

# EU Balancing Regulation EU 312/2014

## Interim Measures Update Report

Version 3.0

Submission to the Utility Regulator

19<sup>th</sup> July 2017

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TRANSMISSION

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## Executive Summary

The Balancing Regulation intends that TSOs should aim to develop traded markets within their balancing zone by introducing market based balancing rules, with the ideal compliant model being that the TSO can then use that market to buy/sell residual balancing gas at the best possible prices.

On 8<sup>th</sup> December 2014, the NI TSOs submitted their first report under the Balancing Regulation, recommending the adoption of Interim Measures in Northern Ireland. The Utility Regulator subsequently approved the report. The Interim Measures proposed were that NI TSOs should continue to utilise balancing contracts for residual balancing. In addition, the NI TSOs recommended that Imbalance Tolerances for Shippers should be retained and undertook to ensure that Imbalance Charging and the calculation of the tolerances were compliant with the Interim Measures rules in the Balancing Regulation.

This document is the NI TSO's first annual report on the implementation of Interim Measures and recommends that they should continue to be utilised.

In Northern Ireland, the NI Network Codes have historically included market based balancing rules, under which Shippers are incentivised to manage their Imbalance positions, and the NI TSOs take residual balancing action only where it is necessary to keep the system physically balanced. The net costs are met by all Shippers through a 'disbursement account' which is managed by the NI TSOs.

The changes to the NI Network Codes in 2015 for EU compliance introduced the Northern Ireland Balancing Point ('NI BP' or 'Trading Point') for the first time. The NI BP is a notional location at which Shippers can trade gas with each other within the NI balancing zone. These arrangements have just completed their first year of use, and whilst there is some trade taking place, it is at minimal levels.

The overall requirement for residual balancing by the NI TSOs has not changed dramatically as a result of the introduction of the new arrangements in October 2015, illustrating that Shipper balancing performance is also typical compared to previous years.

The Balancing Regulation stipulates that, where they are used, Interim Measures should aim to foster market development to the extent possible. Therefore, various changes were made to the tender process for balancing services for 2016-2017 to try to encourage greater participation and more competition in their provision, and to encourage trade at the NI BP. Consequently, these changes included introducing the NI BP as a delivery location for balancing gas, and changes to the minimum quantities designed to enable more, especially smaller, Shippers to participate. They also included changes to the required pricing structure intended to encourage even more competitive pricing. However, these changes have proved unsuccessful.

The NI TSOs are now actively considering how to improve the arrangements in a way which will foster market development to the extent possible, whilst continuing to minimise balancing costs. This document sets out a number of proposals for change for the tender for next year, in particular relating to the pricing structure for balancing gas buy contracts.

The NI TSOs will continue to monitor the developments in the regime but, in their view, it is too early to assess whether it would be appropriate to remove Shipper Imbalance Tolerances, or whether Interim Measures could be replaced by a Balancing Platform or any other alternative approach. This report discusses the issues and sets out an outline of potential timescales for steps towards considering removal of Interim Measures.

## Contents

<b>Executive Summary</b> .....	2
1. Introduction: Interim Measures Implementation in Northern Ireland.....	5
2. Report Structure.....	5
2.1 Interim Measures Update Report Requirements .....	5
2.2 Structure of this Report .....	6
3. Implementation of 2014 Interim Measures Proposals .....	6
3.1 2014 Proposals .....	6
3.2 Implementation Steps .....	6
4. Gas Trading Activity.....	7
5. Operational Balancing Performance – Use of Balancing Services.....	8
5.1 Demand Characteristics .....	8
5.2 Aggregate Imbalance Position .....	8
5.3 Balancing Actions.....	9
5.4 Conclusion.....	9
6. Shipper Balancing Performance .....	10
6.1 Imbalance Tolerances .....	10
6.2 Shipper Balancing .....	10
6.3 Conclusion.....	11
7. Developments in the provision of Balancing Services - Changes to the Tender Process in 2016..	12
7.1 Background to the Tender Process .....	12
7.2 Aims of Changes made for 2016 - 2017 .....	12
7.3 Summary of Changes Made for 2016 - 2017 .....	13
7.3.1 Delivery Points and Contract Types.....	13
7.3.2 Quantity and Rate Requirements.....	14
7.3.3 Price Structure Changes .....	14
7.3.4 Tender Evaluation Changes.....	15
7.4 Objectives of the Changes .....	15
7.5 Tender Outcome .....	15
7.6 Shipper Feedback and TSO Assessment of the Process.....	15
8. Options for next year's Tender Process .....	16
8.1 Quantity and Rate Changes.....	16
8.2 Delivery Point/Contract Changes .....	16
8.3 Sell-Side Price Structure Changes.....	17
8.4 Buy-side Price Structure Changes.....	17
8.4.1 NTS Commodity Charges .....	17
8.4.2 Gas Price.....	18
8.4.3 Contract Fees.....	18

8.4.4	Potential exposure to NI Entry Capacity Overrun Charges .....	18
9.	Assessment of the State of Development of the Market .....	19
9.1	The Current Market .....	19
9.2	Outlook for further Market Development and Possible Removal of Interim Measures .....	20
9.2.1	Trading Platform .....	20
9.2.2	Balancing Platform .....	20
9.2.3	'TSO-trades-in-an-Adjacent-Balancing-Zone' .....	21
9.2.4	Way Forward for Interim Measures Removal .....	21
10.	Interim Measures during 2016-2017 .....	21
10.1	Interim Measures to be retained .....	21
10.2	Continue monitoring Market Developments .....	22

## 1. Introduction: Interim Measures Implementation in Northern Ireland

The EU Balancing Regulation of 24<sup>th</sup> March 2014 (EU312/2014, 'the Balancing Regulation') set down legislative requirements concerning gas balancing on gas transmission networks. The Balancing Regulation contains market based balancing rules, and further develops and harmonises the balancing rules which were set down in Article 21 of Regulation 715/2009 (the 'Third Package' Regulation).

The Balancing Regulation offered three possible routes to compliance. In the first instance, Transmission System Operators (TSOs) were required to comply with the requirements of the Balancing Regulation by 1<sup>st</sup> October 2015. Alternatively, TSOs were permitted to request approval from their National Regulatory Authorities (NRAs) for up to 24 month's delay from 1<sup>st</sup> October 2014 (i.e. until 1<sup>st</sup> October 2016) provided they did not implement any 'Interim Measures'. The third approach was to adopt Interim Measures.

The NI TSOs (Premier Transmission, Belfast Gas Transmission and GNI (UK)) prepared a first report on Interim Measures in Northern Ireland and submitted it to the Utility Regulator on 8<sup>th</sup> December 2014. The report recommended that an Interim Measures approach should be adopted in Northern Ireland and was approved by the Utility Regulator in its letter of 28<sup>th</sup> March 2015.

In accordance with the Utility Regulator's decision letter and the Balancing Regulation, the NI TSOs are required to monitor the implementation of Interim Measures and annually update the report. This document has been produced to meet that requirement.

