Implementing the European Gas Regulation (EC) 715/2009 in Northern Ireland

Conclusions Paper

5 June 2013

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Acronyms and Glossary

BGE(NI)	Bord Gais Eireann (Northern Ireland)
BGN	Bord Gais Networks
BGTL	Belfast Gas Transmission Limited
BTP	Ballylumford Torytown Pipeline
CAG	Common Arrangements for Gas
CAGSO	Common Arrangements for Gas System Operator
CAM	Capacity Allocation Mechanism
CBA	Cost Benefit Analysis
CER	Commission for Energy Regulation
CJV	Contractual Joint Venture
CMP	Congestion Management Procedures
DETI	Department of Enterprise Trade and Investment
DSOs	Distribution System Operators
ENTSO-G	European Network of Transmission System Operators for Gas
EU	European Union
FG	Framework Guideline
FOIA	Freedom of Information Act
HSE(NI)	Health and Safety Executive for Northern Ireland
MEL	Mutual Energy Limited
MO	Market Operation
NI	Northern Ireland
MEL	Northern Ireland Energy Holdings
NPV	Net Present Value
NWP	North West Pipeline
PTL	Premier Transmission Limited

RAs	Regulatory Authorities
SNIP	Scotland to Northern Ireland Pipeline
SNP	South North Pipeline
TSO	Transmission System Operator
UR	The Utility Regulator

1. Introduction

Purpose of this document

1.1. This document sets out our conclusions on how those aspects of Gas Regulation (EC) 715/2009 (the 'Gas Regulation') not currently applied in Northern Ireland will be implemented together with the next steps in the process.

1.2. It follows a consultation paper published in December 2012. The consultation proposed that system operation should be rationalised before the changes necessitated by the Regulation are made. The responses received to this consultation are summarised at appropriate points in this document and published alongside this document.

Background

1.3. Northern Ireland (NI) is obliged to implement Gas Regulation (EC) 715/2009 (the 'Gas Regulation'), including the European network codes required by Article 8. This will require a number of significant changes to the gas industry and regulatory framework. The original intention was to deliver implementation of some aspects of the Regulation through the Common Arrangements for Gas (CAG) project.

1.4. In December 2012, the UR issued a consultation[1] on the work needed to implement the Regulation in Northern Ireland including how best to organise system operation.[2] Building on work completed as part of the CAG project that document consulted upon:

[1] http://www.uregni.gov.uk/publications/consultation_on_gas_regulation
[2] See the RAs' update on the CAG project at http://www.allislandproject.org/GetAttachment.aspx?id=4d3a5d5b-85b9-4c58-b6b0-2987b46ebfb1

- the appropriate arrangements for system operation in Northern Ireland; and
- the scope of work required to implement the Gas Regulation in Northern Ireland.

1.5. For background on the Gas Regulation, system operation in NI, and previous work in these areas, including the detailed options for single system operation please refer to sections one and two of the December consultation paper. In addition, further information on many of these issues can be found on our website[3], or at the website of the All-Island Project[4], which includes CAG.

Structure of the Document

1.6. This document is organised into four sections:

- Section One – introduction
- Section Two – single system operation
- Section Three – implementation of the Gas Regulation
- Section Four – next steps.

[3] http://www.uregni.gov.uk/
[4] http://www.allislandproject.org/

2. Single system operation in NI

2.1. This section:

- Recaps on the proposals put forward in the December consultation on single system operation for NI;
- Summarises the responses received on single system operation in the December consultation document; and
- Sets out the UR's conclusions on single system operation.

Summary of consultation proposals on single system operation in NI

2.2. The consultation proposed that we should decide how system operation in NI is to be organised before any changes to implement the Gas Regulation are made. This was in light of the scope of change needed to implement the Gas Regulation. To this end it proposed applying proposals for single system operation in the CAG context to the NI only context. It also:

- Described our view of single system operation in NI. In practice it would mean implementing a single transmission code, single IT system, single TSO team to represent NI, and a single control room;
- Why we believe that this would be advantageous for NI, including the benefits of a single code and single IT system;
- The system operation functions that could be performed on a single basis;
- The options for single system operations in NI focussing on a new entity as the single TSO and the contractual joint venture option. Also;
- The assessment criteria for the options. These were based on the criteria used for CAG to assess the options for single system operation as part of that project.

