



Gas storage facility owners and operators, gas shippers, gas suppliers and other interested parties

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25 October 2007

Dear Colleague,

Final Decision: SSE Hornsea Ltd's application for an exemption from section 19B of the Gas Act 1986

On 10 October 2007, Ofgem published a draft decision (the 'October draft decision')¹ on the exemption application² submitted by SSE Hornsea Limited (SSEHL) in relation to its share of the proposed storage facility at Aldbrough. In the October draft decision and the consultation document (the 'May consultation document')³, Ofgem set out its initial view that an exemption should be granted from requirements regarding third party access.

This letter sets out Ofgem's final view and decision on SSEHL's application. It should be read in conjunction with the October draft decision and the May consultation document.

Background

In October 2006, SSEHL submitted an application under section 19A(2) of the Gas Act 1986 (the 'Gas Act') requesting an exemption⁴ from section 19B of the Gas Act in relation to its share of the Aldbrough storage facility which is currently under construction in East Yorkshire. Section 19B of the Gas Act concerns the requirement to provide third party access to gas storage facilities.

The Aldbrough gas storage facility is a two-part facility with respective parts being owned by SSEHL and Statoil UK Limited (STUK).

The total project consists of 4,550GWh of gas storage space with the ability to deliver a maximum of 421GWh/day. The SSEHL share of the project consists of 3,033GWh of space with 141GWh/day of injection capacity and 281GWh/day of deliverability, two-thirds of the total. All costs will be split on a two-thirds to one-third basis between SSEHL and STUK respectively.

¹ Draft Decision: SSE Hornsea Ltd's application for an exemption from section 19B of the Gas Act 1986, 241/07, 10 October 2007, available from the Ofgem website, www.ofgem.gov.uk.

² Application: SSEHL UK Ltd's application for an exemption from Section 19B of the Gas Act 1986, available from the Ofgem website, www.ofgem.gov.uk.

³ Consultation Document: SSE Hornsea Limited's application for an exemption from Section 19B of the Gas Act 1986, 118/07, 16 May 2007, available from the Ofgem website, www.ofgem.gov.uk.

⁴Section 19A(6)(a) of the Gas Act 1986 states that the Authority shall give an exemption with respect to a new facility where it is satisfied that "use of the facility by other persons is not necessary for the operation of an economically efficient gas market".

In September 2005, Ofgem consulted on the treatment of split facilities under the Gas Act. In a letter dated 20 December 2005 Ofgem concluded that, where there are multiple owners of a facility, it is appropriate to accept exemption applications from more than one owner provided that effective operational separation is achieved.⁵

May consultation document

As indicated above, our initial view was that an exemption should be granted to SSEHL. The May consultation document explained the grounds on which we considered that SSEHL had met the test for the exemption to be granted.

Ofgem received six responses to the May consultation document. These included responses from SSE, the parent company of SSEHL and from STUK.⁶

October draft decision

As a result of our consideration of the responses to the May consultation document, we undertook additional analysis to take into account the comments received. This new analysis did not alter our view that an exemption should be granted. However, to enable interested parties to provide comments, we published our analysis in the October draft decision.

Ofgem received two responses to the October draft decision, one from SSE and one from STUK. Both respondents welcomed Ofgem's revised analysis. One respondent welcomed the conclusion that the relevant market for flexibility should be widened to include both LNG imports and a portion of Langede flows.

Ofgem's final views

This section sets out our final views on the relevant market definition for the Aldbrough facility, our market share analysis for SSEHL's capacity at that facility and our conclusion that use of the facility by other persons is not necessary for the operation of an economically efficient gas market. We have not altered our views from those set out in the October draft decision.

Market definition

We consider that the relevant product market is the flexibility market and the relevant geographic market is Great Britain. However, we acknowledge that the product definition of gas flexibility is not straightforward.

In order to define the market for flexibility we looked at information on how sources of gas flowed over the most relevant time period. We then sought to determine which sources of gas showed similar flexible characteristics to the proposed facility. Such sources of gas were then included in the market definition.

Significant new gas import capacities came online during winter 2006/7 (e.g. the Langede pipeline and the BBL Dutch-UK interconnector) which altered the previously observed supply and demand balance. We therefore began our data analysis from the date that the BBL interconnector came on line as this was the last of these new projects to start operation during winter 2006/7. The BBL interconnector came online on 25 November 2006.

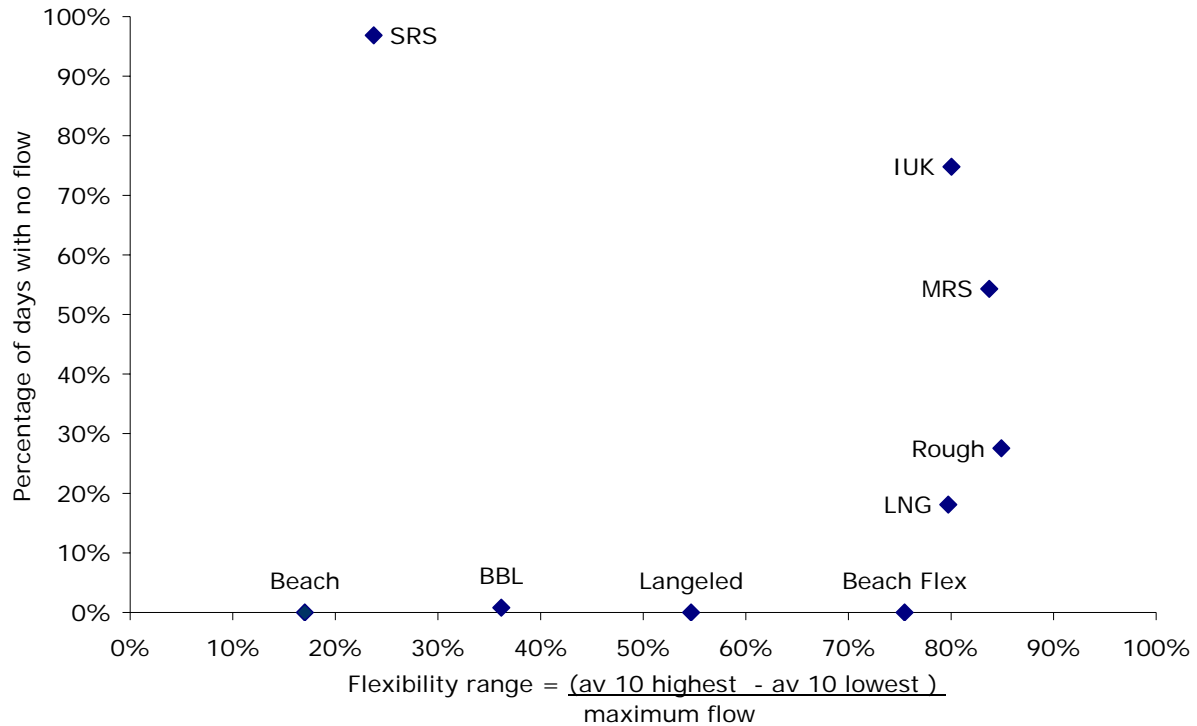
⁵ Ofgem letter, Decision on the proposed treatment under section 19A of the Gas Act 1986 of gas storage facilities with split ownership, Ref: 290/05, 20 December 2005, available from the Ofgem website, www.ofgem.gov.uk.

⁶ Non-confidential responses to both the October draft decision and the May consultation document have been published on Ofgem's website, www.ofgem.gov.uk.

We used 31 March 2007 as the end date for our analysis period as this date marks the end of winter. Whilst we recognise that MRS can be used as a source of gas over the rest of the year we note that this is much less likely and that analysis of flexible behaviour over other periods, such as the summer months, can be complex due to likelihood of maintenance periods where other sources of gas might display 'flexible' characteristics which are driven by factors other than price and demand.

Figure 1 presents our analysis for the period from 25 November 2006 to 31 March 2007.

Figure 1: The flexibility of gas supply (25 November 2006 to 31 March 2007)



Our analysis indicates that in addition to MRS, LRS and imports through the IUK both LNG import facilities⁷ and Langeded⁸ could be considered to have provided flexibility and should potentially be included in the market definition.

For the purposes of Langeded we have not considered the total daily deliverability of the facility⁹, as we do not consider that the total should be included in the relevant market. At periods of high demand we would expect MRS to flow. We have also observed that Langeded is also able to increase the volume of supply in response to peak demand days. However, unlike Langeded, MRS is not expected to flow during non-peak demand days. To take account of this pattern of flexibility at Langeded we have modelled two different scenarios, one where a relatively low proportion is considered to be flexible (200GWh/day) and the other where a relatively high proportion is considered to be flexible (600GWh/day).

In considering the market definition for MRS we have therefore concluded that there are three separate potential market definitions. These are set out below:

⁷ This is based on observed flow data at the Isle of Grain. The flow of gas from the Isle of Grain was fairly steady from the period 25 November to the start of February. From the start of February until 31 March the flow of gas from this facility was much more limited. This indicates that this may be considered a flexible source. However, the flow pattern is different from that observed for MRS where the flow of gas may be much more varied between days over the whole of the period.

⁸ Due to data constraints it is not possible to observe the flow of gas from the Vesterled pipeline over the relevant period and hence we have not been able to consider its flexibility as per Figure 2 in the October draft decision. However, we recognise that it may provide an additional source of flexibility in a similar manner to Langeded. We therefore consider that the two levels of deliverability that we have included in our market share calculations for Langeded are likely to incorporate the combined level of flexibility from both Vesterled and Langeded.

⁹ The maximum daily flow at Langeded is 741GWh/day.

- Medium range storage (MRS) + long range storage (LRS) + imports through Interconnector UK (IUK)¹⁰ + Flexible beach¹¹ + LNG imports,
- MRS + LRS + IUK imports + Flexible beach + LNG imports + Flexible element of supplies from the Langed pipeline (200GWh/day),
- MRS + LRS + IUK imports + Flexible beach + LNG imports + Flexible element of supplies from the Langed pipeline (600GWh/day).

Ofgem considers any of these definitions to be appropriate, and conducted its analysis of SSEHL's market share of the relevant market in all three market definitions.

We have not included demand-side response within our market definition. There are significant difficulties in modelling the relevant level of demand-side response over the relevant time period. We consider that trying to establish a level of potential demand-side response by considering the volume identified during winter 2006/7 may not provide an accurate figure going forward. For example, the complex contractual position of suppliers and customers, that will enable a demand side response, may vary considerably from year to year and is therefore difficult to quantify. We observe that our analysis is likely to be conservative in terms of potential substitutes, given its focus solely on supply. The effect of including demand-side response within our market definition is likely to increase the size of the relevant market against which to compare the market share of SSEHL.

Market share analysis

Ofgem has calculated the market share of SSEHL based on its expected future capacity¹² in the sources of supply considered to be part of the relevant market for each of the three years following commencement of operations at Aldbrough. Our market share analysis has used deliverability as the measure of expected future capacity.

To present a complete analysis of the market shares of the applicant we have conducted analysis under three scenarios. These scenarios capture different approaches to the treatment of facilities that are subject to third party access obligations.

Scenario a) 100% of capacity at TPA facilities owned by the applicant to be included in the applicant's market share. In this case this relates to 100% of the capacity at Hornsea.

Scenario b) Applicant's current primary capacity holdings and predicted future holdings at TPA facilities to be included in the applicant's market share.¹³

¹⁰ We note that the current maximum technical deliverability at IUK is 74 mcm/day (801 GWh/day), However, in our modelling, IUK capacity was calculated based upon National Grid's assessment of maximum winter outlook for 2007/8, at 40 mcm/day (433 GWh/day). This anticipated lower rate is caused by a combination of technical and contractual matters. We note that flows could increase significantly in the future.

¹¹ We were unable to observe data at most beach fields as a result of data constraints. Because of this we have not been able to observe whether, and to what extent, they demonstrate flexible behaviour. However, as data is available for the Barrow fields we were able to analyse this for flexible characteristics and use this as a proxy for "Beach Flex". Ofgem's initial analysis (illustrated by Chart 1 in the May consultation document and supported by the evidence of the Barrow fields) illustrated that there was a degree of flexibility in certain beach supplies. In Figures 1 and 2 in the October draft decision we also used data for Barrow as a proxy for "Beach Flex" to assist in our market definition. In conducting the market share analysis we have included the deliverability figures for both the Barrow and Sean fields (a gas field with 'known flexible characteristics') within our definition of Beach Flex. Whilst we recognise that there may be other beach sources which show flexible behaviour we are using the deliverability capacity at Barrow and Sean as a proxy for the whole of Beach Flex. We are therefore likely to have been conservative in our analysis in terms of the volume of Beach Flex included.

¹² The measure that we have used in this instance is deliverability. This appears to be the most appropriate measure for comparing MRS with other sources of gas in the market definition. Total available space and injectability are also important characteristics of a storage facility. However, they are not directly comparable with other sources of gas within the flexible market definition such as IUK imports and Beach Flex.