## 2. Report Structure

### 2.1 Interim Measures Update Report Requirements

Article 46 of the Balancing Regulation sets out the requirements that an annual report on Interim Measures should meet, as follows:

- (a) *a description of the state of development and the liquidity of the wholesale gas market at the time of preparing the report, including, where available to the TSO, inter alia:*
  - (i) *the number of transactions concluded at the virtual trading point, and the number of transactions in general*
  - (ii) *the bid/offer spreads and the volumes of bids/offers*
  - (iii) *the number of participants having access to the short term wholesale gas market*
  - (iv) *the number of participants having been active on the short term wholesale gas market during a given period*
- (b) *the interim measures to be applied*
- (c) *the reasons for the application of interim measures:*
  - (i) *an explanation of why they are needed, due to the state of development of the short term wholesale gas market;*
  - (ii) *an assessment of how they will increase the liquidity of the short term wholesale gas market*
- (d) *an identification of steps that will be taken to remove interim measures, including criteria for making those steps and an assessment of the related timing.*

In addition, the Balancing Regulation states that TSOs are required to consult with stakeholders on the proposed report and then submit it to the NRA for approval. In making its decision (which it must do within six months of receipt of the complete report) the NRA is required to assess its effect on balancing regimes' harmonisation, facilitation of market integration, ensuring non-discrimination, effective competition and the efficient functioning of the gas market.

## 2.2 Structure of this Report

The following section introduces the Interim Measures that were proposed in 2014 and the steps that have been taken to implement compliant arrangements.

The report then presents some analysis illustrating the current state of development of the market, starting with gas trading activity in section 4, followed by operational balancing performance (section 5) and Shipper balancing performance (section 6).

Section 7 describes the work that has been done to try to foster market development through the design of the tender for balancing gas services, including an assessment of the outcome and the NI TSOs views on potential improvements for next year.

Section 8 sets out some specific options for changes to the Tender Process.

Section 9 then summarises the NI TSOs view of the current state of the market, including an assessment of steps that might be taken towards removal of Interim Measures.

Section 10 sets out the NI TSOs plans for the coming year and includes the recommendation that Interim Measures should be retained.

## 3. Implementation of 2014 Interim Measures Proposals

### 3.1 2014 Proposals

The Interim Measures proposals approved in the 2014 report were to use Balancing Services for residual balancing.

In addition, in that report, the NI TSOs undertook to:

- ensure the calculation of Imbalance Tolerances and Charges was compliant with Interim Measures rules.
- introduce Trading Functionality at the Northern Ireland Balancing Point ('NI BP' or 'Trading Point') and compliant Nominations arrangements at IPs

The report also set out that there would be an Exit Review (including demand forecast information provision).

### 3.2 Implementation Steps

The use of Balancing Services is accomplished via the annual tender process for Balancing Contracts. This process has been redeveloped during 2016 for implementation from 1<sup>st</sup> October 2016 but attracted very limited interest. The approach and the outcome are described further in section 7.

Imbalance Tolerances and Charging requirements were implemented with effect from 1<sup>st</sup> October 2015 with the implementation of PTL Modification 34 and GNI (UK) Modification 19.

NI BP Trading and IP Nominations arrangements were implemented with effect from 1<sup>st</sup> October 2015 with the implementation of PTL Modification 31 and GNI (UK) Modification 16.

The Regulator chose to address the elements of the Balancing Regulation that require demand forecast information provision by a central party separately from the Exit Review<sup>1</sup>. Shippers already receive all the forecast information required by the Balancing Regulation from their respective Distribution Network Operators.

A consultation on the technical options for the forecasting party was published in June 2015, and the process was concluded mid-September 2015 with the designation of PTL as the forecasting party. Systems and processes to support the relevant provisions of the Balancing Regulation for the forecasting party are currently under development. Delivery of these arrangements is currently scheduled for October 2017. The delivery of the forecasting party arrangements will mean that Shippers will receive a single aggregated figure as well as continuing to receive the information from the individual Distribution Network Operators.

## 4. Gas Trading Activity

Currently there are 12 Shippers in Northern Ireland. Of these, 10 are actively shipping, 5 are registered to trade at the NI BP, but only 3 are actively trading. There are trades taking place every day, although on a minimal basis.

The gas year commencing 1st October 2015, when gas trading was first introduced, has been analysed.

Over the 366 days, there were around 1500 transactions, i.e. an average of around 4 transactions per day.

Typically, there are a total of between 1 to 5 trades completed per day, with a typical total volume in aggregate of around 10,000,000kWh, though there is some daily variation around this figure.

The trading behaviour suggests the use of the NI BP as a transaction point in long term contracts, as opposed to it being used to source gas on a daily basis (i.e. as a 'spot market'). Since Shippers trade 'over-the-counter' between themselves, it is not possible for the NI TSOs to provide any information about the prices at which deals may be done at the NI BP.<sup>2</sup>

However, all gas entering Northern Ireland is currently sourced from National Grid's network via Moffat, which means that the NI BP price is likely to be at least the market price of the GB NBP (National Balancing Point) plus the transportation costs to deliver it to the NI BP.

For comparison, in GB there are over 200 companies registered as shippers, of whom at least 40 are sizeable and active parties. On the GB on-the-day commodity market (OCM) typically, there are between 150 - 350 trades per day for each of the within day and the day ahead gas products alone, and the OCM offers a much wider range of additional products as well. Total trade at the NBP is on a completely different scale, and being an active, liquid market, includes forwards and futures contracts. For example, total traded volumes reported by ICIS Heren for each of January and February 2016 at the NBP were approaching 2,000 TWh.

It is evident that gas trading within Northern Ireland is still very much in its infancy. It has only just been introduced and the extremely low volume of trade reflects both the small number of market participants, and the proximity of the GB NBP as a liquid and reliable source of spot gas.

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<sup>1</sup>An Exit Review was conducted by the Utility Regulator at the start of 2016, concluding in July 2016 focusing on the exit capacity arrangements in Northern Ireland. The conclusions can be found at [http://www.uregni.gov.uk/publications/exit\\_review\\_call\\_for\\_evidence\\_conclusions](http://www.uregni.gov.uk/publications/exit_review_call_for_evidence_conclusions)

