

Ian Marlee
Partner, Trading Arrangements
Ofgem
9 Millbank
London SW1P 3GE

25 March 2010

Ref: 100325/REG/LET/PD

Dear Ian

Project Discovery

Interconnector (UK) Limited welcomes the opportunity to comment on the issues identified in the Project Discovery Consultation.

Project Discovery is a thought provoking document, which outlines several key challenges for the energy market of Great Britain in the medium term if policy objectives are to be met. It is generally accepted by all stakeholders that there is a need for high levels of investment in Great Britain's energy infrastructure if we are to move to a lower carbon economy and to align the security of supply expectations of the authorities with what the market is likely to deliver if left unchecked. We believe the challenge is to create the regulatory stability to secure such investment in difficult financial conditions, against a background of increased risk and uncertainty.

The scenarios outlined by Project Discovery are, we feel, credible and we believe that if Great Britain is to meet the challenges ahead then action needs to be taken. In our response we have chosen to identify a number of key themes, rather than respond to each of the specific questions posed in the consultation.

Until such time as the issues identified in Project Discovery are resolved, and in particular those surrounding which is the most appropriate regulatory model for delivering Great Britain's energy policy objectives, there is a real risk of inertia impacting the delivery of investment. The only way to address this is to expedite the formulation of a coherent and comprehensive regulatory policy package and we urge Ofgem along with the government, to expedite this process.

In undertaking a fundamental review of the market mechanisms it is important that sight is not lost of the progress that has been made in developing the most liberalised energy market in the world and that investors who have so recently made long range commitments to infrastructure are not disadvantaged by any changes. Existing infrastructure which is still being financed and infrastructure under development must be assured that the commercial



Interconnector

and regulatory arrangements which underpinned that investment will not be undermined. We acknowledge that there is tension between securing new investment, with the long-term arrangements valued by investors, and the short term arrangements that enable new players to enter the market. To be fair to all parties, a balance needs to be found. It would seem appropriate to address short term price signals that at times of stress do not fully reflect the true significance of security of supply.

We strongly support the market principle upon which the GB energy market has developed. It is important that the various participants' roles remain clear and that risk apportionment is well understood. Investors have demonstrated their willingness to develop infrastructure in an open market and our view is that by modifying incentives within a market framework it is possible to align the infrastructure delivered with the policy objectives. Shippers are best placed to assess and assume market risk. The role of the authorities must be to set policy and provide clear regulatory certainty to the market so that the market may operate efficiently. Introducing centralised mechanisms whereby a central authority is empowered to 'pick winning projects', contract for energy or capacity or operate strategic assets is at odds with the market principles and would undermine GB's position.

A number of large energy infrastructure projects have come forward in recent years and sufficient capacity to supply the market exists (particularly in the case of gas). In the medium term in respect of issues regarding gas quality and gas storage it is unlikely that the current market arrangements provide sufficient incentive for investments to align with authorities' expectations. Suppliers either do not know they need a service or the price signals which should underpin investment are softening and therefore they are willing to accept a lower security standard. As import dependency increases, Great Britain needs to encourage investment such that it is in the centre of energy flows transiting the country rather than at the end of a very long supply chain. Action must be taken to avoid the risk of sterilising the ability of gas to be imported (gas quality) or put peak supply at risk should the stress tests identified by Discovery converge (long range storage)

Even in these specific cases we consider that the required signals can be amplified effectively. Thus, either policy package A (Targeted Reforms) or B (Enhanced Obligations) would, we believe, allow the authorities to align their policy objectives with investment in infrastructure within a market framework.

Finally we would note a general concern, based on feedback we have received, that the operational and regulatory requirements for Shippers accessing the GB energy grids are overly complex and a number of recent proposals have only added to the complexity. We would urge Ofgem, in considering the responses to this consultation, to adopt the view that better regulation does not necessarily mean more regulation.

We do not consider this response to be confidential.

Yours sincerely

Mary Simmons
Legal Manager

For and on behalf of
Interconnector (UK) Limited