstream of Moffat
- Section 4 breaks down the three options (Options A, B and C, which are discussed further in the Appendix) into four issues for public consultation
- Section 5 discusses the expected legal and regulatory considerations that will be required to facilitate any reforms of the current Moffat agreements
- The concluding section summarises the discussions and explains the CER's preference for Option A as a mechanism for ensuring long-term security of supply and avoiding the possibility of market foreclosure.

Comments on this paper should be forwarded to Jill Murray at jmurray@cer.ie by close of business on Friday the 17th of November.

1. Introduction

Significant reforms to the current regulatory arrangements for offtaking gas from the U.K. transmission system operated by National Grid NTS (NG NTS) are due to come into effect in the next twelve months. These reforms follow on from proposals by the U.K. energy regulator (OFGEM). They have been well documented in various OFGEM and NG NTS publications and have been the subject of intensive industry consultations within the U.K.[1]

The reforms will apply to all exit points on the U.K. system, including Moffat in Scotland which accounts for 85 per cent of all gas supplies within the Republic and 100 per cent of supplies to Northern Ireland and the Isle of Man.

For some while now, the Commission for Energy Regulation (CER) has been concerned that a simple, unqualified application of the planned reforms to Moffat, without taking account of the unique role Moffat plays in meeting Ireland's gas supplies, would pose very serious problems to Ireland. These problems would focus primarily on issues of;

- security of energy supply
- potential market foreclosure effects here if all or most of Moffat capacity were contracted to existing market players for 3 to 7 years, as could well be the case.

These concerns are shared to some extent by the CER's counterparts in Northern Ireland (OFREG) and the Isle of Man (MEA).

There has been a lot of engagement between the various regulators and with market players in each jurisdiction. OFGEM, for its part, has acknowledged the special role of Moffat as an exit point and has been quite open to tailoring the planned reform arrangements to accommodate this special role, while not undermining the basic principles driving the reforms in the first place.

In this consultation paper, the CER sets out the background to the issues involved at Moffat and proposes a number of alternative approaches to resolving them. For convenience, these approaches are presented under the headings of **Option A, B and C**.

[1] See, for example the draft Transmission Pricing Control Reviews (TPCR) published by OFGEM, the latest published on the 25th of September and the Code Modification (0116) published by NG NTS on the 13th of September, both of which are available on their respective websites.

The issues and proposed remedies are complex. They are also urgent. Once the preferred Option is chosen, a very considerable volume of preparatory work by the regulators, the transporters and the industry itself will be required to ensure an orderly, efficient and responsible application of the reform measures to Moffat from the scheduled date – October 2007

2. Background

2.1 Rationale for UK Reforms

The sale of the gas distribution networks in June 2005 created a new interface for exit points on the National Transmission System (NTS) in Great Britain. These changes as well as the predicted investment that would be required to sustain the level of growth and demand on the system motivated OFGEM to develop a new "enduring offtake" framework for all exit points on the system.

Under the enduring offtake regime, two products will be offered at each exit point; a flat capacity product and a flow flexibility (flow flex) product. The advance booking of flat capacity will enable shippers to secure their long and medium term requirements for gas while providing NG NTS with a solid basis on which to plan and build their system with firm bookings underpinned by financial commitments. The introduction of flow flexibility allows system transporters to apportion costs to shippers who do not ship gas at a constant flat rate. It will do away with the current tolerance levels and any shipper who does not book flexibility and deviates from their firm capacity will be charged for an overrun.

2.2 Main Features of Reforms

The principal initiative behind the new arrangements is the creation of a "user commitment" model with an emphasis on all shippers who offtake at an NTS exit point to secure sufficient capacity to meet their needs 3-7 years in advance. OFGEM's stated objectives of these "enduring offtake arrangements" are to;

a) provide efficient investment signals to the National Grid;
b) promote efficient operation of the NTS;
c) ensure offtake rights in a non-discriminatory manner;
d) facilitate effective competition between shippers and
e) protect the interests of customers in England, Scotland and Wales.

National Grid published, on the 13th of September 2006, a Code Modification Proposal developing the business rules that will incorporate these objectives into the NTS Grid Code. In this modification, NG NTS have outlined; the operational aspects of the 'user commitment' model; their intention to terminate the 'certification process[2]'; and the basis of the 'flow flex' product.

