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25 November 2004

Dear Colleague,

The Second EU Gas Directive and storage regulation Great Britain

As a result of the coming into force of the Second EU Gas Directive there have been a number of important changes made to the legal and regulatory framework applying to gas storage facilities in Great Britain (GB). The purpose of this letter is to provide a brief summary of these changes and their impact on new and proposed gas storage facilities. The letter sets out in more detail:

- ◆ the changes to the third party access (TPA) arrangements for gas storage in GB;
- ◆ the routes available to exemption from these TPA arrangements;
- ◆ the process for applying for exemptions¹; and
- ◆ how Ofgem would assess applications for exemptions from storage operators and the information and analysis that should accompany an application for an exemption.

Background

The First Gas Directive

Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 (the First Gas Directive)² established common rules for the transmission, distribution, supply and storage of natural gas. The First Gas Directive, amongst other things, required Member States to ensure TPA to transmission and distribution networks, and gas and LNG storage facilities.

The First Gas Directive gave Member States the option to meet these requirements through implementing either a negotiated or regulated TPA regime. The access requirements of the First Gas Directive can be found in full in Chapter VI of the Directive. A summary of the access requirements is given below.

¹ The 2004 Regulations also amended the Gas Act 1986 to introduce TPA (and an associated exemption regime) for LNG import facilities. However, this letter is concerned only with the changes to the Gas Act 1986 in respect of gas and LNG storage regulation.

² http://europa.eu.int/eur-lex/pri/en/oj/dat/1998/l_204/l_20419980721en00010012.pdf

- Under both the negotiated and regulated regimes, storage operators are required not to discriminate between parties or classes of parties, particularly in favour of related undertakings (Article 7).
- Under both the negotiated and regulated regimes, storage operators can only refuse access to the facility on the basis of lack of capacity; where the access to the facility would prevent them from carrying out their public-service obligations; or where the access to the facility would cause the storage operator serious economic and financial difficulties as a result of take-or-pay contracts being in place (Article 17).
- Under the negotiated regime, parties must be able to negotiate access to storage facilities so as to conclude voluntary commercial agreements for supply. In addition, negotiations for access are to take place in good faith and any disputes relating to the negotiations for access are to be settled by a competent authority. Further, storage operators are required to publish their main commercial conditions for the use of the facility system within the first year following implementation of the First Gas Directive and then on an annual basis (Article 15).
- Under the regulated regime, parties must be given a right of access to the storage facility on the basis of published tariffs and/or other terms and obligations for use of the facility (Article 16).

On the basis that the gas storage industry had been deregulated in GB, and that competition in the market for gas storage services was increasing, the Department of Trade and Industry (DTI), who were responsible for transposing the First Gas Directive into GB law, decided, after public consultation, to implement a 'light touch' regime for access to gas storage. The DTI chose to implement a negotiated regime for access to storage and also introduced an exemption regime whereby Ofgem could exempt storage facilities from all or some of the TPA provisions on the basis that certain criteria set out in the Gas Act 1986 had been met.³

The Gas (Third Party Access and Accounts) Regulations 2000

The First Gas Directive was transposed into GB law by the Gas (Third Party Access and Accounts) Regulations 2000 (the 2000 Regulations) on 10 August 2000, amending the Gas Act 1986. The 2000 Regulations inserted sections 19A to 19D into the Gas Act 1986.

Sections 19B and 19D of the Gas Act 1986 required gas storage facilities and LNG storage facilities respectively to provide negotiated TPA consistent with the requirements in the First Gas Directive. Section 19A provided Ofgem with the ability to exempt gas storage facilities from the TPA arrangements in section 19B. Section 19C provided Ofgem with the ability to exempt LNG storage facilities from the TPA arrangements in section 19D. The only material difference between the two sets of exemption arrangements put in place in sections 19A and 19C was in respect of the exemption criteria.

For gas storage facilities, section 19A provided two routes for exemption: the facility could be exempt if either certain requirements of the TPA arrangements in section 19B were already met with respect to the facility concerned by existing market arrangements which promoted competition; or use of the facility concerned was not necessary for the operation of an economically efficient gas market.

³ "Implementation of those provisions of Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas: Consultation document", DTI, May 2000.

Section 19C, however, provided only the first route for exemption for LNG storage facilities, i.e. if certain requirements of the TPA arrangements in section 19D were already met with respect to the facility concerned by existing market arrangements which promoted competition.

