ACER

Agency for the Cooperation of Energy Regulators

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UK gas industry proposal to amend EU network codes to retain existing Gas Day

Meeting of O&GUK and Gas Forum with ACER

Ljubljana, 5 December 2014

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The current UK position

- Uniform Gas Day of 6am-6am in UK since early development of gas industry in 1970s
- GB and Irish markets both 6am-6am; IUK and BBL pipelines manage different gas days
- CAM <u>and</u> BAL Network Codes (and UNC Mod 461) require change in downstream Gas Day on 1 October 2015
- No legal obligation on terminal operators (TOs) or upstream producers to change Gas Day; most TOs and offshore operators cannot reasonably meet deadline
- Extensive one-off costs of change concentrated in upstream (€50-60m); no impact assessment or cost-benefit analysis undertaken in UK
- No longer possible with two different gas days to operate Claims Validation Information Agreement (CVIA) underpinning integrity of NTS and liquidity of NBP wholesale market
- Extensive industry discussion and DECC's Gas Day Working Group on interim arrangements but no agreement yet
- Gas industry wants single Gas Day but GB is heading towards sub-optimal, inefficient, two gas day outcome with adverse consequences for NBP market

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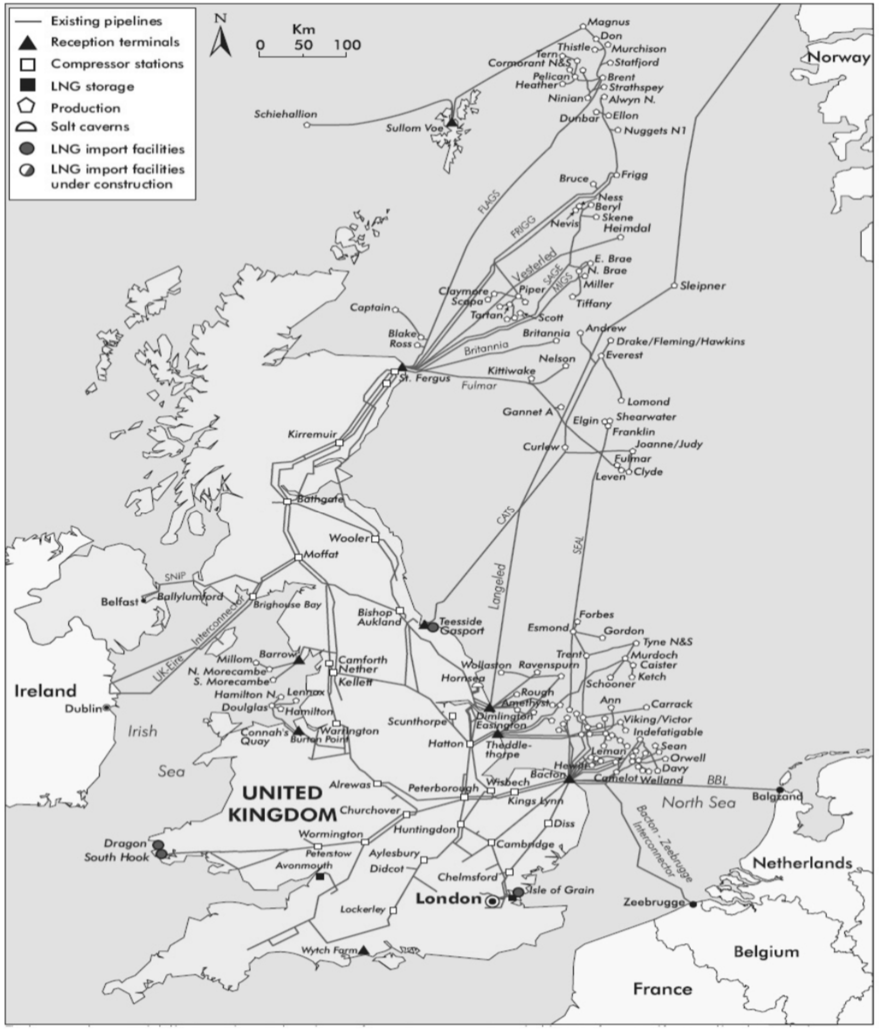
UK upstream gas is highly integrated with NTS