The establishment of a flow flex regime will aim to provide flexibility to shippers who do not offtake from the system on a flat or consistent basis throughout the day. According to the initial proposals, a total of 22 mcm of flow flex exit capacity will be available across the NTS. It will be sold on a zonal basis, with 17 allocated zones on the system and zonal maxima of 4.6 mcm. The product will be sold at annual pay as bid auctions but there will be scope for inter and intra zonal secondary trading.

Introducing a flow flex capacity product will require within day measurement and allocation systems to keep track of how and where flow flex is used as opposed to the current retrospective allocation and balancing regime.

2.3 Existing Arrangements at Moffat

Moffat, as a Connected System Exit Point (CSEP) on the NTS Network, will be subject to the NTS exit reform changes. Shippers downstream of Moffat importing gas from Great Britain will be forced to change their booking patterns as of July 2007.

Currently, downstream shippers book entry capacity at Moffat and nominate their gas deliveries on a daily basis to Bord Gais transportation (BGN). The Moffat agent matches the bookings downstream and up-stream of Moffat and advises any mismatches to the transporter and the shippers. Obtaining capacity downstream of Moffat entitles the shipper to nominate a UK shipper to deliver gas at Moffat. Only Shippers who have a counter-party on the downstream capacity register may acquire firm, long-term NTS Exit Capacity at Moffat – other shippers may only book interruptible capacity. This is known as the 'ticket to ride' and it prevents a UK shipper hoarding exit capacity at Moffat. UK shippers serving the downstream markets book their exit capacity with National Grid and

[2] The certification process is the basis from which the 'ticket-to-ride" system, currently in operation at Moffat, works. It is the mechanism through which a non-NTS shipper can assign a 'ticket' to an NTS shipper to buy a defined level of capacity from NG NTS. It is designed to prevent hoarding of capacity at a certain node.

nominate the gas flows on a daily basis through Moffat using the NTS system.

The Moffat Agent, currently BGE(UK), is appointed by downstream shippers and British shippers under the Moffat Administration Agreement (MAA) and the Offtake Profile Notice Agreement (OPNA). The Agent is responsible for matching nominations on both sides of the flange, advising NG NTS of all expected offtakes at Moffat for a given day and submitting to them an End-Of-Day-Quantity (EODQ). After the gas day, the agent will apportion the gas allocations for each individual shipper and will update the Moffat IT system (Gemini) with this information.

3. Impact of Reforms on Three Jurisdictions Downstream of Moffat

OFGEM and NG NTS outlined their proposals and intentions for the current reform proposals in March 2005 (OFGEM had signalled its intention for reform in May 2003). The CER responded to these proposals and wrote to OFGEM explaining the difficulties the proposed regime changes would pose for users downstream of Moffat. In its correspondence, the CER outlined a rationale for the Moffat Connected System Exit Point to be treated differently than other exit points on the NTS system and for the current arrangements to remain in place. As part of this rationale, the CER posited that the current arrangements at Moffat are complex and involve a number of contractual agreements between the different parties. A renegotiation of these arrangements would be a significant task and would involve multifaceted operational changes for those transacting at Moffat.

Adding to this complexity is that 85 per cent of gas usage in the Republic of Ireland is sourced at Moffat, while Northern Ireland and the Isle of Man source 100 per cent of their gas demands through the interconnector. Given this dependence on gas flowing efficiently from the NTS, the proposed reforms could have significant consequences for the security of supply of the three jurisdictions downstream of Moffat. This would have a knock on effect in the electricity sector as over 60% of electricity in Ireland is generated using natural gas.

The adverse impact of the NTS reforms in the three jurisdictions downstream of Moffat derive in part from the fact that the gas and electricity markets in these jurisdiction are young and immature. It is hoped that a number of new entrants will enter the newly liberalised markets. Existing players (in electricity and gas markets) ought, in theory, to reflect this by reducing their gas capacity bookings but in the real world new entrants will not be known three years in advance so these bookings will not be replaced. Even in the electricity sector the timings could be critical and new entry by gas generators could be prejudiced if capacity cannot be secured in a timely manner without undue risk. Hence the market foreclosure risk.