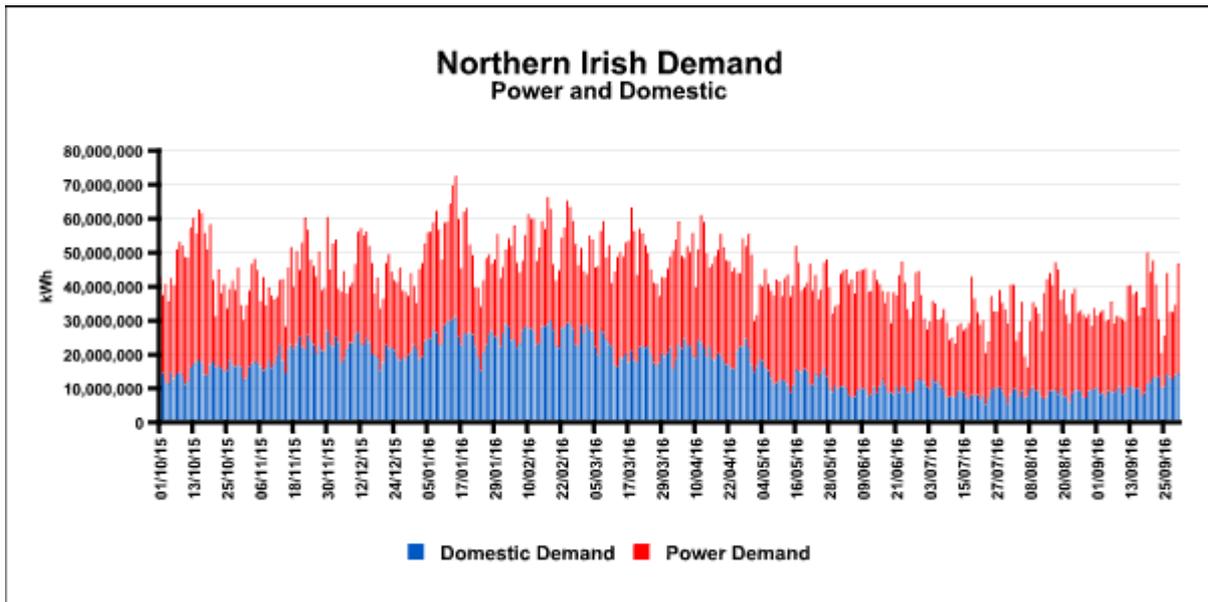
<sup>2</sup>This is also the reason why NI Balancing Contracts are referenced to NBP prices and not to NI BP prices.

## 5. Operational Balancing Performance – Use of Balancing Services

### 5.1 Demand Characteristics

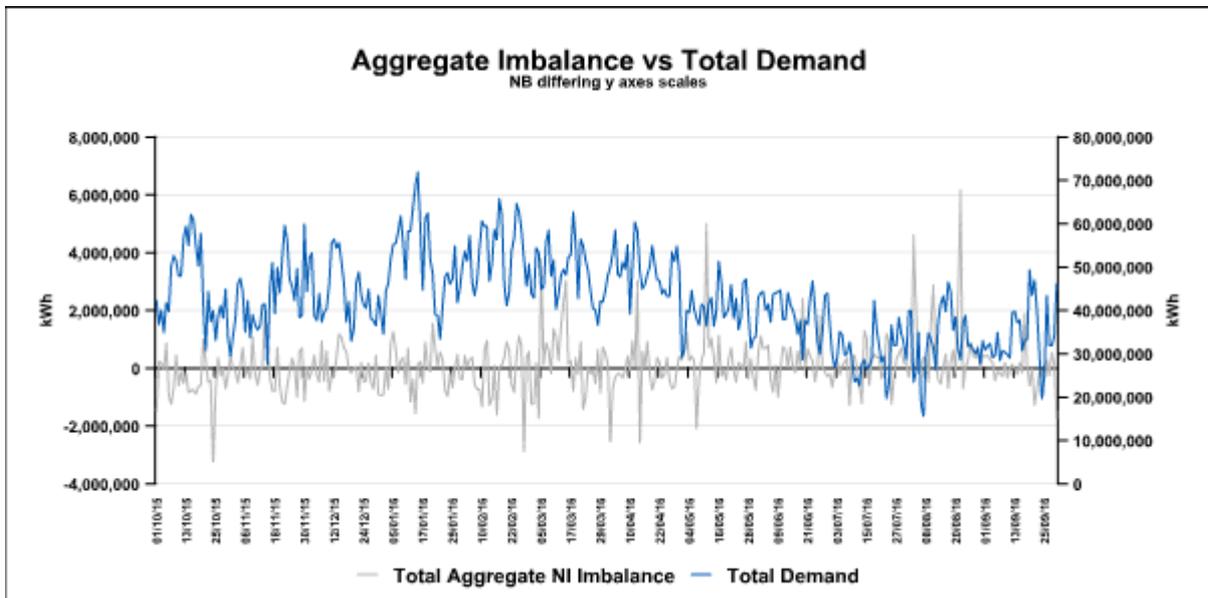
In Northern Ireland, the peak daily demand in 2014/2015 was around 6.4mcmd and in 2015/2016 it was around 6.7 mcmd.

Demand is dominated by the requirements of the power stations, as illustrated by the chart below showing domestic and power station demand separately for the 2015-2016 period.



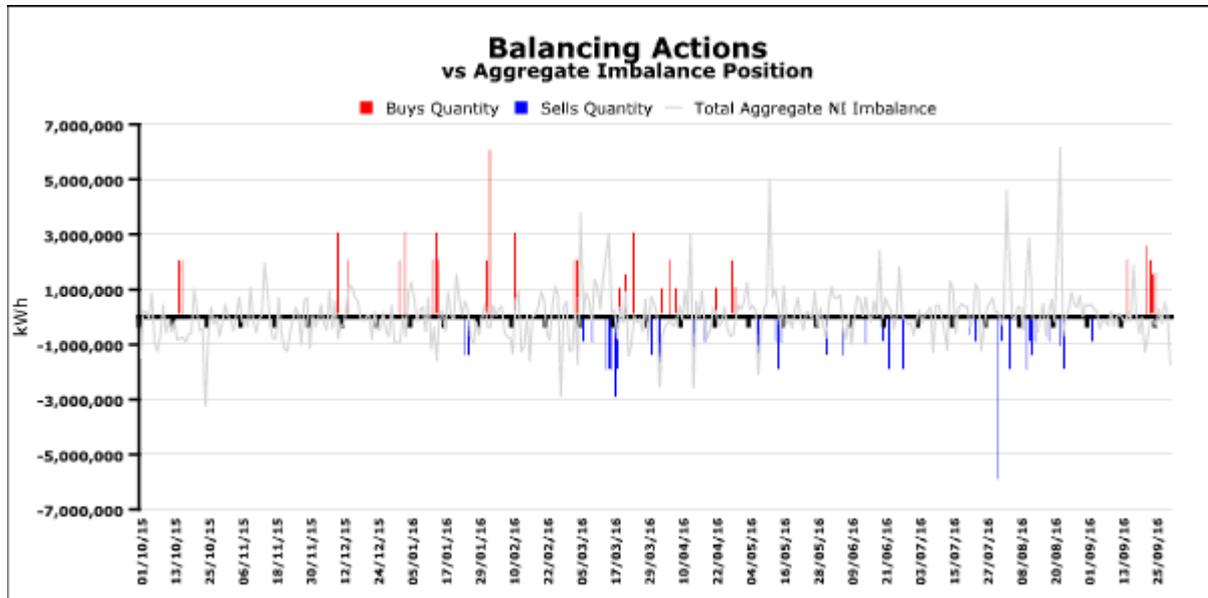
### 5.2 Aggregate Imbalance Position

The following chart shows the total NI gas demand for each day of the period from 1<sup>st</sup> October to 30<sup>th</sup> June 2016, against the daily aggregate imbalance position (the sum of all Shipper’s entry allocations less the sum of all Shipper’s exit allocations).



### 5.3 Balancing Actions

The following chart shows when balancing action was taken by the NI TSOs, and the quantity of Balancing Gas bought or sold, against the aggregate imbalance position for the same period.