2.3. The concept of single system operation proposed for NI is therefore similar to that which we wished to implement as part of CAG. However, it would be simpler to implement in NI as there are no issues of all-Island regulation to consider.

Summary of responses

2.4. The UR received nine responses to its December consultation. This section summarises the responses received to each of the questions on system operation in that document and the Utility Regulator's response.

Have we adequately described what single system operation would deliver or are there other elements which would need to be delivered?

2.5. Most respondents who addressed this question agreed that the consultation had identified what single system operation should deliver. Mutual Energy argued that roles and responsibilities for health and safety issues should be clearly defined, and two respondents expressed concerns about the costs of implementation of single system operation. In addition, SSE wrote that the timetable for compliance should be a primary driver for determining which option to take forward.

2.6. We agree that responsibilities for health and safety should be clearly defined. As set out below the TSOs prefer the CJV over the new entity single TSO option. Under a CJV model responsibilities for health and safety would remain as they are now. In relation to the costs of single system operation, see para. 2.36 – 2.38 below.

2.7. The idea that single system operation could be put off in favour of compliance featured in a number of responses. We consider this below in paras. 2.31 to 2.33 and our overall conclusion is that the changes we wish to make in NI are

a prerequisite for successful implementation of the Gas Regulation and will actually help to achieve compliance quicker than would otherwise be the case because the TSOs will have a mechanism to resolve disagreements and changes will need to be made to only one IT system and one code.

Do you agree that, in the absence of CAG, single system operation would deliver benefits for NI over the current operational regime?

2.8. Most respondents agreed that single system operation would deliver benefits for NI over the current operational regime. Mutual Energy argued that, given the magnitude of the proposed changes, all potential costs and savings should be identified.

2.9. We welcome the general consensus that system operation would deliver benefits for NI over the current operational regime. In relation to the costs of single system operation, see para. 2.36 below.

Do you agree with the proposed list of system operation functions which would be delivered on a single basis in NI?

2.10. Most of the respondents to this question agreed with the proposed list. Mutual Energy argued that Health and Safety obligations needed to be clarified, and AES responded that there should be clarity as to the boundary between the single TSO and the transmission asset owners.

2.11. As set out below the TSOs prefer the CJV over the new entity single TSO option. Therefore responsibilities for health and safety would remain as they are now and it would not be necessary to define the boundary between the single TSO and the transmission asset owners.

Are there any other advantages/disadvantages of the single TSO and CJV options which we have not considered?

2.12. CCNI proposed three further criteria: time required to develop the option, integration with CAG work and impact on investment in gas storage. Mutual Energy argued that costs for changing contracts should be assessed, and that the time necessary to comply with EU requirements should also be considered.

2.13. We agree that the time required to implement either of the options is a relevant factor and in this case the CJV model is the most time effective model to implement as it does not require the same scope of licence changes or new contracts as the new entity single TSO model. In relation to CAG the consultation stated our commitment to ensure that an NI only approach to gas regulation compliance should not obstruct any subsequent work on all-island transmission issues and this remains the case. In relation to single system operation the preferred model for CAG was a CJV. Moving forward with a CJV model in NI would entail a resolution of many of the issues that would need to be resolved for CAG such as how a governing committee would work and disputes would be resolved between the TSOs. In respect of storage we believe that this project should be largely indifferent to the structure for system operation in NI.

2.14. In relation to contract costs these were considered as part of our work on the CJV model in CAG and our view is that these are likely to be minimal once the TSOs have agreed the principles on which the contract will be drafted. We agree that the timetable for EU work needs to be considered and this is being discussed with the TSOs as set out below.

Do you agree with the criteria proposed to assess the options for single system operation?

2.15. Most of the five respondents who commented agreed with the criteria used to assess the options for single system operation. However, three respondents

(AES, Mutual Energy and BGE(NI)) argued that the timescale was important, given the need to comply with EU requirements. BGE(NI) also argued that risks attendant on unifying system operation should be taken into account. Mutual Energy proposed two further criteria: the impact on investor confidence, and the interaction with other IME3 issues.