In its discussions with OFGEM, the CER highlighted this overall concern and outlined how the specific rules being proposed as part of the reforms could further threaten security of supply. As part of OFGEMs proposed incentive regime, NG NTS is introducing a 'substitution' mechanism, whereby instead of investing in new infrastructure at a node, NG NTS will be incentivised to substitute capacity from another node which has not received a long-term user commitment. This could mean that capacity would not be available at Moffat when required although the infrastructure could support additional capacity. For example, if the capacity requirements for the three jurisdictions is underbooked the extra capacity needed to service all demand downstream of Moffat may not be available.

As well as the issue of security of supply the inherent requirement to predict the gas requirements many years in advance could act as a barrier to entry for new competitors in both the gas and electricity markets because of price uncertainty or uncompetitive prices. New entrants could not be guaranteed gas capacity supplies in the future if sufficient capacity has not been secured to accommodate the increased demand. Under the business rules currently proposed by NG NTS, if a shipper has not reserved capacity in advance they will enter into a 'pay-as-bid' auction where they will have to compete with all shippers transacting on the NTS and bid for their requirements. Securing capacity, however, would depend on the prices submitted by the other shippers in the auction as auctioned capacity will be allocated according to the highest bid prices. The bid auction process will have the likely effect of elevating the price of short term products, which would act as a further barrier to entry and hamper the development of competition in the three downstream markets.

At a higher level the CER also expressed its concern that the Irish Government would no longer be able to meet its commitments to Northern Ireland and the Isle of Man under the Interconnector Treaties if the NTS exit reforms were implemented as proposed. Under these Treaties the Irish Government undertakes to make available a guaranteed pressure at Moffat to ensure the needs of Northern Ireland and the Isle of Man are met. If shippers in all three jurisdictions book their own requirements independently the government could not be held responsible if the guarantees were not met.

A further issue was that any re-enforcements at Moffat by NG NTS would be ineffective if these were not matched by BGN investment downstream. Therefore, the principle that shippers should signal their requirements at Moffat, allowing NG NTS to invest to meet these requirements, cannot be pursued in isolation. Investment at Moffat for shippers downstream will need to be carried out following consultation and co-operation between both transporters if inter-operable systems are to be developed.

OFGEM has been clear and consistent in its responses to the CER that it will not discriminate between exit points on the NTS but that it can acknowledge and take account of the special role played at Moffat by treating the exit point in a similar manner to a distribution network rather than a direct connection point. Since these initial communications, the CER, accompanied by its counterparts in Northern Ireland and the Isle of Man and by BG Networks, has been in regular contact with both NG NTS and OFGEM discussing the exit reforms and their subsequent impact on transactions at Moffat.

The exit reforms are now in the final stages of development and OFGEM has published a final draft Transmission Pricing Control Review (TPCR) report of their proposals (which are open for comment until close of business on the 24th of October). Responding to reforms on the NTS is, therefore, an urgent matter for the three jurisdictions downstream of Moffat.

4. Issues for Consultation

NG NTS has published a draft Code Modification to accommodate the changes introduced by OFGEM in their TPCR Paper. As part of this modification, NG NTS are proposing to terminate the certification process mechanism which underpins the current Moffat Agency Arrangements. It is likely that this modification will be consulted on within the next month and if implemented will change the operational arrangements at Moffat considerably. For this reason, there is an urgent need to develop and establish a substitute regime at Moffat which will accommodate both the Exit Reforms and the CER's core objectives (as stated earlier). Phase 1 of this regime, which will accommodate the booking of long-term capacity, will need to be in place by July 2007, while Phase 2, accommodating medium and short term bookings and reconciliation processes will need to be established by the summer of 2008.

4.1 The Single Party (SP) Route – Options A and B

During the meetings between NG NTS, OFGEM, MEA, OFREG and the CER, possible solutions to accommodate the NTS exit reforms at Moffat have been discussed. These discussions centred on the principle of a single party (SP) securing capacity for all parties downstream of Moffat.

