

To: Ian Marlee
Partner, GB Markets
Ofgem
9 Millbank
London
SW1P 3GE

17th December 2010

Reference: STOR-1915

Dear Ian,

Re: Storengy UK's response to the consultation "Guidance on the Third Party Access regulatory regime for gas storage facilities in Great Britain"

Storengy UK welcomes the opportunity to respond to this consultation on nTPA and would like to thank Ofgem for its presentation to the SBGI Gas Storage Operators Group.

Storengy UK is currently developing the Stublach Gas Storage Project, a highly flexible salt caverns scheme that will enable us to offer a broad range of innovative flexible products to interested parties. The first phase of the project has been granted TPA exemption.

General comments

It is worth stressing that fostering the development of new storage facilities when and where required, remains the best way to ensure flexibility markets will function efficiently whilst also enhancing security of gas supply. The nTPA framework should therefore be properly designed in order not only to ensure transparent and non-discriminatory access to existing (non exempt) storage facilities but also to foster the right investment climate for storage development.

Economies of scale are of paramount importance to developing storage facilities that have the *lowest long run marginal cost*. Ensuring that the regulatory framework, whilst addressing any competition issue in the flexibility market, does not prevent the development of large storage facilities is therefore ultimately extremely beneficial to gas consumers. Developing major gas storage facilities requires significant upfront investments. It is therefore essential that investment risks brought about by geology, reservoir characteristics, facility operations and storage prices fluctuations are not compounded by unnecessary regulatory risks. Should this not be the case, hurdle rates for such projects would be raised to levels at which they would no longer be viable.

Furthermore, the imposition of a too prescriptive and rigid framework for marketing flexibility services and continuous changes to this framework would stifle commercial innovation and would not be conducive to the growth of storage activities.

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Any regulatory framework should take into account the maturity of the market and the likelihood of potential abuse of a dominant position. The UK gas market is comparatively more mature than other European markets and, in our opinion, exhibits a healthy level of competition for the supply of flexibility, not only between SSOs but also between storage and other sources of flexibility.

Storengy UK is concerned that some of the proposals laid out in this consultation document go well beyond the requirements contained in the Third Package and, if "imposed" upon SSOs, would hinder further development of storage in the UK thereby weakening security of supply. Our four main concerns are:

1. Market player with "Significant Market Power". Storengy UK is of the opinion that this type of assessment is more relevant for gas storage users rather than SSOs. Indeed, SSOs have an obligation to make storage capacity available to the market but do not decide the usage of gas in store (and do not therefore have a direct ability to influence gas prices). In addition, Storengy UK believes that gathering information about the flexibility of related undertakings would be contrary to the concept of unbundling promoted by the Third Package;
2. Setting reserve prices. Storengy UK believes that Ofgem's proposal of auctioning short term capacity with a reserve price set at "short run avoidable cost" not only goes well beyond the Third Package requirements but would also create a climate in which scarcity of storage capacity has a high value thereby providing SSOs with disincentives to develop new capacity (even incentives not to disclose opportunities of marginal capacity development). Storengy UK believes SSOs should be entitled to try to recoup their investment costs and should not therefore be "forced" to auction capacity with a reserve price below the long run marginal cost;
3. Multiple facilities. Offering services that combine storage capacity from a nTPA facility and from a TPA exempt facility might be very valuable to customers as the combined product might better fit their requirements. Storengy UK believes that instead of imposing the same regulatory arrangements on both facilities (thereby annihilating de facto the benefit of TPA exemption) SSOs should ensure that the aggregate of capacity offered by the nTPA facility on its own and the capacity offered in the combined product is equal or exceeds the maximum technical capacity of the nTPA facility;
4. Storage contract duration. Storengy UK believes any regulatory framework should take into account the requirements of both the demand side and the supply side of storage capacity in order for the market to deliver flexibility with the lowest long run marginal cost. Storengy UK is of the opinion that a framework that would encourage long term storage contracts would be beneficial in this respect. Indeed, a reasonable level of long term stable revenues would undeniably facilitate decisions about projects that require large upfront investments and would provide more certainty to storage users.

