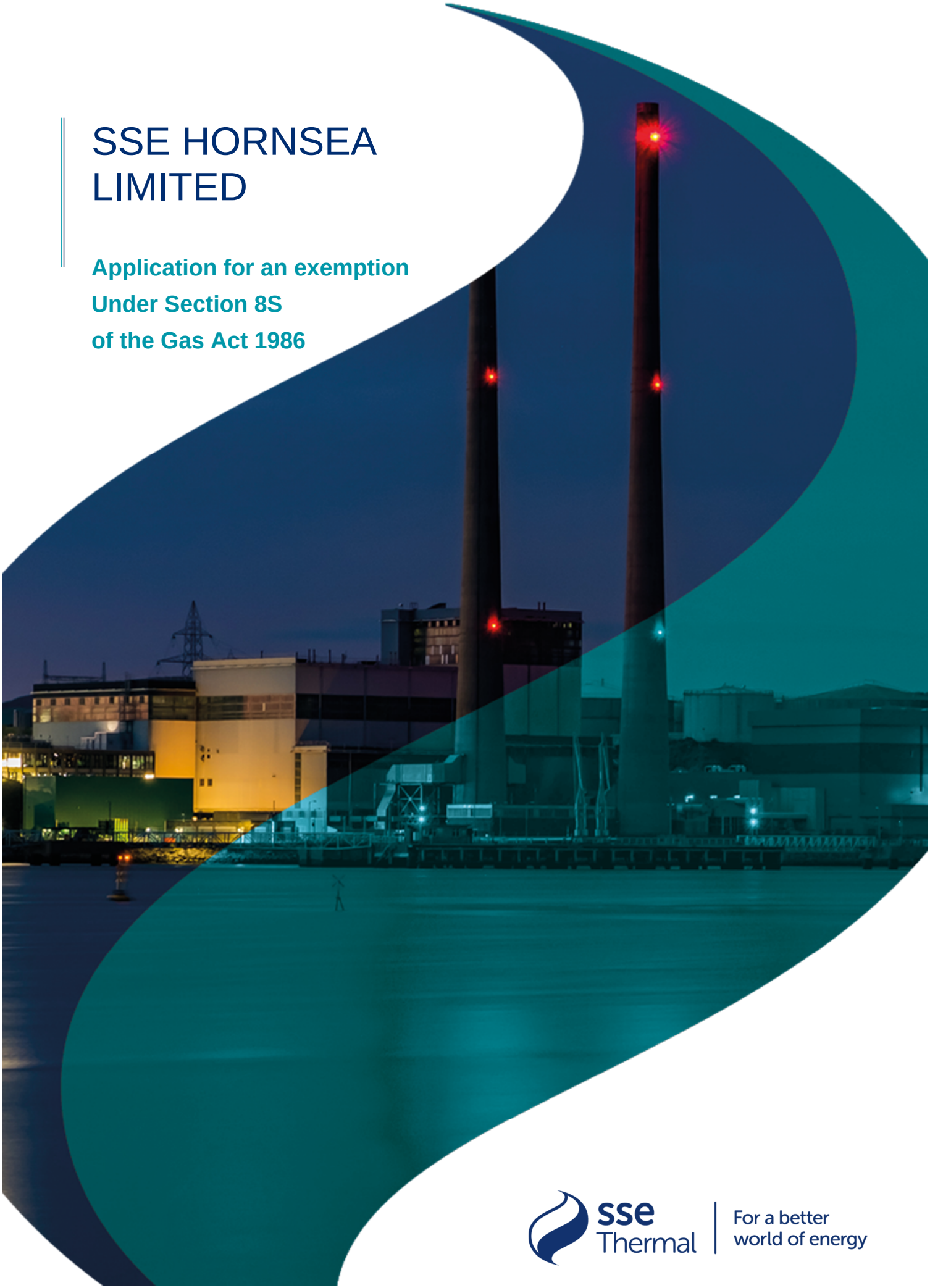
SSE HORNSEA LIMITED

Application for an exemption Under Section 8S of the Gas Act 1986



sse Thermal | For a better world of energy

INTRODUCTION

This application is submitted under Section 8S[1] of the Gas Act 1986 (the Act), as amended, on behalf of SSE Hornsea Limited (***SSEHL***) in respect of the Atwick Gas Storage facility (***Atwick***), wholly owned and operated by SSEHL. The application is submitted with the intention of seeking a level playing field with other storage facilities. Atwick is the only facility within GB which is subject to the administrative burden and business separation requirements of the Act.