- Offshore production, gas processing, transportation and onshore terminal operations
- 140 offshore fields, 61 equity producers, 27 offshore operators and 12 terminals delivering gas into NTS
- Gradual development of offshore basins; from Southern North Sea to West of Shetland
- Thousands of commercial agreements, many signed before Network Code 1996-97 and UNC in 2006
- N Grid has bilateral Network Entry Agreements or legacy agreements with terminal operators
- Upstream regulated by DECC; downstream network transporters and shippers regulated by Ofgem
- Integration of physical and commercial data flows ensure integrity of NTS and NBP market

UKCS fields will supply 35 bcm of total NTS intake of 70 bcm in 2014

Offshore physical and commercial complexity

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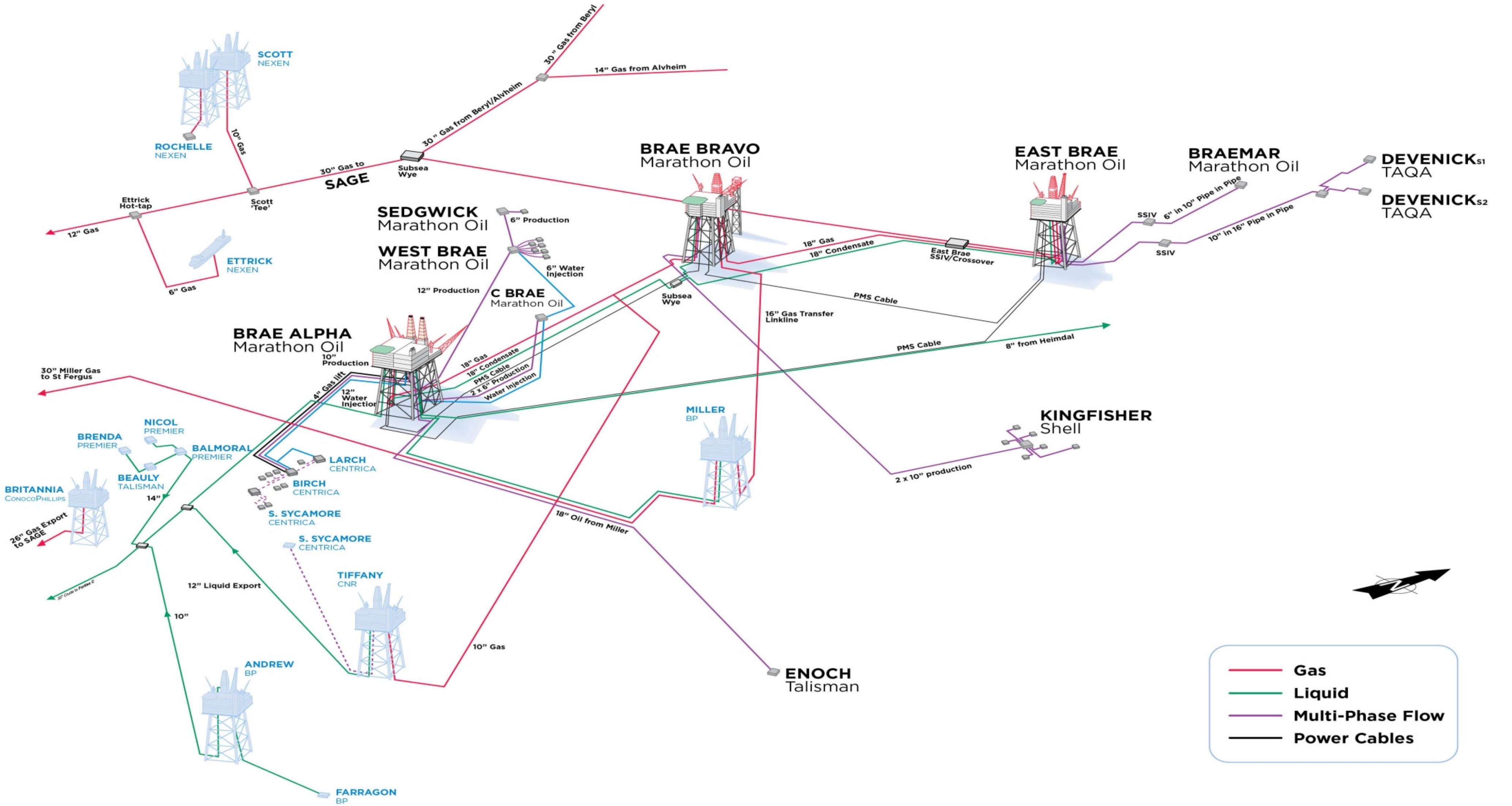