¹³ This data has not been included in this document at the request of SSEHL on confidentiality grounds. The data is therefore presented in the form of data ranges.

Scenario c) No capacity (zero ownership) at TPA facilities to be included in the applicant's market share.

As outlined earlier, our analysis considered the capacity held by the SSE company group rather than SSEHL itself. In this document therefore, references to SSEHL in the context of market share analysis are references to SSE company group.

The resultant market shares of the applicant for each scenario for each market definition for the next three years are shown in Tables 1, 2 and 3.

Table 1: SSEHL Market Shares under various scenarios for treatment of TPA (Gas year 2007/08)

Market Definitions	Scenario "a"	Scenario "b"	Scenario "c"
MRS + LRS + IUK + Flexible Beach + LNG	12.8%	5-10%	4.2%
MRS + LRS + IUK + Flexible Beach + LNG + Langed (200)	11.7%	5-10%	3.8%
MRS + LRS + IUK + Flexible Beach + LNG + Langed (600)	10.1%	5-10%	3.3%

Table 2: SSEHL Market Shares under various scenarios for treatment of TPA (Gas year 2008/09)

Market Definitions	Scenario "a"	Scenario "b"	Scenario "c"
MRS + LRS + IUK + Flexible Beach + LNG	9.9%	5-10%	4.4%
MRS + LRS + IUK + Flexible Beach + LNG + Langed (200)	9.4%	5-10%	4.2%
MRS + LRS + IUK + Flexible Beach + LNG + Langed (600)	8.5%	5-10%	3.7%

Table 3: SSEHL Market Shares under various scenarios for treatment of TPA (Gas year 2009/10)

Market Definitions	Scenario "a"	Scenario "b"	Scenario "c"
MRS + LRS + IUK + Flexible Beach + LNG	12.3%	5-10%	7.3%
MRS + LRS + IUK + Flexible Beach + LNG + Langed (200)	11.7%	5-10%	6.9%
MRS + LRS + IUK + Flexible Beach + LNG + Langed (600)	10.7%	5-10%	6.3%

For the purposes of this application, Ofgem believes the most relevant scenarios are "b" and "c" above. As set out in the May consultation document we do not consider that scenario "a" is an appropriate approach as this scenario does not take into account the fact that Hornsea is subject to nTPA.

All of the market shares attributed to SSEHL in our revised market definitions under scenarios "b" and "c" are less than 10%. We note that, for scenario "a" the market share figures are typically close to or above 10%. However, as explained above, we do not consider that weight should be given to the market share figures for scenario "a".

We therefore continue to consider that access to SSEHL's share of the Aldbrough facility is "not necessary for the operation of an economically efficient gas market".

Ofgem's decision

After giving due consideration to the responses received to the May consultation document and the October draft decision, we believe that the test under Section 19A(6)(a) of the Gas Act is met by the SSEHL exemption application, for the reasons set out in this letter. Ofgem therefore is of the view that an exemption should be granted from the nTPA requirements set out under section 19B of the Gas Act for the proposed capacity of the Aldbrough facility held by SSEHL.

For the avoidance of doubt, any views expressed, or decisions made, in respect of the giving of exemptions from section 19B of the Gas Act are expressed or made solely in relation to the relevant criteria for the giving of exemptions set out in section 19A. Any decisions that Ofgem may make, or view that Ofgem may express, in relation to this application for an exemption does not preclude or impact in any way on the operation of the Competition Act 1998 or the Enterprise Act 2002. Further, as the analysis contained in the document is in relation to a specific situation, the analysis may or may not necessarily be relevant to a consideration of any related issues that may arise, for example under the Gas Act, the Competition Act 1998 or the Enterprise Act 2002.

Finally, it should be noted that as part of its on going market surveillance activities, Ofgem takes into account the effect of exemptions on the market and it should be noted that this exemption, as is the case with all other exemptions granted under section 19A(6)(a) of the Gas Act, may be amended or revoked if the Authority considers that the use of the facility is necessary for the operation of an economically efficient gas market.

Attached to this letter is a copy of the exemption order granted by the Gas and Electricity Markets Authority (the 'Authority').

Yours sincerely,



Philip Davies
Director, GB Markets

GAS ACT 1986
SECTION 19A
EXEMPTION

Pursuant to sub-section 19A(6)(a) of the Gas Act 1986 (the "Act"), the Gas and Electricity Markets Authority hereby gives to SSE Hornsea Limited¹⁴, as a person who expects to be an owner of a storage facility, an exemption from the application of section 19B of the Act, in respect of the storage facility located at Aldbrough, Garton, Hull HU11 4QB, subject to the attached Schedule.



