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Dear Colleague

### **Gas storage third party access (TPA) exemptions – minor facilities**

The default access regime for a gas storage facility in GB is that it is operated under negotiated TPA (nTPA) compliant arrangements<sup>1</sup>. Two routes are available for an exemption to be granted from these requirements.

This letter only relates to exemptions granted under the Gas Act or the Petroleum Act to minor facilities<sup>2</sup>, i.e. exemptions granted on the basis that Article 19 of the Second Gas Directive<sup>3</sup> does not apply as nTPA is not economically and/or technically necessary for providing efficient access to the system for the supply of customers (referred to in this letter as “minor facility exemptions”). This letter does not relate to exemptions granted to major new gas storage facilities<sup>4</sup> (“Article 22 exemptions”<sup>5</sup>). For the avoidance of doubt, unless explicitly stated, any discussion below on exemptions relates to minor facility exemptions.

This letter follows an internal review by Ofgem. In particular, this review was conducted with the aim of ensuring that our approach to exemptions continues to be appropriate going forward. The outcome of this review is that Ofgem will continue to grant minor facility exemptions where the Article 19 requirements do not apply<sup>6</sup>.

As part of our review we have also considered the criteria that we use to determine whether an exemption should be granted. This letter provides guidance to the market on

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<sup>1</sup> The nTPA requirements are set out in s.19B of the Gas Act and s.17D of the Petroleum Act. Broadly, the storage provisions in the Gas Act cover onshore and territorial waters whilst the Petroleum Act sets out the off-shore requirements.

<sup>2</sup> Such exemptions can be granted under s.19A(5) and (6)(a) of the Gas Act and s.17C(5) and (5A)(a) of the Petroleum Act. Under these provisions, the Authority shall grant an exemption to a storage operator in relation to a 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.

<sup>3</sup> Directive 2003/55/EC concerning common rules for the internal gas market, 26 June 2003  
[http://www.energy.eu/directives/L\\_17620030715en00570078.pdf](http://www.energy.eu/directives/L_17620030715en00570078.pdf)

<sup>4</sup> Exemptions for major new gas storage facilities are considered under s.19A(6)(b) of the Gas Act and s.17C(5A)(b) of the Petroleum Act.

<sup>5</sup> Where an exemption is being requested on the grounds that without it a major facility is unlikely to be constructed under nTPA arrangements, potential applicants should give consideration to requesting an Article 22 exemption.

<sup>6</sup> Our position on gas storage exemptions previously granted is also not expected to change following our review. However, we will continue to monitor the impact of exemptions on the market and give further consideration to exemptions granted where the circumstances have subsequently significantly changed. For example, we will give further consideration to the exemption granted in relation to the proposed Caythorpe facility where the facility owner (Warwick Energy) was purchased in 2008 by Centrica Storage Limited (CSL).

the criteria that Ofgem generally expects to use when considering applications from storage operators<sup>7</sup> for minor facility exemptions.

Note that we will continue to examine each exemption application on its own merits.

### *Demand for flexible gas*

Flexibility in the supply of gas is required to meet seasonal and daily fluctuations in demand by customers. It also contributes to overall system security by responding to unexpected system outages.

As UKCS sources of flexible gas decline, the demand for other sources of flexibility (including storage) is likely to increase. Other developments such as increased renewable generation (e.g. wind) may also increase the demand for flexible gas sources to support complementary gas fired generation. Storage is one of the ways in which this demand for flexible gas could be met. In addition, the decline in UKCS production including that part which provides a source of flexibility may lead to an increased requirement to store summer flows from less flexible sources.

### *Storage in the GB market<sup>8</sup>*

Two gas storage facilities (Rough and Hornsea) currently operate under nTPA requirements, i.e. they have not been granted exemptions<sup>9</sup>. The remaining eight operational storage facilities have been granted exemptions under the Gas Act.

