ANNEX A:

Interconnector (UK) Limited

Request under Article 37 of Commission Regulation (EU) 2017/460 establishing a network code on harmonised transmission tariff structures for gas by Interconnector (UK) Limited for a derogation from the application of one or more Articles of this Commission Regulation

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Draft for Consultation

Interconnector

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Interconnector

Executive Summary

Article 37 of Commission Regulation (EU) 2017/460 establishing a network code on harmonised transmission tariff structures for gas (the TAR NC) allows National Regulatory Authorities (NRAs) to grant an interconnector operator derogations from the application of one or more Articles of the TAR NC if the application of such Articles would have one or several types of negative consequence[1]: not facilitate efficient gas trade and competition, not provide incentives for new investment, unreasonably distort cross-border trade, distort competition with other infrastructure operators, or not be implementable when taking into account the specific nature of interconnectors.

IUK operates a merchant gas interconnector without a regulated allowed revenue. It relies exclusively on market demand and capacity bookings for its revenues. It has no captive demand and competes directly with a number of other flexibility assets such as storage and LNG. It provides economic value and benefit to consumers, through market integration and security of supply, which far outweigh its expected market revenues[2].

IUK faces a challenge to its financial viability from October 2018 when its initial set of long term capacity contracts expire. Its historical utilisation pattern has been of low to moderate average annual utilisation but with peak capacity being required from time to time. As the market is moving increasingly towards short term bookings matching utilisation, this type of asset utilisation will produce a highly volatile revenue pattern. A shift away from long term contracts to more short term contracts will also likely impact utilisation patterns.

A derogation from certain aspects of the TAR NC is necessary for IUK's ongoing business viability. IUK needs tariff flexibility to be able to compete, in a challenging market environment, with other flexibility assets such as storage and LNG. IUK needs to be able to calculate, adjust and set tariffs more flexibly than do other regulated TSOs with captive demand, as unlike them it faces direct competition from these other assets which have less restrictive regulatory frameworks. Without the ability for IUK to compete on a level playing field with other providers of system flexibility, competition in the flexibility market will be harmed and cross-border trade distorted.

IUK is therefore proposing derogations from the following Articles for an enduring period to limit a number of negative consequences of implementing these obligations:

Table 1: Summary of IUK's proposed derogation from Articles of the TAR NC due to the negative consequences of implementation

Article Reference	The negative consequences of implementation
Paragraph 3(b)(iii) of Article 4: *Complementary revenue recovery charge*	Distorts competition and risks IUK's ability to maintain capacity as it removes from IUK the option of also using commodity charges to recover transmission revenue.
Article 5: *Cost allocation assessment*	IUK has no domestic points. The purpose and the practicality of applying the formula therefore becomes meaningless.

[1] References in this document to Articles are to Articles of the TAR NC.

[2] Estimates of IUK's societal benefits are provided later in this draft application document.

Paragraph 1 of Article 6: *Reference price methodology application*	Linked to Article 26 and 27. See negative consequences outlined in implementing Article 26 and 27 shown further below. Given the link to Article 26 and Article 27 a derogation is required from Article 6.1 as it requires the reference price methodology to be set in accordance with Article 27 and subject to periodic consultation as outlined in Article 26.
Paragraph (a) of Article 7: *Reproducing and accurate forecasting of reserve prices*	IUK is not able to accurately predict flows/bookings and therefore forecast tariff evolution. Even if IUK could make such predictions, it is still not appropriate from a competition point of view to consult/publish this information given that IUK competes with other flexibility assets that are not under the same obligation. The application of this Article would distort competition in the flexibility market.
Paragraph 3 of Article 12: *Reserve prices published before annual CAM auction to be binding for the subsequent gas year*	Linked to Article 29. Given no baseload demand, it is not possible for IUK to accurately predict flows/ bookings and therefore to lock in a "correct" tariff structure effectively over a year. Application of this Article would harm competition and cross border trade. IUK would not be able to respond to changing market conditions, unlike competing flexibility assets.
Article 13: *Level of multipliers and seasonal factors*	This threatens IUK's ability to maintain cross border capacity and harm cross-border trade. The relevant caps are not sufficient to enable IUK to achieve reasonable revenue recovery in a market that is moving strongly to short term capacity bookings.
Paragraph 4 of Article 16: *Ex-post calculation of an interruptible reserve prices*	An ex-post compensation payment option of three times the reserve price for daily products is not appropriate given IUK's risk exposure as a commercial asset with full market exposure, in a market environment which favours short term capacity bookings.
Article 26: *Periodic consultation*	Application of this Article would harm competition in the flexibility market as it would reveal commercially sensistive information to IUK's competitors (e.g. via consulting on prices and outlining other charges). Furthermore, a two-month consultation would unreasonably delay approval processes for IUK noting that other flexibility assets have no such 2 month obligation.
Article 27: *NRA decision making*	This Article is linked to the Agency (ACER) analysing the Article 26 consultation. As IUK is seeking a derogation from Article 26, for the negative consequences outlined above, an ACER review is not necessary. Furthermore, two months for an ACER assessment and five months for NRAs to make a decision would unreasonably delay IUK's ability to adjust tariffs. This harms IUK's ability to compete with other flexibility assets and respond to changing market conditions.

Article 28: *Consultation on discounts, multipliers and seasonal factors*	As a merchant asset, IUK's tariffs should not be set by NRAs. Other competing flexibility assets have no such restriction. It is not appropriate for IUK's proposed pricing structure to be consulted on and to be locked in for an extended period. Revealing commercially sensitive information to competitors would be detrimental to IUK and competition in the flexibility market, distorting competition, risking IUK's ability to maintain capacity, and distorting cross-border trade.
Paragraph (a) and paragraph (b)(i) of Article 29: *Information to be published before the annual yearly capacity auction*	Linked to Article 12.3. Given no baseload demand, it is not possible for IUK to accurately predict flows and therefore lock in a "correct" tariff structure effectively over a year. This Article would harm competition and cross border trade as IUK would not be able to respond to changing market and competitive conditions.
Sub-paragraphs (a)(ii) and (b)(iii)(2) of paragraph 1 and paragraph 2 of Article 30: *Information to be published before tariffs period specifically forecasted capacity, cost of capital, tariff evolution*	Interconnectors are single line transmission pipelines which facilitate market flexibility and arbitrage. Flows and capacity bookings will depend on market circumstances and will be highly difficult to predict. This makes forecasting capacity bookings and publishing information to enable users to forecast tariff evolution impractical. From a competition point of view, any assumptions that IUK makes in these areas are commerically sensitive. Therefore publishing such information would harm competition by allowing competing assets (who are not under the same obligation) to take advantage of this sensitive information.
Paragraph 2(a) of Article 31: *Form of publication*	This Article is linked to Article 29 and 30. IUK is seeking a derogation from certain parts of Article 29 and 30 due to the negative consequences noted above. Therefore this Article should be applicable only to the extent that the requirements set out in Article 29 and 30 apply.
Paragraph (a),(c) and the last paragraph of Article 32: *Publication notice period*	This Article is linked to Article 12(3), 29 and 30. IUK is seeking a derogation from Article 12(3) and certain parts of Article 29 and 30 due to the negative consequences noted above. Therefore this Article should be applicable only to the extent that the requirements set out in Article 12(3), 29 and 30 apply.

IUK is seeking derogations from the identified Articles above to ensure an appropriate degree of tariff flexibility to enable effective competition in the flexibility market. Even with these derogations, it should be noted that a number of safeguards and checks will ensure that IUK's prices are fair and transparent:

- IUK's obligations under the Belgian Gas Act and GB interconnector licence obligations continue to require IUK to consult stakeholders for at least one month and obtain NRA approval for changes to its Charging Methodology (CM);

- IUK is obliged to review the CM annually to ensure that it remains compliant with the relevant charging methodology objectives under its interconnector licence;

- IUK must continue to publish a charging statement with applicable prices and charges;

- IUK will be implementing the other applicable provisions of the TAR Code including publishing relevant information on the ENTSOG transparency platform;

- IUK is committed to providing NRAs, confidentially, the parameters/ assumptions used to derive its proposed annual reference price, before its publication;
- IUK is committed to publishing prices sufficiently in advance of offering the capacity to meet the needs of shippers/ potential capacity purchasers;

- IUK will continue to provide capacity and price information for the standard CAM auctions as required by the PRISMA rules to comply with the CAM network code;

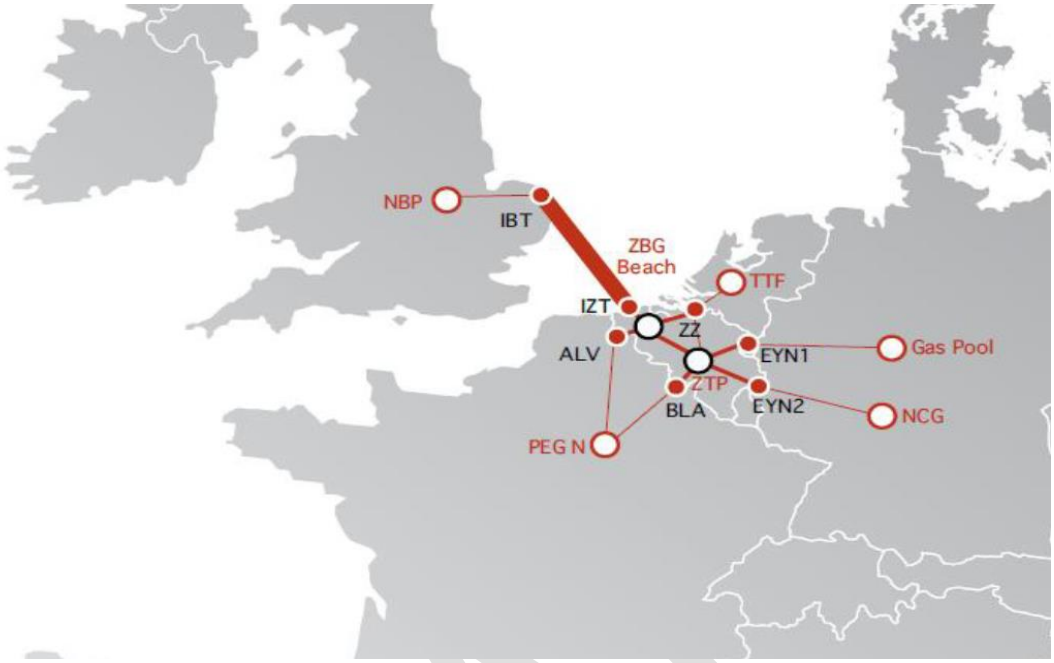
- IUK is committed to publishing indicative price information on its standard CAM products for the coming gas year no later than thirty days before the annual yearly capacity auction; and

- Additionally, the Belgian NRA, CREG is proposing to establish a financial control regime on IUK which is designed to provide a safeguard against excess profit[3].

[3] The consultation is open from the 8th August until the 5th of September. For further details please see http://www.creg.be/fr/consultations

Section 1: Introduction

1.1 IUK's history, strategic role in gas markets, and need for flexibility



IUK is a strategic market integration asset, serving the interests of consumers in the UK, Belgium, and Europe as a whole. It is a certified TSO and its access arrangements and its charging methodology are subject to consultation and approval by the Belgian and GB national regulatory authorities (CREG and Ofgem).

IUK is the only physically bi-directional gas interconnector between the UK (Bacton) and Continental Europe (Zeebrugge) and plays an important role in integrating the markets of North West Europe. It was the first interconnector between the UK and Continental Europe and has played a crucial role in the price convergence that we see today between the NBP and continental hubs. IUK started operations in October 1998 and has been a major catalyst in the creation of spot gas markets in Europe. As an arbitrage pipeline, its flows are highly responsive to price signals. It is capable of transporting 630.1 GWh/d of gas into Belgium and 803.4 GWh/d into GB and offers available capacity on PRISMA. It is approximately 17 times bigger than a large electricity interconnector[4]. IUK's track record of almost 100% reliability over the past 19 years has shown that it provides a highly reliable gas transport route.

IUK helps in providing increased energy security for a large number of European countries and consumers, and also in reducing gas price volatility. In times of system constraints in GB and Continental Europe it has proven to be a vital security of supply asset with gas flowing to its maximum capacity in either direction as needed[5]. In a recent economic study, IUK's economic value has been estimated to be over €300 million per annum. This economic value reflects substantial market integration price benefits for consumers in the UK and in North West Europe and significant security of supply benefits, particularly to UK consumers. This economic value, however, is not reflected in IUK's market revenues and cannot be captured by the asset owner.

[4] Electricity Interconnector: 500 to 2,000 MW; Interconnector (IUK) 26,000 or 34,000 MW.
[5] For further details please see Annex 2.

Whilst IUK is a certified TSO subject to the European Network Codes and NRA regulatory oversight, it is also a "merchant" asset in that it is fully exposed to the market. Its regulatory framework provides it with no allowed revenue or any other form of consumer underwriting. Whilst it provides transportation services, it has no captive demand and it operates in the highly competitive gas flexibility market, alongside LNG, storage and production swing. IUK faces a challenging future when it emerges from its original long term contracts which expire on 30 September 2018. Tariff flexibility will be vital for IUK, to allow it to respond to changing market conditions in the short term market and to allow it to compete on a level playing field with other flexibility assets who are not subject to the TAR NC. Such tariff flexibility will help to avoid distorting competition between the different providers of flexibility services and harming cross-border trade (if national flexibility service providers are advantaged). Damage to competition and cross-border trade would ultimately be to the detriment of the market, shippers and consumers. Tariff flexibility will help IUK to design a business model and behave in a way which is more aligned to the actual market in which it operates and more aligned to how shippers can use the asset to meet their needs.

1.2 Article 37 of the Gas Regulation 2017/460 ("TAR NC")

An "interconnector" is defined under Gas Directive 2009/73/EC as "a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States".

Article 15(5)(a) 15 of the Belgian Gas Act states with respect to interconnector operators that: "*The tariffs and underlying tariff methodology are objective, transparent, non-discriminatory and compliant with Regulation (EC) No 715/2009 as well as all legally binding decisions made by the European Commission and/or ACER.*"

Standard licence condition 10(4) of IUK's GB interconnector licence states that: "*the charges and the application of the underlying charging 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 (collectively, the 'relevant charging methodology objectives')"*. Furthermore, any modification of the charging methodology is to be accompanied by a report stating how the modification better achieves the relevant charging methodology objectives.

The TAR NC is a new network code adopted by the EU Commission under article 6(11) of Gas Regulation 715/2009 and governs tariffs and the tariff setting mechanisms to be used by TSOs at entry and exit points and interconnection points.

IUK is therefore required under the Belgian Gas Act and its interconnector licence to implement the TAR NC as a Network Code given effect under the umbrella of Gas Regulation 715/2009. However, there is a derogation mechanism for interconnector operators in Article 37 of TAR NC as outlined below:

Article 37 of the TAR NC provides, amongst other things, that NRAs may:

(a) grant derogations from the application of one or more Articles of the TAR NC subject to and in accordance with Article 37(2) to Article 37(6) of that Network Code; and

(b) grant such derogations at the request of an entity which operates an interconnector that has benefitted from an exemption from Article 41(6), (8) and (10) of Directive 2009/73/EC (the 'Third Gas Directive') in accordance with Article 36 of that Directive or a similar exemption.

Article 37

Power to grant derogations

1. *National regulatory authorities may, at the request of an entity which operates an interconnector that has benefited from an exemption from Article 41(6), (8) and (10) of Directive 2009/73/EC in accordance with Article 36 of that Directive or a similar exemption, jointly grant such entity a derogation from the application of one or more Articles of this Regulation in accordance with paragraphs 2 to 6 of this Article where the application of those Articles to such entity would have one or several of the following negative consequences. It would:*
   - *(a) not facilitate efficient gas trade and competition;*
   - *(b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;*
   - *(c) unreasonably distort cross-border trade;*
   - *(d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;*
   - *(e) not be implementable when taking into account the specific nature of interconnectors.*
2. *The entity requesting a derogation under paragraph 1 shall include in its request a detailed reasoning, with all supporting documents, including, where appropriate, a cost-benefit analysis, demonstrating that one or more of the conditions in paragraph 1(a) to (e) are complied with.*
3. *The national regulatory authorities concerned shall jointly assess the request for a derogation and deal with it in close cooperation. Where the relevant national regulatory authorities grant a derogation, they shall specify its duration in their decisions.*
4. *The national regulatory authorities shall notify their decisions granting such derogations to the Agency and the Commission.*
5. *The national regulatory authorities may revoke a derogation if the circumstances or underlying reasons, or both, no longer apply or upon a reasoned recommendation of the Agency or the Commission to revoke a derogation due to a lack of justification.*

Article 37 was included in the TAR NC in recognition of the fact that interconnectors are a distinct type of transmission system operator (TSO). It recognised that the specific nature of interconnectors meant that some of the Articles contained in the TAR NC would not be appropriate if applied to these types of asset.

