

August 2017

Dear Stakeholder,

## **Consultation on IUK's Implicit Allocation Mechanism**

IUK is pursuing the implementation of an Implicit Allocation Mechanism ("IAM") to create more opportunities for the market to purchase IUK capacity, in addition to the standard Capacity Allocation Mechanism Network Code ("CAM NC") Auctions on PRISMA.

In this consultation we are seeking your views on:

- The mechanism we are proposing;
- The possible changes to the IUK Access Code ("IAC") to allow for an IAM.

This Consultation is divided into 4 parts:

- Part 1 sets out background information about IUK;
- Part 2 summarises our model for an IAM;
- Part 3 sets out our proposed timetable for introducing this allocation mechanism;
- Part 4 explains how you can help us by providing feedback on these proposals.

In accordance with IUK's interconnector licence, the Belgian Gas Act 1965 and relevant EU legislation, IUK is actively engaged in discussions with National Regulatory Authorities ("NRAs") on the introduction of an Implicit Allocation Mechanism as a way to, in addition to the CAM NC auctions on PRISMA, sell IUK capacity. Following the consultation process, IUK will, in Q4 2017, need to seek a number of approvals, including from Ofgem and CREG for the Access Rules and Charging Methodology to be modified to include this allocation mechanism.

## **PART 1. BACKGROUND INFORMATION**

### **1.1 Our role in the gas markets**

IUK owns and operates the Interconnector that runs between Bacton in the UK and Zeebrugge in Belgium. IUK is the only physically bi-directional pipeline between the UK and mainland European gas markets. As such, IUK plays an important role in the realisation of the single European energy market and in providing security of supply to both GB consumers and to European consumers in other Member States. IUK is the largest entry point and the largest exit point on the UK gas network. It delivers significant net economic benefits to European markets, through its impact on lowering wholesale energy costs, enhancing market liquidity, improving upstream competition and enhancing security of supply.

The capacity in the Interconnector pipeline is currently held under a series of long term contracts, which expire at the end of September 2018. From 1 October 2018 ("post-2018"), IUK will rely exclusively on capacity sales to secure a viable business model because, unlike most other TSOs in Europe, it is not under-written by consumers and is wholly exposed to the market. Without Implicit Allocation, which is allowed for under the CAM NC, IUK capacity will be available solely on the joint booking platform PRISMA through auctions, which follow a tightly defined timetable and product definition. This capacity will become available where economic, subject to, amongst other things,

capacity already sold<sup>1</sup>, the availability of the facilities, contractual terms and conditions and the prevailing market and regulatory conditions.

IUK is currently looking at additional ways in which we can offer capacity to the market that remain within the framework of the CAM NC. Having this flexibility will be critical to IUK's future success. We believe that having additional methods of booking will promote cross-border flows, support the efficient use of IUK capacity, attract new shippers, and reduce the overall cost to consumers. It will help to sustain the flexibility of the asset into the medium term, better satisfy the market's need to trade capacity and support the UK, Belgium and other countries' gas security of supply.

With Implicit Allocation, market players will be able to purchase capacity when they choose to. As things currently stand, the next opportunity for the market to buy post-2018 capacity will be the annual capacity auctions in July 2018. This means that there is a 16 month gap from the March 2017 auctions during which no capacity can be offered to the market. Whilst the pipeline has the technical ability to meet changing market demands, the nature of the CAM NC auction timetable limits Shippers ability to purchase IUK capacity whenever they see market value. This is an important contextual driver as the market needs the ability to buy capacity when a shift in price spreads creates an economic rationale to do so, and hence a transient demand for IUK capacity. If Shippers cannot purchase capacity when it is most required they may seek to secure gas from other, more expensive sources which would increase costs for consumers, both in the UK and Belgium. Furthermore, there is only a single opportunity to purchase the various capacity products. For example, monthly capacity can be purchased only on the third Monday of the previous month. Offering monthly capacity further in advance of this through Implicit Allocation would ensure that the extrinsic value or time value of holding IUK capacity is available to the market.

## **PART 2. PROPOSED MODEL FOR IMPLICIT ALLOCATION OF IUK CAPACITY**

Part 2 is split into three sections:

- Implicit Allocation in the CAM Network Code;
- A description of IUK's proposed model for an Implicit Allocation Mechanism; and
- The advantages for Shippers and end consumers if IUK implements the proposed model.

### **2.1 Implicit Allocation in the CAM Network Code**

The CAM NC allows for two methods of capacity allocation. The first is via auctions on a joint booking platform which IUK is currently adhering to by offering the standard capacity products on PRISMA at the times prescribed by the CAM NC and specified in the ENTSOG auction calendar. The second is via Implicit Allocation which Article 3.6 of the CAM NC defines as:

“an allocation method where, possibly by means of an auction, both transmission capacity and a corresponding quantity of gas are allocated at the same time”.

In addition, Article 2.5 states that:

“Where implicit capacity allocation methods are applied, national regulatory authorities may decide not to apply Articles 8 to 37.”

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<sup>1</sup> 113GWh/day of capacity from Belgium to the UK was sold from October 2018 for 10 years in the first 2015 sale of post 2018 capacity held in May 2015.

