



Making a positive difference
for energy consumers

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CC. Marie-Pierre Fauconnier,
President of the Commission for Electricity and
Gas Regulation, Belgium

Date: 2 March 2018

Dear Sean

Authority decision to approve proposed modifications to Interconnector (UK)'s Access Rules and to disapply certain articles of Commission Regulation (EU) 2017/459 in relation to the Implicit Allocation Mechanism

On 23 February 2018, Interconnector (UK) ('IUK') proposed modifications to its Access Rules to the Authority¹ for approval, pursuant to Standard Licence Condition ('SLC') 11A of the Gas Interconnector Licence ('the Licence').² This was a revised version of changes initially submitted to us for approval on 4 December 2017.

The proposed modifications include, amongst other things, changes to enable IUK to offer a portion of its capacity using an Implicit Allocation Mechanism, and the introduction of a Capacity Conversion Service. In the same application, IUK also requested that we exercise our discretion under Article 2(5) of Commission Regulation (EU) 2017/459 establishing a network code on capacity allocation mechanisms in gas transmission systems ('CAM')³ to disapply certain articles of CAM in relation to the Implicit Allocation Mechanism.

After careful consideration, we have decided to approve the proposed modifications to IUK's Access Rules. We have made this decision on the basis that we are satisfied that the proposed modifications meet the relevant Access Rules objectives,⁴ as required under IUK's licence.⁵ We have also decided to disapply Articles 8, 10, 19 and 37 of CAM where capacity is offered through the Implicit Allocation Mechanism established under the modified Access Rules.

The annexes to this letter contain two directions. The first to approve the proposed modifications to IUK's Access Rules, and the second to disapply the relevant articles of CAM. This letter also explains the reasons for our decision as required under section 38A of the Gas Act 1986. As per the implementation timetable proposed by IUK, the changes to the Access Rules will take effect as of the start of the gas day on 5 March 2018.

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem', 'the Authority', 'we' and 'us' are used interchangeably in this letter.

² https://epr.ofgem.gov.uk/Content/Documents/Gas_Interconnector_SLCs_Consolidated%20-%20Current%20Version.pdf

³ <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1503060564207&uri=CELEX:32017R0459>

⁴ SLC 11A(5) of the Licence.

⁵ SLC 11A(14) of the Licence.

Background to the application

Implicit allocation

Article 2(5) of CAM allows for National Regulatory Authorities to disapply Articles 8 to 37 of CAM where implicit allocation methods are applied. Under Article 3(6) of CAM, 'implicit allocation method' is defined as "a capacity allocation method where, possibly by means of an auction, both transmission and a corresponding quantity of gas are allocated at the same time".

IUK is seeking to offer an Implicit Allocation Mechanism that would require us to exercise our discretion to disapply certain aspects of CAM in relation to that product. IUK has requested that we disapply Articles 8, 9, 10, 19 and 37 of CAM.

Capacity conversion

Bundled capacity is where transmission system operators ('TSOs') on both sides of an interconnection point simultaneously grant capacity rights. This is in contrast to unbundled capacity, where TSOs each grant capacity rights separately. For bundled capacity, a shipper obtains the right to flow gas at an interconnection point in a single transaction. For unbundled capacity, a shipper must obtain unbundled capacity from each TSO in order to flow gas at an interconnection point.

One of the purposes of CAM is to simplify booking arrangements for shippers by maximising the offer of 'bundled' capacity products at interconnection points.⁶ As such, Article 19 of CAM requires that all firm capacity at interconnection points "be offered as bundled capacity, in so far as there is available firm... capacity on both side of the interconnection point".

However, a consequence of the requirement to bundle all available capacity is that a shipper may have to purchase bundled capacity where they already have unbundled capacity on one side of an interconnection point.

In order to address this risk, Article 21(3) of CAM requires TSOs to offer network users a free-of-charge 'capacity conversion service' from 1 January 2018. The capacity conversion service should be based on a model developed by the European Network of Transmission System Operators for Gas ('ENTSOG').⁷

Development of the proposed Access Rules

On 8 August 2017, IUK launched a consultation on changes to its Access Rules. The proposed changes included, amongst other things, an Implicit Allocation Mechanism and a capacity conversion service. A number of responses to the consultation requested further information in relation to implicit allocation, particularly around the contractual terms for use of the product, and the process for setting and publishing prices.

