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To all interested Parties

13 December 2004

Consultation on an application by Energy Merchants Gas Storage (UK) Limited for an exemption under section 19A of the Gas Act 1986 from section 19B of the Gas Act 1986 for the planned expansion capacity at the Hole House gas storage facility

Introduction

This document provides details of an application by Energy Merchants Gas Storage (UK) Limited (EMGS) for an exemption under section 19A(2) of the Gas Act 1986 ('the Gas Act') from the negotiated third party access (TPA) requirements contained in section 19B of the Gas Act. The application relates to the planned expansion capacity at the Hole House gas storage facility.¹ This document also provides Ofgem's initial views on the application and invites responses on these views.

Background

As a result of the entry into force of the Second EU Gas Directive there have been a number of important changes made to the legal and regulatory framework applying to gas storage facilities in Great Britain (GB). These changes were made through the Gas (Third Party Access) Regulations 2004 (the 2004 Regulations), which transposed, in part, the Second Gas Directive into GB law and which came into force on 26 August 2004. On 25 November 2004, Ofgem published a document² setting out a summary of the changes made to the Gas Act as a result of the 2004 Regulations and set out its view on their impact on new and proposed gas storage facilities.

In summary, although the 2004 Regulations did not make any material changes to the nature of the negotiated TPA requirements for gas storage, which are set out in section 19B of the Gas Act, a number of significant changes were made to section 19A of Gas Act, which contains the arrangements by which storage facilities can be exempted from these TPA requirements. In particular, for new storage facilities or for existing facilities which are, or are to be, modified to provide a significant increase in capacity, section 19A of the Gas Act now provides two routes for exemption: the facility can be granted an exemption if either: use of the facility by other

¹ Following discussions with Ofgem, EMGS has amended its application to cover the entire capacity of the Hole House gas storage facility. This is discussed in more detail later in this letter.

² "The Second EU Gas Directive and storage regulation Great Britain", Ofgem, November 2004. This document can be found under the 'Europe' area of work on Ofgem's website.

persons is not necessary for the operation of an economically efficient gas market; or, if the six exemption requirements contained in section 19A(8) of the Gas Act are met³.

In respect of a facility which is, or is to be, modified to provide for a significant increase in its capacity, section 19A of the Gas Act specifies that, where an exemption is given on the basis that the use of the facility by other persons is not necessary for the operation of an economically efficient gas market, the exemption may be given in relation to the whole of the capacity of the facility or any significant increase in the capacity of the facility, but where an exemption is given on the basis that the six exemption requirements contained in section 19A(8) are met, the exemption may only be given in relation to that increase in its capacity.

The Hole House gas storage facility

The Hole House project consists of two development phases. Phase I of development consists of two cavities each of approximately 150GWh of useable space and a gas processing plant. Phase II of development consists of two additional 150GWh salt cavities and an upgrade of the gas processing plant.

On 21 December 2000, Ofgem gave an exemption from the TPA requirements in the Gas Act to Aquila Energy Storage Limited ("AESL") for Phase 1 of the Hole House gas storage facility. This exemption was given on the basis that the use of the facility by other persons was not necessary for the operation of an economically efficient gas market.

The Hole House gas storage facility started commercial operations in February 2001 with the gas processing plant and the first 150GWh cavity operational.

On 9 October 2002, EDF Trading Limited acquired the entire issued share capital of AESL and AESL's company name was changed to Energy Merchants Gas Storage (UK) Limited. EMGS now owns and operates the Hole House Storage Facility under the exemption granted in December 2000.

Phase I of the development of the Hole House gas storage facility was completed in March 2003. The facility currently provides approximately 300GWh of capacity, with a deliverability of approximately 30 GWh/day and an injectability of approximately 60 GWh/day.

EMGS is planning to implement Phase II of the project by leaching two more cavities, which combined are expected to add approximately 300GWh of usable space. In addition, EMGS is planning to upgrade the gas processing plant to add approximately 60GWh/d of deliverability

³ The six exemption requirements are contained in section 19A(8) of the Gas Act 1986 and are set out below:

- (a) the facility or (as the case may be) the significant increase in its capacity will promote security of supply;
- (b) the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption;
- (c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility;
- (d) charges will be levied on users of the facility or (as the case may) the increase in its capacity;
- (e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility; and
- (f) the Commission of the European Communities is or will be content with the exemption.

and approximately 60GWh/d of injectability. EMGS expects the first of these two cavities to be commissioned by the end of 2006 and the second to be commissioned by the end of 2008.

On 30 April 2004, EMGS wrote to Ofgem applying for an exemption under section 19A(2) of the Gas Act from the application of section 19B of the Gas Act for the planned expansion capacity at the Hole House gas storage facility on the basis that the use of the facility by other persons is not necessary for the operation of an economically efficient gas market.

Ofgem's initial view

As noted above, the existing capacity of the Hole House storage facility is the subject of an existing exemption. However, the capacity that is covered by that exemption is relevant to Ofgem's consideration of whether an exemption should be given in respect of the significant increase in capacity. This is because, as set out in section 19A of the Gas Act, Ofgem must consider whether the use of the facility, as opposed to just the use of the increase in capacity, is necessary for the operation of an economically efficient gas market.

