

25th November 2015

Adrian Leigh
Project Manager
Rough Undertakings Review
Competition and Markets Authority
Victoria House
Southampton Row
London WC1B 4AD

Dear Adrian,

Re: Rough Review - Issues Statement and invitation to comment

We would like to take this opportunity to provide our comments to the CMA Issues Statement on the Rough undertakings variations.

As outlined in our initial response to the CMA's invitation to comment, SSEHL supports the view that the changes in Rough's operational conditions outlined in Centrica Storage Limited's (CSL's) letter are sufficient to commence a review of the Rough storage undertakings.

SSEHL also believes that taking into account security of supply issues and the important role that gas storage facilities have in this sphere, it is important for the CMA to prioritise this case for review.

As the CMA outlines in their invitation to comment on the Issues statement, CSL and Centrica have suggested a number of proposed variations to the undertakings to address the change in circumstances and to reflect their view that the physical performance of the assets of Rough could be expected to become less predictable.

Despite no respondents to the CMA's initial invitation to comment have suggested that there has been a material change in competitive conditions in the gas storage market since the last review, we believe that it is important for the CMA to carefully consider the CSL and Rough proposed changes to undertakings and further consider that the purpose of the initial question was not to comment on market conditions but to indicate if there was a need for review.

On this topic, the CMA should note that whilst it is widely agreed that gas storage facilities are required for the assurance of security of supply to the UK, the market conditions that have prevailed over the past years have led to a reduction in value for these assets. This can be attested to by the significant industry impairments, the cancellation of projects and the mothballing of UK based assets over the course of the previous 2 years.

Our response below focuses on the issues which CMA envisages will be relevant to the review and which are outlined in paragraphs 18 to 25 of the Issues Statement.

- 1. The CMA should have the power to vary the Obligated Capacity (OC, i.e. MRC and/or AS) where the physical capabilities at Rough are reduced. The CMA can also increase OC, but not above the historical level (i.e. 455m SBUs of MRC and 1.534TWH of AS).**

Our view is that the CMA should have the power to increase or decrease the Minimum Rough Capacity (MRC) and/or Additional Space (AS) in line with the changing physical capabilities of Rough.

However, we are seeking further clarification on MRC and AS to ensure a full understanding of the variations which have been requested.

Minimum Rough Capacity (MRC)

We believe that the amended definition of MRC in conjunction with the comment on investment outlined in Paragraph 2.10(b) might result in an ambiguous interpretation of the flexibility which the CMA is being asked to grant to Rough.

The amended definition of MRC in the CSL and Rough Proposed Changes to Undertakings suggests that:

- (a) Minimum Rough Capacity means 455 million SBUs (*or such lower amount as is permitted by the OFT in accordance with paragraph 2.10*), or
- (b) *If the OFT approves a request pursuant to paragraph 2.3(b) capacity comprising the sum of: (i) Unbundled Units and (ii) SBUs, which together represent the total amount of each of injectability, space and deliverability represented by the number of SBUs comprising the Minimum Rough Capacity;*

In addition, Paragraph 2.10(b) of the CSL and Rough Proposed Changes to Undertakings suggests that “investment by CSL or other members of the Centrica Group in Rough shall not be a ground for the OFT to increase the Minimum Rough Capacity and/or the Additional Space”.

We are seeking further clarification on whether the notion of “investment” referred to in Paragraph 2.10(b) is related to capital expenditure in new Rough capabilities (beyond historic) only or if it is envisaged that “investment” could be also interpreted as capital costs required to improve the current capabilities of Rough, such as a reservoir volume and injectability performance (within historic levels).

In our view, a clarification of the “investment” definition will help eliminate the risk of an unintentional change to the Specified Capacity level which limits the volume of capacity and space that can be sold to Centrica and is currently limited to 25% in relation to MRC.

Furthermore, the MRC definition suggests that the CMA can also increase OC, but not above the historical level of 455 million SBU which could further complicate the monitoring of the cap which is currently placed on Centrica. Our further views on Specified Capacity are also outlined in our response to Issue 3 on Page 3 of this paper.

Additionally, we would recommend that the CMA look to the definition of MRC being translated from SBUs to a volumetric measure. This would aid in simplification of reporting of data across the capacity ranges for CSL and also provide the market with greater clarity to both the volume held by Centrica and the volume available to the market. SBUs by their nature can vary in shape year on year.

Additional Space (AS)

The amended definition of AS in the CSL and Rough Proposed Changes to Undertakings suggests that:

Additional Space means 1534 GWh or such other amount as is permitted by the OFT in accordance with paragraph 2.10. The aggregate of space in Rough that is allocated to Additional Space and Minimum Rough Capacity with respect to a Storage Year will not exceed 31,854 GWh.

