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CC. Marie-Pierre Fauconnier,
President of the Commission de
Régulation de l'Electricité et du
Gaz (CREG)

Date: 19 December 2014

Dear Sean,

Approval of the access rules and charging methodology submitted by Interconnector (UK) including directions to approve pursuant to Standard Licence Condition (SLC) 11A and 10 of the gas interconnector licence ('licence').

Approval of provisions to implement relevant aspects of the CMP Guidelines¹, pursuant to Annex I point 2.2 of the Gas Regulation².

On 30 September 2014 Interconnector (UK) ('IUK')³ submitted access rules and a charging methodology for a new contractual framework, the IUK Access Agreement (IAA), to the Authority⁴ for approval. These were submitted pursuant to Standard Licence Condition (SLC) 11A(2) and SLC 10(2) respectively of IUK's licence⁵.

IUK also submitted the proposed amendments to the existing long-term contracts known as Standard Transportation Agreements (the 'proposed STA amendments'), for Ofgem to ensure compliance with the CMP Guidelines in accordance with Article 24 and Annex I point 2.2 of the Gas Regulation.

This letter and the annexed directions set out our approval of the submitted proposals. Attached to this letter are two directions to IUK approving the proposed access rules and charging methodology on the basis that they meet the relevant access rules objectives⁶ and relevant charging methodology objectives⁷. This letter also contains the approval of the provisions implementing relevant aspects of the CMP Guidelines.

¹ Annex Point 1 of Commission Decision 2012/490/EU of 24 August 2012 on amending Annex I to Regulation (EC) No 715/2009 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks (the 'CMP Guidelines').

² Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 as amended (the 'Gas Regulation').

³ IUK is a certified Transmission System Operator (TSO) and holder of a gas interconnector licence. It operates a bi-directional gas interconnector that links the UK and continental European energy markets.

⁴ The Gas and Electricity Markets Authority. Ofgem is the Office of the Authority. The terms "Ofgem", "the Authority", "we" and "us" are used interchangeably in this letter.

⁵ The current version of the gas interconnector licence standard licence conditions can be found at <https://epr.ofgem.gov.uk/>

⁶ The relevant access rules objectives are set out in SLC 11A(5) of the licence.

⁷ The relevant charging methodology objectives are set out in SLC 10(4) of the licence.

Background

Ofgem, in its role as National Regulatory Authority (NRA) for Great Britain (GB) is responsible for overseeing implementation of the legally binding 'Guidelines' and 'Network Codes' established under the suite of European Union (EU) legislation on European electricity and gas markets, referred to as the 'Third Package'⁸. Part of these responsibilities includes ensuring compliance of the TSOs it regulates with their obligations under the CMP Guidelines.

The CMP Guidelines aim to reduce contractual congestion by getting unused capacity back to the market. They introduce four mechanisms at interconnection points on all TSOs, including IUK: oversubscription and buy-back (OSBB), capacity surrender, long-term use-it-or-lose-it (LT UIOLI) and day-ahead UIOLI.

On 12 March 2013 Ofgem published an open letter recommending an industry-led approach to implementing the CMP Guidelines in GB⁹. It stated that, in accordance with the CMP provisions in the Guidelines, day-ahead UIOLI would only be introduced in 2016 if OSBB is not functioning efficiently. Throughout the implementation process, Ofgem consulted and took account of views shared by all relevant parties including CREG (the Belgian NRA), other neighbouring NRAs, ACER¹⁰ and the European Commission¹¹.

IUK conducted two consultations in 2013, each running for four weeks¹². Launched on 30 April 2013, the first was on the principles for implementing the three CMP mechanisms: OSBB, surrender and LT UIOLI. A summary of the 12 representations and IUK's response was published on 17 July 2013 on IUK's website. The second consultation was launched on 10 October 2013 and sought stakeholders' views on a new contractual framework: the IUK Access Agreement (IAA) and an associated IUK Access Code (IAC).

