



Shippers, relevant gas transporters
and other interested parties

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Your Ref:
Our Ref:
Direct Dial: 020 7901 7172
Email: sonia.brown@ofgem.gov.uk

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Dear Colleague,

Decision on the proposed treatment under section 19A of the Gas Act 1986 of gas storage facilities with split ownership

After careful consideration of respondents' views and the issues raised, Ofgem has taken the decision to adopt a policy which it considers allows it the maximum flexibility in which to assess applications for exemption from third party access (TPA) under section 19A(6)(a) of the Gas Act 1986 (the Gas Act). In situations where there is more than one owner of a new storage facility, this decision will enable:

- ◆ each party to apply for a separate exemption for its respective share of the new facility;
- ◆ Ofgem to grant an exemption in respect of part of the capacity of that facility; and
- ◆ Ofgem to consider such factors as the contractual arrangements for the facility when considering applications for exemption for such facilities.

This letter sets out the background to this decision, the responses received to Ofgem's consultation on this issue and the reasons for Ofgem's decision.

Background

On 22 September 2005, Ofgem issued a consultation in respect of the proposed treatment under section 19A of the Gas Act of new gas storage facilities with split ownership (the September consultation).¹

The September consultation aimed to inform Ofgem's considerations on how it should approach applications for exemption from TPA under the de minimis criteria, where the ownership of the new relevant facility is split between two or more parties. Ofgem noted in the September consultation that although the consultation had been prompted by applications for exemption

¹ 'Consultation on the proposed treatment under section 19A of the Gas Act 1986 of gas storage facilities with split ownership', Ofgem, September 2005.

from Scottish and Southern Energy Plc and Statoil (UK) Limited in respect of each of their shares of the Aldbrough gas storage facility, Ofgem was not seeking views at that stage on whether an exemption should be granted in respect of the applications made for the Aldbrough facility, but was solely seeking views from market participants on the approach to adopt in relation to applications under section 19A(6)(a) of the Gas Act, where a facility has more than one owner.

Respondents' views

Twelve responses were received to the consultation from a wide range of stakeholders (including customers, shippers, storage owners). A copy of the non-confidential responses can be found on the Ofgem website.² The views of the respondents are summarised below.

In addition to consulting with industry, Ofgem has also discussed these issues with the European Commission, who consider that the decision on the exact treatment of such cases should be left to the Member State. Ofgem also brought the matter to the attention of the European gas focus group, which raised no concerns on the issue.

Should Ofgem allow separate applications and partial exemptions?

The majority of respondents considered that it was appropriate for Ofgem to allow separate applications and partial exemptions, with only two respondents considering that it was not appropriate to allow such applications.

Respondents that were in favour considered that the regulatory regime should be structured in such a way as to encourage the development of new storage facilities in order to reinforce UK security of supply and therefore separate applications and partial exemptions should be allowed.

One respondent considered that it was only by considering the use of the facility through its separate owners that an assessment of the impact on the market can be made. It was also noted that it would be difficult to see how a test of market shares could be conducted using the facility as a whole where the facility is owned by a number of parties.

One respondent considered that different applications for TPA exemptions regarding the same storage facility may be treated in a different way, depending on the position of the applicant in the storage market, and the size of ownership share in the storage facility. Whilst another respondent considered that the key issue is the extent to which a storage owner, including a part-owner, holds market power in relation to any relevant market segment.

The two respondents that were not in favour were concerned that allowing individual parties to apply separately for exemptions in respect of a share of the facility may give rise to arrangements being put in place simply to gain the exemption.

Should Ofgem consider contractual arrangements?

Those respondents who were in favour of allowing separate and/or partial exemptions considered that it was appropriate to consider the contractual arrangements. One respondent considered that such applications should be considered based on the commercial arrangements

² www.ofgem.gov.uk under Areas of Work > Wholesale Markets.

in place, as the decision to operate facilities separately appeared to be based on the grounds of efficiency, which should be welcomed. Another respondent noted that considering exemption applications solely on the physical nature of a facility could lead to the inefficient development and operation of that facility.