As described in ENTSOG's accompanying implementation document[6] the specific characteristics of interconnectors include:

- *They are single pipelines with very few entry / exit points;*
- *They have no captive demand, that is no directly connected end-user demand;*
- *They are not directly connected to downstream distribution networks;*
- *They may compete directly with other assets such as storage, LNG and other pipelines in providing flexibility to the connected transmission networks; and*
- *They may be merchant assets without an allowed or target revenue set in accordance with Article 41(6)(a) of the Gas Directive.*

IUK meets all of these characteristics.

[6] For further details please see: https://www.entsog.eu/public/uploads/files/publications/Tariffs/2017/170322_ENTSOG_TAR%20NC%20IDoc_High-Res.pdf

1.3 IUK's eligibility to apply for a TAR NC derogation

IUK operates an interconnector that has benefitted from an exemption that is similar to an exemption granted in accordance with Article 36 of the Third Gas Directive. IUK's construction and operation predates the exemption arrangements, established by the Second Gas Directive and referred to in Article 37 of the TAR NC. IUK does however have an EC Article 85[7] "comfort" letter from the European Commission in accordance with the practice at the time. This comfort letter was considered similar to a Second Gas Directive exemption when IUK was certified as ownership unbundled and had also been the basis for Ofgem dis-applying paragraph 2 and 4-11 of Stand Licence Condition 10 which concerned NRA approval and review of the CM.

1.4 What make merchant operators different and why they need flexibility

Merchant operators, like IUK, rely exclusively on market demand and revenues to establish a viable business model and are not under-written by consumers. There are not that many merchant interconnectors across Europe, as traditionally interconnectors have been built and operated by regulated TSOs with captive demand and allowed revenue. As a result, EU legislation is predominantly drafted for regulated businesses and merchant assets have traditionally been considered by EU policy makers "as the exceptions to the rule". Unless they are sufficiently supported by long term contracts, merchant interconnectors require full commercial flexibility to establish a viable business model and to be able to compete successfully in the market..

A derogation from certain aspects of the TAR NC, which is drafted primarily for regulated transmission businesses with captive demand and allowed revenue, is necessary for IUK's viability. IUK needs the tariff flexibility to be able to compete in the market with other flexibility assets such as storage and LNG. IUK needs to be able to calculate, adjust and set tariffs more flexibly than do other regulated TSOs with captive demand, as unlike them it faces direct competition from other assets which have less restrictive regulatory frameworks. Without the ability to compete on a level playing field with other providers of system flexibility such as storage and LNG, competition in the flexibility market will be distorted. IUK also needs a less restrictive framework when it comes to publication of its tariffs and transparency obligations to avoid having to share commercially sensitive information with competing flexibility assets who do not face the same obligations.

In the next section we set out in more detail the specific TAR NC Articles from which IUK needs a derogation and the rationale behind our thinking. This is supplemented by Annexes which provide more context on the IUK asset in the flexibility market and evidence on its challenge and consequent need for tariff flexibility.

[7] Article 85 of the EC Treaty (now Article 101 of the Treaty of the EU (TFEU)) prohibited agreements that have effect on trade between Member States and restrict or distort competition within the common market (now EU). Such agreements were void and unenforceable (Article 85(2)) unless they benefitted from an exemption (Article 85(3)).

Section 2: Articles within the TAR NC from which IUK requires a derogation

In this section we outline the key issues that IUK has with the TAR NC. We then outline the Articles within the code from which IUK requires a derogation and explain why, based on the conditions under which a derogation is permitted.

2.1 Key implementation concerns for IUK

The major restrictions within the TAR NC that IUK is seeking to address via its derogation application concern 3 broad areas:

1. A formulistic approach to calculating and adjusting tariffs;
2. Restrictions on adjusting tariffs and caps on these tariffs; and
3. Some consultation and publication obligations which reveal commercially sensitive information.

Each of these issues is elaborated below.

1) A formulistic approach to calculating tariffs does not work for IUK

IUK's circumstances are very different to those that underpin the standard approach to determining national TSOs' charges. National TSOs are generally low risk assets that have a core and predictable demand profile and associated revenue stream from captive customers. The TAR NC is primarily focused on providing more transparency on how these national TSOs calculate tariffs. It is seeking to ensure monopoly positions are not being used to exploit consumers or harm competition.

The standard approach to TSO charging broadly involves the following steps:

- Calculate the TSO's efficient costs, including an appropriate return for shareholders based on the asset value and the WACC;
- Forecast the expected booking of capacity, derived from use of the assets and flows across the system to get to a set of unit charges;
- Allocate recovery of the costs across the system in a fair, practical and efficient way; and
- Adjust charges on a periodic basis across the whole network to ensure allowed revenue recovery.

There are a number of challenges with taking this approach and applying it to IUK:

- IUK's flows and capacity bookings are highly unpredictable ex-ante. This reflects its use as an arbitrage and security of supply asset, with no captive demand which must be met irrespective of exact market conditions. Actual use of the asset will reflect market conditions and competitive dynamics. This is illustrated in more detail in Annex 2. Therefore, it would be impossible to determine a set of tariffs which would recover IUK's costs with a relatively high level of reliability. The need for ex-post adjustments is likely to be much higher than is the norm for TSOs. IUK would furthermore not be able to socialise charges to recover necessary revenue across a network of entry/exit points.
- IUK does not have captive baseload demand. It does not have an effective under-recovery mechanism. Increasing its capacity tariffs could simply result in reduced revenues. This is in

contrast to meshed network TSOs which receive their revenues from a largely captive demand base, and may be able to absorb the shift to short term products at interconnection points by adjusting their charges over their entire network.

- It is possible that a mechanistic cost divided by flow = tariffs approach leads to the calculation of tariffs which are not competitive compared to alternative flexibility and arbitrage options available to Shippers. We outline in Annex 1 that IUK is in a competitive flexibility market with a number of alternative flexibility assets and therefore it will be viable only if its tariffs are competitive.

- As an asset with full market exposure, revenue recovery during exceptional market events is likely to be vital. IUK therefore requires the ability to adjust tariffs to reflect changing market conditions. We show in Annex 2 that IUK's historic (and expected) utilisation is one of relatively low average annual utilisation, but with peak capacity being called upon occasionally in response to exceptional events. We also highlight in this Annex that from October 2018, IUK's ability to earn revenue is extremely challenging. In a market moving more short term, IUK will rely on revenue generated in exceptional events[8].

2) Restrictions on adjusting tariffs and caps on these tariffs

Articles 12.3, Article 13 and Article 29(a) and 29(b)(i) impose restrictions to both the level of short term standard capacity prices and TSOs' ability to adjust those tariffs. Article 13 restricts monthly product prices up to 1.5 times the annual tariff, and daily/ within day tariffs are restricted up to 3 times the annual tariff. These multiplier values default to a cap of 1.5 times the annual tariff from April 2023. Articles 12.3 and Article 29(a), 29(b)(i) furthermore require TSOs to publish binding multipliers one month before the annual CAM auction for the coming gas year. This binding requirement effectively locks in a tariff structure for over a year. IUK needs a derogation from these obligations to prevent a distortion of competition. IUK needs tariff flexibility in order to compete effectively with other flexibility providers and achieve vital revenue in a challenging market environment. There are likely to be occasional demand-supply events in the future which lead to temporary high utilisation of IUK. If IUK bears full market exposure and is relying on short term capacity bookings, it is necessary to allow tariff arrangements which enable IUK to adjust multipliers and share market value with Shippers from these occurrences. This will facilitate fair and effective competition between flexibility providers and reduce the risk of IUK earning insufficient markets revenues to maintain its capacity (and to maintain its full, ongoing contribution to market integration and other societal benefits).

3) Consultation and publication obligations which reveal commercially sensitive information

Articles 26-28 describe obligations to consult on a number of parameters (e.g. multipliers). Articles 29-30 describe obligations to publish a number of parameters (forecasted capacity and tariffs). As mentioned earlier Articles 12.3 and Article 29(a), 29(b)(i) furthermore require TSOs to publish binding multipliers one month before the annual CAM auction for the coming gas year. Some of the obligations would reveal IUK's pricing strategy and other commercially sensitive information to competitors who will be aware IUK is locked into this pricing strategy for a significant period of time. As a merchant interconnector in a competitive market it is not appropriate for IUK's prices to be consulted on months in advance of the actual auction. This would be unfair compared to other flexibility assets under no such requirement. Annex 1 highlights that IUK is in a competitive flexibility market yet other flexibility assets enjoy considerably more tariff flexibility than IUK. It is also not practical for IUK to be locked into pricing

[8] This assessment does not change with the recent announcement that the GB Rough Storage facility with close. See Annex 2 for further details.

proposals given the unpredictability of flows and consequent bookings. As IUK is exposed to competing assets, the market will act as an effective constraint against excessive prices.

2.2 Articles from which IUK requires a derogation

Article 37.1 of the TAR NC outlines five reasons why a derogation from one or more Article of the TAR NC can be granted. These five reasons are that implementation would:

a) *Not facilitate efficient gas trade and competition;*

b) *Not provide incentives for investment for new capacity or to maintain existing levels of capacity;*

c) *Unreasonably distort cross-border trade;*

d) *Distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector; and*

e) *Not be implementable when taking into account the specific nature of interconnectors.*

We now set out the specific Articles from which IUK requests a derogation, and justify this using the five criteria under which a derogation is permitted by the TAR NC.

Derogation from Article 4.3(b)(iii)

IUK requests an enduring derogation from paragraph 3(b)(iii) of Article 4 and that all references to Article 4 in the remainder of the TAR NC are treated as not including paragraph 3(b)(iii). For the avoidance of doubt, the remainder of Article 4 shall still apply.

Article 4

Transmission and non-transmission services and tariffs

1. *A given service shall be considered a transmission services where both of the following criteria are met:*

(a) *the costs of such service are caused by the cost drivers of both technical or forecasted contracted capacity and distance;*

(b) *the costs of such service are related to the investment in and operation of the infrastructure which is part of the regulated asset base for the provision of transmission services.*

Where any of the criteria set out in points (a) and (b) are not complied with, a given service may be attributed to either transmission or non-transmission services subject to the findings of the periodic consultation by the transmission system operator(s) or the national regulatory authority and decision by the national regulatory authority, as set out in Articles 26 and 27.

2. *Transmission tariffs may be set in a manner as to take into account the conditions for firm capacity products.*

3. *The transmission services revenue shall be recovered by capacity-based transmission tariffs.*

As an exception, subject to the approval of the national regulatory authority, a part of the transmission services revenue may be recovered only by the following commodity-based transmission tariffs which are set separately from each other:

(a) a flow-based charge, which shall comply with all of the following criteria:

(i) levied for the purpose of covering the costs mainly driven by the quantity of the gas flow;

(ii) calculated on the basis of forecasted or historical flows, or both, and set in such a way that it is the same at all entry points and the same at all exit points;

(iii) expressed in monetary terms or in kind.

(b) a complementary revenue recovery charge, which shall comply with all of the following criteria:

(i) levied for the purpose of managing revenue under- and over-recovery;

(ii) calculated on the basis of forecasted or historical capacity allocations and flows, or both;

(iii) applied at points other than interconnection points;

(iv) applied after the national regulatory authority has made an assessment of its cost-reflectivity and its impact on cross-subsidisation between interconnection points and points other than interconnection points.

4. The non-transmission services revenue shall be recovered by non-transmission tariffs applicable for a given non-transmission service. Such tariffs shall be as follows:

(a) cost-reflective, non-discriminatory, objective and transparent;

(b) charged to the beneficiaries of a given non-transmission service with the aim of minimising cross-subsidisation between network users within or outside a Member State, or both.

Where according to the national regulatory authority a given non-transmission service benefits all network users, the costs for such service shall be recovered from all network users.

Why a derogation is justified from Article 4.3(b)(iii)

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity

4.3(b)(iii) restricts IUK to recover revenue only via capacity charges as it forbids a complementary (commodity) revenue charge at IPs. This harms IUK's ability and optionality to generate revenue from alternative mechanisms. IUK should not be prevented from seeking to find the best approach to recover revenue. This could, for example, be via some charge on commodity flows rather than exclusively on capacity bookings. We show in Annex 2 that IUK is facing a revenue challenge once its initial long term contracts expire in September 2018. Under such a challenging environment alternative mechanisms may well need to be explored. It is noted that National TSOs can still, subject to NRA approval, adopt a complementary revenue charge at non IPs. Given the majority of their points are typically non IP, this restriction does not materially harm them and this optionality largely remains in place. Overall this provision jeopardises the maintenance of existing capacity levels as it closes a revenue recovery option.

37.1(c) unreasonably distort cross-border trade

As shown in Annex 1 IUK is in a competitive flexibility market. It is in its own interest as an asset with full market exposure to ensure its tariffs are competitive and do not cause a cross border distortion. By not

allowing IUK optionality in how revenue is recovered, it potentially risks the maintenance of existing capacity as IUK faces a challenge to remain viable from October 2018.

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

IUK competes with a number of flexibility assets who enjoy both product and tariff flexibility (see Annex 1). Other competing flexibility assets are under no such restriction to recover charges via just capacity charges. They are free to adopt any approach and indeed are encouraged to innovate (Storage in particular). The requirements in Article 4.3(b)(iii) therefore potentially distorts competition with other flexibility providers.

Derogation from Article 5

IUK requests an enduring derogation from Article 5 and that all references to Article 5 in the remainder of the TAR NC are treated as not applying to IUK.

Article 5

Cost allocation assessments

1. *The national regulatory authority or the transmission system operator, as decided by the national regulatory authority, shall perform the following assessments and shall publish them as part of the final consultation referred to in Article 26:*

(a) *a cost allocation assessment relating to the transmission services revenue to be recovered by capacity-based transmission tariffs and based exclusively on the cost drivers of*

(i) technical capacity; or

(ii) forecasted contracted capacity; or

(iii) technical capacity and distance; or

(iv) forecasted contracted capacity and distance;

(b) *a cost allocation assessment relating to the transmission services revenue to be recovered by commodity-based transmission tariffs, if any, and based exclusively on the cost drivers of:*

(i) the amount of gas flows; or

(ii) the amount of gas flows and distance.

2. *The cost allocation assessments shall indicate the degree of cross-subsidisation between intra-system and cross-system network use based on the proposed reference price methodology.*

3. *The cost allocation assessment referred to in paragraph 1(a) shall be carried out as follows:*

(a) *the transmission services capacity revenue to be obtained from intra-system network use at both all entry points and all exit points shall be divided by the value of the relevant capacity cost driver(s) for intra-system*

network use in order to calculate the intra-system capacity ratio, which is defined as a monetary unit per measurement unit, such as in euro per MWh/day, in accordance with the following formula:

$$\text{Ratio}_{\text{cap}}^{\text{intra}} = \frac{\text{Revenue}_{\text{cap}}^{\text{intra}}}{\text{Driver}_{\text{cap}}^{\text{intra}}}$$

Where:

$\text{Revenue}_{\text{cap}}^{\text{intra}}$ *is the revenue, defined in a monetary unit such as the euro, which is obtained from capacity tariffs and charged for intra-system network use;*

$\text{Driver}_{\text{cap}}^{\text{intra}}$ *is the value of capacity-related cost driver(s) for intra-system network use, such as the sum of the average daily forecasted capacities contracted at each intra-system entry point and intra-system exit point, or cluster of points, and is defined in a measurement unit such as MWh/day.*

(b) the transmission services capacity revenue to be obtained from cross-system network use at both all entry points and all exit points shall be divided by the value of the relevant capacity cost driver(s) for cross-system network use in order to calculate the cross-system capacity ratio, which is defined as a monetary unit per measurement unit, such as in euro per MWh/day, in accordance with the following formula:

$$\text{Ratio}_{\text{cap}}^{\text{cross}} = \frac{\text{Revenue}_{\text{cap}}^{\text{cross}}}{\text{Driver}_{\text{cap}}^{\text{cross}}}$$

Where:

$\text{Revenue}_{\text{cap}}^{\text{cross}}$ *is the revenue, defined in a monetary unit such as the euro, which is obtained from capacity tariffs and charged for cross-system network use;*

$\text{Driver}_{\text{cap}}^{\text{cross}}$ *is the value of capacity-related cost driver(s) for cross-system network use, such as the sum of the average daily forecasted capacities contracted at each cross-system entry and exit point, or cluster of points, and is defined in a measurement unit such as MWh/day.*

(c) the capacity cost allocation comparison index between the ratios referred to in points (a) and (b), which is defined in percentage, shall be calculated in accordance with the following formula:

$$\text{Comp}_{\text{cap}} = \frac{2 \times \left|\text{Ratio}_{\text{cap}}^{\text{intra}} - \text{Ratio}_{\text{cap}}^{\text{cross}}\right|}{\text{Ratio}_{\text{cap}}^{\text{intra}} + \text{Ratio}_{\text{cap}}^{\text{cross}}} \times 100\,\%$$

