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22 September 2005

Dear Colleague,

Consultation on the proposed treatment under section 19A of the Gas Act 1986 of gas storage facilities with split ownership

Background

In November 2004 Ofgem published a letter (the 'November letter') summarising the changes made by the second EU Gas Directive to the legal and regulatory framework applying to gas storage facilities in GB.¹ The letter outlined the possible routes for exemption from the requirement to offer third party access and included initial guidance on the application process and the operation of the new exemption regime.

The letter noted that for new storage facilities² or for existing facilities which are, or are to be, upgraded, section 19A(6) of the Gas Act 1986 (the Gas Act) now provides two routes for exemption from the requirement to offer regulated third party access (RTPA). Under section 19A(6) 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 (the 'de minimis' test) (section 19A(6)(a)); or
- ◆ the six exemption requirements contained in section 19A(8) of the Gas Act are met (section 19A(6)(b)).³

¹ 'The Second EU Gas Directive and storage regulation in Great Britain', open letter, Ofgem, November 2004.

² The term 'new facility' is defined in section 19E of the Gas Act 1986 to mean: (a) a storage facility the construction of which is or is to be completed after 3 August 2003; or (b) a storage facility the modification of which to provide for a significant increase in capacity is or is to be completed after 3 August 2003.

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

The letter also noted that for existing storage facilities⁴ without an exemption, section 19A of the Gas Act now provides only one route for exemption: the facility can only be granted an exemption if use of the facility by other persons is not necessary for the operation of an economically efficient gas market (i.e. the 'de minimis' test).⁵

Exemption applications in the case of split ownership

In the November letter⁶ Ofgem noted that "where there is split ownership of the facility itself (i.e. where company A has ownership rights over 50 per cent of the storage capacity in the facility and company B has ownership rights over the remaining 50 per cent), each company may apply for an exemption for the capacity of the facility over which it has ownership rights."

Ofgem is considering whether there may be circumstances in which it would be appropriate to issue separate exemptions to two or more owners of a facility in respect of the capacity of that facility and is seeking views on its treatment of facilities with split ownership.

Purpose of this consultation

This consultation aims to inform Ofgem's considerations on how it should approach applications for exemption from RTPA under the de minimis criteria, where the ownership of the relevant facility is split between two or more parties.

These considerations are important, as Ofgem has received applications for exemption from Scottish and Southern Energy Plc (SSE) and Statoil (UK) Limited (Statoil) in respect of each of their shares of the Aldbrough gas storage facility. Having discussed these applications informally with both parties, Ofgem considers that it is appropriate to further clarify relevant aspects of the guidance issued in November, and is seeking views from market participants on (1) the relevant factors which Ofgem should consider when deciding whether the requirements of section 19A(6)(a) are met in respect of a facility which is owned by two or more parties, and (2) whether joint owners of a facility should apply for one exemption for the entire facility, or for separate exemptions for their respective shares of the facility.

Whilst this consultation has been prompted by the applications from SSE and Statoil, Ofgem is **not** at this stage seeking views on whether an exemption should be granted in respect of the applications made for the Aldbrough facility. Ofgem is solely seeking views from market participants on the approach to adopt in relation to applications under the 'de minimis' criteria, where a facility has more than one owner.

The SSE and Statoil applications

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- 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 Those facilities not defined as new.

⁵ Section 19 A(5).

⁶ Appendix Three of that letter.

On 30 November 2004, Statoil applied to Ofgem for an exemption for its one-third share of the Aldbrough gas storage facility on the basis that use of its share of the facility by other persons is not necessary for the operation of an economically efficient gas market.⁷ On 28 February 2005, SSE applied on behalf of SSEHL to Ofgem for an exemption for its two-third share of the Aldbrough gas storage facility on the basis that use of its share of the facility by other persons is not necessary for the operation of an economically efficient gas market.⁸

Background to the Aldbrough facility

The original intention of Statoil and SSEHL was to develop separate gas storage facilities. In 2002 Statoil started to develop a three salt cavern gas storage facility at Aldbrough. Subsequently in 2003, SSEHL began to develop a separate gas storage facility at Aldbrough consisting of six caverns on land adjoining the Statoil development. Given the parallel nature of the developments and the opportunity this created to reduce the costs and risks associated with storage development, in 2004 agreement was reached between Statoil and SSEHL to share the development of a nine cavern facility.

The project is structured as a joint venture. However, rather than using a joint venture company in which Statoil and SSEHL each have a share, the asset itself is joint owned. The project is structured such that Statoil owns and utilises one-third of the facility, and SSEHL the remaining two-thirds. While the parties will utilise common above ground infrastructure they are distinct and separate commercial entities.

