

October 2016

Dear Stakeholder,

### **Consultation on IUK's proposed new services**

Previously, we sought 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<sup>1</sup>. Your feedback helped us develop our future service provision and changes to our Access Rules to meet market demand and ensure compliance with the Congestion Management Procedures ("CMP"), Capacity Allocation Mechanism ("CAM") and the Balancing ("BAL") Network Codes.

Following continued discussion with the market we are delighted to announce that IUK is considering introducing new services to enable Shippers to enhance annual capacity bought for gas years from October 2018 onwards in the March 2017 CAM annual auction to better meet their expected Interconnector requirements. These are:

- A **Re-profiling Service** to allow the Shipper to release a proportion of the annual capacity secured on PRISMA at the CAM annual auction to achieve a profiled capacity holding.
- A **Simplification Conversion Service ("SCS")** to ensure that the same profile is achievable at both ends of the pipeline and that suitable capacity bookings can be made in the adjacent TSO systems.

In this consultation we are seeking your views on:

- The services we are proposing;
- The changes to our Charging Methodology to introduce these new services;
- The changes to allow for these new services in the contract that Shippers are required to sign to purchase capacity (the Access Rules).

This Consultation is divided into 4 parts:

- Part 1 sets out background information about IUK;
- Part 2 summarises our proposed new commercial offering;
- Part 3 sets out our proposed timetable for introducing these new services;
- Part 4 explains how you can help us by providing feedback on these proposals.

In accordance with IUK's interconnector licence and relevant EU legislation, IUK is actively engaged in discussions with National Regulatory Authorities ("NRAs") on these proposals. Following the

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<sup>1</sup> <http://www.interconnector.com/about-us/our-consultations/archived-consultations/>

consultation process, IUK will need to seek NRA approval from both relevant NRAs for the Access Rules and Charging Methodology to be modified to include these services.

## 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. IUK is the only physically bi-directional pipeline 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 consumers. IUK is the largest entry point and the largest exit point on the UK gas network. It provides significant benefits to consumers and European markets, including lowering wholesale energy costs, enhancing market liquidity and improving security of supply.



Our capacity was sold under long-term contracts, following open seasons, until the end of September 2018. From 1 October 2018, capacity will become available where economic, subject to, amongst other things, capacity already sold<sup>2</sup>, the availability of the facilities, contractual terms and conditions and the prevailing market and regulatory conditions.

### *Our future challenges and current proposals*

Following the implementation of the Third Energy Package, IUK was certified as a TSO in both the UK and Belgium and was subsequently required to comply with all the relevant EU regulations applying to TSOs across Europe. However, unlike most other European TSOs, IUK operates in a highly

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<sup>2</sup> 113GWh/day of capacity from Belgium to the UK was sold from October 2018 for 10 years in the first 2015 sale of post 2018 capacity held in May 2015.

competitive market for flexibility and has no captive demand. As things stand, from 1 October 2018 IUK will rely exclusively on market demand for its capacity without an allowed revenue regime whilst being required to comply with all the legislation developed for TSOs with allowed revenue regimes, like the European Network Codes.

As such, the applicable legal framework raises significant challenges for IUK. The Authorities have recently recognised this by including a derogation process in the current draft of the Network Code on harmonised transmission tariff structures (TAR). This is a really important step forward in recognising the need for a more flexible regulatory treatment of interconnectors.

Given the challenging commercial environment and regulatory arrangements applying, IUK's survival is not guaranteed and in order to maintain capacity availability we must be innovative in the services we offer, while still complying with the applicable laws.

We are therefore pleased to announce that we are consulting on two new services to be offered in conjunction with our 2017 CAM annual sales process, held on PRISMA, that will enable Shippers to enhance their flat annual Interconnector capacity to better match their individual needs.

Given the current seasonal nature of market demand for Interconnector services, IUK is proposing services which better suit most Shippers' requirements whilst retaining the basic CAM service. Discussions with the market and observed flow dynamics show that providing Shippers with an ability to re-profile annual capacity would add value, secure a key transmission route and reduce the risk of a longer-term booking, whilst better matching the typical utilisation patterns of the Interconnector.