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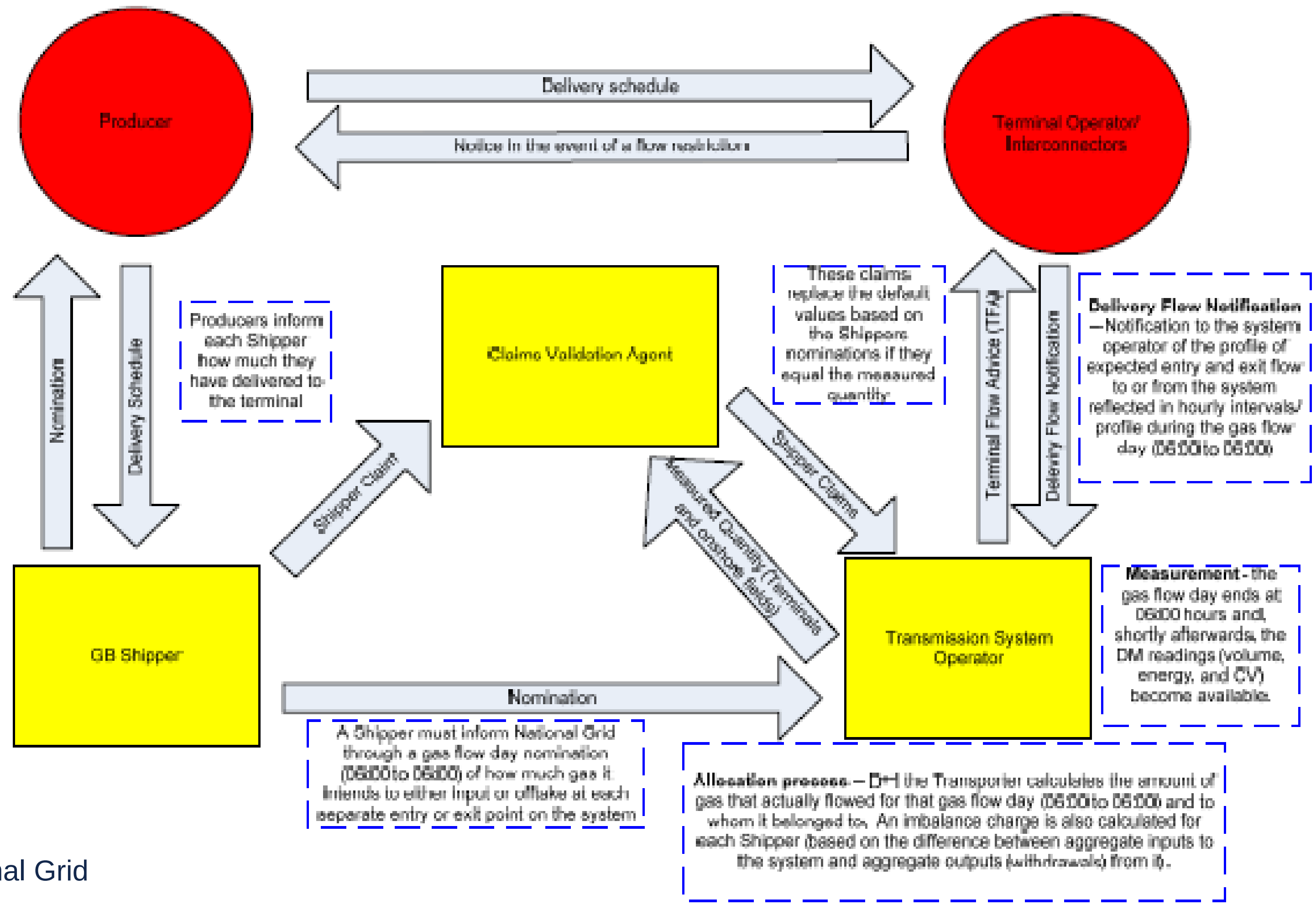
Data flows within UK industry



