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22 January 2015

Dear Stakeholder,

Consultation on sale of post-2018 Interconnector capacity

Last year, we asked you for your views on proposals for our future business model and services in preparation for the expiration of our current long-term capacity contracts in October 2018 and new regulatory requirements from November 2015. We would like to thank you for participating in this process and for your positive feedback, which has helped us develop our future service provision.

Today, we are launching the sale of Interconnector capacity from 1 October 2018. The timeline and details of this sales process are outlined in our Information Memorandum available on www.interconnector.com.

In parallel, we are seeking your views on elements of this process and our future arrangements in this consultation, specifically:

- The products and allocation process for this sale;
- The principles of our Charging Methodology outlining how the tariffs for this sale of our services will be calculated;
- The contract that Shippers will be required to sign to access these services and under which capacity from November 2015 onwards may be purchased.

This Consultation is divided into 4 parts:

- Part 1 sets out background information about us and our services;
- Part 2 summarises our proposals;
- Part 3 sets out our indicative timetable for marketing capacity;
- Part 4 explains how you can help us by providing feedback on these proposals.

In accordance with IUK interconnector licence and relevant EU legislation, IUK has actively engaged in discussions with National Regulatory Authoritys ("NRAs") to date and will continue to engage with them throughout the sales process. Following the consultation process, IUK will seek NRA approval for the IUK Access Agreement ("IAA"), the IUK Access Code ("IAC"), Charging Methodology and the allocation mechanism described in this letter and the accompanying annexes.

PART 1: BACKGROUND INFORMATION

Our role in the gas markets

We own and operate the Interconnector Pipeline that runs between Bacton in the UK and Zeebrugge in Belgium. The bi-directional pipeline provides a unique strategic link between the UK and mainland European gas markets. As such, we play an important role in the realisation of the single European gas market and in providing security of supply to both GB and mainland European markets.

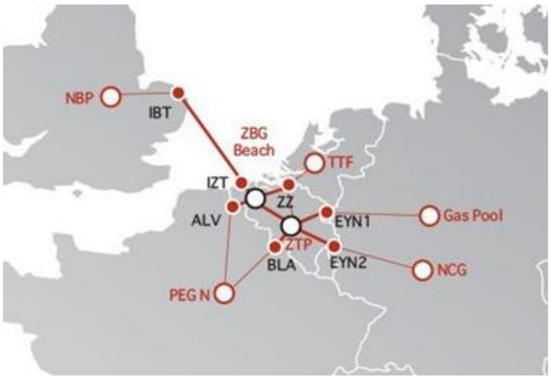
All of our capacity was sold under 20 year long-term contracts, following open seasons, until the end of September 2018. Our technical capacity was designed to meet the level of demand indicated in these open season processes. Our capacity has been actively traded since 1998 and, during the course of its operation, we have developed a number of mechanisms that make interruptible capacity available and enable parties who are not currently Shippers to access capacity in the system via the secondary market.

Our future

From 1 October 2018, it is anticipated that all of the technical capacity of the Interconnector will become available, subject to, amongst other things, the availability of the facilities, contractual terms and conditions and the prevailing market and regulatory conditions.

Changes to our regulatory framework mean that our current business model and services will have to change. Last year we undertook an extensive stakeholder engagement programme to find out what services and products the market would like us to offer from 1 November 2015[1] and 1 October 2018, and how we could best integrate these within the regulatory framework[2]. The proposals included in this consultation have taken into consideration feedback received to date.

The Interconnector plays a crucial role in linking the markets of North West Europe. Our Information Memorandum launching the sale of post-2018 capacity is produced jointly with Fluxys Belgium highlighting how capacity can be purchased to connect the UK to the wider European area.



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[1] The new model and contract will be implemented from 1 November 2015, albeit the only capacity available during this period originates from the implementation of the Congestion Management Procedures ("CMP") outlined in amended Annex I to Regulation (EC) No 715/2009. This includes any Oversubscription Capacity ("OS Capacity") that we may make available plus any capacity that has been surrendered by a long term Shipper or released through the Long Term Use It Or Lose It ("LT UIOLI") mechanism that applies to these Shippers.

[2] Our consultation documents and industry workshop presentations are available on www.interconnector.com to review, along with your responses to our consultations and further information.

PART 2: MAIN CONCEPTS

Proposed Products and Capacity Allocation Process

Annex 1, our Proposed Products and Capacity Allocation Process, outlines in detail the service provision and allocation process offered in our post-2018 sales process. Below we summarise our proposals.

Summary

We are offering capacity products to all parties who meet the criteria for becoming signatories to the IUK Access Agreement. These products are for annual and quarterly durations, commencing on Gas Day 1 October 2018.