Philip Davies
Authorised in that behalf by the
Gas and Electricity Markets Authority
25 October 2007

¹⁴ England No. 04467860. Registered Office: SSE Hornsea Limited, 55 Vastern Road, Reading, Berkshire, RG1 8BU

SCHEDULE
PERIOD, CONDITIONS, AND REVOCATION OF EXEMPTION

A. Interpretation and Definitions

In this exemption:

"the Authority"	means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000, as amended from time to time
"the Act"	means the Gas Act 1986, as amended from time to time
"the facility"	means SSE Hornsea Limited's share of the Aldbrough gas storage facility located at Garton, Hull, HU11 4QB, being a capacity of 3,033 GWh
"facility owner"	means SSE Hornsea Limited in its capacity as owner of the facility
"facility operator"	means SSE Hornsea Limited in its capacity as operator of the facility

B. Full description of the storage facility to which this exemption relates

The capacity of the facility, being 3,033 GWh.

C. Period

Subject to section E below, and pursuant to section 19A(3)(a) of the Act, this exemption shall come into effect on the date that it is issued and will continue until it is revoked in accordance with Section E.

D. Conditions

Pursuant to sub-section 19A(3)(b) of the Act, this exemption is made subject to the following conditions:

1. The material provided by the facility owner to the Authority in respect of this exemption is accurate in all material respects.

2. The facility owner furnishes the Authority in such manner and at such times as the Authority may reasonably require, with such information as the Authority may reasonably require, or as may be necessary, for the purpose of:

(a) performing the functions assigned to it by or under the Act, the Utilities Act 2000, or the Energy Act 2004, each as amended from time to time; or

(b) monitoring the operation of this exemption.

3. The facility owner complies with any direction given by the Authority (after the Authority has consulted the relevant gas transporter and, where relevant, the Health and Safety Executive) to supply to the relevant gas transporter such information as may be specified or described in the direction -

(a) at such times, in such form and such manner; and

(b) in respect of such periods,

as may be so specified or described.

Where the facility owner is prevented from complying with such a direction by a matter beyond its control, it shall not be treated as having contravened the condition specified in this paragraph.

In this condition:

"information"	means information relating to the operation of the pipe-line system which is operated by a relevant gas transporter
"relevant gas transporter"	means any holder of a gas transporter licence under section 7 of the Act owning a transportation system within Great Britain to which the facility is connected or with whom the facility operator interfaces with as a system operator

4. Should any of the grounds for revocation arise under section E of this exemption, the Authority may, with the consent of the facility owner, amend this exemption rather than revoke the exemption.

5. The Authority may, with the consent of the facility owner, amend this exemption.

6. This exemption is transferable to another facility owner where the Authority has given its written consent to such a transfer. For the avoidance of doubt, all of the conditions contained in this exemption order continue unaffected in respect of any facility owner to whom this exemption order may be transferred (and as if the transferee was substituted in the definition of "facility" and "facility owner").

E. Revocation

Pursuant to sub-section 19A(4) of the Act, this exemption may be revoked in the following circumstances:

1. This exemption may be revoked by the Authority by giving a notice of revocation to the facility owner not less than four months before the coming into force of the revocation in any of the following circumstances:

(a) where:

(i) the Authority considers that the use of the facility is necessary for the operation of an economically efficient gas market;

(ii) the facility owner has a receiver (which expression shall include an administrative receiver within the meaning of section 251 of the Insolvency Act 1986, as amended from time to time) of the whole or any material part of its assets or undertaking appointed;

(iii) the facility owner has entered administration under section 8 of and Schedule B1 to the Insolvency Act 1986;

(iv) the facility owner is found to be in breach of any national or European competition laws, such breach relating to the facility; or

(b) the facility owner has failed to comply with a request for information issued by the Authority under paragraph D2 above and the Authority has written to the facility owner stating that the request has not been complied with and giving the facility owner notice that if the request for information remains outstanding past the period specified in the notice, the exemption may be revoked; or

(c) the facility owner has failed to comply with a direction issued by the Authority under paragraph D3 above and the Authority has written to the facility owner stating that the direction has not been complied with and giving the facility owner notice that if the direction remains outstanding past the period specified in the notice, the exemption may be revoked.

2. This exemption may be revoked by the Authority with the consent of the facility owner.