4. The cost allocation assessment referred to in paragraph 1(b) shall be carried out as follows:

(a) the transmission services commodity revenue to be obtained from intra-system network use at both all entry points and all exit points shall be divided by the value of the relevant commodity cost driver(s) for intra-system network use in order to calculate the intra-system commodity ratio, which is defined as a monetary unit per measurement unit, such as in euro per MWh, in accordance with the following formula:

$$\text{Ratio}_{\text{comm}}^{\text{intra}} = \frac{\text{Revenue}_{\text{comm}}^{\text{intra}}}{\text{Driver}_{\text{comm}}^{\text{intra}}}$$

Where:

$\text{Revenue}_{\text{comm}}^{\text{intra}}$ *is the revenue, defined in a monetary unit such as the euro, which is obtained from commodity tariffs and charged for intra-system network use;*

$\text{Driver}_{\text{comm}}^{\text{intra}}$ *is the value of commodity-related cost driver(s) for intra-system network use, such as the sum of the average daily forecasted flows at each intra-system entry and exit point, or cluster of points, and is defined in a measurement unit such as MWh.*

(b) the transmission services commodity revenue to be obtained from cross-system network use at both all entry points and all exit points shall be divided by the value of the relevant commodity cost driver(s) for cross-system network use in order to calculate the cross-system commodity ratio, which is defined as a monetary unit per measurement unit, such as in euro per MWh, in accordance with the following formula:

$$\text{Ratio}_{\text{comm}}^{\text{cross}} = \frac{\text{Revenue}_{\text{comm}}^{\text{cross}}}{\text{Driver}_{\text{comm}}^{\text{cross}}}$$

Where:

$\text{Revenue}_{\text{comm}}^{\text{cross}}$ *is the revenue, defined in a monetary unit such as the euro, which is obtained from commodity tariffs and charged on cross-system network use;*

$\text{Driver}_{\text{comm}}^{\text{cross}}$ *is the value of commodity-related cost driver(s) for cross-system network use, such as the sum of the average daily forecasted flows at each cross-system entry and exit point, or cluster of points, and is defined in a measurement unit such as MWh.*

(c) the commodity cost allocation comparison index between the ratios referred to in points (a) and (b), which is defined in percentage, shall be calculated in accordance with the following formula:

$$\text{Comp}_{\text{comm}} = \frac{2 \times \left|\text{Ratio}_{\text{comm}}^{\text{intra}} - \text{Ratio}_{\text{comm}}^{\text{cross}}\right|}{\text{Ratio}_{\text{comm}}^{\text{intra}} + \text{Ratio}_{\text{comm}}^{\text{cross}}} \times 100\,\%$$

5. The transmission services revenue to be obtained from intra-system network use at entry points referred to in paragraphs 3(a) and 4(a) shall be calculated as follows:

(a) the amount of allocated capacity or, respectively, flows attributed to the provision of transmission services for cross-system network use at all entry points shall be deemed equal to the amount of capacity or, respectively, flows attributed to the provision of transmission services for cross-system network use at all exit points;

(b) the capacity and, respectively, flows, determined as set out in point (a) of this paragraph shall be used to calculate the transmission services revenue to be obtained from cross-system network use at entry points;

(c) the difference between the overall transmission services revenue to be obtained at entry points and the resulting value referred to in point (b) of this paragraph shall be equal to the transmission services revenue to be obtained from intra-system network use at entry points.

6. Where distance is used as a cost driver in combination with technical or forecasted contracted capacity or flows, the capacity weighted average distance or, respectively, commodity weighted average distance shall be used. Where the results of the capacity, or respectively commodity cost allocation comparison indexes referred to in paragraph 3(c) or, respectively paragraph 4(c), exceed 10 percent, the national regulatory authority shall provide the justification for such results in the decision referred to in Article 27(4).

Why a derogation is justified from Article 5

37.1 (a) not facilitate efficient gas trade and competition

IUK as an interconnector consists of two interconnection points and has no domestic points. The purpose of this Article is to assess and compare the ratio of transmission services revenue recovered from domestic (intra) users and cross system users aiming to avoid cross subsidisation. The purpose and the practicality of applying the formula therefore becomes meaningless. This test is therefore not relevant nor necessary and it does not facilitate efficient gas trade and competition when applied to IUK.

37.1 (e) not be implementable when taking into account the specific nature of interconnectors

As per above, IUK as an interconnector consists of two interconnection points and has no domestic points. The purpose and the practicality of applying the formula therefore becomes meaningless. This test is therefore not relevant nor necessary.

Derogation from Article 6.1

IUK requests an enduring derogation from paragraph 1 of Article 6.

Article 6

Reference price methodology application

1. The reference price methodology shall be set or approved by the national regulatory authority as set out in Article 27. The reference price methodology to be applied shall be subject to the findings of the periodic consultations carried out in accordance with Article 26 by the transmission system operator(s) or the national regulatory authority, as decided by the national regulatory authority.

2. The application of the reference price methodology shall provide a reference price.

3. The same reference price methodology shall be applied to all entry and exit points in a given entry-exit system subject to the exceptions set out in Articles 10 and 11.

4. Adjustments to the application of the reference price methodology to all entry and exit points may only be made in accordance with Article 9 or as a result of one or more of the following:

(a) *benchmarking by the national regulatory authority, whereby reference prices at a given entry or exit point are adjusted so that the resulting values meet the competitive level of reference prices;* (b) *equalisation by the transmission system operator(s) or the national regulatory authority, as decided by the national regulatory authority, whereby the same reference price is applied to some or all points within a homogeneous group of points;* (c) *rescaling by the transmission system operator(s) or the national regulatory authority, as decided by the national regulatory authority, whereby the reference prices at all entry or all exit points, or both, are adjusted either by multiplying their values by a constant or by adding to or subtracting from their values a constant.*

Why a derogation is justified from paragraph 1 of Article 6

37.1 (a) not facilitate efficient gas trade and competition;

37. 1(b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;

37. 1(c) unreasonably distort cross-border trade;

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

This Article is linked to Articles 26 and 27. IUK is seeking a derogation from both Articles 26 and 27 for the reasons outlined further below in this document. As will be seen when looking at the grounds for derogation from Articles 26 and 27, all of the exemption criteria are relevant.

Given the link to Article 26 and Article 27, a derogation is required from Article 6.1 as it requires the reference price methodology to be set in accordance with Article 27 and is subject to periodic consultation as outlined in Article 26.

Derogation from Article 7(a)

IUK requests an enduring derogation from paragraph (a) of Article 7 and that all references to Article 7 in the remainder of the TAR NC are treated as not including paragraph (a). For the avoidance of doubt, the remainder of Article 7 shall still apply to IUK.

Article 7 **Choice of a reference price methodology** *The reference price methodology shall comply with Article 13 of Regulation (EC) No 715/2009 and with the following requirements. It shall aim at:* *(a) enabling network users to reproduce the calculation of reference prices and their accurate forecast;* *(b) taking into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network;*

(c) ensuring non-discrimination and prevent undue cross-subsidisation including by taking into account the cost allocation assessments set out in Article 5;

(d) ensuring that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;

(e) ensuring that the resulting reference prices do not distort cross-border trade.

Why a derogation is justified from Article 7(a)

37.1(d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

Article 7(a) requires enabling network users to accurately forecast tariffs. We outline further below and in more detail in Annex 2 why it is not possible for IUK to accurately predict flows and therefore forecast tariff evolution.

Furthermore, even if IUK could do it, it is still not appropriate from a competition point of view. IUK is one of a number of alternative flexibility providers in a competitive market as shown in Annex 1. If IUK had to publish information which enabled the accurate forecasting of reserve prices whist competing flexibility assets were under no such obligation, these competitors could exploit the information to adjust their tariff structure to undercut IUK. This distorts competition.

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

With respect to enabling network users to be able to forecast tariffs accurately, IUK's flows are far more variable than those of a typical national TSO (seen Annex 2). IUK does not have captive demand. It is one of a number of competing flexibility assets. Therefore, providing accurate price forecasts based on an accurate forecast of bookings is not achievable given a dynamic and competitive market place and the unpredictability in interconnector flows with short term bookings.

Derogation from Article 12.3

IUK requests an enduring derogation from paragraph 3 of Article 12 and that all references to Article 12 in the remainder of the TAR NC are treated as not including paragraph 3. For the avoidance of doubt, the remainder of Article 12 shall apply to IUK.

Article 12

General provisions

1. For yearly standard capacity products for firm capacity, the reference prices shall be used as reserve prices. For non-yearly standard capacity products for firm capacity, the reserve prices shall be calculated as set out in this Chapter. For both yearly and non-yearly standard capacity products for interruptible capacity, the reserve prices shall be calculated as set out in this Chapter. The level of multipliers and of seasonal factors, set out in accordance with Article 13, and the level of discounts for the standard capacity products for interruptible capacity, set out in accordance with Article 16, may be different at interconnection points.

2. Where the tariff period and gas year do not coincide, separate reserve prices may be applied respectively:

(a) for the time period from 1 October to the end of the prevailing tariff period; and

(b) for the time period from the beginning of the tariff period following the prevailing tariff period to 30 September.

3. The respective reserve prices published according to Article 29 shall be binding for the subsequent gas year or beyond the subsequent gas year in case of fixed payable price, beginning after the annual yearly capacity auction, unless:

(a) the discounts for monthly and daily standard capacity products for interruptible capacity are recalculated within the tariff period if the probability of interruption referred to in Article 16 changes by more than twenty percent;

(b) the reference price is recalculated within the tariff period due to exceptional circumstances under which the non-adjustment of tariff levels would jeopardise the operation of the transmission system operator.

Why a derogation is justified from Article 12.3

37.1(a) not facilitate efficient gas trade and competition;

As a merchant interconnector in a competitive market it is not appropriate for IUK to publish prices months in advance of the actual auction and to be locked into that tariff structure for the entire gas year. It does not facilitate efficient cross border trade because IUK will not be able to accurately predict its optimal tariffs, as these depend on market conditions and competitive forces. IUK does not have a baseload demand. As outlined in Annex 2 (Figure A2.5), IUK's flows are variable and unpredictable even on a day to day basis. In the winter of 2014/15 IUK's flows switched directions 39 times in the 6 months of winter. This illustrates that without the ability to react to changing market conditions, there is a high probability that prices could be locked in at levels that benefit neither IUK nor shippers. IUK would have to, as outlined in the TAR rules, base a tariff structure on an assumed flow and an assumed direction many months in advance and lock in that tariff structure. It could for example estimate bookings assuming IUK will be in the GB import direction over the winter period and set a tariff structure accordingly with higher short term multipliers in the GB import direction. However, suppose the reality was an unanticipated glut of LNG landing in GB meaning those import bookings did not transpire. IUK would, in such a scenario, need to consider whether it should try to incentivise some GB import flows/bookings via lowering prices (therefore benefiting any shipper booking IUK import capacity). IUK would also need to review its GB export tariff structure to see if it could secure bookings to flow gas to Continental Europe. This flexibility is vital to enable IUK to maintain capacity to the benefit of the market and consumers. Without captive demand and faced with competition, IUK cannot simply adjust tariffs to "recover" revenue in the next tariff period.

Furthermore, this Article harms rather than facilitates competition. Many other flexibility assets are not under the same obligation to publish and lock in a tariff structure so far in advance of selling capacity. They would be in a position to take advantage of IUK's published and locked-in prices to marginally undercut IUK, safe in the knowledge that IUK could not respond. This distorts competition. For example a continental LNG provider could adjust prices to undercut the attractiveness of delivering an LNG cargo into the GB market and using IUK to exporting gas into the continent. GB LNG or Producers could also adjust prices to just undercut continental flows via the interconnectors. Hindering a competitive response from IUK harms competition and the prices may actually be higher.

In a market which is demonstrably moving short term[9] and with most of IUK's capacity bookings expected to be short term, the value to shippers in knowing a fixed IUK multiplier in June is not necessary. We believe there will be no detrimental impact on market participants if they do not have a binding short term tariff in June. Short term prices need to be known in a reasonable timeframe before the relevant auction and IUK will do this as it is in its own interest. IUK will explore reasonable timeframes for publishing prices with shippers for the different standard products.

We do recognise that shippers need to consider the value of the annual product in comparison to the shorter term products at the time of considering buying the annual product. IUK would be prepared to provide indicative price information at that time and also consider commitments (e.g. via contractual guarantees) that annual capacity holders would not be paying more than short term users). We believe this mitigates any risk that shippers face in valuing the annual product. The risk otherwise is locking in a wrong multiplier structure for multiple months without the ability to change it. If that locked in tariff harms IUK's financial viability and capacity cannot be maintained, it stops IUK facilitating cross border trade and competition.

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;

As mentioned above, this binding requirement effectively locks in a tariff structure for over a year. IUK needs a derogation from both Article 12.3 obligations as flexibility to adjust tariffs in response to changing market conditions is likely to be a vital source of revenue in a challenging market. We can only see net benefits in not forcing IUK to lock in a tariff structure so far in advance of the actual auctions. The risk otherwise is locking in a multiplier structure for multiple months which could neither be providing the right incentives to shippers to book capacity nor enable IUK to earn sufficient market revenues. This risk IUK's financial viability and its ability to maintain capacity. It should be noted that IUK's capacity brings wider benefits to GB and Belgian consumers which could be lost without such tariff adjustment flexibility. In any case, the market already acts as an effective safeguard to ensure IUK's tariffs remain at a competitive level if IUK is to secure market revenue and compete effectively with other flexibility providers.

37.(c) unreasonably distort cross-border trade;

Distortions to cross border trade could arise from:

a) An unfair advantage for flexibility assets pricing just below IUK's tariffs to take gas bookings via alternative routes;

b) IUK risking publishing tariffs that are uncompetitive but being unable to adjust this tariff structure, which would harm both IUK and potential customers;

c) IUK being unable to recover sufficient revenue if is unable to adjust tariffs to reflect the value of interconnector capacity when exceptional events occur. This could lead to the removal of IUK cross border capacity to the detriment of markets, consumers, and cross-border trade.

37.(d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;

Annex 1 highlights that IUK is in a competitive flexibility market and yet other flexibility assets enjoy considerably more tariff flexibility than IUK. Competing assets are under no such obligation as Article

[9] The 2017 sale of annual CAM auctions across European interconnection showed 65% of 128 IPs selling no annual capacity and a further 13% of IPs selling under 1% of offered capacity.

12.3 mandates. They will be aware of IUK's tariff structure and have the possibility to price just below IUK's prices e.g. LNG cargo could be diverted and take away potential IUK (GB) export bookings. Furthermore, other flexibility assets have the flexibility to adapt to changing market conditions. This gives them more tools to remain viable.

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

Publishing binding tariffs a month before the annual CAM auctions for the subsequent gas year means that IUK would need to discuss appropriate multiplier levels with NRAs around January. NRAs would assess and consult on the levels (as required by Article 28) before making a NRA decision in time for publication of the tariff structure in June. IUK therefore would need to accurately predict bi-directional flows and appropriate short term tariffs in January for the coming gas year starting in October and finishing at the end of September the following year. So IUK would for that September month at the end of gas year need to be able to confidently predict flows and appropriate tariffs around 20 months beforehand. This is not achievable with any accuracy for an interconnector like IUK. In Annex 2 we highlight IUK's flows are far more variable than those of a typical national TSO. IUK's average utilisation is low and it will need to rely on occasional exceptional event occurrences where utilisation can be expected to be high for a very short time. Those occasional events are, by their very nature, unpredictable. Under such a challenging, dynamic and competitive market, prices for short term products simply cannot be set accurately months in advance of the yearly CAM auction.

Furthermore, as noted earlier, unlike a typical TSO IUK does not have captive baseload demand. For a meshed network which receives its revenue from a largely captive demand base, the consequences of locking in a "wrong" standard product tariff structure at a handful of points may not be a major issue. It is able to adjust tariffs over its entire network in the future and can rely on more stable domestic demand. IUK cannot do that. Its tariffs must remain competitive as increasing its capacity tariffs could simply result in reduced market revenues and threaten IUK's financial viability.

Derogation from Article 13

IUK requests a derogation from Article 13 and that all references to Article 13 in the remainder of the TAR NC are treated as not applicable to IUK.

Article 13

Level of multipliers and seasonal factors

1. The level of multipliers shall fall within the following ranges:

(a) for quarterly standard capacity products and for monthly standard capacity products, the level of the respective multiplier shall be no less than 1 and no more than 1,5;

(b) for daily standard capacity products and for within-day standard capacity products, the level of the respective multiplier shall be no less than 1 and no more than 3. In duly justified cases, the level of the respective multipliers may be less than 1, but higher than 0, or higher than 3.

2. Where seasonal factors are applied, the arithmetic mean over the gas year of the product of the multiplier applicable for the respective standard capacity product and the relevant seasonal factors shall be within the same range as for the level of the respective multipliers set out in paragraph 1.