Prior to submitting documents to us for approval, IUK furnished the Authority with a report in December 2013 pursuant to SLC 11A(6)(b) and SLC 10(5)(b) of the licence. The report set out the terms originally proposed, the representations made by interested persons, and the changes as a consequence of the consultations.

Proposal

IUK proposes to introduce a new contractual framework (the IAA) to set out the rules for accessing IUK's interconnector. In parallel, IUK has prepared an amendment to modify the existing Standard Transportation Agreements (STA), which all existing STA users will be asked to execute.

1. Proposed Access Rules

The following documents were submitted by IUK for approval as its access rules in accordance with SLC 11A(2) of its licence:

⁸ In relation to gas, the Third Package includes Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (the "Gas Directive") and the Gas Regulation.

⁹ Ofgem Open Letter: Next steps for Great Britain's implementation of the first European Union network code for gas on CMP, 12 March 2013 <https://www.ofgem.gov.uk/ofgem-publications/59242/ofgem-cmp-implementation-open-letter.pdf>

¹⁰ The Agency for the Cooperation of Energy Regulators established by Regulation 2009/713/EC of the European Parliament and of the Council of 13 July 2009. ACER non-binding guidance for NRAs, "Issue Paper" on the need for coordinated decisions at EU level for the implementation of the Congestion Management Procedures Guidelines, 8 August 2013, http://www.acer.europa.eu/Official_documents/Lists/Other%20documents/Attachments/3/ACER_CMP_Guidance%20issue%20paper%20on%20CMP%20implementation_20130808.pdf

¹¹ Commission Staff Working Document 'Guidance on best practices for congestion management procedures in natural gas transmission networks' 11 July 2014, SWD(2014)250 http://ec.europa.eu/energy/gas_electricity/codes/doc/20140711_guidance_congestion_management_ngtn.pdf

¹² The consultation documents are available on IUK's website, <http://www.interconnector.com/about-us/what-we-have-to-say/consultations/>

- The IAA is a wrap agreement setting out general terms and conditions that a user must accept to obtain interconnector capacity.
 - By signing the IAA, users are bound by the IAC as well (see below).
 - If a user is already a signatory to the STA, and wishes to access capacity made available under the IAA, it must also sign the IAA. Such STA users' operations under the IAA will be in parallel to their STA operations.
- The IAC includes arrangements for obtaining capacity, nomination procedures, OSBB, balancing arrangements and operating rules.
 - It introduces a new way of accessing IUK capacity in addition to IUK's current secondary market mechanisms.
 - In the IAC, IUK offers day-ahead capacity in a 'pay-as-bid' auction.
 - All capacity offered under the IAC stems from the application of the three CMP mechanisms: OSBB, surrender and LT UIOLI.
 - Under the OSBB mechanism, IUK can offer additional capacity in excess of technical capacity, and a capacity buy-back process applies if aggregate nominations exceed (or are expected to exceed) technical capacity¹³.
 - If buy-back is triggered, IUK determines the quantity of capacity required to reduce aggregate nominations to within the system's physical capability. IUK publishes a notification, providing details of the buy-back required. A voluntary auction-based process allows IAA and STA users to sell capacity back to IUK in the buy-back process and IUK will accept offers in order of price, starting with the lowest offer. If buy-back is triggered after 22:00 (UK time) or IUK's buy-back requirement is not met by the voluntary process, a 'forced buy-back' process applies whereby the relevant amount of capacity is bought from all IAA users on a pro rata basis.
- The System User Agreement (SUA) sets out general terms and conditions for all users to access IUK's IT system, through which capacity can be obtained and used. It covers all IUK users (signatories to the STA and IAA as well as STA sub-lessees).

A document summarising the new framework for prospective users was also provided to the Authority for information and we note IUK intends to publish this 'IAA Summary' alongside the approved IAA, IAC and SUA. The new documents will be introduced once approved, running in parallel to the STAs.

2. *Proposed Charging Methodology*

IUK's proposed charging methodology sets out how the proposed charges and payments applied under the IAA have been derived.