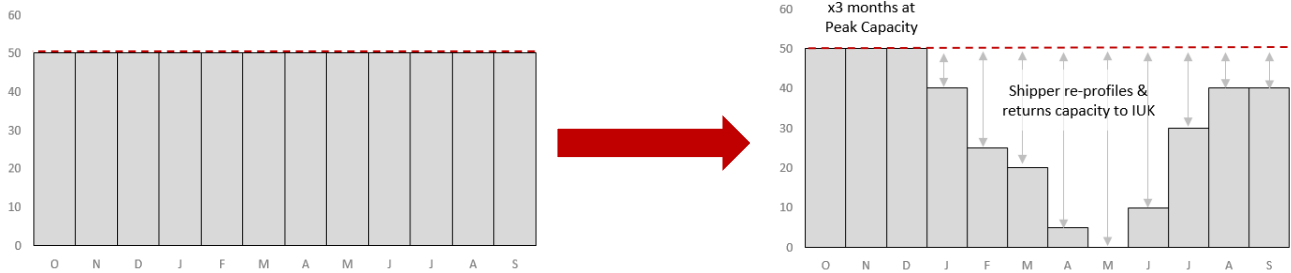
Current technical difficulties affecting the Rough storage facility (which have limited its ability to fill over the summer) are, we understand, impacting individual Shipper's portfolios. Accessing seasonal storage facilities in Continental Europe will help the GB market to efficiently manage the problems arising from the Rough storage technical issues ultimately reducing the impact on consumers; however, access to seasonal Interconnector capacity, booked in advance would be needed to support this. IUK's new services would do exactly that and enable Shippers to achieve a profile over the year, securing the capacity to match the seasonal demand of consumers without the risk of being required to pay for capacity not needed or being unable to access IUK capacity when required.

IUK's proposed services will enable Shippers to re-profile capacity to a long-term seasonal product - meeting the needs of the market and consumers, promoting cross-border flows, facilitating more efficient use of IUK capacity and allowing IUK to demonstrate innovation commensurate to that which competing non-TSO assets can provide, as expected of a network asset that is fully exposed to the market

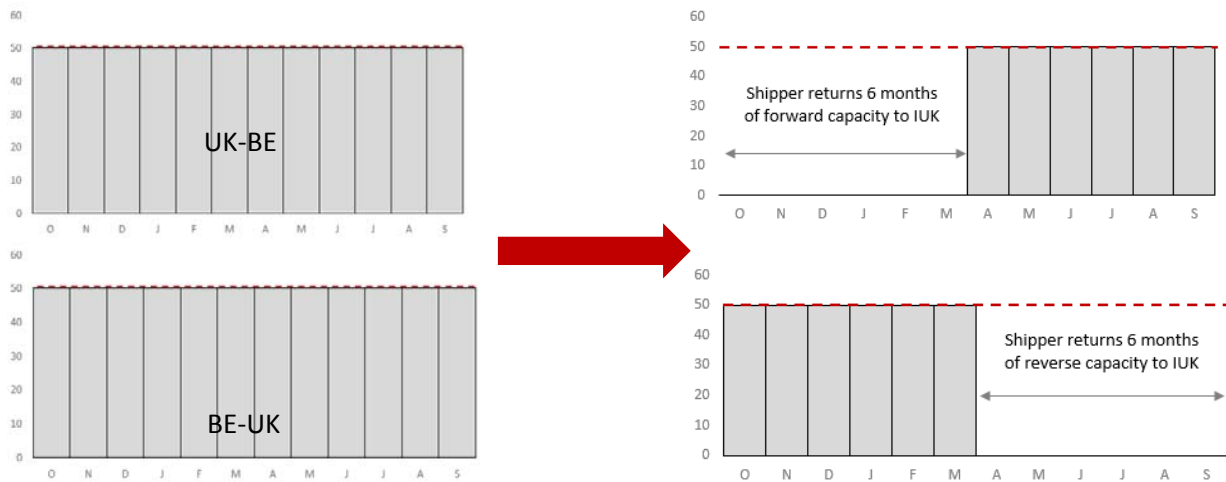
## **PART 2: PROPOSED NEW COMMERCIAL OFFERING**

**IUK proposes to offer a Re-profiling Service and a Simplification Conversion Service which enables a flat annual capacity booking, made under the CAM annual auction, to be re-profiled to meet individual Shipper's requirements.**

### Example 1: Create profile in one direction



### Example 2: Create bi-directional profile



### The Mechanisms and the Access Rules

The components required to make this possible are:

- i) CAM annual auction;
- ii) Contractual right to arrive at a re-profiled capacity holding (the “Re-profiling Service”); and
- iii) Possibility to ensure that the same profile is achievable at both ends of the pipeline and that suitable capacity bookings can be made in the adjacent TSO systems (the “Simplification Conversion Service (SCS)”).

