Who Pays the Piper?

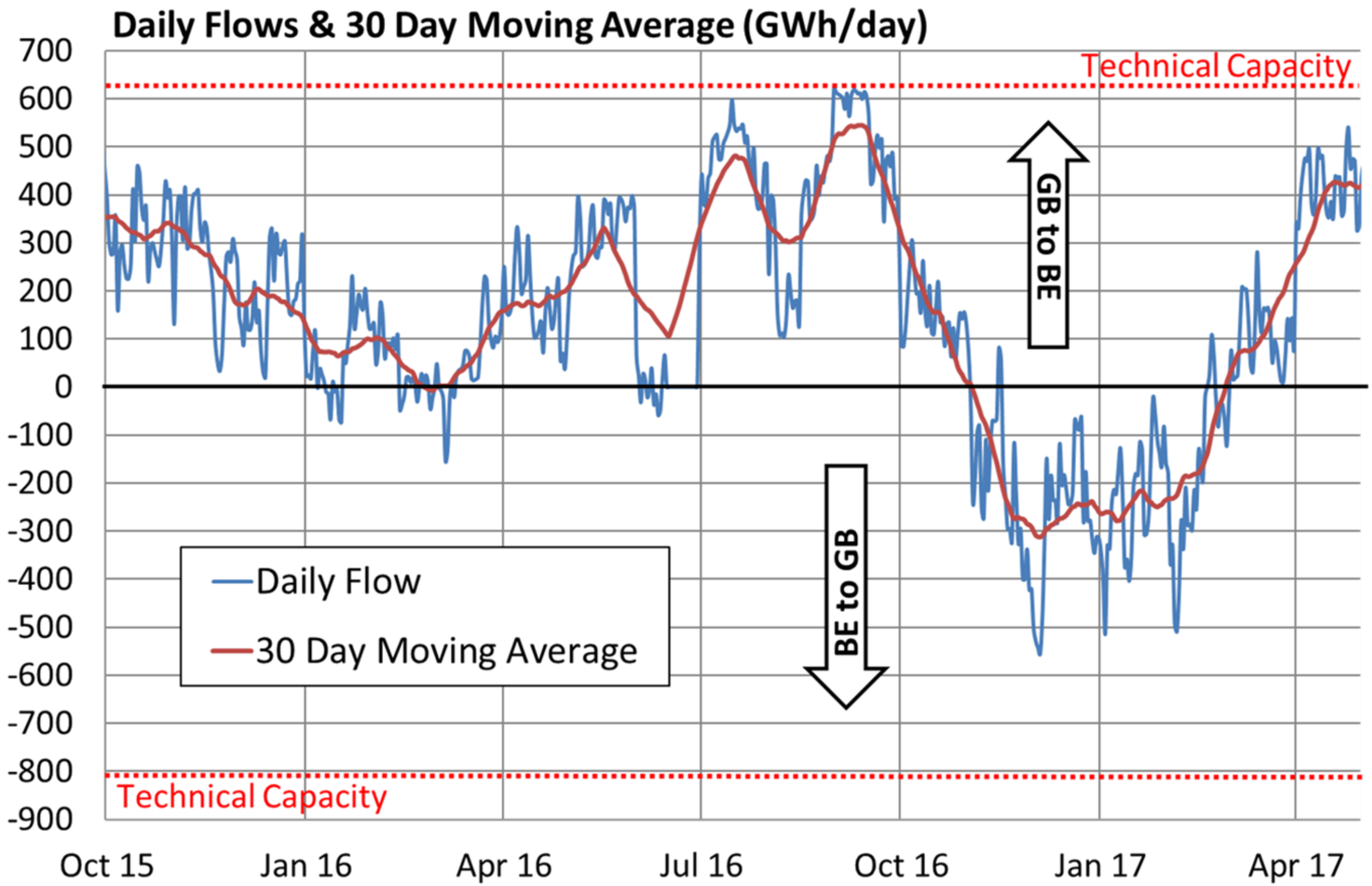
Flame Conference 2017

