

CMA'S REVIEW OF THE ROUGH UNDERTAKINGS GIVEN BY CENTRICA STORAGE LIMITED AND CENTRICA

Statement of Issues

Introduction

1. On 27 October 2015, the Competition and Markets Authority (CMA) announced its decision to appoint a Group to undertake a review, under paragraph 16 of Schedule 24 to the Enterprise Act 2003, of the Undertakings given in December 2003 by Centrica Storage Limited (CSL) and Centrica, and amended on 3 April 2006 and on 5 March 2012, in relation to the completed acquisition by Centrica of Dynegy Storage Limited and Dynegy Onshore Processing UK Limited ('the undertakings').¹
2. The CMA's decision to undertake a review of the undertakings followed the CMA's consultation on whether to conduct a review and consideration of the responses to that consultation.² The review of the undertakings will be undertaken by a group of CMA panel members, appointed by the CMA Panel Chair. The CMA panel members for the review are: Martin Cave (Chair), Roger Finbow and Marisa Cassoni.
3. The group of panel members will be advised by a case team of CMA staff. The CMA will also, when appropriate, seek the advice of Ofgem, the sector regulator of gas and electricity markets in the UK.
4. This issues statement is based on the information and evidence provided by CSL and Centrica in their request for a review of the undertakings.³ We are publishing this statement now to assist those submitting evidence to focus on the issues we envisage being relevant to this review (in particular, paragraphs 18 to 25). We invite interested parties to comment on these issues, including the information and evidence provided by CSL and Centrica.
5. We also invite parties to tell us, with reasons, if they believe either that (a) the issues we have identified should not be within the scope of our review or are mischaracterised, or (b) there are further issues we have either not identified,

¹ See the [decision statement](#) (October 2015) on the consultation page.

² See the [invitation to comment](#) (September 2015) on the consultation page.

³ See the [consultation page](#): 'CSL and Centrica application for a variation to the undertakings', and 'CSL and Centrica proposed changes to undertakings'.

or which we have indicated we are not minded to pursue but which we should consider. We ask parties to support their views with relevant evidence (including original documentation and analysis).

6. Representations with any relevant evidence should be made, preferably by email only (with any attachments in PDF or Excel), by 5pm on 26 November 2015 to:

rough.undertakings@cma.gsi.gov.uk

Or:

Adrian Leigh
Project Manager
Rough Undertakings Review
Competition and Markets Authority
Victoria House
Southampton Row
London WC1B 4AD
Phone: 020 3738 6095
Email: adrian.leigh@cma.gsi.gov.uk

7. Please note that we may publish responses, or refer to responses in any subsequent report. If you wish to submit a response containing information or evidence that you consider to be confidential, please submit both a confidential and non-confidential version, and provide an explanation as to why you consider the material to be confidential. For further information please refer to *Transparency and disclosure – statement of CMA’s policy and approach: CMA6*.⁴
8. In this issues statement, by way of background, we set out a brief description of the case. We then set out the changes in circumstances highlighted by CSL and Centrica in the request for a review of the undertakings, and the main issues for the review.

Background

9. In 2002, Centrica bought two companies (Dynergy Storage Limited and Dynergy Onshore Processing UK Limited) that owned and operated the Rough gas storage facility, located in the North Sea, off the east coast of Yorkshire.

⁴ *Transparency and disclosure – statement of CMA’s policy and approach: CMA6*.

10. Rough is the largest gas storage facility in Great Britain, used by market participants to store gas in the summer and deliver that gas to meet peak demand in the winter.
11. Following the acquisition, the Office of Fair Trading (OFT) referred the merger to the Competition Commission (CC). The CC concluded in its 2003 report that the merger would increase the uncertainty faced by other industry participants and potential entrants, and that, in the absence of further constraints Centrica may be expected to:
 - discriminate between customers in giving access to capacity at Rough;
 - withhold, or use to its advantage, sensitive information from the operation of Rough;
 - be less innovative in marketing Rough products; and
 - invest less in expanding Rough's capacity.
12. The CC requested a number of behavioural undertakings from Centrica, which Centrica agreed with the Secretary of State in December 2003. Key aspects of these included:
 - ensuring non-discriminatory access to Rough for users;
 - restrictions on Centrica's access to capacity; and
 - the legal, financial and physical separation of CSL from Centrica.
13. In November 2005, Centrica requested a variation of the original undertakings in order to enable a minor group restructuring of the Centrica Group. After considering advice on the proposed variation prepared by the OFT, the CC accepted the variation and the new, amended, undertakings ('the amended undertakings') came into force on 3 April 2006.
14. In 2011, following a request from Centrica to be released from the undertakings by reason of a change of circumstances, the CC conducted a review and decided to make a small number of variations to the undertakings, primarily in relation to Centrica's access to capacity.⁵

⁵ CC (2011), Review of Undertakings given by Centrica following its acquisition of the Rough Gas Storage Facility. See the Competition Commission's final report on the [CMA's webpages](#).

