

ERGEG

By email: CAM_CMP_storage@ergeg.org

8 October 2010

Dear Sir, Dear Madam

Re: ERGEG Public Consultation on the Assessment of Capacity Allocation Mechanisms and Congestion Management Procedures for Effective Access to Storage and Proposals for the Amendment of the GGPSSO

Centrica welcomes the opportunity to contribute to ERGEG's work on the storage access regime within the EU and to this July 2010 consultation on improving the capacity allocation mechanisms and congestion management procedures for a more effective storage market in Europe.

This response is on behalf of the Centrica group excluding Centrica Storage Limited.

Centrica Energy is a user of storage capacity within Great Britain. It has also assessed the storage access regime in a number of North West Continental markets.

This response is structured in two main parts. The first part includes our answers to the questions raised in the July consultation. The second part includes more general comments on the consultation document and related subjects.

If any element of our response is unclear or you require further detail of any of our comments or suggestions, please do not hesitate to contact me.

Yours sincerely,

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ERGEG Public Consultation on the Assessment of Capacity Allocation Mechanisms and Congestion Management Procedures for Effective Access to Storage and Proposals for the Amendment of the GGPSSO

Introduction

Centrica welcomes the opportunity to contribute to ERGEG's work on the storage access regime within the EU and to this July 2010 consultation on improving the capacity allocation mechanisms and congestion management procedures for a more effective storage market in Europe.

This response is on behalf of the Centrica group excluding Centrica Storage Limited.

Centrica Energy is a user of storage capacity within Great Britain. It has also assessed the storage access regime in a number of North West Continental markets but has not yet succeeded in entering into contracts for such capacity.

This response is structured in two main parts. The first part includes our answers to the questions raised in the July consultation. The second part includes more general comments on the consultation document and the proposed enhancement of the guidelines.

Part 1 – Public Consultation Questions

- 1. To what extent do you agree that auction is the best allocation mechanism for storage and what will be the implications?*

Of primary importance is the use of a transparent, non-discriminatory market based mechanism, whether this be an auction or another such mechanism.

- 2. In your opinion, what are the most important aspects regarding transparency that should minimally be addressed by SSOs for both CAM and CMP?*

Information on CAM and CMP is essential to market participants when deciding to engage in the storage market. Thus the details of the methodologies and processes used must be available in a transparent and non-discriminatory way. In addition, storage users require information on the terms and conditions of access and details of the technical/operational characteristics of the storage facility. This for example would include information on the injection/withdrawal curves applicable to the individual storage facility and not just information on the minimum or maximum capabilities of the site.

The manner, timing and format in which information is made public are also important issues to consider when establishing transparency criteria.

We note that the topic of data transparency is not included within the scope of this consultation or revised guidelines but contained within the ERGEG October consultation on fundamental data transparency, to which we will also be responding.

- 3. In your opinion, what is most important when designing UIOLI (including products and contracts) as to leave a storage user the flexibility to use its storage capacity when needed?*

It is essential that UIOLI is assessed in more detail. This should not be seen as an option by the storage operators but as a legal obligation as contained within the 2009 Gas Regulation article 17.3 (a).

UIOLI should however be seen as the final step in congestion management. For congestion management there are other tools that can and should be used first such as use-it-or-sell-it (UIOSI), whereby primary capacity holders can sell unwanted capacity on the secondary market (as per article 17.3(b) of the 2009 Gas Regulation). A secondary market should be facilitated by the storage operator, potentially via the provision of a bulletin board.

Prior to this, however, an improved capacity allocation mechanism can also reduce the need for UIOLI and improve the efficient use of the facility. This issue is discussed in more detail in our general comments on CAM and CMP in part 2 of our response below.

- 4. In your opinion, to what extent should offered services and terms & conditions on secondary markets be standardised as to improve secondary trade of storage capacity? Is standardisation a way forward to enhance liquidity of secondary markets? What aspects of secondary markets (products, contracts, etc.) are the priorities to be harmonised?*

The harmonisation of primary market design is the first step to be taken. Without this, work on secondary markets will not succeed.

