Interconnector

Interconnector (UK) Limited
4th floor, 10 Furnival Street
London EC4A 1AB
Switchboard: +44(0)20 3621 7800
Email: consultation@interconnector.com
Website: www.interconnector.com

@IUK_Ltd

All Stakeholders

25 October 2017

Dear Stakeholder,

Further consultation on IUK's Charging Methodology for capacity sales from January 2018 and IUK's updated Implicit Allocation rules in the IUK Access terms

Introduction

IUK consulted in **August 2017** on its:

- Charging Methodology for capacity sales from 2018 ("CM")
- A draft Tariff Network Code Derogation Application ("TARDA")
- Access Terms (i.e. IUK Access Agreement ("IAA"), IUK Access Code ("IAC"), System User Agreement ("SUA"))
- Implicit Allocation Mechanism ("IAM")

The consultations closed on **7 September 2017**. IUK received several responses from market participants which have been published on our website[1]. The key feedback from Shippers in those consultations concerned needing more pricing transparency and more details about the Implicit Allocation rules. Since the consultation closed IUK has been meeting with Shippers, our National Regulatory Authorities ("NRAs"), Ofgem and CREG, to discuss the market responses and has also further developed its proposals. IUK would now like to hear stakeholders' views on its amended CM proposals and its updated Implicit Allocation Rules.

Section 1 provides some background on IUK and summarises the feedback received from our August consultations.

Section 2 outlines our proposed changes to the Charging Methodology since our last consultation.

Section 3 outlines the updated Implicit Allocation Rules which are included in Annex B-3 of the IUK Access Code (which is published alongside this letter).

Section 4 includes the questions on which we are particularly interested in your views and our proposed next steps.

[1] The responses and consultation documents are available here: http://www.interconnector.com/about-us/our-consultations/latest-consultation/

Section 1 - Background & Consultation feedback

IUK is the only physically bidirectional pipeline between UK and mainland European gas markets. It has played a significant 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. 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 Transmission System Operators ("TSOs") in Europe, it is not under-written by consumers and is wholly exposed to the market.

IUK is designing its future business model under challenging market, political and regulatory conditions, specifically: a move from long term to short term contacts, a set of EU rules designed primarily for TSOs with captive demand who are under-written by consumers, and additional market uncertainty triggered by Brexit and changes to National Grid's charges.

Through the proposals on which IUK consulted the market in August 2017 and the updated proposals published today, IUK is seeking to design a business model that meets the market needs, allows the asset to continue providing its vital benefits to consumers in terms of security of supply, reduced energy costs and efficient trading, while at the same time allowing IUK to have a viable future. A key feature of this model is commercial flexibility to be able to offer capacity through additional means apart from the Capacity Allocation Mechanism Network Code ("CAM NC") capacity auctions held on PRISMA which do not necessarily meet the utilisation pattern of IUK's capacity by the market. It also needs to be able to decide when and how to set its tariffs more flexibly than a TSO which faces limited market risk and is fully under-written by consumers, while respecting the market need for more transparency.

From the market responses to our last set of consultations, we were pleased to see that there is a good understanding of the unique situation of IUK and why this flexibility is needed. The market was positive on the idea of IUK being able to also sell capacity through Implicit Allocation which will allow market players to buy capacity when they choose to (subject to some limitations).

At the same time, there were some concerns with the level of freedom that IUK is seeking and a clear message that the market needs more transparency on tariffs and tariff publication timings. Shippers were also keen to make sure that Implicit Allocation is an additional method of selling capacity to the CAM NC auctions, which has always been IUK's intention. They also sought more detail on the Implicit Allocation Rules, particularly around pricing, capacity availability and interaction with the CAM NC auctions. **Annex 1** summarises the key concerns raised by market participants.

Having taken into account the responses and additional feedback from bilateral meetings that we had with all the Shippers who responded to our consultation, we have developed further our proposals on our Charging Methodology and the Implicit Allocation Rules which are outlined in **Sections 2 and 3**. We would very much appreciate any further market feedback on our updated proposals, particularly on the questions outlined in **Section 4.**

Section 2- Consultation on IUK's amended Charging Methodology proposals for capacity sales from January 2018

2.1 Introduction

The Charging Methodology (CM) outlines the principles for setting IUK's prices. IUK is proposing changes to the CM to ensure that it is appropriate for the sale of all types of capacity durations from 2018. Changes are proposed to ensure compliance with relevant parts of the European Tariff Network Code ("TAR Code") and to enable IUK to offer capacity of different durations for the post-2018 period when IUK's original long term contracts end and more than 90% of its capacity will become available. This capacity will be offered as CAM NC standard products and also, subject to NRA approval, via other allocation mechanisms, such as, Implicit Allocation.

