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Our Reference:

Your Reference:

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Dear Sonia,

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

Thank you for the opportunity to respond to this consultation. We welcome the fact that this consultation should provide clarity on the treatment of facilities with split ownership in application for exemptions from TPA.

In the November 2004 letter, Ofgem expressed the view that the separate owners of a single facility may each apply separately for an exemption for the capacity of the facility over which they have ownership rights. We agree with this interpretation of the Gas Act and believe that any such separate applications should be considered on a case by case basis. We believe that in each case, the ownership structure and the contractual arrangements that confer the actual control of the facility on the individual owners should be given due weight when considering such applications. To consider applications for exemption solely on the physical nature of a facility could lead to the inefficient development and operation of that facility. This could lead to further inefficiencies in the system to which the facility was connected.

Ofgem have more recently suggested that an exemption can only be considered as applying to a whole facility and that this is the only way that applications can be considered. Ofgem believe a test of the wholeness of the facility is whether or not the separate shares of capacity can be physically operated independently. However, we believe that whilst in some cases, it may not be practical to physically operate the independent shares of the facility in a stand-alone fashion without some further (uneconomic) work on site, contractually they can be operated independently, which can bring additional benefits to this type of operation. For example, in instances where one owner is using its capacity to inject while another uses its capacity to withdraw, this would not result in the physical flow of gas in either directions in this jointly owned facility, but would in physically separate facilities. Whilst both owners are exercising their control of the facility independently, the physical operation of the site merely reflects the efficient operation of the facility. Indeed, it would seem perverse that a different interpretation could result in the economic and efficient development and operation of the facility in the market being lost.

Should the consideration of separate ownership result in, as Ofgem have highlighted, situations where, in relation to two facilities of equal size, one is subject to an exemption and the other is not, then this is simply a correct reflection of the contractual use of the facility, and the separate owners' impact on the market through their independent market shares.

Ofgem have previously stated that in assessing the application for an exemption that the test that will apply is whether the use of the facility (as opposed to the use of the capacity represented by the respective ownership shares) by other persons is not necessary for the operation of an economically efficient gas market. In carrying out that test, the impact on the gas market would be assessed through consideration of market shares. However, it is difficult to see how a test of market shares could be conducted using the facility as a whole where the facility is owned by a number of parties. The facility itself cannot be attributed a market share that could be correctly assigned to any other market participant. It is only by considering the use of the facility through its separate owners (who are likely to be in direct competition) that an assessment of the impact on the market can be made. On the basis that the assessment would be made on the separate shares, the exemptions should be considered in the same way.

### **Aldbrough**

With respect to Aldbrough, as noted in our application, SSEHL and STUK will each have primary control over their respective shares of the facility. This resulted from the separate development of three caverns by Statoil in 2002, prior to the Second EU Gas Directive and its transposition into UK law. In considering the treatment of Aldbrough in relation to section 19A, it is important to take into account the project's development history. The owners originally initiated the development of their own separate facilities independent of each other. The development structure that was subsequently put in place was intended to minimise the costs of development and operation of the site by the two owners. This represents the most logical and efficient solution and the ownership structure that is now in place reflects the strong desire of both owners to retain independent control. We believe that the structure transparently shows the ownership and contractual separation of the two parties. This is reflected in Ofgem's comments in the consultation, that "while the parties will use common above ground infrastructure, they are distinct and separate commercial entities."

We do not believe that the consideration of the Aldbrough application should unduly influence the assessment of future applications, given the particular history of the development. It simply provides an example of the methodology of assessment, but each subsequent case can be judged on its own merits.

### **Summary**

We believe that it is appropriate for Ofgem to take account of factors other than just the physical nature of the facility. We believe that it is the ownership and contractual arrangements that will ultimately determine how the facility is utilised and thus the impact on the operation of the market.

We do not believe that it is possible to make an assessment of the impact of the facility on the market without consideration of the separate shares of the parties involved, the entities that already exist in the market.

On the basis that such an assessment can only be undertaken based on the relevant shares of the participants, then those participants should each be able to have an application for exemption separately assessed. Should only one party apply for an exemption, it remains appropriate only for that single exemption to be issued.

We do not believe that the assessment of the Aldborough site should necessarily set any precedents for future applications.

Please give me a call if you wish to discuss this further.

Yours sincerely

Rob McDonald  
**Director of Regulation**