Sean Waring

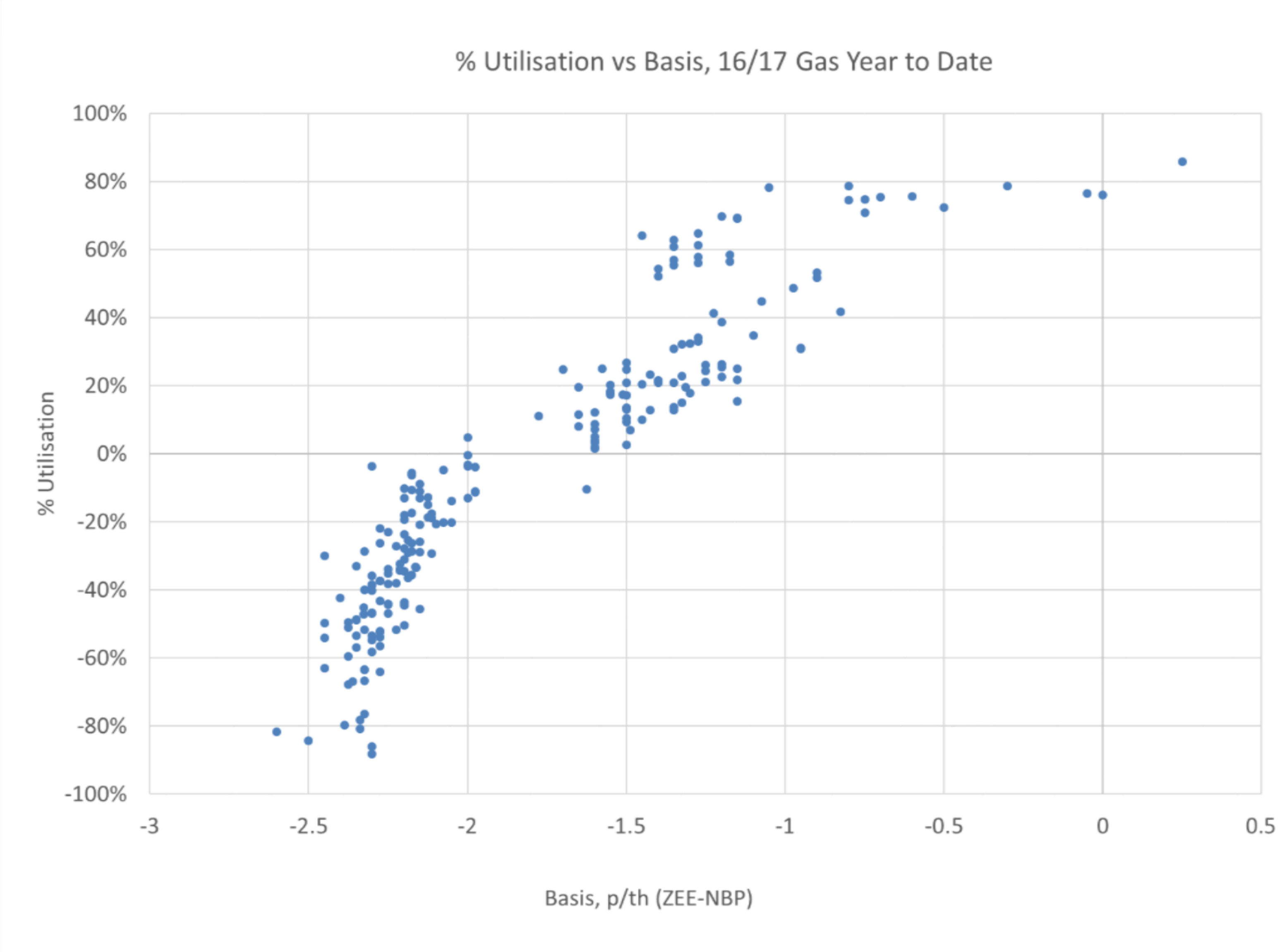
Who Pays the Piper?