Given that the IAA will only offer capacity released by the application of the CMP mechanisms until the STA expires, the charging methodology is at present related to CMP capacity releases. Future modifications to the charging methodology are anticipated in 2015 and will be necessary to incorporate capacity made available beyond the STA expiration date (30 September 2018).

The proposed charging methodology introduces several charges and payments, including:

- a registration fee introduced for new users signing up to the IAA.
- a monthly administration fee applied to each user in addition to capacity-related charges.

¹³ IUK will offer capacity in excess of the technical capacity level on a day-ahead basis under OSBB. The amount offered will be up to 15% of IUK's technical capacity. Capacity surrendered or withdrawn under the STA is offered under the terms of the IAA and IAC.

- a reserve price for day-ahead capacity, calculated from the average cost of capacity derived from IUK's Financial Statement for 2012-2013. This price is for the 2014-2015 gas year.
- a maximum price for accepting users' offers to sell capacity back to IUK during its buy-back process. This price is calculated as the weighted average price paid for capacity on the day of the buy-back event plus a premium equivalent to the base price set for the 2014-2015 gas year. Where IUK implements its 'forced buy-back' process and reduces capacity for one or several users, IUK will reimburse the relevant user(s) the original price paid for the reduced amount of capacity plus a 5% premium of the weighted average price paid for that day's capacity.
- the net annual revenue from OSBB (accumulation of oversubscription revenues and buy-back payments during the gas year) will be shared between IUK and its users. If the balance is positive at the end of the gas year, users will receive 75% of the revenue based on the allocated flow over the year. If the balance is negative, IUK will cover 100% of the costs with a maximum deficit specified in the Charging Methodology Statement (see below).
- the revenue from reallocating surrendered or LT UIOLI capacity (as described below) released from STA users and sold under the terms of the IAA will be disbursed back to the respective STA user(s).
- a user's daily fuel gas charge which will be set equal to the negative imbalance daily gas price multiplied by the volume of fuel gas for that gas day. We note there is no balancing charge because delivery nominations must equal offtake nominations (i.e. in=out).
- a user's monthly fuel electricity charge which will be calculated based on an estimated compressor electricity unit cost, with annual reconciliation occurring after each gas year.

The proposed charging methodology also states that the registration fee, monthly administration fee, the base price for day-ahead capacity and the maximum buy-back price will be subject to an annual increase based on the producer price index.

3. *Proposed STA Amendments*

The proposed STA amendments will enable the release of capacity to be offered under the new IAA contract, and defines the relationship between the IAA and the STA.

In accordance with the CMP Guidelines, it introduces the capacity surrender and LT UIOLI mechanisms, which have the following key aspects:

- **Capacity surrender:** IUK will accept any surrender of firm capacity of one day's duration or longer. IUK proposes to reallocate surrendered capacity under the IAA on a time-stamp basis, i.e. in order from the earliest to latest submission. If any of the surrendered capacity is reallocated, the STA user of the relevant surrendered capacity receives 100% of the reallocation revenue for that capacity. If any surrendered capacity is not reallocated, the STA user can use the capacity because it retains its rights and obligations for the capacity.
- **LT UIOLI:** IUK will monitor the use of long-term contracted capacity, identify systematic underutilisation, invite the relevant user(s) to provide justification for underused capacity, and then provide a report on underused long-term capacity to Ofgem and CREG. If Ofgem directs IUK to withdraw underused STA capacity, it will be offered under the IAA and reallocated such that capacity withdrawn first will get reallocated first. Revenue disbursed to the user from reallocated LT UIOLI capacity is capped to the relevant user's original payment obligation. This aims to prevent users deriving any potential reward for hoarding long-term capacity and to incentivise users to offer unused capacity on the secondary market or surrender it to IUK.