During the period that this exemption regime was in place, Ofgem granted exemptions from TPA to three gas storage facilities (Hatfield Moor, owned by Scottish Power; Hole House, owned by Energy Merchant Gas Storage (UK) Limited; and Humbly Grove, owned by Star Energy) and each of the five LNG storage facilities owned by Transco LNG.

The two other existing gas storage facilities, Rough, owned by Centrica Storage Ltd, and Hornsea, owned by Scottish and Southern Energy, are both subject to the TPA requirements in section 19B of the Gas Act (Centrica Storage Ltd has also provided written undertakings in respect of the Rough gas storage facility).

Details of the status of existing and publicly known potential future storage facilities are set out in Appendix 1 to this letter.

The Second Gas Directive

The Second Gas Directive, concerning common rules for the internal market in natural gas, repealed the First Gas Directive. The Second Gas Directive, amongst other things, amended the requirements for TPA for transmission and distribution networks (including interconnectors), LNG import facilities, and gas and LNG storage facilities.

In relation to the TPA arrangements for gas and LNG storage facilities, Article 19 of the Second Gas Directive retained the option for Member States to meet the TPA requirements through implementing either a negotiated or regulated TPA regime.

Article 22 of the Second Gas Directive permits exemptions to be given to major new gas infrastructures⁴, including gas and LNG storage, from the TPA requirements contained in the Directive. The Second Gas Directive sets out that an exemption may, upon request, be granted by a competent authority under the following conditions:

- (a) the investment must enhance competition in gas supply and enhance security of supply;
- (b) the level of risk attached to the investment is such that the investment would not take place unless an exemption was granted;
- (c) the infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built;
- (d) charges are levied on users of that infrastructure;
- (e) the exemption is not detrimental to competition or the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.

Where the relevant authority reaches a decision to grant an exemption, the Second Gas Directive requires that this decision be notified to the European Commission. The European

⁴ The exemption provisions apply also to significant increases of capacity in existing infrastructures and modifications of such infrastructures which enable the development of new sources of gas supply.

Commission then has two months after receiving a notification of an exemption decision in which it may request that the regulatory authority or the Member State concerned amend or withdraw the decision to grant an exemption.⁵

The DTI initiated a consultation in February 2004 on the implementation of the Second Gas Directive⁶. The DTI was of the view that, as a consequence of the liberalised, competitive market in GB, and the regulatory regime currently in place, GB was broadly compliant with the requirements of the Directive. In relation to gas and LNG storage, the DTI was of the view that the negotiated TPA regime set out in the Gas Act 1986 would not need to be significantly amended. However, the DTI considered that amendments to the Gas Act 1986 were needed in order to implement the exemption procedure for major new gas infrastructures set out in Article 22 of the Second Gas Directive.

The Gas (Third Party Access and Accounts) Regulations 2004

The Second Gas Directive was transposed into GB law by the Gas (Third Party Access) Regulations 2004 (the 2004 Regulations), which came into force on 26 August 2004. Appendix 2 to this letter sets out a consolidated copy of the relevant elements of the Gas Act 1986 in relation to the exemption regime and TPA requirements for gas and LNG storage. The 2004 Regulations made a number of amendments to the exemption regime and TPA requirements for gas and LNG storage facilities set out in the Gas Act 1986.

First, in order to put in place a regulated access regime for LNG import terminals, sections 19A and 19B of the Gas Act 1986 were amended to include the exemption regime and TPA requirements respectively for both gas and LNG storage facilities. Sections 19C and 19D were amended to address LNG import facilities.

Second, although the 2004 Regulations did not make any material changes to the nature of the negotiated TPA arrangements for gas and LNG storage, a number of significant changes were made to the exemption regime. Most significantly, the exemption regime for gas and LNG storage facilities now distinguishes between existing storage facilities and new storage facilities (including significant increases in capacity, which are referred to as 'upgraded facilities' in this letter).