The harmonisation of primary market should cover products as well as general terms & conditions for the use of the storage facility. Harmonisation does not equate to identical design but rather to the use of common terms & conditions and product characteristics wherever this is possible.

Where capacity is sold on an aggregated basis across a number of individual facilities, then the design of the contract terms as well as the product itself should be harmonised in order to facilitate such marketing activity.

- 5. To what extent do you agree that (next to probability of interruption) pay-as-used can be applied as a pricing strategy for storage prices that are not regulated and what other pricing strategies would be suitable? How can pricing strategies incentivise new investment in storage and efficient use of storage?*

This question, and the concept of 'pay as used', is not clear. If the suggestion is that holders of interruptible storage capacity should be interrupted (where necessary) in reverse price order based on their bid prices, then we would agree that this is one possible pricing arrangement.

Where the storage price is unregulated, then the design of such pricing strategies should be left to the storage operators in consultation with current and potential storage users.

6. *In your opinion, to what extent do you consider that combined products (i.e. storage services offered at virtual hubs) of storage and transport capacities are a useful and efficient service?*

We would welcome the offer of combined storage and transmission capacity products as this can alleviate problems in some Member States relating to poor coordination of services or lack of access to the transmission grid for storage users. In Great Britain, for example, Rough storage capacity is routinely offered in a bundle with transportation, on an entry-paid basis at the NBP (known as the “C Store” product), as well as on a standard ex-storage basis. A number of Continental storage operators leave it entirely to the shipper to arrange transportation, which can make co-ordination with a storage capacity booking problematic.

7. *In your opinion, what market mechanism (incentive) should be in place to stimulate a storage user to offer any unused capacity on the secondary market?*

As mentioned above in response to question 3, the facilitation of secondary markets by the storage operator is an important tool. Indeed the entitlement of storage users to sell unwanted/unused capacity on the secondary market is now contained in the 2009 Gas Regulation (article 17.3(b)). This could be done via the provision of a bulleting board by the storage operator that can be used by both buyers and sellers of storage capacity.

8. *In your opinion, to what extent is the (cross-border) offering of storage products/combined transport-storage products useful to market parties and what should these products (e.g. minimum requirements) look like?*

If the internal gas market is to become a reality then access to cross border products and services is paramount.

First of all, we support capacity allocation mechanisms that permit non-discriminatory storage access to shippers from neighbouring Member States. Mechanisms that restrict storage access to national players such as ‘capacity goes with the customer’ could be seen by their very nature to be contrary to the principle of the internal market. In the interest of solidarity for the delivery of European security of supply, access to cross border storage is an important consideration. Indeed when preparing risk assessments and preventive action plans according to the new Gas Security of Supply Regulation, it is important that Member States clearly explain the role of cross border access to storage in the event of a gas emergency.

Secondly the offer of combined cross border storage and transmission products may be useful for certain storage facilities, especially those located close to national borders. As with any product and service offered by the storage operators, their design should be consulted upon with current and potential storage users to ensure that market demand is being addressed.

9. *To what extent do you consider the proposals will facilitate allocation and congestion management of storage capacity? What other measures should be in place?*

We provide general comments on the consultation document and draft guidelines within the second part of our response.

9.1 In particular, what possibilities do you see to enhance efficient use of storage, reserved for public service obligations like e.g. strategic storage or other reserved storage? Under which conditions would additional use of such storage as (interruptible) short-term product or remarketing on secondary market be acceptable? Could you give examples from your day-day experience?

Storage capacity that is currently allocated according to a public service obligation should still be subject to the UIOLI rules established in the market, and thus unused capacity in such facilities should be released on a day ahead and interruptible basis.

We have no direct experience of such regimes.

9.2 In particular, what best practice for CAM and CMP should be in place for specific cases when parts of LNG terminal facilities potentially function as storage capacity? Could you give examples from your day-day experience?

