

**Statoil (U.K.) Limited  
Gas Division**

Statoil House  
11a Regent Street  
London SW1Y 4ST

Switchboard: 020 7410 6000  
Central Fax: 020 7410 6100  
Website: [www.statoil.co.uk](http://www.statoil.co.uk)  
Email: [rob.cross@statoil.com](mailto:rob.cross@statoil.com)  
**Direct Line: 020 7410 6157**  
**Direct Fax: 020 7410 6108**

Sonia Brown  
Director, Wholesale Markets  
Office of Gas and Electricity Markets  
9 Millbank  
London SW1P 3GE

03 November 2005

Dear Sonia,

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

With reference to the above-mentioned consultation process, Ofgem has invited interested parties on 22<sup>nd</sup> September 2005 to give their views on:

- whether, as part of Ofgem's assessment of applications for exemption under the "de-minimis" test set out under section 19A (6a) of the Gas Act 1986, contractual arrangements would need to be considered, where the same facility is split between two independent parties;
- whether joint owners of the facility should apply for one exemption for the facility, or for separate and independent exemptions for their respective shares of the same facility;
- any views on any other alternative options for treating split-ownership facilities.

Statoil (UK) Ltd. (hereafter referred to as "STUK") would like to provide Ofgem with assistance on resolving the issues detailed in this consultation.

Our submission opens by looking at the rationale for third party access (TPA) and associated exemptions, before moving on to security of supply issues. Thereafter, we will point out why the degree of control over participants' interest is key to allow for the creation of a stand-alone-storage unit within one facility. STUK will provide Ofgem with high level parameters for assessing whether the contractual framework can, in fact create stand-alone-storage units within the same storage facility, and what the minimum requirements for this "test of autonomy" may be.

**1. Rationale behind TPA**

Before making a determination with regards the application of the TPA exemption arrangements, it is important to re-affirm the economic basis underpinning the third party access regime for gas storage investments in the UK.



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- 1.1. The primary reason for regulators insisting upon the application of TPA is to introduce and promote competition in the supply of gas customers. In the case of storage facilities, access relates to the storage services required to inject, store, and withdraw gas from the facility. These services are commonly known as “storage capacities”. TPA provides potentially excluded market players with access to essential services necessary to support their businesses, and in doing so, facilitate competition, price discovery, and improved market functioning. These desirable outcomes produce an environment which encourages new investment in new build storage capacity, or considerably increases the efficiency of existing storage infrastructure.

The Gas Act recognises, however, that TPA is only required where, in the case of the *de minimis* test, the use of the facility by other persons is not necessary for the operation of an economically efficient gas market. This is entirely consistent with the philosophy underpinning the application of TPA insofar as without it, competition and market development is likely to be compromised.

Without a route to obtaining TPA exemption, owners of new facilities would be denied the flexibility to operate the facility in a manner which complements their commercial strategies. The effect of TPA exemption is to encourage the development of new facilities, which in turn contributes to national security of supply.

- 1.2. TPA exemptions provide storage owners with greater flexibility and autonomy in terms of utilisation of the facilities and, as a result, provide competition to other sources of flexibility, including non-TPA exempt storage facilities. Any ruling which deprives new storage units from securing TPA exemption will, in our view, negatively impact the industry’s willingness to invest in new infrastructure, and will act as an impediment to the establishment of joint ventures created solely to realise cost efficiencies.

**We believe it is important that the industry focuses on the intent of TPA and the associated exemption regime and clearly delineates between joint ventures which exploit development and operational efficiencies, as opposed to those which exploit commercial/market share advantages in the utilisation of storage services.**

## 2. Security of Supply

Security of supply in the UK gas market can only realistically be safeguarded by substantially increasing gas storage capacity as new gas imports are unlikely to display the levels of flexibility historically provided by domestic offshore production. As with all new cost-intensive investments it is imperative that the regulatory environment is certain and stable and, in the case of storage facilities, that TPA exemptions are available.

- 2.1. In STUK’s view, the regulatory environment should encourage joint ventures to be established which allow for new facilities to be developed in a cost effective manner. In light of this, the TPA exemption process should be unambiguous, but flexible enough so that it embraces, rather than undermines this aim.

STUK believes that as long as it can be shown, to the Regulator’s satisfaction that the partnership has been established for the purposes of co-operation in storage



construction/operation and then TPA exemption applications by the individual parties should be permitted. We concede, however, that the applicant must demonstrate that the commercial operation of the facility is outside the terms of the joint venture arrangements, having the effect as to limiting co-operation to the achievement of cost saving benefits and increased efficiency. In the event that this can be demonstrated, then we would argue that TPA exemptions are valid. Where a TPA exemption it is not granted it is assumed that the joint venture would have the potential to exploit commercial/market share advantages in the utilisation of storage services.