Existing storage facilities with an exemption

As set out earlier in this letter, during the period that the previous exemption regime was in place, Ofgem granted three exemptions. The exemptions granted prior to 26 August 2004 under section 19A of the Act in respect of gas storage facilities (i.e. Hatfield Moor, Hole House, and Humbly Grove) are unaffected by the coming into force of the 2004 Regulations. Further, the exemptions granted prior to 26 August 2004 under section 19C of the Gas Act in respect of LNG storage facilities (i.e. each of the five LNG storage facilities owned by Transco LNG) are treated as having been granted under section 19A of the Gas Act and therefore are unaffected by the coming into force of the 2004 Regulations.⁷

⁵ This two month period may be extended by one additional month where additional information is sought by the European Commission.

⁶ "Implementation of EU Directive 2003/55 Concerning Common Rules for the Internal Market in Gas. Consultation", DTI, February 2004.

⁷ Regulation 3 of the 2004 Regulations.

Existing storage facilities without an exemption

For existing storage facilities without an exemption, section 19A of the Gas Act now provides only one route for exemption: the facility can be granted an exemption only if use of the facility by other persons is not necessary for the operation of an economically efficient gas market.⁸

New facilities

For new storage facilities or for existing facilities which are, or are to be, upgraded, section 19A of the Act now provides two routes for exemption: the facility can be granted an exemption if either: use of the facility by other persons is not necessary for the operation of an economically efficient gas market; or, if the six exemption requirements contained in section 19A(8) of the Gas Act 1986 are met. The six exemption requirements are set out below:

- (a) the facility or the significant increase in its capacity will promote security of supply;
- (b) the level of risk is such that the investment to construct the facility or to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption;
- (c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility;
- (d) charges will be levied on users of the facility or (as the case may) the increase in its capacity;
- (e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility; and
- (f) the Commission of the European Communities is or will be content with the exemption.

It should be noted that it is against these exemption requirements that Ofgem will assess any application for exemption rather than the five conditions specified in the Second Gas Directive which were set out earlier in this letter. However, Ofgem does not consider that there are any material differences between the two sets of criteria.

Application process

Appendix 3 to this letter provides further detail on the application process and further guidance in relation to the operation of the exemption regime as it relates to gas and LNG storage.


Conclusions

In this letter Ofgem has provided an overview of the amendments made to the TPA and exemption regime for existing and new gas storage facilities following the coming into force of the Gas (Third Party Access) Regulations 2004 on 26 August 2004.

⁸ Section 19A(5).

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number or Matt Buffey on 020 7901 7088.

Yours sincerely

A handwritten signature in black ink, consisting of several overlapping, fluid strokes that form a stylized representation of the name 'Steve Smith'.

Steve Smith
Managing Director, Markets

Appendix 1: Summary of existing and publicly known proposed storage facilities⁹

| Projected Start date | Storage facility | Owner | TPA status | Space (GWh) | Deliverability (GWh/d) | Injectability (GWh/d) |
|---|---------------------------------|--|---|-------------|------------------------|---------------------------|
| <i>Existing gas storage facilities</i> | | | | | | |
| N/A | Rough | Centrica Storage Limited | Required to provide Gas Act TPA. Also provided undertakings | 30300 | 455 | 160 |
| N/A | Hatfield Moor | Scottish Power | Exempt | 1260 | 25 | 25 |
| N/A | Hornsea | Scottish and Southern Energy (SSE) | Required to provide Gas Act TPA | 3495 | 195 | 21.6 |
| N/A | Hole House | Energy Merchant Gas Storage (UK) Limited | Exempt | 300 | 90 | 120 |
| <i>Existing LNG storage facilities</i> | | | | | | |
| N/A | Avonmouth | Transco LNG | Exempt | 876 | 156 | 2.3 |
| N/A | Partington | Transco LNG | Exempt | 1121 | 219 | 2.4 |
| N/A | Dynevor Arms | Transco LNG | Exempt | 304 | 49 | 2.6 |
| N/A | Glenmavis | Transco LNG | Exempt | 505 | 101 | 1.6 |
| <i>Planned storage facilities</i> | | | | | | |
| Q4 2005 | Humbly Grove | Star Energy | Exempt | 3146 | 79 | 90 |
| First cavity Q3 2006 Second cavity Q3 2008 | Hole House (increased capacity) | Energy Merchant Gas Storage (UK) Limited | Formally applied for exemption for increased capacity | 150 | N/A | N/A |
| 2007 | Welton and Scampton North | Star Energy | Not applied | 4720 | 89 | Information not available |
| Mid 2007 | Caythorpe | Warwick Energy | Not applied | 2000 | 80 | 80 |
| 2007/08 | Aldbrough | SSE/Statoil | Not applied | 4427 | 421 | 211 |
| 2007/08 | Byley | Scottish Power | Not applied | 1758 | 175 | 88 |
| 2007/08 | Fleetwood | Cantaxx | Not applied | 18000 | 1200 | 1200 |

⁹ The data in this appendix has been provided to Ofgem directly by the relevant storage facility owners.