There is limited reference to Implicit Allocation in the CAM NC and there is no further definition as to what constitutes Implicit Allocation or how it should be structured<sup>2</sup>. It is clear that NRAs have the discretion not to apply Articles 8 to 37 of the CAM NC on a case by case basis i.e. for a specific Transmission System Operator (“TSO”) at a specific interconnection point where that TSO uses Implicit Allocation. Where this is granted by the NRAs, the TSO has a degree of flexibility as to the mechanism used to offer capacity, the type of products offered, the timing of their sale and the bundling requirement. IUK has designed its Implicit Allocation mechanism with this in mind, seeking Implicit Allocation to be implemented without Articles 8 to 37 having effect. IUK intends to continue offering its post-2018 capacity through auctions on the PRISMA platform, under Articles 8 to 37, in addition to Implicit Allocation. The auctions on PRISMA and Implicit Allocation shall be held at different times as explained further in this document.

Appendix 1 explores the examples of Implicit Allocation being implemented around Europe. Implicit Allocation has been developed in these markets to relieve specific problems such as congestion or as the first step in market integration. Efficient and practicable applications for Implicit Allocation elsewhere are likely to be limited to scenarios such as these because the majority of EU TSOs have regulatory underwriting and so having the ability to gain additional revenue through Implicit Allocation is not a matter of viability, as it is to IUK. IUK has different drivers and motives for implementing Implicit Allocation which are discussed in detail in Section 2.3.

## **2.2 IUK’s proposal for Implicit Allocation**

In addition to the CAM NC auctions on PRISMA, IUK intends to implement Implicit Allocation with Articles 8 to 37 of the CAM NC dis-applied, as per the provisions of Article 2.5 of the CAM NC, so that it is able to offer capacity at a fixed price, at any time, for any duration (subject to certain limitations) and unbundled, as further described within this document. IUK is currently not considering offering day-ahead or within-day capacity via Implicit Allocation. It is possible however that this may change as we gain experience going forward. IUK believes that for Shippers, day-ahead and within-day auctions on PRISMA are likely to be better suited as the timescales to pick up capacity from neighbouring TSOs are limited.

IUK would still maximise the capacity offered at all times and intends to continue offering all unsold, post-2018 capacity through the auctions on PRISMA under Articles 8 to 37 of the CAM NC in addition to Implicit Allocation. In accordance with the CAM NC, 20% of technical capacity will be set aside and not be offered in the annual yearly auctions beyond 5 years out; of this 20%, half will be retained for the annual quarterly auctions (i.e. 10% of the technical capacity will be retained for the annual quarterly auctions). All other unsold capacity may, in the first instance, be offered via Implicit Allocation.

### **2.2.1 The Process**

IUK as a pipeline operator has transmission capacity to offer to the market but not gas, and so, in order to offer capacity through Implicit Allocation, IUK needs to find a partner that offers and allocates gas products to the market through a transparent, non-discriminatory mechanism.

After engaging with the market IUK is proposing to offer implicitly allocated capacity through partnership with:

- a European based Exchange, so capacity is allocated at the same time as gas bought through exchange trades, or

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<sup>2</sup> There is no suggestion within the CAM NC that Implicit Allocation should be the same as Implicit Auctioning which is widely used in the electricity markets across Europe.

- a Broker along with a Third Party Communication Platform, so capacity is allocated at the same time as gas bought through OTC (over the counter) trades.

The specific arrangements between the Exchange and the Broker/Communication Platform (“the Implicit Allocation Partner”) and IUK will be developed in more detail if IUK decides to proceed with Implicit Allocation following the conclusion of this consultation.

Both methods will allow IUK to market its capacity in a non-discriminatory and transparent manner as all active participants on either the Exchange or the Communication Platform would see that IUK capacity was being made available and at what price. They would also be alerted to the fact that in order to complete a transaction they would need to be a registered IAA Shipper (i.e. have signed the IUK Access Agreement (“IAA”)). IUK will provide the Implicit Allocation Partner with a list of registered IAA Shippers to enable this.

As per the CAM NC definition, the capacity purchased through the Implicit Allocation Partner would match up with a corresponding quantity of gas. In order to keep the process objective, transparent and non-discriminatory, IUK would have no knowledge of the gas transaction. A Shipper would choose to purchase IUK capacity along with their gas trade and this would result in two separate transactions: between the Shipper and the gas seller and between the Shipper and IUK. There is no other link between the gas transaction and the capacity transaction apart from the fact that the quantities match. The Implicit Allocation Partner will notify IUK of the capacity sale and this will become a transaction under the IAA Contract held between IUK and the purchasing IAA Shipper. Payment and settlement for IUK capacity would be subject to the terms defined in the IAC. Appendix 2 gives more details on these two potential mechanisms.

IUK has introduced the concept of a capacity conversion service, as required by Article 21(3) of the CAM NC, into the IAC. IUK will be offering the Capacity Conversion Service (“CCS”) on a non-discriminatory basis. Where an IAA Shipper who has bought unbundled IUK capacity through Implicit Allocation is unable to acquire unbundled capacity from the adjacent TSO in the CAM NC auctions on PRISMA, they will be able to use the CCS to resolve this following a successful bid on PRISMA for bundled capacity. The IAA Shipper will be able to convert their existing unbundled capacity into the new bundle and release the quantity converted back to IUK. The service will cover Annual, Quarterly, Monthly and Daily firm capacity products.

