



All Stakeholders

29 September 2015

Dear Stakeholder,

Consultation on IUK's Charging Methodology (CM) for capacity sales from March 2016

Interconnector (UK) Limited ("IUK") would like to hear stakeholders' views on its proposed CM for capacity purchased from March 2016. Our CM outlines the principles for setting our prices. The proposed changes are outlined in Annex B (marked version compared to the current approved CM) and Annex C (clean version). Actual price information will be published as proposed in Section 2.3 of the CM.

1. Proposed changes to the CM

With March 2016 a key date for the sale of annual capacity in accordance with CAM and the possibility of pre-2018 capacity becoming available, e.g. by surrender, it is appropriate to revise the CM. Our proposed changes aim to meet the obligations highlighted in Annex A, and to allow IUK to set prices that are attractive to the market, reflect market conditions, and which are appropriate for an interconnector which is wholly dependent on market revenues to meet its costs for maintaining capacity and offering services to the market. IUK is also seeking to make the methodology as enduring as possible.

IUK's proposal seeks to update the methodology where necessary. It also addresses price multipliers for capacity products less than a year and also outlines when prices will be published depending on the duration of the capacity product.

For short term reserve prices, section 2.1.2 has been inserted which states:

"The same principles as outlined in 2.1.¹ will be used to determine the level of the price multiplier for each entry and exit product less than a year in duration relative to the annual price. This includes, but is not limited to, the reserve price multiplier for standard capacity products². The multipliers can differ

¹ The key factors determining the reserve prices include competitive forces, costs, projected demand and avoiding cross subsidy from STA shippers.

² Transmission system operators are required to offer standard capacity products as specified in Article 9 of Commission Regulation (EU) No 984/2013. These standard capacity products are yearly, quarterly, monthly, daily and within day capacity products.

for different entry and exit points, types of capacity, durations and time periods to reflect the different underlying market and cost conditions.”

With respect to when tariffs are published, section 2.3 has been inserted which says:

“The relevant price will be published at least:

- Twenty eight days ahead of any capacity product sale with a capacity duration equal to, or greater than one year.*
- Fourteen days ahead of any capacity product sale with a duration equal to, or greater than, a quarter.*
- A day ahead of any capacity product sale with a duration greater than one day and less than a quarter.*
- An hour ahead of any daily and within day capacity product sale.”*

2. Reasoning behind the changes

We believe the proposed changes are appropriate to enable IUK to comply with its obligations and to respond to market conditions in a flexible way. The approach set out in the CM is appropriate taking into account IUK’s full market exposure, the unpredictability of its flows, and the fact that it faces direct competition from a range of flexibility assets. Specific points to note are that:

- The proposed approach is consistent and compatible with the draft Tariff Network Code. This code notes the “specific nature of interconnectors” and allows for the development of a charging regime which meets their needs.
- IUK currently bears full market exposure. It is therefore appropriate that the CM gives IUK the flexibility to set short run tariffs at a level which reflects short run market conditions.
- IUK flows cannot be forecast reliably, as it is a physically bi-directional pipeline, used primarily for arbitrage which depends on short run market conditions. In these circumstances, prices for short term products cannot be set months in advance of an auction. If IUK is to be able to set prices that reflect prevailing market conditions, it needs a matching degree of flexibility in the timetable for setting prices.
- IUK faces direct competition from other supply sources and gas flexibility providers, such as storage, LNG and upstream providers who are not subject to the European network codes. Many of these competing assets already enjoy the flexibility that IUK is proposing in this CM. Applying these proposals to IUK would enable IUK to compete on a more level playing field with these other flexibility assets.
- Any shipper who wishes to lock in a price on a longer term basis will be able to do so via a longer term capacity booking. The publication timetable will be chosen in such a way as to give shippers adequate notice, because it is in IUK’s interests to develop arrangements which meet shippers’ needs and which result in capacity bookings.
- As IUK is currently exposed to competing assets, the market acts as an effective constraint against excessive prices. IUK will need to price in such a way to attract customer demand.

It should also be noted that the price will continue to be fixed at the time of purchase and will increase only in line with inflation provisions, providing price certainty for Shippers.

Finally costs, such as fuel gas and administration fees, continue to be defined in the CM and detailed in the IUK Charging Methodology Statement, such that Shippers can assess the total cost of transporting gas through the Interconnector.

If any party would like a more detailed explanation of IUK's prevailing regulatory framework, and how the proposal is consistent with that framework, IUK would be happy to arrange a bilateral meeting to discuss this.

3. Your feedback

We are interested in hearing your views on our proposed changes to the IUK Charging Methodology.

We would welcome your response to a number of specific questions:

- Do you agree that the CM, for the sale of capacity from March 2016, is appropriate?
- Do you agree with IUK's proposed approach to determine the short run prices?
- Do you support IUK's reserve price publication proposals?
- Do you agree that the proposals are appropriate for an interconnector with full market exposure?
- Do you have any other feedback on the proposed changes?

We would appreciate comments from all interested parties.

Please send your response to consultation@interconnector.com by 17:30 UKT on 27 October 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 Pavanjit Dhesi on +44 (0)20 7092 6500 or Pavanjit.dhesi@interconnector.com

We look forward to hearing from you.

Yours faithfully

PAVANJIT DHESI
Senior Regulatory Economist

ANNEX A: IUK CM obligations

IUK's CM is subject to regulatory approval as described below.

- Article 13 of the European Gas Regulation (EC) 715/2009, requires National Regulatory Authorities 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.
- IUK must also ensure its CM meets the relevant objectives as set out in Standard Licence Condition 10(4) of its GB interconnector licence. These relevant objectives are that the charges and the application of the underlying methodology shall be objective, transparent, non-discriminatory and compliant with European Gas Regulation (EC) 715/2009 and any relevant legally binding decision of the European Commission and/or the Agency (i.e. ACER).
- Standard Licence Condition 10 of IUK's interconnector licence states that IUK shall only enter into agreements for access to the interconnector on the basis of the CM last approved by the Authority, unless the Authority determines otherwise. Standard Licence Condition 5(a) furthermore notes that prior to submitting the CM 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 CM are consulted and allow them a period of not less than 28 days within which to make written representations.

ANNEX B: Proposed changes to IUK's Charging Methodology (marked version compared to current methodology)

www.interconnector.com/media/102714/annex_b_proposed_changes_to_iuk_s_charging_methodology_marked_version.pdf

ANNEX C: Proposed changes to IUK's Charging Methodology (clean version)

www.interconnector.com/media/102717/annex_c_proposed_changes_to_iuk_s_charging_methodology_clean_version.pdf