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**Ref: Gas Storage Regulatory Framework and Concept Licence**

Dear Richard,

Bord Gáis Energy (BGE) and Storengy, a company of GDF SUEZ, welcome an opportunity to respond to the consultation issued by the Northern Ireland Utility Regulator on the Gas Storage Regulatory Framework. BGE and Storengy are currently investigating the feasibility of developing an underground salt cavern storage facility in Northern Ireland, approximately one mile underground in the Larne area, Co. Antrim, under the mineral prospecting licence granted by the Department of Enterprise Trade and Investment in September 2008. We therefore consider the timing of this consultation to be particularly opportune. Our response to the consultation is broadly structured as follows:

- Part 1: Response to the specific questions raised in the consultation on the proposed regulatory framework for gas storage (Questions 2-6)
- Part 2: Application of the Third Gas Directive in the context of the concept gas storage licence and comments on the proposed conditions of the licence (Question 1);

**1. PART 1**

***1.1 Are there any further aspects of the Third Package legislation that should be considered for the future regulatory framework of gas storage in Northern Ireland?***

We note that, in common with the provisions in this regard in the First and Second Directives, the Third Gas Directive provides that TPA is only required for a storage facility if

access to the storage facility in question is technically and/or economically necessary for providing efficient access to the system for the supply of customers, as well as for the organisation of access to ancillary services (“**Necessary Storage**”) – in which case Member States may choose either or both of the TPA regimes.

We would like to confirm our understanding of the sequencing of the analysis with regard to the triggers for and order of application of the following concepts of the Third Directive in respect of any storage facility:

- (a) first, consider whether it constitutes Necessary Storage as defined above; if not, neither paragraphs (b) or (c) below apply; if yes, proceed to paragraph (b);
- (b) consider which (if any) of the TPA regimes (i.e. regulated or negotiated) should apply to the facility or, in the alternative, whether it is suitable for consideration for an exemption; regardless of the determination, proceed to paragraph (c);
- (c) consider whether the SSO is part of a vertically integrated undertaking, as defined at Recital (20) of the Third Gas Directive; if not, the unbundling requirements will not apply to it

*Could you confirm that the above description and order of the analysis is correct? Assuming it is, the Authority might also confirm its view as to how, practically, steps (a) and (b) might interrelate, a question on which we comment further below in relation to exemptions generally.*

If a storage facility is deemed to be Necessary Storage, then either a negotiated or regulated TPA regime can be applied. The adoption of either such regime is a key element in the design of the gas storage framework.

The Consultation considers the factors to apply in determining which is the most suitable TPA regime to be as follows:

- Definition of the relevant market – in terms of geographic and product markets
- Market power – the level that could be gained through the use of a storage facility;
- Market share – being a key contributor to the level of market share that a storage owner may hold;
- Emergency – the existence of such would increase the level of market power.

We comment on the above factors below (Questions 3-6 in the Consultation).

## ***1.2 The Utility Regulator seeks industry views on the relevant geographic and product markets applicable to a gas storage facility in Northern Ireland***

The relevant geographic market for a gas storage facility in Northern Ireland should be taken to be UK and Ireland as Irish shippers have access to NBP and therefore gas storage in the

GB market. An all-island gas market, which will combine the NI and ROI gas markets into a single market, is already being contemplated through the Common Arrangements for Gas (CAG) process and is critical to commercial viability of gas storage located in Northern Ireland. The island of Ireland sources 90% of its gas from the GB through the Interconnectors and SNIP and is effectively a gas price taker on the GB market. The scale of new indigenous production and proposed gas storage projects are unlikely to change this situation, i.e. the Interconnectors are expected to continue as marginal source of gas.

Given the strong link between the NBP and both Northern Ireland and the Republic of Ireland gas prices, de-linkage would happen only if a major supply disruption occurs at Moffat or if, in the future, LNG import in Ireland sets the price. Hence, we agree with the view that it is appropriate to consider these three markets together as the relevant market for a gas storage facility in Northern Ireland. It is therefore paramount that all potential barriers to flows between these markets are avoided and that, if required, interconnections could be made bi-directional.