IUK launched a second consultation on 25 October 2017 that included further changes to the Access Rules to address the concerns raised in the first consultation. The updated proposal included, amongst other changes, a set of Implicit Allocation Rules. The consultation was open for 28 days, as required under the licence.⁸ Most responses to the second consultation supported the introduction of an Implicit Allocation Mechanism, although some raised issues in relation to the details of the proposal.

⁶ See for instance Article 37(5) of CAM.

⁷ https://www.entso.eu/public/uploads/files/publications/CAM%20Network%20Code/2017/CAP0717-17_170724_ENTSOG_Capacity-conversion-model_final%20GA.pdf

⁸ SLC 11A(11)(a) of the Licence.

IUK submitted proposed changes to the Access Rules on 4 December 2017, alongside a request that we disapply Articles 8, 9, 10, 19 and 37 of CAM in relation to the proposed Implicit Allocation Mechanism. The submission incorporated changes to address the responses to the second consultation. IUK resubmitted revised versions of the Access Rules on 7 December 2017, 19 January 2018 and 23 February 2018.

As required by the licence, IUK submitted the proposed changes alongside a report setting out the modifications as originally consulted on, any representations made by interested persons, the changes to the proposal as a consequence of the representations received and a timetable for the implementation of the modifications.⁹ On 9 January 2018, IUK submitted an addendum to the report that included an explanation of how the proposed modifications better achieve the relevant Access Rules objectives.¹⁰ In accordance with standard licence condition 11A(9) the Authority therefore considers that IUK has satisfied the requirement to review the Access Rules in the 2017 calendar year.

As IUK operates in both Great Britain ('GB') and in Belgium, IUK simultaneously sought approval of its proposal from both Ofgem and the Belgian energy regulator, the Commission for Electricity and Gas Regulation ('CREG').¹¹ Ofgem and CREG have ensured frequent communication during the application process and we have taken into account CREG's views in reaching our decision.

Summary of the proposal

Changes to the Access Rules to introduce an Implicit Allocation Mechanism

IUK is proposing to offer firm unbundled capacity via a partner, such as an exchange or broker. When a user of the communication platform purchases capacity via the Implicit Allocation Mechanism, they must purchase an equivalent quantity of gas at the same time. The buyer will effectively be entering into two separate contracts in one transaction. One is the purchase of IUK capacity through the communication platform, and the other is the purchase of the equivalent quantity of gas from another client of the relevant broker or exchange.

The broker or exchange will notify IUK that the purchaser has been allocated a certain amount of capacity, which IUK will then register as capacity held by the purchaser. The notification will include a time stamp for each transaction along with confirmation the matching quantities of gas and capacity were purchased at the same time. IUK will only offer annual, six monthly, quarterly, monthly and daily products, as well as combinations of these. Day-ahead and within-day products will not be offered.

The sale of products of each duration will be restricted to a certain amount of time in advance of the period being offered:

Contract length	Annual	Six monthly	Quarterly	Monthly	Daily
Offer period begins	5 years in advance	3 years in advance	For the next 4 quarters	3 months in advance	After the preceding monthly auction

IUK has introduced a number of restrictions on the Implicit Allocation Mechanism to ensure that the auction process outlined in Articles 8 and 11-18 of CAM remains the primary mechanism for allocating capacity. Of the Technical Capacity for any Gas Day, up to a cumulative total of 50% may be sold through Implicit Allocation. Any capacity unsold when capacity for that period is scheduled to be sold in the CAM auction timetable, will be sold in

⁹ SLC 11A(11)(b) (i), (ii), (iii) and (v) of the Licence.

¹⁰ SLC 11A(11)(b)(iv) of the Licence.

¹¹ Also known as the Commissie voor de Regulering van de Elektriciteit en het Gas or the Commission de Régulation de l'Électricité et du Gaz, <http://www.creg.be/en>

the relevant auction process outlined in Articles 11-15 of CAM. Any capacity that is advertised as available in an upcoming auction will not be offered simultaneously via the Implicit Allocation Mechanism.

