

Ms Sonia Brown
Ofgem
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Dear Ms Brown

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

Introduction

energywatch welcomes the opportunity to comment on this short consultation paper.

UK's additional gas storage requirements

The development of new gas storage facilities is becoming increasingly important to the security of the UK's gas supply. Unlike many major import dependent European countries, the quantity of storage space in the UK is, proportionately, extremely low. We understand that the UK has the equivalent to 14 days' supply at average winter gas demand rates, whereas our European partners have large strategic storage facilities capable of supplying around 80 days of gas at winter demand levels. In terms of the relationship between annual demand and storage space, currently in the UK, the total quantity of storage space equates to around 4% of total annual demand. The larger import dependent European countries tend to have enough storage capacity to meet 20% of their annual demands.

It is well known that the UK is becoming import dependent as the UKCS supplies decline and, therefore, it is essential that we address what would appear to be a significant storage deficit to support both seasonal and non-seasonal demand fluctuations.

The regulation of storage facilities must be considered in this light as it is critical that the UK gas market and, moreover, UK industry is not undermined by preventable supply constraints.

Treatment of exemption applications

Ofgem outlines the current routes available to storage facilities for obtaining an exemption from the requirement to offer negotiated third party access (NTPA) under Section 19A(6) of the Gas Act 1986.

In a letter of November 2004, Ofgem set out its initial views on "split ownership", proposing that, in the event that two companies have split

ownership rights to the storage capacity, then each company may apply separately for an exemption for the relevant capacity.

energywatch understands that, in the case of the new Aldbrough facility, the two owners, Statoil and Scottish and Southern Energy, have separately applied for an exemption in accordance with the Ofgem guidance letter highlighted above.

energywatch understands that split ownership may result in competition issues which should be considered when applying the '*de minimis*' test, and is unclear as to whether, in that context, separate exemption applications are, in fact, appropriate. In addition, there is a risk of a decision on one joint application being treated as a precedent which may cause facility owners to consider structuring their ownership of facilities in such a way as to secure NTPA exemptions in the future.

At this stage, energywatch believes, due to the critical importance of storage to the UK market, that each exemption application should continue to be viewed on a case by case basis. We see no reason to disallow separate exemptions, but understand that Ofgem may want to view the contractual and operational relationships between the parties making the applications at the relevant facilities. Indeed, we believe that if parties are denied the opportunity to make individual applications then it is possible that one party may be disadvantaged by a single application, i.e. the party which would normally be granted an exemption.

Clearly, the "success" of an application will be determined by a number of factors, not least of which would include:

- the *de minimis* test and other related criteria provided for in Section 19A (6) of the Gas Act, including the relative size of the capacity owned by the parties;
- the operational control exerted by any one party at the facility;
- the contractual arrangements existing between the parties at the facility; and
- the physical nature and location of the facility.

energywatch believes that each party should make a separate application stating its case for an exemption, but, at the same time, make all pertinent information relating to the operation of the facility available to Ofgem (to include operational, commercial and physical information). This will ensure that Ofgem is able to judge each application on its merits whilst still being able to request information relating to the relationship with the other party.

Conclusions

energywatch believes that the regulatory regime should be structured in such a way as to encourage the development of new storage facilities in order to reinforce UK security of supply. The exemption application process should be transparent and simple to administer whilst at the same time effective in terms of requiring third party access where appropriate to facilitate competition.

energywatch believes that the separate application process should be adopted. This approach should ensure that each application is treated on its merits and, in the event that an exemption is awarded to a single party but not the other, there is a clear demarcation between the awards. A single application process may “blur” the award and result in future problems when attempting to police the operation of the facility, i.e. a partial exemption under a joint application may be both difficult to monitor and ensure that the non-exempt party is adhering to third party access provisions. In addition, this may also lead to enforcement issues.

If you do wish to discuss any of the points in this response in more detail please do not hesitate to contact me on 0191 221 2072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs