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

Decision Document

CER/07/002

10th January 2007
Introduction

On the 20\textsuperscript{th} October 2006, the Commission for Energy Regulation (“the Commission”) published its consultation paper “Implications for Ireland of Planned Reforms of UK Gas Transmission Exit Regime”.

This consultation paper set out:

- The potential implications for security of energy supply and risks of market foreclosure in Ireland of the planned reforms of the UK gas transmission system given our reliance on the Moffat exit point.

- A number of possible solutions to address these implications and

- A number of questions to industry participants, with the intention of developing a consensus as to the best steps to take to secure gas supplies at Moffat into the future.

The Commission sought comment from interested parties on its proposals and questions. Having reviewed and considered these comments, the Commission is now publishing a decision document, which will form the basis of a work plan to progress new arrangements at the Moffat exit point.

Background

Following the sale of the gas distribution networks in June 2005, OFGEM sought to develop a new “enduring offtake” framework for all exit points on the UK National Transmission System (NTS). The main features of this regime are: the introduction of a user commitment model and of two exit capacity products – a flat capacity and a flow flexibility capacity product. The principle objectives of these reforms are to provide investment signals to the Transmission System Operator (National Grid NTS), to promote the efficient operation of the NTS and to ensure non-discriminatory access to exit capacity.

On the 13\textsuperscript{th} of September 2006, National Grid NTS (NG NTS) published a Code Modification Proposal, which develops the appropriate business rules incorporating these objectives into the National Grid Code of Operations. In response to this modification proposal, other UK parties published a number of alternative modifications\textsuperscript{1}, which have also been presented to the public for comment. Consultation on these proposals concluded on December 6\textsuperscript{th}. Following this, the proposals and all comments are being submitted to the Modification Panel, who may or may not recommend implementation.

\textsuperscript{1} Modification 116A put forward by E.ON UK, proposes retaining the current arrangements as the enduring offtake arrangements for all exit points. Modification 116B, presented by RWE Trading is a similar modification to that of 116 but proposes expanding the tolerances allowed to shippers from 1.5 \% as in the 116 proposal to 3 \%. Modification 116C was developed by Centrica. It proposes introducing the flat capacity product as per National Grids 116 proposal but dismisses the introduction of flex capacity.
All comments will subsequently be presented to OFGEM who will have the final decision on what modification is approved and implemented. A decision on the future of enduring offtakes is expected in January/February, with a July 2007 implementation date.

The proposed reforms affect the three jurisdictions downstream of the Moffat exit point, the Republic, Northern Ireland, and the Isle of Man, with modification 116 potentially having the most significant impact. From the Commission’s point of view, the principle areas of concern arising from the proposed reforms are, security of supply and market foreclosure or barriers to entry to the Irish market. These concerns were described in some detail in the 22 October consultation Paper. The Commission has also had extensive discussions with both OFGEM and National Grid who have been available to discuss how best our concerns could be accommodated under the proposed Exit Reforms.

The Commission has met and consulted with its counterparties in Northern Ireland and the Isle of Man over the past year also and has held wider participant fora attended by shippers, transporters and other interested parties from the affected regions.

As a result of these discussions, the Commission developed three alternative arrangements that could address our concerns (these were referred to as Options A, B and C. Both Options A and B involve establishing a Single Party at Moffat, which would take responsibility for booking NTS Exit Capacity at the Moffat Exit Point for all parties downstream of Moffat.

Under Option A the Single Party would book and pay for all NTS Moffat Exit Capacity. This would give the Single Party ownership of the capacity, permitting it to sell the capacity onto downstream parties.

Under Option B, the Single Party would simply reserve the required capacity. Each downstream party would be responsible for booking and buying their own capacity. In the event that the reserved capacity was larger than the booked capacity, the Single Party would pay the National Grid for the balance. In the event that the reserved capacity is less than the required capacity, downstream shippers would be responsible for procuring the surplus amounts. Following clarification of the arrangements intended under Option B, National Grid explained that it would not be operational under the proposed Exit Reform arrangements.

Option C was a suggestion that the current arrangements at Moffat would remain following Exit Reform. Basically it was proposed that shippers would continue to book their own individual capacity and take responsibility for the long term commitments that are required as part of the Exit Reforms.
The Commission consulted on these alternative options in its consultation document\(^2\) on 20\(^{th}\) October 2006. The consultation requested responses on a number of issues, specifically:

- Preference between options A, B and C
- Opinions on the appointment of a Single Party as the aggregate booker of NTS Exit Flat and Flex Capacity for all shippers downstream of Moffat, and
- Thoughts on the appropriateness of appointing Bord Gais Transportation as the Single Party and/or suggestions of any other party who may carry out the function in an effective and efficient manner.