Changes to the Access Rules to introduce a Capacity Conversion Service

Within three Gas Days of the end of an annual, quarterly or monthly capacity auction, or within two hours of the end of a daily capacity auction, shippers will be able to notify IUK of the amount of capacity they wish to convert. IUK must notify shippers of the amount that it has accepted for conversion within three business days. IUK will reduce the shipper's registered capacity by the amount accepted for conversion from the date of acceptance.

All rights and obligations in relation to the converted capacity will cease, except those in relation to payments. However, shippers will receive a rebate equal to the IUK component of the reserve price for the capacity purchased in the relevant auction. This will effectively mean, for the IUK component of the bundled capacity, the shippers will pay the price of the original, unbundled capacity, plus the IUK component of any auction premium on the auctioned capacity.

Other changes to the Access Rules

The proposed modification also includes changes to:

- Replace the reconciliation process for fuel gas and electricity charges for compressor usage with an ex-ante commodity charge.
- Remove IUK's discretion to accept alternative arrangements for unrated entities in relation to invoicing, payment and credit.
- Define the timetable for IUK to issue notice of suspension, and subsequently suspend the contract between shippers and IUK, removing the discretion of IUK over the suspension timetable.
- Revise the definition of Force Majeure to ensure that it does not rely on the probability of an event occurring.
- Ensure analogous maximum liabilities for IUK and shippers under relevant indemnities.
- Remove a number of indemnities.
- Clarify which arrangements are relevant to the period prior to 06:00 (CET) on 1 October 2018 and those which are relevant after this time.

Consultation responses

IUK's first consultation

There were twelve responses to IUK's consultation in August 2017, two of which were confidential. IUK has published the non-confidential responses on its website.¹² Most responses were broadly in favour of IUK offering a greater range of capacity products in addition to the existing auction process.

However, many respondents were concerned that the documentation included in the consultation did not provide sufficient information to shippers. One area of concern was a lack of information about the contractual arrangements between IUK and the broker or exchange, and the contractual terms that shippers will be obliged to enter into with the broker or exchange. Some respondents were of the view that IUK should be required to consult on the contractual arrangements between IUK and the broker or exchange.

Some respondents suggested further restrictions to the use of the Implicit Allocation Mechanism, such as to the number of years ahead that capacity could be offered, or

¹² Currently available at <http://www.interconnector.com/about-us/our-consultations/latest-consultation/>

restrictions to how much capacity could be allocated to one company or group of companies. One respondent stressed the importance of the capacity being in a form that could be traded on the secondary market. A number of respondents noted that one consequence of use of the product would be the creation of additional unbundled capacity on the National Grid side of the Bacton interconnection point.

IUK's second consultation

There were eight respondents to IUK's consultation in October 2017 consultation, two of which were confidential. IUK has published the non-confidential responses on its website.¹³

Respondents were again generally supportive of IUK offering implicit allocation products, although some raised issues in relation to the details of the proposal. Some respondents reiterated a view that they would need to know the contractual arrangements between IUK, the broker or exchange, and the shippers, before being able to assess whether to support the proposal.

The Authority's decision

We have reviewed the proposed modifications to IUK's Access Rules, submitted on 23 February 2018 and have concluded that they meet the relevant Access Rules objectives.¹⁴ As such we have decided to approve the proposed modifications to IUK's Access Rules. A direction to this effect, issued in accordance with SLC 11A of the Licence, can be found in Annex 1 to this letter.

We have also decided, pursuant to Article 2(5) of CAM, to disapply Articles 8, 10, 19 and 37 of CAM in relation to capacity offered through the Implicit Allocation Mechanism established under the modified Access Rules. A direction to this effect can be found in Annex 2 to this letter.

In reaching our decisions, we have considered the consultation responses and supporting evidence and liaised with our regulatory colleagues in Belgium to ensure we have made consistent regulatory decisions.

The reasons for our decisions are set out below.

Reasons for approving the proposed changes to IUK's Access Rules

Transparency

Our view is that the arrangements proposed by IUK satisfy the licence objective that the Access Rules be transparent, as required by SLC11A(4) and SLC11A(14) of the Licence.

We note although stakeholders were broadly in support of IUK's proposals, some respondents wanted more information on details such as the contractual arrangements that would be entered into between IUK and the broker or exchange, and the contractual terms shippers would need to enter into with the broker or exchange.