Two possible options were discussed as to how this might be done in practice. Under the first option **(Option A)** the SP would book and pay for all the capacity required and sell it on to the downstream shippers. Under the second option **(Option B)** the SP would reserve the capacity, shippers would book their requirements and the SP would pay for any shortfall in the capacity reserved and that which was actually booked. The high level operational aspects of the two options are outlined and explained in the **Appendix.**

4.2 Avoiding the Single Party – Option C?

It has been argued that the proposed Options A and B are complex, if not unnecessary. It has been suggested that there is an alternative option **(Option C)** – to retain the status quo and not react to the changes on the NTS side of Moffat. The implications of this are also discussed in the appendix. The CER has taken this into consideration but is not at present convinced that transactions at Moffat can continue under the new NTS regime and still achieve the core objectives of security of supply and the development of competitive markets without the development of a new Moffat system and the deployment of one or other of Options A or B. However, it would welcome opinions to the contrary supported, preferably by practical illustrations.

4.3 The Appointment of a Single Party

Both Option A and B as presented, are premised on the appointment of a Single Party (SP) to secure NTS exit capacity for all parties downstream of Moffat. A Joint Capacity Statement for each jurisdiction will be prepared which will indicate the expected capacity requirements for all downstream users at Moffat. The SP will be obliged to book that amount of capacity as specified by the regulatory authorities.

Downstream Irish interconnector tariffs would be set with a view to recovering the costs that the SP might be envisaged to pay in respect of NTS exit charges. However, any increases in NTS exit capacity charges above expectation (which might for example arise from unexpected large Moffat throughput requirements where capacity is available either side of the flange) would be incorporated into the following year's tariff and paid for by all downstream consumers.

It is the opinion of the CER that the appointment of a SP would be the most effective mechanism in ensuring security of supply downstream of Moffat while also facilitating the entrance of new competitors into both the downstream electricity and gas markets. There would also be benefits in having a SP booking capacity if short term capacity were required in an emergency situation e.g. sudden loss of Corrib. In this scenario there would be only one shipper seeking capacity rather than multiple shippers bidding against each other. Thus capacity could be obtained more cheaply and allocated in an efficient manner.

The CER invites comments on the merits of a SP at the Moffat NTS exit point and possible suggestions as to whether its role could be accommodated under an alternative regime.

4.4 The Appropriate Entity to Act as the Single Party

Throughout the discussions on the different options it has been assumed that BGN would act as the SP at the Moffat NTS exit point. It is the general consensus that BGN is in an appropriate position to independently secure long term capacity requirements for all users of the Moffat interconnectors. It would also facilitate the method of purchasing capacity as BGN is responsible for allocating and selling Moffat entry capacity. However, if BGN is to assume the role of the SP, it may require an exemption from the British Department of Trade and Industry (DTI) as, under U.K legislation, transporters are generally not permitted to transact as shippers on the NTS network. Assuming that it is accepted to appoint a SP at Moffat, the CER invites parties to comment on the appointment of BGN as the SP or to suggest another party that may effectively assume the role.

5. General Legal and Regulatory Considerations

In addition to the market rules, grid codes and contractual arrangements at Moffat that need to be addressed, there are also legal, regulatory and jurisdictional issues that will require consideration throughout the process.

There will be a need for a redevelopment or creation of legal and/or institutional structures between the different parties interacting at Moffat. For example, the current Moffat Administration Agreement (MAA) and Offtake Profile Notice (OPN) Agreement may need adjustment to accommodate the new arrangements. Currently, these agreements provide a structure for the reconciliation of gas contracts, the creation of exit profiles and the appointment of the Moffat Agent. At this point it is not envisaged that the role and functions of the Moffat Agent will change following the implementation of new arrangements at Moffat. However, there may be additional functions to be incorporated into the post.

If it is decided that the cost of securing capacity at Moffat by the SP constitutes a public service obligation within the meaning of Directive 2003/53/EC, a Ministerial direction will be required for the administration of the public service obligation and its associated levy. This would require clearance from the European Commission

There is also the possibility that the existing Treaty between the Irish and British Governments may need to be updated to take the new arrangements into account. This treaty, signed on the opening of the second interconnector in September 2004, pertains to the transmission of natural gas between the UK, Northern Ireland and Ireland, with provisions for the connection to the Isle of Man.

The implementation of a new regime along the lines of Option A and B would require agreements and understandings between the different regulatory authorities. OFREG, MEA and the CER will need to agree on how the issue of shortfalls will be costed between the different jurisdictions and the level of responsibility each jurisdiction takes for the underwriting of either the booked or reserved capacity. This will require some contractual commitment between the three parties.

