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Dear Fay,

RE: GSOG's response to the Assessment of Capacity Allocation Mechanisms and Congestion Management Procedures for Effective Access to Storage and Proposals for the Amendment of the GGPSSO (ref. E10-GST-09-06)

The Gas Storage Operators Group (GSOG) welcomes the opportunity to participate in the consultation process on the amendment of the Guidelines of Good Practice for Gas Storage Service Operators (GGPSSO) on Capacity Allocation Mechanisms (CAM) and Congestion Management Procedures (CMP). Please refer to this document as a non-confidential response to the ERGEG consultation (ref. E10-GST-09-06).

The GSOG is a trade association which was formed in May 2006 within the Society of British Gas Industries (SBGI). The group has 17 members and comprises almost all of the active participants in the GB Gas Storage Market, and as such represents a wide range of interests. The group includes both established operators and developers of new storage projects, large multinational companies and smaller private ventures. The current members of the group and signatories to this submission are detailed in Appendix A.

In general, GSOG agrees to the need of updating the current GGPSSO in the light of the new requirements of the 3rd Energy Package. While we believe that suggestions and interpretations of new requirements could help both National Regulatory Authorities (NRAs) and individual Storage Service Operators (SSOs), we do not believe that any credible conclusion can be made until enough time has elapsed after the implementation at national level.

Since we generally agree with the GSE's response to this consultation, instead of replicating their response, we would like to provide additional information based on our experience in Great Britain. In particular, we would like to highlight the necessity of allowing individual Storage Operators the freedom to design a CAM that delivers the regulatory objectives, market efficiency and customers' satisfaction.

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Background

There are currently six active gas storage sites in GB with a total capacity of circa 4.4 bcm (≈ 48 TWh)[1]. Six more sites are expected to in operation by 2015 and additional eight before 2020[2]. The total expected capacity in the long term is envisaged to be circa 22 bcm (≈ 238 TWh) with a deliverability of up to 600 mcm/d[3].

Within these active facilities, only two operate under a Negotiated Third Party Access regime (nTPA). These are considered necessary for achieving operational and economical market efficiency and make up a considerable percentage of available capacity. Non-exempted SSOs are required to publish regularly on their website technical details of both products offered and allocation mechanisms. Other existing (envisaged) facilities are exempt from such requirements.

The GB National Authority (Ofgem) monitors the transparent, objective and non-discriminatory offer of non-exempted storage capacity to third parties but it does not specifically regulate CAM and CMP of individual facilities. In other words, it is up to the SSO to implement CAM and CMP, since it has the duty to ensure efficient access to its storage capacity. As far as we are aware, no complaints have been received by either Ofgem or operators in relation to the allocation procedures currently utilised.

Justification for auction and unlikely conditions of implementation in GB

In the consultation document, ERGEG concluded that "*auction is an allocation mechanism which fulfils the requirements of the regulation better than other CAMs*"[4]. We would like to warn about this conclusion, providing the example of pros and cons of a possible implementation of auction mechanisms in the GB market.

Referring to the economic theory[5], the correct functioning of the auction mechanism in allocating storage capacity requires the following assumptions on market conditions:

1. *storage capacity is a scarce resource*; due to the development of 14 new sites and other sources of gas flexibility, we do not believe storage capacity will became a scarce resource in the long run. This will actually boost competition among storage operators and act as a disincentive to withhold capacity for the purpose of driving prices up, whatever will be the CAM in use;
2. *presence of a significant number of users (bidders) not vertically integrated with storage operators (auctioneers)*; GB currently records more than 25 users, who are not vertically related with storage operators. This would actually prevent bidders to behave strategically and collude with each other to get a lower winning price;
3. *low spread between user (personal) and market's (common) valuation of capacity*; empirical evidence from the last five years shows a constant decline in the volatility of the seasonal spread of gas prices on the wholesale market.

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[1] from National Grid "TBE 2010", July 2010, Appendix 1, §A2.3
[2] from National Grid "TBE 2010", July 2010, Appendix 1, §A2.4-7
[3] from National Grid "TBE 2010", July 2010, Appendix 1, figure A24
[4] it refers to results summarized in "*Status Review on CAM and CMP for Storage*", ERGEG 2009
[5] from "*Status Review on CAM and CMP for Storage*", ERGEG 2009, chapter 3

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4. This trend has created uncertainty in the sustainability of future extrinsic value of long-range gas storage service[6]. Such uncertainty would make it difficult for

5. users to achieve an ex-ante valuation of capacity on time for bidding in the auction. Consequently, the fear to over-estimate (and bid too high) the value of capacity would result in a lack of participation and, finally, in an inefficient outcome[7]. On the contrary, other mechanisms such the "*first committed, first served*" allow the user to bid the required capacity upon evaluation.

Auction has also been addressed as the methodology that best "*provides appropriate economic signals for the efficient and maximum use of capacity and facilitate investment in new infrastructure*"[8]. In GB, all new sites that are expected to provide additional storage capacity in the future have been planned and are being developed by private operators, without the direct intervention of any State department. Since mechanisms other than auction have been used so far in GB to allocate existing capacity, we argue that the current practise (mostly "*first committed, first served*") provides the market the proper signal for additional investments.

Moreover, the implementation of a fixed schedule of successive auctions would require the SSO to keep the characteristics of the product sold for the entire period of the schedule. This may result in a reduced ability to mix and adjust services to match customers' demands and may lead to inefficiencies in marketing products where actual demand has not met the forecasted demand. On the contrary, other mechanisms allow operators to react on time to users' needs, adjusting the characteristics of their offer.

Conclusion

The above reasoning should not be interpreted as an absolute criticism of the auction mechanism as an efficient CAM. On the contrary, we would like to highlight the importance of setting the mechanism under market analysis before arguing on its potential efficiency. In the case of competitive markets, storage operators should be allowed to design both products and allocation mechanisms in order to better match customer's needs. In case of inefficient allocations, concerns should be raised to the relevant Authority, which will also continuously look at the overall market efficiency and security of supply, as stated by article 17(2)(b) of Regulation 715/2009.

We hope that you have found these comments useful and please do not hesitate to contact us if you wish to discuss the response further.

Your sincerely,

Roddy Monroe
Chair – SBGI Gas Storage Operators Group

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[6] we are looking on the impact of changing CAM in long-range storage service only, because only this type of facilities is subject to TPA regulation in UK.

[7] this effect is known in auction theory as "*winner course*" ad is particularly present in "*1st price sealed bid*"design.

[8] consultation document, page 12, table 1

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Appendix A

SBGI Gas Storage Operators Group Members:

BGE UK
Centrica Storage Ltd
Cheshire Cavity Storage Group Ltd
E.ON Gas Storage UK Ltd
EDF Trading Gas Storage Ltd
Eni UK Ltd
Gateway Gas Storage Company Ltd
Halite Energy Group
INEOS Enterprises Ltd
Infrastrata Plc
National Grid LNG Storage
Scottish Power Energy Management Ltd
SSE Hornsea Ltd
Star Energy Group plc
Statoil (UK) Ltd
Storengy UK Ltd
WINGAS Storage UK Ltd

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