Ofgem is adamant that the proposals set out in the consultation document would only provide SSOs with guidance and not impose rules upon them. However, realistically, a prudent and reasonable operator is very likely to implement the guidance in order to reduce the regulatory risks in case of dispute. These proposals therefore somehow outline the nTPA framework and constrain SSOs.

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Storengy UK understands that Minor Facilities TPA exemptions already granted would generally not be impacted/reviewed as a result of the Third Package implementation. Given the potential overlap between the SMP methodology described in this consultation paper and the process for deciding on TPA exemption application, Storengy UK would be grateful if Ofgem could clarify any potential link between both approaches.

Detailed responses to the consultation questions have been appended.

We hope that you have found these comments useful. Should you want to discuss the above further please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Bruno Leray". The signature is stylized and fluid.

Bruno Leray
Managing Director

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Appendix: responses to consultation questions

Chapter Three

Preamble

On the one hand the Third Package imposes TPA obligations on SSOs in relation to the access to their (non exempt) storage facilities. On the other hand, especially in the UK, gas suppliers have access, on a commercial basis, to several sources of flexibility including "non regulated" ones.

Storengy UK believes that, realistically, it is only by withholding (pivotal volumes of) gas in store that peak gas price could be directly influenced. It is worth noting that SSOs have no direct control on the way the storage capacity is used and cannot direct customers to withdraw gas from the store. SSOs cannot therefore by themselves manipulate the offer of gas in order to raise wholesale gas prices. Within the TPA regime, the only way to restrict access to storage for a SSO is not to offer available capacity in order to raise the expectation of storage value and get higher storage rates in the future. Implementation of such a strategy seems rather unrealistic as:

- for an unbundled SSO (now mandatory), that would mean giving up revenues;
- withholding unused storage capacity can very easily be spotted (compared to withholding gas in store);
- contrary to peak gas demand, demand for storage capacity has no reason to be inelastic, especially in the UK where other sources of flexibility are readily available and accessible.

Storengy UK is of the opinion that the consultation document contains many occurrences of issues in relation to SMP that apply to gas suppliers (and the wholesale gas market) rather than to SSOs (and the access to storage capacity). Indeed, it is clear in Ofgem's consultation document that the SMP assessment is to apply to all sources of potentially pivotal gas volumes of all related undertakings. This means that this assessment actually applies to all flexibility sources, not only gas storage capacity on the basis that the "group" might influence gas prices.

There seems therefore to be a real disconnection between the potential issue of SMP (i.e. a gas supply issue) and the proposed remedies to address this potential issue (i.e. by "imposing" very strict rules on SSOs). Indeed, one could be in a situation whereby, following application of the SMP test, strict rules would apply to the SSO whereas, even without booking any storage capacity in the related storage facility, the related undertakings active in gas supply would have a significant share of pivotal volumes. Alternatively, even if strict rules were "imposed" on the SSO, since the SSO cannot discriminate between customers, nothing would prevent the related undertakings from securing, through the transparent and non discriminatory primary allocation process, a significant share of the storage capacity thereby acquiring SMP status (and potentially abusing it to raise gas price by withholding gas in store).

Finally, according to Ofgem's proposal, the onus would be on the SSO to continuously assess SMP. As discussed above, this could only be done by gathering information from related undertakings on all their



sources of contracted flexibility. These exchanges of commercially sensitive information seem at odds with the robust unbundling promoted by Third Package¹.

Question 1: Should pivotal gas volume be used when assessing SMP? If no, please explain why.

No. Please see above-mentioned reasons.

If SSOs were forced to assess SMP in accordance with the pivotality methodology laid out in the consultation document, the implementation of SMP assessment would give rise to a number of operational issues. Storengy UK would request that more details are provided in order to significantly alleviate the regulatory uncertainty. Information of particular interest would be:

- gas demand level(s) to be used in the assessment;
- sources of gas supplies to be used in the assessment;
- "capacity coefficients" for each source at each timescale;
- relevant timeframes.

Given the very strict limitations that would be "imposed" upon SSOs in case of SMP it is crucial the assessment can be made without requiring the SSOs to apply "some judgment". Storengy UK does not foresee any reason why Ofgem would be prevented from making this information available to market players and updating it as and when is necessary.

