

Guidelines for Good Practice for Gas Storage System Operators (GGPSSO)

Storage National Report – Ofgem

1. Background

There are currently five active gas storage sites in GB. Hatfield Moor, Hole House and Humbly Grove are currently exempt from providing TPA under Article 21 of the Gas Directive.

National Grid [NG] operates LNG storage sites throughout the UK which are exempt from TPA under the definition of the Gas Directive - but which do however, provide TPA through an annual auction to the gas market. Although not explicitly covered by the GGPSSO, NG have completed the questionnaire to demonstrate that it has measures in place to comply with the guidelines, (their response to the questionnaire is attached at Annex1).

There are two sites that provide TPA to storage facilities in the UK as defined under the Gas Directive to which the GGPSSO applies:

- Central Storage Limited (CSL) Rough Gas Storage , and
- Scottish and Southern Energy (SSE) Hornsea Gas Storage

There is unlikely to be any additional TPA storage coming online in 2006.

Following the submission of the questionnaires from the SSOs and recent meetings with both Centrica and SSE, Ofgem intends to put in place an ongoing process to ensure that the guidelines are complied with.

1.2 Description of Ofgem and other bodies/entities role in storage

a. Ofgem

Ofgem's role with respect to regulating gas storage largely involves monitoring the behaviour of SSOs (particularly against the Standard Storage Service Contracts). Ofgem has a specific role in monitoring the undertakings given by Centrica and CSL in respect of Rough, which it carries out through regular meetings, reports and general market monitoring. Third parties are able to approach Ofgem with concerns they may have in relation to discriminatory or otherwise anti-competitive behaviour by SSOs. Ofgem can take action against anti-competitive behaviour through its role as a competition authority.

Ofgem also decides on applications for exemption from third party access (TPA) for storage facilities, and arbitrates any disputes over access terms and prices where negotiated TPA is in place at a facility.

b. Office of Fair Trading (OFT)

The OFT has Concurrent Competition Act powers, and has a role in monitoring the undertakings given in respect of the Rough storage facility 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.

c. Other parties involved with gas storage in Great Britain include:

- **Department of Trade and Industry** - Responsible for setting the legislative framework for gas storage, including transposing EU Directives in UK legislation;
- **Health and Safety Executive (HSE)** - responsible for ensuring those involved with the transmission, distribution and storage of natural gas comply with the relevant health and safety legislation; and
- **Competition Commission** – Competition Act powers.

2.1 Roles and Responsibilities of SSOs

Both CSL and SSE are separate legal entities within their larger corporate group and therefore neither is required to comply with 1.3 of the GGPSSO – i.e. to put in place a document setting out the terms and conditions for the use of storage by affiliates.

In the case of CSL this is however required through Centrica's undertakings to the Secretary of State following its purchase of Rough. Both SSO's are required to provide fair and non-discriminatory access to storage for third parties and must publish terms of access provision.

2.2 Necessary TPA Services

2.2.1 Institutional Arrangements

Ofgem is the body which decides on all applications for exemption from TPA for gas storage facilities. Section 19A of the Gas Act sets out the rules for excluding storage capacity from TPA. Under this section, an exemption will only be given where the authority is satisfied that 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)¹ of the Gas Act 1986 are met. There remain various grounds for revocation of an exemption.²

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- ¹ (a) the terminal will promote security of supply
(b) the level of risk is such that the terminal would not be built without the exemption
(c) legal separation between terminal operator and Transco
(d) charges will be levied on users of the facility
(e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the NTS
(f) the Commission of the European Communities is or will be content with the exemption.

² 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
- v. there is merger or acquisition activity in relation to, or by the facility owner, that is

Decisions regarding the exclusion of storage capacity from TPA are published on the Ofgem website (www.ofgem.gov.uk). Where Ofgem reaches a decision to grant an exemption by virtue of the six exemption requirements being met, the Second Gas Directive requires that this decision be notified to the European Commission. The European Commission then has 2 months after receiving a notification of an exemption decision in which it may request that the regulatory authority of the Member State concerned amend or withdraw the decision to grant an exemption.

No party is responsible for Public Service Obligations (PSO) according to national legislation.

If an issue arose whereby necessary TPA services were not introduced because of delays in IT development, Ofgem would monitor the situation to assess whether the delay was reasonable and justified.

2.2.2 Role of Ofgem in designing the menu of services offered by the SSO

The SSO is required to negotiate with relevant parties (i.e. Storage system users), to determine the services to be offered by the SSO. Ofgem monitors this process.

The Standard Services Contract (SSC) contains details of the services offered. In the case of the Rough facility (operated by CSL), the SSC is an integral part of the undertakings given to the Secretary of State. The SSC was developed through an industry workgroup, with regulatory supervision by Ofgem. Ofgem monitors the undertakings and can veto any proposed changes to the SSC.