THE FACILITY

Atwick is located near Hornsea on the East Yorkshire coast. It consists of nine caverns with the capacity to store around 325 million cubic metres (mcm) of gas. The facility first entered commercial operation in 1979 and was purchased by SSE in September 2002.

Four compressors provide the means of injecting up to 2 mcm of gas per day into the salt cavities where it is stored at pressures between 120–270 bar. Gas can be withdrawn at a rate of up to 11.8 mcm per day, which is equivalent to the gas requirements of around four million homes. Relative to other medium-range storage facilities in the GB market, these injection and withdrawal rates mean that Hornsea's ability to cycle gas is comparatively slow.

The basis of the Hornsea storage service is the Standard Bundled Unit (SBU). Each SBU affords the customer approximately: (i) 1 kWh deliverability (ii) 34.66 kWh space (iii) 0.24 kWh injectability. SBUs are currently sold for a minimum period of one storage year running from the start of May through to the end of April.

Capacity is sold through an annual auction process on the basis of a standard contract, the Storage Services Contract ("the Storage Contract"). These terms are available to all parties on a non-discriminatory basis. A "firm" service is offered to all customers and, accordingly, all nominations are allocated whole. Under the Storage Contract, customers may make unlimited re-nominations on either a day-ahead or within-day basis.

As well as selling firm storage services, SSEHL also offers customers access to unutilised capacity, thereby allowing them to inject, store and withdraw gas on an interruptible basis. This service is offered to all customers that have signed a Storage Contract, irrespective of whether they have managed to secure SBUs during the auction process. In other words, all market participants are entitled to gain access to the facility on an interruptible basis, without purchasing SBUs in the storage year, as long as they have signed the Storage Contract.

ANNUAL CAPACITY AUCTION

The annual auction, to offer gas storage capacity contracts from Atwick, held in April 2021, resulted in no third-party contracts being secured. As such the assets are being commercially operated to ensure economic and efficient use of the facility and the business continues to manage its commodity exposure arising from the storage of physical gas to changes in the spread between summer and winter prices, market volatility and plant availability.

RATIONALE

Atwick is the only facility within GB which is subject to the requirements of Section 8S of the Gas Act (1986), as amended. We do not consider that the facility is technically or economically necessary to the

[1] https://www.legislation.gov.uk/ukpga/1986/44/section/8S

efficient operation of the gas market. This view is supported by our analysis using the same assessment framework as that applied to assessing the exemption for Stublach, owned and operated by Storengy.

In 2021 Stublach moved out of the 5-10% market share range and into the 10-15% bracket (within 1-2% of SSE Storage). Within both its 2015 decision letter to SSEHL's application for a minor facilities exemption for Hornsea gas storage facility[2], and its Final Decision: Storengy UK Limited's application for an exemption from section 19B of the Gas Act 1986[3] Ofgem notes *"as part of our ongoing market surveillance activities, we will continue to assess the effect of exemptions on the market",*

SECTION 8S OF THE ACT

Section 8S of the Act (as amended) states that:

"The Authority must give a minor facility exemption in respect of a facility where it is satisfied that use of the facility by other persons is not technically or economically necessary for the operation of an efficient gas market."

Accordingly, the two tests that Ofgem must consider are:

i. whether the Facility is "technically necessary" for the operation of an efficient gas market; and
ii. whether the Facility is "economically necessary" for the operation of an efficient gas market.