- Can interconnectors survive with the current model?
- Does it matter?
- What about BREXIT?
- How will market prices react once capacity is no longer ‘sunk’?
- Solutions

Historic Flows



IUK the most price responsive pipe in Europe



IUK an asset with challenges

Market conditions are challenging

- Harmonised prices across NW Europe. Low locational spreads.
- Lot of flexibility options in NW Europe.
- Shipper capacity bookings moved short term.
- Shippers face additional uncertainty (Brexit, NG floating capacity charges)

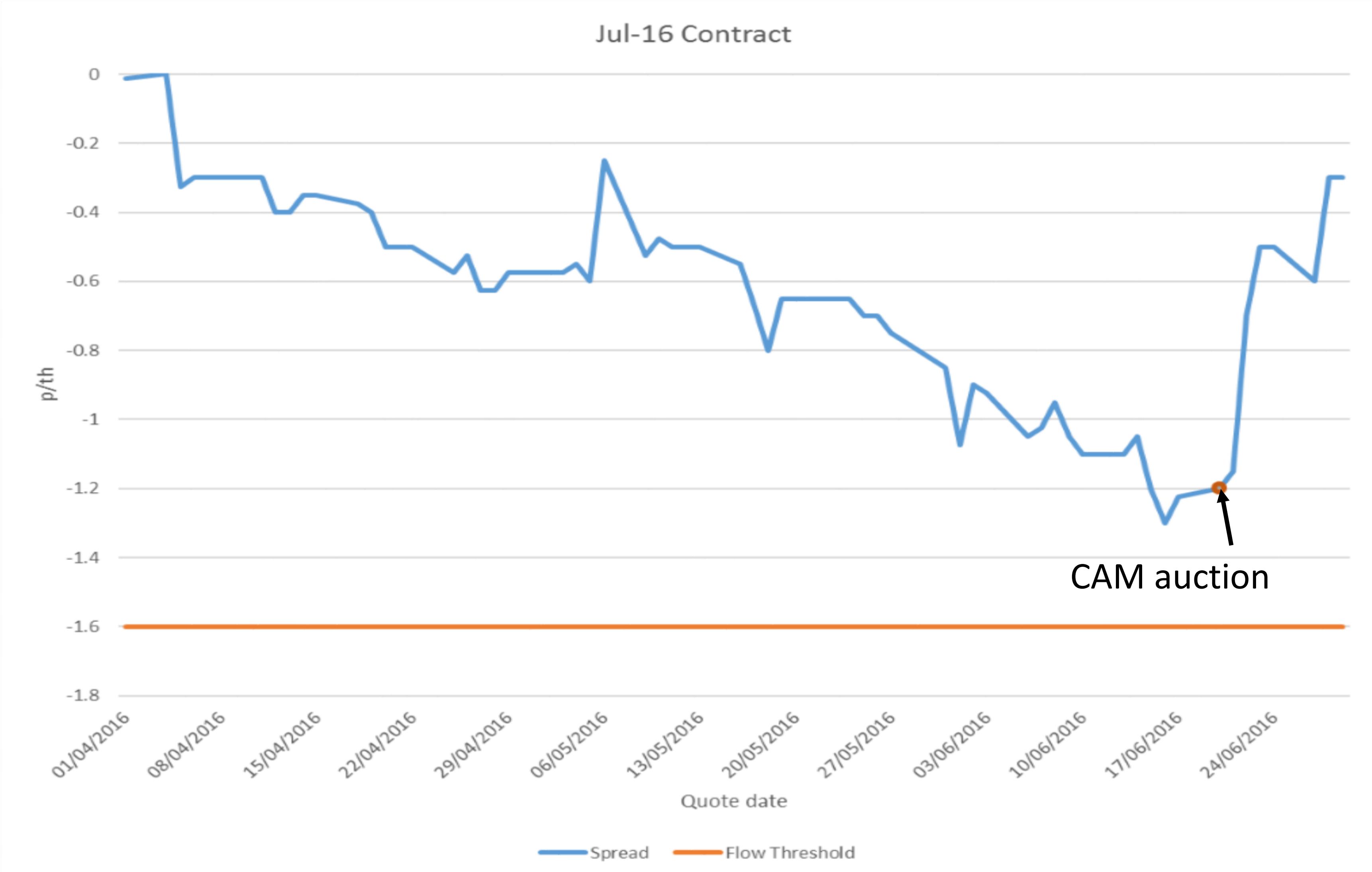
The "regulated merchant model" for interconnectors is not fit for purpose

- All of the TSO regulation applies
- No captive market
- Non-physical competition
- Full commodity market exposure
- No allowed revenue
- Product: flat annual doesn't fit IUK utilisation pattern
- Timetable: the shop is closed most of the time!