We have no direct experience of an LNG terminal which may also temporarily function as a storage facility. Paramount when considering such a case is the recognition that such a facility cannot serve as a storage and LNG terminal at the same time. Therefore the utmost care is needed in addressing this issue so as not to inadvertently hinder the operation of or investment in LNG terminals, which are crucial entry points for gas into the European market, and especially so in certain Member States.

The third Gas Directive clearly state that the rules relating to storage access “shall not apply to ... temporary storage that are related to LNG facilities and are necessary for the regasification process and subsequent delivery to the transmission system” (article 33.2).

Where storage tanks at an LNG facility are clearly and permanently part of the LNG value chain, then they should be treated through a regime directly addressing the use of LNG terminals. In such a case the CAM and CMP rules will be designed by taking into consideration the operation and characteristics of LNG operations.

Where storage facilities contain liquefied natural gas (usually used for quick release peak demand) rather than gas in its gaseous form and this is unrelated to an LNG terminal, then the rules governing the utilisation of the facility should be those designed for the storage market.

10. To what extent would you agree NRAs should be endowed with additional competences in developing CAM and CMP?

The third Gas Directive gives the Member State the choice to decide whether it is the Member State or the NRA who take the necessary measures to ensure access to storage. Where this power has been given to the NRA, then they will require the associated competences. This is the case whether the access is by a regulated or negotiated regime. Also, in either model, there is a duty to consult system users to ensure that the products and services on offer meet market demands.

Part 2 – General Remarks on the Consultation Document and Draft Guidelines

Whilst we have separated our comments within this part of the response between CAM and CMP, it is important to recognise the relationship between these two elements. The success of congestion management can be affected by the initial model and terms used when allocating capacity.

Capacity Allocation Mechanisms (CAM)

General Comments on CAM arising from the consultation paper

In its discussion of the results of the status review carried out during 2009 on page 14 of the consultation document, ERGEG states that one of the issues mentioned by participants is the length of contracts, stating that in some countries storage capacity is locked into contracts that are longer than 5 years in duration. We are aware of legacy storage contracts in The Netherlands and Germany, for example, whose duration is much more than 5 years. This is a clear example of how the design of products and the format of the initial allocation can lead to difficulties in later years for other, newer market participants.

Firstly we do not believe that large volumes of capacity in non-exempt storage facilities should be tied up through such long duration contracts. Where long duration products are offered, then these should not cover the entire storage capacity. Nor should the longer duration capacity all be sold at the same time, thus ensuring a regular offer of capacity to the market, on a rolling basis. Where a part of the capacity is held on long term contracts and a portion is sold to the wider market on a shorter term basis, it is important to ensure that the terms & conditions for each arrangement are in other respects fully non-discriminatory.

Where however very long term capacity products do in fact continue to exist and especially where they account for a large share of total capacity at a particular storage site, it is important that all possible congestion management tools are explored in order to maximise the utilisation of capacity and to endeavour to meet current market demands. This should clearly include the facilitation of secondary markets. It could also include discussions with primary holders to explore the potential use of buy back of some firm capacity with a view to resell firm UIOLI capacity in the primary market. Storage operators could also expand the volume of capacity sold as interruptible, beyond the day ahead time period. The pricing of such interruptible capacity would of course need to reflect the expected likelihood of interruption.

On page 6 of the consultation, the issue of sufficiency and scarcity of storage capacity is mentioned. Whilst the principle of scarcity/sufficiency is understood, it is not clear how this can always be judged in practice. If storage capacity in the market remains unutilised, does this automatically mean that there is sufficient capacity in the market, or does it mean that the terms & conditions of access are considered prohibitive by market players? Similarly, if capacity is fully booked and utilised, would this be interpreted as there being a scarcity of storage capacity – or is this simply a reflection of market-clearing pricing arrangements?

Moreover, the consultation appears to presume that sufficiency or scarcity can be judged *ex ante*, with the corresponding CAM to be adopted accordingly. We do not consider this to be practical or realistic.

Sufficiency/scarcity is again mentioned on pages 12-13 when discussing the 'first come first served' model. Rather than allowing the use of the FCFS in the belief that storage capacity is plentiful, which (with capacity hoarding) could result in the creation of scarcity for third parties, it would be preferable and much clearer to use a non-discriminatory market based mechanism for CAM from the outset.