These elements are described in more detail below:

- i) As required under CAM, IUK would offer a flat annual capacity product in the **CAM annual auctions**, bundled at both IPs as required by CAM and maximising the technical capacity as set out in CAM. IUK will reserve capacity for short term auctions as required by the CAM NWC.
- ii) **Re-profiling Service**  
Our contract terms would include drafting to allow the Shipper to trigger the right to re-profile their capacity over the gas year. The timings and limitations on amounts of capacity which could be re-profiled would also need to be determined and discussions with Shippers to identify their requirements will be key. An example of our current thinking would be:

- a. No month can exceed peak monthly capacity (i.e. the level of capacity booked under (i));
- b. Need to retain at least 3 months at the peak capacity; and
- c. Shipper has the right to return 50% of the total capacity booked.

These limitations on the amount of re-profiling have been proposed with the aim of ensuring that the amount of capacity that can be offered in future annual auctions is not restricted and the potential for gaming is avoided. We would welcome Shipper views on our proposed requirements.

The generic concept of a Re-profiling Service will be included in the IUK Access Code (“IAC”) with the specific rules applying to a particular offer of a Re-profiling Service being defined and published in a separate document called the Re-profiling Rules. This would be published a month in advance of the CAM annual auction. Please see Annex 2 for a version of the IAC with marked changes to include this service.

iii) **Simplification Conversion Service.**

IUK appreciates that for Shippers to be able to commit to long term IUK capacity they need to have the possibility to ensure that the same profile is achievable at both ends of the pipeline and that suitable capacity bookings can be made in the adjacent TSO systems. In order to avoid a mismatch of capacity if only bundled capacity was available and the capacity in the adjacent TSO’s system cannot be re-profiled, IUK proposes to introduce a **Simplification Conversion Service**.

It was considered at the time of implementing CAM whether IUK should operate under “a 2IP model” or the simpler “1IP model”. It was concluded that the underlying model for the Interconnector should be 2IP (i.e IBT and IZT) as it offered advantages over the 1IP model:

- 2IP model allowed access to the flexibility afforded by the pipeline inventory.
- 2IP model allowed Shippers to use the flexibility in the Interconnector to act as a buffer between the two different regimes in the UK and Belgium.
- 2IP model allows a Shipper with different legal entities in the UK and Belgium to transfer rights from one legal entity to the other in the pipe so that they can keep their chosen corporate structure.
- 1IP model directly linked the UK and Belgium regimes causing operational issues.

However, there were Shippers who would have preferred to purchase capacity in a single auction rather than risk being allocated different quantities at either end of the pipe. There are also simplifications in the nomination process that can be offered with 1IP capacity. The SCS allows the model in the Interconnector to be 2IP, whilst allowing an option for any Shipper wishing to purchase simpler 1IP capacity to have this ability.

Instead of buying capacity at 2IPs this would allow a Shipper to buy capacity at 1IP in the CAM auction, they would then have a short pre-defined period, currently proposed to be 10 days, during which they could opt to pay IUK a fee to convert their capacity into simpler 1IP-equivalent capacity. This means they only need to purchase capacity in one transaction to be able to move gas from one end of the pipe to the other.

i) Capacity is offered at 2IPs in the CAM auction



ii) Shippers buys capacity at 1IP and uses SCS



Offering the Simplification Conversion Service allows Shippers to solve concerns they may have regarding capacity only being offered as bundled such as:

- No ability to re-profile in NGG's system meaning that Shippers' capacity in NGG's system remains as flat annual capacity and may not match their profiled requirements.
- The difference in pricing regimes between IUK and NGG. IUK seeks to incentivise longer term bookings whereas the NGG pricing regime incentivises short-term capacity bookings.
- Uncertainty of the future NGG charging regime which is currently being reviewed.

