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Date: 26 June 2014

Dear colleague

### **Final Decision – Storengy UK Ltd's application for a minor facilities exemption for Stublach gas storage phase 2**

We have decided to grant Storengy UK a minor facility exemption (MFE) for phase 2 of the Stublach gas storage facility. This is because we consider that negotiated Third Party Access (nTPA) at the facility is not technically or economically necessary for the operation of an efficient gas market.

On 7 March 2014 we published a consultation<sup>1</sup> on our initial view to grant the MFE. This consultation closed on 2 May. We received one response to our consultation, which was supportive of our initial view. Taking this response into account, we have confirmed our initial view. Our final decision is to grant the MFE. This letter explains the reasons for our decision, and includes the exemption order. Our consultation contained more detail on our assessment.

### **Background**

Storengy UK Limited, a wholly-owned subsidiary of GDF Suez, is the owner and operator of the Stublach gas storage facility in Cheshire. Phase 1 of Stublach is currently under development. It will provide 200 mcm of capacity with 16 mcm/d peak deliverability and injectability when fully operational. This is expected by winter 2015.

In 2009 we granted an MFE for phase 1. In March 2013 we amended this exemption to account for an increase in the working volume of gas (ie, space, but not deliverability) available under phase 1.

In December 2013 Storengy submitted an application under section 8S of the Gas Act 1986 (the Act), as amended, for an MFE from the requirements of sections 8R and 19B of the Act. Phase 2 would double the capacity of the facility, with ten additional caverns. The expanded facility (phases 1 & 2 combined) would have total space of 400 mcm and peak deliverability and injectability rates of 30 mcm/d. This work is expected to be completed by winter 2018.

### **Exemption criteria**

The Gas and Electricity Markets Authority (the Authority) exempts storage facilities from nTPA and independence requirements when it considers that the use of the facility by other

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/storengy-uk-ltds-application-minor-facilities-exemption-stublach-gas-storage-phase-2>

persons is not technically or economically necessary for the operation of an efficient gas market. This test for an MFE is contained in section 8S of the Act.

Ofgem is also required to interpret national law in the context of European legislation. Therefore, when assessing an MFE application we consider, pursuant to Article 33 of the Third Gas Directive<sup>2</sup>, whether the facility is technically and/or economically necessary for providing efficient access to the system for the supply of customers, as well as for the organisation of access to ancillary services.

The basis for our assessment approach is our 2009 open letter<sup>3</sup>. Our consultation explained why we thought that Storengy met the criteria for the MFE to be granted. We summarise our key findings below; you can find more detail in our consultation document.

## **Our assessment of the application**

### *Technically necessary*

We have determined that nTPA at Stublach is not technically necessary for the operation of an efficient gas market. To reach this view, we assessed whether nTPA at Stublach is technically necessary for a peak day and a cold winter. Our test was whether supply capability (excluding Stublach) was sufficient to meet demand over these periods. In all scenarios examined, this was the case.

### *Economically necessary*

We have determined that nTPA at Stublach is not economically necessary for the operation of an efficient gas market. We reached this conclusion after considering a range of indicators. The focus of our assessment was on whether granting the MFE could give GDF Suez market power in the GB gas flexibility market. Our analysis is therefore forward looking.

To a greater or lesser extent, a range of supply sources are substitutes for gas storage in the flexibility market. There is some uncertainty about the future behaviour of flexible gas sources. To address this, we used three possible market definitions, which are designed to account for a range of future scenarios. We calculated market shares for each definition, which showed GDF Suez's share of the gas flexibility market generally remained below 10 percent. This indicates that it is unlikely that GDF Suez would hold market power in the gas flexibility market if Storengy is granted an MFE for Stublach phase 2.

We also consider the impact of an MFE on concentration in the storage market. We calculated Herfindahl–Hirschman Indices (HHIs)<sup>4</sup>. These suggested that the storage market is not concentrated, and that the construction of Stublach results in a marginal reduction in concentration.

We assessed the potential for market power using pivotality modelling. A player is pivotal if total demand cannot be met from all available sources of supply controlled by other players. Using our base assumptions, GDF Suez was not pivotal. A combination of very high demand and a significant supply outage was required to create a situation of pivotality.