This chart illustrates how balancing gas is used by the NI TSOs to rectify the situation when the system is long or short. As is evident from the chart, the NI TSOs usually purchased and sold balancing gas in standard sized quantities, rather than making smaller or larger adjustments, depending on the size of the system imbalance position. This also reflects the processes and provisions of the balancing gas contracts in place during this period.

### 5.4 Conclusion

The residual balancing requirements for Northern Ireland do not appear to have been especially affected by the new arrangements put in place in October 2015, as balancing activity is fairly typical compared to previous years.

## 6. Shipper Balancing Performance

### 6.1 Imbalance Tolerances

As part of Interim Measures, Northern Ireland has retained a regime of Imbalance Tolerances. Imbalance Tolerances are calculated for each Shippers' portfolio based on the type of consumer, as shown in the table. An Imbalance Tolerance provides a margin for a Shipper's Imbalance position within which it is not penalised for being out of balance. Outside of the tolerance level, marginal prices apply, to provide an incentive on the Shipper to balance its inputs and outputs to within its tolerance.

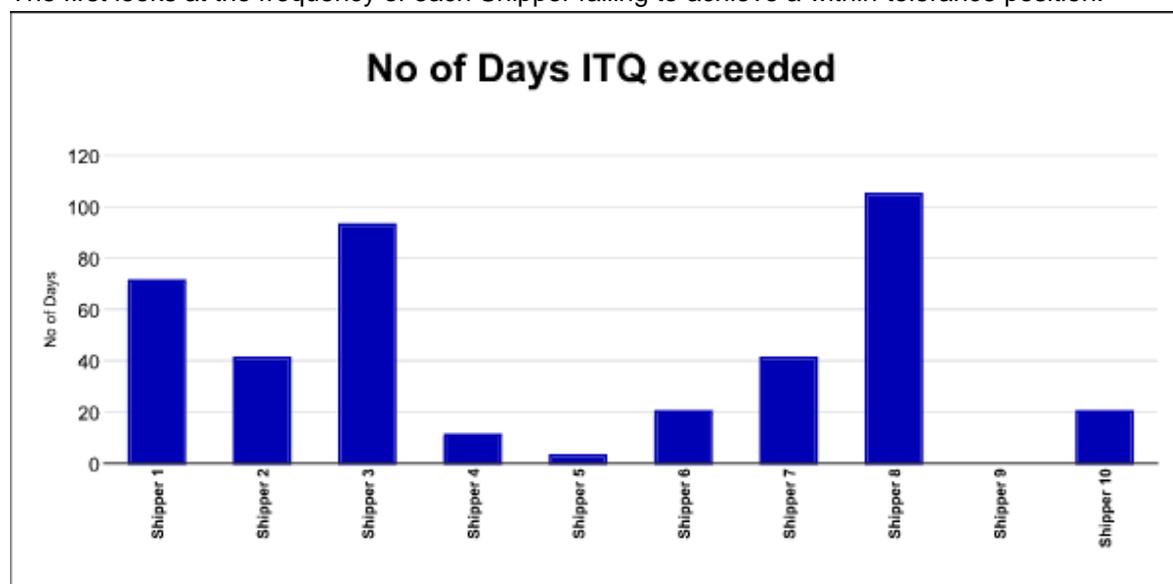
Downstream Load Category	Type of Consumer	Tolerance %
1	Power Generation	3%
2	Downstream consumers whose loads are greater than or equal to 1,465,416,000 kWh/annum and are not power generation consumers	3%
3	Downstream consumers whose loads are greater than or equal to 733,000 kWh/annum but less than 1,465,416,000 kWh/annum	10%
4	Downstream consumers whose loads are less than 733,000 kWh/annum	20%

Shippers submit Downstream Load Statements so that the NI TSOs can evaluate the Shippers' applicable tolerance levels. A Shippers' overall portfolio tolerance is a weighted average calculation based on the proportion of the different categories of consumer in their portfolio. Typically, Shippers have individual Imbalance Tolerances of between 3% and around 17%.

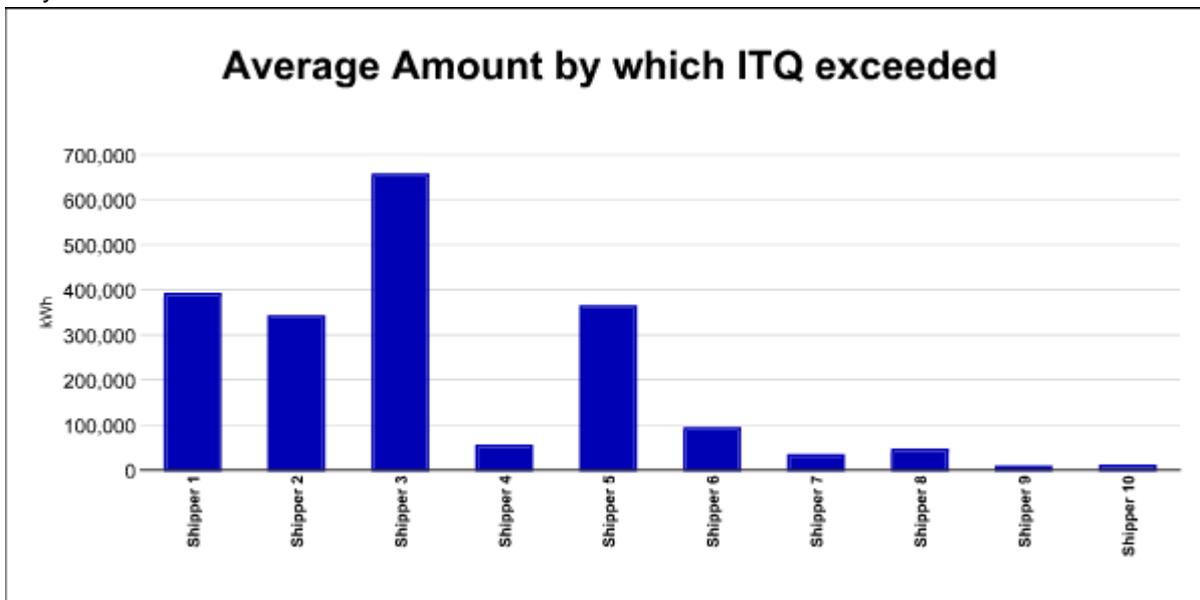
### 6.2 Shipper Balancing

Examining Shipper balancing performance through the past gas year, there is a range of individual Shipper success in staying within their Imbalance Tolerance. Some Shippers routinely balance to well within their tolerance levels, and others rarely achieve a within-tolerance imbalance position. This appears to reflect closely the nature of the consumers within the individual portfolios and there is no particular evidence of any behaviour which might suggest that tolerances should be tightened or removed. On the contrary, for some smaller Shippers with mainly domestic consumers, it appears that the tolerance remains important.