Following a review of the comments received, the Commission is today publishing its decision on how to proceed with developing arrangements at Moffat to ensure security of supply, negate any chances of market foreclosure at the exit point and reduce any barriers to entry for new players seeking to enter the markets downstream of Moffat.

**Consultation Responses and the Commission’s Decision**

The Commission received 7 responses to the consultation document. These are published in conjunction with this decision document.

**Option A, B or C**

Respondents were not in favour of either Option B or C, feeling that both options would not address the risks created by the Exit Reforms. Most respondents came out in favour of Option A as the preferred option. The Commission has also concluded itself that it should pursue the appointment of a single party in line with Option A. Respondents also raised a number of queries in relation to the detailed implementation of Option A. The Commission is aware that the appointment of the single party and booking of capacity is a first step and considerable work is needed to determine precisely what the role should be and to develop the rules, processes and procedures that will need to be put in place for the effective performance of the function. It is the Commission’s intention to engage in wide ranging consultation with industry players to decide on the detailed implementation.

**The Single Party**

The Commission has decided that a single party should be established to book to book both NTS exit flat and flexibility capacity for all parties downstream of Moffat. The appointment of a Single Party (SP) should address the main concerns associated with the impending exit reforms, ensuring security of

\(^2\) Implications for Ireland of Planned Reforms of UK Gas Transmission Exit Regime
supply, counteracting the chance of market foreclosure and reducing the risks for new parties seeking to enter the downstream markets. The details of the functions of the SP will be determined following industry consultation, however the high level principles are described below.

The Single Party will sign up to the Unified Network Code (UNC) in the UK, allowing it to book both flat and flexible exit capacity on the NTS network. The amount which will be booked will be approved by the Regulatory Authorities (RAs) and will most likely be based on a Joint Capacity Statement. The Single Party will inform NG NTS of any increases in capacity that will be needed to meet downstream demand and commit to pay for any such increases in the constrained period. This exit capacity will be held on behalf of downstream shippers by the Single Party and will be made available to them on a non-discriminatory basis. The SP will be kept whole in respect of the booked capacity as approved by the RAs.

One respondent suggested that a Single Party entity would not be required in the event that OFGEM decide against the introduction of NTS Exit Flexible Capacity. Effectively, the response suggested that shippers would be capable of booking and securing NTS Exit Flat Capacity in the unconstrained period themselves and that the proposed “enduring arrangements” for the booking of NTS Exit Flat Capacity did not warrant the complexity involved in creating a Single Party. The respondent felt that the Single Party was only warranted to address the complexity of booking Flexible Exit Capacity. However, the Commission feels, a Single Party will be needed to book flat capacity and reduce the risks for new entrants seeking to enter any of the three markets downstream of Moffat. This is particularly so given the financial commitments and uncertainty surrounding the booking of flat capacity in the unconstrained period under the proposed arrangements.

The SP will also provide assurance for non-UNC parties as well as UK shippers, who would, in the absence of a Single Party, have to enter into long-term financial commitments. Furthermore, the Commission considers that UK shippers may be unwilling to incur the risks of trading at Moffat if the current Exit Reform Proposals are introduced without restructuring the current Moffat Arrangements to reduce the level of uncertainty. Therefore, the Commission is of the opinion that the Single Party will provide a mechanism which will facilitate continued trade at Moffat.

Most Appropriate Entity to Act as the Single Party

In its consultation paper, the Commission proposed that Bord Gáis Transportation would be in the most suitable position to act as the Single Party and asked industry participants to respond whether they agreed with their appointment or to suggest another party that would be in a better position to take on the role.

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3 Commission fro Energy Regulation (CER), Northern Ireland Authority for Energy Regulation (NIAER), Manx Electricity Authority (MEA)
The majority of responses were satisfied that Bord Gáis Transportation assumed the role of the Single Party. However, one response questioned its appropriateness in terms of the correlation between Bord Gáis Transportation and Bord Gáis Energy Supply. As regulated entities, the Commission is satisfied that the two divisions are appropriately ring-fenced and that any commercially sensitive information held by Bord Gáis Transportation as the Single Party would not be shared or made available to any other party, including of course Bord Gáis Energy Supply. The Commission concludes that Bord Gas Transportation should be appointed as the Single Party, at least for the early years of the new offtake regime. This is based on considerations of pragmatism, urgency, and BGT’s track record to date for fairness and professionalism. BGT has indicated its willingness to take on this role.