Because the 'capacity goes with the customer' model is typically based on historic, backward looking market shares, it will tend to favour incumbent suppliers. Thus it can be seen as a barrier to entry by new entrants. Furthermore, because the customers considered under such models are often residential or other small customers connected to the distribution network, it also favours those suppliers serving these market segments whereas access to storage can be important for all suppliers for a variety of reasons. For example, suppliers of gas to power stations may need access to storage in a number of Member States where networks cannot readily support significant within-day offtake variations, in order to support the necessary flexible operation of the power plant. Residential markets often also have lower switching levels than non-residential markets and thus again the model tends to favour incumbent suppliers. Furthermore as mentioned above in response to question 8, restricting access to those supplying national customers does not recognise the role of storage in cross border traded markets or solidarity between Member States when considering security of supply in the gas market.

ERGEG states that its preferred CAM is auctions as it strongly delivers on the requirements set out in the third package for a methodology that is non-discriminatory and transparency; that provides appropriate economic signals for the efficient and maximum use of capacity and facilitates investment in new infrastructure; and that is compatible with the market mechanisms including spot markets and trading hubs, while being flexible and capable of adapting to evolving market circumstances. It is important to recognise that auctions are not the only market based mechanism available to storage operators. Bilateral negotiations can also be used, provided that pricing can be linked transparently to a relevant market price indicator. This is the case at the Rough facility in Great Britain, where the operator, CSL, adopts a market derived pricing methodology to price its products (typically, as a multiple of the seasonal price spread on the NBP forward curve) and concludes deals bilaterally with customers on that basis.

When considering the application of article 17.2(b) of the 2009 Gas Regulation which requires storage CAM to be compatible with market mechanism including trading hubs, we would support arrangements by which storage products, wherever possible, are offered fully firm at the hub, and not just subject to force majeure at the storage location.

Specific comments on the draft guidelines on CAM

The references used in this section conform to those used in the proposed enhancement of the CAM guidelines contained within section 4.1 of the suggested guideline text.

4.1 (c) The problem with combining storage and transmission bookings is not merely an issue of timing as is suggested in paragraph (c). As referred to in response to question 6, we would support the offer of combined storage and transmission capacity products. This would then alleviate any problems with differing terms and conditions for the two elements of the product, which are not limited to the issue of timing or lead times. We would thus suggest that the 'i.e. regarding timing/lead times' contained in paragraph (c) either be changed to an 'e.g.' and/or the reference be expanded to include all elements of product design and allocation methodologies.

4.1. (e) ERGEG has correctly recognised the role that storage services can play in balancing markets. Where this is the case, it is important that all aspects of the capacity utilisation is compatible with the balancing market design, for example the timing of storage nomination would need to consider the notice times required in the flexibility/balancing markets.

4.1 (f) When setting out the rules for the conduct of an open subscription period, it is important to remember that storage years are often not calendar years, as is indicated in the example given within the explanatory section of this paragraph.

4.1 (g) As previously mentioned, it is not always possible to determine ex ante of the actual allocation process whether demand will exceed supply or not. In practice, demand is a function of price. As the price is unknown prior to an allocation process in a market based environment, the resulting actual demand will also be unknown.

The setting of any reserve price must be made with care, as the establishment of an excessive reserve price can clearly lead to low demand for a product.

As previously commented, the guidelines should also recognise that auctions are not the only market based mechanism that is available to storage operators, as can be clearly seen at the Rough storage facility in Great Britain.

Congestion Management Procedures (CMP)

General Comments on CMP arising from the consultation paper

One of the main reasons why the application of UIOLI to storage is complicated is that primary firm capacity is often tightly/exclusively held (often by dominant incumbent companies) such that interruptible injection/withdrawal rights (where available at all) are of limited value to third parties. The point here is that interruptible space (from which the third party's gas can effectively be ejected at short notice by the incumbent holder of firm storage capacity) is not a very useful product.