### ***1.3 The Utility Regulator seeks industry views on market power in relation to a storage facility in Northern Ireland and its influence on selecting the most appropriate TPA regime***

As discussed above, a gas storage facility in Northern Ireland should be viewed as part of a wider UK and Ireland gas market. The Larne area in Northern Ireland has a unique geological makeup which could allow a development of a high deliverability underground gas storage facility with working gas capacity in the region of 300mcm based on initial estimates. While such a facility in Northern Ireland may be the only gas storage of this type on the island of Ireland supplying 6.5% of 2014/15 projected annual consumption, when viewed as part of a wider UK market it would account for only 0.3% of consumption<sup>1</sup>. As discussed above, Irish shippers have access to gas storage capacity in the GB market. The existing storage capacity in the GB market (3.6bcm) is expected to increase as a significant number of storage facilities in various stages of development are currently being proposed in the UK and any storage facility build in NI will be competing against similar projects in the GB market. Therefore, given the linkage to NBP and competition from storage facilities in the GB market, a facility in Northern Ireland will have limited ability to influence market prices.

The consultation states that the level of market power would increase in the event of an emergency.

We would like to point out that in either TPA regime a gas storage operator only makes storage capacity services available to the market and does not make commercial decisions in respect of the working gas in store and as such does not have the ability to exercise market power with respect to gas prices. Developing a new storage facility in Northern Ireland would dramatically enhance the security of gas supply to Northern Ireland in case of major disruption to import from Great Britain. Insurance against such an event will be reflected in the price paid by customers (e.g. suppliers, shippers, etc.) for storage capacity in Northern

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<sup>1</sup> 2008/09 – 2014/15 Gaslink Transmission Development Statement: average consumption c. 7,729 mcm; 2008 National Grid 10 year Statement: 2014/15 annual demand c. 104,997mcm

Ireland. It is therefore important that any regulatory provisions that prevent the supplier/shipper from abusing its position, whether temporarily dominant or otherwise, do not unduly preclude that entity from benefiting from the insurance implied in the gas storage capacity it purchased without fair compensation.

We support the Regulator's opinion that nTPA is the most appropriate regime for storage in Northern Ireland, as the relevant geographic market should encompass Great Britain and the relevant product market encompasses non regulated sources of flexibility. Indeed, it is very important that storage in Northern Ireland is as much as possible on a level playing field with its alternatives/competitors.

#### ***1.4 The Utility Regulator seeks industry views on the application of the technically and/or economically necessary assessment regarding access to a gas storage facility in Northern Ireland***

Whether a facility is deemed to be technically and/or economically necessary depends on the range of flexibility tools available to gas market participants to balance supply and demand. We would like to point out that the Irish market is currently functioning well without a gas storage facility in Northern Ireland. Irish shippers currently have a number of flexibility tools available to them which include South West Kinsale reservoir storage, indigenous production (Inch today, future supplies from Corrib production), inventory product on the interconnectors, short term products and capacity trading as well as having access to the mechanisms available in GB including gas storage.

Given the linkage of the Irish gas markets to the GB market, the price of flexibility services offered in Ireland would be linked to the price of gas in GB market, i.e. NBP, and therefore a storage operator in NI would be competing with other flexibility products in the UK (including storage) and not be able to influence prices.

In summary, we agree with the view that storage facility in Northern Ireland would not be technically and economically necessary as Irish shippers have access to a liquid and competitive gas market in GB including the range of flexibility mechanism which that market offers.

#### ***1.5 The Utility Regulator seeks industry views on the appropriateness of each regime (negotiated and regulated) as a framework for access to gas storage facilities in Northern Ireland.***

As discussed above, Irish shippers have access to a liquid and competitive gas market in GB. Markets that are developed tend to adopt a light touch approach to regulation and therefore favour negotiated versus regulated approach to rate setting.

