

# Gastransport Services

Draft application for an exemption for the Balgzand Bacton Pipeline project (BBL)

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## 1. Introduction

- 1.1. Gastransport Services (GTS) is currently planning the construction of a gas pipeline between the UK and the Netherlands, connecting Balgzand and Bacton. The project is referred to as the Balgzand Bacton Line (BBL). The BBL project is a very large investment, which carries corresponding risk. To deal with this risk, the BBL will only be built on the basis of longer-term certainty about the contracted capacity as well as the applicable legal/regulatory framework. The latter is also important because the BBL is an interconnecting pipeline between two EU member states involving multiple jurisdictions.
- 1.2. In the past months, GTS has met regularly with the regulatory authorities and governments in the UK and the Netherlands, as well as with the European Commission, in order to gain more clarity and certainty about the regulatory framework for the BBL. The assurances GTS has been seeking are notably related to the proposed access regime of the BBL on the basis of an open season and the terms and conditions of the long-term contracts that the BBL will need in order to underpin the BBL investment.
- 1.3. The uncertainty with regard to the legal/regulatory framework may be attributed to a large part to the fact that at the EU level, new legislation (with direct impact on the regulation of interconnectors) has been in preparation since 2001. Only recently has the “second” EU Gas Directive (2003/55/EC) been adopted by the European Parliament and Council. Implementation of the new Directive in national legislation has yet to start.
- 1.4. GTS believes that the assurances sought for the BBL are in line with the provisions of article 22 of the new EU Gas Directive. The provisions of article 22 allow for an exemption by the Dutch and UK regulatory authorities whilst at the same time informing the European Commission. The European Commission may subsequently decide on the exemptions.
- 1.5. DTI and Ofgem have recently issued an initial views document setting out the way DTI and Ofgem are minded to implement the requirements of the EU gas Directive with respect to the regulatory regime - and exemptions therefrom - for interconnectors. In the initial views document, interested parties are invited to give their views on the proposed regulatory regime for interconnectors, as well as to make a draft application for an exemption.
- 1.6. It is expected that Ofgem will have the authority to decide on exemptions (as part of the foreseen licensing regime) in the UK. It is further expected that the Ministry of Economic affairs will have that authority in the Netherlands and that Dutch regulator DTe will advise the Ministry of Economic affairs on exemptions. In the discussions that have been held in the past months it has been suggested by DTI and Ofgem as well as Dutch Regulator DTe and the Dutch Ministry of Economic affairs that GTS makes a draft application for an exemption. Ofgem and DTe have indicated that they wish to consult on such an application. These consultations will run in parallel and Ofgem and the Dutch Ministry of Economic

affairs will subsequently give regulatory guidance with respect to the application for an exemption.

- 1.7. GTS hereby submits its draft application for an exemption from the requirements of the regulatory regime for interconnectors according to Article 22 of the recently adopted EU gas Directive. This application will be formally submitted once the provisions of the new Gas Directive (2003/55/EC) have been transposed into Dutch and UK law. This document is submitted in four versions, allowing DTe and Ofgem to consult simultaneously in the Netherlands and the United Kingdom. The four versions comprise a confidential and public version, in both English and Dutch. GTS is hopeful that the application will receive sympathetic consideration, and that the draft application will allow the Dutch and UK authorities to give regulatory comfort to the BBL project<sup>1</sup>.
- 1.8. Article 22 of the EU Gas Directive further stipulates that the European Commission will be informed of any exemptions granted and that the EC may subsequently make a decision. GTS is equally seeking comfort from the European Commission, who will be informed of the regulatory comfort the Dutch and British authorities wish to grant GTS.
- 1.9. This document is structured as follows. First, the general background to the project is given, including an overview of the open season. In the second part of the document the application for an exemption is further elaborated, notably the way GTS believes that the BBL will fulfil the criteria set out in article 22 of the EU Gas Directive. Ofgem has indicated a number of topics that GTS should take into account when developing the application for an exemption in the initial views document. A number of additional topics have been raised by Ofgem and DTe. These topics are addressed in this document. Finally, attention is given to the duration of the exemption for which GTS is applying. Any information that is deemed to be confidential will be disclosed to DTe, Ofgem and the Dutch Ministry of Economic Affairs in separate annexes to this application. The availability of additional confidential information is indicated in this application where relevant.

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<sup>1</sup> This application is drafted in English. A Dutch translation has been made available for the benefit of the consultation procedure in the Netherlands. The English version however must be considered authentic.

## 2. General Background

- 2.1. A general introduction and background to this project is described in the brochure that GTS published to inform the market. The brochure has been widely disseminated and a copy is enclosed with this application for an exemption [ANNEX 1].