Where primary capacity allocation is more widely held by a number of market participants, then UIOLI can work well. Whether interruptible products are attractive to the market is a question raised on page 14 of the consultation. In the main, interruptible rights alone are not considered sufficient by shippers to participate in the storage markets. Where additional interruptible rights to inject and withdraw gas can be combined with firm rights to working volume (space), then this is of much greater value/interest to shippers. Thus the initial allocation of firm capacity has a direct impact on the practical success of UIOLI and hence of managing congestion. This issue is addressed briefly above in our general comments on CAM.

In referring to UIOLI, it is important to distinguish between firm and interruptible UIOLI. On page 8 of the consultation, ERGEG states that "the application of UIOLI in gas storage is complicated because it limits the use of storage as a flexibility tool". This may be true in the case of firm UIOLI, unless capacity hoarding is taking place. However the same does not hold true for interruptible UIOLI applied to injection/withdrawal capacity. This issue is addressed below when considering guidelines 4.2(f).

When considering UIOLI on page 13, ERGEG correctly states that the 2009 Gas Regulation requires this at least on a day ahead and interruptible basis. We would emphasise the words 'at least'. Where primary capacity is tightly/exclusively held, in order for UIOLI to become effective, there may be a need to go beyond this minimum requirement. However, considerable care needs to be taken not to introduce any general requirement for firm UIOLI in a form which could undermine incentives, either to invest in new storage or to make effective use of existing facilities with unbooked capacity.

Specific comments on the draft guidelines on CMP

The references used in this section conform to those used in the proposed enhancement of the CMP guidelines contained within section 4.2 and 4.5 of the suggested guideline text.

4.2. (f) The proposed text appears to confuse the issues of firm and interruptible capacity rights. In order to comply with the 2009 Gas Regulation, the storage operator must offer unused storage capacity on the primary market at least on a day ahead and interruptible basis. This legal requirement refers to interruptible UIOLI. Because the capacity rights are interruptible, the storage operator does not require the primary capacity holder to relinquish its renomination rights by selling back capacity to the operator. The primary capacity holder retains these renomination rights; the nomination made by the interruptible capacity right holder only stands if the owner of the primary firm capacity rights does not re-nominate an increased use of its capacity. Thus the issue of

relinquishing renomination rights only needs to be addressed when selling firm UIOLI capacity, and not interruptible UIOLI.

The text associated with paragraph (f) is also confusing. Whilst we support the principle of best efforts of nomination, it is questionable whether the primary capacity holder will know far in advance on which days it intends to inject or withdraw capacity. Even storage with (say) 60-90 withdrawal days which is aimed primarily at seasonal winter storage withdrawals leaves considerable flexibility to select, at short notice, those winter days on which withdrawals will actually take place. Thus the reference to best efforts for the provision of quarterly and monthly previews especially is unlikely to provide much clarity to the storage operator or other storage users.

4.2. (h) ERGEG correctly states that the design of products should not be customised to such an extent that they only suit the needs of one user. Neither should the design be dependent on the behaviour of a major user (potentially a dominant incumbent company), for example by making a service only available when aggregated flows exceed a minimum level. Any such restrictions should be dependent solely on the technical/operational limitation of the facility.

4.2. (i) It is not clear what information on 'non nominated capacity at longer outlooks' refers to. Nomination is not required to be made until day ahead.

4.2. (l) As previously mentioned in relation to paragraph (h) above, minimum flow rates should only be in place for technical/operational reasons of the particular facility. Where such restrictions are in place, these should apply to the aggregated flow volumes and not on a per user level. Where minimum flow levels do apply and the aggregated nominations are below this minimum level, one way for the storage operator to continue to offer a service is through a 'virtual storage product' to be delivered at a hub.

4.5. Whilst we welcome the suggestion contained within the new text, indeed the message is clear while not being too prescriptive, it is unclear how through a voluntary set of good practice guidelines, NRAs can be awarded legal powers to define and introduce more detailed measures. This is especially the case in markets where the authority in charge of determining storage access conditions is the Member State, as previously discussed in question 10.