Question 2: Is the proposed figure of ten per cent of pivotal gas volume an appropriate threshold for defining SMP? If no, what is an appropriate threshold?

Without further information on the values to be included in SMP assessment (most notably the sources of gas supplies to be included and their capacity coefficients) it is very difficult to provide views on the level of pivotality.

Question 3: Is it appropriate to also consider market outcomes to assess whether a market player may have SMP at lower levels of pivotality?

Storengy UK understands that this would essentially be an ex-post analysis of events having occurred when the market player assumed it had no SMP since its pivotality was below the critical threshold. As such this should be used only in case of major concern and/or complaint against the market player.

Question 4: Are there any additional factors that should be used when considering if a market participant has SMP?

Storengy UK notes that all items listed in paragraph 3.26 do not apply to SSOs but to gas suppliers.

Chapter Four

Question 1: What factors should be taken into consideration when defining the maximum capacity of a group of facilities?

Storengy UK does not support the views expressed by Ofgem about multiple facilities (statement 4.23 and associated footnote 32), especially if strict limitations are "imposed" on the TPA facility.

¹Similar information can be requested in relation with a TPA exemption application. It is worth noting that, in this case, the party requesting the TPA exemption is very often not yet a SSO and may never be subject to TPA requirements. Furthermore, the request is made very often well before the start of commercial operations when that information has little value.

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Offering services that combine storage capacity from a nTPA facility and from a TPA exempt facility might be very valuable to customers as the combined product may better fit their requirements. For instance, a SSO may operate two separate facilities with "complementary" performances.

	Facility A (seasonal)	Facility B (fast cycling)
TPA regime	nTPA	TPA exempt
Injectability (Mcm/day)	7 (~ 140 days)	20 (10 days)
Deliverability (Mcm/day)	17 (~ 60 days)	20 (10 days)
Space (Mcm)	1000	200

Customers may value more highly a product that would be more "reactive" (i.e. higher injectability and higher deliverability) than the one offered by Facility A alone.

	Combined product
Injectability (Mcm/day)	7+8 = 15 (~ 66 days)
Deliverability (Mcm/day)	17 + 8 = 25 (~ 40 days)
Space (Mcm)	1000

Storengy UK believes that there is no need for imposing the same regulatory arrangements on both facilities, as the SSO benefiting from TPA exemption granted to Facility B can provide the difference as an additional service, finally aggregated to the capacity offered by the nTPA facility. Then the SSO would not be released from the obligation to make available the maximum capacity of the nTPA facility.

Question 2: What concerns, if any, do market participants have with Ofgem's preliminary views on capacity allocation? What concerns, if any, do storage users have with the use of allocation mechanisms other than auctions to allocate capacity, particularly standard services?

It is worth stressing that the Third Package does not stipulate any preference for a specific capacity allocation mechanism and does not point to auction as "best mechanism". Storengy UK does not therefore see any reason why unnecessary restrictions should be introduced in the already competitive UK market.

Storengy UK believes that "compulsory" auctioning of capacity is not suitable for the mature UK market. If bilateral sales were prohibited and auctions were imposed for some or all of the sales, this would create some real risks of inefficiency in the allocation and pricing of storage.

Furthermore, in practice, in order to attract enough bidders, the auction mechanism must be very simple. This in turns creates rigidity in the products definitions and prevents SSOs from offering a broad range of products that may better suit customers. Since SSOs have to compete in the UK with non-regulated sources of flexibility such as North Sea gas production swing, flexible gas imports and, to some extent, demand-side management, overly restrictive mechanisms such as auctions would **hinder commercial innovation** in marketing storage and disadvantage storage.

Finally, when faced with major commitments – long term contracts and/or large capacity bookings – numerous customers are more inclined to negotiate bilaterally.

Question 3: Does the use of auctions provide market participants with sufficient safeguards that any market player with SMP will provide standard services to the market on a non



discriminatory basis? What other measures/safeguards in relation to how any market player with SMP allocates capacity could be considered?

See above comments on SMP and "compulsory" auctions.

