

Gas storage facility owners and operators, gas shippers, gas suppliers and other interested parties

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Dear colleague

Final Decision – SSEHL’s application for a minor facilities exemption for Hornsea gas storage facility

On 27 February 2015, we published a consultation¹ on our initial view to reject the Minor Facilities Exemption (MFE) for the Hornsea gas storage facility owned and operated by SSE Hornsea Limited (SSEHL). This consultation closed on 24 April. We received three non-confidential responses to our consultation. We have considered the consultation responses, but the information provided has not led us to change our minded-to position. As a result, our decision is that nTPA is economically necessary at the Hornsea facility, and so SSEHL should not be granted an MFE. Our consultation sets out the detailed assessment of the MFE tests.

Background

SSEHL, a wholly-owned subsidiary of SSE plc, is the owner and operator of the Hornsea gas storage facility in East Yorkshire. Hornsea gas storage facility was developed by British Gas and came into operation in 1979. It has been owned by SSEHL since September 2002 when it was purchased from Dynegy Hornsea Ltd and has operated without an MFE thus far. Hornsea has storage capacity of 300 mcm, deliverability of 18 mcm/d and injectability of 2 mcm/d.

Since 1 May 2015, SSEHL has made a decision to reduce deliverability at the site by a third. Our understanding is that this mothballing is potentially temporary. However, the application related to the full historic capacity of the facility, so we have not taken this reduction into account in our decision.

Exemption criteria

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

The basis for our assessment approach is set out in our 2009 open letter². Our consultation explained why we thought that SSEHL did not meet the criteria for the MFE to be granted. We summarise our key findings below; you can find more detail in our consultation document.

¹ <https://www.ofgem.gov.uk/publications-and-updates/sse-hornsea-ltds-ssehl-application-minor-facilities-exemption-hornsea>

² <https://www.ofgem.gov.uk/publications-and-updates/gas-storage-minor-facility-exemptions-open-letter>

Our assessment of the application

Economically necessary

Our initial assessment was that the use of Hornsea by other persons is economically necessary for the operation of an efficient gas market. We reached this conclusion after considering a range of indicators. We considered whether any of the indicators suggest that granting the MFE could give SSE market power or distort the market. We focused this analysis on SSE as a group.

We used gas flexibility in GB as the relevant market. This is because the main service provided by gas storage is the ability for shippers to vary supply levels in response to changes in prices or demand. Other sources of supply can also provide flexibility, so we do not limit our focus to the storage market. This is consistent with our approach to previous MFEs and the Competition Commission's³ work on the Rough undertakings.

To assess which supply sources are substitutes for gas storage, we have analysed responsiveness to changes in price and demand. We specified three possible market definitions to account for different future scenarios. These scenarios are consistent with those used for the Stublach phase II MFE decision of June 2014⁴. We considered whether granting an MFE could lead to increased potential for market power by looking at market shares, market concentration, pivotality and vertical effects. Of these tests, our analysis of market shares raised concerns.

We calculated market shares under the definitions of the gas flexibility market outlined above. As set out in our consultation, SSEHL's market shares were significantly above those in previous decisions in most cases. This indicated there is potential for SSE to hold a degree of market power in the gas flexibility market if we granted the MFE. Our analysis did not indicate a dominant position. However, it did suggest a significant increase in the share of the flexibility market that SSE would hold without any of the safeguards that nTPA provides. This potential for market power creates risks that SSE could have the ability to distort the flexibility market.

On the basis of the concerns raised by our market share analysis, our conclusion was that access to Hornsea is economically necessary.

Technically necessary

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

Response to consultation

This consultation closed on 24 April. We received three non-confidential responses – from SSE Energy Supply Limited (SSEESL), SSEHL, and the Gas Storage Operators Group (GSOG). While SSEESL and SSEHL were in favour of the exemption, GSOG did not explicitly state a preference but raised issues outlined in Table 1 below. None of the respondents had specific comments on the detail of our analysis of the MFE tests; however some responses highlighted concerns surrounding our approach and assessment. We have responded to these issues in Table 1 below.

³ The Competition Commission closed on 1 April 2014. Its functions have transferred to the Competition and Markets Authority.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/final-decision-%E2%80%93-storengy-ukltds-application-minor-facilities-exemption-stublach-gas-storage-phase-2>

Table 1 Summary of consultation response concerns

Respondent	Issue	Response
(SSEESL) <i>(In favour of exemption)</i>	Exemption would allow SSEHL to offer services more flexibly than under nTPA.	While we appreciate that the nTPA regime can be more restrictive, this is not an argument within the context of the MFE tests.
GSOG	Lack of clarity between how we weight the outcomes of the different tests to assess economic necessity.	We do not have a definitive weighting; our decision is made on the balance of all tests. More detail is provided in the consultation.
SSEHL <i>(In favour of exemption)</i>	Burden of proof appears to have shifted from proving an adverse effect with Stublach, to proving there isn't one with Hornsea.	The tests are still the same; we must be satisfied that use of the facility by other persons is not technically or economically necessary for the operation of an efficient gas market. SSE with an MFE at Hornsea has market shares in excess of those of GDF with Stublach (our most recent MFE decision).
SSEHL	Lack of clarity surrounding market share definition selection.	We have used market shares consistent with our 2014 MFE decision for Stublach; these are explained in detail in the Hornsea and Stublach consultations.
SSEHL	Disagree with statement that "any one MRS facility is likely to be a very close substitute for Hornsea".	We are not referring to deliverability here, simply that all MRS facilities tend to respond to market signals in a similar way.
SSEHL	Included market share analysis of space which is not consistent with Stublach.	We included this as additional analysis relative to the Stublach consultation. The results of this analysis are not material to our recommended decision. Our concerns centre primarily on market shares of deliverability.

We have considered the consultation responses, but do not think any information has been provided that should lead us to change our minded-to position. In response to stakeholders' comments, we have provided further detail on our approach and assessment of the market tests. We believe that our original assessment still holds with regard to the economic necessity of the facility. As a result, our decision remains that nTPA is economically necessary at the Hornsea facility, and so SSEHL should not be granted an MFE.

Our final decision is to reject the exemption

We have considered SSEHL's application, the assessment we have carried out and responses to our consultation on that assessment. Based on this, we have decided to reject the application.

It should be noted that our decision on the exemption has been made on the basis of information provided by SSEHL in their application. As part of our ongoing market surveillance activities, we will continue to assess the effect of exemptions on the market.

If you have any questions about this letter, please contact Amy O'Mahoney (via wholesale.markets@ofgem.gov.uk).

Yours sincerely

**Frances Warburton
Partner, Wholesale Markets**