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To all interested Parties

8 February 2005

Decision 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 decision on the application.

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. The 2004 Regulations 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 exempt from these TPA requirements. In particular, for new storage facilities or for existing facilities which are, or are to be, modified to provide for 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

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.

other 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 facility⁴, 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 requirements contained in section 19A(8) of the Gas Act 1986 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 be) 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.

⁴ See also the definition of 'new facility' in section 19E of the Gas Act.

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 views

On 13 December 2004, Ofgem consulted on EMGS's application for an exemption. Having taken into account the expansion planned as part of Phase II of development of the Hole House gas storage facility, Ofgem's initial view was 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, was 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. Ofgem invited responses on its initial views and on the draft exemption order to be received by close of business 21 January 2005.

Respondents' views

Ofgem received three responses to the consultation and these responses can be found in full on the Ofgem website. Of the respondents, two agreed with Ofgem's initial view that the use of this storage facility by other persons is not necessary for the operation of an economic and efficient gas market and that it would therefore be appropriate to grant the exemption. The remaining respondent suggested that the impact on the market for storage services should be assessed separately before any exemption is granted.

One respondent considered that the increase in storage capacity at the facility would benefit security of supply. This respondent considered that the size of the facility and the level of competition that already exists in the market mean that the exemption would not have a negative impact on the UK gas market.

In respect to the draft exemption order, one respondent suggested that any amendment to this exemption, even with the consent of the facility owner, should only be after wider consultation with the industry and any other affected parties.

Ofgem's final view

Having considered respondents' views, Ofgem remains of the view that use of the facility by other persons is not necessary for the operation of an economically efficient gas market. The Authority has therefore granted EMGS an exemption in respect of the entire capacity of the proposed Hole House gas storage facility under section 19A(6)(a) of the Gas Act from the TPA requirements in section 19B of the Gas Act. This exemption order is set out in Appendix 1 of this document.

Ofgem notes the view of one respondent that the market for storage services should be assessed separately before any exemption is granted. Ofgem remains of the view, however, that the

relevant markets for the assessment of the exemption application are the market for storage space and the market for flexibility.

Ofgem would like to note that, in the event that any of the circumstances occur which may give rise to the need to amend an exemption, in the absence of a need to act urgently, Ofgem would likely consult interested parties before an amendment is made.

The way forward

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 (and EMGS agrees) that, in the interests of consistency and administrative efficiency, it would be appropriate in this case for the exemption granted to EMGS in respect of Hole House to be for the entire 600GWh capacity of the facility rather than grant an exemption covering only the additional planned 300GWh of capacity. This requires the existing exemption, which covers Phase I of the facility, to be revoked, which, under the existing exemption order, may be upon four months notice from the Authority. Ofgem has written to EMGS giving EMGS four months notice that the existing exemption order in respect of Phase I of the Hole House gas storage facility has been revoked and that this revocation will be effective from 7 June 2005. The attached exemption order (at Appendix 1) will be in effect from 8 June 2005.

If you wish to discuss any matters in this document, please contact Adam Higginson on 020 7901 7432.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Steve Smith', written in a cursive style.

Steve Smith
Managing Director, Markets

Appendix 1: 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) Limited⁵, 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 February 2005

⁵ 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 proposed 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 8 June 2005 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 is satisfied that use of the facility by other persons 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 any national or European competition laws, such breach relating, directly or indirectly, to the facility.
- (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.