*BBL pipeline will be an independent company*

- 2.2. The BBL pipeline company will be owned and managed by a separate legal entity specifically incorporated for this purpose (the "BBL-Company"). This entity will be owned by GTS and - probably - one or two other system operators. Operations of the BBL will be sourced out by the BBL Company to GTS on the basis of a service agreement on an arms length-basis. All agreements for transmission through the BBL-facilities and all agreements for related services, if any, will be concluded between the BBL Company and customers and the revenues thereof will be for the BBL Company.
- 2.3. GTS is currently part of N.V. Nederlandse Gasunie. The Dutch Gas Act requires the unbundling of the accounts of vertically integrated companies (article 32), as well as the putting in place of measures preventing the use of commercially sensitive information when negotiating for - or in providing transmission services (article 37). N.V. Nederlandse Gasunie has chosen to implement these legal requirements by way of organisational unbundling and a system of firewalls between the divisions. As such, GTS is unbundled in organisational form from Gasunie Trade & Supply, providing amongst others for:
- (i) Firewalls between Gastransport Services and Gasunie Trade & Supply, including yearly auditing thereof by independent experts;
  - (ii) The location of the two divisions in separate buildings; and
  - (iii) The requirement for Gasunie Trade & Supply to contract for transportation capacity and services with Gastransport Services on terms and conditions that do not discriminate between Gasunie Trade & Supply and other shippers.
  - (iv) A compliance officer has been appointed to ensure the correct application of the requirements of article 37 of the Dutch Gas Act.
- 2.4. In ANNEX 2 to this application, an abstract from the internal firewalls handbook details the arrangements that have been put in place with respect to the organisational unbundling, firewalls, and the responsibility of the Compliance Officer.
- 2.5. Currently, preparations are being made for a legal separation of N.V. Nederlandse Gasunie into Gasunie Trade & Supply and GTS. The legal separation will at least be in conformity

with the provisions of the new EU Gas Directive, and is anticipated by July 2004. Work however is continuing on a separation of the shareholding of the two companies and this is expected to be completed at a later stage. It is foreseen that GTS will be fully owned by the Dutch Government when the separation of ownership has been completed.

*Access based on an open season*

- 2.6. Initially, GTS started the BBL project at the request of Gasunie Trade & Supply on the basis of their long term gas supply contract with a UK based company. Gasunie Trade & Supply have indicated that they wish first gas to come on stream in the summer of 2006. In order for the construction of the pipeline to be completed by that date, the current deadline for the investment decision is 5 December 2003. In order to meet this date, final proposals to the GTS board need to be available on the 24 November 2003.
- 2.7. GTS has offered shippers the possibility of gaining access to the BBL on the basis of long-term contracts for capacity through an open season. The issuing of the open season brochure marked the start of the open season (which ran from 19 March 2003 to 16 May 2003) for shippers wishing to contract capacity.
- 2.8. The capacity and technical specifications of the pipeline will be based on contracted long term capacity rights. Given the projected increase in the UK import dependency the expected physical flow will be from the Netherlands to the UK.
- 2.9. The European Commission has – in the context of the second EU gas Directive – indicated that long term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings insofar as they do not undermine the objectives of the second Gas Directive and are compatible with the Treaty, including competition rules. GTS is confident that the long term contracts that are currently being negotiated with shippers for the BBL will be compatible with EU competition law.

### 3. Application for an exemption

- 3.1. With respect to the legal/regulatory framework within which the BBL will operate GTS is seeking an exemption, based on article 22 of the Gas Directive from both the Dutch and UK authorities. The exemption is notably related to the proposed access regime on the basis of an open season and the terms and conditions of the initial long-term contracts that are needed to underpin the BBL investment. GTS wishes the terms and conditions in the initial BBL transmission contracts not to be subject to regulatory or governmental approval for the duration of these contracts<sup>2</sup>.
- 3.2. Article 22 of the EU Gas Directive (2003/55/EC) allows Members States to exempt certain new infrastructure from the provisions of articles 18, 19, 20 and 25 (2,3,4) under certain conditions. Article 18 relates to providing access to networks on the basis of published tariffs and article 19 and 20 deal with access to storage and upstream pipelines respectively. Article 25 defines the roles and responsibilities of the regulator, notably with respect to the ex ante approval procedure for access tariffs. Articles 18, 22 and 25 of the Gas Directive are included in ANNEX 3
- 3.3. The 5 conditions relating to an exemption are:
  - a. The investment must enhance competition in gas supply and enhance security of supply
  - b. The level of risk attached to the pipeline is such that the investment would not take place unless an exemption is granted.
  - c. The infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built.
  - d. Charges are levied on users of that infrastructure.
  - e. The exemption is not detrimental to the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.
- 3.4. Article 22 further allows the relevant (regulatory) authority to take a decision on the rules and mechanisms for capacity management and allocation in the interconnector, insofar this does not obstruct the carrying out of long term contracts.
- 3.5. Finally, article 22 stipulates that the European Commission may take a decision after notification of the exemptions by the relevant national authorities.

