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Email: GB.Markets@Ofgem.gov.uk

Dear Ian,

The Gas Storage Operators' Group Response to Ofgem's consultation on Storengy UK Limited's application for an exemption from section 19B of the Gas Act 1986

The Gas Storage Operators Group (GSOG) welcomes the opportunity to comment on the above consultation and whilst we broadly support Ofgem's initial view that the first phase of Storengy's Stublach gas storage facility should be granted TPA exemption we do have a number of concerns regarding Ofgem's approach in its assessment of the competition issues. In particular we believe that Ofgem's assumptions employed when defining the gas flexibility market, may potentially lead to a significant underestimation of the flex pool.

The GSOG is a trade association which was formed in May 2006 within SBGI. The group has 16 members, comprising almost all the active participants in the GB Gas Storage Market, and as such represents a wide range of interests. The group includes both established operators and developers of new storage projects, large multinational companies and smaller private ventures. The signatories supporting the views to this submission are detailed in the Appendix. Storengy UK Ltd and Ineos Enterprises Ltd feel it is inappropriate to be signatories as this Consultation relates to their own commercial interests. Statoil does not support the views expressed.

We now provide answers to the questions raised in the consultation.

Question 1: Do you agree with Ofgem's approach to considering whether nTPA is technically necessary for providing access to the system for the supply of customers? If not, please explain why.

It seems reasonable to base an assessment of technical necessity on whether expected demand could be met by expected supply in the absence of the proposed project. We would note however that the conclusions of such an analysis will depend

on the assumptions made, and therefore its reasonableness will depend on the reasonableness of assumptions made on future demand and supply conditions.

Further it should be noted that the types of measures employed by Ofgem in its assessment of whether TPA is technically (or indeed economically) necessary for providing efficient access to the system for the supply of customers may well be sufficient to rule out concerns in the case of individual small market players, but they are not sufficiently sophisticated to allow Ofgem to conclude that granting a larger player TPA exemption would lead to any physical or economic distortion such that "efficient access" would no longer be achieved.

Question 2: Do you agree with our overall assessment that nTPA at the proposed Stublach is not technically necessary for providing efficient access to the system for the supply of customers? If not, please explain why.

Although we have not had access to the demand and supply data underlying Ofgem's assessment we have no reason to doubt the conclusion that Stublach is not technically necessary to ensure that British customers have access to sufficient flexible gas to meet their needs.

Question 3: Do you consider that our market scenario analysis is appropriate. If not, please explain why.

See our response to question 4

Question 4: In particular, do you consider that our three potential market definition scenarios to be appropriate? If not, please explain why

It is difficult to comment in detail on the analysis set out in the consultation document, given that many of the input assumptions are treated as confidential. Whilst we fully accept that defining the gas flexibility market is problematic, we would note that Ofgem's assumptions underlying even the broadest market measurement used appear conservative in a number of respects, in particular:

- The limitation of flexible beach gas to deliveries through the Barrow and Sean terminals excludes a number of fields that between them contribute significantly to UKCS flexibility;
- The assumption that the BBL pipeline is not capable of providing flexibility to the British market but will be used as baseload import (particularly when NGT forecasts suggest that significant volumes of gas will be exported from the UK to the continent in future years, and the current Winter Outlook shows significantly higher imports from BBL in winter than summer in recent years);
- The assumption that IUK flexibility is constrained to a maximum import level that appears to be well below maximum import capacity, and even below the maximum import levels that have been seen in recent years;
- The assumption that Norwegian imports do not provide flexibility to the British market, despite their variable delivery patterns, is almost certainly wrong and, in our thinking, a rather unsophisticated way of dealing with this important source of supply;
- The exclusion of SRS: while clearly SRS play a limited role in meeting seasonal flexibility requirements, clearly they can have an important role to play on peak demand days. It should be possible to capture their limited duration through alternative flexibility measures, rather than by excluding them from the relevant market altogether;
- The apparently rather ad-hoc assumptions made on the ability of LNG imports to provide market flexibility; and

- The exclusion of demand side response – which, as you acknowledge, can be an important contributor to market flexibility.

Question 5: Do you agree with Ofgem's approach to considering whether nTPA is economically necessary for providing access to the system for the supply of customers? If not, please explain why.

Although we agree with Ofgem's use of market share as a preliminary indicator of a firm's market power, we see certain weaknesses in the specific approach taken. As noted above, the method of somewhat arbitrarily removing or restricting certain sources of flexibility from the market definition seems a rather crude and overly conservative approach to estimating market power in the British flexibility market.

The use of "pivotality" as an indicator of market power is not very satisfactory, given that a player who is not pivotal may (depending on the costs and benefits of doing so) still have an incentive to withdraw flexibility from the market to drive up price, while a player who is pivotal may still not have such an incentive.

We would also like to understand what interpretation is placed on the HHI impact of building a new facility: given that even building a new facility that increases HHI would still likely result in a reduction in market prices. Further, while we understand the difficulty of identifying market shares for all significant players in such a fragmented and complex market as that for British gas flexibility, we do not see restricting the market to gas storage for the purposes of HHI calculation as a helpful response to these challenges.

Finally, in relation to the assessment of vertical relationships, it is important to recognise (as is done in the European Commission's guidelines on non-horizontal mergers, for example), that vertical integration cannot be presumed to be generally problematic, as it is also associated with potentially important pricing efficiencies that can benefit final consumers. Moreover, as the Competition Commission noted in its assessment of Centrica's acquisition of the Rough storage facility, downstream pass-through constraints can further reduce the incentive of upstream firms to attempt to raise wholesale prices.

While these weaknesses are not likely to be problematic in the context of a relatively small facility such as Stublach, in the assessment of TPA exemptions for larger facilities these weaknesses could well become problematic and result in the wrong conclusions being drawn. We would therefore welcome the opportunity to discuss with Ofgem alternative approaches to market assessment that might add value in such cases.

Question 6: Do you agree with our overall assessment that nTPA at the proposed Stublach facility is not economically necessary for providing efficient access for the supply of customers? If not, please explain why.

The GSOG has no reason to expect that granting TPA exemption to the Stublach facility would create any distortions or inefficiencies in the British gas flexibility market.

Question 7: Do you agree with the drafting of the exemption order?

We have not examined the drafting of the exemption order in detail.

Question 8: Do you agree with our overall conclusion that an exemption should be granted to Storengy for Phase I of the proposed storage facility at Stublach?

As noted above, the GSOG has no reason to expect that granting TPA exemption to the Stublach facility would create any distortions or inefficiencies in the British gas flexibility market.

Finally, we hope you find our responses a useful contribution to Ofgem's thoughts on its analysis of competition issues and as regular attendees at our bi monthly meetings; perhaps Ofgem would consider this to be a suitable opportunity to discuss our contribution further.

Yours sincerely



PP Roddy Monroe, Chair – SBGI Gas Storage Operators Group

Appendix 1

List of Members of the Gas Storage Operators Group:

Bord Gais Eiereann
Canatx Gas Storage Limited
Centrica Storage Limited
E.On Gas Storage Ltd
EdF Trading Gas Storage Limited
ENI UK Gas
Gateway Gas Storage Company Ltd
National Grid LNG Storage
Portland Gas plc
Scottish Power Energy Management Ltd
SSE Hornsea Limited
Star Energy Group plc
Wingas Storage UK Ltd