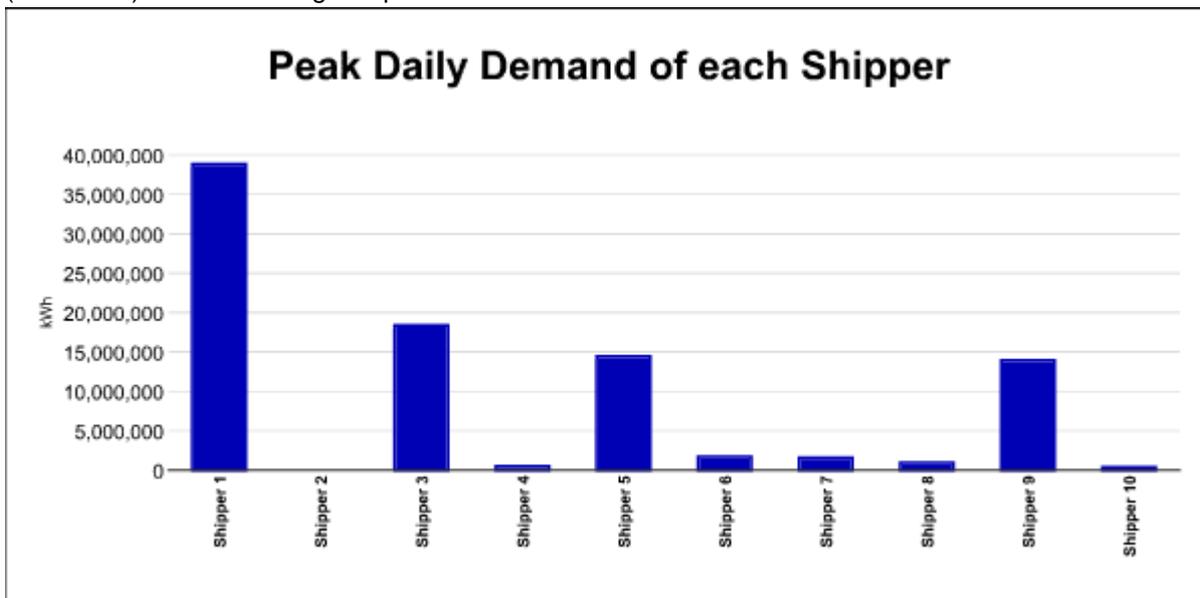
The following charts provide an indication of overall (anonymised) Shipper balancing performance. The first looks at the frequency of each Shipper failing to achieve a within-tolerance position:



The following chart shows the average amount by which the tolerance was exceeded. This illustrates that some Shippers are generally staying within tolerance, others breach tolerances more frequently but by relatively small quantities, and others occasionally exceed their tolerances but by a relatively larger quantity. On the whole, though, the quantities by which ITQs are generally exceeded are still very small.



The final chart provides an indicative measure of relative size of the Shippers i.e. their highest (consumer) demand during this period.



### 6.3 Conclusion

This analysis is provided for transparency and as a matter of record, but it is not intended to make any assessment of whether this represents good or bad performance, given that there has only been one gas year since the EU arrangements came into place. It simply shows that there is a range of balancing performance amongst the Shippers, which is to be expected in a market with a few large Shippers supplying power stations and a number of much smaller participants.

The fact that the overall balancing requirements have not changed significantly compared to previous years indicates that Shipper balancing performance is also typical compared to previous years.

## 7. Developments in the provision of Balancing Services - Changes to the Tender Process in 2016

### 7.1 Background to the Tender Process

The Interim Measures being used in Northern Ireland are to rely on Balancing Services. The NI TSOs publish a tender on an annual basis for the provision of Balancing Gas Services. All Shippers and other interested parties (including GB-only Shippers i.e. parties who are GB Shippers but not NI Shippers) are invited to participate.

Historically the tender process has set out the following key requirements for Balancing Gas Services:

- A prescribed price structure:
  - for Balancing Buys, specifically:
    - the OCM Price for quantity of gas purchased (i.e. the NBP price)
    - the OCM transaction fee
    - the NTS Commodity Charge
    - the Moffat Agent Fee (not applicable since October 2015)
    - a standing contract fee and
    - an execution fee, for making a purchase
  - for Balancing Sells, which was based on  $SMP_{sell} - x$
- A minimum bid level of 8,667,000kWh/day for buys or sells
- A maximum hourly rate requirement of 1,000,000 kWh/hr
- Balancing Buy delivery point: Moffat
- Balancing Sell delivery point: an exit point specified by the Shipper, with a corresponding turn-down at Moffat

Typically, the NI TSOs would award a single buy contract, a primary sell contract and a secondary sell contract. Contracts with these characteristics were in use for the gas year 2015-2016 analysed above.

During 2016, the NI TSOs redesigned the requirements and the tender process to try to better facilitate the requirements of the Balancing Regulation for market development.

### 7.2 Aims of Changes made for 2016 – 2017

As part of encouraging trade at the NI BP (as a means of market development which could ultimately lead to the implementation of a Balancing Platform), it was important to allow Shippers to deliver Balancing Gas Services at the newly introduced NI BP. It was hoped that this would start to encourage market confidence in utilising the NI BP as a trading location.

The primary aim of the other changes to the tender design was to try to encourage more Shippers, including smaller Shippers, to participate.

In addition, the NI TSOs intended to allow Tenderers greater freedom to structure their prices as they wished, in the hope that this would encourage Shippers to be as competitive as possible with their pricing and hence reduce balancing costs for all Shippers.

However, it is important to note that at present:

- On the buy-side: Moffat is the only point at which additional gas can be physically delivered to the NI Network

- On the sell side: there is no physical capability amongst end users for an increase in demand at exit. Hence where a Shipper wishes to offer an exit-side sell, it must be related to a physical turn-down at Moffat in order to achieve the required physical reduction in flows on the network. This reflects the way the arrangement worked in the 'point-to-point' regime which existed in NI prior to October 2015 and contractual provisions are needed to ensure that the turn-down in Moffat IP Entry Nominations is actioned as well as the sell transaction at the exit point.

### 7.3 Summary of Changes Made for 2016 – 2017

The following changes were therefore introduced to the requirements set out in the tender for 2015-2016.

#### 7.3.1 Delivery Points and Contract Types

The overall requirements were divided into separate Lots (Buy and Sell), with each Lot including various contract types for delivery at different points, including the NI BP (referred to in the table below as the Trading Point). The following table shows the Lots and locations which were included in the tender document:

Lot	Contract Type	Transaction Type	Transaction Point
<b>Lot 1:</b> Balancing Buy	<b>1A:</b> Non-Locational Balancing Gas Buy	Buy	Trading Point
	<b>1B:</b> Locational (Moffat) Balancing Gas Buy	Buy	Moffat IP
	<b>1C:</b> Locational (Moffat) Balancing Gas Buy for a non-NI Shipper	Buy	Moffat IP
<b>Lot 2:</b> Balancing Sell	<b>2A:</b> Non-Locational Balancing Gas Sell	Sell	Trading Point
	<b>2B:</b> Locational (Moffat) Balancing Gas Sell	Sell	Moffat IP
	<b>2C:</b> Locational (Combined) Balancing Gas Sell (PTL System Only)	Sell, combined with a 'turn down' at Moffat	Transaction Point = Exit point(s) on PTL System to be specified by Tenderer
	<b>2D:</b> Locational (Combined) Balancing Gas Sell	Sell, combined with a 'turn down' at Moffat	Transaction Point = Exit point(s) on GNI (UK) System or the PTL System to be specified by Tenderer

This set of contracts enables balancing gas buys to be delivered at the NI BP/Trading Point as well as at Moffat. Sells can be delivered at the NI BP/Trading Point and at an exit point (or points) specified by a Shipper (plus a Moffat turn-down).