As set out in its November 2004 document on the Second EU Gas Directive and storage regulation in GB, Ofgem considers that, where appropriate, an application for exemption should include an appropriate competition analysis. The only instance in which Ofgem considers that a competition analysis would not be required is in the case of a very small storage facility where it is self evident that the facility is not necessary for the operation of an economically efficient gas market.

The planned increase in capacity at the Hole House gas storage facility would increase the space available at the facility to 600GWh, the deliverability to 90GWh/d and the injectability to 120GWh/d. Based on the information available to Ofgem, the Hole House gas storage facility, including the increase in capacity, would constitute only around two per cent of the overall market for existing (maximum) gas and LNG storage space in GB. Based on figures provided by the Competition Commission⁴ on maximum daily flexibility, the Hole House gas storage facility, including the increase in deliverability, would constitute only around two per cent of the overall market for flexibility in GB.

Having taken into account the expansion planned as part of Phase II of development of the Hole House gas storage facility, it is Ofgem's initial view that the use of the facility by other persons is not necessary for the operation of an economically efficient gas market. Ofgem's initial view, therefore, is that an exemption should be granted to EMGS under section 19A(6)(a) of the Gas Act from the TPA requirements in section 19B of the Gas Act to cover the entire capacity of the Hole House gas storage facility.

Draft exemption order

As set out previously, Phase I of the Hole House gas storage facility is already exempt from the TPA requirements in section 19B of the Gas Act. Ofgem considers that, in the interests of consistency and administrative efficiency, it would be appropriate in this case for any exemption granted to EMGS in respect of Hole House to be for the entire 600GWh capacity of the facility

⁴ "Centrica plc and Dynegy Storage Ltd and Dynegy Onshore Processing UK Ltd", Table 5.9, Competition Commission report, August 2003.

rather than grant an exemption covering only the additional planned 300GWh of capacity. This would require the existing exemption, which covers Phase I of the facility, to be revoked, which, under the existing exemption order, it may be upon four months notice from the Authority.

This decision is reflected in the draft exemption order for the Hole House gas storage facility set out in Appendix 2. In addition, the drafting of this exemption order is, where relevant, consistent with the exemptions granted to South Hook⁵ and Isle of Grain⁶ LNG import facilities.

Views invited

This document presents Ofgem's initial views on EMGS's formal exemption application. Ofgem would welcome views on the initial views contained in this document and the draft exemption order contained in Appendix 2 to be received by close of business 21 January 2005. All responses will normally be published on Ofgem's website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as confidential. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.

Responses should be addressed to:
Steve Smith
Managing Director, Markets
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Electronic responses should be sent to adam.higginson@ofgem.gov.uk If you wish to discuss any aspect of this paper, Adam Higginson (telephone 020 7901 7432) would be pleased to help.

Way forward

Ofgem will consider responses received to this formal consultation in making its decision on whether to grant an exemption to EMGS under section 19A(6)(a) of the Gas Act from the TPA requirements in section 19B of the Gas Act to cover the entire capacity of the Hole House gas storage facility. Ofgem will publish its decision in a final views document.

Yours sincerely



Steve Smith
Managing Director, Markets

⁵ Application by South Hook LNG Terminal Company Ltd (SHTCL) (owned by Qatar Petroleum and ExxonMobil) under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986, Ofgem final views, November 2004.

⁶ Application by Grain LNG Ltd under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986, Ofgem final views, December 2004.

Appendix 1: Table 1 - Summary of existing and publicly known proposed storage facilities⁷

Projected Start date	Storage facility	Owner	TPA status	Space (GWh)	Deliverability (GWh/d)	Injectability (GWh/d)
<i>Existing gas storage facilities</i>						
N/A	Rough	Centrica Storage Limited	Required to provide Gas Act TPA. Also provided undertakings	30300	455	160
N/A	Hatfield Moor	Scottish Power	Exempt	1260	25	25
N/A	Hornsea	Scottish and Southern Energy (SSE)	Required to provide Gas Act TPA	3495	195	21.6
N/A	Hole House	Energy Merchants Gas Storage (UK) Limited	Exempt	300	30	60
<i>Existing LNG storage facilities</i>						
N/A	Avonmouth	Transco LNG	Exempt	876	156	2.3
N/A	Partington	Transco LNG	Exempt	1121	219	2.4
N/A	Dynevor Arms	Transco LNG	Exempt	304	49	2.6
N/A	Glenmavis	Transco LNG	Exempt	505	101	1.6
<i>Planned storage facilities</i>						
Q4 2005	Humbly Grove	Star Energy	Exempt	3146	79	90
First cavity Q3 2006 Second cavity Q3 2008	Hole House (increased capacity)	Energy Merchants Gas Storage (UK) Limited	Formally applied for exemption for increased capacity	300	60	60
2007	Welton and Scampton North	Star Energy	Not applied	4720	89	Information not available
Mid 2007	Caythorpe	Warwick Energy	Not applied	2000	80	80
2007/08	Aldbrough	SSE/Statoil	Not applied	4427	421	211
2007/08	Byley	Scottish Power	Not applied	1758	175	88
2007/08	Fleetwood	Cantaxx	Not applied	18000	1200	1200

⁷ The data in this appendix has been provided to Ofgem directly by the relevant storage facility owners.