Appendix 2: Sections 19A, 19B and 19E of the Gas Act

Please note that the following text has been produced by Ofgem and is not an official consolidated version of the Gas Act 1986 as amended by the Gas (Third Party Access) Regulations 2004.

19A Application of section 19B to storage facilities

- (1) Section 19B applies to a storage facility unless, or except to the extent that, its capacity is exempt under this section.
- (2) A person who is or expects to be an owner of a storage facility may apply in writing to the Authority for an exemption with respect to the facility.
- (3) An exemption shall be given in writing and may be given—
 - (a) so as to have effect for an indefinite period or for a period specified in, or determined under, the exemption;
 - (b) unconditionally or subject to such conditions as the Authority considers appropriate;
 - (c) so as to have effect—
 - (i) in the case of a facility other than a new facility, in relation to the whole of the capacity of the facility; or
 - (ii) in the case of a new facility, in relation to the whole of the capacity of the facility or any significant increase in the capacity of the facility.
- (4) An exemption may be revoked in accordance with its provisions and, in any event, may be revoked by giving a notice of revocation to the owner of the facility concerned not less than four months before the coming into force of the revocation.
- (5) The Authority shall give an exemption with respect to a facility (other than a new facility) where it is satisfied that use of the facility by other persons is not necessary for the operation of an economically efficient gas market.
- (6) The Authority shall give an exemption with respect to a new facility where it is satisfied that either—
 - (a) use of the facility by other persons is not necessary for the operation of an economically efficient gas market; or
 - (b) the requirements of subsection (8) are met.
- (7) In respect of a facility which is or is to be modified to provide for a significant increase in its capacity, an exemption by virtue of subsection (6)(b) may only be given in relation to that increase in its capacity.

(8) The requirements of this subsection are that—

- (a) the facility or (as the case may be) the significant increase in its capacity will promote security of supply;
- (b) the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption;
- (c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility;
- (d) charges will be levied on users of the facility or (as the case may) the increase in its capacity;
- (e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility; and
- (f) the Commission of the European Communities is or will be content with the exemption.

(9) Subject to subsection (10), an exemption may not be given by virtue of subsection (6)(b) more than once in respect of the same facility.

(10) Subsection (9) does not prevent a further exemption being given by virtue of subsection (6)(b) in respect of a facility if—

the facility is or is to be modified to provide for a significant increase in its capacity;

the exemption has effect only in relation to that increase in its capacity; and

no previous exemption has been given by virtue of subsection (6)(b) in relation to that increase in its capacity.

(11) The Authority shall publish its decision to give or refuse to give an exemption together with the reasons for its decision in such manner as it considers appropriate.

19B Acquisition of rights to use storage facilities

- (1) The owner of a storage facility to which this section applies (a “relevant facility”)—
 - (a) shall publish at least once in every year the main commercial conditions relating to the grant to another person of a right to have gas or liquid gas stored in the facility on that person’s behalf; and
 - (b) shall publish any changes to the published conditions as soon as they become effective.
- (2) In subsection (1) “year” means any year ending with 9th August.
- (3) The owner of a relevant facility shall ensure that the conditions which he is required to publish under subsection (1) do not discriminate against any applicants or descriptions of applicants, or any potential applicants or descriptions of potential applicants, for a right to have gas or liquid gas stored in the facility.
- (4) Any person who seeks a right to have gas or liquid gas stored on his behalf in a relevant facility (“the applicant”) shall, before making an application to the Authority under subsection (8), apply to the owner of the facility for the right.
- (5) An application under subsection (4) shall be made by giving notice to the owner specifying what is being sought.
- (6) Such a notice shall, in particular, specify—
 - (a) the period during which the gas or liquid gas is to be stored in the facility;
 - (b) the kind of gas or liquid gas to be stored (which must be of, or similar to, the kind which the facility is designed to store); and
 - (c) the quantities of gas or liquid gas to be stored.
- (7) Where an applicant gives notice under subsection (5), he and the owner of the facility shall negotiate in good faith and endeavour to reach agreement on the application.
- (8) If the owner and the applicant do not reach any such agreement, the applicant may apply to the Authority for directions under subsection (11) which would secure to the applicant the right specified in the notice under subsection (5).
- (9) The Authority shall not entertain an application under subsection (8) unless it is satisfied that the parties have had a reasonable time in which to fulfil their duties under subsection (7).
- (10) Where a person applies to the Authority under subsection (8) and the Authority is satisfied as mentioned in subsection (9), the Authority shall—
 - (a) decide whether the application is to be adjourned (so as to enable further negotiations to take place), considered further or rejected;

