

**Interconnector (UK) Limited**

8<sup>th</sup> floor, 61 Aldwych  
London WC2B 4AE

Direct Line: + 44 (0)20 7092 6598

Switchboard: + 44 (0)20 7092 6500

Central Fax: + 44 (0)20 7092 6501

Email: [robert.sale@interconnector.com](mailto:robert.sale@interconnector.com)

Website: [www.interconnector.com](http://www.interconnector.com)

Pamela Taylor  
Associate Partner  
Wholesale Markets  
Ofgem  
9 Millbank  
London  
SW1P 3GE

4 January 2013

Dear Pamela,

**Re: Consultation on National Grid Grain LNG's application for exemption from regulated third party access for Isle of Grain phase 4**

Thank you for the opportunity to respond to the consultation letter published on the 12 November 2012. Following some brief introductory comments, IUK would like to respond to three of the consultation questions raised by Ofgem.

IUK, as one of the largest flexibility sources for GB, welcomes Ofgem's recognition of the growing importance of flexibility sources as indigenous GB sources of gas decline. We also welcome Ofgem's recognition of the importance of not undermining the value of remaining contracts and of having regulatory certainty. This is relevant to both current assets and new investment. Both investors and buyers of capacity must have confidence that long term agreements are honoured if GB is to achieve the levels of energy infrastructure investment envisaged under Project Discovery and the Government's Electricity Market Reform.

We have specific comments relating to three questions, as follows:

**Question 3. What are your views on the competition analysis undertaken by Frontier? In particular, do you consider that they have sufficiently extended the analysis into the future to support the conclusion that no competition concerns from the Grain 4 exemption would arise?**

Frontier have provided an insightful analysis of competitive impacts, focusing on the expected changes to market shares and HHIs in various gas industry segments under various scenarios. Notwithstanding this analysis, there are aspects of the competitive landscape which cause concern.

Firstly, Grain 4 would represent a substantial expansion of GB gas import capacity in a market characterised by significant current and expected over-supply. Page 64 of Frontier's report provides some metrics regarding the magnitude of GB surplus import capacity. In this context, it is possible that there could be dynamic impacts on infrastructure which go beyond those analysed by Frontier. For instance, there is a risk that additional import infrastructure within a market governed by excess supply could lead to the partial closure of

some existing assets, which would serve to reduce the beneficial impact of increased LNG import capacity.

To mitigate this risk and as a general matter of principle, it is important that regulatory arrangements place competing assets on a level playing field. The evolution of regulatory arrangements will not necessarily achieve this. Firstly, Network Codes developed as part of the Third Energy Package introduce different rules for storage, LNG import facilities and interconnectors, despite their competing with one another to provide flexibility services to wholesale customers. Secondly, to the extent that some facilities are protected by regulatory exemptions, it may be unrealistic to assume that those not so protected will achieve adequate remuneration wholly through reliance on the residual competitive market. If Ofgem accepts that Grain 4 exemption has no risk of competitive detriment, it will be assuming that fair and effective regulatory arrangements will be devised to underpin competing infrastructure.

**Question 7. Do you consider that anti-hoarding arrangements at the Isle of Grain terminal might need to be improved to reflect the possible increasing importance of LNG as a route to market in the future? Should they be subject to regulatory approval and periodic reviews?**

As acknowledged in the analysis, GB is in the fortunate position of having a surplus of import infrastructure. Not all the capacity can be utilised on a regular or baseload basis, but the infrastructure is important to meet peak demand and exceptional events. Suppliers will require and book such capacity on a long term basis, to provide balancing flexibility, supply optionality and security of supply insurance. When Ofgem monitors suppliers' utilisation of capacity, under the Congestion Management Procedures, it will clearly need to take the overall surplus of capacity into account. Further it is important that consistent UIOLI rules apply across all flexibility sources, including interconnectors, storage and LNG terminals, to avoid distorting supplier choice and competition.

**Question 8. Do you consider that there should be any further conditions imposed on the requested exemption? If so, which specific conditions do you suggest?**

It is important that investment in Grain 4 does not foreclose other supply sources. If it were to lead to this outcome, its security of supply benefit would be correspondingly reduced or negated. In this context Ofgem may want to consider a further condition relating to incremental NTS entry capacity.

Before consideration of Grain 4, Isle of Grain phase 1-3 has a capacity of 650 GWh/day<sup>1</sup>. National Grid's "Entry Capacity Substitution Methodology Statement" of 5 December 2012 shows that Grain has an ASEP Baseline capacity of 464.2 GWh/day<sup>2</sup>, which suggests that further Grain enhancement will require incremental NTS entry capacity.

We do not believe it would be appropriate to substitute entry capacity away from Bacton to meet the Grain 4 enhancement, given that this would reduce the ability of shippers to use existing supply sources such as BBL, IUK and UKCS to supply the GB market. In particular, it would be inappropriate to use the 730 GWh/day of capacity that National Grid's document shows as "Substitutable Capacity" available at Bacton. With the two interconnectors alone

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<sup>1</sup> <http://www.nationalgrid.com/uk/Media+Centre/PressReleases/2010/01.12.10+Grain.htm>

<sup>2</sup> National Grid Entry Capacity Substitution Methodology Statement v4.0 - effective 02 January 2013  
[http://www.nationalgrid.com/NR/rdonlyres/BE1D7951-FDD8-4E6C-B2C2-85FA5A52482B/57941/EntryCapacitySubstitutionMethodologyStatement\\_40\\_authority\\_approval.pdf](http://www.nationalgrid.com/NR/rdonlyres/BE1D7951-FDD8-4E6C-B2C2-85FA5A52482B/57941/EntryCapacitySubstitutionMethodologyStatement_40_authority_approval.pdf)

capable of using 73% of Baseline capacity to meet GB demand plus sizable UKCS production flows into Bacton, any substitution of entry capacity away from Bacton would have a detrimental impact on GB security of supply if these alternative supply sources are then unable to deliver gas into GB to meet peak demand.

It is also important that the approach to entry capacity substitution is consistent with the exit capacity substitution methodology which rightly recognises obligations under the Security of Supply Regulation; and also with Third Energy Package requirements in terms of making maximum capacity available across border. So an additional condition for the requested exemption could be that additional NTS entry capacity is not provided for Isle of Grain by reducing the Baseline entry capacity available at Bacton.

This response is not confidential and we are content for it to be published on the Ofgem website.

Yours sincerely,

**ROBERT SALE**

Business Development and Regulation Director