Interconnector (UK) Limited

Relevant sections of Charging Methodology for Consultation

This paper sets out the proposed principles for setting the tariffs for capacity bought in this sale for the period from October 2018 onwards.

It also sets out the principles for setting tariffs for capacity applying from 1 November 2015 to 30 September 2018 purchased under the IAA when the long-term STA contracts run in parallel.

Section of IUK's proposed Charging Methodology relevant to first sale of IUK Capacity applying from October 2018 onwards

1. Introduction

This document sets out the charging methodology that Interconnector (UK) Limited ("IUK") intends to apply to charging for the products that IUK will offer in early 2015 for gas transportation services from 1 October 2018.

In early 2015, IUK will offer market participants the opportunity to purchase capacity for transportation services from 1 October 2018.

Market participants that intend to participate in the mechanism for allocation of such capacity will be required to enter into the IUK Access Agreement ("IAA") setting out access terms for such capacity.

2. Objectives

Article 13 of the European Gas Regulation (EC) 715/2009, requires NRAs to approve the tariffs, or the methodologies used to calculate them, applied by TSOs, ensuring transparency, non-discrimination and including an appropriate return on investment.
Standard Licence Condition 10(1) of IUK's interconnector licence states that IUK shall only enter into agreements for access to IUK's interconnector on the basis of the charging methodology last approved by the Authority, unless the Authority determines otherwise.

Standard Licence Condition 5 (a) also notes that prior to submitting the charging methodology to the Authority for approval, IUK shall take all reasonable steps to ensure all persons, including those in other Member States, who may have a direct interest in the charging methodology are consulted and allow them a period of not less than 28 days within which to make written representations.

Also, Standard Licence Condition 17 notes that, where tariffs and/or tariff or charging methodology has been established or approved by a Regulatory Authority other than the Authority, the Authority may issue a notice to the licensee that the establishment or approval by that Regulatory Authority meets the requirements of this licence condition. Such notice will constitute approval of a charging methodology for the purposes of this licence condition and switches off paragraphs 2 and 5-15 of IUK's licence with respect to the Authority.

This charging methodology for IUK's new sales of capacity for transportation services for the period starting from 1 October 2018 is therefore subject to the approval of the Authority in accordance with IUK's interconnector licence. Once approved, this charging methodology will be published on IUK's website.

IUK believes this charging methodology meets the relevant objectives as set out in Standard Licence Condition 10(4). These relevant objectives are that the charges and the application of the underlying methodology shall be objective, transparent, non-discriminatory and compliant with the Regulation and any relevant legally binding decision of the European Commission and/or the Agency (i.e. ACER).

3. Capacity Products for post 2018 capacity sales

In early 2015, IUK will offer capacity for sale. The products offered will comprise annual entry capacity at Bacton, exit capacity at Bacton, entry capacity at Zeebrugge and exit capacity at Zeebrugge with separate reserve prices for each of the four products, for up to 12 years (from 1 October 2018). In addition, IUK will also offer quarterly products to shippers who would like to book additional seasonal capacity to their flat annual booking of 5 year duration or longer. The entry and exit capacity products will be independent from each other. IUK will make available all of the technical capacities subject to 20% being reserved for later allocation processes.

4. Capacity Charging Methodology

Entry and exit capacity charges are payable when a right to flow gas is purchased irrespective of whether or not the right is exercised.

The reserve prices for capacity sales in early 2015 for entry and exit capacity products will be set by IUK to ensure objective and non-discriminatory treatment across shippers taking part in the capacity sales.

The key factors determining the reserve prices for the capacity sales in early 2015 are:

- Operating costs for operating and maintaining the company and its assets
- Capital expenditures required to maintain the service
- Projected customer demand for IUK capacity and the forecast volume of both long term and short term sales under a range of market scenarios
- Competitive forces and the prices of competing and complementary services.

Taking into account these drivers, in accordance with European regulation (EC) 715/2009 and subject to NRA approval, IUK will set reserve prices which are attractive to shippers, reflect the value of the services, and which are expected to be sufficient to cover IUK's costs including an appropriate return.

5. Principles for price structure

The capacity offered in early 2015 will be long term capacity booked well in advance of delivery. It is important for IUK to know in 2015 that some capacity has been booked post 2018, to allow for more efficient and effective capacity planning of IUK's future business model. To reflect this fact, various incentives will be introduced in early 2015 capacity sales to encourage long term booking.