### **2.2.2 Timings and Limitations**

IUK will offer its capacity through Implicit Allocation and the auctions on PRISMA at different times. Prior to an auction the relevant capacity would be withdrawn from being offered via Implicit Allocation whilst it was advertised and offered on PRISMA (for example, one month in advance of the auction for annual capacity). Following the auction on PRISMA, any unsold capacity would then be able to be offered via Implicit Allocation again. This means that any capacity allocated during the standard CAM NC auctions reduces the capacity available for sale through Implicit Allocation and vice versa (see Appendix 3 for more detail).

Any particular hour of capacity will only be offered via one allocation method at any given time in order to guarantee that capacity cannot be inadvertently sold twice. IUK does not envisage this being a problem with using an Exchange and a Broker/Communication Platform, as IUK can notify each as to the quantity available and modify that quantity when necessary, prior to the offer of capacity.

In addition, IUK proposes the following timings and limitations for any capacity offered through Implicit Allocation in order to limit the possibility of market manipulation and gaming:

- IUK will retain 20% of capacity for short-term auctions<sup>3</sup> under PRISMA and may offer the remaining capacity through Implicit Allocation, with the actual amounts offered being determined by IUK.
- The table below sets out the timings of when products of different durations may be purchased through Implicit Allocation. In addition it shows the time period when capacity will not be available as a result of it being advertised for the relevant CAM NC auction on PRISMA.
- Figure 1 provides a visual representation of the IAM products that will be offered on two example dates, 22 January 2018 and 5 April 2018.

Product length	Offered through Implicit Allocation	Auction Publication on PRISMA, capacity not offered through Implicit Allocation	Auction Start on PRISMA
Annual	Any time during the 15 years in advance of the period (can cover any 4 quarters including gas year or calendar year)	4 weeks before Auction Start	1 <sup>st</sup> Monday of July for following 15 Gas Years
6 monthly	Any time during the 3 years in advance of the period (can cover any 2 quarters)	4 weeks before Annual Auction Start	n/a
Quarterly	Any time during the 2 years in advance of the period	2 weeks before Auction Start	1 <sup>st</sup> Monday of August for Q4, Q1, Q2, Q3; Nov for Q1, Q2, Q3; Feb for Q2, Q3; May for Q3
Monthly	Any time during the 6 months in advance of the period*	1 week before Auction Start	3 <sup>rd</sup> Monday of each month for next month
Daily	Any time after Monthly auction on PRISMA	At Auction Start	15:30 UKT / 16:30 CET day before

\*in advance of the CAM NC annual auctions in July, the monthly products for the following gas year will only be offered to a maximum of 40% to limit potential impact on annual availability in the auctions on PRISMA. This affects capacity offered for October, November and December.

IUK is considering whether some capacity should continue to remain available under Implicit Allocation at all times so that it is simpler for the market to understand which capacity is offered where and when. Without this there are periods when the market cannot access capacity due to the PRISMA publication period which is sub-optimal for the market. IUK is therefore considering if during the PRISMA auction periods 10-20% of capacity should continue to be offered under Implicit Allocation as long as the relevant amount to be set aside for short-term capacity as defined in CAM continues to be met. We would welcome your views on this.

<sup>3</sup> 20% of technical capacity will be set aside and not be offered in the annual yearly auctions beyond 5 years out; of this 20%, half will be retained for the annual quarterly auctions (i.e. 10% of the technical capacity will be retained for the annual quarterly auctions).