In addition, exemptions have been granted to both SSE Hornsea Limited (SSEHL) and Statoil UK for the Aldbrough facility which is in the process of commencing operation. Exemptions have also been granted to three further facilities (Caythorpe, Holford and Saltfleetby) that are not yet operational.

### *Summary of regulatory framework*

The access arrangements for gas storage facilities flow from Article 19 of the Second Gas Directive. These will not materially change under the Third Gas Directive<sup>10</sup>. Article 19(1) of the Second Gas Directive requires Member States to choose either nTPA or regulated TPA (rTPA) for:

*"... the organisation of access to storage facilities...when technically and/or economically necessary for providing efficient access to the system for the supply of customers".*

As noted earlier, in the GB market the default access regime for storage facilities is nTPA. Under Article 19(3), where a Member State has chosen nTPA then it shall take the necessary measures for natural gas undertakings (industry participants but not final customers) and eligible customers either inside or outside of the interconnected system to:

*"...be able to negotiate access to storage...when technically and/or economically necessary for providing efficient access to the system".*

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<sup>7</sup> In this letter we have used the term "storage operator" to refer to current storage facility owners or those parties that expect to be such an owner.

<sup>8</sup> Further detail on GB storage facilities is provided in Annex 1.

<sup>9</sup> Additional undertakings on access to the Rough facility have also been provided by CSL following the 2003 Competition Commission report into its purchase of the facility from Dynegy.

<sup>10</sup> The Third Gas Directive is expected to enter into force this summer. It must be implemented within 18 months. Note that the access arrangements for storage operators under the Third Gas Directive will not significantly change although Member States will be required to publish criteria according to which it may be determined which access regime (either or both of negotiated access (nTPA) or regulated access (rTPA)) shall be applicable to storage facilities. However, the new Gas Regulation in the Third Package introduces a number of additional requirements for storage operators e.g. on the types of services offered and transparency.

In certain circumstances, a storage operator will not be required to offer nTPA at a specific facility. That is, nTPA will not be required to be offered at a facility where access to that facility is not technically and/or economically necessary for providing efficient access to the system for the supply of customers.

To provide transparency to the market on when nTPA is required to be offered at a storage facility, the Gas Act and Petroleum Act require that an assessment be made and a facility be specifically excluded from the requirement to provide nTPA<sup>11</sup>. The assessment required under the Gas Act and the Petroleum Act is as follows:

*“The Authority shall give an exemption with respect to a 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.”*

Note that Ofgem is required to apply the requirements of domestic legislation in such a manner as to achieve the results envisaged by the relevant European legislation. Accordingly, we will consider the issues of technical and economic necessity when granting an exemption under the Gas Act or Petroleum Act<sup>12</sup>.

#### *Exemption criteria*

When considering an application for an exemption from the nTPA requirements for minor gas storage facilities, we will therefore consider, on a case by case basis, whether nTPA is technically and/or economically necessary for providing efficient access to the system for the supply of customers.

There is no single test that we consider should be relied upon to demonstrate whether an exemption should be granted. Instead we are likely to examine a series of indicators to help Ofgem come to a view on whether an exemption should be granted. Note also that Ofgem would expect that applicants for an exemption should also have considered these indicators and to have provided an assessment against them (where possible) before submitting an exemption application to Ofgem. In addition, we welcome any further analysis that storage operators may consider supports their application.

The following section gives further consideration to how the terms “technically necessary” and “economically necessary” may be interpreted in this context. Note that this information is not exhaustive and may be reconsidered based on the specifics of the case. However, it represents our view at this point in time on the criteria that we will generally expect to use and how these are likely to be applied.

#### 1. “Technically necessary”

We will consider whether there are circumstances where it would be technically necessary to require nTPA to be offered at a storage facility to provide efficient access to the system for the supply of customers.