The contracts also include a sell contract to be delivered by a simple Moffat turn-down, rather than via an exit sell related to a Moffat turn-down (2B).

All bids for Lot 1 for balancing buys were to be evaluated together, and similarly all bids for Lot 2 were to be evaluated together, to ensure the best price for each of the buy-side and sell-side requirements could be achieved.

The Tender also set out that the NI TSOs intended to award multiple contracts for both the buy and sell sides; as many as would be required to meet the daily balancing gas requirement. A Framework Agreement would be introduced (one for buys and one for sells), to which all the Shippers with awarded contracts would be party.

### 7.3.2 Quantity and Rate Requirements

The hourly rate requirement was removed altogether, given that specific hourly rates are not a requirement in the new NI Network Codes introduced for October 2015.

The total quantity of balancing gas requirement (8,667,000kWh /day) was assessed operationally, and remained the same as previous years.

However, in the tender process, instead of setting this as a minimum quantity (which might limit participation to Shippers big enough to provide this quantity), the NI TSOs decided to instead set a smaller minimum quantity of 1,000,000kWh. This was the smallest quantity that would be operationally practical. In addition, they decided to allow Shippers to specify their own maximum available quantities that they could undertake to deliver on a day.

The intention was to enable more participants to bid, and to enable a balancing action on a day to be met by the NI TSOs calling on multiple smaller quantities of balancing gas, rather than relying on a single service provider on a day.

Therefore, in conjunction with these changes, the NI TSOs also developed the operational rules for calling on a range of balancing gas contracts under the Framework Agreement, to ensure that the rules were transparent and fair for all Shippers who had been awarded a balancing gas contract. The operational rules were included in the Tender, the Framework Agreement. The rules were also incorporated into the NI Network Codes<sup>3</sup> to ensure that they were also fair and transparent for Shippers who may not have tendered, or been awarded a contract, but who still pay the costs of balancing gas through the disbursements account.

### 7.3.3 Price Structure Changes

The price structure for the sell-side was retained in its existing form. The price structure was amended for the buy-side by removing the fixed fee element for the balancing buys, and the prescription over what costs could be included, and instead making the price structure the same as for the sell-side i.e.:

- for Lot 1 - Balancing Gas Buy contracts, the price structure was  $SAP + X$
- for Lot 2 - Balancing Gas Sell contracts, the price structure was  $SMP_{sell} - X$

The intention was to enable more freedom for Shippers to consider individually what costs they wished to build into the contract. This would hopefully encourage Shippers to be as competitive as possible.

It should be noted that in previous years, in the point-to-point regime, Shippers did not have to book entry capacity into Northern Ireland at Moffat. GB-side exit capacity was available as interruptible capacity at zero cost. This is why no capacity charges were included in the previous price structure. Participants were expected to bid in their contract fees at a level to cover any administrative costs they associated with the contract.

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<sup>3</sup> Mod refs

With the introduction of the entry-exit regime, NI Shippers were allocated an initial amount of entry capacity reflecting their long term exit capacity bookings. NI Shippers are now required to hold IP Entry Capacity at Moffat, which may still be bundled or unbundled at present, and overrun charges apply if allocations exceed capacity bookings.

Under the Balancing Regulation, it is necessary to avoid balancing gas contracts causing capacity to be with-held from the market. Therefore, rather than trying to specify how capacity charges might be built into a price structure for balancing gas the NI TSOs considered that the SAP+X structure offered the best way to give Shippers freedom to price their bids to cover their costs as they wished.

#### **7.3.4 Tender Evaluation Changes**

As a result of the changes above, it was necessary to update the evaluation rules in the tender. These changes included changes to the scoring criteria, for example, referring to the pricing structure, but were essentially mechanistic changes required to ensure the process of evaluating tenders alongside each other remained fair.

#### **7.4 Objectives of the Changes**

As a result of the changes above, the NI TSOs therefore hoped that:

- More Shippers (including smaller Shippers) would be able to participate due to the lower quantity requirement
- More balancing gas contracts would be awarded
- More Shippers would have their balancing gas contracts utilised on a daily basis, by virtue of smaller minimum quantities and the new rules for calling off contracts
- Prices bid would be more competitive due to less prescription in the price structure.

#### **7.5 Tender Outcome**

The new tender attracted very little interest in the market, with only a very small number of Shippers responding at all. Of the responses received, not all the bids were in line with the required submission and therefore failed to pass the selection criteria of the tender.

Consequently, the NI TSOs were only able to award one contract under the new Sell Framework Agreement. It was therefore necessary to roll over the provisions of the Buy contract from 2015-2016 and the Secondary Sell contract from 2015-2016.

#### **7.6 Shipper Feedback and TSO Assessment of the Process**

The outcome of the tender for 2016-2017 indicates that there are still some improvements required. The NI TSOs plan to make further changes to the process for the tender for 2017-2018, to try to better achieve the objectives of increasing participation and competitiveness whilst encouraging development of trade at the NI BP.

The NI TSOs have discussed the issues individually with Tenderers and with interested non-respondents (to maintain confidentiality). Based on the feedback received, and their own views on the process, the NI TSOs consider that there are a number of potential reasons why participation was so low, including:

- Removal of the standing fee for the buy contract making participation less attractive;

- Lack of correlation between the SAP price for the day, and the actual price to be paid at the time at which a balancing gas action may be taken within day, creating a potential price risk for Shippers;
- Potential exposure to IP Entry Capacity overrun charges;
- Complexity, especially in relation to the various sell-side contract options;
- 2015-2016 was an extremely busy period for Shippers with the introduction of a new entry-exit regime and all the new arrangements introduced for EU compliance;
- Most NI Shippers are relatively small and some are still relatively new entrants to the market. Participating in balancing contracts is therefore both operationally challenging and potentially risky if their costs are not covered appropriately.

Given the outcome and the feedback received, the NI TSOs are actively considering their approach for next year and the next section sets out some options.

It should be noted that the requirement for Balancing Gas Services ultimately arises from the physical operation of the NI Network. Maintaining the safe and effective operation of the system will remain the number one priority of the NI TSOs at all times.

## 8. Options for next year's Tender Process

### 8.1 Quantity and Rate Changes

The NI TSOs consider that the changes concerning quantities and rates, and the rules for calling on balancing gas contracts remain appropriate.

### 8.2 Delivery Point/Contract Changes

The NI TSOs consider that the changes to introduce the NI BP as a delivery point for Balancing Gas Services remains appropriate and necessary.