The key feedback from Shippers in the August consultations on the CM and TARDA concerned needing more pricing transparency. The market understands why IUK as a physically bi-directional merchant interconnector with no captive demand is seeking derogations from some provisions of the TAR Code. At the same time, Shippers wanted more clarity and certainty on IUK's tariffs and on when prices would be published within the CM.

In response to this feedback, IUK is proposing to include within the CM binding commitments for when pricing information will be published for all IUK capacity products. The final proposed changes are outlined in the marked up CM version (compared to the current approved CM) and the clean version of the CM which are also published today.

2.2 Background

Article 15/5bis, § 15 of the Belgium Gas Act and Condition 10 of IUK's GB Interconnector Licence require IUK to prepare and submit for the respective NRA approval, a CM for access to the interconnector. Regulation (EU) 2017/460 which establishes a Network Code on harmonised transmission tariff structures for gas ("TAR Code") also includes rules on the application of a reference price methodology, consultation and publication requirements as well as the calculation of reserve prices for capacity products.

IUK's CM is approved by both Ofgem and CREG. The CM takes into account and recognises that IUK, given its specific circumstances, needs the flexibility to be able to set competitive, market-based tariffs which both reflect market conditions and allow for cost recovery in order to manage the risks which it faces. The CM has been reviewed annually, as required by the governing rules, since its original approval in June 2015.

2.3 Summary of key changes to the CM proposals

We have taken the opportunity in this second consultation to address pricing transparency concerns. The specific changes can be seen in the marked up version published today. The key changes are:

Publishing binding ranges in advance of the CAM NC auction

We propose to amend section 2.1 (General Principles) to bind IUK to publish prices as set out in publication timetables in a new Annex 1 to the CM. The publication timetable (T1) outlines IUK's commitment to publish a binding cap and floor multiplier price range for short term standard CAM NC products relative to the annual standard product for the coming gas year when publishing prices 30 days in advance of the annual CAM NC auction. For the standard CAM Day Ahead and Within Day products we are inviting views on 2 options. This is either a binding range or instead an average binding range with a cap.

As outlined in IUK's TARDA consultation which was published in August 2017, locking in a tariff structure in June for the coming gas year is not feasible when applied to IUK. As a merchant interconnector in a competitive market it is not possible to publish prices months in advance of the actual auction and to then be locked into that tariff structure for the entire gas year. This 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. A formulistic approach to calculating tariffs does not work for IUK, for the following reasons:

- 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. Actual use of the asset will reflect market conditions and competitive dynamics. Therefore, it would be impossible to determine a set of tariffs which would satisfy market demand and 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 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 probable that a mechanistic 'cost divided by flow = tariff' approach leads to the calculation of tariffs which are not competitive compared to alternative flexibility and arbitrage options available to Shippers as the flows are not known in advance.
- As an asset with full market exposure, revenue recovery during exceptional market events is likely to be vital for the asset's financial viability. IUK therefore requires the ability to adjust tariffs to reflect changing market conditions.
- Competing flexibility assets (e.g. Gas Storage, LNG, upstream flexibility) do not have an obligation to lock in a tariff structure in June for the coming gas year. This 'non-transmission competition' is not subject to the same regulation that applies to IUK and therefore IUK needs to be more on a level playing field in order to be able to compete effectively with these other flexibility assets.

A binding range or caps were suggested by some Shippers responding to our earlier consultation as a way to allow IUK some flexibility whilst also providing Shippers with a reasonable degree of certainty. We believe that binding ranges can be a pragmatic compromise. It allows IUK flexibility within the range, thus recognising the challenge for IUK to lock in a binding tariff structure far in advance of actual auctions. It also recognises Shippers' need to be able to value longer term products compared to shorter term products at the time of considering buying the annual product.