Choosing a regulated access in a competitive market would have a number of drawbacks. Firstly, a regulated approach is typically based on cost-based tariff design and does not

accurately reflect the value of storage service in peak periods or periods of high volatility which salt cavern storage provides. In addition, it is worth pointing out that choosing rTPA for storage in Northern Ireland without some kind of compulsory bookings imposed upon suppliers would result in a very high level of commercial risk that might deter developers from investing in storage projects in Northern Ireland. Indeed, if there is no obligation to book storage capacity in Northern Irish facilities but the storage capacity prices for these facilities are regulated by a fixed tariff, it is very likely that shippers will buy storage capacity in Northern Ireland only when the fixed tariff is lower than the costs of other flexibility sources (such as storage in Great Britain, the price of which would be set at market rate). If the fixed tariff was higher than the market rate no capacity would be booked and the storage operators would get no revenues. This makes an rTPA regime very difficult to administer.

We therefore agree with the Regulator's views that reduced regulatory intervention will send a positive signal to investment in storage and that a regulated regime in Northern Ireland, given the alternatives to storage in Northern Ireland (including storage in Great Britain), would significantly reduce the interest in pursuing gas storage projects in Northern Ireland.

#### CEER Regulated TPA or Negotiated TPA Checklist (section 7.6)

- *Does the storage company have significant market power, i.e. is it able to increase prices above the cost-reflective competitive level?* We agree with Regulator's views that the storage facility in Northern Ireland and especially any SSO of such facility would not have significant market power and the ability of influence prices (please see the above comments in relation to the market power)
- *Does the market provide incentives for potential collusion between market operators?* Given the alternatives to storage in Northern Ireland (including storage in Great Britain) and the link to NBP price, collusion between gas storage operators that would allow them to effectively impact on gas price is very unlikely and can, in practice, be virtually ruled out.
- *Has the storage operator any incentive to withhold capacity? Are the costs of such a strategy consistent with benefits for the company and its affiliates?* The investment required to build a gas storage facility is very significant and the developer will have to bear such investment risk. Very often firm gas storage capacity is sold before the beginning of a storage year. It is therefore a very risky commercial bet to withhold "ex-ante" capacity when revenues can be "hedged" at reasonable price. In addition, the powers of the Regulator to undertake an "ex-post" analysis of the storage operator's "hoarding" behaviour would increase the risk of such a strategy even further.
- *Has the storage operator the ability and any incentive to discriminate between customers in the provision of capacity?* Since gas shippers/suppliers in Northern Ireland will have the ability to choose between several sources of flexibility (including gas storage services in Great Britain) implementing a commercial strategy based on discrimination would very quickly prove unsustainable.
- *Does the storage operator hold information that gives it an unfair advantage with respect to its users and competitors? Does lack of information increase risk and uncertainty faced by customers, competitors and potential entrants?* The level of information disclosure recommended in

the Guidelines for Good TPA Practice for Storage Operators (GGPSSO) should be sufficient to alleviate any concern regarding lack of information.

- *Does the storage operator lack the incentive to innovate in marketing new products and invest in increasing capacity?* Since there is no storage in Northern Ireland, any new gas storage development would demonstrate that there was no lack of incentive to innovate and invest in gas storage!

Based on the above, we believe that as long as there is commercial interest to develop gas storage projects in Northern Ireland, negotiated access to storage capacity pricing should be adopted. However, given a small number of players in the Irish market, conditions around third party access should not be unduly restrictive (this relates to % of capacity that could be sold to a single party, contract term, etc.)

#### ***1.6 The Utility Regulator seems industry views on the suitability of applying exemptions to the TPA requirements for a gas storage facility in Northern Ireland.***

An applicant for an SSO licence may apply to the Utility Regulator and (ultimately, via the Utility Regulator) to the Commission for an exemption from the third party access requirements contained within the Third Gas Directive. It is noted that it is not the case that the Utility Regulator alone determines whether exemptions should apply; the criteria against which the application for exemption is assessed are provided for in the Third Gas Directive and while the Utility Regulator makes an initial determination, this is subject to the Commission's confirmation.

