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Dear Ms Angelidaki

Consultation on Cap and Floor Regime for regulation of project NEMO and future subsea interconnectors

Thank you for the opportunity to comment on your consultation document regarding the regulation of the electricity interconnector project NEMO and future subsea interconnectors.

IUK continues to support the over-arching objective of improving cross-border cooperation and harmonisation of energy markets and infrastructure but, as set out below, would also like to note certain concerns about the regulatory model that is the subject of this consultation.

IUK's view is that regulation of cross-border infrastructure should be effected on a case by case basis, so that regulatory treatment is appropriate to the particular circumstances of each case, and treatment is consistent where the cases are similar. Interconnection between the UK and continental Europe is very different to interconnection between member states that share a land border. Whilst in continental Europe interconnectors are an extension of the grid systems and can be regulated as such, connecting an island requires significant investment external to the two national systems, and demands different treatment. IUK acknowledges that this is recognised in the consultation document, and supports the cooperative approach taken by Ofgem and CREG in seeking an appropriate framework for regulation of cross border infrastructure.

In its response to Ofgem's January 2010 consultation on Electricity Interconnector Policy IUK expressed its support for the merchant operator model in a market-based framework. The recent history of gas import projects in the UK has shown that the market is capable of delivering timely investment, with market participants willing to make the necessary long term commitments to enable investors to invest. It should also be recognized that the merchant model attracted substantial investment from many different investors; a number of parties now own and operate storage, import and LNG facilities, offering real competition in import and flexibility services to the UK. These investments were achieved because a transparent and flexible, yet stable and predictable, regulatory framework was established; a clear example of the effectiveness of positive, light touch, regulation enabling long-term investment to deliver essential infrastructure requirements.

The view presented by Ofgem in the consultation is that the merchant route is no longer tenable and, by extension, that the market is no longer capable of delivering efficient

investment. Yet significant investment in UK gas infrastructure has been achieved under a market based framework. We believe that this framework should be repaired and restored, rather than discarded.

Interconnector notes that there are several regulatory models for cross-border infrastructure and welcomes Ofgem and CREG's vision of an approach in which merchant operations can co-exist alongside other models such as the proposed cap and floor regime. However, such an approach creates a new challenge to ensure that a level playing field is maintained for all owners and investors; specifically, that the consumer is not underwriting an uneconomic investment, thereby distorting the market to the detriment of another investment that would otherwise have been economically sound.

Whilst the 'cap and floor regime' is not IUK's preferred approach, its view on the cap and floor range is that it should be 'wide', in order to limit the potential for divergence from the merchant route. The floor should be the minimum level at which developers can realise the benefits of cheaper capital, thus minimizing the risk to consumers, and minimizing the risk of incentivising uneconomic investment. Discussion of the level at which a cap should be set cannot take place without discussion of the associated access regime and tariff methodology, which in themselves can provide additional risks and opportunities. The risk of over or under return should be reduced through applying an appropriate access regime, in particular, to provide a balance between long and short term bookings, and to avoid a situation where the infrastructure is highly utilised but poorly compensated. It should be the role of the operator to determine a non-discriminatory tariff methodology and access regime. The cap and floor provide ample incentive for the operator to find the optimal solution that is mutually beneficial to operator, market and consumer. The cap should then be set to reflect the level of risk faced by the operator, whilst providing incentives for efficiency and innovation.

IUK maintains the view that if investment is needed in order to deliver policy objectives, then it is up to the relevant authorities to use incentives and market based mechanisms to deliver a regime in which the investment environment and policy objectives are aligned. The market is more than capable, and should be allowed, to pick the most efficient means of delivering the required investment. At a time when significant long term investment in energy infrastructure is needed, it is essential that a stable and consistent regime is established by regulators.

Yours sincerely



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