We are currently considering our proposed multiplier ranges. For quarterly products our current thinking is that our proposed range will be within the TAR Code allowed range. For monthly products, our current thinking is that the multiplier range will not exceed X3 of our annual tariff. Given the challenges of locking in a tariff structure noted above, for Day-Ahead and Within-day products in particular, there is a need for additional flexibility. We are seeking your views on two options:

Option 1: A binding range for Day-Ahead and Within-day products, which would provide Shippers with a cap and floor. Given the uncertainty, this range would need to be relatively wide compared to the longer term products.

Option 2: An alternative option for the Day-Ahead or Within-day products would be an average range with a cap. This option would enable IUK to offer a more narrow range, though recognising that prices could vary higher or lower than the range on any given day or hour within the gas year. A cap would however provide certainty for Shippers that the price would not go above a specified level. The average range would provide the market with visibility of how the daily pricing would fit with the suite of products, to continue to incentivise longer-term bookings.

For **Option 1**, our current thinking is of a binding multiplier range for day ahead and within day capacity between X0.8 and X6 of our annual tariffs. For **Option 2**, it would be between X1 and X3 with a cap set at X6 of our annual tariffs.

Publishing actual prices sufficiently in advance of the CAM NC auction

With respect to when actual prices are published for CAM NC standard products, this is set out in Table T1 below (the key parts of which form Table 2 of the CM). We understand short term prices need to be known in a reasonable timeframe before the relevant auction and it is in IUK's own interest to do this. IUK does however need the ability to adjust tariffs to reflect changing market conditions, particularly for Day Ahead and Within Day products, if it is going to secure sufficient revenue in a market increasingly moving short term. As shown in the Table below, IUK is proposing that prices are published in advance of when the amount of capacity is notified on PRISMA for the Quarterly, Monthly and Day-Ahead products. For Annual and Within-day products, we propose that publication would be in line with when available capacity is notified on PRISMA.

Table 1: Proposal for the publication of prices in advance of auction

Standard CAM NC product auction	When the amount of capacity to be offered is notified to users in advance of CAM NC auction	When IUK proposes to publish actual prices in advance of CAM NC auction (as outlined in Table T2 of the CM)
Annual	30 days	30 days
Quarterly	2 weeks	30 days
Monthly	1 week	2 weeks
Day-Ahead	At the time of the auction	5 hours
Within-Day	1 hour	1 hour

Pricing of Implicit Allocation relative to Explicit Allocation

In response to Shippers asking for more clarity and certainty on the pricing of Implicit Allocation products relative to explicit allocation, additional text has been proposed in Annex 1 of the CM. This text commits IUK to ensuring that the binding ranges for standard CAM NC products would be the same as the binding ranges for equivalent Implicit Allocation products transacted in the same year. If an Implicit Allocation product is for a different duration (e.g. a 2 monthly product or end of the month type product), the price will dovetail within the binding ranges of multipliers for the nearest standard CAM NC product. For example, a 2 month product will fall within the monthly product range but be cheaper than a 1 month product and more expensive than a quarterly product.

Additional text commits IUK to publishing the actual Implicit Allocation prices at least a day in advance of the relevant sales offerings. This is for all Implicit Allocation products. We believe that this publication timetable is appropriate for a mechanism through which capacity will be continuously offered and where prices need to reflect changing market conditions in order to be attractive to Shippers.

2.4 Further clarification on proposals consulted on in August 2017

We outline below other changes to the CM which were consulted on in August 2017. Some Shipper responses asked for more details on why changes were being proposed. We seek to provide more explanation below. We are also proposing to make some minor changes to the proposals to address specific feedback and make the text clearer.

References to the amended Belgium Gas Act and TAR Code

The amendments in the introduction were proposed to reflect the need for the CM to comply with relevant new legislation:

- A reference to the CM being prepared as required under Article 15/5bis, § 15 of the Belgium Gas Act which was amended in January 2017 to require interconnector operators to prepare a CM and submit it for approval to CREG.
- A reference to the TAR Code, which came into force in April 2017. This text has been further amended in response to Shippers' feedback to more fully reflect that the TAR Code includes rules for the application of a reference price methodology, consultation and publication requirements as well as the calculation of reserve prices for standard capacity products.