Source: National Grid

Key role of CVSL (CVA) in reconciliation of upstream allocations and shipper nominations

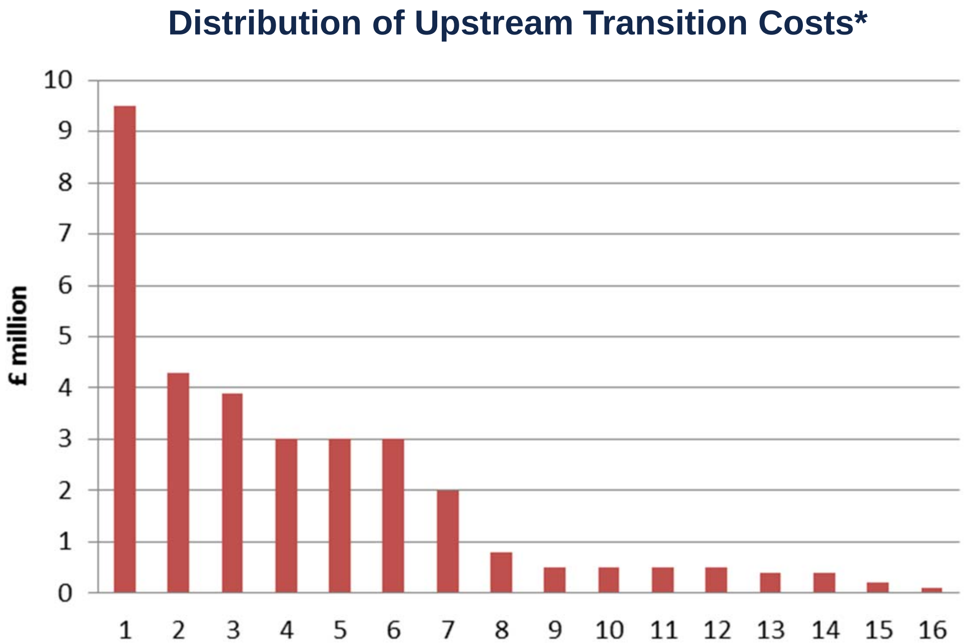
Costs of proposed Gas Day change upstream

- **IT systems** (mainly bespoke systems, some pre-date Network Code)
  - Offshore data flows; onshore and offshore allocation of gas; timing of transactions
  - Deadlines for capacity nominations/outages/OCM; interaction with liquids
- **Metering systems** (natural gas *and* NGLs)
  - Meter validation/telemetry equipment/ metering equipment
  - Fiscal meters offshore
- **Commercial agreements** (many pre-date Network Code)
  - Production allocation, gas lifting, transportation and processing and gas sales
  - Other field-level upstream agreements e.g. POSAs
  - Claims validation agreements and other agency agreements

Relative cost is highest at terminals/systems serving complex, multi-company operations and at low-volume, late-life offshore fields and systems

Estimated total upstream cost of at least £40-50 million (€50-60 million)

Upstream costs of changing Gas Day



Source: O&GUK member survey (Aug 2014)

* O&GUK members only, excluding shippers, DNOs and TSOs

- Costs of change throughout gas chain but concentrated in upstream
- Survey of O&GUK members of 'one-off' transition costs of upstream change, as requested by DECC
- 16 respondents, covering about 75% of UK upstream gas flows
- Total estimate of £33m, comprising legal costs, IT costs and metering changes
- Gross estimate of £40-50m (€50-60m), excludes any contingencies
- Some respondents cited need to halt offshore operations to implement metering changes
- One operator unsure whether it was technically feasible to change existing system