3. By 1 April 2023, the maximum level of multipliers for daily standard capacity products and for within-day standard capacity products shall be no more than 1,5, if by 1 April 2021 the Agency issues a recommendation in accordance with Regulation (EC) No 713/2009 that the maximum level of multipliers should be reduced to this level. This recommendation shall take into account the following aspects related to the use of multipliers and seasonal factors before and as from 31 May 2019:

(a) changes in booking behaviour;

(b) impact on the transmission services revenue and its recovery;

(c) differences between the level of transmission tariffs applicable for two consecutive tariff periods;

(d) cross-subsidisation between network users having contracted yearly and non-yearly standard capacity products;

(e) impact on cross-border flows.

Why a derogation is justified from Article 13

37.1 (a) not facilitate efficient gas trade and competition

Competition and trade can be faciliated only if IUK's cross boder capacity is maintained. The ability to adjust prices above the multiplier caps will be important in helping IUK to address its post 2018 revenue challenge. The derogation from Article 13 is necessary to support IUK maintaining capacity, which is a necessary condition for facilitating gas trade.

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity

A multiplier cap of 1.5 or 3 times the annual reserve price is not high enough for IUK, as a merchant cross border interconnector with intermittent usage, to incentivise long term bookings. It is furthermore not sufficient to enable IUK to achieve reasonable and sufficient revenue recovery in a market moving to short term bookings. We have in Annex 2 highlighted IUK's revenue challenge and the vital need for it to be able to adapt tariffs to changing market conditions. In particular, revenues from exceptional events are likely to be very important in helping IUK to address its post 2018 revenue challenge. Under such occasional events IUK will need to be able to adjust its tariffs above the artificial multiplier caps of 1.5 or 3. Without this derogation the risk to IUK's ability to maintain its capacity and the wider societal value that it delivers will be a lot higher. We recognise that adjusting the tariffs upward during an exceptional event reduces arbitrage value for shippers but this is a short term value opportunity loss. Longer term, by sharing some of the increased price spread, IUK's capacity is more secure. Thus capacity will be available for more opportunities for shippers to gain value and can continue to provide wider societal benefits to the market and consumers. Overall therefore there is a net benefit in allowing this derogation.

37.1(c) unreasonably distort cross-border trade;

We have mentioned above that tariff flexibility will be vital to IUK in seeking to address its post 2018 revenue challenge. The multiplier caps would need to be breached if IUK is trying to recover and live off

revenue in short run exceptional events. Without it IUK's viability is risked and there could be no IUK cross border capacity.

Any concern that a higher multiplier would harm cross border trade is mitigated by the fact IUK is exposed to competing assets. IUK will continue to need to price in such a way as to attract customer demand and not cause a barrier to trade (IUK is not incentivised to try to take all the spread). The market therefore acts as an effective constraint against excessive prices and will create a market determined cap on prices.

37.1(d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

You will note from Annex 1 that IUK competes in a flexibility market with other assets who are under no restriction to cap their short term pricing levels. This enables these assets to adapt tariffs to changing market conditions. Restricting IUK from doing likewise would be undue discrimination and would give competing assets much greater capability to remain viable in a challenging market than would be allowed to IUK. Please see Annex 1 for a further comparison of the regulatory rules applying to LNG, Producers and Storage facilities compared to IUK.

37.1(e) not be implementable when taking into account the specific nature of interconnectors

IUK is a merchant interconnector without captive demand. For TSOs comprising meshed networks with allowed revenue and a material captive demand base, the consequences of this desired tariff incentive structure is not an issue which threatens their financial viability. These TSOs can recover revenue over the rest of their network if insufficient revenue is generated at the IPs. IUK cannot do that, which is why this Article is not implementable when taking into account the specific circumstance of interconnectors.

Derogation from Article 16.4

IUK requests a derogation from paragraph 4 of Article 16 and that all references to Article 16 in the remainder of the TAR NC are treated as not including paragraph 4.

Article 16

Calculation of reserve prices for standard capacity products for interruptible capacity

1. *The reserve prices for standard capacity products for interruptible capacity shall be calculated by multiplying the reserve prices for the respective standard capacity products for firm capacity calculated as set out in Articles 14 or 15, as relevant, by the difference between 100 % and the level of an ex-ante discount calculated as set out in paragraphs 2 and 3.*
2. *An ex-ante discount shall be calculated in accordance with the following formula:*

$$Di_{ex\text{-}ante} = Pro \times A \times 100\ \%$$

Where:

$Di_{ex\text{-}ante}$ *is the level of an ex-ante discount;*

Pro factor is the probability of interruption which is set or approved in accordance with Article 41(6)(a) of Directive 2009/73/EC pursuant to Article 28, and which refers to the type of standard capacity product for interruptible capacity;

A is the adjustment factor which is set or approved in accordance with Article 41(6)(a) of Directive 2009/73/EC pursuant to Article 28, applied to reflect the estimated economic value of the type of standard capacity product for interruptible capacity, calculated for each, some or all interconnection points, which shall be no less than 1.

3. *The Pro factor referred to in paragraph 2 shall be calculated for each, some or all interconnection points per type of standard capacity product for interruptible capacity offered in accordance with the following formula on the basis of forecasted information related to the components of this formula:*

$$\text{Pro} = \frac{\text{N} \times \text{D}_{\text{int}}}{\text{D}} \times \frac{\text{CAP}_{\text{av. int}}}{\text{CAP}}$$

Where:

N is the expectation of the number of interruptions over D;

D_{int} is the average duration of the expected interruptions expressed in hours;

D is the total duration of the respective type of standard capacity product for interruptible capacity expressed in hours;

$CAP_{av.\ int}$ is the expected average amount of interrupted capacity for each interruption where such amount is related to the respective type of standard capacity product for interruptible capacity;

CAP is the total amount of interruptible capacity for the respective type of standard capacity product for interruptible capacity.

4. *As an alternative to applying ex-ante discounts in accordance with paragraph 1, the national regulatory authority may decide to apply an ex-post discount, whereby network users are compensated after the actual interruptions incurred. Such ex-post discount may only be used at interconnection points where there was no interruption of capacity due to physical congestion in the preceding gas year.*

The ex-post compensation paid for each day on which an interruption occurred shall be equal to three times the reserve price for daily standard capacity products for firm capacity.

Why a derogation is justified from Article 16.4

37.1(b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;

An ex-post compensation payment option of three times the reserve price for daily products, as set out in Article 16.4, is not appropriate given the risk exposure of a commercial asset with full market exposure, in a market environment which favours short term capacity bookings. We outline in Annex 2 the challenges faced by IUK from October 2018. IUK's financability could be at risk if such a compensation payment was triggered. We therefore do not believe it is appropriate for NRAs to decide that IUK should apply such a compensation mechanism.

37.1(c) unreasonably distort cross-border trade

See comments above.

37.1(d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

Competing flexibility providers such as Storage are not required to price interruptible products in such a prescriptive manner. Applying this Article would give alterantive providers more flexibility in differentiating their products and an advantage in terms of the ability to offer more commercially-viable options. So applying this Article to interconnectors would distort competition.

37.1(e) not be implementable when taking into account the specific nature of interconnectors.

With respect to an ex-post compensation payment option of three times the reserve price for daily products IUK does not have an effective mechanism (e.g. recourse to consumers) if a compensation mechanism threatened the financial viability of IUK. Such a high compensation level is not appropriate to the risk exposure of a commercial asset with full market exposure.

Derogation from Article 26

IUK requests a derogation from Article 26 and that all references to Article 26 in the remainder of the TAR NC do not have effect.

Article 26

Periodic consultation

1. *One or more consultations shall be carried out by the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority. To the extent possible and in order to render more effective the consultation process, the consultation document should be published in the English language. The final consultation prior to the decision referred to in Article 27(4) shall comply with the requirements set out in this Article and Article 27, and shall include the following information:*

(a) the description of the proposed reference price methodology as well as the following items:

(i) the indicative information set out in Article 30(1)(a), including:

(1) the justification of the parameters used that are related to the technical characteristics of the system;

(2) the corresponding information on the respective values of such parameters and the assumptions applied.

(ii) the value of the proposed adjustments for capacity-based transmission tariffs pursuant to Article 9;

(iii) the indicative reference prices subject to consultation;

(iv) the results, the components and the details of these components for the cost allocation assessments set out in Article 5;

(v) the assessment of the proposed reference price methodology in accordance with Article 7;

(vi) where the proposed reference price methodology is other than the capacity weighted distance reference price methodology detailed in Article 8, its comparison against the latter accompanied by the information set out in point (iii);

(b) the indicative information set out in Article 30(1)(b)(i), (iv), (v);

(c) the following information on transmission and non-transmission tariffs:

(i) where commodity-based transmission tariffs referred to in Article 4(3) are proposed:

(1) the manner in which they are set;

(2) the share of the allowed or target revenue forecasted to be recovered from such tariffs;

(3) the indicative commodity-based transmission tariffs;

(ii) where non-transmission services provided to network users are proposed:

(1) the non-transmission service tariff methodology therefor;

(2) the share of the allowed or target revenue forecasted to be recovered from such tariffs;

(3) the manner in which the associated non-transmission services revenue is reconciled as referred to in Article 17(3);

(4) the indicative non-transmission tariffs for non-transmission services provided to network users;

(d) the indicative information set out in Article 30(2);

(e) where the fixed payable price approach referred to in Article 24(b) is considered to be offered under a price cap regime for existing capacity:

(i) the proposed index;

(ii) the proposed calculation and how the revenue derived from the risk premium is used;

(iii) at which interconnection point(s) and for which tariff period(s) such approach is proposed;

(iv) the process of offering capacity at an interconnection point where both fixed and floating payable price approaches referred to in Article 24 are proposed.

2. The final consultation prior to the decision referred to in Article 27(4) shall be open for at least two months. Consultation documents for any of the consultations referred to in paragraph 1 may require that replies submitted in response to the consultation shall include a non-confidential version suitable for publication.

3. Within one month following the end of the consultation, the transmission system operator(s) or the national regulatory authority, depending on the entity that publishes the consultation document referred to in paragraph 1, shall publish the consultation responses received and their summary. To the extent possible and

in order to render more effective the consultation process, the summary should be provided in the English language.

4. *The subsequent periodic consultations shall be conducted in accordance with Article 27(5).*
5. *After consulting the European Network of Transmission System Operators for Gas (hereinafter 'ENTSOG'), the Agency shall develop a template for the consultation document referred to in paragraph 1. The template shall be made available to national regulatory authorities and transmission system operators before 5 July 2017.*

Why a derogation is justified from Article 26

37.1(a) not facilitate efficient gas trade and competition

IUK is a merchant asset whose tariffs are constrained by the competitive flexbibilty market. The identified provisions are not needed to facilate efficient trade or comptition when applied to IUK and worse, it would harm competiton as it would reveal commercially sensistive information to competitiors (e.g. consulting on prices). If IUK's viability is threatened and it exits the market, other flexibility assets would, most likely, have the ability to increase prices above what would have been in the case. This would be an inefficient outcome.

37. (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity

The requirement to consult on proposed tariffs and also share forecasted capacity booking assumptions only serve to help competing assets gain an unfair advantage over IUK given they are not under the same obligations. If competing assets are able to use the revelaed information to undercut IUK, it threatens IUK's viability and its ability to maintain capacity.

37. (c) unreasonably distort cross-border trade

If competing assets are able to exploit commercially sensitive information to gain bookings at IUK's expense it distorts trade.

37. (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

From a competition perspective it would also not be appropriate for IUK as a merchant interconnector to be consulting on indicative prices, many months before offering the actual capacity. This harms IUK's competition prospects with other flexibility assets who are under no such obligation to do the same e.g. storage and LNG providers. Furthermore the additional requirements to share parameters such as forecasted bookings and revenue assumptions would reveal commerically sensitive information. IUK being forced to reveal commercially sensitive information to competitors ultimately risks the loss of capacity bookings and therefore IUK's ability to maintain capacity.

We also believe that a two-month consultation and the obligation to carry out consultations in accordance with Article 27(5) (which extends the deadline for NRAs to make a decision on the proposed reference methodology to five months) would unreasonably delay approval processes for IUK. These provisions have the effect of delaying IUK's ability to adjust tariffs and respond to changing market conditions. It also gives competing assets ample time to use the published indicative information to beat IUK when they offer competing services. We note again that other flexibility assets have no such 2-month obligation. A one-month obligation to consult on IUK's charging methodology should remain the

requirement and is a sufficient window for stakeholder feedback. The current 3-month deadline that IUK faces for an NRA decision under its interconnector licence on its charging methodology is sufficient.

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

We have already highlighted in the section discussing Article 12.3 that it is not practical to be seeking to predict tariffs so far in advance of the actual auctioning of capacity. Providing and consulting on indicative prices so far in advance of the actual auctions leads to expectations in the market. Yet predictions so far out are likely to be inaccurate given the variability and unpredictability of interconnector utilisation as highlighted in Annex 2.
Furthermore, given that a mechanistic approach to calculating tariffs is not appropriate to IUK, we do not believe that the requirement to compare a proposed reference price methodology to a capacity weighted distance approach and then consult on the results is appropriate or practical. The requirement for consultation on a cost allocation text is also not appropriate. As already outlined in discussing Article 5 IUK does not have any domestic points. The requirement to provide the indicative information as set out in Article 30(2) is also not practical given it requires the publication of a mechanistic tariff model. IUK, without captive demand and connections to markets with multiple supply sources, cannot accurately forecast future bookings. Furthermore, even if IUK could make assumptions in these areas we would be concerned about publishing commercially sensitive information on how the level of transmission tariffs is likely to evolve.

Derogation from Article 27

IUK requests an enduring derogation from Article 27 and that all references to Article 27 in the remainder of the TAR NC are treated as not applying to IUK.

Article 27

Periodic national regulatory authority decision-making

1. *Upon launching the final consultation pursuant to Article 26 prior to the decision referred to in Article 27(4), the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority, shall forward the consultation documents to the Agency.*
2. *The Agency shall analyse the following aspects of the consultation document:*

(a) whether all the information referred to in Article 26(1) has been published;

(b) whether the elements consulted on in accordance with Article 26 comply with the following requirements:

(1) whether the proposed reference price methodology complies with the requirements set out in Article 7;

(2) whether the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met;

(3) whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met.

3. *Within two months following the end of the consultation referred to in paragraph 1, the Agency shall publish and send to the national regulatory authority or transmission system operator, depending on which entity published the consultation document, and the Commission the conclusion of its analysis in accordance with paragraph 2 in English.*

The Agency shall preserve the confidentiality of any commercially sensitive information.

4. *Within five months following the end of the final consultation, the national regulatory authority, acting in accordance with Article 41(6)(a) of Directive 2009/73/EC, shall take and publish a motivated decision on all items set out in Article 26(1). Upon publication, the national regulatory authority shall send to the Agency and the Commission its decision.*

5. *The procedure consisting of the final consultation on the reference price methodology in accordance with Article 26, the decision by the national regulatory authority in accordance with paragraph 4, the calculation of tariffs on the basis of this decision, and the publication of the tariffs in accordance with Chapter VIII may be initiated as from the entry into force of this Regulation and shall be concluded no later than 31 May 2019. The requirements set out in Chapters II, III and IV shall be taken into account in this procedure. The tariffs applicable for the prevailing tariff period at 31 May 2019 will be applicable until the end thereof. This procedure shall be repeated at least every five years starting from 31 May 2019.*

Why a derogation is justified from Article 27

37.1 (a) not facilitate efficient gas trade and competition;

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;

37.1 (c) unreasonably distort cross-border trade;

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

All the criteria outlined in 37.1(a) to 37.1(e) are relevant in justifying a derogation from this Article which is linked to the requirements in Article 26. IUK does not believe Article 26 should apply for the reasons outlined earlier. Consequently, there would not be a need for the Agency to review whether the information referred to in Article 26 has been published. We are also concerned that the process in Article 27 increases the timescales for getting approval. IUK already is obliged under its CM obligations to consult for at least one month and its NRAs have up to 3 months to make a decision. We believe that the two months under Article 27.3 for an ACER assessment and the five months under Article 27.4 for NRAs to make a decision would unreasonably delay IUK's ability to adjust tariffs. This harms IUK's ability to compete with other flexibility assets and respond to changing market conditions. Given that IUK is merchant interconnector in a competitive environment without an allowed revenue or price cap regime, this is not appropriate. We note again that other flexibility assets have no such lengthy timelines for consultation and approval.

Derogation from Article 28

IUK requests a derogation from Article 28 and that all references to Article 28 in the remainder of the TAR NC are treated as not applying to IUK.

Article 28

Consultation on discounts, multipliers and seasonal factors

1. *At the same time as the final consultation carried out in accordance with Article 26(1), the national regulatory authority shall conduct a consultation with the national regulatory authorities of all directly connected Member States and the relevant stakeholders on the following:*

(a) the level of multipliers;

(b) if applicable, the level of seasonal factors and the calculations set out in Article 15;

(c) the levels of discounts set out in Articles 9(2) and 16.