2.16. As above the timetable for EU work is being discussed with the TSOs. In relation to any risks related to unifying system operation, the pros and cons of the various models were considered thoroughly as part of the CAG process and the model the TSOs prefer for NI is the same as that preferred for CAG, the CJV. The CJV does not change the scope of licensed activities or the regulatory model of either TSO therefore investors should be indifferent.

2.17. We will consider the interactions with other EU work streams with the TSOs as part of the process of developing an overall timetable for the gas compliance project.

Do you agree with the assessment of the single system operation models against the criteria?

2.18. The three respondents who commented on the UR's assessment of single system operation models against the criteria listed in the consultation document broadly agreed with it.

2.19. We note that Mutual Energy was concerned about the impact of the single TSO model on its funding costs but as set out below we have concluded that the TSOs should be given the opportunity to implement their preferred option, the CJV. BGE(NI) differed in some respects on the analysis of the two key models against the assessment criteria but overall preferred the CJV model.

Which options for the single system operation in NI do you prefer and why?

2.20. AES, the EAI and the CCNI requested further information before expressing a view. Mutual Energy argued that the cooperation approach could deliver a single code and IT system, PNGL supported a single TSO, though requesting more detail, and BGE(NI) supported a contractual joint venture.

2.21. We note the preference of the TSOs for the CJV over the single TSO model but also the desire for further information from some respondents. Before a CJV could be implemented it would require a new contract between the TSOs and licence modifications which would necessitate further consultation with industry. See the next steps in chapter 2 below.

TSOs to include any further thoughts they may have on their CJV models in the NI only context

2.22. Mutual Energy noted that the NI TSOs had jointly established a working group to review compliance work streams of EC 715/2009. The work done under CAG in an NI only context would be reviewed under this group. MEL's preliminary view was that the CJV staff and office should be based in NI. However, to deliver cost savings the control room operation should be tendered, which may result in the most appropriate counterparty being based outside NI. BGE(NI)'s response indicated its view that the costs of introducing a new control room for NI would outweigh the benefits and introduce new risks.

2.23. We welcome the fact that the TSOs have established a working group to review Gas Regulation compliance issues but as set out below we wish to see concrete progress resulting from this and will review progress in October.

2.24. For clarity we are not proposing that a new control room is established based in NI. Rather we agree with MEL that the control room function should be tendered. None of the Northern Ireland TSOs has a control room at present and therefore the model in Northern Ireland has been, for efficiency reasons,

to contract for control room services. BGE(NI) contract to BGN and PTL/BGTL tender for these services every five years. Going forward we envisage that the TSOs grid control needs will be met by the same provider to be selected by a competitive tender. We would expect that the contract for NI grid control would be tendered every five years or so, i.e. it would not be on an evergreen basis. The provider need not be based in NI.

2.25. BGE(NI) said that the TSOs believed that the focus for the EC715 implementation project in NI should be on developing arrangements for compliance with the Gas Regulation and also noted that NI TSOs had jointly established a working group to review compliance work streams. As set out elsewhere our overall conclusion is that the changes we wish to make to the structure of system operation in NI are a prerequisite for successful implementation of the Gas Regulation and will actually help to achieve compliance quicker than would otherwise be the case.

2.26. With regard to the Contractual Joint Venture (CJV), the NI TSOs under CAG were of the view that the CJV was the preference for single system operation and proposed to review the work done under CAG in an NI-only context through the joint working group.

2.27. See below where we have concluded that the TSOs should be given the opportunity to demonstrate practically that the CJV model can work and will deliver EU compliance, a single code, single IT system, single TSO team and single control room for NI.

Do you agree with our proposal to implement a single transmission code of operations and a single IT system in NI?

2.28. Each of the five respondents who commented on this question supported the UR's proposal to implement a single transmission code of operations and a single IT system overall, though some had comments on aspects of the proposal.

