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To all interested Parties

15 March 2005

Consultation on an application by Caythorpe Gas Storage Limited for an exemption under section 19A(6)(a) of the Gas Act 1986 from section 19B of the Gas Act 1986

This document provides details of an application by Caythorpe Gas Storage Limited (CGSL), a wholly owned subsidiary of Warwick Energy Limited (WEL), for an exemption under section 19A(6)(a) 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 proposed gas storage facility to be located in Caythorpe, East Yorkshire. 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 Directive¹ 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 result in 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 allows for owners of storage facilities to be granted exemptions 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 may be granted an exemption if either: use of the facility by 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.

¹ Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

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

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;

The Caythorpe gas storage facility

WEL, through subsidiary companies, owns and operates the Caythorpe gas field near Bridlington in East Yorkshire. The field, which produces gas from conventional porous strata, was put on production in 1992 and will be nearly fully depleted by 2007 under its current operating regime. WEL plans to convert the depleted gas field into a gas storage facility and intends to commence gas storage operations at Caythorpe in mid-2007. The facility will be built, owned and operated by Caythorpe Gas Storage Limited.

WEL has stated in its application that the ultimate capacity of the project is a function of the reservoir size, the number of wells drilled and the size of the compression facilities. However, WEL suggests that the maximum capacity of the facility will not exceed 3000 GWh of space with 120 GWh/day of peak deliverability and 90 GWh/day of peak injectability.

It is intended that the Caythorpe storage facility will have a single customer who will commit to paying capacity fees to CGSL on a long term basis in return for rights to store gas in the facility.

On 24 February 2005, WEL wrote to Ofgem under section 19A(2) applying for an exemption under section 19A(6)(a) of the Gas Act from the application of section 19B of the Gas Act for the planned Caythorpe 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

Based on the information available to Ofgem⁴, the Caythorpe gas storage facility, with an estimated 3000 GWh of space, would constitute around seven per cent of the overall market for existing (maximum) gas and LNG storage space in GB. Based on the market definition provided by the Competition Commission⁵ in relation to maximum daily flexibility, the facility's estimated deliverability of 120 GWh/day would constitute around three per cent of the overall existing market for flexibility in GB. If a more narrow approach was adopted to the definition of the flexibility market – to the flexibility provided by existing and likely future medium duration storage facilities⁶, the facility's estimated deliverability would represent around 11 per cent of this market.

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- (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.

⁴ Please see Appendix 1 to this document for a summary of existing and potential storage facilities.

⁵ Competition Commission, *Centrica plc and Dynegy Storage Ltd and Dynegy Onshore Processing UK Ltd*, August 2003, Table 5.9.

⁶ For the purpose of this calculation Hatfield Moor, Hornsea and Hole House are classified as existing medium duration storage facilities, and the Humbly Grove, Welton, Aldbrough and Byley storage facilities are classed as the likely future medium duration storage facilities. Ofgem considers that this interpretation is consistent with Table 4.5B of Transco's Transportation Ten Year Statement 2004 on the basis that 'likely future' storage facilities are those that have progressed beyond the 'conceptual' stage.

It is Ofgem's initial view that, on the basis of the size of the market share that the Caythorpe gas storage facility would represent in the market for storage space and for flexibility (under both market definitions), the use of the facility by other persons is not necessary for the operation of an economically efficient gas market. Ofgem's initial view is, therefore, that an exemption should be granted to CGSL under section 19A(6)(a) of the Gas Act from the TPA requirements in section 19B of the Gas Act in respect of the whole of the capacity of the Caythorpe gas storage facility.

For the avoidance of doubt, any views expressed, or decisions made, in respect of the giving of exemptions from section 19B are expressed or made solely in relation to the relevant criteria for the giving of exemptions set out in section 19A. Any decision that Ofgem may make, or view that Ofgem may express, in relation to this application for an exemption does not preclude or impact in any way on the operation of the Competition Act 1998 or the Enterprise Act 2002. Further, as the analysis contained in this document is in relation to a specific situation, the analysis may or may not necessarily be relevant to a consideration of any related issues that may arise, for example under the Gas Act 1986, the Competition Act 1998 or the Enterprise Act 2002

Draft exemption order

A draft exemption order for the Caythorpe gas storage facility is set out in Appendix 2. The drafting of this exemption order is, where relevant, consistent with exemptions granted to other gas storage and LNG import terminal facilities since the 2004 regulations came into force.

Views invited

This document presents Ofgem's initial views on CGSL'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. Any responses should be received by close of business 29 April 2005. All responses will normally be published on Ofgem's website and held in the Research and Information Centre. If respondents do not wish their response to be made public then they should clearly mark their response as being not for publication. 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 (matthew.buffey@ofgem.gov.uk). If you wish to discuss any aspect of this paper, Matthew Buffey (telephone 020 7901 7088) 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 CGSL under section 19A(6)(a) of the Gas Act from the TPA requirements in section 19B of the Gas Act to cover the whole of the capacity of the Caythorpe gas storage facility. Ofgem will publish its decision in a final views document.

Yours sincerely

A handwritten signature in black ink, consisting of several overlapping, fluid loops and strokes, positioned below the text 'Yours sincerely'.

Steve Smith
Managing Director, Markets

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	Exempt	300	60	60
Mid 2007	Caythorpe	Warwick Energy	Applied for exemption	3000	120	90
2007	Welton and Scampton North	Star Energy	Not applied	4720	89	Information not available
2007/08	Aldbrough	SSE/Statoil	Not applied	4427	421	211
2007/08	Byley	Scottish Power	Applied for exemption	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 2: 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 Caythorpe Gas Storage Limited⁸, as a person who expects to be an owner of a storage facility, an exemption from the application of section 19B of the Act in respect of the storage facility located at Caythorpe, near Bridlington, East Yorkshire, subject to the attached Schedule.

Steve Smith

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

⁸ Registered in England No. 5283117. Registered Office: Wellesbourne House, Wellesbourne, Warwickshire, CV35 9JB.

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, as amended from time to time
“the Act”	means the Gas Act 1986, as amended from time to time
“the facility”	means the Caythorpe storage facility
“facility owner”	means Caythorpe Gas Storage Limited in its capacity as owner of the storage facility
“facility operator”	means Caythorpe Gas Storage Limited in its capacity as operator of the storage facility

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

The capacity of the facility, being up to 3000GWh.

C. Period

Subject to section E below, and pursuant to section 19A(3)(a) of the Act, 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, as amended from time to time) 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, as amended from time to time, made in relation to it;
 - (iv) the facility owner is found to be in breach of any national or European competition laws, such breach relating to the facility; or
 - (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.