

29 October 2002

Rochelle Ladd  
Strategy and Corporate Transactions Manager  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Dear Ms. Ladd,

**SSE Energy Supply Limited's Completed Acquisition of Dynegy Hornsea Limited's Gas Storage Facility  
A Response from Centrica plc to the Ofgem Consultation**

This response represents the views of the Centrica Group of companies and therefore includes British Gas Trading Limited and Accord Energy.

We agree with the need to maintain undertakings based on those previously given BG Storage Limited and by Dynegy at the time of its purchase of the Hornsea storage facility. Our letter to the Office of Fair Trading dated 21<sup>st</sup> October sets out how we would envisage them going forward. We therefore attach a further copy of our letter to the OFT in this respect.

The Ofgem consultation paper invited response in relation to four key areas and our views on these are set out below.

**Competition In and Substitutes for Storage**

We do not believe that Rough and Hornsea being under separate ownership will, of itself, lead to greater competition in the storage market. This is partly due to the different characteristics of each facility to each other and to Transco's LNG storage. In our view, the consultation paper underplays the importance of the fact that, for the UK gas security criteria to be met, Hornsea (and Rough) need to be fully sold and utilised (in view of the overall shortage of flexible storage capacity) and Transco needs to ensure that such sites are fully utilised. The Network Code Top Up rules require Transco to book any spare capacity – this process thereby means storage operators are indifferent about who they sell capacity to and hence could set high prices for storage capacity.

Furthermore, we do not believe it is currently appropriate to regard sites for which planning permission has been granted but in respect of which no development work has yet started to provide any form of competition in the storage market today. In view of the costs involved of developing such facilities, it is by no means certain, even if planning permission is in place, that any development will commence. In any

event, the planning permission alone does not exert significant, if any, competitive pressure.

We therefore strongly recommend that undertakings are necessary to address the market power which will be exhibited by SSE as owner of the Hornsea facility.

### **SSE's Access to Storage and Other Forms of Flexibility/SSE's Vertical Integration**

We do not regard the vertical integration which will be displayed by SSE as a result of this transaction as a problem. This is not so much based on the low level of shipping and gas supply market shares demonstrated by the SSE Group but more based on the fact that, if the undertaking regarding the separation between storage and trading is put in place (as we recommend and as we note Ofgem recommends), there will be no advantage placed upon the supply and trading businesses of the SSE Group by having storage within the Group. When seeking storage services, the trading arm of SSE will be in no better or worse position than any other third party user of those storage facilities. The undertakings which ensure that all capacity is used or marketed mean that other storage users are not disadvantaged by the ownership (the undertakings should aim to prevent SSE from using their market power to artificially inflate storage prices). For this reason, the undertaking in this respect is essential.

We do not believe that vertical integration between gas storage and electricity generation is an issue here nor, for the reasons already set out, does the ownership by SSE of a storage facility alongside its existing gas supply function raises any concern.

### **Undertakings**

As set out above (and in our response to the OFT), we fully support binding undertakings from SSE. However, we recommend a set of undertakings which are broader in scope but more focussed on specific issues than those given by Dynegy.

We agree with the comments made in the consultation paper relating to market sensitive information and the need for an undertaking in this respect. It is our view that the separation envisaged by Ofgem is necessary but must be complemented by an undertaking that SSE as storage operator will not use such information to inform its trading business (as set out in our letter to the OFT).

The undertakings (assurances) previously given by BG Storage Limited and those now in place from Dynegy were expected to expire in 2004 (based on the view taken in 1998-9 of the storage market and competition therein in the future). It is our view that undertakings given by SSE should endure beyond 2004, on the basis that the level of competition in the storage market by 2004 is unlikely to be significantly different to the present situation.

We therefore suggest that the undertakings given by SSE are framed to last beyond 2004 – possibly for an initial period of 4/5 years reviewable. This will, we believe, provide clarity at this stage and going forward for users of the storage facility and for SSE (in view of the need for capacity beyond 2004 to be available for booking now). The consultation paper appears to suggest that undertakings will be sought only to 2004 as a result of this transaction and that a further market review will be held. We believe that this two stage process will not provide the necessary clarity.

We are not clear why these undertakings are being suggested on an informal basis rather than as undertakings given pursuant to the Fair Trading Act in lieu of a reference to the Competition Commission. However, if the OFT is minded to recommend to the Secretary of State that there is no public interest concern with this merger, such that a reference is highly unlikely, then obviously informal undertakings to Ofgem by SSE would be necessary (although every attempt should be made to make them binding).

If you have any questions regarding this response please do not hesitate to contact me on 0208 734 9372.

Yours sincerely,

Sarah Whittingham  
Principal Legal Counsel