15. Currently, therefore, the main provisions of the undertakings are that CSL will be maintained legally, financially and physically separate from all other businesses of Centrica and that CSL must:
- offer all Rough capacity for sale on a non-discriminatory basis;
 - unless otherwise agreed with Ofgem, retain the Storage Service Contract (SSC) for all sales of Rough capacity;
 - unless otherwise agreed with Ofgem, sell Minimum Rough Capacity (MRC) in Standard Bundled Units (SBUs) comprising combined rights to fixed units of space, injection and withdrawal;
 - sell the following 'obliged capacity' before the start of the Storage Year (May):
 - 455 million SBUs of MRC; and
 - at least 1.5TWh of 'Additional Space' (AS);
 - not sell more to Centrica per year than a maximum 'specified capacity' of:
 - 25% of MRC; and
 - 1.5TWh of AS;
 - offer at least 20% of MRC (equivalent to 91 million SBUs) on annual contracts;
 - auction all unsold obliged capacity one month before start of the next Storage Year;
 - offer for sale capacity that becomes available during the Storage Year;
 - facilitate the efficient operation and development of a secondary market in Rough capacity;
 - disclose information on storage operations to all market participants simultaneously;
 - ensure that no commercially sensitive information arising from the operation of Rough is passed directly or indirectly to any business of either Centrica or any other member of the Centrica Group; and
 - provide sales and operational information to Ofgem and the CMA for compliance monitoring purposes.

CSL's and Centrica's request for a review of the undertakings

16. CSL and Centrica requested a review of the undertakings by the CMA by reason of a change in circumstances. In March 2015, following technical reports, CSL announced a decision to limit the maximum operating pressure in Rough.⁶ CSL is conducting further tests, but it considers that there is a risk it will be physically unable to meet the capacity sales requirements as set out in the undertakings for the 2016/17 Storage Year and potentially beyond.⁷
17. In July 2015, CSL informed the market that it would need to conduct further tests that will last until the end of the Summer 2016 injection season (between September and December 2016), before it will have sufficient information to determine if it can raise the maximum permitted operating pressure.⁸

Issues to be considered in the review of undertakings

18. The current fall in pressure has had the effect of limiting the maximum reservoir volume (space) to between 29 and 32TWh (the maximum reservoir volume was 41TWh in 2014) and decreasing injection performance (the rate at which gas can be transferred into the reservoir).
19. CSL further submitted that, as an ageing asset, the performance of the assets that constitute the Rough storage facility could be expected to become less predictable, increasing the potential for CSL to be physically unable to meet the undertakings' capacity sales requirements in future years. In its letter to the CMA of 18 September 2015, CSL provided further explanation of the changes to Rough's capacity.⁹
20. Neither CSL nor Centrica have suggested that there has been a material change in competitive conditions in the gas storage market since the last review. In addition, none of the respondents to the invitation to comment suggested there had been any such changes.
21. CSL and Centrica have suggested a number of proposed variations to the undertakings to address the change in circumstances and to reflect their view

⁶ See CSL press release (March 2015): [Rough operating pressure limited to 3000 psi](#).

⁷ CSL therefore separately requested an indication of the CMA's approach to prioritisation of enforcement action if CSL were to undertake the compliance steps it has identified for 2016/17. See [CSL's and Centrica's request for an indication of the CMA's prioritisation principles](#) (18 September 2015), available on the consultation page. The CMA published its response to this request, indicating that, provided the assumed facts set out in CSL's letter of 18 September 2015 were to continue to apply and the proposed actions set out in the letter were undertaken by CSL, CMA officials anticipate they would not recommend prioritising the taking of enforcement action. See the [CMA's letter of indication of prioritisation](#) (22 September 2015), available on the consultation page.

⁸ See CSL press release (July 2015): [Rough operating pressure limit extended](#).

⁹ See [CSL and Centrica application for a variation to the undertakings](#) (September 2015), available on the consultation page.

noted above that the physical performance of the assets of Rough could be expected to become less predictable. Specifically, CSL and Centrica have proposed that the undertakings be varied such that:¹⁰

- the CMA should have the power to vary the Obligated Capacity (OC, ie MRC and/or AS) where the physical capabilities at Rough are reduced. The CMA can also increase OC, but not above the historical level (ie 455m SBU of MRC and 1.534TWH of AS);
- 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);
- 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); and
- the capacity defined as Further Additional Space (FAS – ie space becoming available during the storage year)¹¹ should be incorporated into the definition of Incremental Capacity (IC).¹²

22. In the absence of evidence of a wider change of circumstances, the CMA considers that the review should be focused on addressing the implications on the capacity obligations in the existing undertakings of the potential for increasing variability in the performance of the facility. In doing so we would seek to ensure that the effect of these undertakings in remedying or mitigating the aspects of the merger which the CC considered may operate against the public interest are maintained.
23. In conducting the review, we will assess the proposed amendments as suggested by CSL and Centrica and consider whether there are alternative approaches that better achieve the effect of the undertakings. We will consider the implications of changes to the capacity-related undertakings for the gas transmission system and wholesale gas market. We are not intending to review the market for the provision of gas storage facilities and whether any such changes would warrant any variation to the undertakings.

¹⁰ For the detail of CSL's proposed changes to the wording of the Undertakings, see: CSL and Centrica proposed changes to undertakings on the CMA's [consultation page](#).

¹¹ In contrast to AS, FAS can only be quantified and sold during the Storage Year. It does not include space created through Incremental Capacity (IC).

¹² IC is the space that is created through new investments in the storage facilities.

24. In addition, we have been made aware by Ofgem and CSL that there have been potential issues related to the effectiveness of the monitoring and compliance arrangements included within the undertakings. We therefore consider it appropriate to include within our review an assessment of the monitoring and compliance arrangements to consider whether they are achieving the objectives initially intended. If we find they are not, we will consider whether there are alternative arrangements that should be put in place.

Conclusions

25. We have highlighted in this issues statement areas where we would particularly welcome submissions. We also welcome views on any areas that we have not covered, and note that we may revisit the areas of focus for our review should we uncover evidence of potential problems in the course of our work.

5 November 2015