Addition: Setting reserve prices

Storengy UK vigorously opposes Ofgem's proposal set out in 4.49 stipulating that short run avoidable cost should be used for short term services.

First, Storengy UK believes this goes well beyond the Third Package requirements and is not in keeping with the spirit of "negotiated" access, especially when alternatives to products offered by SSOs are freely negotiated in the marketplace.

- As far as reserve price is concerned Storengy UK understands that Ofgem is mainly concerned about SSOs potentially setting reserve prices at a level that would allow them to discriminate in favour of their related undertakings.

Storengy UK believes that SSOs are entitled to try to recoup their investment costs and should not therefore be "forced" to sell capacity at a price lower than their long run marginal cost. The ratio SRMC/LRMC for a large seasonal facility is typically 1/10! Storengy UK is therefore of the opinion that **SSOs should be allowed to set the reserve price of any auction up to the level of their long run marginal cost:**

- if flexibility is scarce demand for storage capacity will be higher than supply and the auction clearing price will be above the long run marginal cost;
- if flexibility is not scarce alternatives to storage will be available at a price below the long run marginal cost. In this case Ofgem should not be concerned about SSOs exercising any market power as by definition, the market is not tight and SSOs will not be able to "fiddle the auctions" since alternatives are readily available. Furthermore, faced with lower demand for their capacity, SSOs will adjust their sales strategy (but will not be forced to go down the single auctioning route).

"Forcing" SSOs to auction short term capacity with a reserve price well below their long run marginal cost will definitively impact the mix of long term/short term products offered to the market. Indeed, SSOs will try to avoid being exposed to potentially very low and volatile short term revenues.

This would also have distributional effects as it would give storage users access to "under-priced" capacity. This would transfer the value of storage to storage users whilst preventing SSOs from getting the return on investment (that would be obtained on the basis of long run marginal cost). This would send a **wrong economical signal** and hinder the development of new storage facilities which in turn would result in higher priced storage capacity and a more volatile price.

This might also give rise to windfalls for storage users as short term markets may change dramatically over a few months and make the storage capacity very valuable indeed. SSOs should be allowed to sell capacity until the very last time whilst ensuring all the capacity is eventually offered to the market. Storengy UK believes that, when faced with poor market conditions resulting in very low value for their "standard one year" services, SSOs are entitled to sell very short term services (duration < 1 year) such as calendar spreads or park and loan services thereby benefiting from short term changes to market conditions.

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Question 4: Do market participants consider that the prevailing anti hoarding arrangements currently in place at GB storage facilities that are subject to the TPA regime are appropriate and compatible with the requirements of the Gas Regulation? If no, please explain why.

Storengy UK is not aware of any complaints regarding anti hoarding arrangements currently in place and therefore assumes these are appropriate.

It is worth noting that the ability of SSOs to offer interruptible services sometimes depends on the historical in and out flows experienced by the storage facilities. For instance, if gas was withdrawn from a salt cavern continuously at high flow-rate this would reduce the temperature of the gas in the cavern and therefore reduce the remaining working gas volume that can be withdrawn. The SSO would then have to wait for the temperature in the cavern to increase again before the remaining working gas volume could be withdrawn. From the SSO's perspective and the firm customers' perspective it is important that sales of interruptible capacity do not detrimentally impact upon firm rights (especially when storage is nearly empty).

Finally, it is worth stressing that since SSOs cannot direct customers to withdraw gas anti-hoarding arrangements implemented by SSOs, it will not impact upon the ability of customers to withhold stored gas. Withholding gas in store should not always be considered as an attempt to distort gas price signals; indeed, this may result from a customer acting reasonably and prudently by keeping gas in store to cover the risk of a late cold spell (after all, gas storage does provide insurance against variable weather conditions).

Question 5: Do market participants consider that the mix of interruptible and firm storage services is appropriate and compatible with the requirements of the Gas Regulation? If no, please explain why.

Storengy UK is not aware of any issues/complaints regarding the sales of interruptible services and therefore assumes these are effective.

