WARWICK BUSINESS SCHOOL
THE UNIVERSITY OF WARWICK

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RE: Call for Evidence: Change of Existing Arrangements for Accessing Licence Baseline Exit Capacity on the National Transmission System at Bacton Interconnection

Dear Mr Corcut

For a number of years, I have been engaged in research on UK gas security, much of which has been funded by the UK Energy Research Centre (UKERC). In the last 18 months I have run a number of seminars at the WBS-Shard facility that have involved a range of stakeholders from industry, academe and Government. My responses below are based on the insights gained from these activities.[1] They relate to issues raised in section 1, are non-technical in nature and consider the wider 'strategic' benefits of providing BBL with access to export capacity at Bacton.

1. General - Competition

1.1. Do you think that changing arrangements for accessing Licence Baseline Exit Capacity at Bacton (BBL):

1.1.1. Would be good for competition?

The simple answer is yes. The current situation is a historical artefact as IUK has been allocated all of the export capacity because until this year they were the only interconnector to offer physical exports to UK shippers. Now that BBL has completed its investment, they too can offer export capabilities. There is already a functioning regulatory regime that handles physical imports from IUK and BBL to the UK and I assume that a similar approach can create a level playing field for exports from the UK. The two interconnectors connect to different continental gas markets: IUK to Belgium and the Zeebrugge Trading Point (ZTP) and BBL to the Netherlands and the Title Transfer Facility (TTF). The latter is now the most liquid European gas hub and serves as the EU's benchmark price. The fact that the current capacity ascribed to IUK is not fully utilised suggests that there should be an opportunity to meet BBL's request without damaging IUK's business. However, both interconnectors are facing greater volatility and uncertainty due to the phase out of long-term contracts and the need to develop new short-term business models. It is also the case that Brexit adds to the uncertainty as the UK's future relationship with the EU's Single Energy Market (SEM)

[1] See for example: Michael Bradshaw (2018) *UK Gas Security: a Position Paper*. WBS/UKERC: Warwick. Available at: http://www.ukerc.ac.uk/publications/future-uk-gas-security-a-position-paper.html

and the future legal status of the interconnectors are unclear. If we set Brexit aside, adding BBL export capacity will offer greater competition to UK shippers as they will have a choice that previously they did not have. As noted above, the two interconnectors are not serving the same continental gas markets and this adds diversity.

1.1.2. Would improve efficiency and competitive bi-directional interconnection with Europe?

The EU's gas security strategy aims for all interconnectors to be bi-directional, thus providing BBL access to utilise its new export capacity is in keeping with the direction of travel in the EU. It also provides additional capacity for the UK to supply gas to customers in continental European markets. Recent developments in the Netherlands at the Groningen field are of significance here. In recent weeks the Dutch Government has announced that all production at Groningen will cease production by 2022, much earlier than previously thought. This means that the Dutch will have to import more gas sooner than expected. Obviously, they have their own LNG import infrastructure and are also well connected to the northwest European gas market. As things stand at present, UK shippers wishing to deliver gas to the Dutch market (TTF) can do so via IUK and the Belgium market (they can also use swaps). However, the BBL pipeline connects the NBP to TTF at the Bacton facility and is therefore a much more cost-effective way of accessing the Dutch market. This may mean that UK shippers could gain more of the Dutch market by using BBL than would have been the case if IUK were the only route to the TTF. Thus, BBL's export capacity would enhance efficiency and the competitiveness of bi-directional interconnection with Europe.

1.1.3. Would open new trading opportunities for Shipper User?

Yes, this explained above.