The SCS also resolves two issues that have been consistently raised by Shippers:

*Issue 1: Shippers who own existing capacity on one side of the IP may not be able to purchase unbundled capacity on the other side and will have to purchase bundled capacity that they do not require.*

Capacity contracts exist post-2018 for unbundled capacity on the NGG side of IBT and the SCS allows Shippers who own this capacity to use the capacity by purchasing bundled capacity at IZT and using the SCS to be able to deliver gas at IBT. This avoids the risk of them having to buy bundled capacity at IBT which would result in them re-purchasing NGG capacity even though they already purchased sufficient NGG capacity.

*Issue 2: Shippers are set up with different legal entities in the UK and Europe but bundled capacity can only be bought by a single legal entity.*

For example, Shipper A has 2 subsidiaries: "Shipper A\_UK" in the UK who currently purchases NGG capacity and "Shipper A\_EU" who owns IUK capacity and capacity across Europe. When NGG capacity and IUK capacity is sold as a bundle either "Shipper A\_UK" has to buy NGG and IUK capacity or "Shipper A\_EU" has to buy NGG and IUK capacity neither of which works under the current organisation set-ups.

The SCS allows "Shipper A\_EU" to purchase bundled capacity at IZT then convert the IUK capacity to be able to deliver at IBT. The respective NGG capacity to complete the route can then be purchased by "Shipper A\_UK" resolving the single legal entity issue.

Additionally, offering the SCS which allows Shippers to purchase capacity in just one auction solves Shipper concerns raised in past industry engagement that they may end up with mismatching capacity at either end of the IUK pipe under the 2IP model.

Shippers who want to buy the normal 2IP capacity at both ends of the pipe can buy bundled capacity in the CAM annual auction before the Simplification Conversion Service is offered; so the capacity offered in the CAM annual auction is maximised as required by CAM.

The amount of capacity made available at the other IP in future auctions would be reduced by the 1IP-equivalent amount; this does not adversely impact Shippers as: i) the 1IP Shipper would have needed to buy that capacity anyway in order to flow through the pipe and ii) it would not be practical for a different Shipper to buy that capacity without leaving themselves with unmatched capacity across the pipeline.

The generic concept of a Simplification Conversion Service will be included in the IUK Access Code ("IAC") with the specific rules applying to a particular offer published in separate Simplification Conversion Service Rules. Please see Annex 2 for a version of the IAC with marked changes to include this service.

**Annex 1** includes a detailed example of how the commercial offering would work in practice.

### **Pricing and the Charging Methodology (CM)**

We propose that the reserve price for annual capacity in the March 2017 auctions will be increased compared to the 2016 annual auctions to acknowledge the fact that the Shipper has the right to re-profile this capacity therefore reflecting the increased value of the Shipper being able to release capacity that they do not need and secure a profiled capacity holding on a long-term basis. In line with the CAM NWC, the reserve price will be published a month in advance of the auction on IUK's website via the Charging Methodology Statement and on PRISMA.

The Simplification Conversion Service will be subject to a fee to acknowledge the fact that a Shipper is converting their 2IP capacity to 1IP-equivalent capacity and ensure non-discriminatory treatment across different Shippers. The fee will be slightly higher than the equivalent cost of capacity as a Shipper benefits from additional services that IUK will be performing on their behalf such as converting a nomination for entry into a corresponding deemed nomination for exit allowing for fuel gas and shrinkage. This fee will be published a month in advance of the auction on IUK's website via the Charging Methodology Statement.

There are no changes required to IUK's existing Charging Methodology (CM) to allow for the re-profiling mechanism. The current CM states that the reserve price is set to be competitive and market responsive. The proposed increase in the reserve price is to acknowledge the higher market value of a product which can be re-profiled.

To enable the SCS, the following change is proposed to the Charging Methodology:

*"Section 2.3 Additional Services: IUK may from time to time develop and offer to market additional services with the aim of better meeting the market and shipper requirements. These services will be priced to be competitive and market responsive whilst ensuring objective and non-discriminatory treatment across Shippers subscribing to the service."*

A marked-up version of the Charging Methodology showing this proposed change can be found in Annex 3.

It is IUK’s intention that, post-2018, short term products are marketed at a multiple significantly greater than the annual reserve price to incentivise longer term bookings. IUK will consult the market on further proposed changes to the Charging Methodology in the future.