Specifically in relation to the exit-side sell agreements, the TSOs have concluded that there is now a need for change to reflect the entry-exit system and, in the context of the new Single IT system, to simplify the arrangements for the sell contract. It is also timely to introduce Gormanston as a possible delivery point for buy contracts. The following table sets out the contract types that the TSOs propose should be offered in the tender for 2017-2018:

Lot	Contract Type	Transaction Type	Transaction Point
<b>Lot 1:</b> Balancing Buy	<b>1A:</b> Non-Locational Balancing Gas Buy	Buy	Trading Point
	<b>1B:</b> Locational (Moffat) Balancing Gas Buy	Buy	Moffat IP
	<b>1C:</b> Locational (Moffat) Balancing Gas Buy for a non-NI Shipper	Buy	Moffat IP
	<b>1D:</b> Locational (South North) Balancing Buy	Buy	South North IP
	<b>1E:</b> Locational (South North) Balancing Gas Buy for a non-NI Shipper	Buy	South North IP
<b>Lot 2:</b> Balancing Sell	<b>2:</b> Non-Locational Balancing Gas Sell	Sell	Trading Point

### 8.3 Sell-Side Price Structure Changes

In relation to the sell-side contracts, the NI TSOs consider that the structure of  $SMP_{sell} - X$  remains appropriate. This is because there are no transportation costs involved in delivering a ‘turn-down’ of gas and the  $SMP_{sell}$  price represents a reasonably favourable price for Balancing Gas Sell Providers.

### 8.4 Buy-side Price Structure Changes

In relation to the buy-side contracts, the NI TSOs consider that the  $SAP + X$  price structure is the main issue discouraging participation. As identified above, Shippers have voiced concerns over potential gas price risk, exposure to capacity overrun charges, and over how their costs of delivering the service can be reasonably covered. The NI TSOs are therefore considering possible improvements to address these issues, whilst maintaining an element of competition over the pricing in order to continue to minimise balancing costs.

The following diagram provides a summary of the changes made for 2016-2017 and the NI TSOs views on potential changes for the next tender process. Each potential change is then discussed in turn below.

#### Buy-side Price Structure

Historic Price Components	Changes for 2016-2017	Potential Changes for 2017-2018
Execution Fee	→ Replaced by X in the $SAP + X$ structure	Some contract fees may be necessary to encourage participation
Contract Fee	→ Replaced by X in the $SAP + X$ structure	
Moffat Agent Fee	→ No longer applicable	Unclear whether this will still apply following GB Charging Review – propose pass through to the extent applicable
NTS Commodity Charge	→ Replaced by X in the $SAP + X$ structure	
OCM Price & OCM Transaction Fee	→ Replaced by SAP and X respectively	
	Plus Potential for Capacity Overruns	Propose to eliminate exposure to NI Entry Capacity Overruns

*It should be noted that the structure shown as the ‘historic price components’ in the diagram above reflects the structure for Moffat IP, as there was no buy contract at the South North IP. Going forwards, the TSOs anticipate that the changes proposed would apply for both Moffat IP and South North IP, should a balancing buy contract be implemented at South North IP.*

#### 8.4.1 NTS Commodity Charges

A GB Charging Review is currently underway and may result in substantial changes to the structure of transportation charging on the GB transmission system (the ‘NTS’). It is therefore not possible to be specific about what elements of NTS charging it may be appropriate to include within the price structure. In broad terms, the NI TSOs would propose to allow a ‘pass through’ of commodity charges,

if these remain applicable (i.e. the Balancing Buy Provider would be reimbursed for the specific amount of any commodity charges incurred)

In relation to NTS capacity charges, it is also not currently clear whether interruptible unbundled exit capacity will remain available, or whether changes will be proposed in relation to charging for capacity, including interruptible capacity. Therefore, the NI TSOs do not propose any changes in relation to this at present, but note that it may be appropriate to consider this potential cost element in the future.

#### 8.4.2 Gas Price

Instead of SAP, the NI TSOs propose to use the specific price paid by the Shipper/Balancing Service Provider on the GB OCM as the price for the gas. Balancing Gas Buy Providers would need to provide some evidence of the price paid, and the associated transaction fee, and this would then be reimbursed in full.

#### 8.4.3 Contract Fees

To encourage participation, the NI TSOs envisage re-introducing some form of contract fees. Historically these comprised a standing monthly contract fee and an execution fee, applicable when a balancing gas buy was made. Both of these were competitively specified by the potential Balancing Gas Buy Providers as part of the tender process.

Since this is likely to be the only component of cost where competition might be possible within the tender process, there appear to be 5 options available:

1. A Single (monthly) Contract fee, competitively specified by each Tenderer, and no execution fee
2. A Single (monthly) fixed Contract fee, and a competitively set Execution fee
3. Competitively specified Contract and Execution fees
4. A Fixed Execution fee, and a competitively specified monthly Contract Fee
5. Competitive Execution fees only

These options are illustrated in the diagram below:



*'Competitive' means the Tenderer stipulates the price in its bid*  
*'Fixed' means the level is set by the TSOs in the ITT.*

#### 8.4.4 Potential exposure to NI Entry Capacity Overrun Charges

In relation to NI IP Entry Capacity charges, the current arrangement includes contracts (1B and 1C) where the delivery point is the Moffat IP Entry Point. For this arrangement, the NI TSOs do not pay for NI Entry Capacity, since the capacity being utilised is un-used capacity which has otherwise been booked by Shippers but is not being used on a day.

This is generally likely the most economically favourable option in terms of keeping the costs of balancing gas to a minimum. However it may currently distort competition for Balancing Buy contracts

between, for example, GB-only Shippers, who don't need to have NI Entry Capacity (since they are supplying the gas at the Moffat flange and may use either unbundled firm or interruptible NTS Exit Capacity) and NI Shippers who must hold NI entry capacity to bring gas into the NI Network. This is because where an NI Shipper brings balancing gas in at Moffat IP Entry Point, it would currently be liable to overrun charges if its' entry allocations exceed its booked capacity.

With the current state of supply and demand and the existing NI Network infrastructure, when balancing gas buys are needed, there must be available IP Entry Capacity which is not being used (since the system will be, by definition, short of gas being delivered). It would be possible to create commercial congestion if capacity were to be withheld from the market (i.e. bought by the TSO, or indeed any other party) specifically for balancing purposes.

Furthermore, as mentioned, the Balancing Regulation prohibits balancing gas arrangements resulting in capacity being withheld from the market. Therefore, it is not possible or appropriate to reserve capacity specifically for balancing purposes. It is also the case that capacity holdings will progressively become bundled as existing unbundled contracts expire. At this point, any party bringing gas across the flange will have to hold capacity on both sides (bundled capacity).

Given the current uncertainty in the GB regime over capacity products and charging, it is not possible to comprehensively tackle this issue at this time. However, it would seem appropriate to take steps to try to create a more 'level playing field' between the balancing buy contract types, at least for the interim period until there is greater clarity. The NI TSOs consider that this could be accomplished by removing the potential for exposure to NI IP Entry Capacity Overrun charges, for the quantity of gas which is the subject of a confirmed balancing buy.

## 9. Assessment of the State of Development of the Market

### 9.1 The Current Market

Northern Ireland is a small region, in the context of the European Union. At present, there are 12 Shippers in Northern Ireland. Peak daily demand in 2014/2015 was around 6.4mcmd and in 2015/2016 it was around 6.7 mcmd.

For comparison, in GB there are over 200 companies registered as shippers, of whom at least 40 are sizeable and active parties. The highest demand day for GB during winter 2015-2016 was 393mcmd. Northern Ireland has a direct link to the GB market and the NBP, which is regarded as one of the most liquid markets in Europe, and it is therefore dominated by activity the NBP.

