

Modification proposal:	Centrica Storage Limited (CSL)'s proposed changes to the Storage Services Contract (SSC) and the V store, I store and 30 day storage contracts (alternative contracts)
Decision:	The Authority ¹ has decided to approve the SSC and alternative contracts modification proposals
Target audience:	CSL, customers of CSL, storage operators and other interested parties
Date:	20 November 2014

Decision

After due consideration, we have decided to approve the SSC and alternative contracts modification proposals. We think the changes proposed by CSL improve the clarity of the contracts and their consistency with legislation, industry documents and current commercial practice. We do not consider that the changes proposed are likely to exacerbate the potential problems that the undertakings² are seeking to address.

Background to the modification proposal

On 14 November 2002, Centrica Storage Holdings Limited (CSHL), a wholly owned subsidiary of Centrica plc (Centrica), acquired the entire issued share capital of Dynegy Storage Limited (now CSL) and Dynegy Onshore Processing UK Limited. The effect of this was the affiliation of Centrica with two companies which owned and operated the Rough gas storage facility and associated assets. Rough is the largest gas storage facility in the UK.

On 25 February 2003, the resulting merger was referred to the Competition Commission (CC) under sections 64 and 69(2) of the Fair Trading Act 1973.

The CC's report concluded that the merger would increase the uncertainty faced by other industry participants and potential entrants and that, in the absence of further constraints, Centrica may have been expected to:

- Discriminate between customers in giving access to capacity at Rough;
- Use to its advantage sensitive information gained from the operation of Rough;
- Withhold information about the operation of Rough;
- Be less innovative in marketing Rough products than another owner; and,
- Invest less in expanding Rough's capacity than another owner.

As a result, the CC considered that competition in the markets for flexible gas and domestic gas supply would be weakened. The CC also thought that innovation and investment at Rough would be lower than under another owner. Therefore, the CC concluded that the merger may have been expected to operate against the public interest.

In order to remedy or prevent these adverse effects, the CC requested a number of behavioural undertakings. These undertakings were given by Centrica and CSL to the Secretary of State for Trade and Industry pursuant to Section 88 of the Fair Trading Act 1973 (the "undertakings").

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² given by Centrica and CSL to the Secretary of State for Trade and Industry pursuant to Section 88 of the Fair Trading Act 1973

The undertakings require CSL to seek our approval for changes to their contracts, and set out the processes that must be followed for changes to SSC and the alternative contracts used for non-standard products.

Application to modify the SSC

CSL notified us they intended to consult on changes to the SSC and alternative contracts (V store, I store and 30 day storage) on 15 August 2014 (the "contract modification proposals"). As required by the undertakings, we approved the consultation on the alternative contracts on 5 September 2014. On 12 September 2014, CSL published the two consultations on their website³, and sent copies of the consultations to Ofgem. CSL's rationale for these changes was set out in their consultation. In summary, CSL consider their contract modification proposals:

- Align the contracts with industry codes;
- Align the contracts with current commercial practice;
- Facilitate financing for customers; and,
- Improve transparency and clarity for current and potential customers.

CSL set out the proposed changes as:

- a. Consistency with the revised definition of the Gas Day scheduled for 1 October 2015, as set out in UNC modification 0461;
- b. Enhancing the scope for third party financing secured against gas in store, through expedited capacity assignment, which CSL think will attract more providers of financing and potentially assist current and potential customers to reduce their cost of capital;
- c. Termination in the case of long term force majeure events, which CSL think will thereby reduce disincentives to enter into multiyear contracts;
- d. Correcting out of date and incorrect references and definitions;
- e. Managing risk associated with bribery, corruption or trading sanctions by inserting appropriate contractual provisions; and,
- f. Improved clarity, transparency and on-going certainty of sales confirmation documents associated with purchasing products under the SSC and relevant contracts.

Changes b and c refer exclusively to the SSC modification.

CSL's consultations

The consultations closed on the 13 October 2014. CSL received two responses to the consultation on the SSC. Respondents were largely in favour of the proposed amendments, with some minor amendments suggested:

- b. *Third party financing* – respondents raised two questions, querying the rationale for the £1000 administration fee⁴ and suggesting more flexible financing arrangements through partial year and multi-lender financing options.

³ <http://www.centrica-sl.co.uk/index.asp?pageid=85>

⁴ Charged when a customer makes multiple requests for expedited assignment.

- c. *Long term force majeure* – respondents proposed to link compensation to the gas price at the time of termination and cancel all capacity charges from the point of termination.
- d. *Other corrections* – respondents identified an inconsistency in the definition of the winter period.
- e. *Anti-corruption and bribery* – respondents proposed to broaden the amendment to address the risks associated with other financial crimes.

CSL received no responses to the consultation on the alternative contracts.

CSL's views on consultation responses

As CSL did not receive any responses to the alternative contract consultation, they did not make any amendments to the versions of the contracts that were consulted on. CSL submitted an application to amend these contracts to us on 24 October 2014.