**Compliance with the legal framework**

The legal framework that governs IUK and the Interconnector has been the subject of significant change in recent years. The changes derive mainly from the implementation of third energy package (TEP) requirements including CAM, BAL and CMP requirements. Following previous consultations we have put in place extensive arrangements to ensure compliance with our TEP obligations. These have included amending our Access Rules and entering into new arrangements with PRISMA. Our proposals for the new services do not envisage any amendment being made to those aspects of our arrangements that have been put in place to ensure TEP compliance. Our objective is, therefore, to offer the new services in a way that is consistent with the applicable legal framework.

We are in ongoing discussions with our NRAs on our proposed services and we will continue to engage with them throughout the consultation process, prior to submitting our proposals to them for formal approval. As indicated elsewhere in this document, our offer of the new services to the market is subject to NRA approval.

**PART 3: PROCESS AND TIMETABLE**

Below is the indicative timetable that we propose to follow.

<b>Date</b>	<b>Action</b>
13 October 2016	Consultation opens. All stakeholders are asked to provide us with feedback on our proposed new services and the Access Rules and Charging Methodology changes to offer them
19 October 2016	Industry Workshop in Brussels
26 October 2016	Industry Workshop in London
10 November 2016	Consultation closes. The process of reviewing stakeholder feedback begins
w/c 21 November 2016	Non-confidential responses to our consultation are published on our website for stakeholders to review
1 December 2016	Following consideration of stakeholder feedback, the Access Code and Charging Methodology are submitted to the NRAs for approval
By early February 2017	The Re-profiling Rules and Simplification Conversion Rules are published (subject to the required agreements and approvals)



By 6 February 2017	The Charging Methodology Statement is updated to include the SCS fee (subject to the required agreements and approvals)
6 February 2017	Quantity and Reserve Price for annual capacity published on PRISMA
By 5 March 2017	Confirmation that approvals have been received for Access Rules and Charging Methodology and that the Re-profiling Service and Simplification Conversion Service will proceed
6 March 2017	Annual Capacity Auction held on PRISMA
[16 March 2017]	Deadline for notifying IUK of application to use Re-profiling Service and/or Simplification Conversion Service

#### **PART 4. YOUR FEEDBACK**

We are interested in hearing your views on our proposal to introduce a Re-profiling Service and a Simplification Conversion Service to enhance annual capacity purchased in the 2017 auctions.

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

- Do you support the proposal to introduce Re-profiling so that a Shipper can match their needs?
- Do you support the proposal to introduce a Simplification Conversion Service to enable Shippers to purchase the most suitable product in the adjacent TSO system and resolve concerns previously raised by Shippers regarding unintended consequences of bundling requirements?
- Do you think both the Re-profiling and Simplification Conversion Service will be beneficial for the market, provide additional flexibility to Shippers and incentivise them to book IUK capacity?
- Do you think the proposed limitations on the amount of capacity that can be released under the Re-profiling service are suitable?
- Do you agree that our proposals meet our licence obligation for a transparent, objective and non-discriminatory charging methodology?
- Do you have any comments on the proposed changes to the Charging Methodology?
- Do you have any comments on the proposed legal drafting amendments to the Access Rules to introduce these services?
- Do you have any other feedback on the proposed service or any other services you think IUK should consider offering in the future?

We would appreciate comments from all interested parties.

Please send your response to [consultation@interconnector.com](mailto:consultation@interconnector.com) by 10 November 2016.

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 Danielle Stoves on +44 (0) 203 621 7816 to discuss.

Please note that this consultation does not commit or bind IUK to introducing the new services or offering them in conjunction with the 2017 annual auction.

We look forward to hearing from you.

Yours faithfully,

**DARREN REEVE**  
Commercial Director

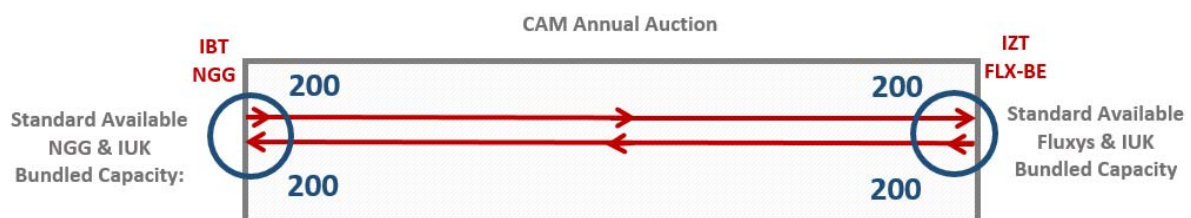
## Annex 1

This Annex provides an illustration of how the commercial offering would work in practice, including the charging arrangements.