Subject to the agreement of the regulating authorities in Northern Ireland and the Isle of Man, the details surrounding the establishment and role of the Single Party will be consulted on with industry participants in the three jurisdictions. The arrangements outlining how the Single Party transacts in the UK and with downstream shippers at Moffat will also be considered and consulted on. This will include arrangements surrounding capacity bookings, pay-as-bid auctions, cost allocation and agreements between the different transacting parties.

**Other issues raised**

A number of parties commented on the costs of the proposed regime and how they would be allocated to the different parties. The allocation and recovery of costs is a very complex area and the Commission shall be consulting widely on the issues involved. In the first instance the allocation of costs across jurisdictions will need to be addressed. Costs of unbooked reserved capacity may give rise to a PSO levy and the implications of this need to be considered and addressed if necessary. Some respondents felt that the costs should be smeared across all users and it may be possible to do this without the need for a PSO levy. The Commission, which has not concluded that the proposed arrangements would necessarily give rise to a potential PSO levy, is currently discussing this issue with the Department of Communications, Marine and Natural Resources. The Commission considers that a bundled entry / exit tariff at Moffat might be appropriate under option A and will be examining the possibilities and implications of this arrangement as part of the consultation with industry.

In order for Bord Gáis Transportation to carry out the function of the Single Party it may require an exemption from the Department of Trade and Industry (DTI) in the UK. It was brought to the Commission’s attention that this is likely to be a lengthy process. The Commission will therefore endeavour to progress this exemption with DTI, in conjunction with the Department to ensure that an exemption, if needed, is in place by July 2007.
A significant part of the proposed “enduring offtake” reforms is that each shipper will have prevailing rights to exit capacity from National Grid (NG NTS). A number of parties, who are not registered shippers in the UK, are concerned that this will preclude them from carrying forward their current bookings of NTS Exit Capacity, thus requiring them to make a financial commitment for three-seven years in the future. This may also be the case for the Single Party, who currently does not book any NTS Exit Capacity and therefore has no prevailing right to that capacity. The Commission recognises that this may be an issue. However, it does not affect the decision on whether to appoint a Single Party or not. The Commission will discuss the matter of prevailing rights with NG NTS and OFGEM and update all parties accordingly.

A number of respondents considered that there was an insufficient level of clarity and information with regards to the regime that is to be implemented in the UK. The rules and procedures surrounding the sale of flexible capacity, substitution, prevailing rights and the different prices for commodity and capacity products have not yet been agreed upon and it cannot be said at this time how or if these proposals will be implemented.

The Commission acknowledges that a lot of further clarification and work on developing detailed arrangements remain to be done. However, the Commission is of the view that it would not be prudent to postpone developing arrangements to address NTS Exit Reforms until such a time as further information is made available. In order to have a regime in place to accommodate booking Moffat Exit Capacity in the unconstrained period by July 2007, the Commission believes that progress must be made and must continue to ensure the existence of appropriate arrangements at Moffat for the July implementation date. The Commission accepts that more information will be needed before any final decisions on the detailed implementation can be made. Monitoring the developments in the UK will therefore be an integral part of the work programme to implement the project and the Commission shall maintain communications on the reforms with OFGEM and NTS.

Conclusion

Responses to the Commission’s consultation paper, “Implications for Ireland of Planned Reforms of UK Gas Transmission Exit Reforms”, are generally supportive of the Commission’s position as presented in the October consultation paper. All parties expressed concern at the impending NTS Exit Reforms and its potential impact on security of supply and market foreclosure in the regions downstream of Moffat.

It is clear from the comments that all parties support the development and implementation of arrangements at Moffat to address a number of issues that may arise as a result of OFGEM’s proposed “enduring arrangements”. Responses to the consultation supported the establishment of a Single Party to act as the aggregate booker for all shippers downstream of Moffat.
The Commission has decided to pursue Option A which entails the establishment of the SP. The Commission has concluded that Bord Gáis Transportation is the best candidate for role of the Single Party. As the network system operator and holder of entry capacity downstream of Moffat, it is in the best position to assume the role and responsibility for NTS Exit Capacity.

The detailed arrangements surrounding the establishment and role of the Single Party will be decided following further consultation with industry. Also the Commission is engaging with the Department of Communications, Marine and Natural Resources on the proposed appointment of Bord Gáis Transportation as the Single Party and any issues to which this may give rise.