Whilst the market may have a technical requirement for flexible gas sources to meet fluctuations in demand, it clearly does not follow that nTPA for either storage generally or at a specific gas storage facility will be “technically necessary”. On the contrary, at all but a very few large or strategically important gas storage facilities we consider it unlikely that nTPA could potentially be considered to be technically necessary in the GB market. However, we recognise that in a dynamic market this position may be subject to change.

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<sup>11</sup> Note that it is open to Member States to put in place additional rules and considerations to the extent that these do not obstruct the objective of the Directive. In this case we consider the requirement to grant an exemption to be such an example.

<sup>12</sup> We consider that the requirements of the Gas Act and the Petroleum Act for when a minor facility exemption can be granted do not require additional analysis to that which we propose to undertake to consider when nTPA is technically and/or economically necessary.

In considering an application for minor facility exemptions Ofgem would generally expect to consider the availability of capacity to supply gas from various sources, including from exempt storage facilities, to meet forecast peak and winter demand and the demand for flexibility. We will in particular consider the role of the proposed storage facility and the impact of any exemption in meeting this demand.

## 2. “Economically necessary”

In considering an application for a gas storage exemption we will consider whether it is economically necessary to offer nTPA at a facility to provide efficient access to the system for the supply of customers. In doing this we would expect to examine whether the exemption is likely to distort the market and provide a materially worse outcome than if the exemption is not granted.

The principal ways through which such distortion may arise is through market power or weak competition in the relevant market or markets for flexibility<sup>13</sup>. For example, if the exemption appreciably increased the market power of the capacity holders then that may imply that they would be able to exert a distortionary influence on the price of flexibility services.

As with our consideration of technical necessity, the relevant counterfactual is likely to be that the exemption had not been granted (rather than the facility having not been built at all). Whilst we would normally expect that a facility would be used when the market signals suggest that it should be used, we note that nTPA provides some additional safeguards, for example, the publication by the storage operator of the main commercial conditions, the provision of non-discriminatory access, requirements to negotiate in good faith and the ability of the Authority to issue ex-post determinations when disputes arise over access.

In modelling the impact of the exemption we generally expect to consider the facility as if all of the storage space and deliverability was assigned to the storage operator (given that the safeguard provided by nTPA is proposed to be removed). However, we recognise that in some cases, a storage operator will provide access to other market participants and that, the specific facts of each case would need to be considered. We will therefore conduct further analysis on the basis of the expected allocation of capacity to third parties.

### i. Market power

The first area that we would generally expect to examine is whether the exemption appreciably impacts on competition. For example, a party which obtained a high proportion of the market for flexible gas might be able to raise barriers to entry to potential rivals or foreclose access to services with the effect of an appreciable increase in the cost of accessing the system.

There is no single indicator that is likely to infer potential market power so several factors are likely to be considered for example (note that the following list is not exhaustive):

- **Market share analysis:** An examination of the market share (deliverability and capacity) of the facility owner, or any other capacity holder in the facility in the flexibility market.
- **Winter period market power:** Review of the market’s ability to manage without the presence of the proposed exempt storage facility, e.g. over the winter period when demand is likely to be higher, and hence the potential ability of capacity holders to take advantage of a temporary market position.

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<sup>13</sup> We are assuming that, for the purposes of this letter, the relevant market for gas storage is flexible gas. It is likely that, given the difficulties in identifying direct substitutes for a specific gas storage facility, when considering an exemption application, Ofgem will conduct scenario analysis against a number of potential market definitions for flexible gas.

- **HHI level and degree of change:** The level of concentration in the market is an indicator of the degree of competition and level of market power (it is possible to conduct this test for both deliverability and capacity in the storage market).

ii. Market signals

The second area that we would generally expect to consider is the likely impact of an exemption on effective market signals and economic use of storage capacity.

In relation to market signals, we would seek to establish that the exemption would not distort these by, for example, making the price formation mechanism less effective.