As noted earlier, Paragraph 2.10(b) of the CSL and Rough Proposed Changes to Undertakings suggests that “investment by CSL or other members of the Centrica Group in Rough shall not be a ground for the OFT to increase the Minimum Rough Capacity and/or the Additional Space”.

Currently one of the main provisions of the undertakings is that CSL will not sell more to Centrica per year than a maximum Specified Capacity of 1,534GWh of AS. We believe that the amendment of the AS definition results in a dilution of this provision as the adjustment mechanism to ‘cap’ does not clearly define a “substantial change” in Rough’s AS which would trigger Ofgem’s review of the Centrica’s cap.

The definition of ‘Additional Space’ also states that *the aggregate of space in Rough that is allocated to Additional Space and Minimum Rough Capacity with respect to a Storage Year will not exceed 31,854 GWh*. Our understanding is that the level of 31,854GWh represents the current maximum limit of Rough’s reservoir volume on the back of the limited maximum operating pressure driven by changing physical capabilities of Rough. We believe that to eliminate any ambiguity about Specified Capacity in light of changing physical capabilities of Rough, Centrica should be limited to 25% of the aggregate of the MRC, AS and FAS, with the latter to be incorporated into AS (our further views on this are outlined at the end of this document).

2. The CMA could review the OC by its own initiative or following a request from CSL (in the latter case, the request is considered approved if the CMA does not respond in one month).

- We support the view that the CMA could review the OC by its own initiative.

Taking into account that CSL intends to publish the testing results of the Rough’s reservoir between September and December 2016 following the summer injectability season, we believe that the review of Rough’s OC level should be undertaken shortly after the testing results are published.

Paragraph 2.10(a) of the CSL and Rough Proposed Changes to Undertakings stipulates that the OFT decision to increase or decrease MRC and/or AS following its review of the levels in place, may be announced *by no later than 1 May in the Storage Year preceding the Storage Year in which it is to take effect*. Although we do not disagree with this clause in principle, we would like to highlight that such timeframe allows Rough a potential to introduce loser restrictions on Centrica’s access to capacity and further limit the ability of the market to secure capacity required to satisfy Security of Supply measures.

- We also support the view that the CMA could review the OC following a request from CSL.

However, we believe that a one month timeframe for the CMA to respond to CSL’s request seems to be tight, taking into account that a complex evaluation of Rough’s physical capabilities might be required to make a decision on the update of the OC level.

In addition, we would ask for any such requests from CSL to the CMA to be made public upon application to allow the market to analyse and factor the implications.

3. Ofgem would also be allowed to vary the cap on Centrica if the CMA decides to change OC (currently Ofgem can do this only if Rough’s market power changes or Centrica’s requirements for flexible gas change).

We believe that Ofgem should be allowed to vary the cap on Centrica if the CMA makes a decision to change OC in light of “substantial change” in Rough’s physical capabilities. We have outlined our detailed comments on this as part of our response to Issue 1 addressed earlier in this document.

4. The capacity defined as Further Additional Space (FAS – i.e. space becoming available during the storage year) should be incorporated into the definition of Incremental Capacity (IC).

We support a simplification of financial and regulatory reporting requirements associated with Rough.

However, in our view FAS should be incorporated in AS rather than moved into IC. Taking into account that CSL has clarity on the level of FAS, which is the 0.59TWh of space sold after 1 May each storage year, we believe that this space should be offered to the market in the first instance either as Firm within their annual offerings or as Interruptible to all customers on a fair and transparent basis.

Currently there is no limit on the quantity of FAS or IC that CSL may sell to the Centrica Group or the Centrica Group may purchase from CSL. Therefore if FAS is incorporated into Rough's IC the amount of capacity accessible to the Centrica Group would increase.

For the avoidance of doubt, the above suggestion does not require changing the definition of IC which is currently proposed by CSL. Specifically, CSL defines 'Incremental Capacity' as capacity which is incremental to the Minimum Rough Capacity and Additional Space and which is offered for sale by CSL in accordance with paragraph 4.

Conclusion

In conclusion we recognise that the Review is required from both a technical standpoint and also from the changing face of the gas storage market. We believe that CSL should be allowed to explore all avenues available in order to reduce costs, improve their offerings and simplify the regulatory and financial burdens. And whilst we urge the CMA to consider these facts in the round while working on the review we also urge the CMA to be mindful of the impact of changes in regard to market clarity and availability of capacity.

Yours sincerely,

Polina Kharchenko