RWE

Sean Waring
Chief Executive Officer
Interconnector (UK) Limited
10 Furnival Street
London EC4A 1AB

MFM-D

Your ref.	
Your letter	Your letter
Our ref.	Our ref
Contact	Steve Rose
Phone	+44(0)1793 475279
Email	stephen.rose@rwe.com

Swindon, 22/11/17

Consultation on IUK's Charging Methodology, updated Implicit Allocation rules and Access terms

Dear Sean,

RWE Supply & Trading (RWEST) is happy to share its views on IUK's revised proposals regarding the above. Our views are not confidential and may be published on IUK's website.

RWEST reiterates its support for the introduction of implicit allocation and welcomes the changes and clarification IUK has made to its initial proposals. As a consequence it is now clearer that explicit allocation is expected to remain the primary method of capacity allocation, as prescribed by Regulation 2017/459 (CAM NC), with implicit allocation as a complimentary subsidiary mechanism. However, there are still aspects of the proposals which challenge this distinction and which, on the face of it, could disrupt the efficient functioning of the market.

Based on IUK's position as a merchant interconnector TSO with no captive customers, it does seem appropriate to allow it more flexibility in price setting than Regulation 2017/460 (TAR NC) currently allows. However, market participants will still need more certainty and direction on prices than IUK are currently proposing if they are to efficiently fulfil their role of setting price spreads between the UK and continental gas markets. Without such certainty and direction there is a danger that IUK will fulfil this role de facto, which would be a retrograde step.

Whilst the existing long-term capacity contracts have been in place market participants have not needed to book short term capacity. So they are not yet familiar with how IUK capacity prices interplay with market dynamics. Implicit allocation is also a new concept and at this stage it is difficult to predict how effective it will be. At the same time the UK gas market is experiencing structural change (e.g. Rough closure) and regulatory change (e.g. Gas Transmission Charging Review, BBL integration, Brexit). So IUK should avoid making their proposals overly complicated and flexible at this point in time. And regulators should avoid sanctioning derogations to EU Regulations which are too broad or open ended.

RWE Supply & Trading GmbH
Swindon Branch

Windmill Hill Business Park
Whitehill Way
Swindon SN5 6PB
United Kingdom

T +44(0)1793/87 77 77
F +44(0)1793/89 25 25
I www.rwe.com

Registered No. BR 7373

VAT Registration No.
GB 524 921354

Supervisory Board:
Dr Markus Krebber (Chairman)

Board of Directors:
Andree Stracke
Dr Michael Müller
Peter Krembel
Tom Glover

Head Office:
Essen, Germany
Registered at:
Local District Court, Essen
Registered No.
HR B 14327

Bank details:
Deutsche Bank Essen
Bank Code 360 700 50
Account No. 105 127 500
SWIFT: DEUTDEDE
IBAN: DE05 3607 0050 0105
1275 00

Whilst IUK is required to review its Charging Methodology annually the current draft excludes factors relevant to the cost of flow[1] (e.g. multipliers, interruptible discounts, commodity charges). Consequently, proposals that market participants consider appropriate now, but which become inappropriate later, could persist indefinitely. This must not be allowed to happen. Instead, flexible capacity pricing and implicit allocation should be introduced progressively, in such a way as to deliver a "win-win" to both IUK and market participants

Our answers to the specific questions raised in the consultation are as follows.

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?*

Not entirely. Market participants require more certainty over the multipliers that will apply for core short term capacity products, in order to determine whether annual capacity is worth booking to support their futures market trading activities.

As regards explicitly allocated capacity, at least the multipliers for quarterly and monthly products should be fixed for each forthcoming gas year and published 30 days in advance of the annual CAM NC auctions. However, multipliers for day-ahead and within day products could be published as a range, which would give IUK flexibility to optimise capacity sales in relation to spot market dynamics.

Multipliers for all implicitly allocated capacity products could be published as ranges too, reinforcing the primacy of explicit allocation. IUK would then have flexibility to price unsold capacity and allocate it implicitly, maximising its opportunities to earn revenue commensurate with market conditions. No doubt IUK will want to ensure this is done in such a way so as to avoid undermining capacity previously allocated through the CAM NC auctions. So this will create a healthy tension between the desire for stable sustainable capacity sales and the need for flexibility to optimise product offerings in light of market conditions.

2) What are your views of the two pricing options for Day Ahead and Within Day in advance of the annual CAM auction?

We prefer multipliers for day-ahead and within day capacity products to be subject to a binding range (Option 1), not an average range with a cap.

[1] These factors are currently intended to be included in IUK's Charging Statement , which is not subject to consultation and which may, or may not, include sufficient justification.

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3) Do you support IUK's commitment to apply the same binding price ranges for Implicit Allocation products?

Yes. However, as previously stated in our response to question 1, we think multipliers for explicitly allocated quarterly and monthly capacity products should be fixed for each gas year.