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<sup>2</sup> The initial contracts are needed to underpin the investment in the BBL and will define the capacity and technical specifications. The term initial contracts refers to the commitments made by shippers for the booking of long term capacity before the BBL investment decision has been taken.

- 3.6. More detail is given below with regard to these criteria and the way DTe/ Ofgem have indicated these criteria will be applied. GTS believes that the BBL project satisfactorily meets the requirements a - e and also believes that the proposed rules and mechanisms for capacity allocation and management are appropriate, which it is hoped will allow all relevant authorities to reach a positive decision on this application.

*Non-discriminatory access based on open season*

- 3.7. This exemption request is based on a proposed access regime that offered initial capacity to the market through an open season. GTS believes that the open season process is best suited to ensure non-discriminatory initial capacity allocation and therefore is most appropriate with regard to the competitive position of the (potential) users of the BBL. A number of other issues relate to the competitive position of (potential) users of the BBL. These are notably the use-it-or-lose-it (UIOLI) arrangements and information provision. The proposed UIOLI – as well as other capacity management arrangements such as the secondary market - and the provision of information for the BBL are discussed elsewhere in this chapter.
- 3.8. The start of the open season was presented at the International Natural Gas conference (Flame) in Amsterdam on 19 March 2003. Over 450 copies of the brochure accompanying the open season were handed out to visitors of this conference. In parallel brochures were sent to all GTS shippers, press relations and the Dutch, UK and European authorities. Furthermore the open season was published on the European Tender website and was supported by large advertisements in the “world” edition of the Financial Times and in the Netherlands in “Het Financieele Dagblad”. In these publications GTS asked potential shippers to express their non-binding interest before 16 May 2003.
- 3.9. A draft BBL transmission contract was sent to all respondents before the start of the first round of discussions in June 2003. GTS visited 17 interested shippers in June and July. In these discussions the project progress, transmission agreements and required capacities were discussed, as well as a timetable for further discussions. The terms and conditions for the BBL contract have been further developed since these meetings. These will be presented to shippers in the second round of discussions in September. According to the current schedule GTS will have a third and final round of discussions in October and will want to receive a binding commitment from potential shippers before the end of November 2003.
- 3.10. A list detailing shippers that have reacted, shippers that GTS is currently negotiating with, their projected capacity requirements and points of entry into the GTS system will be attached as a confidential ANNEX 4.

**Condition (a)**

The investment must enhance competition in gas supply and enhance security of supply

*Competition*

- 3.11. In Ofgem's initial views document as well as in additional questions put to GTS by DTe and Ofgem, emphasis has been given to competition issues. Whilst GTS believes that the BBL project will have a favourable effect on the operation of the market, both at the European level as well as in the UK market, GTS opines that the effect of the BBL pipeline is not a matter for the operator of that pipeline. Certainly with respect to the competition analysis, as set out for example in the Annex to the initial views document, it is both impossible and inappropriate for the pipeline operator to know to whom shippers using the BBL sell their gas. As indicated above, the BBL will be a separate company, and its shareholder(s) will ultimately be transmission companies that act independently. The BBL operator cannot rightfully ask its contractual counterparts to whom they are selling their gas. We note that an important factor in the proposed qualitative analysis of competition is the effective separation of the interests of transmission and trading.
- 3.12. However, GTS has commissioned an independent study to consider the effects of the BBL on competition in the UK gas market, whilst taking into account the wider effects on competition in the European gas market and the enhancement of security of supply. A report has been prepared by ADL Ltd. and is attached to this application. [ANNEX 5].
- 3.13. As part of the Trans European Energy Networks (TEN), the European Commission has identified an interconnector between the United Kingdom and the Netherlands as a priority. Prioritisation under the TEN is based partly on the positive effect of the various projects on the operation of the internal gas market.
- 3.14. GTS further expects the proposed pipeline to improve the operation of the market in the Netherlands. The fact that the expected physical gas flow will be from east to west is not so important, because the system of contractual counter flows will inevitably create additional scope for arbitrage at both ends of the pipeline.

*Competition in the transport market*

- 3.15. Apart from the operation of the internal market for gas as a commodity, it should also be noted that the BBL will have a positive impact on the operation of the internal gas transport market. At present, apart from the Interconnector, there are no direct links between the United Kingdom and the Continent. The BBL offers an alternative transport route to the existing Interconnector. GTS believes that Interconnector UK is a direct competitor for the



BBL and a possible alternative for shippers wishing to bring gas from the Continent to the UK.