Decision on the proposed access rules and charging methodology

Upon review of the documents submitted on 30 September 2014 to Ofgem for approval, with the key features as summarised above, the Authority consider the proposed access rules and charging methodology to be transparent, non-discriminatory, objective and compliant with the relevant legally binding decision of the European Commission (EC) and/or ACER (including the CMP Guidelines). The Authority has therefore decided to approve the proposed access rules and charging methodology on the basis that they meet the relevant access rules objectives and the relevant charging methodology objectives set out in SLCs 11A(5) and SLC 10(4) respectively of the licence.

Directions issued in accordance with SLC 10(7) and SLC 11A(8) respectively of the licence to this effect can be found in the Annexes 1 and 2 to this letter.

Decision on IUK's implementation of the CMP Guidelines

The Authority considers IUK's proposals to implement relevant aspects of the CMP Guidelines to be in accordance with the requirements of the CMP Guidelines. The Authority, in its capacity as NRA for GB, therefore approves the provisions contained in amendments to the STA and in the access rules and charging methodology that implement relevant aspects of the CMP Guidelines.

On the basis of IUK's proposed documents and pursuant to point 2.2.2(3) of the CMP Guidelines, the Authority has decided that the distribution of revenues and costs under OSBB shall be split between IUK and the users as set out in the approved charging methodology.

Next steps

When publishing the approved documents, we would welcome the simultaneous publication (at least on IUK's website) of updated summaries of the IAA and STA, which outline the main features and principles of these contracts and IUK's compliance with the CMP Guidelines.

Pursuant to point 2.2.2(8) of the CMP Guidelines, we note IUK's obligation to regularly report to Ofgem on the functioning of its OSBB scheme, and upon our request, provide us with all relevant data. In particular we may request from IUK a record of the reasons for not offering additional capacity on any given day under the OSBB scheme.

The Authority has duties to monitor IUK's compliance with the CMP Guidelines and with the terms of its licence to ensure it remains compliant with the relevant requirements as circumstances develop. As the market and legislative landscape develops this may involve adapting in particular the OSBB mechanism to remove the maximum buy-back price, or at least replace it with one set to a market spread. We will also monitor the extent to which STA users' relevant contracted capacity has been used, pursuant to point 2.2.5(4) of the CMP Guidelines and the operation of IUK's LT UIOLI mechanism.

Yours sincerely



Rob Mills,
Interim Associate Partner, Wholesale Markets

ANNEX 1 – Access Rules

Direction issued to Interconnector (UK) Ltd pursuant to Standard Licence Condition 11A (approval of terms for access to the licensee’s interconnector) paragraph 8 of its gas interconnector licence

1. This Direction is issued by the Gas and Electricity Markets Authority (the “Authority”) pursuant to Standard Licence Condition 11A (SLC 11A) paragraph 8 of the gas interconnector licence (“the Licence”) granted or treated as granted under section 7ZA of the Gas Act 1986 (“the Act”) to Interconnector (UK) Ltd (“IUK” or “the licensee”).
2. SLC 11A paragraph 2 provides that the licensee shall prepare and submit for approval by the Authority a statement setting out the Access Rules (as defined in the Licence).
3. SLC 11A paragraph 5 requires that the Access Rules be transparent, objective, non-discriminatory and compliant with the Regulation (Regulation (EC) No 715/2009 on conditions for access to the national gas transmission networks) and any relevant legally binding decision of the European Commission and/or Agency (collectively the ‘relevant access rules objectives’).
4. SLC 11A paragraph 6 requires the licensee to take all reasonable steps to ensure that all persons, including those in other Member States who may have a direct interest in the Access Rules, are consulted and allow them a period of not less than 28 days within which to make written representations. The licensee must also furnish the Authority with a report setting out the terms originally proposed in the Access Rules, the representations, if any, made by interested persons and any change in the terms of the Access Rules intended as a consequence of such representations.
5. SLC11A paragraph 15 requires the licensee to publish (at least on its website) the Access Rules as soon as practicable after the Access Rules have been approved by the Authority. The Access Rules must be published 28 days prior to coming into effect, unless the Authority directs otherwise.
6. In accordance with SLC 11A paragraph 6(b), on 20 December 2013 IUK furnished the Authority with a report setting out the terms originally proposed in its Access Rules, the representations made by interested persons, and the changes as a consequence of the consultations.
7. In accordance with SLC11A paragraph 2, on 30 September 2014 IUK submitted its Access Rules to the Authority for approval.
8. Having regard to the relevant access rules objectives set out in SLC 11A paragraph 5, and to our principle objective and statutory duties, the Authority considers that the submitted Access Rules meet the relevant access rules objectives and so the Authority has decided to approve the IUK Access Rules.
9. The Authority hereby directs, pursuant to SLC 11A paragraph 8, that the IUK Access Rules are approved.
10. This Direction shall have immediate effect. It shall remain in effect until such time as the Authority may revoke or vary the Direction in writing upon reasonable notice.
11. This direction constitutes notice of the Authority’s reasons for the decision pursuant to section 38A of the Act.