OFGEM'S ASSESSMENT APPROACH

To inform this submission, SSEHL has relied on the assessment framework outlined by Ofgem in the following documents:

- Gas storage third party access (TPA) exemptions – minor facilities (Ofgem Open Letter, 16 June 2019)[4]
- Guidance on the regulatory regime for gas storage facilities in Great Britain (Ofgem Guidance, 5 December 2011)[5]
- Guidance on the regulatory regime for gas storage facilities in Great Britain (version 2) (Ofgem Guidance, 24 September 2015)[6]

Ofgem's previous decisions in relation to exemption applications have also been reviewed to further understand the practical application of the assessment framework. As such, Ofgem's exemption decision in relation to the Stublach facility is also relied upon in this submission:

- Final Decision: Storengy UK Limited's application for an exemption from section 19B of the Gas Act 1986

Ofgem clearly states that there is no single test that it considers should be relied upon to demonstrate whether an exemption should be granted. Instead Ofgem is likely to examine a series of indicators to come to a view on whether an exemption should be granted. SSEHL appreciates this approach but does have concerns with the 10% indicative threshold used by Ofgem in the pivotality assessment within the nTPA assessment framework.

[2] https://www.ofgem.gov.uk/publications/final-decision-ssehls-application-minor-facilities-exemption-hornsea-gas-storage-facility

[3] Final Decision on Storengy UK Limited's application for an exemption from section 19B of the Gas Act 1986 | Ofgem

[4] Gas Storage Minor Facility Exemptions Open Letter | Ofgem

[5] Guidance on the regulatory regime for gas storage facilities in Great Britain (2011)

[6] Guidance on the regulatory regime for gas storage facilities in Great Britain (2015)

"TECHNICALLY NECESSARY" TESTS

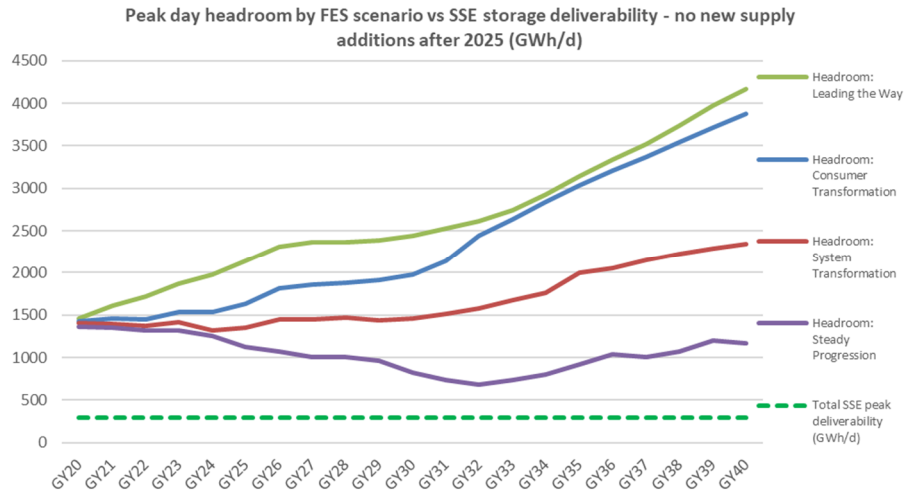
SSE storage is not technically necessary for the GB gas market on either a peak day or over a typical winter period. Headroom is significantly larger than SSE Storage deliverability in all National Grid 2020 Future Energy Scenarios (FES).

Indicator 1: Peak day capacity headroom

Capacity "headroom" is calculated by subtracting 1-in-20 peak day gas demand from peak day gas supply (minus SSE's total daily storage deliverability) for each year. The analysis was done for each of the FES 2020 scenarios. This "headroom" was then compared to aggregated SSE daily storage deliverability (green dashed line, Figure 1) to assess whether SSE can influence the efficiency of the GB gas market by utilising its storage deliverability. We assume that no new gas supplies come onto the GB system after 2025.

Graph 1 shows that peak daily deliverability from the aggregated SSE storage fleet is below capacity headroom in all scenarios and years modelled. Please refer to tab "Headroom_PeakDay" in the accompanying "nTPA_analysis_model_SSE_Ofgem_May21" Excel file to view the supporting analysis.

Figure 1: Peak day capacity headroom vs SSE storage deliverability (GWh/day)



Indicator 2: Winter Day capacity headroom

The second metric for "technical necessity" is headroom on a winter day. First, growth rates for annual demand growth for each FES 2020 demand scenario were calculated. These growth rates were then applied to the total forecasted demand for Winter 2020 from the National Grid Winter Outlook 2020/21 to extrapolate a total winter demand for each forecasted year to GY26. This was done for all four FES scenarios.