*Improved security of supply<sup>3</sup>*

- 3.16. GTS believes that on a European scale it is important for a second physical link to be established between the large markets of the UK and Continental Europe, thus increasing the scope for arbitrage and the sourcing of gas from a greater diversity of sources. The BBL project strengthens both delivery capacity and security of supply in the European single market, especially for the United Kingdom, which will gain a new supply route along which the expected supply-side deficits in the UK can be alleviated. The United Kingdom may also benefit from the increased possibilities for new entrants to the UK gas market that the BBL offers. For Continental Europe, having the ability to carry gas to the most liquid market will also have a beneficial effect on the operation of the internal market.
- 3.17. Moreover, the BBL forms a potential part of the Baltic pipeline, enabling a connection with the enormous Russian gas reserves. Building the BBL could in fact have a positive effect on the establishment of a link to the Baltic pipeline in the Netherlands, thus increasing security of supply for both the UK and the Netherlands. GTS is convinced that the BBL pipeline will play an important role in bringing Russian gas to the UK in the future.
- 3.18. GTS believes that the operation of the Dutch gas market may be improved as a result of the BBL interconnector, by reason of increased arbitrage possibilities. Furthermore, GTS is convinced that the BBL will not lead to any crowding out of existing gas flows in the Netherlands, particularly to domestic gas customers. Elsewhere in this application it is indicated that investments in the GTS network to accommodate gas flows to the BBL may under certain conditions be necessary. GTS believes that these investments would actually lead to an increased resilience of the network.

*Qualitative factors*

- 3.19. Ofgem have indicated a number of qualitative factors that they intend to use in a competition analysis. Above GTS has indicated that the BBL will be subject to appropriate and effective separation provisions from trading interests. In the initial views document,

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<sup>3</sup> GTS believes that security of supply is enhanced through the connection to new sources and the increased opportunities for new entrants to target the UK market. Security of supply is also dependent on the technical specifications of the pipeline itself. GTS will use electrically driven compressors. DTI has asked GTS to address the security of supply of *electricity* to these compressors. The degree of reliability of compressors and the supply of fuel needed for them has been an integral part of the design requirements. The compressors will be directly connected to the high voltage (150 Kv) grid. GTS has concluded that the reliability of the electricity supply satisfactorily meets the design criteria.

reference is made to the Commission's benchmarking surveys and the existence of Hubs. In the latest (2<sup>nd</sup>) Commission survey, the network access conditions in the Netherlands are considered to be positive. Commitments by GTS relating to the Guidelines for Good Practice as established in the Madrid Forum will further contribute to efficient network access in the Netherlands. Furthermore, GTS has developed the EuroHub in the Emden/Bunde area. Here, pipelines of leading European gas companies come together opening possibilities for gas flows from/to Norway, Germany and The Netherlands to meet the demand in the European market. EuroHub intends to facilitate a fully integrated trading place but will not engage itself in any commodity trading.

*Continued application of competition law*

- 3.20. The continued application of EU, UK and Dutch competition law in respect of any exemptions granted has been stressed by Ofgem and DTc. The contracts with users of the BBL will be based on the standard GTS terms and conditions, taking into account specific characteristics of the single pipeline BBL. The aspects of the BBL transport contracts that are not covered by the exemption will be equally compliant with the requirements of competition law.

**Condition (b)**

The level of risk attached to the pipeline is such that the investment would not take place unless an exemption is granted.

*BBL is a legally and financially independent company*

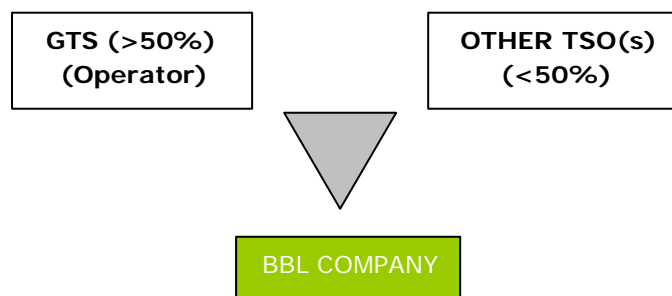
- 3.21. With regard to the risks involved<sup>4</sup> it is important to point out that the BBL will be a fully independent company. It has been indicated in chapter 2 of this application that the BBL facilities will be owned and managed by a separate legal entity specifically incorporated for this purpose (the "BBL-Company"). The BBL Company in turn will be owned by GTS and - probably - one or two other pipeline companies but GTS will be the majority owner of this company. Ownership of the BBL company is expected to be in the hands of pipeline companies only. If an alliance with another pipeline company can be formed, the company to be set up will be a joint venture. In that case, the separation criteria for the BBL company will hold equally for partners in the JV. Having such a separate entity also satisfies condition (c) for an exemption, which requires the new infrastructure to be placed under a separate company.

