

Sembcorp Energy UK feedback on Ofgem's Minded-to Decision to approve UNC728B

19th February 2021

Context of the response

Sembcorp Energy UK, a wholly-owned subsidiary of Sembcorp Industries, is an integrated energy business and leading provider of flexibility offering a range of solutions to the UK energy system. With a total operational portfolio of 973MW that includes significant battery storage, Sembcorp Energy UK helps to keep the country's electricity system balanced and resilient. Sembcorp Energy UK's major industrial power plants on Teesside along with its delivery of high-quality, centralised utilities and services to energy-intensive manufacturers are complemented by the fleet of fast-acting, decentralised power stations situated throughout England and Wales.

On the Wilton International industrial site (Wilton) in Teesside, Sembcorp Energy UK (through its wholly owned subsidiary, Sembcorp Utilities (UK) Limited) delivers high-quality, centralised utilities and services to energy-intensive manufacturers. With 200MW of installed capacity, one of the largest and most efficient Combined Heat and Power (CHP) plants in the UK supplies 24/7 electricity and heat to on-site businesses via the private distribution systems that are owned and operated by Sembcorp. Thus, a competitive and secure provision of utilities and gas supplies is essential to the future of the Wilton cluster and the associated innovation projects, such as the aim for Teesside to become the first Carbon Capture and Storage industrial cluster.

Teesside is a unique cluster in the UK

Teesside is a gas intensive cluster, with natural gas being used as a chemical feedstock, for processes as well as for energy production it.

The ideal topographic characteristics of Teesside have made the area an attractive location as a key industrial cluster, concentrating a large number of industries with significant economic impact for the UK. The cluster involves overall more than 1400 companies directly or indirectly via the supply chain of process industries of North East England. The sector exports £12 billion each year, making this region the only net exporting region in the UK.¹

¹ <https://www.nepic.co.uk/industry/>

Teesside has also been identified as a location with real potential to decarbonise regional carbon-intensive businesses by as early as 2030 and deliver the UK's first zero-carbon industrial cluster. The key role of Teesside in supporting the delivery of net-zero needs to be preserved and the competitiveness of the area as a whole is dependent on ensuring an appropriate level of gas charging reflective of the limited use the GB National Transmission System (NTS) and mindful of its clustered nature.

Within the Teesside region, Wilton International is home to a range of businesses such as chemical and process plants, biofuels and plastics recycling and operated by international conglomerates which generate significant export revenues for the UK. These companies (including Sembcorp) have invested heavily in their operations in the UK and have the desire to invest further. However, these investments are dependent mostly on two factors: reliable and secure supply of power and heat to successfully operate industrial assets, and competitive gas charges that reflect the proximity of the Teesside cluster to a number of exit points, thus only utilising a very short portion of the gas network.

Comments on Ofgem decision

We very much welcome Ofgem's intention to re-introduce a Shorthaul discount to limit the risk of inefficient bypass of the NTS. We welcome Ofgem's thorough assessment of the five options under UNC728/A/B/C/D and agree that 728B and 728D can both help address this issue, albeit in different ways.

However, we believe that 728D is the option that best addresses the realistic prospect of NTS bypass. We support CEPA and Ofgem's conclusion that the proposed 5km distance cap under UNC728D targets the vast majority of routes that are identified as risks and all of the routes that have been classified as higher risks. Allowing UNC0728D would ensure that only those who pose a credible risk of network bypass will be able to access the discount.

One of Teesside's most remarkable characteristics is its integration: industries use - and benefit from sharing - each other's products and by-products. Ensuring that the whole Teesside cluster is captured within one single discount through UNC728D would support such integration and its inherent efficiencies. By contrast UNC728B could undermine such industrial unity: neighbouring sites would be subject to substantial differences in gas charges affecting their competitiveness and ability to efficiently offer each other products and services. The benefits of mutual cooperation would be lost, and consumers based within the Teesside cluster would be harmed above and beyond the increase in gas charges themselves.

We understand the reasons underpinning Ofgem's preference for UNC728B, especially with regards to the perceived proportionate approach allocating lower discounts to longer-distance routes which

are less at risk of bypass and incrementally higher discounts for the short-distance routes that present a higher risk of bypass. While in general this could be a valid method, this approach would not be appropriate for the clustered nature of Teesside.

Teesside is on the border of proposed discount rates

We believe that under UNC728B the difference between the proposed discounts for those routes below or at the 4.4. km mark would introduce unfair discrimination between neighbouring conglomerates, for which gas charges make up a high proportion of their overheads. Teesside would find itself placed at the cut-off point between a higher and a lower discount. This means that many conglomerates within the cluster could choose to move their NTS connection a short distance to an easily accessible and more advantageous exit point which would grant 90% discount. This approach would also be favoured by a return on investment materialising within a very short time. National Grid Gas (NGG) would naturally forecast recovery of network charges according to the allocation based on UNC728B, but this will be rendered inaccurate by industries deciding to connect at another accessible exit point within a short timeframe. Existing pipelines could be repurposed and connected within two/three years, so Teesside conglomerates would not necessarily need to build new infrastructure. Under UNC728D, this risk would be greatly limited because of the shorter distance cap to be eligible for discount, resulting in better forecasts of cost recovery by NGG.

The risk of Teesside consumers bypassing the NTS is likely to be even more material, if we factor in the increased demand that is expected due to forthcoming innovation projects that will form part of the UK's first zero-carbon industrial cluster.

In light of this, we would encourage Ofgem to consider that – in addition to assessing whether a Shorthaul discount is proportionate to the risk of bypass – the issue goes farther than simply accounting for the number of routes that would benefit from the discount or that would be at risk of bypass. More attention should be given to how many industrial sites would be affected, and the repercussions on NGG's ability to recover network charges, should a cluster like Teesside bypass the NTS fully or in part.

Appropriate investment signals

Finally, we believe that the Shorthaul product should continue to send the appropriate investment signals to key and unique industrial clusters like Teesside. The large increase of gas charges, following the removal of Shorthaul with modification UNC678A, means that industries at Teesside are evaluating whether it is still worth investing in the region, and in so doing they are considering options that bypass the NTS. One such conglomerate is very likely to kick off the investment to recommission an existing mothballed pipeline. Others at Teesside would seize the opportunity to



join this project and collectively benefit from sharing the costs of building and connecting a new pipeline, in addition to avoiding all network charges.

Furthermore, the current regulatory uncertainty is affecting investors' confidence and there is little trust that the proposed Shorthaul product will be a lasting regime. Industries in the cluster are having to consider their future on Teesside as well as considering options to build a more secure and guaranteed framework, by detaching their gas supply from the NTS, if they are to remain in the region. The short time for a return on bypass investment is very attractive, making the case for bypass a low-risk financial decision.

Even though some may argue that connecting at Teesside Sub-Terminals will not guarantee the same security of supply as an NTS connection, several conglomerates are willing to accept that risk by timing their production outages with the planned maintenance of the Teesside Sub-Terminals. Any financial implications of a less resilient supply would be mitigated by the significant avoided network charges.

In conclusion, while we agree with the reasoning behind Ofgem's decision to support UNC728B, we do not believe it will deliver the intended result with regards to Teesside and will not discourage bypassing the NTS. Therefore, we submit that UNC728D better meets the objectives of the Shorthaul regime.

We welcome the opportunity to discuss our response in more detail, should you have any questions or comments.

With many thanks,

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