2.2.3 Storage Services tariffs/pricing methodologies

In the case of Rough, as stated above, Ofgem monitors the undertakings and can veto any proposed changes to the SSC. More generally, storage tariffs are not regulated in Great Britain. SSOs are obliged to publish (at least annually) terms and conditions for access to their facility. Ofgem's only involvement is in dispute resolution: where agreement cannot be reached between a SSO and a third party over terms and conditions for access to storage, Ofgem may, after consultation with interested parties, specify the terms on which the SSO should enter into an agreement with that third party.

2.2.4 Overall Assessment of the menu of Services offered by the SSO

Facilities which are obliged to provide TPA are subject to non-discrimination conditions set out in section 19B of the Gas Act 1986. For example, section 19B(3) states that *"the owner of a relevant facility shall ensure that ...he does not discriminate against any applicant...for a right to have gas...stored in the facility."*

All facilities also have to comply with general competition law. Ofgem considers that the competitive gas market, in conjunction with competition law, will ensure that services are delivered in an efficient way. Ofgem monitors the market, and investigates any complaints of market abuse or anti-competitive behaviour.

2.3 Capacity allocation and congestion management

detrimental to competition.

2.3.1 Capacity allocation procedures and congestion management mechanism

The nature of the congestion management and allocation schemes is set out in the Storage Services Contracts (SSCs). SSCs are developed through a consultation process where the relevant parties can negotiate with the storage system operators. This process is supervised by Ofgem.

Hornsea

In the case of Hornsea, Ofgem does not specifically regulate the capacity allocation / congestion management mechanisms. It is up to the SSO to resolve any capacity or congestion issues, but as part of its obligations under section 19 of the Gas Act, the SSO must maintain and enable fair and non-discriminatory access to storage for third parties. Capacity allocation and congestion management are included in these obligations. Third parties can raise concerns regarding capacity allocation / congestion management mechanisms with Ofgem.

Rough

In the case of Rough, CSL uses market-based mechanisms to allocate capacity. It resolves congestion management on a pro rata basis (day ahead), or through bilateral negotiation (within day). The congestion management mechanism includes the overrun charging formula as set out in the Standard Storage Contract, amendment of which Ofgem can veto. In addition Rough has some allocation clauses in its undertakings which restrict the amount it is able to reserve for the Centrica Group.

2.3.2 Description of the relationship between storage contract durations and capacity allocation procedures/congestion management

The relationship between storage contract durations and capacity allocation procedures/congestion management is again a matter for negotiation between the relevant parties. As with most other issues described above, Ofgem only has a role in dispute resolution.

CSL sells short term interruptible capacity via a regulated price structure defined in the SSC or through bilateral negotiation.

2.3.3 Description of the relationship between PSOs and the capacity allocation procedures

There is no party responsible for Public Service Obligations (PSOs) according to national legislation.

2.4 Confidentiality

2.4.1 Overall assessment

Ofgem visited both SSOs recently and confidentiality arrangements were discussed in detail to get a better understanding of how the companies manage these issues.

In the case of the CSL Rough SSO, the confidentiality requirements of their undertaking to the Secretary of State for Trade and Industry are such that they at least comply (and in some cases go further) with the requirements within the GGSSO relating to confidentiality. Ofgem is satisfied that, at this stage, CSL

generally have effective procedures in place regarding confidentiality issues. It has a compliance programme, and a clear code of conduct for staff which is supervised by a Storage Compliance Manager. The code of conduct has also recently been published on CSL's website.

SSE Hornsea SSO, despite being located in the same building as its Supply Business has less robust processes in place. At present, they have no code of conduct regarding confidentiality. In addition, they have not appointed a compliance officer and have not designed and put in place any form of compliance programme. However, during Ofgem's visit to the SSE Hornsea SSO, Ofgem obtained assurances that they would draft a code of conduct and consider whether a compliance officer should be appointed. would be drafted and a compliance officer would be appointed. Ofgem intends to follow these issues up with the aim of further monitoring against the confidentiality requirements of GGPSSO to ensure compliance. It was not clear how separate the SSO's IT system was from the rest of the business although the staff are located in a separate key pad controlled room.

SSE Hornsea SSO assured Ofgem that the confidentiality requirements of their storage contracts were such that it was essential to them that there was no breach. It pointed out that it had never had a complaint from customers on this issue. Ofgem has also not received any complaints from Storage users but is of the opinion that compliance against ex ante confidentiality requirements is more effective and therefore it will continue to monitor the situation with regards to SSE's compliance with the GGPSSO in this area.

2.5 Transparency

CSL Rough provide most of the information required of the GGPSSO. It indicated in their 2005 response that it does not provide (i) rules of storage capacity transfer as it is not applicable. At this stage, this does not give rise to serious concerns regarding the operation of the market.