After the end of the consultation a motivated decision shall be taken in accordance with Article 41(6)(a) of Directive 2009/73/EC on the aspects referred to in points (a) to (c) of this paragraph. Each national regulatory authority shall consider the positions of national regulatory authorities of directly connected Member States.

2. *The subsequent consultations shall be conducted every tariff period as from the date of the decision referred to in paragraph 1. After each consultation and as set out in Article 32(a), the national regulatory authority shall take and publish a motivated decision on the aspects referred to in paragraph 1(a), (b) and (c).*

3. *When adopting the decision referred to in paragraphs 1 and 2, the national regulatory authority shall take into account the consultation responses received and the following aspects:*

(a) for multipliers:

(i) the balance between facilitating short-term gas trade and providing long-term signals for efficient investment in the transmission system;

(ii) the impact on the transmission services revenue and its recovery;

(iii) the need to avoid cross-subsidisation between network users and to enhance cost-reflectivity of reserve prices;

(iv) situations of physical and contractual congestion;

(v) the impact on cross-border flows;

(b) for seasonal factors:

(i) the impact on facilitating the economic and efficient utilisation of the infrastructure;

(ii) the need to improve the cost-reflectivity of reserve prices.

Why a derogation is justified from Article 28

37.1 (a) not facilitate efficient gas trade and competition

As IUK is exposed to competing assets it will continue to need to price in such a way as to attract customer demand. The market therefore acts as an effective constraint against excessive prices and will create a market-determined cap on prices. A consultation on the multipliers is therefore not necessary to

facilitate efficient gas trade and competition. These Article provisions would actually harm competition because competing assets would be aware of the proposed tariff structure that IUK has to offer and have plenty of time to come up with an alternative offering which out competes IUK, therefore distorting competition. Overall this threatens IUK's viability and ability to maintain existing levels of capacity to facilitate trade.

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity

If IUK is locked into a tariff structure so many months in advance of an auction, there is a high probability that IUK is locked into a tariff structure that needs to be adjusted, change given the difficulty in predicting future market conditions/flows/bookings. Without the flexibility to adjust prices, IUK's ability to maintain capacity to the benefit of the market and consumers is threatened. Without captive demand and faced with competition, IUK cannot simply adjust tariffs to "recover" revenue in the next tariff period. Additionally, as mentioned above, consulting on the multipliers helps inform competing assets of the likely IUK tariff structure and thereby undercut it.

37.1 (c) unreasonably distort cross-border trade

See comments made below concerning the distortion of competition with other infrastructure: Consulting on IUK's mutliplier levels only serves to reveal a pricing strategy months in advance of the acutal auctions. This enables competitors to undercut IUK, and so resultant flows may be different to what would have occurred if there were a level playing field. Over time this would not be sustainable. If IUK exits the market there would be a permanent distortion to cross border trade.

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

We do not believe that, as a merchant asset, IUK's tariffs should be set by NRAs. Other competing flexibility assets have no such restriction. It is not appropriate for IUK's proposed pricing structure to be consulted on and for IUK to be locked into it. Revealing commercially sensitive to competitors would be detrimental to IUK and would be unfair treatment compared to other flexibility assets under no such requirement. IUK needs flexibility to respond to changing market conditions and compete fairly with other flexibility assets who are not subject to the European Network Codes. It needs to be able to determine the best tariff structure itself depending on market conditions. Otherwise IUK cannot compete effectively and its financial viability is threatened. This distorts competition.

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

IUK is a market asset with full market exposure in a competitive environment. This market dictates what is a competitive tariff. It is not appropriate therefore for NRAs to set short term (multiplier) prices.

We also mentioned earlier that a formulistic approach cannot be used to determine IUK's tariffs given the unpredictable nature of its flows and no baseline demand (see Annex 2). It is therefore not practical for IUK to firstly discuss with NRAs a multiplier proposal before the NRAs consult on the appropriate levels. Working the timeline for such a process suggests that around December/January every year IUK would be speaking to NRAs about appropriate multiplier levels for the coming gas year and provide additional information as required. NRAs would assess and come to their initial view by around February before preparing a consultation running in that month. An NRA decision would be needed by May and IUK would then publish its proposed tariff structure in June, a month before the annual CAM auction. This is not practical, taking into account the specific nature of interconnectors, and most especially the

highly variable nature of interconnector flows compared to those of a typical TSO. There is a real risk that IUK could lock in an uncompetitive tariff for multiple months without the ability to change it.

Derogation from Article 29(a)and 29(b)(i)

IUK requests a derogation from paragraph(a) and paragraph (b)(i) of Article 29. For the avoidance of doubt, the first paragraph of Article 29 and paragraph (b)(ii) shall apply. References to Article 29 in the remainder of the TAR NC shall be treated as not including those paragraphs of those articles in respect of which IUK has been granted a derogation.

Article 29

Information to be published before the annual yearly capacity auction

For interconnection points and, where the national regulatory authority takes a decision to apply Regulation (EU) 2017/459, points other than interconnection points, the following information shall be published before the annual yearly capacity auction in accordance with the requirements set out in Articles 31 and 32 by the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority:

(a) for standard capacity products for firm capacity:

(i) the reserve prices applicable until at least the end of the gas year beginning after the annual yearly capacity auction;

(ii) the multipliers and seasonal factors applied to reserve prices for non-yearly standard capacity products;

(iii) the justification of the national regulatory authority for the level of multipliers;

(iv) where seasonal factors are applied, the justification for their application.

(b) for standard capacity products for interruptible capacity:

(i) the reserve prices applicable until at least the end of the gas year beginning after the annual yearly capacity auction;

(ii) an assessment of the probability of interruption including:

(1) the list of all types of standard capacity products for interruptible capacity offered including the respective probability of interruption and the level of discount applied;

(2) the explanation of how the probability of interruption is calculated for each type of product referred to in point (1);

(3) the historical or forecasted data, or both, used for the estimation of the probability of interruption referred to in point (2).

Why a derogation is justified from Article 29(a)and 29(b)(i)

37.1 (a) not facilitate efficient gas trade and competition

Article 29(a) and 29 (b)(i) require the publication of binding (Article 12.3) short term multipliers for the standard products in June for the coming gas year. It does not facilitate efficient trade and competition because:

- It locks IUK into a tariff structure which it cannot confidently predict to be "correct" (given how unpredictable IUK's flows are) and hinders IUK's ability to react to changing market conditions. Locking in a pricing structure that turns out to be uncompetitive helps neither IUK nor shippers, and would distort trade.
- It threatens IUK's financial viability in a challenging post 2018 environment. We can see only net benefits in not forcing IUK to lock in a tariff structure so far in advance of the actual auctions, given that such a derogation would contribute to safeguarding the wider societal benefits that IUK provides.
- It also provides competing flexibility assets (who don't have to publish their own tariffs) with a four month advance notice of IUK's tariff structure for the coming gas year. They will be aware that IUK cannot change this tariff structure for the whole coming October to September gas year. This allows them to price up to this tariff structure for each of their competing products, and to take away IUK potential bookings.
- The market is demonstrably moving short term and the bulk of IUK's flows is expected to be short term; an indicative indication of the expected short term tariffs in June should therefore be sufficient information. This allows shippers to determine if a longer term product should be acquired. IUK would also be willing to provide indicative tariffs or a range and also guarantee that a shipper purchasing annual capacity would not pay anymore for capacity than a short term user. Therefore, shippers can confidently consider the annual product offer at this time and this should mitigate shippers' concerns. IUK would publish short term prices in a reasonable timeframe before the relevant auction. Given that it has full market exposure it is in IUK's interest to do that and to find the optimum balance.

37.1(b) not provide incentives for investment for new capacity or to maintain existing levels of capacity

Furthermore building on what we have said above the risk otherwise is locking in an uncompetitive tariff for multiple months without the ability to change it. This risks IUK's financability and ability to maintain capacity. Ultimately this risks the wider value IUK brings GB and Belgian consumers. Overall therefore there is a net benefit in allowing this derogation.

37.1 (c) unreasonably distort cross-border trade

A distortion to cross border trade would arise from applying this Article:

- Without the ability to adjust tariffs to changing market conditions and taking into account the unpredictable nature of IUK's utilisation, there is a high probability of periods of IUK being stuck with unsuitable/uncompetitive tariffs. This is neither to the benefit of shippers or IUK and would distort cross border trade.
- Other flexibility assets, who are under no such obligation to publish their tariffs, would be able to price below IUK and take bookings via alternative routes.

- The potential closure of cross border capacity if IUK must reveal commerically sensitive tariff structure information and not have the ability to adjust those tariffs.

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

As a merchant interconnector, IUK will needs the flexibility to respond to changing market conditions and compete fairly with other flexibility assets who are not subject to the European Network Codes and therefore can continue to respond to changing market conditions. There is a real risk IUK could lock in an uncompetitive tariff for multiple months without the ability to change it. This risks IUK's viability and its ability to maintain capacity. IUK cannot simply recover revenues from captive demand in a subsequent period, in the same way that national TSOs are able to do. The ability to be able to react to changing market conditions is necessary and will benefit both IUK and shippers.

A further concern, as already mentioned, is that the publication of binding tariffs in June provides competing flexibility assets (who don't have to publish their own tariffs) with a four month advance notice of IUK's tariff structure for the coming gas year. They will be aware IUK cannot change this tariff structure for the whole coming October to September gas year. This allows them to price up to this tariff, for some or all of that period to take away bookings.

37.1 (e) not be implementable when taking into account the specific nature of interconnectors

As outlined in the justification for a derogation from Article 12.3 and Article 13, flows and consequent bookings are significantly more unpredictable for IUK as a physically bi-directional arbitrage interconnector, than for national TSO transmission networks. This makes locking in short term tariffs months in advance extremely difficult and could lock in tariffs which turn out to be uncompetitive, which benefits neither IUK nor shippers. With Article 29(a) and 29(b)(i) requiring prices to be published a month before the annual CAM auctions for the subsequent gas year it means IUK would need to be able to accurately predict flow directions and appropriate short term tariffs multiple months before an actual auction. For September we estimated this to be 20 months before (taking into account the need for discussions with NRAs about the multipliers before a NRA consultation and decision on the multipliers as envisaged in Article 28.) This is not achievable.

Derogation from 30.1(a)(ii), 30.1(b)(iii)(2), 30.2

IUK requests a derogation from sub-paragraphs (a)(ii) and (b)(iii)(2) of paragraph 1 and paragraph 2 of Article 30. References to Article 30 in the remainder of the TAR NC shall be treated as not including those paragraphs from which IUK has obtained a derogation

Article 30 **Information to be published before the tariff period**
1. *The following information shall be published before the tariff period in accordance with the requirements set out in Articles 31 and 32 by the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority:*
(a) *information on parameters used in the applied reference price methodology that are related to the technical characteristics of the transmission system, such as:*

(i) technical capacity at entry and exit points and associated assumptions;

(ii) forecasted contracted capacity at entry and exit points and associated assumptions;

(iii) the quantity and the direction of the gas flow for entry and exit points and associated assumptions, such as demand and supply scenarios for the gas flow under peak conditions;

(iv) the structural representation of the transmission network with an appropriate level of detail;

(v) additional technical information about the transmission network, such as the length and the diameter of pipelines and the power of compressor stations.

(b) the following information:

(i) the allowed or target revenue, or both, of the transmission system operator;

(ii) the information related to changes in the revenue referred to in point (i) from one year to the next year;

(iii) the following parameters:

(1) types of assets included in the regulated asset base and their aggregated value;

(2) cost of capital and its calculation methodology;

(3) capital expenditures, including:

(a) methodologies to determine the initial value of the assets;

(b) methodologies to re-evaluate the assets;

(c) explanations of the evolution of the value of the assets;

(d) depreciation periods and amounts per asset type.

(4) operational expenditures;

(5) incentive mechanisms and efficiency targets;

(6) inflation indices.

(iv) the transmission services revenue;

(v) the following ratios for the revenue referred to in point (iv):

(1) capacity-commodity split, meaning the breakdown between the revenue from capacity-based transmission tariffs and the revenue from commodity-based transmission tariffs;

(2) *entry-exit split, meaning the breakdown between the revenue from capacity-based transmission tariffs at all entry points and the revenue from capacity-based transmission tariffs at all exit points;*

(3) *intra-system/cross-system split, meaning the breakdown between the revenue from intra-system network use at both entry points and exit points and the revenue from cross-system network use at both entry points and exit points calculated as set out in Article 5.*

(vi) *where and to the extent that the transmission system operator functions under a non-price cap regime, the following information related to the previous tariff period on regarding the reconciliation of the regulatory account:*

(1) *the actually obtained revenue, the under- or over-recovery of the allowed revenue and the part thereof attributed to the regulatory account and, if applicable, sub-accounts within such regulatory account;*

(2) *the reconciliation period and the incentive mechanisms implemented.*

(vii) *tended use of the auction premium.*

(c) *the following information on transmission and non-transmission tariffs, accompanied by the relevant information related to their derivation:*

(i) *where applied, commodity-based transmission tariffs referred to in Article 4(3);*

(ii) *where applied, non-transmission tariffs for non-transmission services referred to in Article 4(4);*

(iii) *the reference prices and other prices applicable at points other than those referred to in Article 29.*

2. In addition, the following information shall be published with regard to transmission tariffs:

(a) explanation of the following:

(i) the difference in the level of transmission tariffs for the same type of transmission service applicable for the prevailing tariff period and for the tariff period for which the information is published;

(ii) the estimated difference in the level of transmission tariffs for the same type of transmission service applicable for the tariff period for which the information is published and for each tariff period within the remainder of the regulatory period.

(b) at least a simplified tariff model, updated regularly, accompanied by the explanation of how to use it, enabling network users to calculate the transmission tariffs applicable for the prevailing tariff period and to estimate their possible evolution beyond such tariff period.

3. For the points excluded from the definition of relevant points referred to in point 3.2(1)(a) of Annex I to Regulation (EC) No 715/2009, the information on the amount of forecasted contracted capacity and the forecasted quantity of the gas flow shall be published as set out in point 3.2(2) of Annex I to Regulation (EC) No 715/2009.

Why a derogation is justified from 30.1(a)(ii), 30.1(b)(iii)(2), 30.2

37.1 (a) not facilitate efficient gas trade and competition

The obligations in this Article applied to IUK would harm competition. Only interconnectors, among competing flexibility assets, have these transparency obligations to share commercially sensitive information with the market on forecasted bookings, capital costs and potential tariff evolution. Competitors under no such obligation would gain an unfair advantage. For example any assumptions that IUK makes about future bookings could be useful information and be used to competitive advantage. Publishing likely tariff evolution more obviously helps competitors to understand the direction and scale of any future tariff changes. Revealing cost of capital also hinders IUK's ability to negotiate a better rate from alternative lenders given they would be in a position to offer a rate just under IUK's published current cost of capacity. Ultimately this could threaten IUK's business viability. If IUK capacity is lost the remaining flexibility assets would, through less competition, have the potential to charge higher tariffs. This would be an inefficient outcome.

Furthermore, some of the obligations to enable shippers to consider tariff evolution e.g. forecasted capacity Article 30.1 a(ii) and a tariff model (Article 30.2b) are not practical taking into account the nature of IUK. It is very difficult for IUK to adopt a mechanistic approach given the difficulty in predicting forecasted bookings, as shown in Annex 2. Attempting to do so could risk sharing misleading information with the market, which would be detrimental to efficient gas trade.

37.1(b) not provide incentives for investment for new capacity or to maintain existing levels of capacity

We have highlighted earlier our concern about the potential cost to IUK if commercially sensitive information is published while competitors are under no such obligation. This enables other flexibility assets, under no such restrictions, to undercut IUK and take away bookings. We have highlighted in Annex 2 that IUK has a revenue challenge. If competitors are able to exploit this uneven transparency obligation, vital revenue could unfairly be lost which threatens IUK's ability to maintain existing levels of capacity.

37.1(c) unreasonably distort cross-border trade

From a level playing field perspective, IUK does not believe it would be appropriate to publish commercially sensitive information on forecasted bookings, capital costs and information on how tariffs could involve. We have outlined in the Annexes that IUK is in a competitive market (Annex 1) and the potential harm to IUK if competitors take advantage of knowing IUK's tariffs and their proposed evolution. This unreasonably distorts trade.

37.1(d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector

From a competition point of view, IUK does not believe it would be appropriate to publish commercially sensitive information on forecasted bookings, capital costs and information on how tariffs could involve. This unreasonably distorts trade as only interconnectors have the transparency obligation.

