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Lord Andrew Adonis
National Infrastructure Commission
1 Horse Guards Road
London
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6th January 2016

Dear Lord Adonis,

RE: National Infrastructure Commission Call for Evidence – Energy Evidence

Interconnector UK Ltd (IUK) is a significant gas interconnection pipeline between Britain and mainland Europe.

IUK welcomes the establishment of the National Infrastructure Commission (NIC) and its focus on energy infrastructure as one of its initial three focus areas. The NIC provides a valuable central authority that can evaluate Britain's infrastructure priorities and how the country can make the right choices to achieve a rational and optimum outcome. Having sufficient infrastructure is the backbone for the efficient operation of energy markets, and we believe that IUK is a good example of the benefits brought through strong interconnection.

We are responding to this consultation as we believe that, in delivering on its terms of reference, the NIC should consider the future of vital existing energy infrastructure assets such as IUK. We are grateful for the opportunity to highlight the specific issues relating to this critical piece of energy infrastructure.

1. IUK Overview

Operational since 1998, IUK is a sub-sea gas interconnecting pipeline between Bacton in Norfolk, UK and Zeebrugge in Belgium. We are the first and only physically bidirectional gas interconnector between Britain and mainland Europe, enabling gas to flow in both directions. We have substantial throughput capacity and are able to import over 25 billion cubic metres of gas per year, which would represent over a third of the UK's total gas demand. By way of comparison, electricity interconnectors typically have a capacity of up to 2GW, whereas IUK can import the equivalent of 33GW.

2. Economic benefits

IUK is a reliable and significant piece of energy infrastructure with an important function of connecting markets. We provide significant benefits to Britain, which are briefly summarised below.

Lower prices

In the winter, we provide considerable savings to British consumers by importing gas and keeping prices low. We estimate GB consumer savings of around £340m since 2010. We have also been instrumental in increasing gas market liquidity in Britain and thereby further reducing costs for consumers. Our analysis indicates consumer benefits of around £25m a year from this source.

Supply security

The UK currently has a diverse range of gas supply sources. This reduces the risk of a significant supply curtailment which would lead to price spikes or, in the worst case scenarios, restrictions on physical supply.

IUK has played a key security of supply role on various occasions in the past, responding to changing market and infrastructure conditions. For example, following a shutdown at the largest UK storage site in early 2006, IUK flows into Britain almost doubled. During the very cold weather in March 2013, IUK flows stepped up to record levels and the pipeline flowed at maximum capacity. Throughout the 2013 winter as a whole we delivered more gas than either LNG imports or Rough.

Energy demand and supply projections show a continuing need for gas in GB and for multiple options to supply it. Of course, this poses a challenge for a security of supply asset, specifically how to remunerate an asset whose utilisation is predicted to be low on average, but with occasional high peaks.

Increasing trade

As well as importing gas into Britain, IUK's export capability enables surplus gas in Britain to access (via Belgium) the German, French and Dutch markets. Over the last 5 years IUK has resulted in an average of £1.1bn per annum in cross-border trade from Britain to other European markets. These trade revenues provide economic benefits, including tax revenues and maintained jobs in gas production. IUK's export capability is also a factor in attracting new investment into GB gas production, targeting both conventional and unconventional resources.

3. The need for a holistic view, taking into account both new and existing assets

We believe that the narrow scope of the NIC's energy sector mandate is unfortunate and risks leading to sub-optimal or perverse recommendations and outcomes. There are two ways in which the focus is narrow.

First, the "stock" of infrastructure depends on maintaining existing assets, as well as new build. There can be perverse outcomes when favourable regulatory treatment is provided only to new assets, whereas existing assets are taken for granted. This can lead to the premature closure of old assets, to be replaced by new assets which the energy system would not otherwise require.

Second, to consider only electricity interconnection misses the important interrelationships that exist between the gas and electricity systems, including interconnection infrastructure. For instance, gas and electricity interconnectors are substitute means to supply the GB energy system.

The energy market has already been severely impacted by some asset categories receiving regulatory support and subsidies whereas others have not. In the case of interconnection, to achieve a least-cost balancing of demand and supply it is important to take into account the role played by gas interconnectors. For example, a narrow focus on just new electricity interconnection could ignore the possibility that an optimal least-cost outcome may be achieved by supporting new build Combined Cycle Gas Turbine (CCGT) plant in the UK (e.g. through the Capacity Mechanism) in combination with light-touch measures to ensure access to gas for this plant, either via LNG regasification capacity or through pipeline interconnection with the Continent.

This approach should be evaluated and compared against the costs and benefits to the consumer of multiple new electricity interconnectors, which may achieve the same outcomes (sufficient electricity supplies) but at a much higher cost to consumers.

4. Existing assets are not guaranteed

We believe that the NIC should evaluate ways in which critical existing infrastructure can be supported, as well as ways to promote new infrastructure. We note that economic studies sometimes make the assumption that existing assets will remain in place because they represent a sunk cost. However, we believe that this assumption is often invalid, especially where 1) assets need ongoing maintenance investment to prolong their viability; and 2) where a significant part of their economic benefits are societal and not necessarily rewarded in the market.

In IUK's case, we face a challenging environment from 2018 when our initial suite of long term contracts expire. We are also exposed to a form of market failure, in that we are subject to a more restrictive regulatory framework, providing less commercial freedom, than our gas flexibility market competitors. This is because we are classified as a Transmission System Operator (TSO), and therefore subject to very prescriptive European Network Codes which severely limit our product design and charging options. Our gas market flexibility competitors have a less restrictive regulatory framework and more commercial freedom through being classified as upstream flexibility, LNG regasification terminals or storage operators (SSOs). This is not a sound basis for market competition to get the best outcome for consumers.

To help us survive financially from 2018 and continue to make our capacity available to the market, we are seeking additional commercial flexibility of the sort that would allow us to compete in the gas flexibility market on a level playing field with other gas flexibility assets.

We have made these points to DECC and to our regulators (Ofgem in the UK and CREG in Belgium) and continue our dialogue with them whenever an opportunity arises. We have also raised these points with the European Commission and DG Energy. We would encourage the NIC and HM Treasury to support us in our requests for greater commercial flexibility, in the interests of promoting fair competition and maintaining an important piece of energy infrastructure for as long as possible.

5. Conclusions

In its wider infrastructure assessment role, we believe that the NIC should highlight the importance of maintaining valuable existing assets, especially when their social benefits are significant but the regulatory arrangements do not properly support them.

The NIC's focus on electricity interconnection and storage is understandable and reflects exciting new energy sector investment opportunities, but it should not lead to perverse outcomes. IUK would recommend that the NIC also uses its influence to make sure that related existing energy infrastructure is subject to an appropriate regulatory framework and is able to continue to provide its capacity and the associated energy market and societal benefits for as long as possible.

We would be very happy to explain further any of these points in person or to provide further written information if this would be useful.

With Best Regards,

Robert Sale

Regulation Director, Interconnector UK.