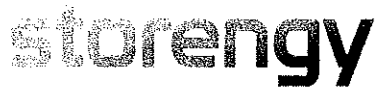
Question 6: Do market participants consider that the existing arrangements for the secondary trading of storage capacity are appropriate and compatible with the requirements of the Gas Regulation? If no, please explain why.

Storengy UK is not aware of any issues/complaints regarding the secondary trading of storage capacity and therefore assumes the current arrangements are appropriate.

Chapter 5

Question 1: What levels of consultation should SSOs undertake when developing main commercial conditions for the first time and when proposing amendments to the standard terms and conditions?

Consulting widely with market players when developing the main commercial conditions for the first time will be beneficial to both SSOs and storage users; we note that this is rather usual practice when marketing new products. As far as amendments to existing conditions are concerned this may prove, in practice, more **cumbersome and time consuming** especially if conflicting views between then prevailing storage customers and potential new customers give rise to potential discrimination concerns. It's anticipated that only significant amendments to commercial conditions would be subject to full and detailed consultation. Whatever the proposed changes it is important the consultation process does not deter SSOs from proposing such amendments in order to be able to offer products that better match customers' requirements.



Question 2: Are there aspects of an SSO's main commercial conditions where small changes are likely to have a significant impact on system users?

No specific comment.

Question 3: Should SSOs be expected to formally consult or test the market before changing existing services or offering any new services to the market? If no, please explain why.

It is worth noting that:

- new services proposed to the market will have very likely originated from customers' requests;
- a formal consultation of the market may bring little additional value compared to informal discussions with customers. Indeed, whatever the level of prior market testing, real commitments are made by interested parties only in the allocation phase.

Question 4: Should SSOs be expected to offer a minimum threshold of capacity on a short term basis? How should SSOs determine the minimum proportion of capacity that should be sold on a short term basis?

Storengy UK notes that:

- no minimum proportion of capacity to be sold on a short term basis has been stipulated in the Third Package;
- if SSOs were "forced" to auction short term capacity with a reserve price set at the level of short run avoidable cost there would be a real incentive for SSOs to minimise the amount of capacity to be sold on a short term basis.

Storengy UK believes that medium to long term contracts would be beneficial for the UK market. Indeed, these would provide:

- storage operators with more stable revenues thereby reducing their costs of capital employed and consequently the long run marginal cost at which they can sell the capacity;
- storage users with more certainty on the costs of their flexibility as well as cheaper capacity price;
- a higher level of security of supply to the UK market as a whole since storage facilities would be located in the UK.

Storengy UK would therefore support initiatives likely to encourage medium to long term contracts.

Question 5: Should SSOs be expected to offer bundled capacity as part of their 'standard services'? Should SSOs be expected to also offer unbundled capacity as part of their 'standard services'? Please explain your views.

No specific comment.

Chapter 6

Question 1: What factors should Ofgem take into consideration when assessing a market player's flexible gas requirements and, in particular, need for storage services?

Storengy UK is of the opinion that this section applies to the related undertakings active in gas supply and/or gas production rather than to the related SSO. Unbundling provisions have clearly been reinforced in the Third Package with the aim of preventing anti-competitive practices between related undertakings of vertically integrated companies. The SSO will therefore not have detailed information on its related undertakings' flexible gas requirements, how these are fulfilled and how their flexibility tools/contracts are optimised subject to limits set within their internal risks management framework.

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The relevant Regulatory Authority will no doubt have the powers under the competition law to investigate such matter should there be suspicions of improper transactions between the SSO and its related undertakings.

Chapter 7

Question 1: Do SSOs provide sufficient information on the services they offer and the terms and conditions of access? Is any further information required? Are there any improvements that could be made to how information is provided by SSOs?

Storengy UK is of the opinion that sufficient information is currently provided.

Question 2: Do SSOs provide sufficient information on the maximum capacity and the level of utilisation? What further information is required? Are the current timeframes for providing this information appropriate?

Storengy UK is of the opinion that sufficient information is currently provided.

Question 3: Should SSOs publish the information required under section 19(4) on their websites or should NGG undertake this role for all SSOs?

Storengy UK believes that, for the sake of more transparency and easy access NGG should publish this information on behalf of all SSOs.