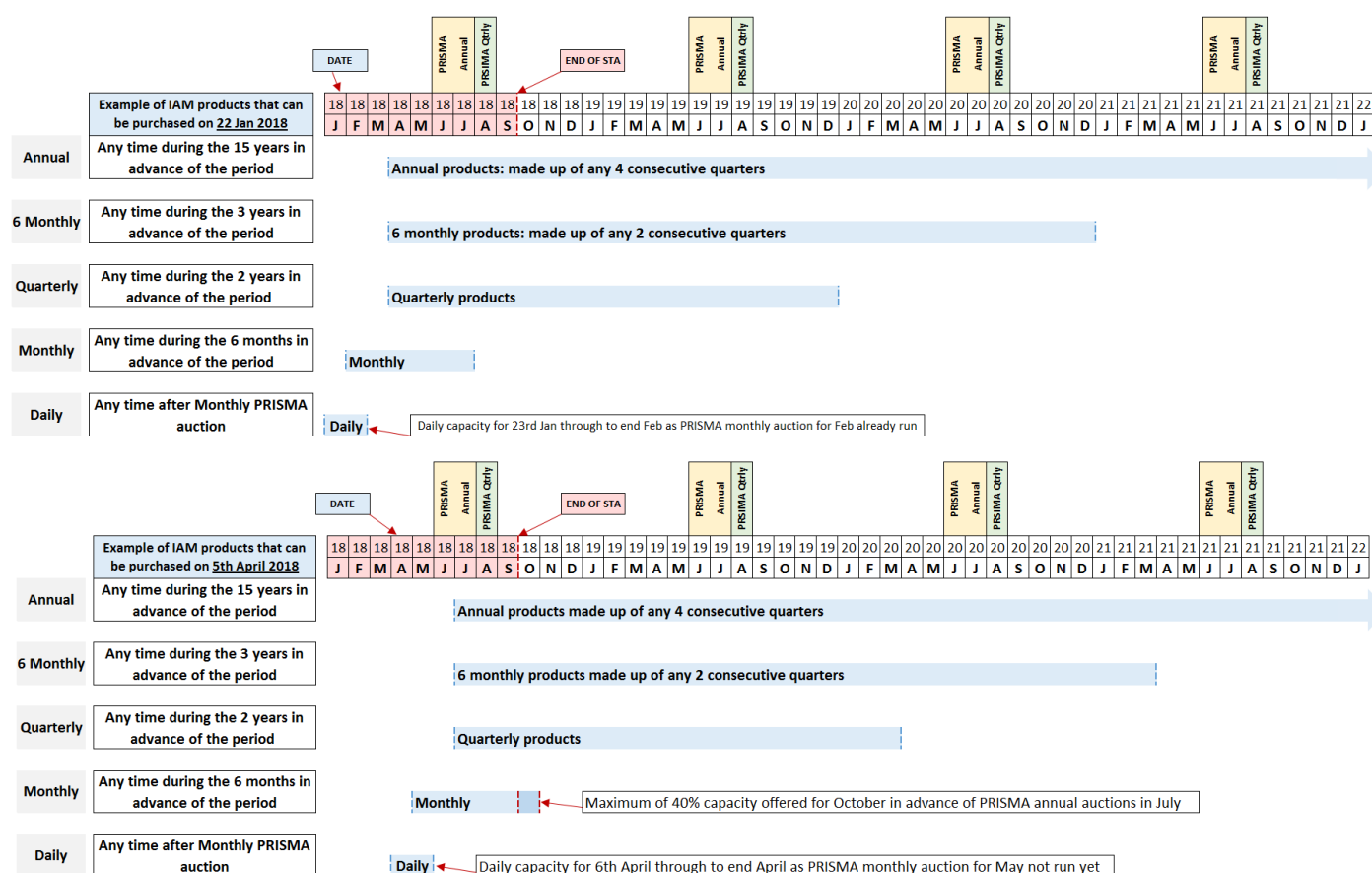


Figure 1 Timeline of capacity made available through IAM a) 22 January 2018 and b) 5th April 2018

## 2.2.3 Pricing

At any time when capacity is offered through Implicit Allocation IUK will publish the price in advance for any potential product offered. As capacity will be allocated at the same time as a corresponding gas commodity trade and for a matching duration and quantity, the pricing will need to allow for any shape of product to be purchased subject to the limitations set out above. This is likely to include non-standard and standard products such as Annual, Quarterly and Monthly products and IUK will publish how the pricing of standard products sold through the IAM will relate to the pricing of the equivalent product durations offered on PRISMA.

IUK is currently preparing the tariff structure for Implicit Allocation and will aim to provide these tariffs to the market by the end of 2017.

## 2.3 Advantages of Implicit Allocation for the market

The Implicit Allocation proposal has multiple benefits for Shippers, consumers, and IUK's economic viability, whilst remaining in line with the CAM NC. The focus is on Shipper benefits, as this underpins demand and feeds through to the consumer and security of supply benefits.

### 2.3.1 Timing Benefits

Through Implicit Allocation, Shippers would be able to access IUK capacity as and when they see an economic case to purchase it. This would increase market efficiency and reduce the risk of gas supply shortages by enabling Shippers to react promptly to market events and price changes. If a Shipper is



unable to purchase capacity when they see an economic case to do so they may source their needs from a more expensive source or simply be unable to realise the arbitrage opportunity, ultimately to the detriment of the end consumer.

### **2.3.2 Longer period to trade around a position**

Shippers would be able to purchase IUK capacity further in advance than under the PRISMA auctions and aligned with the gas commodity market (i.e typically monthly gas commodity products are traded up to 6 months in advance of the month). This increases the time that a Shipper may decide to hold capacity and take trading positions around that capacity, which in turn increases the time value or extrinsic value of the capacity. This creates more potential value for the Shippers, increasing the attractiveness of IUK capacity and enabling the capacity and gas commodity market to operate more efficiently, which in turn may enhance market liquidity. Appendix 4 provides examples of this.

### **2.3.3 Shaped Capacity Purchases**

Discussions with the market and observed flow dynamics show that providing Shippers with an ability to purchase capacity which varies over the year would add value, secure a key transmission route and reduce the risk to Shippers of making a longer-term booking, whilst better matching the typical utilisation patterns of their nominations through the Interconnector. This is possible through Implicit Allocation as the capacity does not have to be sold only at specified points in time as required with standard CAM NC products but can match trading on the gas commodity markets.

### **2.3.4 Cost-efficient access to seasonal storage assets**

It is our understanding that the technical difficulties that the Rough storage facility experienced last year, in particular its limited ability to fill over the summer, had an impact on individual Shipper's portfolios. The subsequent news in June 2017 that the Rough facility will close permanently means that it is now crucial to ensure that Shippers have access to storage facilities in Continental Europe so that the GB market can efficiently manage its security of gas supply and limit the negative impact on end consumers.

The Interconnector provides a strategic link between the UK and Continental markets so access to seasonal capacity through Implicit Allocation would allow the Shipper to secure capacity to match the seasonal demand of consumers without the risk of being required to pay for capacity not needed or being unable to access IUK capacity when required. This will enable the efficient use of existing assets across European markets and enable the UK and continental markets to operate more efficiently. End consumers will ultimately benefit from improved access to and utilisation of existing storage assets in other countries, thereby reducing the need to invest in new costly storage facilities.

The market would be given the ability to decide which is the most cost efficient option to meet security of supply requirements and would not be forced into more costly sub-optimal decisions due to seasonal interconnector capacity not being available for purchase.