Consequences

- **Market prospects uncertain**
- **Risk of capacity closure**
- **Lawmakers & Regulators need to assess what action to take**

Value of Capacity – July 2016



No allowed revenue and short-term contracts is not a sound model for anyone

Models:	1. RAB-based	2. No allowed revenue & LTCs	3. No allowed revenue & STCs
Consumers	✓ Assured capacity ✓ Maximum trade, flow at variable cost × **Consumer bears market risk**	✓ Assured capacity ✓ Maximum trade, flow at variable cost	✓ No long-term commitment × **Price and capacity uncertainty** × **Spreads incorporate full capacity costs** × **Inhibits trade / flow at variable cost** × **Capacity costs recovered at times of constraint**
Shippers	✓ Price and capacity certainty ✓ Socialised exposure × **Risk of over-investment**	× **Shipper takes long-term contract exposure** ✓ Price and capacity certainty	✓ No long-term commitment × **Price uncertainty** × **Transmission “in the market” competing to access value**
TSO	✓ Stable revenue model	✓ Stable revenue model	× **Extreme revenue volatility and uncertainty** × **Full commodity market exposure** × **Need to participate in market to capture scarcity value**

Without an allowed revenue, TSOs need flexibility in the regulatory framework

Solution = comply and innovate!

Comply

CMP code implemented

- Surrendered and Oversubscription capacity

CAM code implemented

BAL code implemented

Gas Day ed

- IUK single e zone

Charging methodology

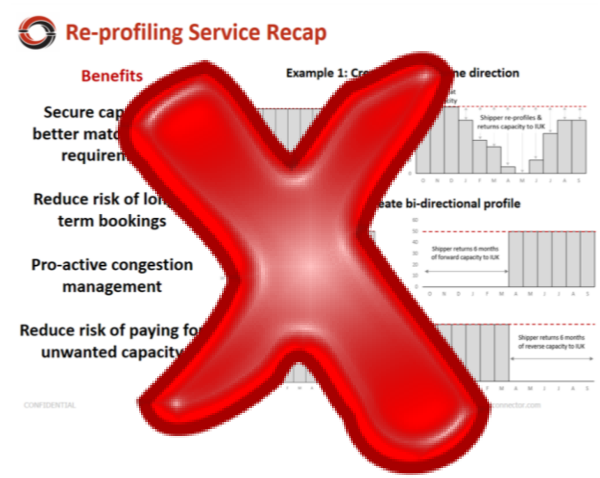
New interconnection agreements

PRISMA auctions held

- Bundled with adjacent TSOs

Innovate and reduce costs

A long term seasonal product?



OK, so what next?