CSL's views on responses to the SSC consultation were:

- b. *Third party financing* – CSL considers the £1000 fee to be proportionate and based on the administrative cost of carrying out the expedited assignment process. CSL's view is that the current drafting provides the flexibility sought by respondents. In relation to multiple lenders, CSL say such arrangements can be accommodated via separate agreement between the borrower customer and lender customer.
- c. *Long term force majeure* – CSL rejected the proposal to link compensation under long-term force majeure to the gas price at the time of termination, as they thought this would not be consistent with the risk sharing principles underlying these provisions. CSL agreed that introducing a provision to cancel all capacity charges from the point of termination would be appropriate and consistent with risk sharing. CSL note that this change is beneficial for consumers.
- d. *Other corrections* – CSL amended the definition of the 'winter period' to ensure it was defined correctly and in line with operational practice. On further review of the proposed SSC, CSL also identified some further corrections to clarify cross-references, capacity confirmations and the difference between day-ahead and within-day nominations.
- e. *Anti-corruption and bribery* – CSL rejected the suggestion to broaden the amendment to address the risks associated with other financial crimes as they thought it would go beyond the intended scope. This scope was limited to ensuring compliance with the Bribery Act 2010.

We did not view CSL's proposed additional changes following consultation to be material, as they related to clarifying drafting or, in the case of long-term force majeure, amendments to provisions that were part of the original consultation. As a result, we told CSL they were not required to carry out further consultation. However, CSL took the view that further consultation, though not required, would be beneficial for market participants. They launched a seven day further consultation on 31 October 2014. This consultation closed on 7 November 2014.

CSL received one response to the further consultation, which agreed in full with all proposed minor amendments set out in the consultation. CSL submitted an application to amend the SSC to us on 7 November 2014.

Our views

a. Consistency with the revised definition of the Gas Day

CSL's proposed changes would amend the definition of the Gas Day for consistency with the UNC – in line with European network code requirements. They would also clarify provisions for nomination and renomination processes as a result of the changes. We agree these changes will improve consistency between the contracts and relevant legislation or codes.

b. Enhancing the scope for third party financing

The proposed changes would allow for expedited assignment of capacity to facilitate secured financing. We think this would help facilitate access to storage by allowing storage customers to gain secured financing on more attractive terms.

CSL intends to provide the first such assignment for free, but charge a £1000 fee for subsequent assignments. We agree it may be appropriate for CSL to charge a fee if the process incurs increased administrative costs. It is for CSL to ensure that the level of fee charged is appropriate and compliant with relevant requirements.

c. Inclusion of a long term force majeure clause

This change would provide for parties to terminate the contract in the case of a force majeure event of 12 months or more. This change is beneficial for Rough customers, and provides greater comfort for those signing long-term contracts.

We agree that linking compensation to gas prices at the time of termination would not be consistent with risk sharing, as it could expose CSL to risks that it is not best placed to manage. We are supportive of the changes proposed following consultation to remove the obligation to pay capacity charges following termination in the case of long term force majeure. This ensures customers aren't exposed to charges if the termination is due to a force majeure event.

d. Correcting out of date and incorrect references and definitions

CSL proposed a number of changes to correct errors and clarify drafting. Following the initial consultation, CSL made further such changes. We agree that these changes enhance clarity of the contracts and reduce risks of misinterpretation.

e. Managing risk associated with bribery, corruption or trading sanctions

The proposed changes aim to mitigate risks associated with breach of relevant bribery or corruption legislation. They also introduce a requirement for a customer to notify CSL if they become subject to sanctions that are binding on CSL. One respondent suggested a widening of this scope. We do not consider that there is sufficient evidence to support a widening of the scope and are content for CSL to maintain their original drafting.

f. Inclusion of sales confirmation documents as schedules

CSL propose to include confirmations as schedules to the contracts. We agree that this will increase transparency of the terms that apply to capacity sales and the types of unbundled capacity available. We also agree this will provide comfort that terms would not change without a consultation and approval process. We note CSL have also clarified the drafting of the confirmations, and we agree that these changes improve consistency and reduce the risk of misinterpretation.

Option to extend

The changes to sales confirmations also include scope for customers to negotiate for the right to extend agreements. We would be concerned if this had potential to cause negative impacts in terms of non-discrimination or access to storage. We have discussed these issues with CSL, who have clarified that safeguards will be put in place to mitigate these risks. These include:

- Volumes under an option to extend be included within the 80 per cent maximum of the Minimum Rough Capacity (MRC) volume that can be sold on a long-term (ie greater than annual) basis;
- 12 month advance notice is required to exercise an option to extend;
- Customers can only hold an option against capacity they have bought (eg cannot have an option that increases capacity holdings); and,
- Continued compliance monitoring will be undertaken.

We welcome these safeguards. We have carried out analysis to assess the historical price impacts of potential scarcity of Rough capacity. We did not find evidence of a significant price effect as Rough capacity sales increase towards their potential maximum for a given year. In any case, we think these safeguards should mitigate any risks arising from potential scarcity of Rough capacity.

Like other aspects of their contracts, it is CSL's responsibility to ensure that the option to extend arrangements are compliant with relevant legislation and the undertakings.

Overall view

In summary, we think the changes proposed by CSL improve the clarity of the contracts and their consistency with legislation and commercial arrangements. We also welcome CSL's proposals to introduce changes in response to customer requirements – such as the inclusion of provisions to facilitate third party financing. This shows innovation in marketing its products in response to customer needs. We do not consider that the changes proposed are likely to exacerbate the potential problems that the undertakings are seeking to address.

In accordance with paragraph 4 of Annex 1 and part B paragraph 8 of Annex B of the Undertakings, Ofgem has decided to approve the proposed changes to the SSC and the alternative contracts for the V store, I store and 30 day storage products.



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