### **2.3.5 Unbundled Capacity**

IUK will continue to offer bundled capacity through the CAM NC auctions on PRISMA. As the CAM NC includes provisions to not apply Articles 8 – 37, the capacity offered through Implicit Allocation will be unbundled capacity. Offering the capacity unbundled addresses several concerns:

- IUK seeks to incentivise longer term bookings whereas the National Grid Gas ("NGG") pricing regime incentivises short term capacity bookings. If a Shipper wants to purchase longer term

capacity in IUK they would be obliged through bundling to purchase more expensive capacity in NGG. Offering unbundled capacity allows a Shipper to optimise their portfolio and allows IUK to incentivise longer-term bookings.

- By purchasing bundled capacity a Shipper who wanted to lock in longer term IUK capacity would have to commit to long term NGG capacity under an unknown future charging regime. Offering unbundled capacity via Implicit Allocation allows a Shipper to mitigate their risk.
- Shippers are set up with different legal entities in the UK and continental Europe but bundled capacity can only be bought by a single legal entity. For example, Shipper A has 2 subsidiaries: “Shipper A\_UK” in the UK who currently purchases NGG capacity and “Shipper A\_EU” who owns IUK capacity and capacity across Europe. When NGG capacity and IUK capacity is sold as a bundle either “Shipper A\_UK” has to buy NGG and IUK capacity or “Shipper A\_EU” has to buy NGG and IUK capacity; neither of these options is attractive under current organisational set-ups. Offering unbundled capacity through Implicit Allocation would resolve this issue.
- For Shippers wishing to purchase bundled capacity, IUK will still be offering bundled products via the auctions on PRISMA.

### **2.3.6 Full Alignment of capacity and gas commodity sales**

A further benefit is that Implicit Allocation helps to resolve the ‘co-ordination problem’ in a way that auctions cannot. As markets are increasingly moving shorter term, Shippers will find it difficult to match the capacity they have acquired through auctions with their quantity of traded gas. Through Implicit Allocation a Shipper purchases capacity that exactly matches their gas commodity booking even if this is not a flat quantity over the period. This means that the Shipper does not have to deal with a mismatch between capacity and gas commodity and is less exposed to the risk of holding capacity that they do not ultimately utilise.

Under Implicit Allocation a Shipper can buy capacity at any time (subject to certain limitations) under a simpler process where liquidity is more visible than it is in auctions. This is more appropriate for a system which is unlikely to be congested.

### **2.3.7 Promoting fair competition**

By not restricting capacity sales to only the PRISMA platform, IUK is reaching a broader range of market participants which will lead to increased competition and therefore increased liquidity, better market integration and price optimisation. When used alongside the existing auctions on PRISMA, Implicit Allocation would maximise the market’s opportunity to complete cross border trades as Shippers could purchase and access IUK capacity when it is most needed.

The ability to sell capacity outside of the CAM NC timetable would help to create a more level playing field for IUK with other flexibility assets who are able to innovate their products and offer their services at any time. This mitigates the risk to consumers that more expensive sub-optimal solutions are booked by the market.

## **PART 3. PROCESS AND TIMETABLE**

Below is the indicative timetable that we propose to follow for this consultation. Within this timetable, IUK will arrange to put in place agreements with an Implicit Allocation Partner. Please note, this consultation does not commit or bind IUK to introducing Implicit Allocation.



Date	Action
8 August 2017	Consultation opens. All stakeholders are invited to provide us with feedback on our proposed Implicit Allocation Model.
7 September 2017	Consultation closes. The process of reviewing stakeholder feedback begins.
w/c 11 September 2017	Non-confidential responses to our consultation are published on our website for stakeholders to review.
w/c 25 September 2017	Following consideration of stakeholder feedback, the Access Rules and CM are submitted to the NRAs for approval.
By December 2017	Confirmation that NRA approvals have been received for the Charging Methodology.
By January 2018	Confirmation that approvals have been received for the Access Rules and that Implicit Allocation of IUK Capacity will proceed.

## PART 4. YOUR FEEDBACK

We are interested in hearing your views on our proposal to introduce Implicit Allocation as a way to offer IUK capacity to the market at any time in addition to the standard auctions on PRISMA. We would welcome your response to a number of specific questions:

- Do you support the proposal to introduce Implicit Allocation as an additional means of booking IUK capacity?
- Do you support the view that Implicit Allocation will enable Shippers to purchase IUK capacity when there is an economic signal to do so, something which is restricted by only being able to purchase IUK capacity through auctions held on PRISMA?
- Do you think the proposed restrictions are sufficient to prevent gaming?
- Do you consider that IUK should continue to offer a percentage of capacity through Implicit Allocation whilst the PRISMA process is taking place to ensure that there is not a time when capacity is unavailable to the market and to remove complexity for the market?
- Do you think that Implicit Allocation of IUK capacity will be beneficial to the market?
- Do you have any comments on the proposed legal drafting amendments to the Access Rules to introduce this mechanism?

Please send your response to [consultation@interconnector.com](mailto:consultation@interconnector.com) by 17:30 UKT on 7 September 2017.

Please ensure that a “read receipt” is requested to confirm that your response has been received. Please note that any responses not marked confidential may be published on IUK’s website. Confidential responses may be shared with Ofgem and CREG at their request.

If you wish to clarify any aspect in relation to this letter, or have any questions, please contact Danielle Stoves on +44 (0) 203 621 7816 to discuss.

We look forward to hearing from you.