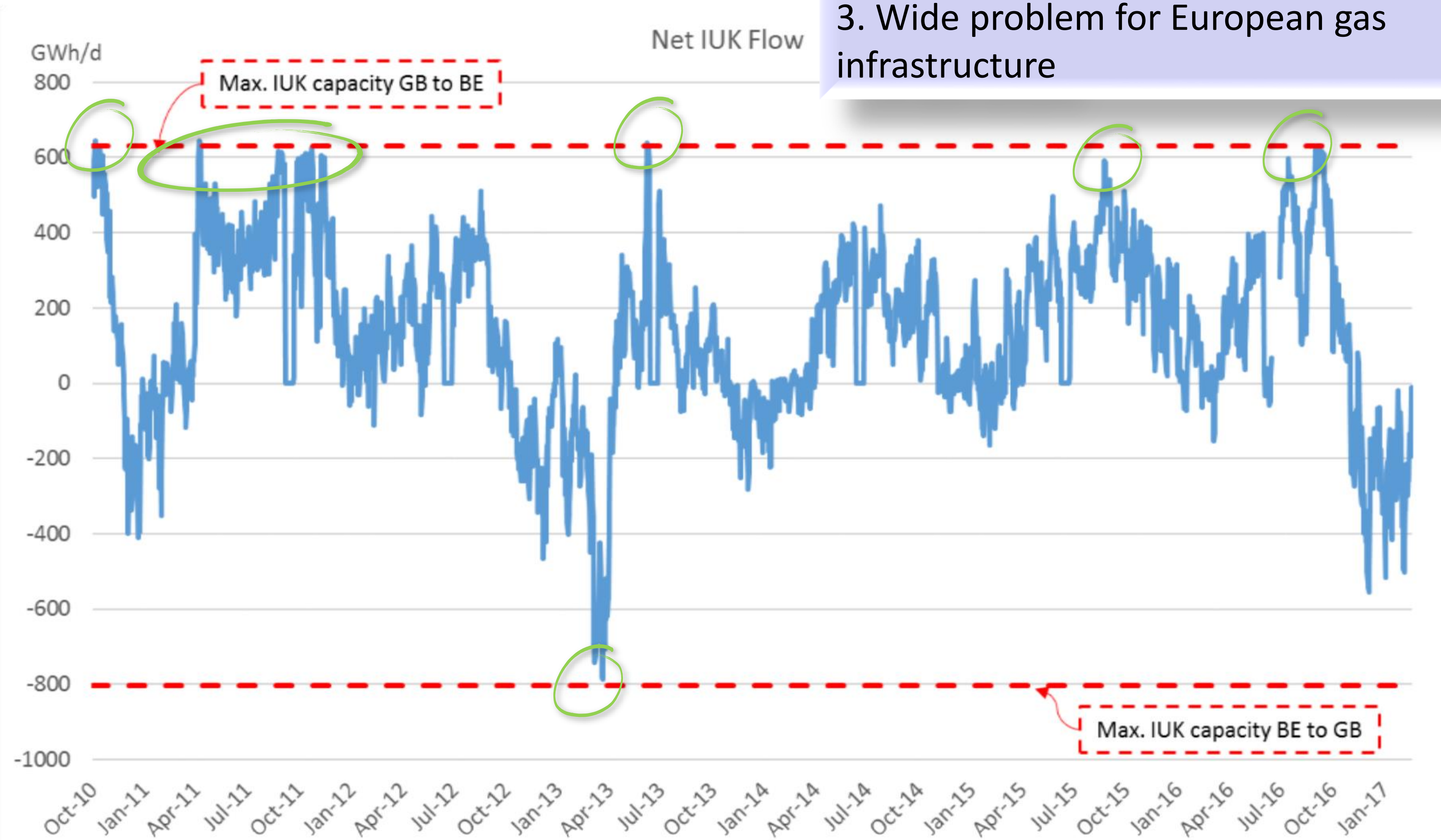
- Tariff flexibility
- Other product ideas

Reduce costs

Close capacity

Does it matter?

1. Capacity not remunerated under a "pay as flow" model
2. Utilisation changes when capacity costs no longer 'sunk'
3. Wide problem for European gas infrastructure



Why care?

Value of interconnectors

- Secure supplies
- Reduce price shocks
- Cap wholesale prices
- Provide trading opportunities & liquidity
- Provide access to storage & LNG across borders
- Provide short-term flex in a market demanding more flex
- Attract investment
- **Harmonise Prices!!**

This is a bigger issues

- Ageing infrastructure and declining demand
- CAMINC – but what about CAMDEC?
- RAB does not work without constant investment
- How do we maintain networks necessary for peak with declining demand
- In short… Who pays the piper?

