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12 December 2013

Dear Rob,

RE: Options for Great Britain's implementation of the European Union Network Code on Capacity Allocation Mechanisms (CAM) in Gas Transmission Systems (Regulation 984/2013) as the Bacton entry point

Thank you for the opportunity to respond to this consultation. Our response to the consultation questions are outlined in Annex 1.

CAM Bundling

We agree that it is appropriate for each GB connected gas interconnector to choose which bundling model best meets their particular future operational and commercial needs. We note that BBL, IUK and, indeed, the Irish interconnectors are operationally and commercially different. As long as the proposals are network code compliant, either 2 TSO or 3 TSO bundling should be permitted. Shippers will benefit from more choice if there are different options.

IUK's success depends on facilitating cross border trade. We believe 2 TSO bundling would be the best solution for IUK to meet the CAM requirements. This is for five key reasons:

- Less complexity compared to 3 TSO bundling
- Enables flexibility services to be offered to shippers
- Enables entry via the SILK entry point
- Enables a wider group of shippers to acquire capacity
- Enables the possibility of future connections

We will outline, in the Concept Document being developed with our adjacent TSOs, more details on how we propose to implement the new CAM and Balancing network code requirements.

Selling entry capacity at Bacton

Given the prescriptive bundling rules under CAM, which do not allow for bundled capacity to be used in an unbundled manner at interconnection points, the only option that we can see is for Bacton NTS capacity to be split. We agree that this split should allocate NTS entry capacity at Bacton to meet the maximum BBL and IUK technical capacities. This is necessary to meet the Third Energy Package and Security of Supply Regulation requirements that TSOs will offer their maximum technical capacity at interconnection points. This maximum technical capacity requirement applies equally to NTS exit from Bacton to IUK.

In considering how to split Bacton capacity that is already sold, we believe that it is important to ensure that there is no discrimination between users of the different Bacton entry points. Distorted incentives in the use of the entry points should be avoided. There should therefore be as much consistency as possible in the trading arrangements at both of the proposed Bacton entry points.

If you wish to clarify anything outlined in this letter please do not hesitate to contact me or my colleague Pavanjit Dhesi.

Yours Sincerely

Robert Sale

Business Development and Regulation Director

ANNEX 1: IUK response to consultation questions

2. Do you agree with the advantages and disadvantages of the 2 and 3 TSO bundle options as presented? Are there any further advantages or disadvantages to be considered?

2 TSO bundling has a number of advantages for IUK and for the market:

- Less complexity

2 TSO bundling allows Bacton issues to be considered separately from Zeebrugge issues. This is likely to make the implementation deadline more achievable and less costly. We have already seen from the discussion around Bacton splitting that there are some difficult issues to address when bundling capacity at interconnection points. Each interconnection point has its particular historical arrangements. It follows that bundling capacity across multiple interconnection points in a single product is likely to be even more challenging than if the historical and national arrangements of 2 countries can be considered individually.

- Enables flexibility services to be offered to Shippers

IUK currently provides its shippers an inventory service. The inventory service allows shippers the flexibility to vary their entry and exit flows. This service is valued by shippers and helps them to meet their balancing needs in GB and Continental markets. A 2 TSO bundle would enable inventory services to continue to be offered when the capacity becomes available from October 2018 as a bundled product. A 3 TSO bundle would not allow inventory services to be offered and this flexibility would be lost from the market. Currently this inventory flexibility can provide as much as 12mcm (138GWh) of flexibility depending on flow rates.

- Enables entry via the SILK entry point

IUK currently has 3 entry points, with an entry connection via the SILK pipeline. This enables the possibility for UKCS production to enter the Interconnector pipeline directly. A 3 TSO bundled product would not accommodate entry via SILK, reducing optionality for shippers and removing a product offering from IUK.

- Enables a wider group of Shippers to acquire capacity

2 TSO bundling will allow a wider group of shippers to access capacity and allows capacity to be sold in Sterling at Bacton. Currently the holder of capacity in the Interconnector does not have to be active in both markets as it can trade at the entry and exit of the pipeline. Under bundling the party has to be the same across the bundle. A 3 TSO bundle would require shippers who currently operate in only one market to register within the other market as well. This may result in additional costs in terms of legal obligations such as acquiring licences and understanding the different market arrangements. This may discourage smaller shippers or new entrants from acquiring bundled capacity. A 2 TSO bundle on the other hand would allow for a shipper who is active in just one market (for example a shipper who is focussed on the GB market) to just buy bundled NGG/IUK capacity at Bacton.

- Enables the possibility of future connections

Whilst no new connections are envisaged in the immediate future, an unintended consequence of a 3 TSO Bundle would be to foreclose the possibility of additional connections to IUK in the future.

3. Do you consider that it would be possible for a 3 TSO approach to accommodate a linepack service (as currently offered by IUK)? If so, please provide details as to how this could be facilitated.