(b) give notice of its decision to the applicant; and

(c) in the case of a decision that the application is to be considered further, give to the owner of the facility, the Health and Safety Executive and any person who has a right to have gas or liquid gas stored in the facility notice that the application is to be so considered and an opportunity of being heard on the matter.

(11) Where, after considering an application under subsection (8), the Authority is satisfied that the giving of directions under this subsection would not prejudice the efficient operation of the facility, or the storage in the facility of—

(a) the quantities of gas or liquid gas which the owner of the facility requires or may reasonably be expected to require to be stored in the facility; and

(b) the quantities of gas or liquid gas which any person who has a right to have gas or liquid gas stored in the facility is entitled to require to be so stored in the exercise of that right;

the Authority may give such directions to the owner of the facility.

(12) Directions under subsection (11) may—

(a) specify the terms on which the Authority considers the owner of the facility should enter into an agreement with the applicant for all or any of the following purposes—

(i) for securing to the applicant the right to have stored in the facility, for the period specified in the directions and in the quantities so specified or determined by or under the directions, gas or liquid gas which is of a kind so specified;

(ii) for securing that the exercise of that right is not prevented or impeded;

(iii) for regulating the charges which may be made for the storage of gas or liquid gas by virtue of that right;

(iv) for securing to the applicant such ancillary or incidental rights as the Authority considers necessary or expedient (which may include, in particular, a right to have a pipeline of his connected to the facility by the owner);

(b) specify the sums or the method of determining the sums which the Authority considers should be paid by way of consideration for any such right; and

(c) require the owner, if the applicant pays or agrees to pay those sums within a period specified in that behalf in the directions, to enter into an agreement with him on the terms so specified.

19E Sections 19A to 19D: supplemental¹⁰

(1) In sections 19A to 19DA and this section—

“accounting information” means such accounting records as would be required by section 221 of the Companies Act 1985 in respect of each of the storage or (as the case may be) treatment activities undertaken by the owner of the facility if those activities were the only business undertaken by the owner and the owner were a person to whom that section applied;

“LNG import facility” means a facility for the following—

- (a) the importation of liquid gas;
- (b) the regasification of liquid gas following its importation and prior to its conveyance to a pipeline system operated by a gas transporter; and
- (c) any temporary storage of liquid gas which is necessary for the operation of the facility;

“main commercial conditions” means—

- (a) in the case of a storage facility, such information as would enable a potential applicant for a right to have gas or liquid gas stored in the facility to make a reasonable assessment of the cost of, or the method of calculating the cost of, acquiring that right;
 - (aa) in the case of an LNG import facility, the terms setting out the cost or the method of determining the cost of acquiring the right to have liquid gas treated in the facility;
- (b) the other significant terms on which such a right as is mentioned in paragraph (a) or (aa) would be granted; and
- (c) such additional information as the Authority may from time to time specify by notice;

“new facility” means—

- (a) a storage facility the construction of which is or is to be completed after 3rd August 2003; or
- (b) a storage facility the modification of which to provide for a significant increase in capacity is or is to be completed after 3rd August 2003;

“owner” in relation to a storage facility or an LNG import facility includes any person occupying or having control of the facility;

“significant transaction” means—

¹⁰ This section of the Gas Act includes provisions for both gas and LNG storage facilities and LNG import facilities.