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<sup>4</sup> With respect to the risks involved in the BBL project it has been indicated to all shippers that GTS is seeking an exemption on the basis of the provisions of the second Gas Directive, and that without such an exemption investment in the BBL will not take place.

3.22. With respect to the operation and governance of the BBL company GTS foresees the following principles:

- The (joint venture) BBL Company will build the BBL at it's own expense and risk.
- GTS will be a majority shareholder The BBL Company will commission GTS to operate the BBL
- GTS will be the operator for the BBL on the basis of a market based service agreement on an arms length-basis.



3.23. All agreements for transmission through the BBL-facilities and all agreements for related services, if any, will be concluded between the BBL Company and customers and the revenues thereof will be for the BBL Company. This will also preclude any cross-subsidisation between users of the GTS system and BBL users.

3.24. For the decision to construct the BBL, it is essential to have certainty regarding the contracted capacity and the applicable tariff. For the BBL, the investment will be based on initial long-term contracts with shippers (10-20 years) under which capacity and tariff (- formulae) are fixed for the contract duration. The duration of individual transmission contracts may vary according to shippers needs. Also, it is important to note here that GTS is seeking an exemption for the initial contracts which may have different durations. Any uncertainties in this regard, as might be introduced, for example, by the possibility of periodical downward revision of the tariff level by regulatory bodies or by additional rules governing capacity management or shortening contract duration, would increase the investment risk appreciably and would mean that the investment will not take place.

3.25. Whilst the long term contracts (10-20 years) are needed to underpin the investment in the BBL and a considerable part of this investment will be recovered during the initial period, not all of the investments will be recovered during that time. As a consequence, risks will remain after the initial contract period. These risks are the consequence of the uncertainties regarding the sale of transport capacity after the initial contracts have expired.

*Investment risk*

- 3.26. In order to put the investment risk of the BBL in perspective, information is given from the GTS annual report as an indication of the magnitude of the investment. However, these figures are not suitable for a financial appraisal. It is emphasised again that the BBL will be placed under a separate legal entity and that this legal entity will, as such, operate as an independent business and be financially independent. Additionally, considering the possibility of another (presumably international) gas transport company having a stake in the BBL, a financial appraisal based on GTS figures is not appropriate.
- 3.27. Subject to the caveats in the previous paragraph GTS provides a number of figures from the annual report of N.V. Nederlandse Gasunie. From these figures, it can be seen that the average capital expenditure for GTS is currently running at around €70 million per annum (average for 2001-2003). Given a total investment in the BBL estimated at €375-550 million (depending on the pipeline diameter finally decided upon), the annual capital expenditure increases in the years up to 2006 by €150-250 million, in other words, somewhere between a twofold and a fourfold increase. As investor in the BBL and, if other investors join, as a partner in the company owning the pipeline, GTS will expect to obtain a normal market return on the capital made available.
- 3.28. The size of the investment in the BBL in relation to the total purchase value of the GTS network (€4,982 billion in 2003, according to the Annual Report) amounts to between 7% and 11%. More financial information regarding the timetable for actual expenditures in relation to this project is contained in a confidential annex to this application (ANNEX 6).

**Condition (c)**

The infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built.

- 3.29. As stated previously the BBL will be a separate legal entity, with GTS acting as operator. This legal entity will be both financially independent and run as an independent business. The possibility of having one or two other gas transport companies taking a participating interest in the BBL project is also currently being explored. If an alliance with another pipeline company can be formed, the company to be set up will be a joint venture.
- 3.30. Reference is made to section 2 of this application for more information on the separation and unbundling of GTS from Gasunie Trade & Supply.

**Condition (d)**

Charges are levied on users of that infrastructure.