Plainly, such an exemption would only be required if, absent such, the facility concerned would be deemed to be Necessary Storage to which TPA would apply. The assessment of whether a facility constitutes Necessary Storage and whether an exemption should be granted are two separate matters.

In Northern Ireland, the Third Directive requirements will be implemented (most likely) through secondary legislation and the conditions of the gas storage licence. In terms of process, it is our understanding that if a gas storage developer wished to apply for a TPA exemption it would – for reasons of efficiency given the different regulatory bodies concerned - make such an application in parallel with its application for a gas storage licence, the terms of which will reflect - through inclusion of a TPA regime - whether in the Utility Regulator's view the facility constitutes Necessary Storage. Therefore, assuming that the SSO licence application is dealt with ahead of the exemption application, if the facility is not Necessary Storage, the application for exemption may ultimately prove to be redundant.

*We would welcome clarifications from the Utility Regulator on the process that would be adopted in Northern Ireland for a developer of a facility to seek a determination from the Utility Regulator as to whether or not the facility constitutes Necessary Storage such that the TPA regime will not apply to it and the process for applying for an exemption from the TPA regime in the event that the determination is that it does constitute Necessary Storage. Would the Utility Regulator agree that these applications will run in parallel?*



The Utility Regulator proposes to use the indicators discussed by Ofgem in the letter “Gas Storage third party access exemptions – minor facilities” of 16<sup>th</sup> June 2009 (“**Ofgem Letter**”) as guidance to granting exemptions to minor facilities. We make the following comments in relation to this.

It is noted that the Ofgem Letter is limited to a consideration of the criteria against which applications for a facility to be deemed to be “Necessary Storage” will be considered – namely whether the facility constitutes storage necessary for the operation of an economically efficient gas market.

In contrast with Northern Ireland, gas storage activities in GB are not subject to licensing. Instead, the commercial operation of gas storage facilities is governed by the Gas Act (for on-shore facilities) and the Petroleum Act (off shore facilities), including the requirement to provide TPA unless exempt. The default access regime for gas storage access in GB is nTPA. The Gas Act sets out the process via which owners of storage facilities can apply for an exemption from nTPA. Two options are available for an exemption to be granted from TPA requirements. As noted above, the Ofgem Letter only relates to “minor” facilities, i.e. exemptions granted on the basis that TPA is not economically or technically necessary for providing efficient access to the system for the supply of customers. (The use of language by Ofgem is confusing; if the facility is not Necessary Storage, it is automatically outside of the TPA regime and does not require to be exempted from it.) The letter does not cover exemptions granted to “major” new gas storage facilities, where the facility is Necessary Storage but an exemption could be requested on the grounds that the facility in question would enhance competition and security of supply but is unlikely to be constructed without such an exemption (provisions under Article 35).

However, in order to provide transparency to the market on when TPA is required to be offered at a storage facility, the GB legislation (i.e. the Gas Act and the Petroleum Act respectively) requires that an assessment is made and a facility be specifically excluded from the requirement to provide TPA. Therefore, in order to comply with the requirements of domestic legislation in such a manner as to achieve the results envisaged by the relevant EU directives, Ofgem has to consider the issues of technical and economic necessity when granting such an exemption. It is open to Member States to put in place additional rules and considerations to the extent these do not obstruct the objectives or the Directive. To that end, Ofgem published exemption criteria for “minor” facilities – in other words the criteria for determining whether or not a facility constitutes Necessary Storage.

Broadly, we support the criteria proposed by Ofgem to assess whether TPA is technically and economically necessary for providing efficient access to the system for supply of customers. However, while we appreciate the requirement to monitor the market in terms of flexibility alternatives available, we would caution against unnecessary change to the exemption status during the period of time for which it is granted as it could undermine investor confidence.