Yours sincerely,

**DANIELLE STOVES**  
Commercial Manager

## Appendix 1 Comparison with Other Examples of Implicit Allocation

### A1.1 Comparison with Implicit Auctioning in Electricity Markets

This appendix looks at some existing examples of Implicit Allocation in European gas markets, and how IUK's proposals share at least some key attributes.

An important introductory point is that Implicit Allocation in gas does not follow the same rules and models as Implicit Auctioning in the power market. This is partly a matter of principle, as power and gas markets have different fundamental needs, and this is reflected in a different gas market design to that used in power. Secondly it is a matter of fact: there are already examples of Implicit Allocation in gas that do not follow the electricity model.

### A1.2 Examples of Implicit Allocation

#### A1.2.1 Baltic States

The Baltic States (Latvia, Lithuania and Estonia) received NRA approval for the implementation of their interpretation of the CAM NC's permitted Implicit Allocation method of allocating cross border capacity in January 2017. The TSOs began capacity allocation under this method from 1 July 2017. They are offering capacity using the GET Baltic Exchange and Figure 2 provides an overview of how their model works.

This example shows capacity being allocated with gas purchases on an Exchange at a fixed price<sup>4</sup>. The model goes on to show that the gas will automatically be nominated and flow through the capacity. This is not true of IUK's model as the markets on either side of IUK are far more developed, liquid markets and trades for gas commodity products of various durations are made and undone numerous times before the final nomination is actually determined and gas is flowed on a particular day. The Baltic States are initially offering only day-ahead capacity because their markets are not as developed or as liquid as the NBP and ZeeBeach (ZTP Physical) which will enable IUK to offer capacity for longer timescales.

*Figure 2 Baltic States Approved Implicit Allocation Model via an Exchange*



<sup>4</sup> Baltic States Consultation Document: The Model of Implicit Capacity Allocation in the Baltic States, [https://www.ambergrid.it/uploads/structure/docs/371\\_efe35c4900841cad9052d441dba99c0f.pdf](https://www.ambergrid.it/uploads/structure/docs/371_efe35c4900841cad9052d441dba99c0f.pdf)

### **A1.2.2 Spain-Portugal**

The national TSOs are looking to implement Implicit Allocation with cross-border tariffs in order to increase transparency and improve the gas market integration between Spain and Portugal. Under the proposed model, part of their available technical capacity will be set aside for Implicit Allocation and the rest is allocated through the auctions on PRISMA. Their current plans which have been submitted to the NRAs to publicly consult on include offering daily, within-day and monthly capacity implicitly. Market participants would make their buy and sell offers on the Portuguese and Spanish sides in two separate order books.

This example again shows capacity being allocated with gas purchases on an Exchange at a fixed price. The products offered are daily and monthly durations. IUK would not intend to limit the capacity offered to this extent as the NBP is one of the most liquid hubs in Europe with a wide range of gas commodity products being traded for different durations and for longer timescales.

### **A1.2.3 France**

GRTGaz are already using Implicit Allocation at their IPs in the network “Liaison Nord-Sud” which is, for much of the year, a heavily congested point. They currently sell day-ahead and within-day firm capacity that remains unsold in the CAM NC auctions on PRISMA, along with a small amount of interruptible capacity.

France is using Implicit Allocation as the first step in market integration. This is not the case for IUK. Implicit Allocation for IUK would be another method for IUK to offer capacity to the market and enable the market to book capacity when it is needed.

## Appendix 2: Implicit Allocation of IUK Capacity using an Exchange and a Broker/ Communication Platform

### A2.1 An Exchange

In this approach, the Shipper is offered the option to buy IUK capacity in addition to any natural gas commodity transaction carried out on a specified Exchange. To ensure the process is transparent and non-discriminatory, IUK capacity offered through Implicit Allocation on an Exchange would be visible to non-IAA Shippers, however they would be notified of the need to sign the IAA to complete a purchase. The gas commodity transaction would be carried out on any hub, timescale or duration that the Exchange traded. IUK, however, would have no knowledge of this transaction to ensure that the process remains non-discriminatory and objective. The IAA Shipper completing the gas commodity transaction would (subject to the capacity being made available by IUK) be given the option to purchase a matching quantity of unbundled IUK capacity at a price determined by IUK, in their chosen flow direction (i.e Belgium to UK or UK to Belgium).

Following the confirmation from the Exchange that a matching purchase of gas commodity and IUK capacity has been transacted, a capacity transaction will be created under the IAA. The contract for IUK capacity would remain directly between the IAA Shipper and IUK and the payment and settlement for any IUK capacity purchased through Implicit Allocation on the Exchange would be subject to the terms defined in the IAC.

IUK will build upon the initial proposal described here taking into account economics, transparency, ease of use and any relevant feedback received from this consultation.