2.29. MEL's response floated the idea that it may be more appropriate for the TSOs to focus on using a common IT platform (as required by EU Capacity Allocation Mechanism (CAM) code) rather than moving to one IT system. On this point specifically the interaction between the timetable for EU code compliance and the timetable in NI for overall gas regulation compliance is being discussed by the TSOs. There are a number of platforms being developed in Europe for the auctioning of gas capacity, but these have been primarily developed for the purpose of CAM and so may not give the TSOs all the functionality of their current systems in which case a single IT system will still have value in NI over maintaining multiple systems. We note in particular BGE(NI)'s view that entry exit in NI will require a single IT system.

UR's conclusions

2.30. The UR has carefully considered the responses to its December consultation in the light of its statutory duties. We note that:

- most of the respondents were in favour of a single system operator in NI and all supported the proposal to implement a single transmission code of operations and a single IT system. Since the close of the consultation the TSOs have agreed that they will work to deliver a single NI transmission code, a single NI IT system, a single control room for NI, and a single NI team. The TSOs are working to establish a single TSO team and in relation to the single control room for NI we have set out for clarity what we mean by this in para. 2.24 above.;
- some respondents requested further detail about the costs and benefits of single system operation, and in particular the likely impact on customers;

- a number of respondents considered that each option should be assessed in terms of the compliance of its timescale with that of the Gas Regulation; and
- both TSOs favour a CJV over a new entity single TSO.

2.31. When considering the structure of NI system operation into the future we have taken a long term view reflecting the fact that the gas regulation compliance project will require intensive work over the next 3-4 years as the network codes on capacity allocation, balancing, and tariffs are implemented. However, the project will continue beyond this timeframe as subsequent network codes at EU level are agreed. In addition the EU compliance work needed will require fundamental changes to the current codes and IT systems in Northern Ireland and intensive coordination and agreement between the TSOs on a number of issues. Therefore it makes sense to ensure that the underlying structures between the TSOs are fit for purpose to deliver compliance at the outset and that is best achieved with a single code, single IT system etc.

2.32. It is our view that attempting to achieve EU compliance in a piece meal fashion with multiple codes, multiple IT systems, and two TSO teams will add cost and delay into the timetable which will increase the risk of infringement. Fundamentally single system operation will improve the capacity of the TSOs to take decisions and resolve disputes and this is a prerequisite for successful implementation of any work area where cooperation between the TSOs is required. It is not a question therefore of work on single system operation delaying EU compliance.

2.33. Our experience working with the TSOs to resolve the issues related to the second gas regulation infringement highlighted their inability to resolve areas of disagreement speedily; in particular issues in relation to virtual reverse flow took until February 2013 to be fully resolved. This delay occurred despite the fact that the UK was referred to the European Court of Justice for non-implementation of the second gas regulation. This experience highlights the

need for fundamental change to the structure of system operation and in any case the need for change has been on the agenda since 2005. In light of the fundamental changes in NI as a consequence of the Gas Regulation we believe that it is now time to ensure that a single code, single IT system etc is delivered.

2.34. Since the close of the consultation we have met with the TSOs to discuss gas regulation compliance and the structure of system operation in Northern Ireland. The TSOs have agreed that they will work to deliver a single NI transmission code, a single NI IT system, a single control room for NI, and a single NI team. We have also received a joint letter from the TSOs which signals their intent to work together to progress matters in relation to gas transportation in Northern Ireland, including work related to Regulation (EC) 715/2009. The TSOs intend to establish a governing committee and have identified a number of work streams to be taken forward. These are positive developments but we need to be confident that any new structures put in place by the TSOs will deliver EU compliance and the four outcomes that are agreed. Given the recent infringement proceedings we will judge the TSOs according to what they deliver. Despite the commitments above concrete progress since December has been limited, for example we do not yet have an agreed work plan for the project. However, we hope this will be agreed shortly.

2.35. Given the responses and our own analysis, the UR has reached the following conclusions:

- The UR wishes to ensure that Northern Ireland complies with the Gas Regulation requirements in a timely way. The existing structures for cooperation and coordination between the TSOs will not deliver this and so change is needed. Our conclusions seek to ensure this change happens in a timely and proportionate way so that work on implementation of the Gas Regulation can occur in parallel.

- A rationalised structure of system operation, and in particular the capacity of the TSOs to take decisions and resolve disputes is a prerequisite for successful implementation of the Gas Regulation and a single code, single IT system etc.