The main principles for the price structure of early 2015 capacity sales are outlined below:

- The price paid for entry and exit capacity products will be the reserve price plus any premium bid at the time of the allocation process. This means the capacity price is fixed at the time of purchase (excluding provision for inflation) providing price certainty to capacity holders.
- A booking incentive on the reserve price will be offered:
    - for bookings that are longer in duration (i.e. booking incentive for bookings of 5-7 years, 8-9 years and for bookings of more than 10 years).
- The reserve prices for entry capacity at Bacton and exit capacity at Zeebrugge will differ from the reserve prices for exit capacity at Bacton and entry capacity at Zeebrugge to reflect the different underlying market and cost conditions.
- IUK will also offer the option of booking sub-annual products for shippers who book for 5 years or more. Products for two quarters or three quarters of entry and exit products will be available in addition to the flat annual booking. These products will be made available at a premium to the price of annual products corresponding to the same duration (i.e. the reserve price after any booking incentives are applied).

6. Capacity class

The capacity for both the entry and exit capacity products will be offered on a firm basis. If, at the 2015 sales process, all firm capacity has been sold, further capacity may be sold on an interruptible basis.

7. Indexation

When calculating the tariff to apply in a future year, the reserve price element will be subject to annual indexation. Any auction premium will remain fixed.

8. Balancing

Shippers will be required to be in balance such that inputs equal offtakes on an hourly basis. Since IAA shippers will be required to be in balance, no daily imbalance charge will be introduced.

9. Buy Back

If at any time aggregate nominations exceed, or are predicted to exceed, the physical capability of the system, IUK will initiate a Buy-Back process. IUK will determine the quantity of capacity that needs to be bought back from shippers to reduce the aggregate nominations to within the physical capability of the system. Shippers can offer any capacity voluntarily to be bought back. If forced buyback procedures are invoked then this will apply to all capacity bought day-ahead and within day.

10. Registration and administration Fee

New IAA shippers will pay a Registration Fee once they have been successfully allocated capacity and all IAA shippers a Monthly Fee. The fees accrue to IUK. The Monthly Administration Fee is payable by each IAA Shipper under an IAA. This covers IUK's costs supporting contract administration, IT support costs, credit review and invoicing.

11. Fuel Charges

<u>Fuel Gas & Shrinkage</u>

Fuel gas is consumed in the operation of the Interconnector comprising:

(a) Fuel Gas used for the operation of compressors at Bacton when gas is flowing from UK to Belgium;

(b) Fuel Gas used for the operation of heaters at Zeebrugge when gas is flowing from UK to Belgium; and

(c) Fuel Gas used for the operation of heaters at Bacton when gas is flowing from Belgium to UK.

Fuel gas and shrinkage are allocated to IAA Shippers in proportion to their allocations of gas flowing into and out of the Interconnector and will be provided as gas in kind based on a fixed percentage notified in advance by IUK.

<u>Electricity</u>

Electricity is consumed in the operation of the compressors at Zeebrugge when gas is flowing from Belgium to UK. IAA Shippers will be allocated electricity costs in proportion to their allocations of gas flowing into and out of the Interconnector.

Section of IUK's proposed Charging Methodology relevant to sale of IUK Capacity applying from 1 November 2015 to 30 September 2018

The reserve price for Entry and Exit Capacity at IBT and IZT applying from 1 November 2015 to 30 September 2018 sold under the IAA will be set by IUK to ensure equitable and non-discriminatory treatment across all Shippers. During this period the IAA will run in parallel to the existing long-term capacity contract, the Standard Transportation Agreement (STA). Existing Shippers have underwritten the investment and operational costs of the Interconnector by committing to ship or pay payments, based on cost related tariffs, for the 20 year term of the STA. Without these long term commitments the infrastructure would not have been built. To avoid cross-subsidy it is proposed that capacity sold under the IAA for periods of a day or longer applying from 1 November 2015 to 30 September 2018 is sold at a price broadly equivalent to the cost paid overall per unit of existing capacity by Shippers under the STA.

Conditions 7-11 outlined above will also be applicable to the capacity sold under the IAA applying from 1 November 2015 to 30 September 2018. However, fuel gas will be charged at a market-based rate rather than provided as gas in kind.