This rationale has been lastly repeated in the First Annual Report to Parliament on the Security of Gas and Electricity Supply in Great Britain, presented by the Secretary for Trade and Industry in July 2005. On infrastructure, the text reads as follows:

*“The Government, with Ofgem, will continue to monitor carefully developments in the energy market, both nationally and internationally. We will keep a careful watch for potential barriers preventing the market from functioning effectively and develop appropriate and timely policy responses. **And we will ensure that the political and regulatory context succeeds in attracting needed investment for the continued security of our energy supplies.**”*

2.2. Should Ofgem come to the conclusion that a participating interest in a storage facility which is run as a stand-alone-unit cannot, under any circumstances benefit from TPA exemption, then STUK believes that the incentives to “partner up” in the development of new facilities would be severely weakened. This would give rise to the following outcomes:

- a) gas storage developers would not benefit from cost efficiencies, and the resulting higher costs would ultimately be passed through to the end-customer; and
- b) a slow down in construction activity for new storage infrastructure.

Likewise it is helpful is to recall the European approach towards TPA exemptions. The Commission clearly set out their intention for the exemption regime in their guidance with the directive, “Note of DG energy & transport on directives 2003/54-55 and regulation 1228\03 in the electricity and gas internal market - Exemptions from certain provisions of the third party access regime” issued at the beginning of 2004. The section below clearly demonstrates that the commission feels that regulators should have the freedom to interpret the exemption regime for the specific needs of the member states markets

*“It must be recalled that any exemption awarded does not need to cover all the possible items identified in the Directives and Regulation. Exemptions may be granted independently from each of the Articles mentioned. There is no obligation on regulators\Member States to grant an exemption from all the items mentioned in this context. Likewise new investments may be covered by partial exemptions or conceivably be covered by two types of exemption. For example it might be 30% “own use” and fully exempt with the other 70% exempt from Article 23 with restricted TPA arrangements.”*



CEER have more recently put forward their views on the approach regulators should take with exemption applications. As recently summarized by CEER's report; "Investments in Gas Infrastructures and the role of EU national regulatory Authorities" of 12<sup>th</sup> May 2005.

The CEER opinion may offer some guidance to Ofgem in the present consultation. The report reads as follows on pages 19, 20 and 21:

*"Article 22 of Directive 2003/55 EC allows also for the possibility of exemptions to general rules of TPA contained in the Directive whereby there is a range of possible exemptions which could apply. The possibility for such exemptions is clearly envisaged to be an exception. However, albeit exemptions will therefore be considered on a case by case basis, there are general criteria that are to be met.*

*These exemptions apply to "major new gas infrastructures, e.g. interconnectors between Member States, LNG and storage facilities" and also to "significant increases of capacity in existing infrastructures and to modifications of such infrastructures which enables the development of new sources of gas supply".*

*The issue seems still at an early stage for new underground storage capacities. The conditions to grant these exemptions are as follows ....*

*This exemption may cover all or parts of the new infrastructure....*

*Therefore, while examining the request of derogation, regulatory authorities may want to focus on: the need to ensure that the exemption must enhance competition. This exemption should not give/increase market power to the company which benefits from the exempted infrastructure. **For this reason, the exemption may be limited to part of the infrastructure.**"*

From the foregoing it becomes clear that the Directive 2003/55 EC recognises the need to permit the regulatory authorities to consider partial exemption at a particular facility. The fact that it is tied in with Article 22 doesn't necessarily prohibit Ofgem from considering this approach in relation to the *de minimis* test.

In our view, by the very fact that the Directive sets out a framework which permits partial exemption it could be implied that some degree of discretion maybe applied more generally to TPA exemption applications. We believe that Ofgem should consider this as a reasonable basis to review applications, in the case of split ownership, as it is clear that as long as market power is not a concern then a TPA exemption can enhance competition and security of supply.

### 3. Contractual arrangements create independent Storage Units

In view of the foregoing, we would like to summarise STUK's position in this consultation as follows:

- 3.1. Contractual arrangements and other circumstances need to be considered when assessing separate applications for exemption under the *de minimis* test as set out



under section 19A (6a) of the Gas Act 1986, where the same gas storage facility is split between two, or more independent parties.

The Third Party Access Regulation, in force as of 26<sup>th</sup> August 2004, does not specifically deal with contractual arrangements for gas storage facilities. Ofgem needs to decide whether contractual arrangements can create separate stand-alone units within the same gas storage facility.