*Access Tariffs*

- 3.31. At this stage it is not possible to comment on final contracting of capacity in the BBL because at the time of writing the discussions with potential shippers have yet to be concluded. However, the minimum size of the BBL will be a 30" pipeline. As a result of the interest expressed in the open season the maximum foreseen capacity - should the pipeline go ahead - is likely to be based on a 36" pipeline. More information on shippers and the capacities / entry-points they wish to book has been included in confidential ANNEX 4.
- 3.32. Clearly, as an independent transmission company the BBL company will charge the users of the infrastructure for the capacity booked. Part of the access regime for the BBL is the open season that has been held to let interested parties express their interests for capacity. Negotiations are now ongoing with these shippers.
- 3.33. Initially an indicative tariff of 65 EUR /m<sup>3</sup>/hr/yr has been given to potential shippers in the course of the open season. This tariff is based on a 30" pipeline for a 15 year contract and includes the fuel costs for the pipeline. In the open season invitation to shippers to express their interest as well as in the ensuing talks/negotiations it has been pointed out to shippers that this tariff may be altered as a consequence of economies of scale (size) as well as contract duration (years). The indications of shipper interest have thus far been promising. On the basis of this interest a tariff schedule will be disseminated to all shippers shortly setting out the economies of scale.
- 3.34. As a result of representations from potential shippers the BBL tariff will further be split into a fixed and variable part. This is in part due to the fact that the single pipeline system will be susceptible to variations in the load factor of the gas that is shipped through it. As a consequence energy inputs for compression may vary greatly with the actual usage. Therefore, the variable part of the tariff will most likely be coupled to an energy price index.
- 3.35. The indicative tariffs for the BBL contracts will be published, as well as the terms and conditions for interruptible contracts. The terms and conditions for interruptible contracts are currently under consideration. Information provision is discussed in more detail below.

*Capacity management and allocation*

- 3.36. The capacity and technical specifications of the pipeline will be based on contracted long term capacity rights with appropriate rules and mechanisms for the management and allocation of capacity in the BBL.
- 3.37. GTS will provide for an adequate system of use-it-or-lose-it to ensure that capacity that is (temporarily) unused (in the primary or secondary market) is made available on an interruptible basis by the BBL company on the primary market.
- 3.38. As regards the management and allocation of capacity, GTS points out that the most important mechanism in the initial allocation procedure is provided by the 'open season' approach that has been taken and which has received extensive publicity. Potential shippers accordingly have had an opportunity to book transport capacity on the BBL, regardless of the magnitude of the volumes or capacities they wish to have carried.
- 3.39. If shippers do not wish to use their contracted capacity for a certain period, it will be possible to make all or part of that capacity available on the secondary market by subletting it to another shipper. If the latter shipper is going to do its own nomination this will be subject to reasonable terms and conditions, covering such things as reliability and creditworthiness.
- 3.40. If a shipper wants to transfer its capacity permanently to another shipper, this will also be possible on appropriate terms and conditions, i.e. in line with prevailing terms and conditions. A credit control protocol will be part of the exhibits that are part of the Transmission contract, and will be based on the protocol used in the GTS standard terms and conditions for transmission services. A draft of the protocol is attached to this application (ANNEX 7).
- 3.41. GTS is considering making available a bulletin board for the BBL to facilitate the secondary trading of capacity. The bulletin board would then be available for (potential) shippers to let it be known that they are searching for other (potential) shippers to obtain transport (through assignment) or to trade transport capacity. This bulletin board would only serve the purpose of bringing (potential) shippers into contact with other (potential) shippers. The Bulletin Board will be similar to the board that GTS has opened for its own network. A brief description of the GTS bulletin board is given in ANNEX 8.
- 3.42. Apart from the possibility for shippers to trade capacity on the secondary market, it is proposed that a use-it-or-lose-it regime should apply with regard to the contracted capacity in the BBL. In other words, contracted but unused capacity will be offered to other shippers on an interruptible basis by the BBL operator. As indicated elsewhere in this application, the terms and conditions for interruptible contracts are currently under consideration.

- 3.43. As an alternative, GTS considered the idea of offering unused capacity to the market on a firm basis rather than an interruptible basis. The conclusion was that this would constitute an excessive infringement of shippers' contractual rights inasmuch as they would lose the right to use their contracted capacity. Since GTS understands from the market that shippers may also like to use the BBL to supply gas to meet seasonal demand and to provide backup, it is considered that such a limitation of their rights would lead to reduced interest in the BBL.
- 3.44. The BBL operator does, however, plan to monitor the extent to which shippers are not using their contracted capacity to ensure transport capacity is not being deliberately tied up. To counter any such tendency, in the event of capacity remaining unused for a long period while there was in fact demand for that capacity<sup>5</sup>, the BBL operator would consider recovery of the unused capacity under the contract with the original shipper.
- 3.45. GTS believes that a strong emphasis on the possibility of trading (unused) capacity on the secondary market, combined with selling interruptible capacity by the transporter and a provision in the transportation contract that the transporter can retrieve unused capacity for which there is a demand, is an effective methodology for the satisfactory management of capacity.
- 3.46. To enable shippers to make considered decisions with regard to both the secondary market and the use of interruptible capacity, the BBL will be transparent in its publication of the necessary information. GTS has in mind the publication of historical data on actual gas flows, with due observance of the confidentiality of information on the gas flows of individual shippers (see below).