Appendix 1: Draft exemption order

GAS ACT 1986 SECTION 19A EXEMPTION

Pursuant to sub-section 19A(6)(a) of the Gas Act 1986 (the Act), the Gas and Electricity Markets Authority hereby gives to Energy Merchants Gas Storage (UK) Limited⁸, as the owner of a storage facility which is to be modified to provide for a significant increase in its capacity, an exemption from the application of section 19B of the Act in respect of the storage facility located at Hole House, off School Lane, Warmingham, Nr Crewe, Cheshire, CW11 3QN, subject to the attached Schedule.

Steve Smith

Authorised in that behalf by the
Gas and Electricity Markets Authority
Dated

⁸ Registered in England No. 2850057. Registered Office: 71 High Holborn, London, WC1V 6ED.

SCHEDULE
PERIOD, CONDITIONS, AND REVOCATION OF EXEMPTION

A. Interpretation and Definitions

In this exemption:

“the Authority”	means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000
“the Act”	means the Gas Act 1986 as amended from time to time
“the facility”	means the Hole House storage facility
“facility owner”	means Energy Merchants Gas Storage (UK) Limited in its capacity as owner of the storage facility
“facility operator”	means Energy Merchants Gas Storage (UK) Limited in its capacity as operator of the storage facility

B. Full description of the storage facility to which this exemption relates

This exemption relates to:

1. The capacity of the facility as at the date of this exemption, being 300GWh, and
2. The modification of the facility to provide for a significant increase in the capacity of the facility of 300GWh arising from two new cavities, the first cavity which is to be commissioned by the end of 2006 and the second cavity which is to be commissioned by the end of 2008.

C. Period

This exemption shall come into effect on the date that it is issued and will continue until it is revoked in accordance with Section E.

D. Conditions

Pursuant to sub-section 19A(3)(b) of the Act, this exemption is made subject to the following conditions:

- 1. That the material provided by the facility owner to the Authority in respect of this exemption is accurate in all material respects.
- 2. The facility owner furnishes the Authority in such manner and at such times as the Authority may reasonably require, with such information as the Authority may reasonably require, or as may be necessary, for the purpose of:
 - (a) performing the functions assigned to it by or under the Act, the Utilities Act 2000, or the Energy Act 2004, each as amended from time to time; or
 - (b) monitoring the operation of this exemption.
- 3. The facility owner complies with any direction given by the Authority (after the Authority has consulted the relevant gas transporter and, where relevant, the Health and Safety Executive) to supply to the relevant gas transporter such information as may be specified or described in the direction -

- (a) at such times, in such form and such manner; and
- (b) in respect of such periods,

as may be so specified or described.

Where the facility owner is prevented from complying with such a direction by a matter beyond its control, it shall not be treated as having contravened the condition specified in this paragraph.

In this condition:

“information”	means information relating to the operation of the pipe-line system which is operated by a relevant gas transporter
“relevant gas	means any holder of a gas transporter licence under

transporter”	section 7 of the Act owning a transportation system within Great Britain to which the facility is connected or with whom the facility operator interfaces with as a system operator
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4. Should any of the grounds for revocation arise under section E of this exemption, the Authority may, with the consent of the facility owner, amend this exemption rather than revoke the exemption.
5. The Authority may, with the consent of the facility owner, amend this exemption.
6. This exemption is transferable to another facility owner where the Authority has given its written consent to such a transfer. For the avoidance of doubt, all of the conditions contained in this exemption order continue unaffected in respect of any facility owner to whom this exemption order may be transferred.

E. Revocation

Pursuant to sub-section 19A(4) of the Act, this exemption may be revoked in the following circumstances:

1. This exemption may be revoked by the Authority by giving a notice of revocation to the facility owner not less than four months before the coming into force of the revocation in any of the following circumstances
 - (a) where:
 - (i) the Authority considers that the use of the facility is necessary for the operation of an economically efficient gas market;
 - (ii) the facility owner has a receiver (which expression shall include an administrative receiver within the meaning of section 251 of the Insolvency Act 1986) of the whole or any material part of its assets or undertaking appointed;

- (iii) the facility owner has an administration order under section 8 of the Insolvency Act 1986 made in relation to it; or
 - (iv) the facility owner is found to be in breach of the Competition Act 1998.
 - (b) the facility owner has failed to comply with a request for information issued by the Authority under paragraph D2 above and the Authority has written to the facility owner stating that the request has not been complied with and giving the facility owner notice that if the request for information remains outstanding past the period specified in the notice, the exemption may be revoked; or
 - (c) the facility owner has failed to comply with a direction issued by the Authority under paragraph D3 above and the Authority has written to the facility owner stating that the direction has not been complied with and giving the facility owner notice that if the direction remains outstanding past the period specified in the notice, the exemption may be revoked.
2. This exemption may be revoked by the Authority with the consent of the facility owner.