UK Gas Day Working Group (GDWG)

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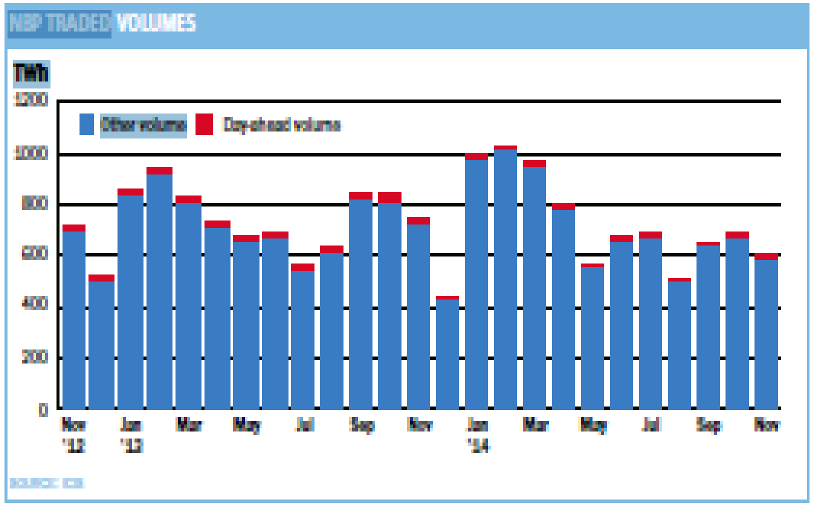
- Regular meetings since March involving producers, terminal operators (TOs), shippers and National Grid to search for way to reconcile 5am-5am downstream and 6am-6am upstream
- Joint search for a pragmatic way to operate in GB with two different gas days at minimal cost and disruption without undermining the integrity of NTS operations and the NBP market.
- No agreement between TOs, shippers and N Grid over how to manage the small discrepancies between 5am-5am flow and 6am-6am flow
- DECC set up GDWG in November: third meeting scheduled for 9 December
- Aim is to find an <u>interim solution</u> by end-2014: industry-wide participation including CVSL , Ofgem and non-producing shippers
- Number of options being gradually reduced but no consensus 'solution' yet
- Unresolved issues: (1) can CVIA be modified to allow some terminals to move to 5am-5am? (2) administration of any new data flows and (3) the design of a possible linepack flexibility service.
- Outcome of the GDWG process will be a temporary 'workaround', <u>not</u> a permanent solution.
- UK gas industry wants a single gas day, <u>not</u> two different gas days

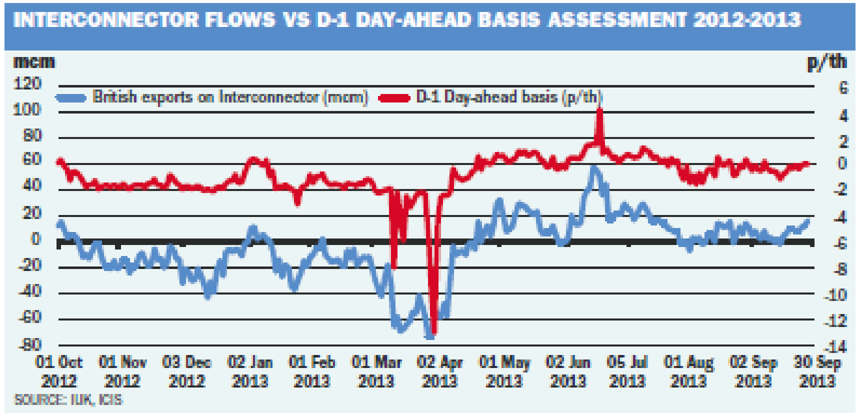
Why risk to NBP market liquidity matters for Europe