Introducing the term "Allocation Mechanism"

In addition to the CM covering sales via PRISMA, IUK proposed to introduce (in sections 1 and 2) text to allow the CM to be used for sales of capacity via other "Allocation Mechanism(s)", subject to NRA approval (and described in the relevant access rules). This proposal is in order to enable the CM to be used for the pricing of all capacity offered by IUK. We can confirm that this text is primarily to enable the CM to be used for Implicit Allocation; however a generic term is appropriate to allow the CM to be used for other products/services that IUK may offer (subject to NRA approval).

Reference to the proposed Belgian IUK financial control

Section 2.3.1 on General Principles included proposed amendments to acknowledge that there is an additional element governing IUK's finances, through financial control under the Belgium Gas Act. This is to recognise the proposed IUK financial control framework proposed by CREG and consulted on by it between 8 August 2017 to 5 September 2017[2]. This control is designed by CREG to establish a safeguard against excess profit.

Relevant CM elements of the Tariff Network Code

IUK believes that the approach set out in the current CM remains appropriate for the reference price methodology, taking into account IUK's full market exposure, the unpredictability of its flows, and the fact that IUK faces direct competition from a range of flexibility assets.

Given that IUK will be offering significant amounts of shorter term products once the original long term contracts expire on 30 September 2018, section 2.3.3 was proposed to commit IUK to using the same principles as outlined in 2.3.1 of the CM to determine the level of multipliers for products less than a year in duration.

Furthermore, our proposals included the introduction of a "risk premium" in the list of key factors determining prices. Some Shippers asked for more information about why IUK was proposing a risk

[2] The CREG consultation is open from 8th August 2017 until the 5th September 2017. For further details please see: www.creg.be/fr/consultations

premium as a factor in determining reserve prices, what products this related to and what the parameter will be. A risk premium has been introduced because IUK will continue to offer fixed prices in the future to provide certainty to shippers. This means that IUK's price will be fixed at the time of purchase and subsequently change only in line with annual inflation provisions. Under the TAR Code, if a TSO offers fixed prices it is required under Article 24 of the TAR Code to apply a risk premium. Without this, prices would be floating (Shippers would pay the prevailing price at the time that the capacity is used, not the price when the capacity was purchased). We have amended the proposals to be clear that the risk premium applies only to the calculation of the annual products. We also commit to publishing the actual parameter in our charging statements. As IUK is seeking to encourage longer term bookings, given it provides IUK stable revenues, we are intending to confirm that the premium will be zero.

Differential pricing

IUK proposed text to clearly allow IUK, whilst ensuring no undue discrimination, the ability to set different prices at different entry/exit points, for different flow directions, and for different products (under section 2.3.1). It had not been clear from the current CM if IUK had the right to do this. IUK believes it is important, as a physically bi-directional interconnector with a typically seasonal profile, to be able to reflect and adjust its prices in the different directions as market and competitive conditions change.

Simplification of the commodity charging

Under section 7, IUK proposed to simplify the section on fuel charges. IUK is proposing to estimate the consumption of gas and electricity, based on transporting a unit of gas through the transportation system, and convert these into a suitable ex-ante commodity charge. The commodity charge will be set out in IUK's Charging Statement. Changes to the way IUK charges for commodity are necessary as the gas inventory within the pipe will no longer be owned by the original long term contracted (STA) Shippers. Shippers have requested to have a simplified and transparent up front charge (rather than ex-post reconciliation) going forward. The separate sections for fuel gas, electricity and shrinkage are hence proposed to be deleted. IUK will fix a commodity charge and adjust this only if required. The commodity charge may take the form of a formula indexed against gas or electricity prices.

Reference to the charging statement for the Initial registration fee and monthly administration fee

These sections were proposed to be amended to say the initial registration fee and monthly administration fees will be published in the IUK charging statement. This is because we believe that the appropriate place for actual fees and tariffs is the charging statement. It enables IUK to amend these fees if necessary without necessarily having to go through a CM amendment process. The initial registration fee for example has been set to zero for 2017-18 and is intended to be maintained at this level in 2018-19.

Buy Back Prices

One Shipper was concerned that IUK's proposal to inform Shippers of the need for a buy back on IUK's Information System would not be open to all the market and this may create REMIT concerns. We have amended the text to now refer to IUK informing Shippers on both the Bulletin Board and the Information System.

The other changes to the section had been proposed mainly to ensure the appropriate place for actual values of the parameters are in the Charging Statement and these be updated as necessary without necessarily going through a CM amendment process.

Simplification/ consistency changes

Some changes had been proposed for consistency and to update the CM to remove historical text. For example:

- Amendments to how prices are represented in section 2.2 (p/(kWh/h)/h) to reflect how prices are invoiced.

- The principles for any Allocation Mechanism pricing structure were amended to be generic rather than refer to the November 2015 Subscription Process which has now passed. The proposed changes have however now been amended to address Shipper feedback to make the text clearer and not be ambiguous.

- The background text explaining how to access capacity had some historical text on the STA being amended to introduce the CMP requirements. The section on balancing charges also had rules for the period to November 2015.

Section 3 - Consultation on Annex B-3 of the IUK Access Code containing IUK's updated Implicit Allocation Rules

3.1 Introduction

In August 2017, IUK also consulted on the introduction of an Implicit Allocation Mechanism("IAM") as a method for Shippers to purchase capacity in addition to the existing CAM NC auctions on PRISMA. This consultation introduced our proposal to implement Implicit Allocation[3] with Articles 8 to 37 of the CAM NC dis-applied, as per the provisions of Article 2.5 of the CAM NC. The disapplication of these Articles, is at the discretion of NRAs and will only be at times where capacity is offered via the Implicit Allocation Mechanism, outside of the CAM NC auctions. If IAM is approved by NRAs, IUK will be able to offer capacity at a fixed price, further in advance than currently allowed for in the CAM NC auctions, for more varied durations and not bundled with adjacent TSO capacity. IUK believes that having an additional way of booking capacity will enable more efficient use of the Interconnector, promote cross-border flows and support the UK, Belgium and other countries' gas security of supply leading to a reduction in the overall cost to end-consumers. As part of that consultation, IUK included a non-legal, non-binding example of the Implicit Allocation Rules which would form part of the IUK Access Code.

IUK is now consulting on Implicit Allocation Rules which will form Annex B-3 of the IUK Access Code, which are also published today. These Rules developed are consistent in terms of content with the drafting contained within the IAC for capacity allocation through the CAM NC auctions. IUK will also publish an Implicit Allocation Guidance Document ("IA Guidance Document") on our website which will notify the identity of Implicit Allocation Partner(s) and provide information on the limitations and restrictions applicable to capacity sold via Implicit Allocation. IUK has included a draft of the IA Guidance Document in this consultation, for information purposes only.

This second consultation provides the additional information that market participants requested to better understand purchasing IUK capacity through Implicit Allocation, such as when tariffs will be published and how the Implicit Allocation products interact with capacity offered via the CAM NC auctions. These points have been addressed in the changes to the Charging Methodology.

3.2 Summary of Key Changes to Implicit Allocation Mechanism proposal

3.2.1 Clarity on the Third Party arrangements

Shippers wanted more information on the Implicit Allocation process and the partners that will help us provide this mechanism. IUK is initially planning to proceed with the Broker – Communication Platform route to market, but will continue to work on offering Implicit Allocation through a European Exchange as well. Subject to NRA approval, IUK will provide this information in Spring 2018.

3.2.2 Publishing information on available capacity

IUK will be publishing the details of all capacity offered and sold through both Implicit Allocation and the CAM NC auctions on our website.

[3] Article 3.6 of the CAM NC defines Implicit Allocation 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."

3.2.3 Ensuring IAM does not undermine the CAM NC auctions

On 1 September 2017 IUK released a clarification note which outlined that IUK would only be requesting that Articles 8 – 37 of the CAM NC were dis-applied for capacity sold via the Implicit Allocation Mechanism. All capacity sold via the CAM NC auctions on PRISMA would be subject to the requirements of Articles 8 – 37. Following this, there was still a concern that IUK may be undermining the CAM NC auctions by using Implicit Allocation. As such, further restrictions, which are summarised below, have been proposed so that the CAM NC auctions remain the primary method for IUK to market its capacity.

Reduction of lead time for purchasing Implicit Allocation products

In response to the market concern that Implicit Allocation should not undermine the CAM NC auctions, IUK will be reducing the lead time for purchasing Quarterly and Monthly capacity via IAM to 1 year and 3 months respectively. As a result of restricting monthly capacity purchasing to 3 months rather than 6 months, IUK is ensuring that there is no overlap of monthly capacity sales into the next gas year prior to the start of the annual CAM NC auction. (IUK has to notify PRISMA how much capacity will be made available in the annual CAM NC auction 1 month in advance, so during this time in June/July no capacity for October will be offered through Implicit Allocation).