### **Step 1) IUK publishes available capacity on PRISMA, Re-profiling Rules and Simplification Conversion Service Rules for the 2017 annual auction**

- According to the CAM calendar, one month in advance IUK publishes the amount of capacity to be offered in the CAM annual auction.
- IUK also announces that they intend to offer re-profiling and SCS for the capacity bought in the 2017 annual CAM auctions. IUK publishes the Re-profiling Rules and SCS Rules that apply including specific criteria, timelines and any charges.
- IUK publishes a revised Charging Methodology Statement including the reserve price for the annual capacity product and the fee for the Simplification Conversion Service.

### **Step 2) IUK offers flat annual capacity products in the CAM auctions on PRISMA, bundled at either IP.**



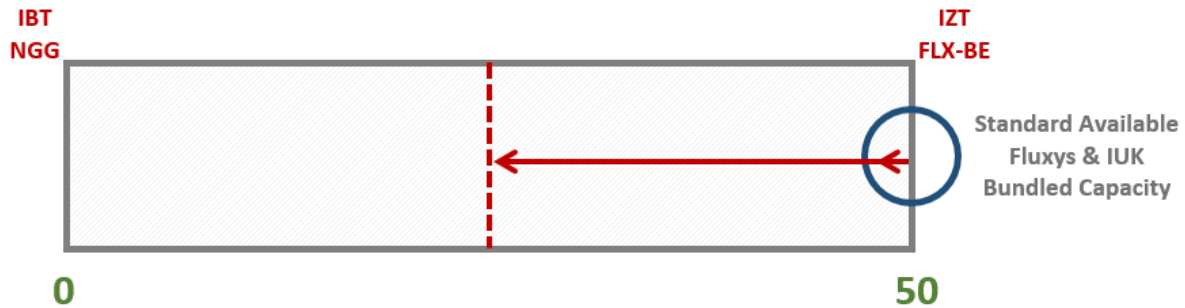
- All of IUK's available capacity is offered, bundled where possible, in the annual CAM auction held on PRISMA thus meeting IUK's obligations under CAM.
- Shippers are able to purchase bundled capacity at either IBT, IZT or both independently depending on their requirements.
- Under the IAA contract, and in accordance with the Re-profiling Rules, any capacity purchased in the 2017 annual auction will include a contractual right to re-profile that capacity to achieve the Shipper's required seasonality. In addition, in accordance with the SCS Rules, any capacity purchased in the 2017 annual auction at IZT is eligible to be converted to 1IP-equivalent capacity by subscribing to the SCS.
- Subject to meeting the requirements set out in the relevant Rules, a Shipper can notify IUK that they wish to re-profile and use the SCS, or just use the SCS. A Shipper can also choose not to take advantage of these mechanisms and simply use the "vanilla CAM product".

It is assumed for the rest of this example that a Shipper wishes to re-profile and take advantage of the Simplification Conversion Service. A price of 1.2p/th is assumed as an example for capacity through the pipe (i.e. 0.6p/th for entry capacity and 0.6p/th for exit capacity). The SCS fee is assumed to be 0.65 p/th.

### **Step 3) A Shipper purchases annual capacity in the CAM auction at IZT bundled with Fluxys Belgium capacity.**

- If a Shipper wishes to use the SCS they need to purchase capacity at IZT but not at IBT as subscribing to the SCS allows them to convert their IZT 2IP capacity to 1IP-equivalent capacity enabling them to exit the Interconnector pipeline at IBT.

- The capacity at IZT is offered to either Zeebrugge Beach or ZTP. If a Shipper purchases the bundled capacity to Zeebrugge Beach they have flexibility to remodel the capacity after the auctions due to the Zeeplatform service offered by Fluxys which reflects the special nature of Zeebrugge.
- In this example it is assumed that Shipper A secures 600 units (50 x 12 months) annual capacity in CAM Auction at IZT bundled with Fluxys BE capacity. The capacity is assumed to be purchased at the reserve price of 0.6 p/th.