*Provision of information*

- 3.47. The provision of information on historic capacity usage, prices and real time information flows for the BBL, is generally supported by GTS subject to any confidentiality issues involved with regard to the publication of information. This notably includes information on real time flows and capacity utilisation when there are less than three shippers. This is also subject of discussions taking place in the Madrid Forum<sup>6</sup> on the Guidelines for Good

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<sup>5</sup> More information on the conditions applying to the duration of not using capacity is given in confidential ANNEX 10.

<sup>6</sup> In 1999 the European Commission took the initiative to set up the European Gas Regulatory Forum of Madrid. The Forum convenes twice a year in Madrid and consists of national regulatory authorities, Member States, the European Commission, Transmission System Operators (GTE), gas suppliers and traders, consumers, network users, and gas exchanges. The Forum was set up to discuss issues regarding the creation of a true internal gas market, which are not addressed in the Directive. The most important issue addressed currently in the Forum are the Guidelines for Good Practice (GGP). The voluntary GGP are a set of basic principles aiming at the enhanced functioning of the Internal Gas Market. Whilst voluntary, the GGP are generally recognized as

Practice. In the Forum it has been suggested by GTE, the European Gas Transporters Association, that where there are less than 3 shippers, confidentiality may need to be respected subject to certain caveats: there must be clear evidence that the shipper has indicated that the relevant information may not be published; this evidence needs to be renewed on a regular basis; an element of approval by the relevant regulatory authority will be necessary.

3.48. Information provision for the BBL will be consistent with current UK and Dutch legislation. Generally, the information on historical usage currently made available by GTS will also be made available by the BBL operator. This information will at least be available to the regulatory authority and - where no issues with confidentiality are involved - publicly available. In the case of confidentiality issues, information that is made available publicly may be aggregated. The information will include :

- Prices charged for third party access
- Prices charged for interruptible access on the basis of the application of UIOLI rules (The terms and conditions for interruptible contracts are currently under consideration).
- Real time flows will be made available to shippers using the BBL on an on-line basis. It is expected that this will be largely similar to such information provision in the GTS network. This is explained on the GTS website. The relevant text has also been included in ANNEX 9.
- Historical data on the actual usage so as to inform shippers considering a booking request for (future) interruptible capacity. This information is especially meant for those shippers who are considering a booking-request for (future) interruptible capacity. The provision of this information will be largely similar to the information provision in the GTS network on import and export capacities.
- Information on planned maintenance that may affect shippers.

3.49. Information on expected flows – insofar as this information is known to the BBL operator - will not be published as this information may have a direct influence on prices in the UK market.

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important in giving guidance to Member States, regulators, TSOs as well as network users in the development of the legislative, regulatory and contractual framework for gas transmission.



**Condition (e)**

The exemption is not detrimental to the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.

- 3.50. Reference is made here to the remarks regarding condition (a) above. GTS is confident that the contractual and technical specifications of transmission through the BBL pipeline will be compatible with the requirements of the Dutch and UK gas networks. To this end, GTS is currently discussing technical and gas specifications with NationalGridTransco. It will be the responsibility of shippers using the BBL to ensure sufficient capacity booking in the UK NTS.
- 3.51. Further to the compatibility of contractual and technical requirements of the BBL, it is expected that shippers using the BBL may need connecting transport through the GTS network. As part of the 'open season', shippers have been invited to indicate their interest in such a possibility. In view of the very limited scope for carrying gas from the most obvious location (Oude Statenzijl) to Balgzand, it will be necessary to invest in increased capacity on this section, based on adequate revenues to warrant such investment. Assuming that is possible, no impact on existing transit volumes or domestic gas transport flows is expected.
- 3.52. The tariff for connecting transport through the GTS network will be based on the normal entry/exit tariff system for the GTS network. A tariff based on a dedicated pipeline does not fit into GTS's tariff philosophy which is based on an equal treatment of transmission services, whether for domestic or transit purposes. Furthermore, GTS believes that there may be an additional benefit for domestic users because the necessary investments will "automatically" increase the possibilities for further technical /operational optimisation by GTS and will subsequently increase the resilience of the Dutch transmission network.
- 3.53. A number of potential shippers consider the availability and booking of connecting entry and exit capacities in the GTS network (from entry-point Oude Statenzijl) a necessary condition for the booking of transmission capacity in the BBL. Therefore, GTS believes that, under current conditions and subject to sufficient demand, the required investments in the GTS network will be made. This investment decision will therefore be strongly interrelated with the investment decision for the BBL pipeline.