- Furthermore, given the likely efficiency advantages listed in the consultation document, it is appropriate to introduce a single system operation in Northern Ireland. The establishment of single system operation would result in a more efficient and coordinated gas industry and as such sits comfortably with our statutory duties. In particular, we believe that it would further our primary statutory objective, which is to promote the development and maintenance of an efficient, economic, and coordinated gas industry in NI and to do so in a way that is consistent with Article 40 of the Gas directive;

- A single code and IT system together with a single TSO team and single control room are appropriate to introduce in Northern Ireland, in particular for efficiency reasons, and also as it is likely to facilitate the entry of new suppliers to the NI gas market.

- Given the positive responses from the TSOs in respect of the CJV model we have concluded that it is appropriate to afford them the opportunity to demonstrate practically that this model can work and will deliver gas Regulation compliance together with a single code, single IT system etc. for Northern Ireland.

- The CJV would not require the purchase of a new building or the recruitment of new staff. It would therefore be a simpler, quicker arrangement to put in place. This is a significant advantage given the need to move forward with Gas Regulation compliance.

- However, the CJV relies on coordination and cooperation between the TSOs introducing risk that matters will not be resolved in a timely way.

Given the risk of infringement that Northern Ireland is now exposed to due to delays in the CAG project, we will wish to keep any CJV structures implemented under review to ensure that they are capable of delivering compliance and the key objectives of a single code, single IT system etc.

2.36. Given the concerns expressed by some respondents about the possible costs of moving to single system operation we have given the costs and benefits further consideration based on the cost data previously used for CAG and with the CJV in mind. In relation to costs establishing a CJV would require a contract to be put in place between the TSOs, entailing legal costs but these costs are likely to be relatively small once the principles are agreed between the TSOs. Also, the need for on-going coordination between the TSOs could impose some costs on the parties. Again, the costs of this are likely to be relatively small given an appropriate degree of cooperation between the TSOs. The CJV model is cost effective over the alternatives considered as costs associated with establishing a new corporate body with premises and its own staff is avoided.

2.37. In the December consultation paper we identified a number of benefits from moving to single system operation such as IT savings, administrative efficiencies for network users, system operators and the Utility Regulator. Also that a new structure would make it easier to implement the code and IT changes that would be needed for Gas Regulation compliance as these changes would only need to be made once rather than to the multiple codes and IT systems we have at present. These benefits are valid in the context of a CJV as MEL accepted in their response. As set out above we believe that single system operation is a prerequisite for successful gas regulation compliance and so will actually enable us to deliver compliance more quickly.

2.38. MEL did note that gas regulation compliance could lead to very high IT implementation costs. At this point such costs (mainly visible at present from the CAM network code) are unclear but costs will be incurred regardless of the

structure of system operation in NI as CAM requires the use of auctions for capacity on a single platform. In moving to a single IT system in NI we would wish to avoid the interaction of multiple systems in NI with any new gas capacity platform. It is also clear that the changes required by CAM are such that the existing IT structures in NI would need to be altered radically to comply with CAM. Our preference therefore would be to move to a single IT system for NI in parallel with work on EU network code implementation so that we can avoid duplication in costs from two IT systems in NI.

Next steps

2.39. The TSOs should therefore move swiftly to put the single code, single IT system etc in place. The clear preference of the TSOs is to do this by means of a CJV. This will require putting a governing committee and single TSO team in place which the TSOs have already indicated they are doing. These can be established and working in practice before the CJV contract is signed between the TSOs. This will ensure that there are appropriate structures in place based on agreed principles between the TSOs which can begin to deliver compliance.

2.40. As above we believe that they should be given the opportunity to put the CJV in place. We will therefore monitor developments over the next few months and assess the degree of progress in October.

2.41. In terms of deliverables by October we expect the CJV structures, in particular the governing committee and single TSO team, to be in place swiftly. Agreement on the detail of the formal CJV contract may need an additional number of weeks. We also expect that the CJV team will deliver the CMP changes required for October 2013 and make such progress on other aspects of gas regulation compliance by this date as will be agreed with the TSOs as part of the overall timetable for gas regulation compliance work which is being developed.