Our assessment concluded that GDF Suez's position in vertically linked markets would be unlikely to lead to market power in the flexibility market. We also determined that the exemption would not have a detrimental impact on market operation.

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<sup>2</sup> Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC.

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/gas-storage-minor-facility-exemptions-open-letter>

<sup>4</sup> HHIs are calculated based on the sum of squared market shares of all market players. Higher HHIs indicate a market is more concentrated.

We noted that Storengy would still be subject to transparency requirements in relation to the physical operation of the facility. We also welcomed Storengy's commitment to introduce a use-it-or-lose-it (UIOLI) mechanism and facilitate secondary trading.

## **Response to consultation**

We received one response to our consultation; they supported granting the exemption.

### *Operating Margins*

The respondent raised a general concern about the interaction between exempt storage facilities and National Grid Gas (NGG)'s licence obligation to promote competition in the market for Operating Margins (OM). They were concerned that exempt storage facilities may choose to not participate in tenders for OM services, and that NGG could not necessarily expect exempt facility owners to enter into negotiations for third-party access. The respondent thought this could limit NGG's ability to obtain the OM services in the most economic manner.

We do not think that the exemption status of a facility would have this effect. In the current OM tender process all storage facilities, whether exempt or not, are free to participate (alongside any other qualified party) to the full extent that they wish. This is a commercial decision for the relevant party. Further, granting an MFE to phase 2 of Stublach does not prevent it from participating in the OM tender process.

## **Anti-hoarding mechanisms**

In our consultation, we asked for views on whether the implementation of anti-hoarding mechanisms should be a condition of the exemption. We did not receive any comments on this issue. After further consideration, we have decided that it should not be included as a formal condition. However, we are supportive of Storengy's plans to introduce UIOLI and a secondary trading platform. We would emphasise that we have considered Storengy's plans to introduce these arrangements as part of our decision to grant the exemption.

## **Our final decision is to grant the exemption**

We have considered Storengy's application, the assessment we have carried out and responses to our consultation on that assessment. Based on this, we have decided to grant the MFE. The formal exemption order is included as an annex to this letter.

It should be noted that our decision on the exemption has been made on the basis of information provided by Storengy in their application. As part of our ongoing market surveillance activities, we will continue to assess the effect of exemptions on the market. If circumstances relating to the exemption change, we may seek Storengy's consent to an amendment of the exemption conditions. Alternatively, the exemption may be revoked if we consider that the facility has become necessary for the operation of an economically efficient gas market.

If you have any questions about this letter, please contact Tom Farmer (via [wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk)).

**Yours sincerely**

**Emma Kelso**  
**Interim Partner, Wholesale Markets**

**GAS ACT 1986**  
**SECTION 8S**  
**EXEMPTION**

Pursuant to section 8S of the Gas Act 1986 (the "Act"), the Gas and Electricity Markets Authority hereby gives to Storengy UK Limited, as a person who expects to be an owner of a storage facility, an exemption from the application of sections 8R and 19B of the Act, in respect of phase 2 of the Stublach storage facility located in Cheshire, North-West England, subject to the attached Schedule.

Emma Kelso  
Interim Partner, Wholesale Markets

Authorised in that behalf by the  
Gas and Electricity Markets Authority

26 June 2014

**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 the Stublach gas storage facility located in Cheshire, North-West England, which the facility owner intends to construct in two phases
"facility owner"	means Storengy UK Limited in its capacity as owner of the facility
"facility operator"	means Storengy UK Limited in its capacity as operator of the facility

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

Phase 1 of the facility was granted minor facility exemption under the Act on 18 December 2009, and the exemption was amended on 15 March 2013. The phase 1 exemption and the amendment thereto are published on Ofgem's website.

This exemption relates to phase 2 of the facility, which will provide an additional 2,200 GWh of space and an increase of 145 GWh/day in maximum injectability and an increase of 145 GWh/day in maximum deliverability. On completion of phases 1 and 2, the facility will provide a total of 4,400 GWh of space, a maximum injection rate of 320 GWh/day and 320 GWh/day of deliverability. This deliverability rate is the maximum which can be achieved when the facility is full.

**C. Period**

Subject to section E below, and pursuant to sub-section 8S(3)(b)(i) 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 8S(3)(b)(ii) 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 owner").

## **E. Revocation**

Pursuant to sub-section 8S(5) 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.