For supply, all non-storage supply deliverability - UKCS, LNG, Continental interconnectors, Norwegian piped - for winter is summed (daily peak deliverability * no of winter days) and added to total GB storage capacity (or "space"). This assumes that storage is 100% full on Oct 1 and 0% full on March 31st. This gives total winter gas supply availability for each year in GWh.

The difference between the total winter supply and total winter demand in each year is the total winter headroom. This is divided by 182 (number of days in Oct-Mar inclusive) to provide the winter period average daily headroom in GWh/day. The headroom for each scenario is again compared to SSE's daily storage deliverability. As shown in Figure 2, SSE storage deliverability is significantly less than the headroom in each scenario. Please refer to tab "Headroom_Winter" in the accompanying "nTPA_analysis_model_SSE_Ofgem_May21" Excel file to view the analysis.

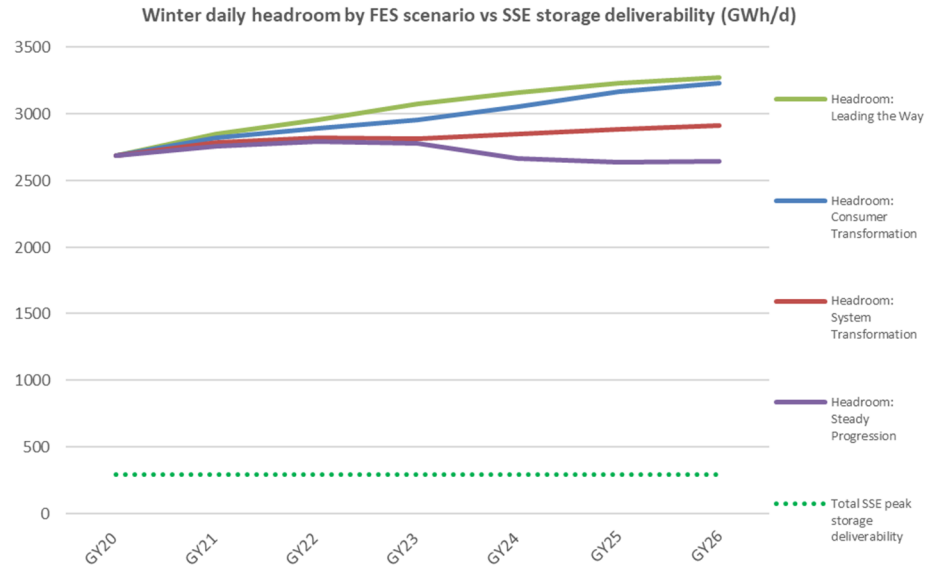


Figure 2: Winter headroom vs SSE storage deliverability (GWh/day)

"ECONOMICALLY NECESSARY" TESTS

Indicator 3: Pivotality

Result: PASS – SSE exhibits no pivotality for any time period, in any year to GY26, under the highest (and therefore the most onerous) Steady Progression demand scenario from National Grid's FES 2020.

To calculate pivotality, the Ofgem pivotality model from 2011 was used. The base year was updated to GY19/20, the most recent full year available. The model was updated with the latest data including:

- GB gas production, NTS demand, Bacton / Moffat exports, storage injections / withdrawals / stocks for base year GY19. Data all available from NG Data Portal
- Capacities and deliverability for all GB gas supply including interconnectors, storage, UKCS, Norway, and LNG imports. Data from NG TYS 2020.
- GB gas demand projections from National Grid TYS 2020.

Table 1 shows SSE pivotality in the FES 2020 "Steady Progression" demand scenario – the highest demand case and therefore the most likely that SSE will exhibit pivotality. The percentage number is SSE's 'pivotal gas volume of supply' as % of GB gas demand, and the number in square brackets is the number of periods in that gas year in which SSE is pivotal**.** SSE exhibit no pivotality for any time period, in any year to GY26, under the highest Steady Progression demand scenario from National Grid's FES 2020. Please refer to tab "Table" in the accompanying "nTPA_analysis_model_SSE_Ofgem_May21" Excel file to view the analysis.