The costs associated with the new arrangements, including IT development and on-going operation of the SP, will need to be decided and allocated appropriately between the three jurisdictions. Furthermore, the development of tariffs at Moffat will be challenging and will require a formula which disperses the risks and costs evenly and appropriately across the different users.

On an individual level, each jurisdiction will also need to consider the necessity for Code Modifications and licence changes to accommodate either Option A or B. These will need to be developed under independent workstreams but will be a further cost for each jurisdiction.

6. Conclusions

Following a meeting on the 8th of September 2006 with gas industry participants in the UK, Isle of Man and the Republic of Ireland, it was decided that the CER would issue for consultation, a document outlining the proposals for the new arrangements at Moffat which will accommodate the impending NTS Exit Reform.

During this meeting it became apparent that special arrangements would be required at Moffat, as an exit point for the three downstream jurisdictions, to facilitate the NTS exit reforms. OFGEM and NG NTS indicated that they have no difficulty facilitating this principle. National Grid has, since this meeting, put forward their modification proposal for the business rules directing the exit reforms. There is leverage in this proposal to accommodate the options being consulted on in this paper.

However, the operational arrangements at Moffat function going forward will be complex and will involve significant discussions between all parties. What is now required is a focus for these discussions and a platform from which to progress the establishment of new Moffat arrangements. The CER is therefore asking interested parties to comment on the different options that were presented at this meeting (i.e. **Option A and B**) and the option of persisting with the status quo (**Option C**). The Commission is also interested in any alternatives or variations that might be proposed.

The CER also invites comments on the establishment of a SP to function as the entity responsible for securing capacity for all users downstream of Moffat in the unconstrained period. This only arises, of course, if Option A or B is taken up.

Throughout the discussions it has been assumed that Bord Gais Networks would act as the SP as it could; a) independently book exit capacity on behalf of all downstream shippers; b) provide the most transparent mechanism through which shippers could purchase both Moffat entry capacity and NTS exit capacity; and c) co-operate with the national regulators who will direct the level of capacity to be secured on behalf of all downstream jurisdictions. However, the CER, assuming the acceptance of the role of a SP, welcomes commentary on the appointment of BGN as the SP.

During the consultation period, the CER will liaise with OFREG, MEA and the relevant Departmental authorities to progress the legal and regulatory considerations that will be required to underline future arrangements at Moffat.

APPENDIX 1

Option A

The Single Party (SP) will book and hold an appropriate amount of NTS Exit Capacity (both "flat" and "flexibility") to accommodate the expectation of flow requirement into the Irish interconnector at Moffat. The amounts booked will be based on a Joint Capacity Statement taking into account the requirements of the three jurisdictions downstream of Moffat. The regulatory authorities shall approve the quantity booked and will underwrite any investment.

The SP will pay National Grid NTS the charges associated with its capacity bookings, which will be underwritten by the regulatory authorities. The SP would also be involved in the shorter term procurement of NTS Exit Capacity via purchases in medium-term (1-3 year) and short-term (daily, monthly, quarterly) product releases. This will allow for adjustments in downstream shipper capacity portfolios as booked in the Irish interconnector.

The SP will be responsible for any NTS overrun charges that arise in respect of Moffat offtakes. As there is effectively one holder of capacity at Moffat, NTS overruns will be calculated on an aggregate basis. This will provide benefits of diversity and could save costs overall on the Irish side.

It is envisaged that the SP will sell Moffat entry and exit capacity as a bundled product to shippers downstream of Moffat. Downstream shippers will then nominate the NTS shipper that will deliver gas for them at Moffat. This is similar to what happens at present with the 'ticket-to-ride' system but NTS shippers will not book capacity on the NTS side as the nominating shipper will have acquired this from the SP.

This aspect of Option A may be particularly advantageous if short term products are required downstream, as the capacity bookings will automatically be matched on both sides of Moffat. Under this option the SP can be incentivised to sell such bundled products and so reduce the liabilities of the Irish customers underwriting the capacity.

Under option A there is a financial disincentive for NTS shippers to independently book UK exit capacity at Moffat, as they will have to pay the bundled tariff on entry to the Irish market. The possibility therefore that an NTS shipper would book cheaper NTS exit capacity in the short run or as interruptible should not arise and gaming is unlikely.

