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Dear Phillip

SSE Hornsea UK Ltd application for an exemption from Section 19B of the Gas Act 1986

Centrica Storage Limited (CSL) offers the following comments in response to your invitation of 16th May 2007 to comment on the possible exemption from third party access (TPA) requirements requested by SSE Hornsea Ltd (SSEHL) for their share of the Aldborough storage facility.

Executive Summary

In general CSL agree that, based on its assessment of the market (using the definition arrived at during the Competition Commission (CC) Inquiry into the acquisition of Rough from Dynegy by Centrica), SSEHL should be exempted from an obligation to offer TPA requirements as the use of the facility, by other persons, is not necessary for the operation of an economic and efficient market. However this consent is conditional on the following comments and reservations in respect of the analysis used by Ofgem to arrive at the market definition; the criteria by which TPA storage services already provided by the applicant within that definition may be excluded, and the provisions we believe are required within the order to safeguard the operation of the market and future developments in the overall flexibility market in Europe and within the UK.

CSL propose that:

- certain changes to the Exemption Order provisions given in Annex 3 should be made so as to ensure that certain key transparency requirements required by a functioning gas market are not circumvented through application for an exemption;
- certain revisions to the definition of the relevant market be adopted for assessment of any future exemption applications;
- any decision to exclude from the relevant market definition TPA storage services be allowed where it can be demonstrated that TPA services are truly effective against the Gas Act, Gas Directives and the Guidelines for Good TPA Practice for Storage System Operators (GGPSSO) (all as amended);
- consideration be given to a future review of the GB storage market in the context of increasing opportunity to obtain exemptions from TPA, and the significance of potential changes following the Commissions' Strategic European Energy Review (SEER) to inter alia the GGPSSO for facilities offering TPA (Rough and Hornsea), and the regulatory framework those operators work: and
- Ofgem recognise that each grant of exemption relies heavily on TPA at existing storage sites. Therefore, as the market grows the continuation of these arrangements may result in undue discrimination against the owners and operators of existing assets. It is therefore important that the way is left open for a wider market review to redress this balance at the appropriate time.

Amendments to Exemption Order

CSL consider that a functioning gas market requires effective UIOLI arrangements for all infrastructure types, irrespective of any Exemption from offering TPA services. Accepting for now the market definition contained in the Ofgem consultation we feel that opportunities may present themselves at both high and low demands for the holders of Aldborough capacity to not fully utilise either injection or withdrawal capacity for the benefit of their wider portfolio. It should be recognised that the facility has planned deliverability rates of 40 mcm/d. This equates to around the maximum deliverability from the Rough storage facility, and the injection rates have the potential to add around 10% of system demand on a typical Q3 gas day.

Although we welcome the announcement of an intended UIOLI arrangement between the Aldborough partners SSEHL and Statoil UK (STUK) the market should prefer to see more robust arrangements in place within the Exemption Order. To ensure effective UIOLI arrangements full transparency on actual and intended flows from the facility should be available to all market participants. The provision of interruptible injection or withdrawal capacity provides an effective anti-hoarding mechanism, be this with interruptible space offered at a known price, or interruptible products packaged with a limited duration space product.

As mentioned in the context of UIOLI arrangements CSL consider that to ensure the effective functioning of a gas market certain key operational information is required by all market participants. We do not believe a successful application for an Exemption from TPA services should enable the Storage System Operator (SSO) to avoid publishing information. We would therefore suggest the Exemption Order contain a requirement to publish via the internet and available to all market participants

- nominated aggregated inflows and outflows daily for day ahead and within the gas day;
- the actual gas in store level in mcm for each Aldborough sub facility, updated at D+1;
- planned maintenance periods; and
- metered flows after the gas day for the facility (we expect National Grid to provide this data and perhaps other operational data).

Relevant Market

CSL consider that the relevant market for storage facilities continues to be flexibility and the relevant geographic market continues to be Great Britain. However we note that increasing interconnection is enhancing the prospect of competition for suppliers of flexibility to the GB market from sources of flexibility from North West Europe.

Whilst CSL agree that the GB gas flexibility market has changed and continues to change since the 2003 CC report we do not necessarily agree that the relevant data set for the analysis should be Q4 2006 to Q1 2007. Even if a longer data set or inclusion of other sources of flexibility would not change Ofgem's initial conclusions, we feel that certain points should be taken into account for analysis of any future exemption request by a market infrastructure operator.