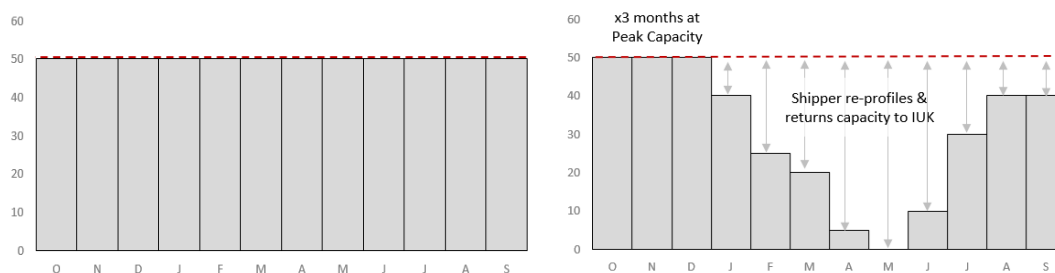


**Step 4) Shipper has 10 days to notify IUK if they want to re-profile the capacity and/or use the Simplification Conversion Service (SCS)**

**Step 4a) Shipper notifies IUK of how they would like to re-profile their capacity to a monthly profile.**

Example conditions that may be defined in the Re-Profiling Rules may be:

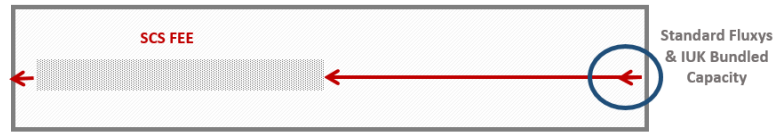
- No month can exceed peak monthly capacity (in this example this is 50);
- Need to have at least 3 months at the peak capacity (in this example 3 x 50); and
- Shipper has the right to return 50% of the total capacity (in this example 300).



**Step 4b) Shipper notifies IUK that they wish to opt to use the Simplification Conversion Service to convert their capacity at IZT into simpler 1IP-equivalent capacity.**

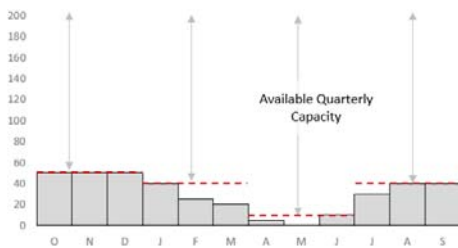
- Converting their IZT 2IP capacity to 1IP-equivalent capacity enables a Shipper to exit the Interconnector pipeline at IBT: by nominating at IZT they are deemed to have submitted a valid nomination for IBT.
- The Shipper can only subscribe to the SCS to the extent that there is a physical ability to provide the service. If too much capacity has been subscribed at IBT this will not be possible and the contract will allow the Shipper to decide whether they want to release more capacity down to the level of SCS that can be provided. It is unlikely that this situation would occur as the SCS is not being offered at IBT in this auction so there would be no commercial rationale for Shippers purchasing IBT capacity without the corresponding IZT capacity.

- The Shipper pays IUK 0.65p/th for the SCS. This is payable on a monthly basis as part of the Shipper's monthly invoice.



**Step 5) Capacity returned by the Shipper during the Re-profiling window of 10 days is made available in the future auctions.**

- Any capacity released through re-profiling increases the amount of available capacity in the following auctions. The first such auction following the annual auction is the CAM Quarterly Auction.
- The amount of capacity available at IBT in future auctions will be reduced to reflect the fact that IZT capacity has been converted to 1IP-equivalent capacity which requires gas to be redelivered at IBT.
- The following illustrates the amount of capacity released and the impact on bundled and unbundled capacity available in the next quarterly auction at IBT:



CAM Quarterly Auctions				
Quarter	IUK		NGG	
	Bundled	Unbundled	Bundled	Unbundled
Q1	150	0	150	50
Q2	160	0	160	40
Q3	190	0	190	10
Q4	160	0	160	40

**Step 6) Shipper purchases optimum capacity product from NGG to suit their requirements and complete their route.**

- If a Shipper uses the SCS the Shipper is now able to purchase the most suitable matching capacity from NGG to complete their route from Zeebrugge to NBP.
- Without using the SCS the Shipper must purchase bundled flat annual capacity with NGG at IBT which cannot be re-profiled and is subject to uncertainty due to the current charging review.
- A Shipper with an existing contract at IBT with NGG can use their existing capacity booking without risk of having to purchase bundled capacity.