No, it is unclear to us how this would be possible. The 3 TSO bundle, as described on p5 of the consultation letter, suggests the interconnector's entry and exit points are collapsed creating an elongated point, with a single nomination across the three TSOs. This means "in equals out" on the interconnector, limiting its ability to offer flexibility services.

4. To what extent do you consider the classification of interconnectors as balancing zones as an opportunity, rather than a disadvantage, of the 2 TSO model?

We do not believe that there are significant disadvantages if interconnectors are classified as balancing zones. The balancing code allows the use of within day obligations and the use of adjacent trading platforms. The code also includes the requirement to take into account the specific nature of interconnectors which permits proportionate rules to be implemented. We believe therefore that compliant balancing rules can be established which serve to facilitate and enhance cross border trade, not hinder it. For example, we are considering the possibility of a link to the ZeeBeach trading platform. 3 TSO bundling, in our view, offers no flexibility to shippers to vary their flows on the IUK interconnector and the "in equals out" principle would also mean that allocations of gas in the Fluxys system would need to align precisely with allocations of gas in the NGG system. 2 TSO bundling on the other hand enables IUK to continue offering shippers some flexibility services. We will outline, in our Concept Document, more details on how we propose to implement the new balancing requirements.

5. Which of the bundle options (2 or 3 TSO bundle) would best enable shippers to react to price differentials between hubs?

The July 2013 Interconnector Efficiency Review undertaken by the GB, Belgium and Dutch regulatory authorities demonstrated that flows across IUK respond well to price differentials between the different hubs. So bundling of capacity is not a necessary condition to enable shippers efficiently to react to price differentials between hubs. In the future, in compliance with the Network Codes, both 2 and 3 TSO bundling will give shippers the opportunity to react to price differentials between hubs. The difference in transaction costs between the two models is expected to be minimal. 2 TSO bundling has the clear advantage that it would allow the use of flexibility in the IUK interconnector in response to price signals. It should also allow a wider group of shippers to access capacity and thereby react to price changes.

6. Do you have a preference for a 2 TSO or 3 TSO bundle? If so, please provide the reasons for your preference.

As outlined in our response to question 2 we believe that for IUK a 2 TSO bundle is appropriate for five key reasons:

- Less complexity
- Enables flexibility services to be offered to shippers
- Enables entry via SILK
- Enables a wider group of shippers to acquire capacity
- Enables the possibility of future connections

We believe a 2 TSO model will facilitate cross border trade and enable shippers to react better to price differentials between different markets. The provisions within CAM specify short term products must be offered and capacity reserved for these short term auctions. The European timetable for auctioning capacity furthermore mandates the sale of capacity at the same time across all interconnection points in Europe. This together with new congestion management procedures, which introduce over-subscription, surrender and long term use it or lose it mechanisms, mean that the risks for shippers of not being able to acquire capacity (or of getting capacity at only one interconnection point) will be minimal. We will, nevertheless, explore the feasibility of enabling shippers to link the bidding for capacity at both interconnection points to mitigate against this risk.

7. Do you agree with our current view that interconnectors should choose the bundling model subject to meeting the requirements of CAM and the objectives of their access rules? Would you have any concerns if different options for bundling were chosen by the two interconnectors?

Yes, we agree that the interconnectors should choose the most appropriate model and the one that best meets their operational and commercial requirements. We do not see why the solutions need to be the same. BBL, IUK and, indeed, the Irish interconnectors are operationally and commercially different. For example IUK is physically bi- directional and provides an inventory service whilst BBL physically flows in one direction and operates an "in equals out" balancing requirement. It is rational therefore for these assets to decide on the bundling solutions which best meet their circumstances. If the interconnectors do propose different options, shippers may actually benefit from more choice and these shippers will ultimately decide through the market whether they like both models or prefer one over the other. As long as the interconnectors propose compliant models which meet the objectives of the CAM code either option should be permitted.

8. Do you agree with the advantages and disadvantages of the various options in respect of the future mechanism for selling entry capacity at Bacton? Are there any further advantages or disadvantages to be considered?

The CAM code requires capacity at either side of an interconnection point to be bundled and the use of a single nominations process. Once bundled, this capacity cannot be used in an unbundled manner and the capacity can be sold on the secondary market only as a bundled

product. The CAM rules also restrict the sale of long term unbundled capacity. Therefore, the only option that we can see is for NTS Bacton entry capacity to be split.

9. Do you agree that, for the time being, CAM auctions should only be implemented in respect of capacity at IPs (and not extended beyond the scope of CAM)?