37.1(e) not be implementable when taking into account the specific nature of interconnectors

The Article 30.2(b) requirement to provide shippers a simplified tariff model to calculate and estimate tariff evolution is not practical. The specific nature of interconnectors means flows and resultant bookings are difficult to predict and hence makes forecasting capacity (Article 30.1(a)(ii)) and publishing

that information to accurately forecast tariff evolution impractical. A formulistic approach cannot be used to determine the tariffs. Furthermore, even if IUK could make assumptions in these areas we would be concerned about publishing commercially sensitive information on how the level of transmission tariffs are likely to evolve.

Derogation from 31.2(a)

IUK requests a derogation from paragraph 2(a) of Article 31. References to Article 31 in the remainder of the TAR NC shall be treated as not including those paragraphs of those articles in respect of which IUK has been granted a derogation.

Article 31

Form of publication

1) *The information referred to in Articles 29 and 30 shall be published as set out in Article 32 via a link on the platform referred to in point 3.1.1(1)(h) of Annex I to Regulation (EC) No 715/2009 to the website of the respective entity.*

Such information shall be accessible to the public, free of charge and of any limitations as to its use. It shall be published:

(a) in a user-friendly manner;

(b) in a clear, easily accessible way and on a non-discriminatory basis;

(c) in a downloadable format;

(d) in one or more of the official languages of the Member State and, unless one of the official languages of the Member State is English, to the extent possible, in English.

2) *The following information shall be published for interconnection points on the platform referred to in point 3.1.1(1)(h) of Annex I to Regulation (EC) No 715/2009:*

(a) at the same time as set out in Article 29, the reserve prices for standard capacity products for firm capacity and for standard capacity products for interruptible capacity;

(b) at the same time as set out in Article 30, a flow-based charge referred to in Article 4(3)(a), where applied.

3) *The information referred to in paragraph 2 shall be published in the following manner:*

(a) as set out in paragraph 1(a) to (c);

(b) in English;

(c) in a standardised table which shall include at least the following information:

(i) the interconnection point;

(ii) the direction of the gas flow;

(iii) the names of the relevant transmission system operators;

(iv) the start and the end time of the product;

(v) whether the capacity is firm or interruptible;

(vi) the indication of the standard capacity product;

(vii) the applicable tariff per kWh/h and per kWh/d in the local currency and in the euro taking into account the following:

(1) where the applied capacity unit is kWh/h, the information on the applicable tariff per kWh/d shall be non-binding, and vice versa;

(2) where the local currency is other than the euro, the information on the applicable tariff in euro shall be non-binding.

In addition, at the same time as set out in Article 30, such standardised table shall include the simulation of all the costs for flowing 1 GWh/day/year for each interconnection point in the local currency and in the euro subject to point vii(2).

4) *Where the information referred to in paragraph 2 is different from the respective information referred to in paragraph 1, the respective information referred to in paragraph 1 shall prevail.*

Why a derogation is justified from paragraph 2(a) of Article 31

37.1 (a) not facilitate efficient gas trade and competition;

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;

37. 1(c) unreasonably distort cross-border trade;

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

This provision is linked to Articles 29. IUK is seeking a derogation from Article 29 for the reasons outlined earlier.

Given the link to Article 29, a derogation is required from Article 31.2(a) as it requires the publication of tariffs at the same time as indicated in Article 29.

Derogation from 32(a),(c) and the last paragraph

IUK requests a derogation from paragraph (a), (c) and the last paragraph of Article 32 with respect to reserve prices for standard capacity products for firm capacity. References to Article 32 in the remainder of the TAR NC shall be treated as not including those paragraphs of those articles in respect of which IUK has been granted a derogation.

Article 32

Publication notice period

The deadline for the publication of the information set out in Articles 29 and 30 shall be as follows:

(a) for the information set out in Article 29, no later than thirty days before the annual yearly capacity auction;

(b) for the information set out in Article 30, no later than thirty days before the respective tariff period;

(c) for the respective transmission tariffs updated within the tariff period as set out in Article 12(3), immediately after the approval in accordance with Article 41(6)(a) of Directive 2009/73/EC.

Each update of the transmission tariffs shall be accompanied by information indicating the reasons for the changes in their level. Where Article 12(3)(b) is applied, it shall also be accompanied by the updated report referred to in Article 29(b) for the respective types of standard capacity products for interruptible capacity.

Why a derogation is justified from paragraph (a), (c) and the last paragraph of Article 32

37.1 (a) not facilitate efficient gas trade and competition;

37.1 (b) not provide incentives for investment for new capacity or to maintain existing levels of capacity;

37.1(c) unreasonably distort cross-border trade;

37.1 (d) distort competition with other infrastructure operators that offer services of a similar nature to those of the interconnector;

37.1 (e) not be implementable when taking into account the specific nature of interconnectors.

This provision is linked to Articles 12(3), 29 and 30. IUK is seeking a derogation from Articles 12(3), 29 and 30 for the reasons outlined earlier.

Given the link to Articles 12(3), 29 and 30, a derogation is required from paragraph (a), (c) and the last paragraph of Article 32 as it requires the publication of information indicated in these Articles.

Annex 1: IUK's relevant market and competition with other flexibility assets

This Annex briefly sets out key conceptual features of the flexibility market in which IUK competes, how IUK serves alongside other assets to meet GB and Belgian market needs, and how IUK is not subject to a level playing field in terms of the regulation applied to competing assets.

A typical national transmission network is a natural monopoly with many entry/exit points. It transports gas from domestic or import sources to distribution networks delivering to customers. National transmission network pricing and access arrangements are regulated to ensure that the monopoly position is not abused by restricting access in order to charge excessively high prices from mainly captive customers. A key objective of the TAR NC is to provide more transparency around how the tariffs are calculated by these TSOs. IUK by contrast is not a monopoly transmission provider. IUK is just one of a number of flexibility providers to the markets it connects. IUK's customers are not captive. These customers can choose alternative routes to get gas to their customers. IUK's tariffs are therefore constrained by the competitive flexibility market. IUK's future success in securing capacity bookings requires an adaptive tariff structure which responds to market conditions.

A1.1 The flexibility market

Gas demand in Europe is typically higher in winter due to colder temperatures and therefore a seasonal demand pattern is observed. The reliable operation of a gas network requires this variable profile of demand to be accommodated, both in its predictable and unpredictable aspects. Shippers via market based balancing are incentivised to ensure their portfolios are balanced. These elements create the need for both physical and commercial gas flexibility. IUK's relevant market is this flexibility market and it helps shippers to meet both their physical demand for flexibility and commercial demand for flexibility in both the GB and Continental geographical markets. Other assets also directly compete in this market, in competition with the services provided by IUK.

Physical demand for flexibility is required to address both predictable variations in demand and unpredictable variations in demand and supply. Predictable changes in demand occur due to changes in temperature e.g. expected colder weather in the winter period creating seasonal demand. Unpredictable changes in demand and supply occur when forecasts turn out to be inaccurate or there is some shock. For example, colder temperatures than expected or there is a technical failure of a key supply source. Unpredictable changes can occur any time of year.

As well as the physical need to balance national networks, there is a commercial need for shippers to manage their portfolios and avoid financial penalties for being out of balance. This often creates a need for commercial flexibility even when the system overall is in physical balance. Shippers may also wish to use flexibility to exploit arbitrage opportunities between markets and different balancing regimes (some regimes have more hourly balancing constraints than others which focus on balancing end of day positions).

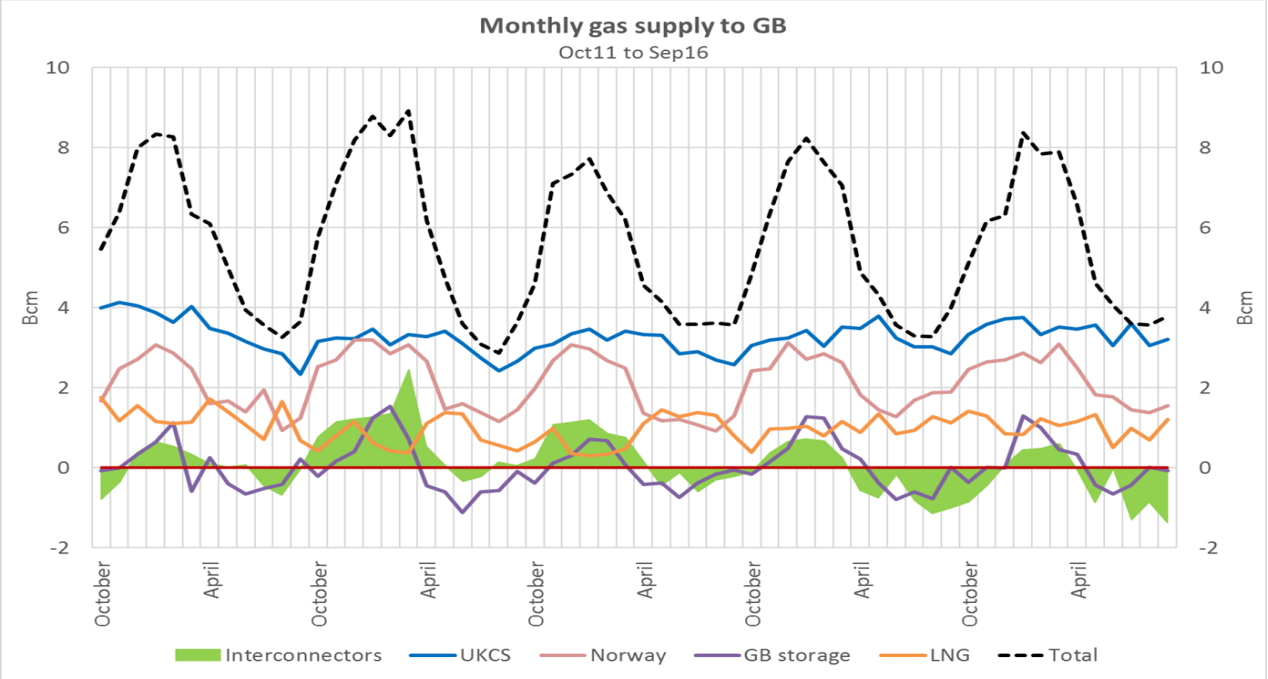
A1.2 IUK as a flexibility supply source into the GB market

IUK's interconnection point at Bacton enables flows into and out of the GB network. It is one of a number of alternative supply sources to meet GB demand. Flows are available from indigenous UKCS production sources, Norway, LNG, GB Storage, and the IUK and BBL interconnectors. Flexibility can also be provided by demand side response.

Figure A1.1 below shows monthly gas supplies into the GB over the period of October 2011 to September 2016. Total supplies to GB are very seasonal, reflecting the seasonal demand profile. Seasonal flexibility

comes from various sources: indigenous production (UKCS), Norway, LNG, GB Storage, and gas interconnectors (IUK and BBL). GB demand side response can also help GB to meet its seasonal peaks. IUK is therefore one of six seasonal flexibility sources to this market. Interconnectors flows[10] are typically seasonal flows out of GB via IUK in the summer period and both interconnectors flow gas into GB in the winter period. In this way IUK is most similar to seasonal GB storage, with "storage injections" from the market via IUK exports moving to continental storage in summer months; and "storage withdrawals" via both interconnectors importing gas into GB in the winter months.

Figure A1.1: GB seasonal flexibility supply sources



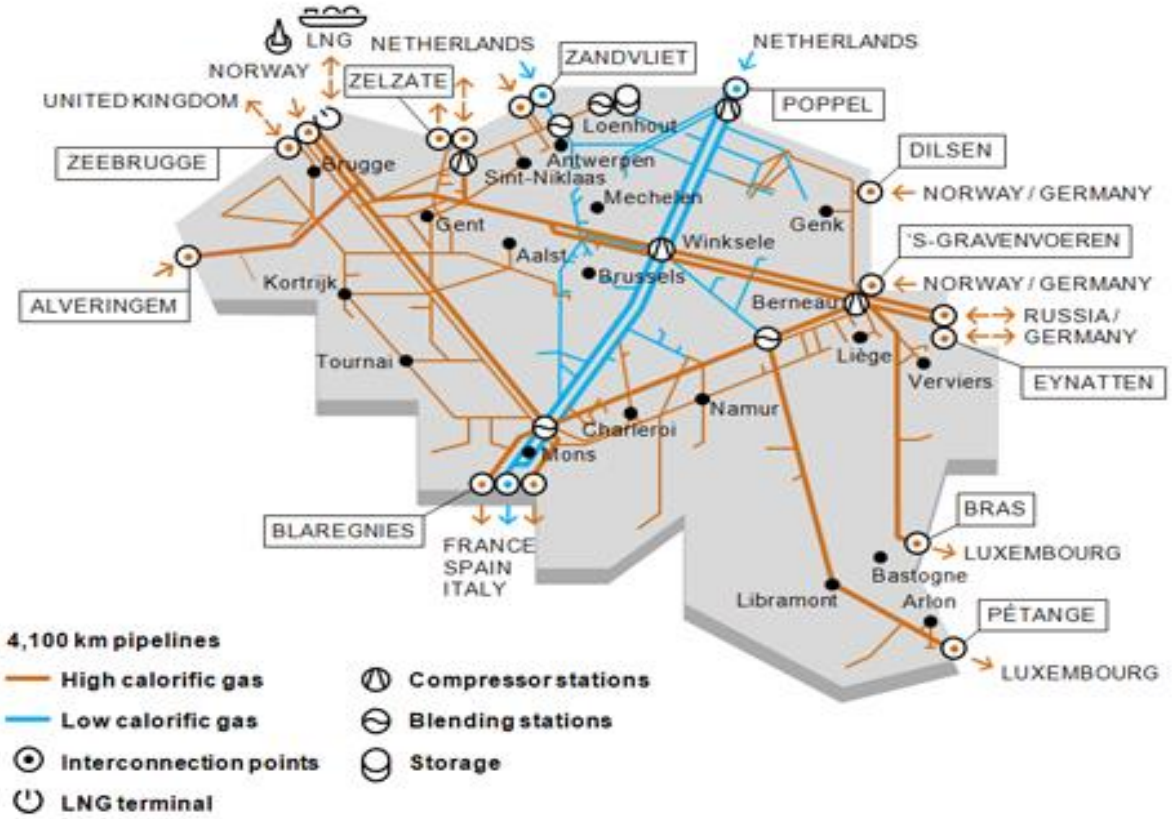
Source: Energy Trends

A1.2 IUK as a flexibility source into Belgium and Continental markets

Similarly IUK's connection at Zeebrugge into the Belgium market enables GB production and LNG landing in the GB market to flow into Belgium and, using Fluxys' network, into other Continental European markets. IUK's interconnection point as Zeebrugge is one of a number of alternative competing supply sources into Belgium (as illustrated below). Gas entering the continental markets can also be via LNG, upstream production from Norway or the Netherlands or transited from other markets. Belgium is not dependent on IUK flows to meet its national demand requirements. A typical flow pattern is for gas flowing across IUK from GB to Belgium in the summer periods to be injected into European Continental storage facilities (including Belgium's Loenhout storage facility). This gas can then be withdrawn in the winter months to meet high seasonal demand, including flowing back into the GB market to meet seasonal GB demand.

[10] Interconnector flows are both IUK and BBL imports and IUK exports (as the only physically bidirectional point).

Figure A1.2: The Belgian gas transmission network



Source: Fluxys

A1.4 The lack of a level playing field for competing providers of flexibility services

A derogation from some of the TAR NC Articles is necessary to provide IUK with a level playing field when competing with alternative flexibility providers. Promoting effective competition and a level playing field are two key principles enshrined in Directive 2009/73/EC. As a general principle there should be as much consistency as possible in the obligations on competing entities to ensure they are able to compete fairly. However, the regulatory rules applying to interconnectors are far more commercially restrictive. Interconnectors are the only flexibility assets required to implement the European Network Codes. These Network Codes are very prescriptive in what capacity products can be offered, when they can be offered and how these products should be priced. They restrict IUK's ability to develop and adapt new commercial solutions and tailor solutions to customer needs.

Relevant to the TAR NC, the tariff regulatory rules are far more commercially restrictive on interconnectors compared to the tariff rules applying to alternative flexibility sources who are in competition with IUK. IUK needs a level playing field to compete and develop a viable business model post 2018. Below we highlight key provisions applying to other asset classes.

Upstream production:

Third party access in upstream gas infrastructure is negotiated in Great Britain. There is a non-statutory industry code which provides guidelines for principles and procedures for third party access. This code was developed by the industry (Oil and Gas UK) with the then Department Energy and Climate Change (DECC)[11]. The principles in this code include the need for access to be transparent and non-discriminatory and for parties to agree fair and reasonable tariffs (where risks taken are reflected by rewards). The Code says high level infrastructure information should be published but it does not require tariffs to be fixed for a defined period nor suggest caps on prices. It also does not suggest indicative prices should be consulted upon. Once a third-party agreement has been agreed an ex-post summary information on the contract should be published which includes the tariff range for the services provided[12].