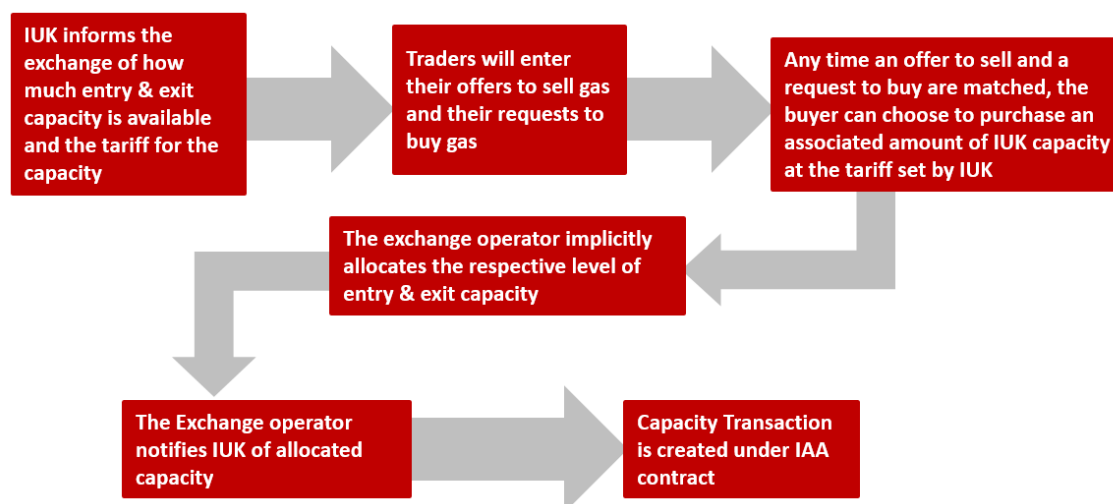


Figure 3 IUK Proposal for Implicit Allocation through an Exchange

### A2.2 A Broker and a Third Party Communication Platform

Another mechanism that IUK is exploring is using a Broker; this option would include the use of a Third Party Communication Platform to give the trader anonymity and eliminate counterparty bias, as well as providing a transparent, non-discriminatory method of viewing the capacity on offer. In this approach, trades are not executed through the platform, but instead trader-broker agreements are in place to facilitate the gas commodity and capacity transactions.

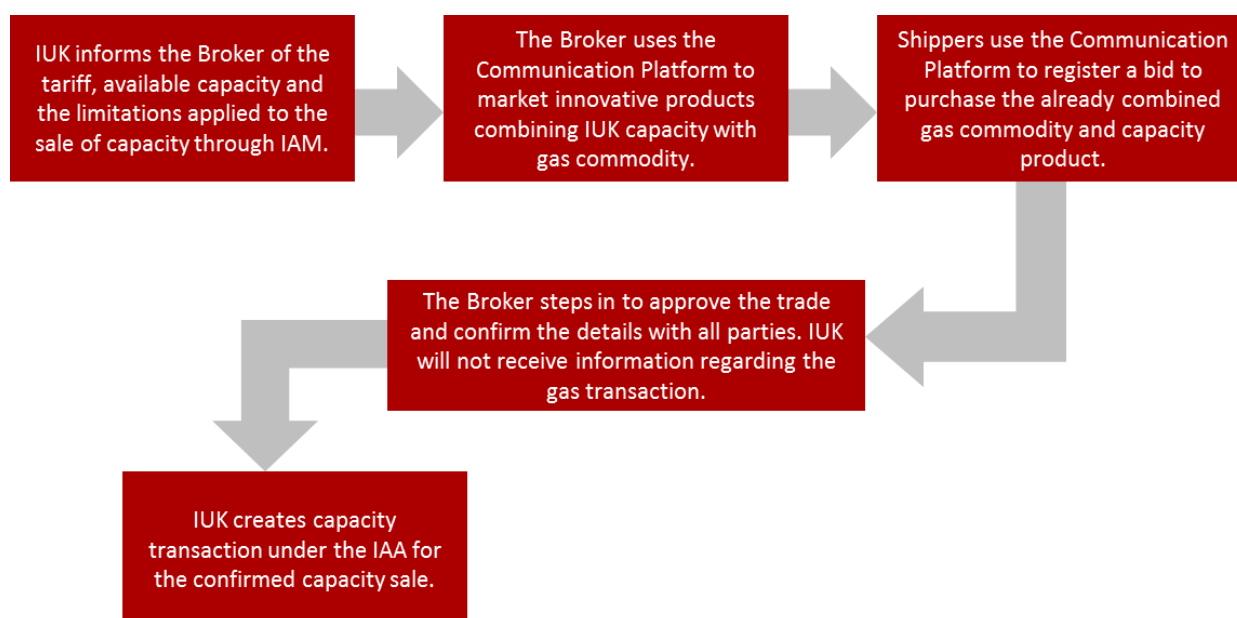
As with the Exchange, a market participant must be signed up to the IAA in order to purchase IUK capacity, however to remain transparent, non-discriminatory and objective, all registered users of the Communication Platform would be able to see what capacity was on offer.

Under this method, IUK would provide the Broker, who is acting as an intermediary between the Communication Platform, IAA Shipper and IUK, with the available capacity. IUK capacity is offered by the Broker unbundled, in accordance with the limitations listed in section 2.2.2 and at a price determined by IUK.

The Broker would create innovative products to offer by including the IUK capacity and various other gas commodity and flex elements together, most typically for durations of one month or longer. To ensure the process is transparent, the Broker will use a Communication Platform to market the capacity, and it is a prerequisite that the IAA Shipper meets the relevant trading and regulatory criteria outlined by the Broker.

All Shippers will use the Communication Platform to bid for the product, however in order to execute the purchase, the Broker will approve the trade and confirm acceptance from all counterparties involved. To remain objective, IUK would have no knowledge of the gas commodity transaction.

Following confirmation from the Broker that a transaction of a matching quantity of gas commodity and IUK capacity has been agreed by the Broker and the IAA Shipper, a capacity transaction will be created under the IAA. The contract for IUK capacity would remain directly between the IAA Shipper and IUK and the payment and settlement for any IUK capacity purchased through Implicit Allocation with the Broker would be subject to the terms defined in the IAC.