In summary, we strongly support an exemption regime for facilities that are not “technically and/or economically necessary” while noting that such a regime is mandated by the Third Gas Directive. In addition, we note that exemption regime is available under the Third Directive on the grounds that the facility in question would enhance security of supply and competition but would not be built without an exemption. A gas storage facility in Northern Ireland would

clearly enhance security of supply on the island but given a small market in terms of number of potential customers, it is conceivable that a TPA exemption may be required for commercial viability of such a facility. Indeed, imposing “unnecessary” constraints on gas storage would only make it more difficult to compete with “unregulated” sources of flexibility thereby reducing overall competition. Furthermore, since storage in Northern Ireland will compete with storage in Great Britain, it is important to have as much as possible a level playing field with Great Britain.

## **PART 2 - Comments on Gas Storage Licence**

### **2.1 General comments**

As a general comment, we would like to note that the licence appears to be drafted with a regulated business model in mind. We believe that a number of conditions (particularly with respect to provision of financial information, audit rights, etc.) would not be applicable in the case of unregulated business.

*Page 12 of the consultation: Business entity to which the licence is granted.*

We understand, it is the Utility Regulator’s initial view that only the operator of the facility, the storage system operator (“SSO”) would be licensed, as the entity with the responsibility on a day to day basis for the operation of the facility. It is not proposed that the owner – who is noted as having some obligations indirectly via the licence – would be licensed. It is not clear how, as stated in the Consultation, the owner would have obligations “indirectly” via the licence if it is not the holder of the licence. The comment is made that this approach is dependant on the particular structure of the business applying for a licence and therefore it would seem the Utility Regulator is making the assumption that:

- the SSO would also be the owner; or
- the SSO and the owner would be members of the same group and the SSO’s licence would require it to procure that the owner would comply with obligations imposed by the licence (and perhaps undertake directly to the regulator to do so).

Since the draft licence addresses mainly issues pertaining to “economic/commercial” regulation we believe that the SSO would be better able to discharge such obligations. However, we would like to point out that in practice the SSO may not necessarily be the owner.

*Page 12 of the consultation: Single licence covering multiple locations.* This would reduce the administrative burden and as such would be welcomed provided however that the provisions relating to assets disposal are such that the transfer of ownership of one of the facilities covered by the licence would not be hindered. Disclosure of information to the regulator and to third parties would also require careful attention.



## 2.2 General Conditions

### *Clause 1 (b) (i) – Grant and Terms of Licence*

We would welcome indicative figures for notice period before the licence can be determined. Such notice periods should take into account the minimum economic lifetime of a gas storage project.

### *Definition of “Capacity Statement” (especially in relation with clause 2.1.3)*

We understand the need to provide transparency of available capacity. However, it seems more difficult to predict flows and demand. We would therefore welcome clarifications on “forecast flows” and on “customer demand”.

### *Condition 1.2 - Separate Accounts for Separate Business*

As a general comment, we do not believe that the obligations with respect to provision and publication of the financial information outlined in this condition should apply to a negotiated TPA or a TPA exempt facility. This clause would appear to be relevant only in the case of a regulated TPA facility.

### *Condition 1.2.12 – Associated Undertakings*

In order not to discriminate between customers, information about commercial contracts between associated undertakings should not be made available to the public.

### *Condition 1.5. – Consultation with the General Consumer Council*

Consulting with GCC on “policies for the conduct of its business activities” might be unduly restrictive, especially for a nTPA or TPA exempt facility.. In any event, we would like to understand the role the GCC would play in the licensee’s business.

### *Conditions 1.7 (Assignment of Licences), 1.8 (Transfer of Business) and 1.9 (Disposal of Relevant Assets)*

As a general comment, it is paramount, especially for gas storage projects developed by Joint-Ventures, that “changes of ownership” are not hindered by unduly restrictive conditions set on assignment, transfer and disposal. Therefore, we believe that the licence should confirm that in these circumstances the Authority’s consent would not be unreasonably withheld.