LNG:

The LNG facilities in the neighbouring markets that IUK connects are mainly exempt facilities[13]. The three facilities in GB (South Hook, Dragon and Isle of Grain) are all exempt facilities and so is the Gate LNG facility in the Netherlands. Other than regularly publishing the amount of gas in each facility and flows, there is no obligation on these facilities to consult on and publish tariffs, nor require tariffs to be fixed for a duration of time.

Zeebrugge LNG on the other hand is a facility with regulated third party access (rTPA). It is regulated through a price control with tariffs approved by the Belgian NRA, CREG. Similar to TSOs, rTPA LNG facilities must maximise capacity and implement/publish non-discriminatory terms of access. rTPA LNG facilities are, however, unlike IUK, not required to bundle capacity with connected transmission operators nor mandated to sell standard capacity on a prescriptive timetable. LNG operators are considered best placed to determine the appropriate mix of services[14]. rTPA facilities are required to publish information on tariff deviation and the structure of tariffs[15]. Zeebrugge LNG hence publishes its approved tariffs as do other rTPA facilites across Europe. There is, however, no restriction from European regulations which mandate a tariff structure being locked in for a certain duration. Artilce 15(1) C of the Gas Regulation[16] requires relevant information on the use and the availability of services to be published in a timetable meeting users reasonable commercial needs. It does not prescribe exactly when information should be published. Furthermore, other than a requirement not to price short term contracts arbitrarily higher than annual contracts[17] there is no cap and floor on short term prices. Ofgem has said in its guidance on

[11] Now within the British Department for Business, Energy and Industrial Strategy.
[12] Code of Practice on Access to Upstream Oil and Gas Infrastructure on the UK Continental Shelf: http://oilandgasuk.co.uk/wp-content/uploads/2015/05/ICoP-revised-2013.pdf. It is also noted that if parties cannot agree terms, an application can be made to the Oil and Gas Authority (OGA) to resolve the dispute. The OGA has the power to determine the terms including the tariffs: https://www.ogauthority.co.uk/media/2712/oga_guidance_disputes-over-third-party-acccess-to-upstream-infrastructure.pdf
[13] Under EU legislation, interconnectors, storage facilities and LNG import terminals may apply for an exemption from being required to offer access to third parties. This is intended to promote the development of such facilities.
[14] See p11 of Ofgem's 2012 Guidance on the regulated TPA regime for LNG facilities in GB (https://www.ofgem.gov.uk/ofgem-publications/40393/guidance-regulated-third-party-access-regime-liquefied-natural-gas-facilities-gb-pdf).
[15] Article 19 of Regulation (EC) No 715/2009 on conditions for access to the access to the natural gas transmission networks outlines transparency requirements concerning storage facilities and LNG facilities.
[16] Regulation (EC) 715/2009.
[17] Article 15.3 of Regulation (EC) 715/2009.

rTPA for LNG in GB[18] that it did not intend to set out guidance on the approach LNG facilities should adopt to determine reserve prices. It also considered that the publication of the reserve price methodology might affect the bidding behaviour of market participants and lead to suboptimal investment decisions. It therefore would only require reserve price methodology information to be provided to Ofgem to enable it to assess that any allocation arrangement was transparent, objective and non-discriminatory[19].

Storage:

In GB, there are several medium range storage facilities which are mainly exemption facilities. Hornsea and Rough (which recently announced it is to close) are negotiated TPA (nTPA) regimes. Fluxys's Loenhout facility in Belgium has a rTPA with tariffs approved by CREG. The Netherlands also has a number of storage facilities some with exemptions and others (e.g. Bergermeer) offering nTPA.

Similar rules to rTPA LNG apply to third party access to storage facilities. These storage facilities must maximise capacity and implement/publish non-discriminatory terms of access. Unlike IUK however, these storage facilities are not required to bundle capacity with connected transmission operators nor are they mandated to sell standard capacity on a prescriptive timetable. As Ofgem acknowledge in their guidance on the regulatory regime for GB Storage[20], nTPA "provides storage facility owners with significant scope to develop the access arrangement that will meet the needs of their customers"[21]. TPA Storage facilities are required to publish information on tariff deviation and the structure of tariffs. Many storage facilities therefore publish tariff information. It is however noted that there is no mandatory obligation to consult on indicative prices nor publish storage reserve prices under the European regulations. Ofgem, in its guidance, encouraged storage owners to however publish indicative prices in line with European guidelines of good practices[22]. There is furthermore, no restriction from European regulations which mandate a tariff structure being locked in for a certain duration. Other than a requirement not to price short term contracts arbitrarily higher than annual contracts[23] European regulations do not prescribe a cap/floor on short term product prices. Ofgem's guidance said that it did not intend to define price methodologies for storage owners that did not have significant market power[24]. Instead it said that it was storage owners' own responsibility to ensure prices were non-discriminatory and objective.

Conclusion

IUK is one of several competing flexibility assets. Because of the different regulatory obligations applying to these assets, as highlighted above, some of the competing flexibility assets could use IUK's published and rigid tariff structure obligations to undercut any IUK offer. IUK would not be able to be able to respond. Knowing this, these competing assets may not offer tariffs as low as they otherwise would have done in a competitive environment. All of this harms effective and dynamic competition in the flexibility market.

[18] See footnote 15 for link to guidance document.
[19] See p14 of the Ofgem guidance on the regulated TPA regime for LNG facilities in GB (link given in footnote 15).
[20] Ofgem's Guidance on the regulatory regime for gas storage facilities in Great Britain (version 2) https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/guidance_on_the_regulatory_regime_for_gas_storage_facilities_in_great_britain_version_2_0.pdf
[21] P6 of the guidelines referred to in footnote 21.
[22] Guidelines of Good TPA Practice of Storage System Operators (GGPSSO) by the European Regulators Group for Elecricity and Gas http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Gas/Tab/C11-GST-15-03_amdt%20GGPSSO%20on%20CAM%20and%20CMP_14-July-2011.pdf
[23] Article 15.3 of Regulation (EC) 715/2009.
[24] P14 of Guidelines referred to in footnote 21.

To have a level playing field with non-exempt flexibility assets, IUK requires derogations from the Articles identified earlier. Existing obligations would continue which already provide significant transparency and IUK is committed to additional safeguards to ensure that its prices are fair and transparent:

- IUK's obligations under the Belgian Gas Act and GB interconnector licence obligations continue to require IUK to consult stakeholders for at least one month and obtain NRA approval for changes to the CM;
- IUK is obliged to review the CM annually to ensure that it remains compliant with the relevant charging methodology objectives under its interconnector licence;
- IUK must continue to publish a charging statement with applicable prices and charges;
- IUK will be implementing the other applicable provisions of the TAR Code including publishing relevant information on the ENTSOG transparency platform;
- IUK is committed to providing NRAs, confidentially, the parameters/ assumptions used to derive its proposed annual reference price, before its publication;
- IUK's is committed to publishing prices sufficiently in advance of offering the capacity;
- IUK will continue to provide capacity and price information for the standard CAM auctions as required by the PRISMA rules to comply with the CAM network code;
- IUK is committed to publishing indicative price information on its standard CAM products for the coming gas year no later than thirty days before the annual yearly capacity auction; and
- Additionally, the Belgian NRA, CREG is proposing to establish a financial control regime on IUK which is designed to provide a safeguard against excess profit[25].

[25] For further details please see: http://www.creg.be/fr/consultations

Annex 2: How IUK is utilised and its post 2018 revenue challenge

This Annex outlines some key features of IUK's historic utilisation and briefly covers the nature of the business challenge that IUK faces when its initial long term contracts expire in October 2018.

A2.1 Flexibility sources merit order

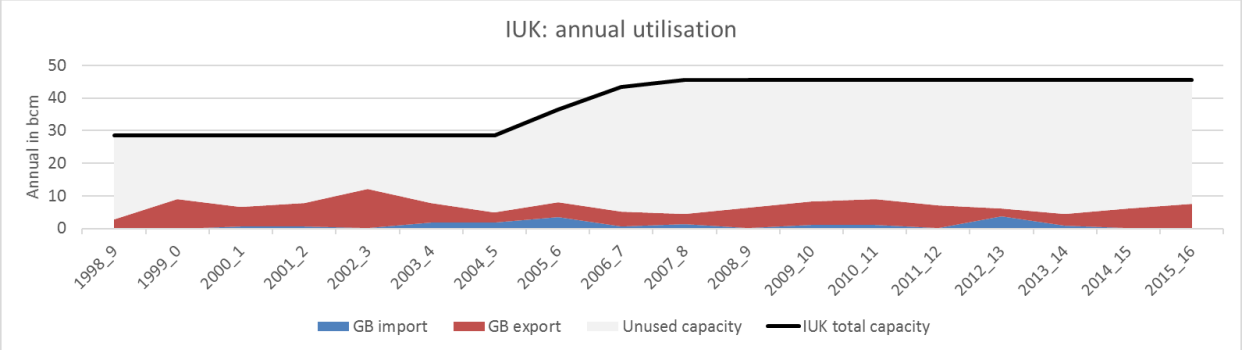
IUK's ability to compete in the provision of physical and commercial flexibility services depends largely on its comparative cost structure compared to the other flexibility providers. Also relevant to the competitive environment is how long term bookings are considered by shippers with access to various flexibility assets. If a shipper has a long term capacity booking, the capacity charges are effectively a sunk cost and therefore not considered in the calculation of whether to utilise the capacity. On the other hand, if a shipper needs to buy short term capacity, the cost of acquiring the short term capacity will be factored into the assessment of the marginal cost to flow through that flexibility asset. This typically creates a 2-tiered utilisation pattern, where assets subject to long term contracts are utilised ahead of assets which will be bought and used (when required) under short term contracts.

When modelling future utilisation patterns across the range of flexibility assets it is difficult to determine the exact cost of the different flexibility sources. A lot of information is not in the public domain and access for some flexibility assets is often on a negotiated basis e.g. LNG. Nevertheless, observing historical supply data and IUK's historical utilisation suggests IUK is a marginal source of gas supply importing into GB. It is more utilised to address unpredictable flexibility needs (additional peak demand or a supply shock). In short, GB relies on IUK for supply diversity and security of supply purposes. For flows out of the GB market to the Continental Europe, IUK has a larger role, for predictable flexibility but can also be called on for security of supply purposes.

A2.2 Low average utilisation with occasional maximum utilisation

Despite IUK capacity being treated as a sunk cost up to October 2018, IUK's average utilisation is consistently low (i.e. a fraction of its total capacity). This reflects IUK's position in the merit order, and its role as the marginal flexibility source, to be called upon when supply-demand conditions require it. As shown in the diagram below, annual utilisation has averaged 15% of the total combined import and export capacities (when measured in the period since the IUK capacity enhancement in 2006/7).

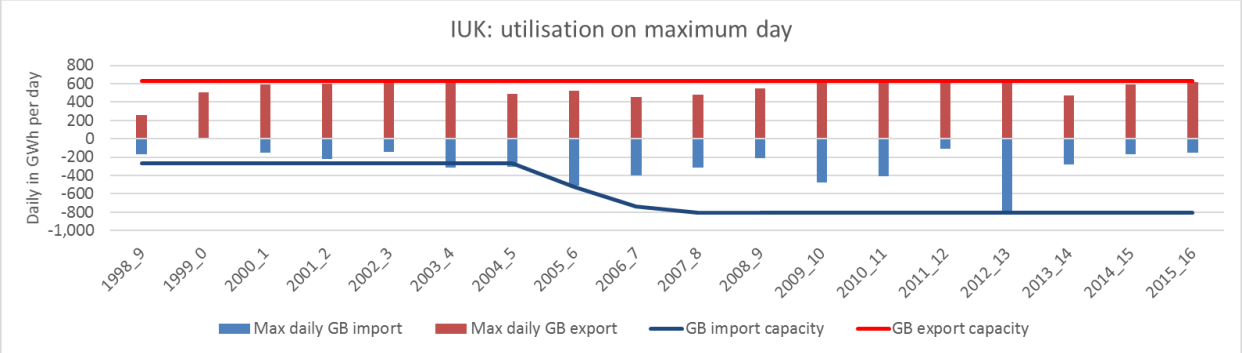
Figure A2.1: IUK's historic utilisation



Source: IUK

However, on the day of highest flow a much larger proportion of the total capacity has been used. The figure below shows the maximum daily flow in each year for GB import (blue) and for GB export (red). The full GB import capacity has been used in only 1 of the last 10 years. This demonstrates how IUK capacity is valued / used on an occasional basis to meet peak system needs. As discussed later, it will be challenging to remunerate capacity needed primarily for peak purposes, on the basis of short term, pay-when-utilised, contracts.

Figure A2.2: IUK utilisation on days of maximum import and maximum export

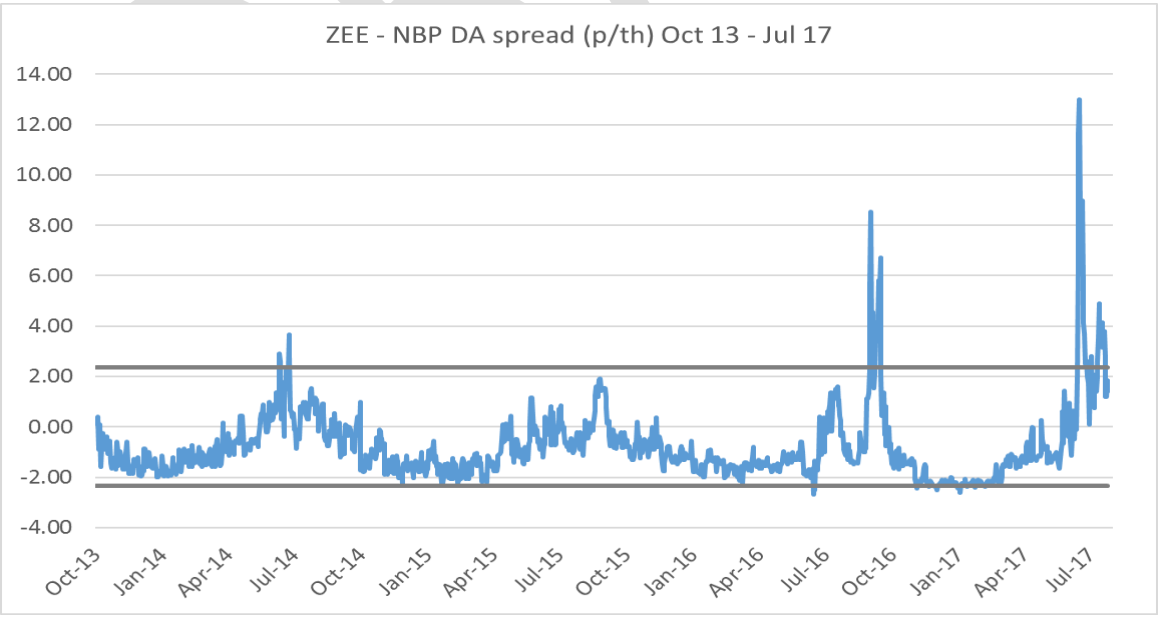


Source: IUK

A2.3 Price convergence reduces arbitrage opportunities

An important reason for the low average utilisation is the strong price convergence between the hubs either side of the interconnector pipeline. Price convergence is welcomed as a sign of market integration, but it reduces arbitrage opportunities. The figure below highlights very narrow spreads. 95% of spreads have been within +/- 2.35 p/th in the past 3 years.

Figure A2.3: Narrow spreads between the ZEE and NBP hubs



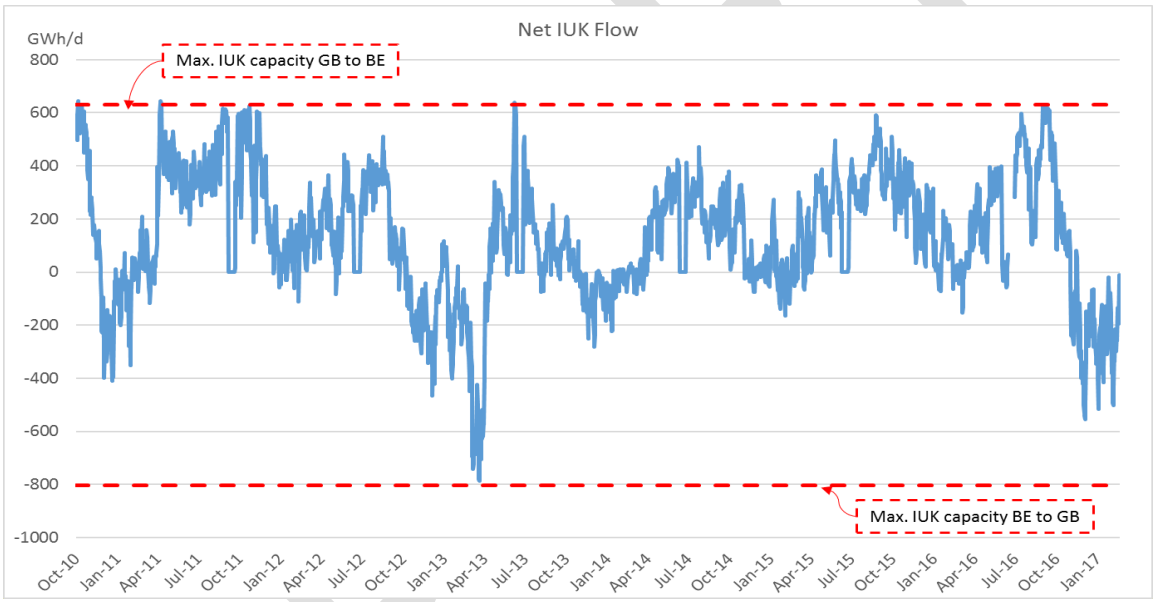
Source: IUK

Price integration has been strongly facilitated by IUK and brings economic benefits to consumers, but at the same provides a challenge to IUK when its long term contracts expire. The very fact the IUK pipeline exists and connects markets has led to this convergence in the spreads. IUK's success in harmonising prices is paradoxically the reason for the low intrinsic value of capacity when considered purely in the context of the price difference between adjacent hubs. Interconnectors remove the price difference used to justify their construction but provide stability, harmonisation and therefore lower overall prices than would be the case if they did not exist. This issue comes to the fore once the initial long term contracts expire.