We note that the Implicit Allocation Guidance Note, which forms part of the Access Rules, requires IUK to make the relevant fees and contractual information for access to the relevant broker(s) or exchange(s) available through the IUK website. We consider this to be sufficient but expect IUK to consider stakeholders' views when developing these contractual arrangements.

¹³ <http://www.interconnector.com/about-us/our-consultations/>

¹⁴ That is, that the Access Rules be transparent, objective, non-discriminatory and compliant with the Regulation and any relevant legally binding decision of the European Commission and / or Agency.

Objectivity

We are of the view that IUK's proposed Access Rules remain objective, as required by SLC11A(4) and SLC11A(14) of the Licence. We note that no respondents to either of IUK's consultations expressed concerns in relation to whether IUK's proposed Access Rules are objective.

Non-discriminatory

We are of the view that the arrangements proposed by IUK satisfy the licence objective that the Access Rules be non-discriminatory, as required by SLC11A(4) and SLC11A(14) of the Licence.

In its proposed Implicit Allocation Mechanism, IUK has introduced measures to prevent the offer of different terms to different users. These include restrictions on when products of different durations will be sold, and ensuring that shippers who use the Implicit Allocation Mechanism are parties to the same capacity contract as shippers who obtain capacity through an auction.

We note stakeholder concerns in relation to the contractual terms that will need to be entered into by shippers who wish to purchase an implicit product. We expect IUK to keep its arrangements under review against the requirement to be non-discriminatory, in particular in relation to the choice of broker or exchange and the associated terms of access to those parties.

Compliance with the Gas Regulation and any relevant legally binding decision of the European Commission

The Capacity Conversion Service

Article 21(3) of CAM requires transmission system operators to offer network users a 'capacity conversion service' from 1 January 2018 that is consistent with the model developed by ENTSOG. The proposed changes introduce a Capacity Conversion Service. We note that all of the following features are consistent with, or exceed, the relevant requirements of Article 21(3) of CAM and the ENTSOG model:

- No charge is levied by IUK for the use of the Capacity Conversion Service
- The service is offered for yearly, quarterly, monthly and daily products
- The service is offered to all users on a non-discriminatory basis, and
- The service is offered to all users, not just those that hold unbundled capacity allocated prior to the implementation of CAM.

As such, the proposed Access Rules bring IUK into compliance with a requirement of a relevant of a legally binding decision of the European Commission.

The Implicit Allocation Mechanism

In our view, the Implicit Allocation Mechanism satisfies the definition of an implicit allocation method under Article 3(6) of CAM. As a consequence, National Regulatory Authorities (NRAs) have discretion to disapply certain Articles of CAM. We have decided to disapply Articles 8, 9, 10, 19 and 37 in relation to the proposed Implicit Allocation Mechanism.

Reasons for our decision to disapply certain Articles of CAM in relation to the Implicit Allocation Mechanism

In making our decision, we note that responses from stakeholders were broadly in favour of IUK offering a greater range of capacity products in addition to the existing auction

process. IUK also made a number of changes to its proposal to address concerns raised during the consultation process.

IUK has introduced a number of safeguards to ensure that the proposed implicit allocation mechanism is objective, transparent and non-discriminatory, and that the standard CAM auction process remains the primary allocation mechanism. These safeguards include restricting the amount of capacity that can be allocated through implicit allocation, restricting the Implicit Allocation Mechanism to a standard set of capacity products offered a certain period of time in advance, and the requirement that all unsold capacity must be offered at relevant CAM auctions. We also note the requirement under Articles 8(6) and (7) of CAM that a proportion of capacity be reserved for allocation in shorter-term auctions and that the standard congestion management procedures applied by IUK will also apply to capacity allocated under the Implicit Allocation Mechanism.

IUK is a merchant asset that, in most current market conditions, competes with alternative providers of flexible gas supply (and demand). On the basis that the proposal is compliant with CAM and meets the relevant Access Rules objectives, and taking into account the above safeguards, it is our view that it is appropriate that IUK be able to offer this product outside of the standard CAM auction process.