The Northern Irish market is evidently much smaller in terms of participants and in terms of gas demand than GB. Given the relatively small geographical scale of Northern Ireland, there is a limit to how much growth could ever be reasonably expected to develop within the market compared to GB.

100% of the gas currently consumed in Northern Ireland is sourced from the GB market, reducing any incentive to trade in Northern Ireland. Whilst the Northern Ireland market is also connected to the market in the ROI, and despite some gas flows from Corrib into the ROI, the ROI market is also dominated by its direct connection to the NBP, such that the price of gas in the ROI market generally reflects the NBP price plus the costs of transportation to the ROI, and there is consequently little incentive for Northern Irish market participants to trade in ROI in other than extreme/emergency circumstances.

However, some small steps towards market development in Northern Ireland are occurring. Trading at the NI BP has commenced for the first time this year, and though at very low volumes, there is at least

some trade taking place on a regular basis, reflecting the use of the NI BP as a contract delivery point.

Shipper balancing accuracy and NI TSO balancing activity are both much the same as in previous years, with the application of tolerances clearly still being relevant for some market participants.

Steps taken by the NI TSOs to encourage market development through the re-design of the balancing gas tender and associated processes have been unsuccessful. It may simply be too early for these changes to be of interest, given that NI Shippers have also had to contend with moving from a point-to-point to an entry-exit regime and all of the other changes implemented for EU compliance in October 2015. It may also be the case that in such a small market, there will only ever be a small number of Shippers willing/able to participate.

Nonetheless, the approach to procuring balancing services is already market based and reasonably cost effective, given that it must include the costs of transporting gas to NI from GB. It may be that it already offers the best possible (least-cost) solution for the provision of balancing gas, and that attempts to use residual balancing to drive market development will never be very successful.

## **9.2 Outlook for further Market Development and Possible Removal of Interim Measures**

Given that the NI BP has only been in place for just over one year, it is too early to make a detailed assessment or projection of likely timescales for the removal of Interim Measures. In particular, the TSOs consider that it is too early to consider reduction of balancing tolerances for Shippers, though this will need to be assessed in due course. However, various possibilities for further market development are considered below, along with an outline 'road map' for the way forward.

### **9.2.1 Trading Platform**

It is unlikely that the market will ever be large enough to justify the costs and complexities of a Trading Platform, especially given the proximity of the GB NBP. Even if it were to be developed, with such a small number of Shippers acting in the NI market, it is difficult to envisage that it would provide a sufficiently liquid market which could be relied upon for residual balancing purposes. The NI TSOs therefore do not propose to explore this option any further at this time.

### **9.2.2 Balancing Platform**

It is possible that trade will continue to develop to a point where the feasibility of a balancing platform could be evaluated. It is possible that there could be significant growth in the penetration of gas in the region, which might increase the number of NI Shippers. There could also potentially be greater interconnection capacity with GB and/or ROI which might have wider impacts on the market as well.

However, even in such a scenario, with all NI Shippers actively participating in trade at the NI BP, it is not clear that using a Balancing Platform at the NI BP for residual balancing would produce a better outcome in terms of balancing costs than that provided by the current arrangement. Hence it would be essential to conduct an evaluation of how to deliver a balancing platform, the associated costs and process issues and how to migrate to the new arrangements, before concluding on whether to go ahead.

By way of a brief example, issues to be considered in such an evaluation could include:

- Whether or not it should be provided on the TSOs own IT platform;
- What rules should govern prices offered by Shippers on the platform, how often/when can they be changed;

- Whether the TSO would require licencing/approval/exemption by the financial regulatory authorities to undertake trading activity using such a mechanism;
- Costs of provision, including associated business process changes/development and training requirements for Shippers/TSO control room staff;
- How to achieve an operationally reliable transition to the new arrangements.

### 9.2.3 'TSO-trades-in-an-Adjacent-Balancing-Zone'

The Balancing Regulation does contemplate the possibility of a TSO seeking regulatory approval for it acting in an adjacent market to buy/sell balancing gas and paying for transportation to/from its own balancing zone (Article 9 (3)) (known as the 'TSO-trades-in-an-Adjacent-Balancing-Zone' approach). The Balancing Regulation requires that the costs of such activity must be reconsidered annually by the TSO and the regulator. This may offer an alternative way forward to a Balancing Platform, but would similarly need to be explored before any decision was taken.

Issues include:

- How TSOs might be licenced in an adjacent zone, if it is necessary for a TSO to transact directly at the adjacent trading point
- The availability of the necessary skills and resources needed for a TSO to undertake trading activity (which are not currently part of the required skill set/resource base for the NI TSOs)
- How to ensure trading decisions and decisions about balancing the network for operational safety reasons remain appropriately separated within a TSOs organisation (e.g. the processes required around the control room operations)
- The costs associated with the TSOs provision of this arrangement (including the staff and operations/systems required to carry out trading)
- Costs of membership of the OCM
- How to achieve an operationally reliable transition to the new arrangements

### 9.2.4 Way Forward for Interim Measures Removal

The NI TSOs intend to tender again for Balancing Gas Services for 2017-2018. This could give Shippers greater confidence to develop their own arrangements using the NI BP and help to demonstrate compliance with the intent of the Balancing Regulation regarding market development.

23

It will then be possible, during 2018, to consider whether it is worth undertaking a feasibility study into the possibility of a Balancing Platform, alongside any alternatives that may be identified including the 'TSO-trades-in-an-adjacent-zone' approach, to explore and evaluate the best way forward.

The costs, risks and benefits of any potential alternative approach would need to be carefully considered alongside and compared with the existing arrangements for tendering for balancing gas services. With this information, the NI TSOs may then be in a position to set substantive criteria for the adoption of a new approach.

## 10. Interim Measures during 2016-2017

The NI TSOs are proposing the following steps for 2016-2017.

### 10.1 Interim Measures to be retained

As explained above, the NI TSOs consider that it is too early to consider removing Interim Measures since the market is not sufficiently developed (and may never have sufficient scale) to rely on trading at the NI BP for residual balancing.

Therefore, for 2016-2017 the NI TSOs propose to continue use of Interim Measures. Specifically:

- **Balancing Services:**  
The NI TSOs propose to continue to utilise balancing contracts and will prepare the tender for 2017-2018 following responses to this document. The design of the tender process will aim to encourage market liquidity by encouraging participation and trade at the NI BP.
- **Imbalance Tolerances:**  
It is not intended to make any changes to Shipper Imbalance Tolerances at this time. The NI TSOs will continue to monitor Shipper balancing performance on an ongoing basis and may make changes at any time during the year should they consider it necessary.
- **Forecasting Party:**  
The NI TSOs are working on the development and implementation of these arrangements with a target delivery date of 1<sup>st</sup> October 2017

## **10.2 Continue monitoring Market Developments**

2015-2016 has been the first gas year following the introduction of new NI Network Code rules for EU compliance, including CAM, Balancing and Interoperability Codes. Trading at the NI BP has been introduced for the first time and it is already being used, albeit to a minimal extent.

Operational Balancing Requirements have not altered dramatically, and nor has Shipper balancing performance.

During 2016-2017, the NI TSOs will continue to monitor market developments and report annually on progress.