*Figure 4 IUK Proposal for Implicit Allocation through a Broker and a Third Party Communication Platform*

## Appendix 3: Interaction of Implicit Allocation and the standard auctions on PRISMA

IUK intends to offer, at different times, its capacity through Implicit Allocation and through auctions on PRISMA. Figure 5, using indicative numbers, provides a visual description of how Implicit Allocation will work when implemented alongside the auctions on PRISMA. The relationship of the methods will follow the same principle for the standard Quarterly and Monthly auctions on PRISMA.



Figure 5 Relationship of IUK capacity allocation through Implicit Allocation and the Annual Auction held on PRISMA



## Appendix 4: Value of monthly products via Implicit Allocation

One of the main advantages of Implicit Allocation is the ability to purchase capacity further in advance than through the auctions on PRISMA, which increases the extrinsic value of the capacity, because Shippers have more time to take trading positions around that capacity. Alongside this, the ability to purchase capacity at any time rather than on just one day as per the CAM NC standard auctions means that Shippers can access IUK capacity as and when they see an economic case to buy it. As can be seen from Figure 6 below the NBP-Zee basis regularly moves by more than 1p/th over the 3 month period when the monthly basis is quoted. Significant intrinsic and extrinsic value is lost to both Shippers and IUK if capacity can be sold only on one day under the CAM NC timetable.

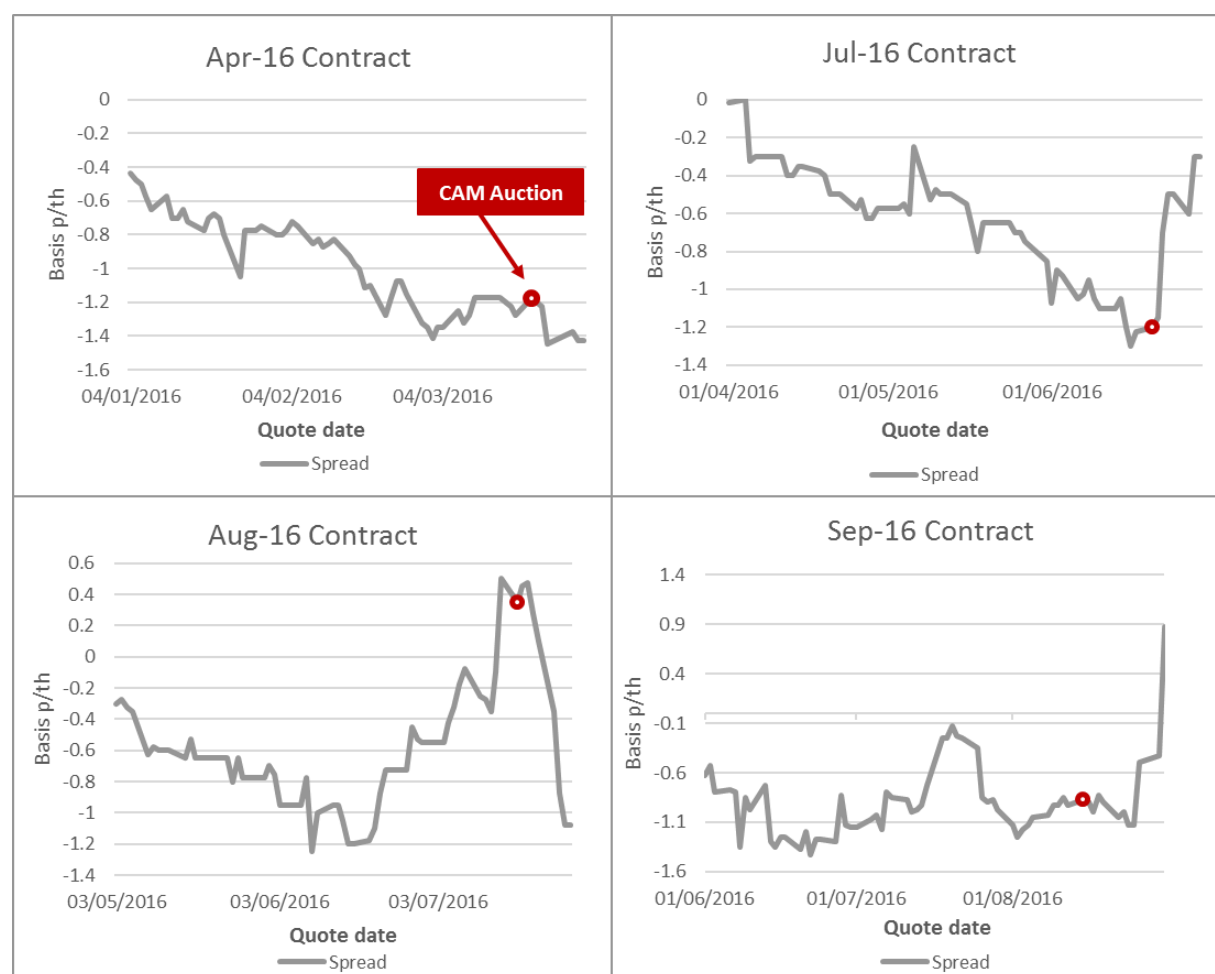


Figure 6 Examples of variation in the NBP-Zee basis