Alignment of IAM Quarterly products with CAM NC standard products

IUK had previously proposed that any 3 months could be used to make up a Quarterly IAM booking. However, following market feedback, we have introduced further restrictions on the Quarterly IAM Capacity meaning that the Quarterly Implicit Allocation Product must be aligned with the Standard CAM NC Quarterly Product (i.e. Q1 Oct- Dec, Q2 Jan – Mar, Q3 Apr – June and Q4 Jul – Sep).

Restrictions on the quantity of capacity offered through Implicit Allocation

To further safeguard the CAM NC auctions, IUK will limit the amount of capacity that can be purchased through the Implicit Allocation Mechanism in advance of the CAM NC auctions to 50% of the total available technical capacity. In our initial consultation IUK had proposed setting a limit on monthly capacity sales that would fall within the following gas year. However, market feedback suggests that restricting the capacity available across all product durations makes the market more comfortable that Implicit Allocation will not undermine the auction process.

IUK is proposing that the quantity of capacity to be offered via Implicit Allocation may be updated, on a rolling basis, every day, with a range of 0 - 50% of the available technical capacity.

Annex 2 summarises the timings and restrictions that will apply against Annual, 6 Monthly, Quarterly, Monthly and Day-Ahead capacity products offered via Implicit Allocation. IUK has further defined the profiling restrictions for capacity sold via Implicit Allocation so that capacity of one month or longer must have a flat profile for each building block. For example, capacity purchased for 2 months may be made up of a profile of 50 units in month 1 and 100 in month 2. Capacity with a duration of less than one month may be profiled down to a daily granularity.

3.3 Additional changes to the IUK Access Code (IAC)

IUK consulted on changes to the Access Terms as part of the August 2017 consultation.

The Access Terms includes:

- The IUK Access Agreement (“IAA”) which contains the general terms and conditions a Shipper must satisfy to access Interconnector capacity. By signing this, parties agree to adhere to the IUK Access Code.
- The IUK Access Code (“IAC”) details the access rules for IUK capacity acquired under the IAA.
- The System User Agreement (“SUA”) contains the terms and conditions for the System User to access and use the IUK information and management system or its successor system

Following our initial consultation we have made further drafting changes to the IAC to ensure consistency and clarity throughout. These can be seen in the marked up version of the IAC included as part of this consultation.

Section 4 - Your feedback and next steps

We are interested in hearing your views on our proposed changes to our Charging Methodology and Implicit Allocation rules. We would appreciate comments from all interested parties. In particular, we would welcome your response to these specific questions:

Charging Methodology

1) Do you support our proposals to publish binding price ranges for the coming gas year for short term products 30 days in advance of the annual CAM auction?
2) What are your views of the two pricing options for Day Ahead and Within Day in advance of the annual CAM auction?
3) Do you support IUK's commitment to apply the same binding price ranges for Implicit Allocation products?
4) Do you support our proposals for when actual prices are published?
5) Do you have any other feedback on the final CM proposals?

Implicit Allocation

6) Do you agree that the limitations to the Implicit Allocation Mechanism are sufficient to ensure that the CAM NC auctions are not undermined?
7) Do you support the proposal that IUK publishes on its website an Implicit Allocation Guidance Document outlining the third party involvement, product restrictions and further information relating to the Implicit Allocation Mechanism?
8) Do you have any comments on the Implicit Allocation rules included in Annex B-3 of the IAC?
9) Do you agree with the other drafting changes proposed to the IAC?

Please send your response to consultation@interconnector.com by 17:30 UKT on **22 November 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.

Additionally, IUK will also hold a workshop on **31 October 2017** at IUK's London office to present its latest thinking on these proposals. If you would like to attend please email: Sarah Cooper (sarah.cooper@interconnector.com).

Following market consultation, IUK will review market responses and will aim to submit its proposals on all areas outlined above (i.e. IUK's Charging Methodology, IUK's Access Terms, Derogation Application from the Tariff Network Code and Implicit Allocation Mechanism) to Ofgem and CREG for approval in early **December 2017**.