Shippers can bid for annual capacity products of a minimum duration of 1 year and a maximum duration of 12 years. Where an annual capacity product of a duration of 5 years or more is booked, a Shipper may also bid for a series of quarterly products for the years booked, for either October to March or April to September each year; that is, a minimum of two quarters per year. A third quarter may also be added to the Shipper's request for these products, if required.

Although not applying until November 2015, we have taken account of the principles promoted by the Capacity Allocation Mechanism ("CAM") Network Code[3] when designing our sales process.

As such, we will make available 80% of the Interconnector's technical capacity for up to 12 years from 1 October 2018, and will set aside the remaining 20% for short-term sales.

The allocation process will be market-based with priority given to longer duration booking requests to reflect the increased willingness to pay. If at any stage demand exceeds supply then an Ascending Clock Auction mechanism will be applied to any capacity as yet unallocated. The document in Annex 1 includes more detail on this process.

To apply for these products we propose that a Shipper completes a subscription booking form. The proposed subscription booking form for non-binding bids will be provided to Shippers who have registered. A registration form can be found on www.interconnector.com along with the Information Memorandum.

Separately, Fluxys Belgium transmission capacity will be offered to the market on the same timescale, and National Grid Gas ("NGG") transmission capacity is also available at a similar time through their existing mechanisms. Therefore, Shippers can use this opportunity to purchase capacity to and from GB and mainland European markets. Shippers may have some long-term capacity in the Fluxys Belgium or NGG systems and could use this opportunity to purchase corresponding quantities within the Interconnector. We will, together with our adjacent Transmission System Operators ("TSOs"), then offer all Shippers the opportunity to voluntarily bundle their capacity at the IUK Bacton Terminal ("IBT") and at IUK Zeebrugge Terminal ("IZT"), to the extent that the Shippers have matching quantities and durations of capacity at either side of each Interconnection Point.

[3] http://www.entsog.eu/publications/capacity-allocation-cam

Interconnector

Charging Methodology

Annex 2 is our proposed Charging Methodology applicable to capacity from 1 October 2018 purchased in this sales process. Our Charging Methodology outlines the principles for setting our tariffs. Actual tariff information will be provided as part of the sales process to Shippers who register their interest in post-2018 capacity sales.

Summary

Our interconnector licence requires that our charges, and the underlying methodology, are objective, transparent, non-discriminatory and compliant with all relevant regulations and legally binding decisions of the European Commission and/or Agency. In addition, Article 13 of the Gas Regulation requires NRAs to approve the charges, or underlying methodologies, applied by TSOs.

Our proposal aims to meet all such requirements and to set reserve prices that are attractive to the market whilst reflecting the value of the services.

Our proposed Charging Methodology is based on a combination of cost-reflective and market-based factors. We propose to set the reserve prices for entry capacity at Bacton and exit capacity at Zeebrugge higher, by about 25%, than the reserve prices for exit capacity at Bacton and entry capacity at Zeebrugge. This difference reflects in part the higher cost per unit of capacity of flowing gas from GB to Belgium compared to that of flowing gas from Belgium to GB. This difference in turn reflects the higher volume of capacity that is available in the Belgium-GB flow direction compared to capacity in the GB-Belgium flow direction. It also takes into account the relative costs and age of the compressor assets at Bacton and Zeebrugge. The Bacton compressors are predominantly utilised when flowing gas from GB to Belgium, whereas the Zeebrugge compressors are predominantly used when flowing gas from Belgium to GB. Our pricing structure also reflects market-based factors. IUK faces direct competition from other supply sources and gas flexibility providers. It needs to have the commercial flexibility to take into account such market-based drivers when deciding on a pricing structure that will enable us to recover fixed and capital costs, in an economically efficient way.

The price paid by a Shipper who successfully bids for capacity will be the reserve price plus any premium. This means the price is fixed at the time of purchase and will increase only in line with inflation provisions, providing price certainty for Shippers.

To encourage long-term bookings, we will offer incentives on quantities booked for 5 years or more. These incentives include a 10%, 15% or 20% reduction on the price for quantities booked for at least 5, 8 or 10 years respectively. An additional incentive is the assurance that a Shipper booking capacity long-term (5 years or more) will pay the lesser of the cleared price as adjusted for inflation (incentivised or auction price in case demand exceeds supply) of this sales process and the cleared price in the subsequent CAM annual capacity auctions.

Multi-Quarter products will be offered as additional products, added on to flat yearly subscriptions of 5 years or more, to answer the market demand for seasonal products. These are offered at a premium to the corresponding annual products, to reflect the fact that these are bought only for two or three quarters.

Further costs, such as fuel gas and administration fees, are also detailed in the Charging Methodology, such that Shippers can assess the total cost of transporting gas through the Interconnector.