Section 19E of the Gas Act defines the owner of a facility as *“person... occupying or having control of the facility.”*

We believe that the degree of control over the individual part of the storage facility is of importance when deciding whether contractual agreements factually create separate stand-alone units within the same storage infrastructure.

The split storage owner should only be allowed to apply for TPA exemption if its interest is in fact a stand-alone unit within the storage facility. The storage owner needs to be in control of his participatory interest in the gas storage facility.

If two or more owners own parts of the same gas storage facility, it needs to be assessed whether the respective share-owners have a sufficient level of control over their interest. Only if they have a sufficient degree of control over the operation of their part of the facility, can they run their participatory interest in the facility independently from others.

Typically, a joint utilisation, or participation agreement (JUPA) provides for the operation of the joint storage facility. The JUPA provides the legal basis by which the different participant's interest-holders work together; how they manage the jointly owned facility; and how they take decisions about budget and joint activities.

A sufficient level of control requires, for example, the owner of the participating interest to have the right to vote in all decisions of the operator's management committee. We do not see any difference if one of the participating interest holders is running the whole operation of the site, or whether the operation is in hands of a separate legal entity. A sufficient level of control by every partner in the joint venture does not require the power to veto any decision of the management committee, but should include the split-owners consent to the following decisions:

- a) Any material change in the scope of the nature of joint activities, or the commencement of new business which is not ancillary or incidental to joint activities;
- b) Any important financial commitment on behalf of the gas storage facility outside the parameters agreed in the budget;
- c) Entering into or materially varying any contract or arrangement outside the ordinary course of the business, or entering into any long-term and onerous contracts of an unusually large magnitude;



d) Any material amendment of the operations budget and operations program, and any decision to change the storage facility design.

e) The operator should only act as representative, or agent of the joint owners within pre-agreed limits within the management committee, for example for joint activities. The operators should not be allowed to generally represent the split-owners outside this limited and agreed scope.

As stated previously, we do not take the view that there needs to be any variation if one owner was appointed operator of the storage facility, if the above mentioned conditions are observed. It does not matter who operates the storage site, but more the degree of control the split-owners have over their participating interest.

These parameters outline STUK's view of the degree of control required, assuming that a participating interest in the storage facility is run as a separate stand-alone unit from other participating interests.

- 3.2.** Split-owners of same gas storage facility should be allowed to apply for the exemptions from the requirement to offer third party access separately and independently from other split-owners of the same gas storage infrastructure.

In Appendix 3 to its November letter, OFGEM takes the *view*:

*“that where there is split ownership of the facility itself (i.e. where the company A has rights over 50 per cent of the storage capacity in the facility and company B has 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.”*

STUK takes the view that also a smaller or, larger interest in the storage facility qualifies the stakeholder for initiating an exemption procedure, as long as the JUPA allows the participants in the JV to run their participatory interests as stand-alone units.

- 3.3.** Any decision on the application of any particular split-owner needs to be judged on its own merits, and applications of split owners of the same storage facilities may be subject to different conditions, as the case may be.

We take the view that the *de minimis* test needs to be applied to the individual participating interest in the storage facility, rather than the total storage facility. It may be that the individual parts of the storage facility are subject to individually determined commercial strategies serving different customer segments.

Commercial arrangements can establish two entirely separate storage units, which are independent of, and in potential competition to each other.

Split-owners may be in a different position in the gas storage market for instance, one split-owner may have a significant market share in the gas storage market. This position may grow stronger through his participation in the JV. Another split-owner may be a newcomer, or an insignificant player in the UK storage market with no, or limited



“storage” market-share. Treating both joint venture partners in the same way would be at odds with the rationale behind TPA, as outlined above in section 1. It would equally be unfair to potentially foreclose the storage market for newcomers, because of probable concerns related to other split-owners.

**Therefore, we take the view that an interest in the same storage facility can be seen as stand-alone unit within the same facility, as long as every participant has a sufficient degree of control as a result of the contractual agreements in place.**

We conclude that different applications for TPA exemptions regarding the same storage facility may be treated in a different way, depending on the position of the applicant in the storage market, and the size of his ownership share in the storage facility.

- 3.4.** Ofgem has raised concern that in accepting separate *de minimis* applications from split-owners at the same storage facility, regulatory costs may increase. We do not fully share this concern. Regulatory compliance appears to be straightforward for those part-storage owners who do not benefit from a TPA exemption since the storage quantities sold to the market can be monitored by Ofgem and compared with the total capacity of the storage site in question.