A2.4 Volatility of IUK flows

IUK's flows have been highly volatile. This is not surprising given IUK's key attributes: no baseload demand, connecting markets with high price converagence, and being utlised for mainly unpredicted flexibility needs. An illustration of how variable interconnector flows are is shown below. Figure A2.4 shows historical flows over the 6 year+ period from 2010/11 to early this year. During this time the maximum GB export capacity was used for short periods of a few days on around half a dozen occasions whilst the maximum GB import capacity was only called on once – the period during in March 2013.

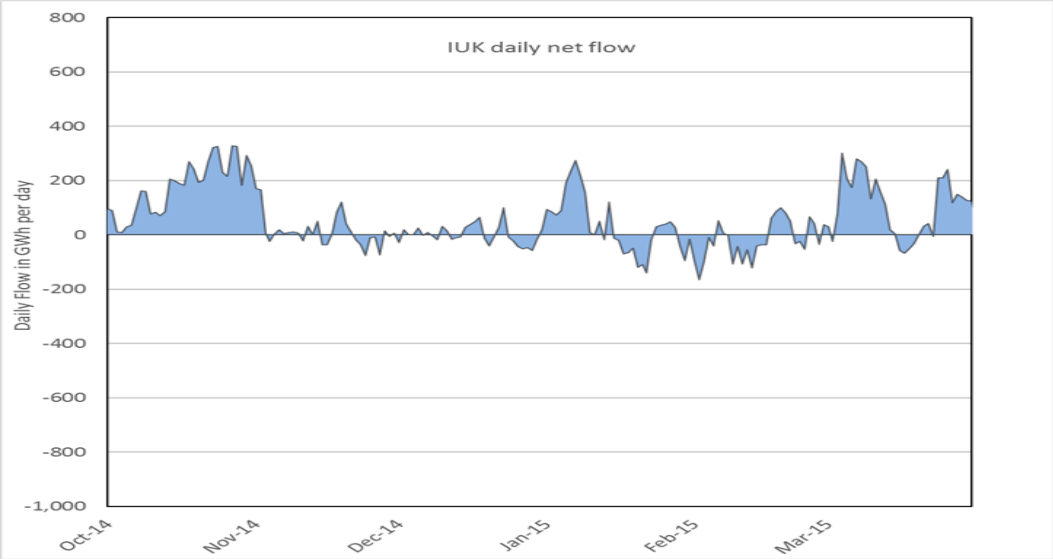
Figure A2.4: IUK Historical flows



Source: IUK

Daily flows are highly volatile and the physical capability afforded by having compressor stations at both ends of the pipeline means that the direction of flow can rapidly switch from GB import to export and vice versa. This flexibility was used extensively in the period October 2014 to March 2015 and figure A2.5 zooms in revealing that the daily net flow changed directions 39 times during the 6 months of winter. In fact a change in flow can happen at any hour of the day meaning that the IUK flexibility is available for hourly balancing.

Figure A2.5: Interconnector flows are highly variable on a day to day basis



Source: ICIS

A2.5 Recent utilisation following closure of the GB Rough Storage

IUK has recently seen higher flows both in last winter and this summer. This is largely due to the GB's largest storage facility Rough suffering technical issues and the announcement in June 2017 that it would be closing. Other flexibility providers have also seen increased utilisation of their assets in this period such as increased deliveries from Norway during the 2016/17 winter and greater cycling of mid-range storage facilities in GB.

Whilst the increased utilisation of IUK is positive we do not believe it indicates a permanent shift in IUK's flow profiles and utilisation levels compared to historical utilisation. It would be incorrect to assume that the flow patterns we have recently observed will repeat itself in the period beyond September 2018 for the following reasons:

- The expiry of IUK's long term contracts: IUK's capacity is currently under long term contracts and therefore the cost of the capacity is a sunk cost for the current system users. From October 2018 this will no longer be the case. Shippers' marginal cost of flow through IUK will increase to take account of the additional cost of IUK capacity. Shippers will optimise based on prevailing costs and their individual portfolios and requirements.

- The GB NTS charging review: There is considerable uncertainty about future charges on the NTS. The optional commodity charge (short haul tariff) is currently a key component of export flows via IUK. This charge along with capacity discounts and short term multipliers is under review. National Grid is also likely to switch to revenue recovery via capacity charges. This could lead to a fundamental change in the current cross border flow incentives.

- Response from competing flexibility assets: The flow pattern of other flexibility assets, particularly LNG, could also respond to the lack of Rough Storage in the GB market. In the recent past LNG flows have been 'counter-seasonal' (i.e. more LNG volumes has appeared in GB in summer than in winter). If LNG flows adopt a more seasonal profile (i.e. more LNG in winter than in summer), this could significantly impact the flows through IUK.

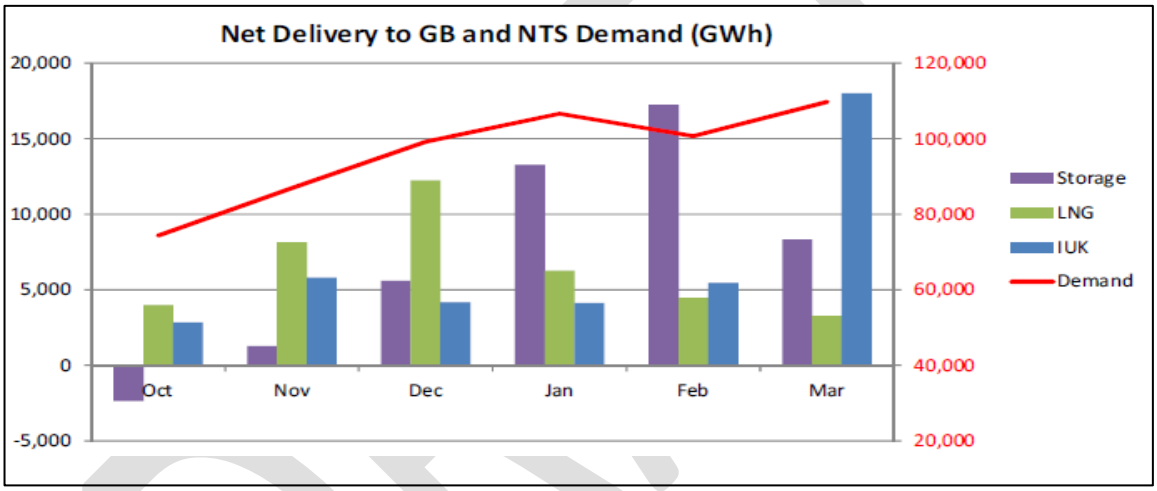
A.2.6 IUK as a vital security of supply source

Whilst average utilisation has been low, there are times when IUK's maximum capacity is critical to meeting demand and mitigating supply shocks. There have been a number of times when markets have relied strongly on IUK's full capacity. Specific examples include:

- Rough Incident in February 2006
- Ukraine supply crisis in January 2009
- Norwegian supply disruptions in January 2010
- Extended cold winter in March 2013

In March 2013, for example, there were record IUK import flows into GB in response to a very cold period late in winter when storage was depleted and LNG cargos had diverted to Asia due to high demand in the Far East. Throughout that winter IUK supplied the GB market (40,371 GWh) with more gas than Rough (38,607 GWh) or LNG (38,387 GWh) as shown in figure A2.6 below.

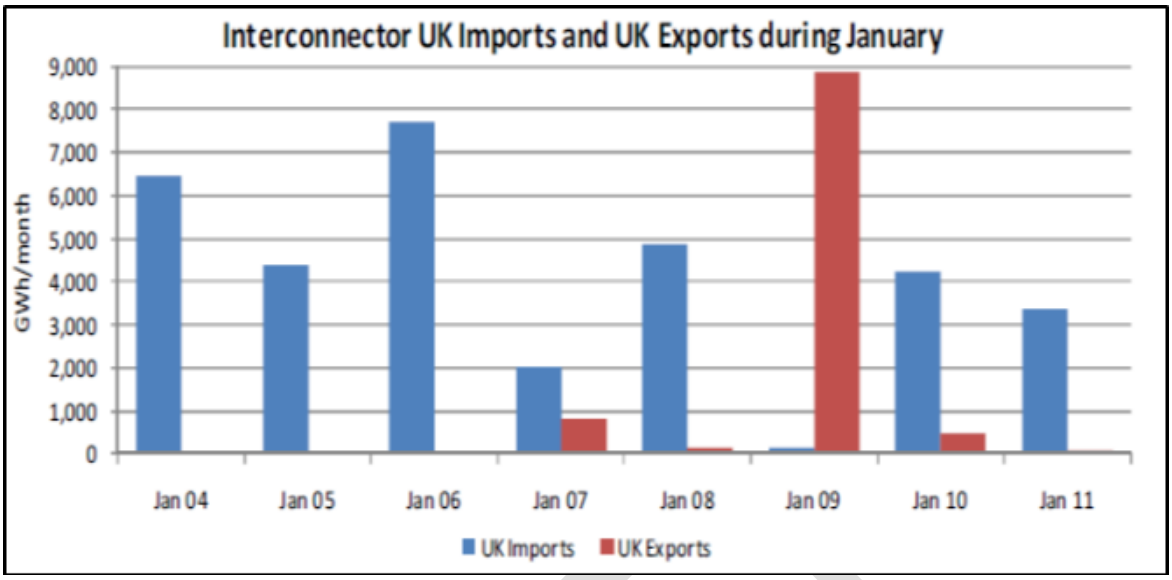
Figure A2.6: High UK demand, March 2013



Source: IUK

When a fire caused Rough to be taken out of service in February 2006, shippers were able to meet UK demand through increased utilisation of IUK, with flows increasing across a period of 3 days from around 300GWh/day (~28mcm/day) to over 500GWh/day (~46mcm/day). A further example as shown in figure A2.7 below was during the Ukraine crisis in 2009. During this period IUK exported gas to the continent in response to an acute shortage of gas and therefore high demand.

Figure A2.7 : High IUK flows into Continental Europe during the Ukraine Crisis 2009

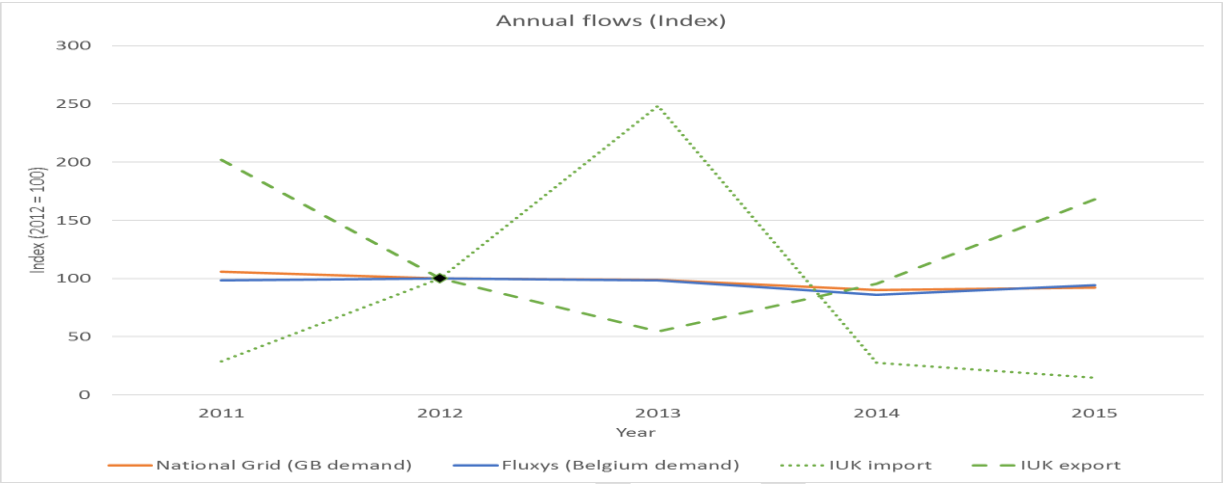


Source: IUK

With such a variable flow pattern IUK is not like a typical TSO for which a reasonable forecast can be made about flows/bookings. Figure A2.8 below provides a good illustration of this when comparing IUK annual flows compared to adjacent TSOs' annual flows. It shows relatively marginal changes in annual demand in both GB and Belgium over the period shown here (2011 to 2015). The biggest change in GB was a 9% decline in 2014 and a 13% decline in Belgium the same year compared to 2011 demand. In comparison, IUK volumes into GB changed 247% in 2013 and 76% in the GB export direction in 2015. This illustrates the difficulty for IUK in seeking to accurately forecast flows and bookings to calculate tariffs compared to national TSOs[26].

[26] National TSOs typically have an allowed revenue set for the entire network and revenue recovery split to a ratio between entry and exit points. Even if TSO's use a pricing methodology which is not postalised, they can still have a degree of socialised charging if the forecasting of bookings at individual points proves not to be accurate. IUK does not have this flexibility. For example, National Grid can mitigate forecasting errors at the Bacton IP entry point via the use of a revenue recovery commodity charge. This charge is the same at all entry points (effectively a postalised charge). In the future the NTS charging review forum has been discussing how the floating capacity charge for revenue recovery can continue to include an element of socialisation to address the challenge of accurately forecasting bookings at specific points.

Figure A2.8 : IUK flows are relatively more variable compared to adjacent national TSOs



Source: IUK, Fluxys BE, National Grid,

A 2.7 IUK's post 2018 revenue challenge

From October 1 2018, when IUK's initial long term contracts expire, IUK expects a challenging market environment. The market is increasingly moving towards short term bookings, which implies that shippers will consider short term capacity charges in their marginal cost calculations. IUK's revenues will depend on a number of factors, including locational spreads, demand-supply conditions, utilisation rates, competitive assets and their pricing, and the balance across short term and longer term bookings. IUK expects market-driven revenue to be highly volatile.

A market moving to more short term bookings

Across Europe, the market is moving more and more to short term bookings. This was highlighted again in the recent sale of annual capacity across European interconnection points in March 2017. 65% of 128 IPs on the Prisma platform sold no annual capacity. A further 13% of IPs sold under 1% of capacity and a further 9% of IP sold less than 10%. Across Europe there is very little demand for annual capacity except where it is linked to new investment.

Impact of the European Network Codes

Whilst a decline in gas demand has contributed to a shift to more short term capacity bookings another key factor has been the European network codes:

- Through the CAM and CMP provisions, shippers can profile their purchases of transmission capacity to closely match their intended use of the capacity to flow gas. CAM mandates the sale of transmission capacity through standardised products offered to the market through a regular cycle of auctions; and the required offerings include a series of short term (less than annual) products. 20% of technical capacity is also set aside for these short term products. CMP furthermore through long term use it or lose it provisions (aimed to prevent shippers from hoarding unutilised capacity) makes it harder for shippers to buy long term capacity for "insurance" purposes. On transmission assets which typically suffer no physical flow congestion, shippers can confidently expect the availability of short term products.
- TAR NC short term multiplier caps mean that shippers have a relatively strong financial incentive to rely on short term bookings for assets that they expect to use only periodically. The strength

of the incentive is proportional to the volatility in the shipper's expected flow. For assets with low but highly variable utilisation and with very high technical capacity availability (such as IUK), the incentive to book short term is likely to be strong.

Revenue projections for post 2018

Given the difficulty in predicting future flows through the pipeline, IUK has used a scenario based approach to develop a number of plausible flow scenarios that it could face in the market in the post October 2018 period. The results from this commercially sensitive analysis, suggest that the future flows through Interconnectors could be materially lower than those experienced in the past. As a result IUK needs tariff flexibility to be able to respond to changing market conditions and thereby have a greater ability to establish a financially viable business under challenging market and regulatory conditions.