(a) any transaction which relates to rights to have gas or liquid gas stored in a storage facility, or (as the case may be) liquid gas treated in an LNG import facility; and

(b) any other transaction which is of a description specified from time to time by the Authority by notice;

“storage”, in relation to liquid gas in a storage facility, includes any liquefaction of gas or regasification of liquid gas ancillary to the storage of liquid gas, and “stored”, in relation to liquid gas in a storage facility, shall be construed accordingly;

“storage facility” means a facility in Great Britain (excluding the territorial sea adjacent to the United Kingdom) for either or both of the following—

(a) the storage of gas in cavities in strata or in porous strata, provided that the facility is or will be used for the storage of gas which has previously been conveyed in a pipeline system operated by a gas transporter;

(b) the storage of liquid gas;

but the reference in paragraph (b) to the storage of liquid gas does not include such temporary storage as is mentioned in paragraph (c) of the definition of “LNG import facility”; and

“treatment”, in relation to liquid gas in an LNG import facility, includes importation, temporary storage and regasification, and “treat” shall be construed accordingly.

(2) For the purpose of considering an application under section 19B(8) or 19D(8), the Authority may by notice require the owner of the relevant facility to provide him with accounting information and details of the main commercial terms of any significant transactions with associated undertakings.

(3) Owners of relevant facilities shall keep their internal accounts in such manner as will enable them to provide accounting information if required to do so by a notice under subsection (2).

(4) For the purposes of sections 19B and 19D, an undertaking is an associated undertaking of another undertaking if one of the undertakings has control of the other, or both undertakings are under the control of the same person or persons; and subsections (2) to (5) of section 416 of the Income and Corporation Taxes Act 1988 shall apply with any necessary modifications for the purposes of this subsection as they apply for the purposes of Part XI of that Act.

(5) Any reference in section 19B to a right to have gas or gas of any kind, or liquid gas or liquid gas of any kind, stored in a storage facility includes a reference to a right to introduce into, or take out of, such a facility gas or gas of that kind, or liquid gas or liquid gas of that kind.

Appendix 3: Application process and the operation of the new exemption regime

As set out earlier, a number of important amendments have been made to the exemption regime by the 2004 Regulations. A number of these issues have been addressed previously in this letter, however, Ofgem considers it would be beneficial to clarify its policy further in regard to the application process and the operation of the new exemption regime.

Application process

Ofgem considers that, where appropriate, an application for exemption, whether for exemption on the basis that use of the facility concerned is not necessary for the operation of an economically efficient gas market or on the basis that the six 19A(8) requirements are met, should include an appropriate competition analysis. The only instance in which Ofgem considers that a competition analysis would not be required is in the case of a very small storage facility where it is self evident that the facility is not necessary for the operation of an economically efficient gas market.

Ofgem does not consider it appropriate for it to set out in detail what it considers would be an appropriate competition analysis. However, Appendix 1 of Ofgem's consultation in respect of the impact of the Directive on regulation of LNG import facilities and interconnectors¹¹ sets out a possible framework for such an analysis. It is important to note that the 'relevant market' for storage should include the 'flexibility' market as well as the market for 'space'¹².

Split ownership

The Gas Act 1986 sets out that it is the owner (or the person who expects to be the owner) of a storage facility that may apply in writing to the Authority for an exemption with respect to the facility. It is Ofgem's view that, where there is split ownership of the facility itself (i.e. where company A has rights over 50 per cent of the storage capacity in the facility and company B has rights over the remaining 50 percent), each company may apply for an exemption for the capacity of the facility over which it has ownership rights. Ofgem considers that this view is consistent with the definition of 'owner' in section 19E of the Act, which is given as "...in relation to a storage facility ... [owner] includes any person occupying or having control of the facility".

"Necessary for the operation of an economically efficient gas market"

With regard to granting exemptions where use of the facility concerned is not necessary for the operation of an economically efficient gas market, consistent with its operation of the previous exemption regime, it is Ofgem's view that, although measures of market share will inform any assessment of market power, Ofgem does not consider that it is appropriate to specify a storage capacity figure below which it considers that use of the facility concerned is not necessary for the operation of an economically efficient gas market. First, Ofgem is of the view that such a level is likely to change over time. Second, Ofgem is of the view that it would be inappropriate to rely on such measures alone since other factors, such as the operating characteristics of the facility and how such a facility would be likely to be used, would also need to be considered.

¹¹ "LNG facilities and interconnectors, EU legislation and regulatory regime, DTI/Ofgem initial views", Ofgem, June 2003.