On the negative side if Bord Gais Transportation is the SP an exemption for a shippers licence from DTI may be required and this could be time consuming. As BGT will have more responsibility for NTS capacity and as the bundled tariff will be more complex, additional resources including information systems may be required to manage the Moffat arrangements.

Option A is designed to meet the objectives of security of supply and preventing market foreclosure. It also facilitates Ireland meeting its obligations under the Gas Inter-Governmental Treaty referred to earlier. It further provides a number of advantages as described above.

Option A should also be more accommodating to the entrance of a flow flex product. A SP, holding flex capacity in trust for shippers, will be able to analyse the flex requirement for the Moffat point and secure this flex on behalf of all customers taking account of the benefit of diversity. As the SP booking the capacity, they will know what shipper uses it and to what level and may then apportion the costs accordingly and appropriately.

Option B

Following a high level development of the operation of Option B, it is envisaged that the SP will reserve NTS flat exit capacity at the Moffat exit point through an ARCA contract[3]. This reserved quantity will be held in trust by NG NTS who will assign it to NTS Shippers nominated by shippers downstream of Moffat. As in Option A, the reservation, made under an ARCA commitment, will be based on a Joint Capacity Statement taking into account the requirements of the three jurisdictions and will be approved by the regulatory authorities. The Regulatory Authorities will underwrite the quantity reserved and shall approve payments to NG for any shortfall in the quantity reserved and quantity booked.

Under this option, a downstream shipper will book Moffat entry capacity from the SP. Following this booking, the SP will provide a "ticket" to the downstream shipper which it will assign to its NTS counterparty. This will allow the NTS shipper to book a designated level of NTS exit capacity

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[3] An "ARCA" is an Advanced Reservation of Capacity Agreement. This is an agreement between BG and shippers for future NTS pipeline capacity at large sites. It allows shippers to reserve capacity in advance of gas flows. This is different from the 'ticket to ride' mechanism outlined in Option A. The ARCA would involve NG NTS holding pipeline capacity in trust for downstream shippers. The 'ticket to ride' offered by the SP in Option A, is effectively an invoice for the NTS shipper to claim capacity already booked by the SP from NG NTS.

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with NG NTS. Under Option B responsibility is delegated to NTS shippers for the booking of capacity, including medium-term (1-3 year) and short-term (daily, monthly, quarterly) product releases. Irish shippers will be responsible for buying Moffat entry capacity products from BGT.

An assumption of Option B is that NG NTS will accommodate a process that will ensure the ARCA reserved capacity will be booked before any independent capacity is sold to NTS shippers for use downstream of Moffat. In the event that all of the reserved NTS exit capacity is booked by NTS shippers and NTS exit capacity over and above this amount is required, the downstream shippers will communicate and contract with NG NTS independently to secure the additional amounts. In order to purchase this extra NTS exit capacity, the Irish shipper would have to liaise with BGT and, via an NTS shipper, with NG NTS to ensure that there is the required capacity available on both sides of the interconnector.

It is difficult to see how the introduction of flow flex could actually be accommodated under Option B. As the regime is currently envisaged, it would be difficult to calculate and reconcile who booked and used the flex capacity unless a SP takes control and reconciles flow flex bookings on a daily basis. In order to avoid this scenario, it is expected that a SP type entity would be required to assess the flow flex capacity needs for Moffat and to charge it accordingly to the appropriate shippers.

In the event of a security of supply scenario (e.g. if Corrib gas pipe should fail) it may be easier for a Single Party to procure capacity on behalf of all shippers and allocate as necessary. This might also be the cheapest solution if the alternative were that shippers bid against each other for capacity. Option B would not facilitate this mechanism as the SP would not sign up to the UKs Unified Code of Operations and therefore would not be in the position to act as a shipper and acquire capacity on behalf of all downstream participants.

From our discussions it is envisaged that the SP will pay for the capacity shortfall – i.e. the difference between what was reserved at the beginning of the year and what was actually booked throughout the year – at the end of the gas year. This would avoid the need for the SP having to make ongoing monthly capacity payments throughout the gas year, but will require new NG NTS systems to accurately calculate the amounts due.

