

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

21st March 2016

Dear Adrian,

Re: Rough Review – Proposed Undertakings

We would like to take this opportunity to provide our comments on the CMA provisional decision on the Rough Undertakings variations.

On balance, we believe that proposed variations to the Undertakings are sufficient and would allow CSL to reduce its costs when driven by the changing physical capabilities of Rough. We are also pleased that our comments submitted in response to the Issues Statement were taken into consideration when reviewing the Rough Undertakings.

Our detailed response below focuses on the main Variations outlined by the CMA in the Provisional Decision document.

Yours sincerely,

Polina Kharchenko
Wholesale Regulation Manager

1. The Obligated Capacity (OC, i.e. MRC and/or AS) and the OC Adjustment Mechanism

We agree with the proposal to cap the Obligated Capacity at 31.834TWh. Based on the current definition of the SBU, it would mean that CSL will continue to be required to sell 455 million SBUs of MRC and at least 1.5 TWh of AS before the start of the Storage Year, as per current Undertakings.

We also support the CMA provisional decision that the Undertakings would be varied to include an Adjustment Mechanism to change the OC in the event of issues that may significantly affect Rough's capacity for prolonged periods. We support the view that the Mechanism should be triggered by CSL only on an exceptional basis and when CSL considers that it can clearly demonstrate a "substantial impact" on its capacity and that alternative actions available to it as outlined in Paragraph 4.34(b)(i)-(vi) will not suffice to address this. As the CMA states in Paragraph 4.34 (b), the use of hedging and buying gas in the market, to the extent that this is compatible with existing regulation, among other actions, can be used to mitigate the business impact of "non-substantial" physical capabilities changes before the Adjustment Mechanism is triggered.

We are satisfied with the evidence requirements outlined in Paragraphs 4.37-4.41 which CSL would be required to provide to prove that a change which has occurred, or is expected to occur, will have a "substantial impact" on Rough's capabilities.

2. Review of the OC by Ofgem or following a request from CSL

We agree with the CMA decision to delegate the decision on whether and how to increase or decrease either Rough's MRC or AS or both to Ofgem and we agree with the reasons provided by the CMA in relation to this decision (Paragraph 4.27). We also support the CMA proposal that at any time during a Storage Year, either CSL or Ofgem could trigger the Adjustment Mechanism. In addition, we also support the decision that third parties, such as customers, could ask Ofgem to trigger it if they have relevant information. Any changes resulting from the OC review would be applied to the next Storage Year.

We note the CSL's desire to have certainty of the capacity it must sell for the next Storage Year by 1 October. While in Paragraph 4.21 the CMA states that an 'Adjustment Mechanism' could be "triggered and concluded in a relatively short timeframe", we believe that requests to vary the OC would need to be received well in advance so that the industry has sufficient time, i.e. no less than one month, to analyse and factor the implications of such requests. We do not therefore believe that any time limitations should be imposed on Ofgem in the revision process of the Undertakings.

Finally, where, following a substantial decrease in Rough Capacity, Ofgem has decided on either a lower level of MRC or AS or both, if there is a subsequent substantial increase in Rough capacity CSL must promptly make an application to Ofgem to raise either MRC or AS or both under paragraph 2.10 of the Undertakings.

3. Review of the Specified Capacity

We agree that as part of evidence requirements to request a change to the OC, CSL would also need to demonstrate that a variation of the OC would leave Centrica no better or worse off relative to the current undertakings.

We support the amendment of Undertaking 3.6 which now includes in the list of circumstances that 'a substantial change in the Minimum Rough Capacity and/or Additional Space' could allow Ofgem or Centrica to trigger the mechanism to adjust the Specified Capacity. As the CMA states, this amendment will allow for circumstances where a "substantial change" to the factors that affect the Centrica Group's requirement for flexible gas might result in Centrica being better or worse off relative to the current undertakings as a result of changes to the Obligated Capacity.

Separately, while an introduction of the 34.7TWh baseline level to address industry concerns in relation to the 'investment' definition is clearly valid and useful, the amendments to Undertakings 3.3 and 3.7 somewhat dilute the purpose of the 34.7TWh baseline. Specifically, Undertakings 3.3 now entitles Centrica to the Specified Capacity of Incremental Capacity and Undertaking 3.7 poses no limit

on the quantity of Incremental Capacity after the Storage Year begins that CSL may sell to the Centrica Group or the Centrica Group may purchase from CSL.

The CMA has amended the definition of '**Incremental Capacity**' in Proposed Undertakings which now states that this is "capacity which is incremental to the Minimum Rough Capacity, Additional Space and Further Additional Space". This amended definition does not longer state that Incremental Capacity is capacity at Rough achieved through investment in storage operations by CSL.

Furthermore, the CMA has amended the definition of '**Specified Capacity**' which now states that:

'Specified Capacity' means twenty five per cent (25%) in relation to Minimum Rough Capacity, 1534 GWh in relation to Additional Space, and no Incremental Capacity until 34.7 TWh of space has been sold before the Storage Year; or such other amounts as are permitted by Ofgem in accordance with paragraph 3.6

In Paragraphs 4.64 and 4.65 of the Provisional Decision the CMA provides further explanation of how the amended '**Specified Capacity**' definition would be applied in practice.

In addition, the CMA has also amended Undertaking 3.7 which now suggests that "there is no limit on the quantity of Incremental Capacity after the Storage Year begins that CSL may sell to the Centrica Group or the Centrica Group may purchase from CSL". This proposal implies that if the additional capacity between 31.834TWh and 34.7TWh (baseline) becomes available within the Storage Year, it would be treated as Incremental Capacity and Centrica Group's entitlement to this capacity would not be limited.

While an introduction of the 34.7TWh to address industry concerns in relation to the 'investment' definition is clearly valid and useful, the above-mentioned proposal somewhat dilutes the purpose of the 34.7TWh baseline level. We would propose that any additional capacity between 31.834TWh and 34.7TWh becoming available after 1 May is offered to the market in a public, transparent and non-discriminatory manner. We agree with the CMA that an introduction of different Specified Capacity caps depending on whether the additional capacity was made available ahead of or within Storage Year would unnecessarily complicate the monitoring process.

Finally, we also note CSL's suggestion that the Undertakings should include an overarching principle that CSL should not be obliged to sell capacity that cannot be physically backed by Rough. In line with CMA's considerations, we believe that where a "non-substantial" mismatch between CSL's obligations and Rough's physical capabilities occurs, alternative actions available to CSL to balance a shortfall, such as the use of hedging and buying gas in the market, mean that this principle arguably cannot be followed in practice.

4. Further Additional Space (FAS) definition

We note that the CMA has decided not to incorporate in the Undertakings our proposal to incorporate FAS in AS. Our proposal was based on the premise that CSL can quantify FAS (0.59TWh) before the start of the Storage Year which meant that the definition of FAS was similar to AS.

We note the CMA's comment that allowing Centrica unrestricted access to the capacity created by investment at Rough (which FAS is deemed to be part of) was included in the Undertakings to maintain CSL's incentives to expand Rough's capacity. We believe however that the amended definition of FAS,

'Further Additional Space' means the first 0.59 TWh of space sold during the Storage Year.

while defining the maximum volume of FAS, should also specify that FAS is the space created by investment at Rough.

Conclusion

In conclusion we believe that, on balance, proposed variations in the Undertakings are sufficient and would allow CSL to reduce its costs driven by changing physical capabilities of Rough.