We do not think that the Gas Act or the current exemption regime requires any change in order to allow Ofgem to consider applications for TPA exemption at, what it terms, split owned facilities. In particular the definition of “facility” does not require any amendment. The broad definition describes the existence of cavities etc...and is independent from ownership questions. The owner of the facility is as defined previously in this response. STUK suggests that if the owner of the facility is that person who has control of the facility then the facility should be considered to be that which it has control over i.e. adopting the terminology used in this response “a stand alone unit”.

Furthermore, assuming Ofgem agrees with this interpretation it is clear that in the event a “split owner” applies for a TPA exemption then Ofgem, in its consideration of the exemption application will only be concerned with the facility owned by the applicant i.e. it will not consider the impact of the other facility (stand alone unit) As stated previously we believe this interpretation of what is meant by facility is consistent with the rationale for introducing TPA.

The paragraph above details STUK’s interpretation of the Gas Act, which we will refer to as the “**top down**” approach. Our approach considers firstly, the party making capable of making the application and secondly, the facility to which the application applies. An alternative way of viewing the legislation would be to firstly, consider the definition of the facility and secondly, to review the application in view of this definition. We would term this a “**bottom up**” approach. STUK believes that the legislation caters for split ownership applications independent of the preferred approach of assessment.



With regards the “**bottom up**” approach, the definition of the facility relates to the physical characteristics of the facility e.g. cavities. As described above the application for a TPA exemption is made by “an owner of a storage facility”. In the event that an owner of a split facility applies for an application via the *de minimis* route then it could be construed that Ofgem needs to consider the capacities of the entire facility. It could be that the facility, if it is viewed as a single physical structure would fail the *de minimis* test, however the crucial test relates to the ownership of the facility. Section 19A of the Gas Act simply refers to a single owner, as it would seem that the incidence of split ownership was not envisaged at the time the legislation was introduced. In light of this one has to revert to what is meant by an owner of the facility as it is this entity which is making the application on its **own** behalf. STUK believes that the definition of the owner of the facility is very clear, although it doesn’t specifically cater for multi-owners.

Again, and in line with the views expressed above, we believe that for the purposes of TPA, that if it can be shown that the owner has control over the facility, or any portion of it, then an exemption application should be permitted (this assumes that the application equates to the portion of the facility over which it has control). In effect, it should be evident that the owners, through their contractual structures **both** have control over the facility meaning that the actions of one owner are independent of the other. In turn, we would argue that the “facility” is being considered in its entirety, however, the application cannot relate to the entire facility, as this is outside of the control of the applicant. The magnitude of the portion of the facility of which the applicant has control should determine the outcome the application, assuming it has been shown that the contractual structures provide the level of separation required by Ofgem.

**In our view the intent of the legislation is clear in terms of relating the degree of “control” to the need for TPA, or otherwise. In hindsight, it would have been helpful if the legislation identified the occurrence of “split ownership”, but as we have highlighted we are of the view that the legislation does not disqualify TPA exemptions for a single or multiple “split owners”.**

Finally, STUK would like to voice its concern that new counterparties bringing more liquidity in the UK storage market may take the view that costly development of suitable storage sites would not make sense, if the TPA exemption was not granted to their interest of the storage facility because of concerns pertaining to their joint venture partners.

Ofgem’s decision to always assess the owners’ applications for the same storage facility collectively may prevent any combined investment joint ventures to develop storage sites together in the future. This would have serious consequences for the UK storage market, which needs to develop for the sake of the security of supply.

### 3.5 Implications of split ownership applications for other EU member states

The *de minimis* route for TPA exemption in the UK exists, in part, due to the advanced stage of liberalisation of the UK gas market. The liquidity of the market enables other forms of flexibility to compete with storage services and ensures that excluding certain new facilities from TPA will not have an impact upon the efficient operation of the market.



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This view has to be seen in light of the different market situation for gas storage in the UK and the rest of the EU. According to EFET, the European Federation of Energy Traders, only 50 % of all storage providers on the continent publish standard storage terms online. According to EFET, access to storage by third parties has been proven to be very difficult due to long term reservations of storage for all, or almost all existing storage capacity.

With such a difference between the development of the UK markets and other European markets it is clear that the *de minimis* route is only relevant in circumstances where liquidity and liberalisation is established. It would be inappropriate to apply specific developments in one market to the regime in another market that is at an entirely different stage of the liberalisation process.

However, given that the Directive clearly envisages partial exemption as set out in the text it should be applied equally to those tests outside the scope of the directive such as the *de minimis* approach in the UK.

As a result it is clear that it should be possible to enable applicants to apply for an exemption to the share of the facility over which they have control.

STUK trust that our views will be taken into consideration. Should you require any further information please do not hesitate to contact me on the above telephone number.

Yours sincerely

Robert Cross  
Regulatory Affairs Manager



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