Pivotality results (Ref)	19/20	20/21	21/22	22/23	23/24	24/25	25/26	26/27
Daily	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]
Weekly	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]
Monthly	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]
Quarterly	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]
Seasonal	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]	0%, [0]

Table 1: SSE pivotality -Ofgem definition, "Steady Progression" FES demand scenario, no infrastructure outages

Indicator 4: Market share

Result: TBC - SSE passes the market share criteria (greater than 10%) under Ofgem's Definition 3 but fails under Definition 1 and Definition 2 of the GB gas flexibility market.

Market share refers to SSE's total share of the GB gas flexibility market. Ofgem provide the following definitions of the flexibility market in their appraisal of the Storengy application in 2014:

- Ofgem definition 1: MRS + LRS + 50% IUK + Beach Flex + 25% LNG
- Ofgem definition 2: MRS + LRS + 70% IUK + 25% BBL + 15% Norway + Beach Flex + 50% LNG
- Ofgem definition 3: MRS + LRS + 100% IUK + 50% BBL + 30% Norway + Beach Flex + 50% LNG

THE PRECEDENT OF OFGEM'S ASSESSMENT OF STUBLACH EXEMPTION APPLICATION

Ofgem reiterated in its final decision on Storengy UK Limited's application for an exemption that Ofgem does not consider that any single test should be relied upon to demonstrate whether an exemption should be granted. Ofgem also stated that *it does not have or use an explicit market share threshold*, although noted that concerns about potential to distort may be greater if a company has more than 10%.

We note that SSEHL's inability to pass the 10% threshold assessment was key to Ofgem not granting an exemption to Hornsea in 2015. However, given that Ofgem granted an exemption to Storengy UK in respect of Stublach, which continues to operate with a Minor Facility Exemption (which SSEHL is supportive of) SSEHL is effectively discriminated against by continuing to be obligated under the nTPA. As the figures above show, under definitions 1 and 2, there is a negligible difference in the market share above 10% which SSEHL and Stublach hold.

THRESHOLD FOR ASSESSING PIVOTALITY AND MARKET SHARE

SSEHL considers that 10% represents an arbitrary and conservatively low threshold for assessing potential market power in the flexible gas market. Ofgem has provided no underlying analysis in support of this threshold either at the time of the consultation in 2010 or since. Further, there is no basis in UK (or EU) competition law for making a presumption of market power at 10%. In 2004, guidance issued by the UK's Competition & Market's Authority (***CMA***) suggested that a market share of 40%-50% is the presumptive threshold for market power. A similar threshold for the presumption of market power is also well-established by precedent in EU law[7]. To conclude that an undertaking has market power with a market share less than 40-50%, a competition authority would need to demonstrate that other market factors existed which, in combination, provided strong evidence of market power.

We note that Ofgem's assessment of SSEHL's 2015 application for an nTPA exemption for Hornsea gas storage facility concluded that the facility is economically necessary due to the potential for market power creating risks that SSE could have the ability to distort the gas flexibility market. SSEHL's inability to pass the 10% threshold assessment, when strictly applied, was therefore key to Ofgem not granting an exemption to Hornsea in 2015. SSEHL does not consider this position to be viable and would urge Ofgem to reassess the significance of its assessment of pivotality in the GB gas flexibility market.

[7] Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, para. 41; also Case C-62/86 *AKZO Chemie BV v Commission* [1991], ECR I-3359, para. 60.

CONCLUSION

SSEHL requests that Ofgem considers the evidence provided and grants an exemption under Section 8S of the Gas Act (1986), as amended for the following reasons:

- SSEHL is operating its Atwick facility on an uneven playing field as the only facility remaining obligated under the negotiated Third Party Rules.
- Granting an exemption to Atwick will remove the unnecessary regulatory burden
- Updated analysis shows that there are no significant risks of adverse effects on the market in circumstances where flexible gas has a greater than 10% market share and is unregulated, as evidenced by the precedent set by the exemption for Stublach.