### *Condition 1.10. – Payment of Fees*

We would welcome an indicative figure for the licence fee

### *Condition 1.11.3 – Compulsory Purchase Orders*

The clause allows the licensee to apply to the Department for an order vesting the required land (that cannot be acquired by agreement) in him. We would make two comments in relation to this draft condition:

- 1) Because it is proposed that the licensee would be the SSO not the owner, it is not clear why it would be appropriate that any vesting of lands would be in the operator and not the owner;
- 2) The Department has the power to compulsory acquire lands under the Mineral Development Act (Northern Ireland) 1969. Therefore it is the Mineral Development Act (Northern Ireland) 1969 that is the enabling legislation through which a licensee (via the

Department) can access compulsory purchase powers. Therefore inclusion of the condition in the license does not, and could not achieve the same effect and hence it does not appear to be meaningful to include it in the licence.

## 2.3 Specific Conditions

### *Condition 2.1.2 – Licence to operate an efficient storage facility*

This is a fairly general clause. We would welcome further details and/or reference to standards.

### *Condition 2.1.3 – Capacity Statement*

We would welcome clarifications on the approval to be given by the Authority of the Capacity Statement, especially on “forecast flows and customer demand”.

### *Condition 2.2.2 (Independence of Gas Storage Business)*

The condition obliges the licensee to operate the business through a legally distinct and separate entity from any other business or venture engaged in the production or supply of gas in Northern Ireland and to ensure that the Licensed Business has effective decision making rights with respect to the assets necessary to maintain, operate and develop the facility.

We would like to point out that the Second Gas Directive does not require Member States to take measures to ensure SSOs are unbundled. However, the Third Gas Directive provides that if a storage facility is technically and/or economically necessary for providing efficient access to the system of supply for customers, and the SSO is part of a vertically integrated undertaking, the SSO must be independent at least in terms of its legal form, organisation and decision making from other activities not relating to transmission, distribution and storage and subject to certain independence requirements with regard to management, decision making rights, etc.

In summary therefore, Member States are not required to take measures to ensure the unbundling of SSOs of storage facilities which are not technically/economically necessary for providing access to the system of supply for customers. This distinction, and its implications, should be accurately reflected in the licence condition, i.e. it only should be included if applicable. The Consultation notes that the unbundling condition is included in reference to the independence requirements of the Third Gas Directive. However, the provisions of the Third Gas Directive with regard to unbundling do not appear to have been accurately summarised at Section 5.6 of the Consultation, most particularly where the language of the Consultation appears to suggest that the appointment of an independent system operator is a trigger for the unbundling regime in respect of an SSO.

### *Condition 2.3.3 – Provision of information to system users*

We would welcome clarifications on “system users” and the type of information they would need.

### *Condition 2.3.5 – Technical rules to ensure the inter-operability of systems*

We would welcome clarifications on the technical data/standards/rules that would be required.

*Condition 2.3.6 – Storage Charges*

We would question the requirement for the Regulatory Authority to have audit rights over prices in the case of a negotiated TPA or TPA exempt facility. It is our understanding, that in GB the Regulator does not have audit rights over prices in the case of nTPA and TPA exempt facilities.

*Condition 2.3.7 – Third Party Access*

This clause will obviously be very important and we would welcome the opportunity to comment on the proposed wording. We would also welcome the Regulator's views on the way a TPA exemption would be dealt with in the licence (i.e. clauses of the licence that would not apply to a TPA exempt facility). We would question the requirement for the Regulatory Authority to have audit rights over prices in the case of a negotiated TPA or TPA exempt facility.

*Condition 2.9 – Facility Development Plan*

We would welcome clarifications on the anticipated content of the Development Plan as well as on the type of “review” to be made by the Authority.

*Condition 2.10 – Public Service Obligations*

We would welcome clarifications on the anticipated type of public service obligations.

I hope you find the above comments useful in finalising your decision. Please do not hesitate to contact me should you have any comments or queries.

Sincerely,

Maria Meade

Strategic Investments

Bord Gáis Energy

{by e-mail}