#### 4. Duration of the exemption

- 4.1. The proposed BBL is a major infrastructure project with considerable associated risk. GTS, as the main sponsor of the project will only give approval provided the regulatory and commercial risks are minimised. To reduce risk, long term contracts are being negotiated. These contracts will have a minimum duration of 10 years and a maximum duration of 20 years. The duration of individual transmission contracts may vary according to shippers needs. An exemption is being sought to correspond to the duration of the initial long term contracts, i.e. contracts that may have different lengths.
- 4.2. Whilst first gas is expected to come on stream in the summer of 2006, this date will not necessarily be the starting date for all shippers that GTS is hopeful will sign on. Some potential shippers have indicated their interest in a later starting date. Moreover, it is expected that shippers using the BBL and sourcing their gas from the Oude Statenzijl entry-point into the GTS network, will not be able to ship until the connection between Oude Statenzijl and Balgzand has been completed. The completion of this connection – subject to a positive investment decision being made – is not expected before 2007.
- 4.3. Whilst the capacity and technical specifications of the BBL will be determined by the contracted long term capacity rights, some capacity may be available between first gas and the start of other initial contracts. Subject to the technical aspects of the realisation of the BBL, a limited amount of capacity may be available over and above the contracted long term capacities. GTS is likely to make this capacity available<sup>7</sup>. The terms and conditions for selling any such “spare” capacity will need to reflect the terms and conditions of the initial contracts. GTS believes that these terms would otherwise be to the detriment of the initial shippers. GTS would therefore also expect the exemption to apply to the contracts for the sale of any such “spare” transport capacity.

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<sup>7</sup> We note however that the scope for the use of this capacity may be limited due to capacity constraints in the Dutch gas network (as is exemplified by the need for increased capacity between Oude Statenzijl and Balgzand).

## 5. Conclusions

- 5.1. Access to the BBL has been offered on the basis of a widely publicised open season. GTS considers that the open season and the way it has been conducted by GTS meets the requirements for non-discrimination.
- 5.2. The BBL will be owned and managed by a separate legal entity which will operate as an independent business and be financially independent.
- 5.3. Charges will be levied on the users of the pipeline, and the indicative charges will be published, as will other information, especially in relation to enabling other shippers to make considered decisions with regard to the secondary market and the use of interruptible capacity.
- 5.4. A well considered system of capacity management measures is proposed in this application. GTS is convinced that the proposed methodology will be effective for the satisfactory management of capacity.
- 5.5. The BBL will connect two gas systems. GTS considers that the contractual and technical specifications of the BBL will be fully compatible with both systems. Indeed, GTS considers that the investment decision for reinforcement of the Dutch network (Oude Statenzijl – Balgzand) should be taken at the same time as the investment decision for the BBL. Such reinforcement will however, remain part of the GTS network, and be operated and priced separately from the BBL.
- 5.6. Even when compared to the figures from the N.V. Nederlandse Gasunie annual report the capital expenditure for the BBL is vast. The risks involved can be mitigated to a degree by the long term agreements on tariffs and capacities that ultimately will underpin the investment. Therefore GTS is seeking an exemption for the duration of those initial contracts.
- 5.7. The 5 conditions as set out in the EU Gas Directive have been addressed in this application. GTS considers that the proposals submitted for the BBL fulfil these conditions.
- 5.8. The initial discussions GTS has had with both the UK and Dutch authorities have been positive and helpful. GTS firmly believes that the BBL project provides an important link in the development of the UK and Continental gas markets. GTS believes that the project would make a significant contribution to the security of supply for the United Kingdom and the Netherlands, particularly as the former moves towards import dependency.
- 5.9. Furthermore, GTS considers that the construction of the BBL pipeline would assist competition in both the British and Continental gas and gas transport markets. Also, as has been indicated GTS believes that the proposed arrangement for ownership and operation of

## Draft application for an exemption

the BBL meets all the regulatory requirements for exemption outlined in the EU gas directive and the views put forward by DTe and Ofgem in the discussions as well as Ofgem's initial views document.

- 5.10. GTS is hopeful therefore that this application for an exemption will receive sympathetic consideration.

**6. List of annexes.**

<b>ANNEX</b>	<b>Content</b>	<b>Confidential</b>
1	Brochure regarding the open season	
2	Abstract from the N.V. Nederlandse Gasunie Firewalls handbook	
3	Abstract from the second EU Gas Directive	
4	Competition study by ADL Ltd.	
5	List of shippers and capacities	Confidential
6	Financial information	Confidential
7	Credit control Protocol	
8	Description of the GTS Bulletin Board	
9	Applications for shippers: On-line Transport Information Service	
10	UIOLI	Confidential