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Dear Sonia

Storage Services Contract Modification Proposal No. 02

Ofgem¹ has carefully considered the application by Centrica Storage Ltd (CSL) sent to the Gas and Electricity Markets Authority (the Authority) on 5 December 2005 of Modification Proposal (the Proposal) 02 – Revision to CSL Injection Overrun Contractual Terms – Ref Storage Services Contract (SSC) Clause 15.3(a).

The Authority has decided to approve the proposed change to the SSC.² This letter explains the background to the proposed change and sets out the reasons for the Authority's decision.

Background

On 29 September 2005 CSL published its revised consultation³ in respect of the Proposal on the CSL website.⁴ The Proposal seeks to amend the current mechanism in respect of the over-run element by enabling CSL to adjust a Customer's Injection Nomination where a CSL customer's nomination exceeds their firm capacity entitlement and any interruptible capacity available to them in the situation where CSL has issued an Interruption Notice.

¹ Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the gas and electricity industries in Great Britain. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² Under the terms of the Undertakings given by Centrica Plc and Centrica Storage Limited to the Secretary of State for Trade and Industry pursuant to Section 88 of the Fair Trading Act 1973 (the Undertakings) Centrica Storage Limited is required to submit an application to Ofgem for it to approve proposed changes to the SSC.

³ The revised consultation superseded CSL's original consultation paper that was submitted on 28 February 2005.

⁴ <http://www.centrica-sl.co.uk/Storage/StorageServicesContract.html>

Clause 15.3 of the SSC allows customers to place unlimited nominations for injection and withdrawals but sets a charging process for nominations in excess of the customer's firm and curtailed interruptible capacity holdings. If CSL is unable to accept all nominated quantities of gas tendered for injection, the interruptible capacity is curtailed in the first instance and any residual gas is sold by CSL.

The Proposal

CSL considers that the SSC injection over-run rules no longer necessarily provide an effective disincentive to nominating above firm injection capacity holdings and thus no longer fulfil the intent of the SSC. CSL has considered alternative formulations to calculate the over-run charges. However, CSL now considers that the issue is better addressed by inserting a new clause into the SSC which would enable CSL to adjust a Customer's Injection Nomination to the extent that it includes an injection over-run element. CSL considers that this solution reaffirms the value of firm capacity and subsequently the various grades of interruptible product available to customers.

CSL proposes that a new Clause 15.4 be inserted as follows:

"In the case in Clause 15.1 (a), CSL may elect to reduce the Customer's Injection Nomination or Renomination (as the case may be) so as to reduce or eliminate the Injection Overrun Quantity but not to any greater extent. This will not prejudice any steps which may be necessary in cases where Clause 10.4 may apply."

Respondents' views

CSL did not receive any responses to the Proposal.

Ofgem's view

Under the terms of the Undertakings there are no criteria specified under which Ofgem is required to consider a proposal to modify the SSC. In the context of the Fair Trading Act 1973 (under which the undertakings were given) Ofgem considers it appropriate to apply a similar public interest test focussing on competition as was applied under that Act at the time the Undertakings were entered into. More Specifically, Ofgem has taken the view that it is appropriate to consider the Proposal in the light of its wider statutory duties, in particular its principal objective to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed.

Ofgem considers that to provide for the most economic and efficient use of the storage facility, it is appropriate for parties to be able to acquire firm and interruptible rights. By allowing this, it ensures that the facility is fully utilised. However, Ofgem considers that effective competition between those shippers with firm rights and those with interruptible rights should be promoted by the effective interruption of those interruptible rights under appropriate circumstances. That is, if CSL is unable to accommodate all firm and interruptible flows then the interruptible flows should be reduced accordingly. Ofgem considers that currently it could be argued that firm rights are discriminated against in favour of interruptible rights, by ensuring that overrun injections are kept whole. Ofgem considers that this proposal would ensure that those shippers that have firm rights benefit from holding such rights. Ofgem agrees with CSL that the actual interruption of such flows is more appropriate than attempting to define

an arbitrary overrun charge, particularly given the ever developing nature of the use of storage throughout the calendar year, therefore indicating that any overrun charge is unlikely to be cost reflective.

The Authority's decision

For the reasons outlined above the Authority has decided to approve the Storage Services Contract Modification Proposal 02 – Revision to CSL Injection Overrun Contractual Terms – Clause 15.3(a) of the SSC.

If you have any further queries in relation to the issues raised in this letter, please feel free to contact Ed Carter on 020 7901 7304.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sonia Brown'. The signature is fluid and cursive, with the first letter 'S' being particularly large and stylized.

Sonia Brown

Director, Wholesale Markets

Signed on behalf of the Authority and authorised for that purpose by the Authority