In this respect, and as we have noted above, transparency is a key issue that has been identified under the Third Package proposals. In particular, the new Gas Regulation in the Third Package will set out transparency requirements for gas storage facilities, including (unless a derogation has been given) some requirements on those facilities that are not required to offer nTPA<sup>14</sup>. We note that information on injections and withdrawals at individual facilities as well as cumulative information on storage stock levels is already available on the National Grid website.

We may also give consideration to how the facility is expected to be used in practice. In general, when an exemption is granted, we would still anticipate that capacity at the exempt facility should be used when it is appropriate for it to be used. For some facilities, in particular those that are not very small, information on the measures that storage operators have put in place to ensure that capacity is effectively used, even in the absence of nTPA, may be relevant to our consideration of the likely impact of the exemption on market distortion. For example, any potential market distortion that might otherwise be identified may be limited or eliminated by the availability of a secondary market.

### *Monitoring*

Finally, it should be noted that as part of our ongoing market surveillance activities, Ofgem will continue to look at the effects of exemptions on the market. Minor facility exemptions may be amended or revoked if the Authority considers that offering nTPA at the facility becomes technically and/or economically necessary for providing efficient access to the system for the supply of customers. In particular, we may give further consideration to an exemption if the circumstances at the facility altered (e.g. change of facility ownership or in the capacity holdings), there was evidence of market power or abuse, or where there was a significant shift in the market (e.g. other sources of flexibility were no longer available or the demand for flexibility significantly increased such that the position of individual storage facilities in the market for flexibility changes).

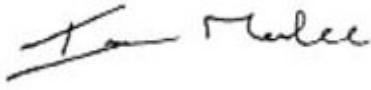
We would also like to reiterate that Ofgem also has powers under the Competition Act 1998 to investigate suspected anti-competitive activity and take action for breaches of the provisions in the legislation in respect of the gas and electricity sectors in Great Britain. We also have concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>14</sup> One of these transparency requirements, Article 19(4) of new Gas Regulation in the Third Package, requires each storage operator to “...make public the amount of gas in each storage ... facility, or group of storage facilities if that corresponds to the way in which the access is offered to system users, inflows and outflows, and the available storage ... facility capacities, including for those facilities exempted from third party access. That information shall also be communicated to the transmission system operator, which shall make it public on an aggregated level per system or subsystem defined by the relevant points. The information shall be updated at least every day”. Note that, unless a derogation has been provided, exempt storage operators will need to comply with Article 19(4) of the proposed new Gas Regulation.

If you wish to discuss the contents of this letter then please contact Andrew Wallace  
(email: [andrew.wallace@ofgem.gov.uk](mailto:andrew.wallace@ofgem.gov.uk), tel: 020 7901 7067).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Marlee', written in a cursive style.

**Ian Marlee**  
**Director, Trading Arrangements**

## Annex 1 – GB storage facilities

Facility	Space (GWh)	Deliverability (GWh)	Duration (Days)	Start date	Owner
Operate under nTPA					
Rough	36,800	455	~81	1985	CSL
Hornsea	3,496	195	~18	1979	SSEHL
Exempt and operational					
Avonmouth	877	156	~6	1978	NG
Dynevor Arms	303	49	~6	1983	NG
Glenmavis	509	101	~5	1975	NG
Partington	1,126	219	~5	1972	NG
Hatfield Moor	1,260	22	~57	2000	Scottish Power
Humbly Grove	3,100	82	~38	2005	Petronas
Hole House Phase 1 + 2	600	90	~7	2004 - 2008	EDF Trading
Holford H165	50	75	~1	2007	Ineos
Exempt and under construction					
Aldbrough	2,600	281	~11	2009	SSEHL
Aldbrough	1,300	140	~11	2009	Statoil UK
Holford	1,758	170	~10	-	E.ON
Caythorpe	2,200	70	~30	-	CSL
Saltfleetby	7,700	85	~90	-	Wingas/ Gazprom