As a flexibility source, IUK competes with other interconnectors, LNG, storage and production. It is important therefore to ensure that there is no discrimination against users of the different entry points and that there are no distorted incentives to buy capacity at one entry point rather than another. As a general principle there should be as much consistency as possible in the trading arrangements. We, and others, have highlighted in the Tariff Framework Guidelines development process our concern that mandating the use of floating reference prices at interconnection points is likely to discourage long term bookings given that shippers will not know with certainty what price they will pay when using the capacity. Without long term bookings there is a risk to security of supply, tariff stability and the financial stability of TSOs like IUK whose business depends on revenue from the interconnection points. These risks will only be exacerbated if interconnection capacity is auctioned with floating prices while other entry points use different auction rules.

Fixed capacity prices have proven successful in GB to develop adequate capacity and to facilitate flows into GB when required. The CAM rules permit both floating and fixed prices to be used for the auctions. We would urge Ofgem, via ACER, to permit ENSTOG to allow both floating and fixed prices in the Tariff code. This would allow GB the opportunity to explore the merits of the different options and choose the most appropriate solution.

11. Do you therefore agree that there is a need to split the Bacton ASEP? If not, please provide details of how you consider CAM can be implemented without the Bacton ASEP being split.

As noted in our response to question 8 the rules imposed by the CAM code mean that we cannot see any alternative to NTS Bacton entry capacity being split.

12. If your view is that there is a need to split the Bacton ASEP, do you agree that it is appropriate to allocate NTS entry capacity at Bacton to meet the maximum BBL and IUK technical capacities and leave the remainder to be sold as UKCS entry under the UNC auction? If not, what do you consider should be the allocation?

We agree that it is appropriate to allocate NTS entry capacity at Bacton to meet the maximum BBL and IUK technical capacities. We believe that this is necessary to meet the Third Energy Package and Security of Supply Regulation requirements for TSOs to offer their maximum technical capacity at interconnection points. This requirement is also reflected under Article 6.1 (a) of the CAM code and Standard Licence Condition 19.3 of our Interconnector Licence, which states the licensee shall "promote security of supply by taking into account all economically reasonable and technically feasible demands for capacity on the licensee's interconnector". For the IUK exit /NGG entry bundle therefore, 807.6 GWh/day of capacity should be made available. This maximum technical capacity requirement applies

equally to NTS exit from Bacton to IUK meaning the existing exit capacity should be maintained for bundling.

13. Do you agree that a single European IP ASEP approach is appropriate (ie, no further division of capacity between the two interconnectors)? If not, please explain why you consider that there should be two European IP ASEPs.

As outlined in our response to question 12, both interconnectors' maximum technical capacity must be made available in the respective bundles. This would allow a GB entry bundle (NGG entry/IUK exit) and a GB exit bundle (IUK entry/NGG exit). As long as both BBL and IUK are provided their full technical capacity, and this capacity is ring fenced from substitution, a single Bacton European interconnection point appears acceptable. It should be noted that once the bundle is purchased, the capacity can only be used in a bundled manner or resold on the secondary market as a bundled product. In that respect it effectively splits the Bacton NTS interconnection capacity again. We see the advantage of a European interconnection point as primarily to allow existing NTS Bacton capacity holders the optionality to use their Bacton NTS capacity with either IUK or BBL capacity.

14. Do you agree that capacity should not be fungible between UKCS ASEP entry and European IP entry? If not, how do you consider such fungibility should be accommodated given CAM network code requirements?

Given the prescriptive rules outlined in the CAM code, it is difficult to see how the bundled CAM products could be made fungible with UKCS ASEP capacity. It would mean allowing shippers to unbundle the CAM bundle in some way. This is restricted under CAM rules.

15. How should long-term (historical) entry capacity contracts at Bacton be dealt with?

This is an issue that needs to be explored further and it is important that users of one of the proposed points are not disadvantaged in comparison to the users of the other point or capacity at one point is sterilised. This means that arrangements at both the proposed Bacton ASEP entry points need to be as consistent as possible. We have sympathy with some of the views expressed by shippers at the 25th November CAM workshop that they have currently purchased an option. By requiring these shippers to split their holding their future flexibility is disadvantaged. With potentially different tariff arrangements at the UKCS Bacton point and Bacton European IP under consideration in the GB charging review, it is difficult to assess the consequences of splitting the capacity.

17. If you are a current holder of Bacton-IUK Interconnector exit capacity, we would welcome your as to whether you will choose to maintain your existing enduring Bacton-IUK Interconnector exit rights post 2018, and if not the process you would like to see regarding end dating of these contracts.

Bacton IUK exit capacity like Moffat exit capacity must be made available at the maximum technical capacity. This is necessary to meet the Third Energy Package and Security of Supply Regulation requirement for TSOs to offer their maximum technical capacity. This requirement is also reflected under Article 6.1 (a) of the CAM code which also states that

the maximum technical capacity should be made available at the interconnection points meaning that the existing exit capacity should be maintained for bundling.