IUK's proposals currently envisage multiplier caps for monthly, day-ahead and within day capacity products far in excess of those defined in the TAR NC, possibly to incentivise annual capacity bookings. Without any real world experience of how these will be applied and how the market will react it is hard to say whether these are appropriate or not. However, lower multipliers do not necessarily mean lower revenues and could trigger surplus demand, in which case IUK would earn auction premiums.

4) Do you support our proposals for when actual prices are published?

No. As previously stated in our response to question 1, quarterly and monthly capacity multipliers should be fixed for the forthcoming gas year and published 30 days before the annual CAM NC auction. Actual prices would still be published at the same time as the amount of capacity offered in each respective auction, but there should be no ambiguity as to what these would be.

Day-ahead capacity multipliers should be notified to the market more than 5 hours before the day-ahead CAM NC auction. Publishing the multiplier at 10:30 UK time (11:30 Continental European time) risks stagnating prompt trading, both in outrights and spreads, during what is one of the busiest trading times of the day. Publishing day-ahead capacity multipliers no later than 09:00 UK time on each UK business day would be more appropriate, with day-ahead multipliers for non-business days defaulting to those published on the previous business day.

As for within day capacity multipliers, we do not think IUK should be allowed complete flexibility to alter these every hour for the remainder of the gas day. Whilst it may find it difficult to effectively operate in such a manner it potentially gives IUK scope to "front-run" the market in response to supply disturbances and significant changes in NDM demand allocations. This would be wholly in appropriate. Much better in our view would be a system whereby the published prevailing day-ahead capacity multiplier defaults to the within day capacity auctions each day. Atypically, IUK could deviate away from this default with justification. But such deviations should be notified at pre-defined set times (e.g. 09:00 and 15:00 UK time) and applied from the next within day auction thereafter.

5) Do you have any other feedback on the final CM proposals?

Whilst multipliers remain outside the scope of the Charging Methodology we think there should be an obligation in the methodology for IUK to publish an annual report on the use of multipliers, This would show what impact they had on booking behaviour, revenue recovery and cross-border flows and is consistent with the obligation under the TAR NC (Article 13.3), which IUK is seeking a derogation from.

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?

Yes, to an extent. Limiting the amount of capacity that can be allocated implicitly to 50% of the available technical capacity, ensuring that specific capacity products are not simultaneously allocated whilst CAM auctions are taking place and restricting the period in advance for which quarterly and monthly capacity can be implicitly allocated are sensible improvements to IUK's previous proposals.

However, the capacity products that IUK offer implicitly must be broadly consistent with the commodity products that typically trade in UK and continental gas markets. This avoids over complication and possible confusion. Bearing this in mind, we still think that 15 years is too long a period for IUK to be allocating capacity implicitly on an annual basis (5 years seems more sensible). And IUK's proposals to allow temporal profiling for all products offered implicitly (with differing degrees of granularity) are superfluous, as the equivalent commodity products exclusively trade flat.

Whilst we support capping the amount of capacity subject to implicit allocation, we are concerned about IUK's proposal to update the quantity offered between 0% and 50% each day. Assuming capacity has not sold out, market participants will not understand why it is not being made available (or fully available). So extensive use of this option risks distorting the market and will undermine confidence in implicit allocation as an effective complimentary allocation mechanism.

Also, whilst conceding that IUK should have more flexibility to price monthly, quarterly and seasonal products implicitly, compared to explicitly, we also have concerns about IUK amending these prices each day. Extensive use of this option similarly risks distorting the market and undermining confidence in implicit allocation.

So maybe a certain minimum percentage (e.g. 25%) of available technical capacity should always be made available implicitly. And the prices for implicitly allocated seasonal, quarterly and monthly capacity should be set at the beginning of each week, at least until such time as the market gets used to this complementary subsidiary mechanism.

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?

Yes. However, the current draft guidelines refer to a matched product as being one where gas is purchased at a delivery point or hub within NW Europe and

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matched at the same time with an equivalent amount of capacity. Presumably matched products could equally be generated by sales of gas, but IUK's definition of NW Europe is too wide. It should only include hubs or delivery points beyond the borders of Belgium's immediate neighbours (i.e. Austria, Italy and Denmark should be excluded).

Once IUK has announced its Implicit Allocation Partner(s) further clarification will be needed around the operational and timing aspects of matched products. The guidelines should also clarify who is responsible for notifying matched product trades (both capacity and commodity) under REMIT.

8) Do you have any comments on the Implicit Allocation rules included in Annex B-3 of the IAC?

We have not been able to review the IAC changes in the time available. A separate legal note outlining all the changes to the IAA, IAC and SUA and explaining the reasons for such changes would help our lawyers to undertake this review.

9) Do you agree with the other drafting changes proposed to the IAC?

See our response to question 8.

Yours sincerely,

Steve Rose
Head of Gas Market Design & Regulation
RWE Supply & Trading GmbH

Konrad Keyserlingk
Senior Expert Regulatory Affairs
RWE Supply & Trading GmbH