¹² For relevant storage markets please see chapter 5, "Centrica plc and Dynegy Storage Ltd and Dynegy Onshore Processing UK Ltd: A report on the merger situation", Competition Commission, August 2003.

The six exemption requirements for new and upgraded facilities

The six exemption requirements for new and upgraded storage facilities are contained in section 19A(8) of the Act and are set out earlier in this letter. Ofgem's interpretation of these criteria, and hence the six 19A(8) requirements, has been set out in a number of previous consultations¹³ and therefore Ofgem does not consider it necessary to address these issues in detail in this letter.

However, Ofgem would like to emphasise that, consistent with its operation of the previous exemption regime, it does not consider that it is appropriate to specify in advance what pricing and/or access arrangements it would consider would facilitate the six 19A(8) requirements being met (in particular requirements (a) and (e)). It is Ofgem's view that it would be more appropriate to evaluate each exemption application on a case-by-case basis (for instance whether the facility owner has, or will be, making an initial offer of capacity to market, i.e. an "open season" and/or whether effective secondary trading and anti-hoarding mechanisms will be in place, i.e. Use It or Lose It (UIOLI) arrangements).

Conditions for the withdrawal of an exemption

Consistent with its operation of the previous exemption regime, Ofgem remains of the view that an exemption can include conditions specific to the facility, for example if there are market power concerns at the time of application for an exemption. Ofgem remains of the view that an exemption given on the basis of certain conditions being met can be revoked where these conditions cease to be met as the result of any action or omission of the facility owner, facility operator, or capacity holder.

With regard to exemptions granted on the basis that use of the facility concerned is not necessary for the operation of an economically efficient gas market since, in Ofgem's view, there is a general trend to increasing competition in the gas storage market, Ofgem considers that it would be unlikely that such an exemption would be revoked.

With regard to exemptions granted on the basis that the six 19A(8) requirements are met, Ofgem considers that there will remain grounds for revocation of an exemption. These grounds are:

- i. there is a material decrease in the degree to which the requirements of sub-sections 19A(8)(a), (c), (d) or (e) of the Gas Act 1986 are met with respect to the facility as the result of any action or omission of the facility owner, facility operator, or capacity holder;
- 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) of the whole or any material part of its assets or undertaking appointed;
- iii. the facility owner has an administration order under section 8 of the Insolvency Act 1986 made in relation to it;
- iv. the facility owner is found to be in breach of the Competition Act 1998; or

¹³ "LNG facilities and interconnectors, EU legislation and regulatory regime, DTI/Ofgem final views", DTI/Ofgem, November 2003; "Gastransport Services, Draft application for an exemption for the Balgzand Bacton Pipeline project (BBL), final views", Ofgem, December 2003; "Qatar Petroleum and ExxonMobil, Draft Gas Directive Exemption Application for an LNG Terminal at Milford Haven, final views", Ofgem, February 2004; "Dragon LNG Ltd, Draft application for an exemption for the Milford Haven LNG import terminal, final views", Ofgem, June 2004. "Application by Grain LNG Ltd under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986, initial views", Ofgem, October 2004'.

- v. there is merger or acquisition activity in relation to, or by the facility owner, that is detrimental to competition.

Ofgem would also like to note that, since any analysis it conducts in relation to an exemption request will have been undertaken on the basis of the facts put to it, any material changes in this underlying data could represent grounds for revocation or amendment of the exemption.

That is not to say that an exemption will automatically be revoked should there be material changes in the nature of the facility. Rather, that it would be open to Ofgem to review the appropriateness of the exemption remaining in place in the event that any of the specified circumstances arise. If grounds for revocation did arise, the likely process that Ofgem would follow would be to enter into discussions with the party or parties involved to establish whether any of the conditions have not been met. Ofgem would then expect, in the absence of a need to act urgently, to give the party or parties involved the opportunity in reasonable timescales to remedy the circumstances which have caused the breach of the condition. In the event that in reasonable timescales the party or parties involved have not remedied the circumstance which has caused the breach of the condition, Ofgem would at this stage consider whether the exemption order should be revoked.

Consistent with its operation of the previous exemption regime, in the event that an exemption was revoked, Ofgem would expect to, at the very least, publish a notice on its website. In addition, where a conditional exemption was to be revoked, Ofgem would consult before any decision and outline the reasons for revocation.