Next steps

The proposed modifications to IUK's Access Rules will take effect as of the start of the gas day on 5 March 2018, as per the implementation timetable proposed by IUK.

As the process of implicitly allocating IUK capacity is implemented we will monitor the arrangements and welcome stakeholder feedback. We expect IUK to keep the Access Rules under review to ensure arrangements remain appropriate.

Yours sincerely

Natasha Zoe Smith
Head of Gas Systems, 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 14 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 14 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 9 requires the Licensee to review its Access Rules at least once in each calendar year and make such modifications to the Access Rules as may be requisite for the purpose of ensuring that the Access Rules better achieve the relevant Access Rules objectives. Following such a review and in accordance with SLC11A paragraph 11, on 23 February 2018 IUK submitted its proposed modified Access Rules to the Authority for approval.
3. SLC 11A paragraph 5 requires that the Access Rules 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 Access Rules objectives’).
4. Having regard to the relevant Access Rules objectives set out in SLC 11A paragraph 4, and to our principal objective and statutory duties, the Authority considers that IUK’s proposed modified Access Rules meet the relevant Access Rules objectives.
5. The Authority hereby directs, pursuant to SLC 11A paragraph 14, that IUK’s proposed modified Access Rules are approved.
6. This Direction will come into effect at the beginning of the gas day on 5 March 2018, at which point the proposed Access Rules will replace the existing Access Rules. This Direction shall remain in effect until the Authority revokes or varies the Direction in writing upon reasonable notice.

Dated: 2 March 2018

Natasha Zoe Smith
Head of Gas Systems, Wholesale Markets
Duly authorised on behalf of the Authority

ANNEX 2 – CAM and the Implicit Allocation Mechanism

Direction issued to Interconnector (UK) Ltd pursuant to Article 2 paragraph 5 of Commission Regulation (EU) 2017/459 disapplying Articles 8, 9, 10, 19 and 37 of that regulation in relation to the Implicit Allocation Mechanism

1. This Direction is issued by the Gas and Electricity Markets Authority (the "Authority") pursuant to Article 2(5) of Commission Regulation (EU) 2017/459 establishing a network code on capacity allocation mechanisms in gas transmission systems ('CAM') in relation to the proposal by Interconnector (UK) Ltd ("IUK" or "the licensee") to introduce an Implicit Allocation Mechanism.
2. Articles 8 to 37 of CAM define the process through which capacity is generally expected to be allocated at an interconnection point. These requirements include for instance, the requirement under Article 8(1) of CAM that capacity at interconnection points be auctioned, and the requirement under Article 19 of CAM that all firm capacity at interconnection points be offered as bundled capacity, in so far as there is available firm capacity on both side of the interconnection point.
3. Article 2(5) of CAM allows National Regulatory Authorities to disapply Articles 8 to 37 of CAM where "implicit allocation methods" are applied. Under Article 3(6) of CAM, "implicit allocation method" is defined as "a capacity allocation method where, possibly by means of an auction, both transmission and a corresponding quantity of gas are allocated at the same time".
4. On 4 December 2017 IUK requested that the Authority issue a direction under Article 2(5) of CAM to disapply Articles 8, 9, 10, 19 and 37 of CAM in relation to an Implicit Allocation Mechanism to be established under proposed changes to its Access Rules.
5. The Authority has concluded that IUK's proposed Implicit Allocation Mechanism satisfies the definition of an implicit allocation method under Article 3(6) of CAM. Having regard to our principal objective and the purpose of CAM and the related Regulation (EC) 715/2009 on conditions for access to the natural gas transmission networks ('the Gas Regulation'), the Authority considers it appropriate to issue a direction disapplying Articles 8, 9, 10, 19 and 37 of CAM in relation the proposed Implicit Allocation Mechanism.
6. The Authority hereby directs that, pursuant to Article 2(5) of CAM, Articles 8, 9, 10, 19 and 37 are disappplied in relation to the proposed Implicit Allocation Mechanism.
7. This Direction shall come into effect at the beginning of the Gas Day on 5 March 2018. This Direction shall remain in effect until the Authority revokes or varies the Direction in writing upon reasonable notice.

Dated: 2 March 2018

Natasha Zoe Smith
Head of Gas Systems, Wholesale Markets
Duly authorised on behalf of the Authority