One respondent that was not in favour of allowing separate and/or partial exemptions considered that whether access to a facility is necessary for the operation of an economically efficient gas market can only be determined through a consideration of the nature of the facility and not of the contractual relationship between its owners. The other respondent not in favour believed the physical nature of the facility should be the determining factor over whether the facility gains an exemption, and that contractual structures are most likely to create a competitive regime where all separate shares are open to TPA.

Ofgem's final views

Having carefully considered the views raised by respondents, Ofgem continues to be of the view that it is appropriate to accept applications from more than one owner where there are multiple owners of a single new storage facility and will consider applications for exemption in respect of all or part of the capacity of that facility. In such situations, Ofgem is of the view that it is appropriate that factors such as the contractual arrangements for the facility are taken into account. It should be noted that this policy decision does not relate to any specific application.

Separate applications and partial exemptions

Ofgem recognises the potential for efficiency gains to be made by parties jointly developing new infrastructure facilities such as gas storage sites. Ofgem therefore considers it is appropriate, where possible, to encourage such initiatives, and that allowing the possibility of separate and/or partial exemptions from the Gas Act requirements for third party access should act as an incentive for innovation and efficiency in the development of new storage sites. Ofgem notes that such increased efficiencies would also be likely to reduce the costs ultimately borne by consumers.

Ofgem agrees with respondents that in an assessment of whether an exemption should be granted it is important to examine the position of the facility's owners in the gas market from a competition perspective. Where a facility has more than one owner, it may be appropriate for Ofgem to issue an exemption to one owner but not the other(s), based on an assessment of the owners' positions in the gas market. Any such decision would be taken on a case by case assessment of the particulars relating to that exemption application, and consistent with the requirements of section 19 A(6)(a) of the Gas Act.

Contractual structure

Ofgem recognises that adopting a policy of considering contractual structures in TPA exemption applications creates a danger of placing incentives on owners of large new facilities to put in place new contractual arrangements specifically in order to gain exemption from TPA on de minimis grounds. However, in assessing applications for exemption from multiple owners, various factors will be taken into account, including the history of the site's development, the robustness of the separation, and the way in which the facility will operate in practice. Ofgem

therefore does not consider that this should constitute a barrier to adopting a policy of considering the contractual structure.

Ofgem will place the onus on parties seeking exemption from the Gas Act requirements to demonstrate that their contractual arrangements provide for effective operational separation and therefore that they can effectively meet the requirements for exemption via separate applications. It should be noted that Ofgem would be unlikely to grant an exemption to separate parties where it could not be demonstrated that the ownership and/or operation of a storage facility had been developed in such a way that could not provide for effective operational separation of the facility.

Where appropriate, Ofgem will therefore take account of the contractual structure in place for a new storage facility when assessing an application for TPA exemption under section 19A(6)(a) of the Gas Act. Ofgem considers that it is beneficial to adopt a policy in regard to joint ownership which affords Ofgem the maximum flexibility to assess applications on their individual merits. Ofgem notes that taking a more flexible approach to such applications may also provide further benefits to consumers in the form of reduced costs due to increased investment efficiencies and lower costs, that would not otherwise have been the case.

Ofgem recognises that adopting a policy of maximum flexibility is likely to place increased resource costs on it in the form of greater ongoing monitoring requirements. Ofgem considers that the costs of regulation should always be proportionate to the benefits of that regulation. However, in this instance, Ofgem is of the view that the benefit of increasing incentives for the development of new gas infrastructure, and therefore potentially increasing investment efficiencies, outweighs the resource costs involved in assessing such applications.

Way forward

Ofgem will continue to consider each application for exemption from TPA under section 19A(6)(a) of the Gas Act on a case by case basis. Ofgem is of the view that it can be appropriate to accept applications from more than one owner where there are multiple owners of a single new gas infrastructure facility and will consider applications for exemption in respect of part or all of the capacity of that facility. In such situations Ofgem will consider such factors as the contractual arrangements for the facility. Ofgem notes that this policy decision has not been taken in respect of any specific application for exemption and its conclusions are confined to consideration of applications under section 19A(6)(a) where there are multiple owners of the new facility in question.

If you have any queries in relation to the issues raised in this letter, please feel free to contact Ben Woodside on 020 7901 7471.

Yours sincerely



Sonia Brown
Director, Wholesale Markets