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Dear Sonia

Ofgem Consultation on the treatment of Gas Storage Facilities with Split Ownership

As an independent part-time consultant active from time to time in areas relating to gas storage I would like to offer the following comments and suggestions in respect of the areas covered by your Consultation Paper on Gas Storage Facilities with Split Ownership.

In my view the key issue is the extent to which an operator or owner of storage capacity, including a part-owner, holds "market power" in relation to any relevant market segment. Thus where an operator/owner controls capacity for more than one storage site (for example, as for Transco LNG Storage at present and Scottish and Southern in future) the tests for exemption should focus on the position of the operator/owner rather than individual facilities.

Hence I believe that where a storage facility is jointly owned and the owners hold distinct rights to a discrete share of the facility's capacity and these are operated and marketed independently the owners should be entitled separately to apply for and be considered for exemptions from the obligation to offer "full" TPA access.

By "full" TPA access I mean TPA under either regulated or negotiated terms as envisaged by ERGEG's "Guidelines on Good Practice for Storage System Operators" (GGPSSO) paper as "adopted" on 18 March 2005 at Madrid Forum. As you will know, this paper lays out "Good Practice" to be expected of Storage Operators offering either negotiated or regulated TPA. It covers areas such as:

- roles and responsibilities of storage operators***
- the definition of TPA services***
- the allocation of services***
- confidentiality requirements***
- publication of information***
- pricing (where regulated rather than negotiated)***
- secondary market issues***
- relationship with the relevant transportation system operator***

These Guidelines were developed against a background where storage operators were expected (simplifying considerably) either –

- to be offering "Regulated TPA", in particular where there was demand for storage services but little competition between storage providers (or providers of other forms of flexibility service) and a storage provider might be expected to be able to exert some market power over service prices and service conditions***

- to be offering “Negotiated TPA” where there was demand for storage services and competition between providers of relevant flexibility services so that a storage provider would be subject to market forces
- to be exempt from offering TPA, where “open” use of the facility is not necessary for the operation of an economically efficient gas market and the operator/owner(s) seeks exemption from the costs of offering TPA of the nature envisaged by GGPSSO

If fully implemented the Guidelines can cause material added costs, particularly if (as is the norm in the UK) the gas movement allocations are generally made equal to the nominations received and any imbalances are charged to the storage operator, and if there are numerous customers who can renominate as often as they like and the operator is expected to make unused capacity available to all (registered) interested parties, even if on an interruptible basis (the “use-it-or-lose-it” concept, UIOLI, to stop anyone buying capacity and withholding it from “the market”).

By contrast, mainland European storage facilities tend to offer simpler services, typically with customers’ flow nominations scaled at the end of the day to aggregate to daily gas flows, so not being met exactly. This means that customers do not know exactly how much storage gas flow will contribute to their daily balance, usually until some time after the end of the day.

It may be appropriate for me to observe that I expect that many future developers of storage capacity will formally seek TPA exemption on the grounds that use of the facility by other persons is not necessary for the operation of an economically efficient gas market (sometimes known as the “de minimis” argument). I think owners may often consider that the costs of providing a “GGPSSO-style” TPA service are unnecessarily high in relation to the benefits to the market and may be unnecessarily high in relation to the benefits to the operator, and they may therefore formally seek “TPA exemption” even while (as has already been seen) intending to sell the capacity rights to one customer under a “simple” form of TPA.

With just one customer, the “TPA” arrangement can be very simple indeed. The primary capacity rights “shapes” can effectively follow the facility’s injectability and deliverability decay curves, and the owner could provide the capacity-holder with their forward estimates of available injectability, deliverability and space covering the full Storage Year, updating these as often as is necessary. For instance, the estimates for about one week ahead could be reviewed and/or confirmed each day, and the within-day and day-ahead estimates might be reviewed hourly.

Nominations would only be accepted from the sole customer. If the customer wished (or was obliged) to sell capacity to a third party, this could be invisible to the owner – the third party would nominate to the sole customer, who would (from the owner’s viewpoint) bundle any nomination(s) with its own. Such sales to third parties need not resemble physical capacity and could be “virtual” (eg NBP deals, not requiring NTS entry or exit rights) with no reference to the storage facility.

Within-day, the owner could advise the customer of any additional capacity available, and the customer’s daily allocations could aggregate to net metered flow.

This Model is thus simple to operate. The owner would need no marketing, trading or risk management functions and (because they need never face daily gas imbalances) there would be no need for a shipping licence or a shipping service. The customer has the option of using the capacity or alternatively selling capacity to those third parties which value the service most highly. The Model minimises the owner’s commercial activity, and is perfectly viable.

But formally TPA exemption is necessary.

Hence I believe that “TPA exemption”, specifically exemption from the need to offer TPA access as envisaged by GGPSSO, is appropriate where the owner of capacity meets appropriate tests and conditions.

As regards whether exemption should be granted I believe that there are several tests which may be relevant.

Simple tests should be sufficient where the case is clear cut. In the UK context I would support exemption wherever the aggregate physical storage capacity held by the operator (and any affiliates) provides less than about 15% of aggregate injectability, deliverability and space in every relevant physical UK “Storage Type” (ie physical storage facilities grouped according to their nominal space/deliverability

ratios into up to 10 days, 10-30 days and 30 or more days, accepting that this subdivision between “short, medium and long duration” facilities is not based on a clear distinction by product markets). Conversely I would generally support the withholding of such exemption where the shares in a “Storage Type” are about 25% or more.

Obviously these percentages are “pragmatic” rather than determined empirically but I believe they are reasonable criteria.

Where a facility falls between the two criteria, then a fuller consideration may be appropriate, but given that the quantities of storage are increasing significantly, and that most storage facilities’ aggregate capacity would within a few years of operation meet the “15%” criteria I favour, I would expect a high proportion of the new facilities to receive favourable consideration if their owners apply for exemption; and obviously where joint owners apply for exemption for a share of the capacity, providing suitable assurances about independent operation, there would be a stronger case for exemption unless the operator controls other capacity.

However, it would be appropriate for any exemption test to take account of bookings of physical capacity as well as capacity owned. If a storage owner and any shipper affiliates control more than about 15% of any “Storage Type” capacity taking ownership and capacity bookings together it would not necessarily be appropriate for TPA exemption to be granted in relation to the capacity owned.

Because physical capacity might be booked or secured in the secondary market at short notice, it might be desirable that any exemptions given require that the owner and its affiliates undertake to provide Ofgem with information on the quantities of storage capacity bookings made and that Ofgem indicates that any exemption test may be reviewed against the composite holdings and may result in exemption being withdrawn or temporarily suspended if Ofgem deem there to be a risk of too great a level of market influence by virtue of the combined holdings.

I would exclude any “virtual storage capacity” from any such tests, largely on the grounds that it is essentially a form of gas trading and distinctions within the broad area of gas trading are too complex to be worth pursuing here.

To my knowledge, adoption of the suggestions made above would not conflict with any exemptions granted to date by Ofgem other than in the case of Transco LNG Storage, whose exemptions would fail to meet any reasonable test I could contemplate.

Yours sincerely

T H Welch