Treatment of facilities with split ownership

Ofgem has granted a number of exemptions to date under Section 19A(6)(a)⁹; i.e. having considered each relevant application separately, Ofgem granted exemptions from the requirements for RTPA for certain facilities on the basis that the use of each of those facilities is not necessary for the operation of an economically efficient gas market. However, Ofgem notes that all of these previously granted exemptions have been granted to single-owner facilities, whereas at Aldbrough, as set out above, the facility is joint-owned and each party has applied separately for an exemption for its share of the facility. Ofgem notes that the Aldbrough facility has a larger total capacity than any of the facilities that have so far been granted exemption under the de minimis criteria.

Ofgem is of the view that the Aldbrough facility is a single “new facility” as defined in section 19E of the Gas Act, which is subject to a capacity sharing arrangement between the joint owners, Statoil (U.K) Limited (“STUK”) and SSE Hornsea Limited (“SSH”). Ofgem is also of the view that any application for an exemption under section 19A(6) requires an assessment of the whole capacity of the facility.

However, in determining whether a single facility which has more than one owner is suitable for exemption under section 19A(6)(a) of the Gas Act, Ofgem considers that it may be appropriate to take into account factors other than just the physical nature of the facility and is seeking views on this point. Ofgem considers that, for example, the contractual rights over the facility may be relevant. The contractual structure may, for example, enable the parties to compete with each

⁷ i.e. under section 19A(6)(a) of the Gas Act.

⁸ i.e. under section 19A(6)(a) of the Gas Act.

⁹ These include Hole House, Humbly Grove and Byley

other and this may, in Ofgem's view, be relevant to a consideration of whether or not to exempt a facility under section 19A(6)(a) of the Gas Act. However, Ofgem is also aware that, if such factors are taken into account, it is possible that this approach could give rise to situations where, in relation to two facilities of equal size, one is subject to an exemption and one is not (as a result of the different contractual arrangements or other relevant factors which apply to the facilities).

Ofgem is also seeking views on whether joint owners of a facility, who are applying under section 19A(6)(a), should apply for separate exemptions for their respective shares of the facility (as suggested by the November letter) or whether, given that Ofgem will need to consider the whole capacity of that facility when assessing any application for an exemption, joint-owners should apply jointly for an exemption in respect of their jointly-owned facility.

Finally, Ofgem is considering whether, in respect of facilities which are owned by two or more parties, it may be appropriate to issue an exemption in respect of part but not all of the capacity of that facility.

Although Ofgem will consider each application on a case by case basis, Ofgem is aware that a risk of adopting an approach along the lines described above is that it may result in owners of storage facilities putting in place ownership and contractual arrangements purely with a view to satisfying the de minimis requirements of section 19A(6)(a). This would increase the regulatory costs involved in administering the exemption legislation and would, in Ofgem's view, be contrary to the intention of the legislation. Ofgem's initial view is that it would not be able to grant exemptions under section 19A(6)(a) in respect of separate owners of a facility, if it is not satisfied that sufficient contractual separation is in place.

Views invited

Ofgem is therefore seeking views on whether, as part of its assessment of applications for exemption under the 'de minimis' test set out in section 19A(6)(a) of the Gas Act 1986 (i.e. that use of a storage facility by other persons is not necessary for the operation of an economically efficient gas market) Ofgem should consider factors such as the contractual arrangements for the facility where the ownership of that facility is split between two independent parties. Ofgem is also seeking views on the other matters covered in this consultation paper, including as to whether joint owners of a facility should apply for one exemption or for separate exemptions for their respective shares of the facility.

Ofgem welcomes views on the potential treatment of split-ownership facilities as detailed in this document and also invites the discussion of any further alternative options to the extent that these exist and have not been discussed in this document. Further, respondents should consider how Ofgem's assessment of the Aldbrough facility, may affect its assessments of future applications for exemption from RTPA to gas storage. As noted earlier, Ofgem is **not** inviting views at this stage on whether the specific applications by either Statoil or SSEHL in respect of the Aldbrough facility should be granted.

Please send all responses to this consultation by **5pm on 3rd November 2005** to:

Sonia Brown

Ofgem
9 Millbank
London
SW1P 3GE

Electronic responses should be sent to Wholesale.Markets@ofgem.gov.uk.

If you have any queries in relation to the issues raised in this letter, please feel free to contact Ben Woodside on 020 7901 7471.

Yours sincerely

Sonia Brown
Director, Wholesale Markets

Consultation code of practice

If respondents have comments or complaints about the way this consultation has been conducted these should be sent to:

Michael Fews
Head of Licensing
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE
Tel: 020 7901 7085

Michael.fews@ofgem.gov.uk