BREXIT

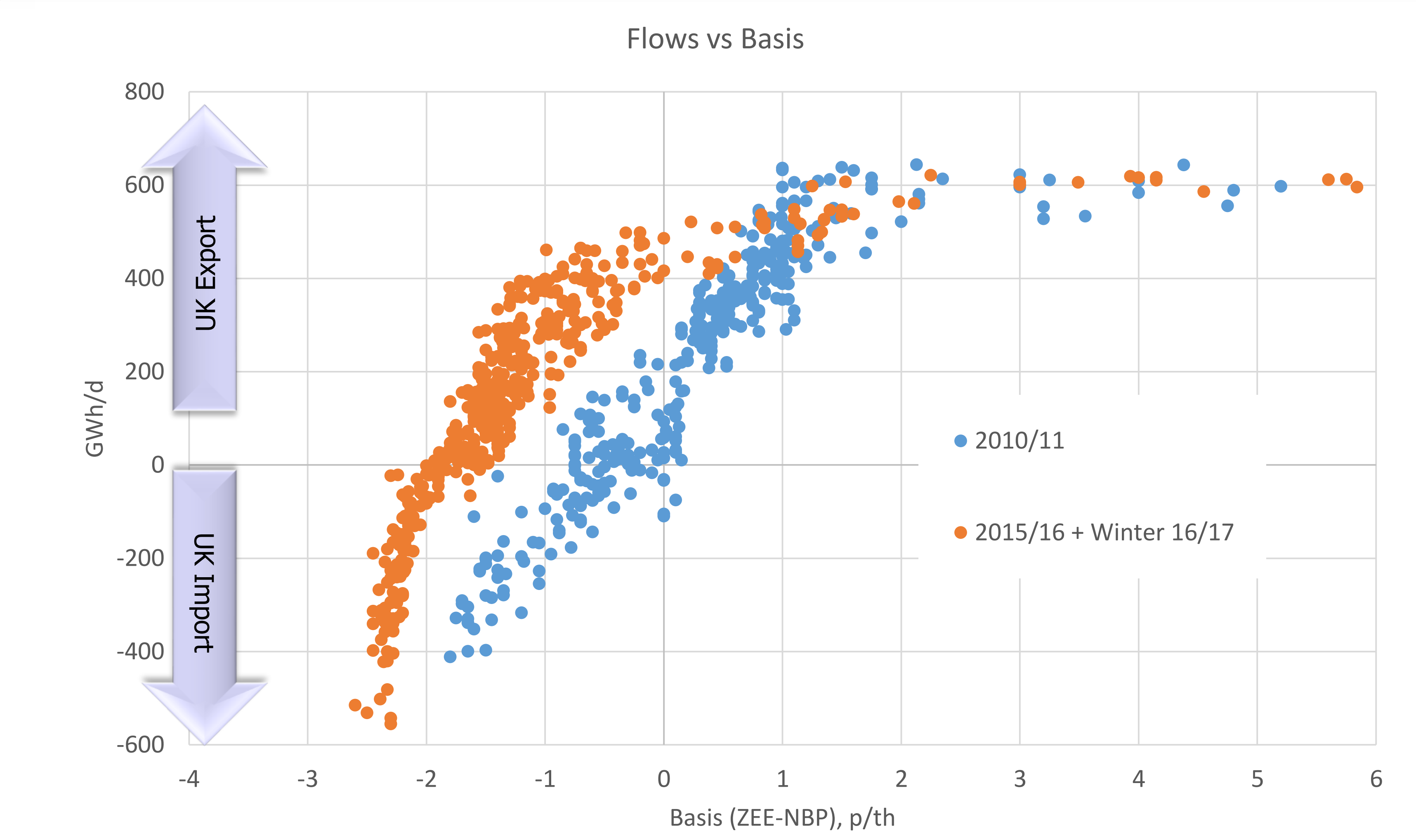
Lots of uncertainty, yes

- Will network codes apply?
- 3rd country?
- Governance - UK voluntary compliance? Disputes?
- Future development or divergence?
- Changes to UK law, Belgian law, UK licence. Dutch law? Irish law?
- How will the current joint regulation apply?
- Where is the 'Brexit border'?

Is BREXIT also an opportunity?

- A new and coherent framework for interconnection while meeting the policy goals?
- Transitional arrangements?

How will prices evolve?



In a short-run world price spreads will open to include capacity costs
Sunk capacity will continue to be used first until LTCs end

Grounds for optimism?

The market

- Pipeline gas is very competitive with LNG
- System needs flexible assets
- We expect spreads will open up
- How much?

Excellent engagement with our regulators

- Form of tariff flexibility
- The model is not fit for purpose but there are routes to flexibility
  - Via an amendment to CAM?
  - Brexit
  - Innovation under CAM
- Looking for a level playing field with storage
- Consumer Underwriting is not something we are pursuing right now…

Interconnectors have no right to survive, they must battle in a difficult market

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Interconnector

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