2.42. By October 2013 we will need to be satisfied that the CJV structure will deliver Gas Regulation compliance, a single transmission code, single IT system, single team, and single control room to the agreed timetable. Assuming satisfactory progress we should be in a position to consult on the formal CJV contractual arrangements and any necessary licence modifications to underpin the CJV.

2.43. If these expectations are not met by October 2013 then we will consider alternative approaches, including steps to move to a more formal single TSO structure.

3. Implementation of the Gas Regulation

Overview of European third package legislative requirements

3.1. The scope of work needed for Gas Regulation compliance in Northern Ireland covers:

- the introduction of a Gas Regulation compliant code and tariff regime, including the implementation of European network code requirements (12 codes in all)[5];
- new TSO transparency requirements applicable; and
- the implementation of the new rules on congestion management procedures (CMP) (e.g. an over subscription and buy-back regime and a firm day ahead use-it-or-lose-it mechanism)

3.2. We will also review existing products such the daily capacity product, interruptible product, and the virtual reverse flow product to establish what changes NI industry may want to these products going forward. It is appropriate to review these now so that any changes can be systemised on the single IT system.

3.3. The above work will require the following regulatory arrangements:

- Changes to the excising codes;
- A new tariff methodology;
- changes to licences to underpin the new regime;
- changes to the IT systems of the TSOs (single system operation would create a single IT system to which the changes would be applied); and
- a review of existing contractual arrangements consequent to the above changes to licences and codes.

[5] See Article 8(6) of Regulation (EC) 715/2009.

Summary of responses

3.4. The UR received nine responses to its December consultation paper, of which five respondents commented on the questions in the consultation paper on the UR's approach to the implementation of the Gas Regulation. This section summarises the responses received to those questions and the Utility Regulator's response.

Are there any other services not mentioned which suppliers require?

3.5. No respondents identified other services which shippers are likely to require, besides those listed in the consultation document.

Do you agree with how we propose to tie in the development of the single code with the EU network code process?

3.6. Five respondents commented on this question. AES agreed with the UR's proposal. Mutual Energy expressed the view that there should be no assumption that the network code adopted should be based on that of a neighbouring jurisdiction. PNGL was not certain about the timescale involved. firmus energy argued that the best approach would be to determine which option was best for NI, then work out how it could be made consistent with EU requirements. BGE(NI) believed that European developments should be monitored consistently.

3.7. We agree that in an NI only context there should be no presumption that models used in neighbouring jurisdictions would be appropriate for NI, although we consider that it is appropriate to use the analysis already completed for CAG as our starting point. As above the timetable is being discussed with the TSOs.

3.8. We intend to monitor EU developments as thoroughly as resources permit, through our membership of ACER. The TSOs are also members of ENTSOG which provides a further avenue to monitor developments.

UR conclusions

3.9. The work that we need to do deliver Gas Regulation compliance will stretch over the next several years.

3.10. In the short term a number of aspects of CMP must be implemented by 1 October 2013. These are capacity increase through an over subscription and buy-back scheme, arrangements for surrender of contracted capacity, and a long term use it or lose it mechanism. The current codes already incorporate some of these concepts although they do not fully meet CMP requirements. However, we do not have an over subscription and buy-back mechanism so this needs to be implemented. BGE(NI) and PTL are together working on a joint work plan for CMP which would result in implementation of the three elements required by 1 October 2013.

3.11. The other aspects of the work require larger scale IT changes and need to be scoped further by the TSOs. Therefore the TSOs are currently elaborating a timetable for gas regulation compliance and the achievement of a single code, single IT system etc. The timetable will be discussed with industry over the summer.

4. Next steps

4.1. We will move forward with those aspects of CMP that need to be implemented by 1 October. The TSOs are putting together a work plan for CMP that will be presented to industry shortly.

4.2. The TSOs will separately elaborate the wider work plan for gas regulation compliance and the development of a single code, single IT system etc. This will be discussed with industry over the summer.

4.3. As set out in section two above the TSOs should now move quickly to put the CJV in place. By October 2013 we will need to be satisfied that the CJV structure will deliver Gas Regulation compliance, a single transmission code, single IT system etc to the agreed timetable.