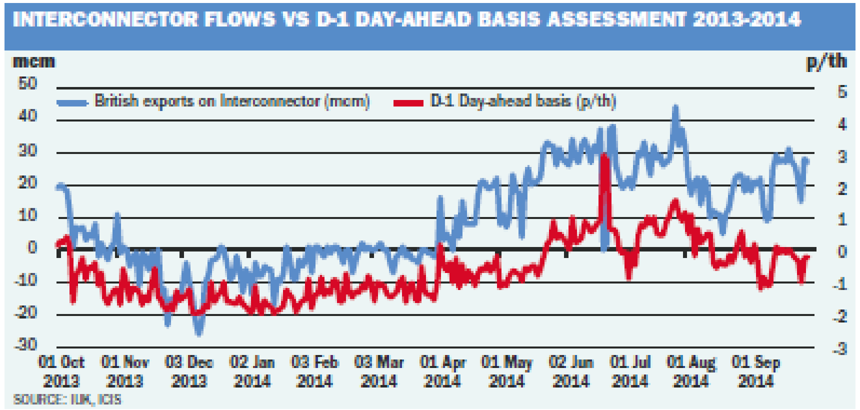
NBP Monthly Traded Volumes 2013-14



- Two GB gas days will create new, additional balancing risk at interface
- Loss of CVIA will undermine the basis for legal title to gas entering NTS from UKCS
- Possibility of renewed commercial disputes
- Some producers may choose to sell at the beach, not at the NBP to avoid this risk
- More offshore trading and aggregation with consequent reduction in supply competition
- NBP remains principal locus of price-determination in NW Europe
- NBP market is interface with global LNG market and has less Gazprom influence on pricing

UK-continent trade and arbitrage efficiency





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- Cross-border gas trade to /from UK via IUK and BBL is by far the most efficient and price-responsive in the EU
- IUK and BBL have always successfully managed different gas days in UK and on continent
- EU harmonisation of gas day creates an economic benefit for consumers only if UK-continent arbitrage efficiency is improved
- IUK could continue to operate with different gas days in UK and on continent
- Non-harmonised gas day is not a barrier to efficient cross-border trade
- Lack of hub liquidity, ill-designed tariffs and mismatched bundled capacity products <u>may</u> be barriers to cross-border trade

Proposed amendment and legal procedure

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- UK and Ireland are unique among EU Member States because of the nature of their interconnections and in the extent of physical integration with each other
- Any amendment or derogation should apply equally to UK and Ireland
- Two alternatives proposed for wording of the amendment: generic or specific
- Amendment must ensure no detriment to other MS or to any EU consumers
- Both formulations limit the entitlement to retain existing 6am-6am Gas Day to UK and Ireland
- Ad hoc amendment or derogation from existing Network Codes?
- Consistency with ACER governance standards?

Summary of the case for an 'ad hoc' amendment

- Changing GB Gas Day imposes certain transition costs but there are no expected benefits
- Changing GB Gas Day to 5am-5am creates a barrier to trade between UK upstream and downstream network for the first time ever
- Operating two gas days in GB introduces risks for integrity and liquidity of NBP market
- Significant impact on upstream (externalities) was not foreseen in NC development process
- Process was not consistent with ACER'S own governance standards
- Disproportionate impact on UK as a mature gas-producing province
- Cross-border UK-continent gas trade is most efficient and price-responsive in EU and has always operated with different gas days
- Harmonising the gas day between UK and continent is very unlikely to promote more efficient cross-border trade; tariffs and bundled capacity terms are more important
- Interconnector pipelines could continue to operate with different gas days
- Granting derogation to UK/Ireland has no adverse impact on EU consumers

Consequences of approving proposed amendment

- UK complies with spirit and intention of EU legislation at least cost
- Avoidance of unnecessary costs throughout the UK/GB gas chain
- No risk to NBP market liquidity
- No change to CVIA or CVSA agreements
- No detriment or cost to any UK or EU consumer
- No linepack flexibility service or new balancing service will be needed at domestic entry points
- No change to National Grid contracts with terminal operators
- Changes restricted to IPs and interconnectors (no change at Moffatt)
- ACER able to review and revoke the amendment at any time in future

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