Contract: IUK Access Agreement and IUK Access Code

Annex 3 comprises:

- IAA, containing the general terms and conditions a Shipper must satisfy to access Interconnector capacity. By signing this, parties agree to adhere to the IAC;
- IAC, detailing the access rules for Interconnector capacity acquired under the IAA;
- IAA Summary ("IAAS"), a non-binding document that describes the IAA and IAC in simple terms.

Summary

The IAA contract and IAC were originally designed for the sale of short-term capacity via day-ahead auctions of capacity originating from the CMP mechanisms: OS, Surrendered and LT UIOLI capacity. The IAA and IAC were first consulted on in October 2013.

Annex 3 is the IAA amended to allow us to comply with CAM and Balancing Network Code ("BAL"), and offer capacity in a variety of durations from November 2015 and October 2018.

Under the IAA, Shippers can purchase entry and exit capacity we make available at each of our two Interconnection Points, IBT and IZT. The IAC sets out the commercial operation rules for utilising this capacity and how the Shipper can acquire capacity or transfer, assign or surrender capacity they have purchased. The IAC also specifies that Shippers will be responsible for ensuring that their inputs equal their offtakes, taking account of their use of trade notifications (commodity transfers) and optional storage services that IUK intend to offer in the future.

IUK aims to take into consideration feedback from this consultation and submit the revised IAA, IAC and associated documents to the NRAs for approval. This means that at the time of making binding offers, some aspects of the contractual package will be subject to NRA approval.

PART 3: PROCESS AND INDICATIVE TIMELINE

Below is the indicative timetable that we propose to follow.

Date	Action
22 January 2015	Consultation opens. All stakeholders are asked to provide us with feedback on our proposed products, capacity allocation and principles for setting tariffs for this sale of capacity from October 2018. In addition, we will seek feedback on the IAA contract under which capacity from 1 November 2015 and October 2018 onwards will be purchased. A joint Information Memorandum with Fluxys Belgium launches the sale of post-2018 capacity. Shippers can register their interest in purchasing capacity and submit non-binding requests for capacity.
3 & 5 February 2015	Industry Workshop(s) jointly with Fluxys Belgium.
18 February 2015	Consultation closes. The process of reviewing stakeholder feedback begins.
23 February 2015	Non-confidential responses to our consultation are published on our website for stakeholders to review.
6 March 2015	Deadline for Shippers to submit non-binding subscription forms.
1 April 2015	Following consideration of stakeholder feedback, the IAA and associated documents are submitted to the NRAs for approval. Binding phase opens: Subscription form for binding phase will be issued following consultation and non-binding phase feedback. Shippers can submit bids for capacity and sign the IAA (which is subject to NRA approvals).
28 April 2015	Binding phase closes.
By 6 May 2015	Following IUK Board approval, capacity is allocated and we inform successful Shippers.
Summer 2015	Regulatory approvals anticipated.
1 November 2015	Capacity is made available on PRISMA under the new contract (subject to the required agreements and approvals, and subject to process and system changes).
1 October 2018	Start of capacity rights allocated in May 2015.

PART 4: YOUR FEEDBACK

We are interested in hearing your views on the products and allocation process, the Charging Methodology and the IAA and IAC.

We would also welcome your responses to a number of specific questions:

Products and allocation process

1. Is the product offered suitable for meeting market requirements?
2. Do you agree that the limitation of quarterly products to 50% of the flat annual capacity subscribed strikes a balance between meeting market demand for seasonality and maintaining capacity for annual products in the future?
3. Do you support the allocation process described?

Charging Methodology

4. Do you agree that the Charging Methodology for this sale of capacity from October 2018 is appropriate?
5. Do you support the proposal that reserve prices for entry capacity at Bacton and exit capacity at Zeebrugge will be about 25% higher than the reserve prices for exit capacity at Bacton and entry capacity at Zeebrugge to reflect the different underlying market and cost conditions?
6. The price for day-ahead capacity prior to 1 October 2018 under the IAA has been set such that Shippers acquiring capacity made available from CMP mechanisms pay a broadly equivalent tariff to existing STA Shippers to avoid cross-subsidy. Do you agree that this basis is also suitable for capacity products longer than a day for the period from 1 November 2015 to 30 September 2018 ?
7. Do you agree that Forced Buy-back should only affect day-ahead and within-day capacity?

Contract

8. We seek your feedback on any elements of the IAA and IAC.

We would appreciate comments from all interested parties. Please send your response to consultation@interconnector.com by 17:30 UKT on 18 February 2015. Please ensure that a "read receipt" is requested to confirm that your response has been received. Please note that any responses not marked confidential may be published on IUK's website. Confidential responses may be shared with Ofgem and CREG at their request.

If you wish to clarify any aspect in relation to this letter, or have any questions, please contact Lucy Manning on +44 (0)20 7092 6594 to discuss.

We look forward to hearing from you.

Yours faithfully

DARREN REEVE
Commercial Director

For and on behalf of
Interconnector (UK) Limited