1.1.4. Would provide additional access to existing storage facilities in Europe that Shipper Users would value?

I cannot speak on behalf of shippers, but it is well understood that following the loss of the Rough Storage Facility the UK has no inter-seasonal storage and only a limited amount of shorter-term storage. The UK Government has shown no appetite to support investment in new domestic storage and there does not seem to be a compelling business case for private investment. Thus, in winter months, when for demand for gas is at its greatest, the UK must rely on deliveries from the UKCS (which are in steady decline) and the NCS (which has limited swing capacity); gas supplied via the three LNG terminals; and the two interconnectors. It is the case that there is significant under-utilised gas storage in continental Europe. Thus, UK shippers could purchase gas in the summer when prices are lower, export it to continental storage facilities and then sell it when market conditions dictate, either in the UK or elsewhere on the continent. The current IUK facility provides this option to shippers and both IUK and BBL can import gas back to the UK. It remains to be seen what 'additionality' BBL can provide in terms of access to continental storage. The question of must be whether or not BBL would cannibalise IUK's summer export market or create new business? There is no way of knowing this, but I assume that it will be a concern for IUK. This

is also another area where Brexit is a source of uncertainty. If the UK finds itself outside of the SEM and treated as a 'third part' in relation to gas security, there may be concerns about the degree of gas security provided by relying on gas in storage in the EU. This highlights the importance of remaining within the SEM, as well as the growing significance of the UK's LNG import capacity.

1.1.5. Would make GB a more attractive place for LNG deliveries due to the additional interconnection with Europe?

There is no doubting that this would be the case. The UK's three LNG terminals all operate somewhat differently and the flow of LNG to the UK has shown itself to be volatile. Until recently, at least, the UK and Europe more generally, was a 'market of last resort' for LNG exporters. This is because most of global demand has been in Asia and prices have tended to be highest there. Thus, LNG came to Europe when demand in Asia was soft, usually in the summer. In Asia, LNG prices are indexed to oil, in the UK, and increasingly across the EU, the gas price is determined by gas-on-gas competition that reflects local market conditions. The LNG that ends up in the UK is sold at the BNP price or if shipped to Europe at local hub prices, but there is significant alignment between hub prices in Europe. In recent years things have become more complex as LNG production has increased and sources of supply have diversified. The UK has been largely dependent on Qatar for its LNG imports, typically over 90%. But this changing and in 2018 Qatar only accounted for 55% of UK LNG imports, with Russia and the US gaining significant market share. With more LNG available at a competitive price, it is possible that as domestic UK production declines more of our gas demand will be satisfied by LNG. This would be good for the terminal owners, but it would potentially expose UK consumers to the volatility of the global LNG market. In any event, the fact that the UK could offer gas traders greater capacity to export gas to continental markets from LNG facilities in the UK would make the UK a more attractive destination for LNG. Across the EU LNG terminal utilisation is generally low, a round the 25% mark. From a domestic energy security perspective, having more gas in the LNG tanks in the UK is undoubtedly a positive and would go some way to addressing the lack of inter-seasonal storage. The counterfactual is that if BBL could not provide increased access for LNG deliveries, that LNG would simply go to import terminals on the continent and UK consumers might have to pay more to import that gas via the interconnectors if needed.

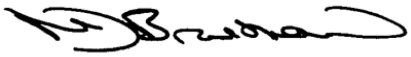
1.1.6. Would be good for market GB's gas market liquidity and transit flows?

The short answer is yes. If more gas were flowing through the UK from the NCS and from the LNG terminals this would improve the economics of that infrastructure. As production from the UKCS declines, less domestic gas is flowing through the offshore infrastructure and the NTS. The more that Norway and the LNG terminals use the midstream infrastructure to transit gas via IUK (and BBL) the greater the resilience of the system.

1.1.7. Would be good for consumers? If yes, how would consumers and Shipper Users benefit from this additional capacity to flow gas to Europe?

A more competitive and liquid domestic gas market is clearly better for consumers. Equally, as explained above, more gas flowing through the UK's infrastructure helps to share the cost of its maintenance and maintains its resilience. If increased pipeline export capacity via BBL results in

greater utilisation of the UK's LNG import terminal gas capacity this is also good for physical security and the price security of supply. As the experience of the "Beast from the East" shows, gas emergencies are usually short-lived and the market is reliant on the gas that is physically available as LNG takes days, if not weeks to arrive, anything that results in more 'gas in the tanks' at any given moment in time is good for consumers. This is particularly important given the uncertainty over the UK's future relationship with the EU's SEM. In short, though it seems counter intuitive, expanding the UK's gas export capacity will improve overall gas security.



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