SSE make available to the market most of the commercial terms required by 6.4 a-d of the GGPSSO. However, the level of operational information made available to the market is limited. At a recent meeting with Ofgem, SSE indicated that this type of information was available to anyone that specifically requested it. However, to obtain access to the information the customer would need to sign a storage user agreement. This would allow SSE to provide it with an ID to access the information through a secure website which is separate from the SSO website. SSE indicated that they would consider the costs of placing this information directly in the public domain. Ofgem intends to formally request that until such time as this information is not published in line with the GGPSSO, details of how to access it are provided on SSE's Storage web page. Ofgem considers that publication of the information directly in the public domain would have significant benefits in terms of transparency in the market for all players not just those that have signed storage user agreements.

SSE only provide 3 of the 14 pieces information required under the transparency section of the GGPSSO. SSE submitted with their response a letter to Ofgem notifying us of their non compliance in this area. Ofgem will be taking this issue forward with SSE Hornsea in the next few weeks.

2.6 Secondary markets

There appears to be measures in place by the SSOs to allow secondary trading to occur and it certainly is not prevented. In the cases of Transco LNG and CSL Rough (attached at Annex 1) they provide the ability to trade in this manner on their website.

3. Need for other measures beyond the GGPSSO

The GGPSSO are a valuable step forward in specifying the arrangements that need to be in place to help ensure that there is fair and non-discriminatory access to storage facilities and services. However, their effectiveness is conditional on them being equally applied in full by all SSOs across the EU. It is clear from ERGEG's work so far on monitoring compliance against the GGPSSO that this is not the case.

There are also some important areas where the GGPSSO could be enhanced to improve access conditions and the operation of the market:

- **Transparency** – although the GGPSSO specify the information that should be made available to market participants there are some areas where improvements could be made:
 - **Less than 3 users rule** – it is clear that this condition is restricting the amount of information that is being published by SSOs. An appropriate balance must be struck between legitimate concerns of commercial confidentiality and transparency in the market. Ofgem recommends that the 3 user rule is reviewed with the aim of improving market transparency;
 - **Public Service Obligations** – there is currently very little information available across the EU on the nature of PSOs that are in place. This includes to which party they apply; the rules about how much gas should be kept in storage; when and under what conditions it can be released; which party needs to authorise the release of gas from storage; and the period of time over which PSOs apply;
 - **Information made available under unplanned interruptions** – when unplanned interruptions occur it is crucial that information is made available to the market (not just storage users) as soon as possible on the nature of the interruption; its expected impact on access to the storage facility; the expected length of the interruption to services etc. If the interruption lasts over a period of time, then the market should be updated on progress as appropriate. This will help to ensure that the market reacts effectively and efficiently to changing conditions. The recent event at Rough demonstrated that transparency in providing information to the market is crucial if stakeholders are to take effective and efficient commercial conditions;
 - **Information on planned maintenance** – it is important that the market is aware in advance of planned maintenance to storage facilities so that they can take commercial decisions. The GGPSSO are not sufficiently prescriptive in terms of the information that should be made available on planned maintenance – the term itself is not defined – which further impacts on transparency in this area;
 - **Reliability information** – storage facilities are an important part of the overall gas network. Generally information, at least in the UK, is collected and published on the reliability of the transportation gas pipeline. This gives useful information to the market on the quality/security of supply. There are currently no requirements within the GGPSSO which relate to the reliability of

the facility. Consideration should be given to strengthening the GGPSSO in this area – this would mean identifying the appropriate reliability measures and defining how they should be measured;

- **Improved definitions** – consistency in information that is published is crucial. The GGPSSO include definitions that SSOs should use – Ofgem recommends that these are reviewed to improve their specificity to help ensure consistency of application across the EU.
- **Confidentiality requirements** – the existing requirements in relation to confidentiality are not sufficiently explicit to ensure that SSOs are taking appropriate steps in this area. Ofgem recommends that they are reviewed – two broad options are to strengthen the existing requirements or to require SSOs to draw up a document specifying how they will manage confidentiality which must be agreed by the relevant national regulatory (NRAs) authority (and subject to consultation with storage users). It is also crucial that NRAs have appropriate powers to monitor the situation at SSOs and to take action if there are problems that are impacting on the market.
- **Other issues** – it is important that there is effective UIOLI arrangements in place at all storage facilities. It is clear that this is the case at present. This is particularly problematic where there are long term contracts in place which is having the effect of constraining the availability of capacity/access to storage facilities across the EU. SSOs must also do more to facilitate the development of secondary markets to improve liquidity and competition. Ofgem recommends that the existing requirements in relation to UIOLI/congestion management/secondary markets are reviewed.

If the GGPSSO are improved and applied by all SSOs this will improve access conditions at individual facilities. It will also improve the operation of the wider EU market for storage. However, it is crucial that all NRAs are given appropriate power to monitor the storage and to take action where there are problems.