Following from this, NG NTS has clarified two important issues which may affect this amount and thus the cost to the downstream customer.

Firstly, short term products and interruptible products may become cheaper closer to the day. Shippers may therefore choose not to book long term capacity in the hope that prices would fall but secure in the knowledge that the SP would have sufficient capacity to meet its demand.

Secondly, NG NTS have advised that it will not incorporate overruns when it is reconciling what is owed by the SP at year end. Both of these particulars would increase the cost to the downstream customer, who would pay for the price of the independent NTS shippers booking, the shortfall and the overrun charges.

It is the CER's view that in theory Option B meets the objectives of security of supply. However, a different process will be required for NTS shippers to procure NTS exit capacity under ARCA arrangements. In the absence of this there is potential for NTS shippers to underbook, leaving the SP with a residual ARCA commitment, imposing additional costs on downstream shippers and therefore downstream customers. As part of the development process examining Option B, NG NTS was asked if it would accommodate such an ARCA capacity process, preventing NTS shippers from independently booking non-ARCA reserved capacity. NG NTS has indicated that it will not discriminate between different exit points and will therefore not facilitate activities beyond its proposed booking arrangements. This impedes the effective operation of Option B and could impose added costs onto the downstream customer.

Option B would guarantee the security of supply downstream of Moffat, and would allow the Irish Government to meet it's Treaty obligations to Northern Ireland and the Isle of Man. However, it fails to address the potential market foreclosure concern and according to the current NG NTS Code Modification proposal, it could be considerably more expensive for the downstream customer.

<u>Option C</u>

It has been suggested by market participants that no change is required at Moffat to facilitate the NTS Exit Reforms. Proposals have indicated that the current interaction between the two systems will adequately accommodate transactions going forward. However, given the proposed Code Modification published by NG NTS, retaining the status quo is not an option. The certification process mechanism is being withdrawn and therefore a fundamental element of the current Moffat Agency Arrangements is being removed. Given this modification, there is no alternative but to re-examine the current arrangements and establish a substitute regime.

In addition to this, there are a number of risks for the three jurisdictions downstream of Moffat in failing to acknowledge the changes on the NTS side of Moffat and retaining the residual current arrangements. In the CER's opinion, the most significant implications and risks are; a) security of supply; b) barrier to new competitors entering the markets in the future; and c) an inability to implement systems in the future to accommodate changes once the impact of the reforms has been assessed.

Firstly, there is the risk, for both current shippers and potential new entrants, that capacity may not be available on the day at some point in the future. Option C would not provide NG NTS or NTS shippers with signals of the required demand downstream of Moffat, therefore NTS shippers may not book sufficient capacity on their behalf. Furthermore NG NTS may have substituted unbooked capacity at Moffat to another node on the NTS. According to the June proposals, NG NTS will be incentivised by OFGEM to substitute capacity to a node requiring an increase in their baseline before investing in expensive infrastructure to accommodate any increase in demand. In the instance that there is insufficient capacity at the Moffat exit point, an Irish shipper would be required to partake in a bid auction process for their required capacity (which given competition between all shippers for the available substitutable capacity has the potential to be quite expensive) or would be unable to bring gas to Moffat to transport across the interconnector to their customers downstream.

The uncertainty of capacity availability could also act as a barrier to entry for new competitors considering entering the downstream markets. Not alone will there be no definite knowledge as to the remaining exit capacity at the node, but the price would also be an uncertainty and would depend on the demand at the node on the day.

A flow flex regime would be impossible to administer if there was no SP to book flexible capacity for all participants at the Moffat exit point. Shippers would not be incentivised to buy it themselves as other shippers would be able to free ride on their booking without a party to administer who uses what capacity. In the absence of a flow flex booking, shippers whose offtake varies throughout the day, will incur overruns. This would increase the level of overruns and therefore costs incurred in operating at Moffat for all shippers.

The CER is not convinced that Option C meets the security of supply objectives and has serious concerns regarding market foreclosure should this option be chosen. The CER considers that we may not be able to meet our obligations under the Treaties if this Option is chosen. Furthermore, the termination of the certification process makes it impossible for market participants to retain the status quo at Moffat. A substitute regime accommodating capacity bookings between downstream and NTS shippers will be required whether it involves a SP or a hybrid mechanism.