NRA decisions are expected by early **March 2018** at the latest. Subject to NRA approval, IUK will implement Implicit Allocation in **Spring 2018** and will also share its proposed tariffs for Implicit Allocation with the market. IUK will aim to publish its Charging Statement annually in June, starting from June 2018, in accordance with the Capacity Allocation Mechanism Network Code ("CAM NC").

If you have any questions or wish to clarify any aspect of the final proposals please contact:

Charging Methodology proposals:
Pavanjit Dhesi (Pavanjit.dhesi@interconnector.com)

Implicit Allocation rules:
Danielle Stoves (Danielle.stoves@interconnector.com)
or Sarah Cooper (Sarah.cooper@interconnector.com)

Yours Sincerely,

Sean Waring
Chief Executive Officer

Annex 1 Summary of key concerns raised by Shippers in the first consultation

<u>Charging Methodology</u>

Publication of prices

Five Shippers commented on needing more information on when IUK would publish prices. One Shipper argued it was not enough to publish a timetable on IUK's website but that it should be consulted on and included in the CM.

Pricing of implicit allocation relative to explicit products

Five Shippers asked for more clarity on how the pricing of implicit allocation products would be calculated compared to the standard products offered on PRISMA.

Pricing levels - Multiplier cap and ranges

Related to the TARDA application and the need for pricing transparency, four Shippers commented on the need for more information on IUK's multiplier levels, caps or ranges. Two Shippers encouraged IUK to find a solution where flexibility was limited to pre-agreed caps.

Risk premium

Three Shippers commented on the proposal to include a risk premium as a factor in determining the reserve price. All three asked for further details on its level and what capacity products this would relate to.

Other comments

Two Shippers supported the simplification of commodity charges and for this charge to be an ex-ante published price. One Shipper wanted to ensure this charge would only cover the cost of providing the service and not provide IUK a double revenue.

There were additionally some general remarks about providing more explanation on the proposed changes.

<u>Implicit Allocation Mechanism</u>

All the stakeholders who responded to the IAM section of IUK's consultation broadly supported the proposal.

Third Party Arrangements

Shippers noted that they would like to see more information on how the allocation process would work with a third party, in particular whether IUK would be using an Exchange or a Broker/Communication Platform. IUK also received several queries regarding the treatment of the third party fees.

CAM NC Auctions

A common theme within the majority of the responses was that Implicit Allocation should be a secondary mechanism to the CAM NC auctions. Several respondents were concerned that Implicit Allocation may undermine the CAM NC auctions.

Pricing

Several of the responses requested information on how the Implicit Allocation pricing would relate to the pricing of the standard CAM NC products. One Shipper commented that without the pricing information it was not possible to assess whether Implicit Allocation was a viable method of purchasing IUK capacity.

Other Issues

Several of the responses raised concerns that about the availability of adjacent TSO capacity and the fact that there was no alternative to purchasing this capacity through the CAM NC auctions on PRISMA which would expose them to potential auction premia.

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Annex 2: Implicit Allocation 'Standard' Product Limitations

Product length	Offered through IAM	Auction Publication on PRISMA, capacity not offered through IAM	Auction Start on PRISMA	Restrictions
Annual	Any time during the 15 years in advance of the period Any 4 Quarters	4 weeks before Auction Start	1st Monday of July for following 15 Gas Years	0-50%* offered Profiling: Yearly granularity for years 4-15, 6 monthly granularity in years 1-3
6 monthly	Any time during the 3 years in advance of the period Any 2 Quarters	n/a	n/a	0-50%* offered Profiling: 6 monthly granularity for years 2-3, quarterly granularity in the first year
Quarterly	Any time during 1 year in advance of the period Standard Quarter as per CAM NC definition	2 weeks before Auction Start	1st Monday of August for Q4, Q1, Q2, Q3; Nov for Q1, Q2, Q3; Feb for Q2, Q3; May for Q3	0-50%* offered Profiling: Quarterly granularity
Monthly	Any time during the 3 months in advance of the period Any calendar month	1 week before Auction Start	3rd Monday of each month for next month	0-50%* offered Profiling: Monthly granularity
Day-ahead	Any time after Monthly auction on PRISMA	At Auction Start	15:30 UKT / 16:30 CET day before	0-50%* offered Profiling: Daily granularity

**IUK will update the quantity of capacity offered through Implicit Allocation every day using a maximum of 50% and minimum of 0% of the technical available capacity. This will be published on the IUK website.*