We believe the relevant market definition should include the following:

- Other forms of beach swing (beyond Sean and Morecombe) especially given the significance of, and scope for flexibility of, flows from Langeled, Vesterled and IUK given different supply/demand fundamentals to those exhibited in the chosen data-set from last winter;
- The transparency created by UNC modification 006 should be used to determine which sub-terminals and hence by inference which fields exhibit tendencies to flex flows within the day and between days;
- Increased re-gasification capacity enabling an increase in the potential for flexible flows from LNG imports;

- The significance and potential role of demand side response (to include CCGT switching) which played a limited role within the data-set period but was extremely significant in previous winters before that covered by the data-set; and
- The (known) planned expansion to Aldborough which has now achieved planning permission but has not being included within the application or been reviewed in the context of market share. Although Article 22 of the 2nd Gas Directive (2003/55/EC) enables SSOs to apply to exemptions following significant increases in capacity it would be more prudent to consider the credible and eventual 'size' of the facility in the first application for Exemption;

As stated above we do not necessarily argue that these refinements would necessarily impact on Ofgem's initial conclusion but feel that future applications would be better assessed if these points were accepted.

Effective TPA Storage Services

For any consideration of the relevant market to exclude TPA storage services already offered we believe that Ofgem has to be convinced beyond reasonable doubt that such TPA offerings are truly effective. This is paramount when one considers that if SSEHL operate both the Hornsea and Aldborough facilities (of which SSEHL owe a 66% share) then around 45 mcm of deliverability is owned and/or controlled by SSEHL. Should SSEHL be able to demonstrate to Ofgem that it offers TPA services on a fair and non-discriminatory basis then CSL agrees to an exclusion of the TPA portion of [storage] capacity from the definition of a relevant market.

However the market is unaware of the terms and conditions by which SSEHL currently offers TPA services. We therefore need to consider other independent guidelines. As you will be aware the GGPSSO are an effective benchmark of what is required by market participants to access TPA storage services accepted by the Madrid Process and endorsed by ERGEG.

We note the following (inter alia) requirements of the GGPSSO which ensure effective TPA storage services from the SSO:

- Publish the main commercial terms for storage services (also required by the 2nd Gas Directive);
- Consult with storage users (market participants) prior to unilaterally amending the main commercial conditions for storage services;
- A statement setting out the terms by which an affiliated company may access capacity;
- The option for storage users to take single or multi-year storage services;
- A Code of Conduct and Compliance Programme to ensure protection of Commercially sensitive information; and
- Site specific gas-in-store levels;

European Dimension

CSL supports steps to ensure that effective TPA to storage services is available in GB and throughout Europe. The main mechanism adopted by the 'Madrid Process' to increase competitive access to storage capacity, as required by the 2nd Gas Directive, was the development of the GGPSSO, effective from March 2005. CSL was active in the development of the GGPSSO and subsequent attempts to improve understanding of, and compliance with GGPSSO by European SSOs. As you know exempted facilities are under no requirement to comply with the voluntary GGPSSO (whereas ERGEG has conducted a number of reports into the compliance with GGPSSO by those SSOs offering TPA).

However this European regulatory framework has the potential for fundamental reform to inter alia address issues covered in the Sectoral Enquiry by DG COMP viz. the foreclosure of gas markets; market concentrations and the ability of new entrants to access the market; effective unbundling of functions and increased transparency in market operations. Moreover the SEER has the potential for significant change on many aspects of the gas market, including the current assessment of Article 22 exemption applications. e.g. the ERGEG+ proposals (e.g. standardising treatment of exemption applications with a cross border dimension). We feel it is important to retain the option for a re-assessment of any exemption should the rules on exemption be reformed, especially given their limited use in Continental Europe. We also note the ERGEG work programme examining ways to publish guidance on the role and application of the TPA Exemption regime.

Furthermore, it is probable that SEER will recommend the voluntary GGPSSO become a Regulation or enshrined within any 3rd Gas Directive. Should the actual regulation of storage change on a European level, it is imperative that any additional regulation imposed on TPA storage facilities at a Member State level should not then be unduly discriminatory nor impact on the ability of TPA facilities to compete with exempted facilities.

Ofgem Review of Flexibility Market

CSL consider that a number of contributory factors have combined to make a review of Exemption Orders and the wider market in which TPA SSOs operate necessary. Given the increasing changes to the GB gas market, we consider that it is imperative that Ofgem undertake a review of the flexibility market as each grant of exemption relies heavily on TPA at existing storage sites to succeed. The review should also assess the effectiveness of any TPA arrangements. This review can then assess the appropriateness of TPA arrangements (and ancillary regulatory arrangements) and the extent to which any due discrimination becomes undue.

In conclusion we agree if SSEHL can demonstrate that they offer TPA at Hornsea by being fully compliant with the GGPSSO, and taking into consideration our views on the definition of relevant market, an exemption from offering TPA services for SSEHL at Aldborough is reasonable and consistent with existing Directive and Gas Act requirements (subject to the proposed amendments to the Exemption Order).

Please contact me should you wish to discuss further. CSL does not consider this response to be commercially sensitive.

Yours sincerely



James Lawson