Dated: 19 December 2014



Rob Mills
Interim Associate Partner, Wholesale Markets
Duly authorised on behalf of the Authority

ANNEX 2 – Charging Methodology

Direction issued to Interconnector (UK) Ltd pursuant to Standard Licence Condition 10 (charging methodology to apply to third party access to the licensee’s interconnector) paragraph 7 of its gas interconnector licence

1. This Direction is issued by the Gas and Electricity Markets Authority (the “Authority”) pursuant to Standard Licence Condition 10 (“SLC 10”) paragraph 7 of the gas interconnector licence (“the Licence”) granted or treated as granted under section 7ZA of the Gas Act 1986 (“the Act”) to Interconnector (UK) Ltd (“IUK” or “the licensee”).
2. SLC 10 paragraph 2 provides that the licensee shall prepare and submit for approval by the Authority a charging methodology for access to (including use of) the licensee’s interconnector.
3. SLC 10 paragraph 4 requires that the charges and application of the underlying charging methodology be objective, transparent, non-discriminatory and compliant with the Regulation (Regulation (EC) No 715/2009 on conditions for access to the national gas transmission networks) and any relevant legally binding decision of the European Commission and/or Agency (collectively the ‘relevant charging methodology objectives’).
4. SLC 10 paragraph 5 requires the licensee to take all reasonable steps to ensure that all persons, including those in other Member States who may have a direct interest in the charging methodology, are consulted and allow them a period of not less than 28 days within which to make written representations. The licensee must also furnish the Authority with a report setting out the terms originally proposed in the charging methodology, the representations, if any, made by interested persons and any change in the terms of the methodology intended as a consequence of such representations.
5. SLC10 paragraph 15 requires the licensee to publish (at least on its website) a Charging Methodology Statement that sets out the prevailing charges for access to the licensee’s interconnector and how the charges have been derived in accordance with its charging methodology as soon as practicable after the Charging Methodology has been approved by the Authority. The Charging Methodology Statement must be published 28 days prior to it coming into effect, unless the Authority directs otherwise
6. In accordance with SLC 10 paragraph 5, on 20 December 2013 IUK furnished the Authority with a report setting out the terms originally proposed in its charging methodology, the representations made by interested persons, and the changes as a consequence of the consultations.
7. In accordance with SLC10 paragraph 2, on 30 September 2014 IUK submitted its charging methodology to the Authority for approval.
8. Having regard to the relevant charging methodology objectives set out in SLC 10 paragraph 4, and to our principle objective and statutory duties, the Authority considers that the submitted charging methodology meets the relevant charging methodology objectives and so the Authority has decided to approve the IUK charging methodology.
9. The Authority hereby directs, pursuant to SLC 10 paragraph 7, that the IUK charging methodology is approved.
10. This Direction shall have immediate effect. It shall remain in effect until such time as the Authority may revoke or vary the Direction in writing upon reasonable notice.
11. This direction constitutes notice of the Authority’s reasons for the decision pursuant to section 38A of the Act.

Dated: 19 December 2014



Rob Mills

Interim Associate Partner, Wholesale Markets

Duly authorised on behalf of the Authority