

Centrica Storage Limited and Centrica plc

Notice of decision to review the ‘Rough’ Undertakings

17 October 2017

Introduction and statutory duties

1. The Competition and Markets Authority (CMA) has decided to conduct a review of the undertakings given in December 2003 by Centrica Storage Limited (CSL) and Centrica plc (Centrica), and amended on 3 April 2006, 5 March 2012 and 26 May 2016, in relation to the completed acquisition by Centrica of Dynegy Storage Limited and Dynegy Onshore Processing UK Limited (the ‘Rough’ undertakings).¹
2. Rough is a gas field in the North Sea used to store gas in the summer and deliver it in winter when the gas is needed to help meet higher demand. It has been an important part of the UK’s gas storage infrastructure and capacity.
3. CSL and Centrica, by reason of a change of circumstances, are seeking removal of the undertakings.²
4. On 29 September, Centrica Storage Limited (CSL) wrote to the CMA requesting that they and Centrica plc (Centrica) be released from the [Rough Undertakings](#) in light of a change of circumstances.
5. The CMA has a statutory duty to keep under review undertakings made under section 88 of the Fair Trading Act 1973 (FTA) by virtue of Schedule 24 paragraph 16 of the Enterprise Act 2002, as amended by the Enterprise and Regulatory Reform Act 2013.
6. The CMA has set out in its published guidance, *Remedies: Guidance on the CMA’s approach to the variation and termination of merger, monopoly and market undertakings and orders* (CMA11),³ that in launching a review, the CMA will consider its published prioritisation principles and whether there is a

¹ These undertakings can be viewed on the [CMA website](#).

² [CSL request](#)

³ See *Remedies: Guidance on the CMA’s approach to the variation and termination of merger, monopoly and market undertakings and orders* – [CMA 11](#).

realistic prospect of finding a change of circumstances.⁴ The guidance reinforces the point that in doing so the CMA will apply its discretion in determining whether ‘a review should take place at a particular point in time’.

7. The evidence we have received from CSL indicates that there is a realistic prospect of a review finding a change of circumstances and that a review would be in line with our [prioritisation principles](#). Given the relatively straightforward nature of the potential change in circumstances identified, and to ensure its resources are used most effectively, the CMA has decided, in this case, to proceed directly to carrying out this review without issuing an invitation to comment on whether to carry out a review.

Background

8. Rough is the largest gas storage facility in GB – used by between 15 and 20 market participants to store gas in the summer and deliver that gas to meet peak demand in winter. When fully operational, Rough represents approximately 70% of the UK gas storage market by volume, capable of storing up to 150 bcf, representing approximately 6% of total UK annual demand. On a daily basis in winter, Rough can produce 10% of peak winter day demand. Rough is owned and operated by CSL.
9. In 2002 Centrica bought two companies that owned and operated Rough and the OFT decided to refer this 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. The CC requested a number of behavioural Undertakings from Centrica, which the Secretary of State agreed 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.
10. In 2011, following a request for a review from CSL, the CC [decided](#) to make a small number of variations to the Undertakings – primarily in relation to Centrica’s access to capacity.

⁴ CMA 11, paragraph 3.10.

11. In 2015, following technical reports on the integrity of its wells, CSL announced a decision to limit the maximum operating pressure in Rough from 3,500 psi to 3,000 psi while it conducted tests to establish whether it could operate the wells at the higher pressure. Consequently, CSL requested a further review of the Undertakings to take account of the reduced performance of Rough following the reduction in maximum operating pressure. In 2016, the CMA [decided](#) to vary the undertakings to take account of the potential for increasing variability in the performance of the facility. Currently, the main provisions of the Rough UTs 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):
 - 455m SBUs of MRC; and
 - At least 1.5 TWh of Additional Space (AS).
- Not sell more to Centrica per year than a maximum 'specified capacity' of:
 - 25% of MRC; and
 - 1.5 TWh of AS.

Centrica can access no incremental capacity in terms of space unless 34.7 TWh of space will be made available to the market ahead of the Storage Year, but may access 100% of incremental capacity above this level.

- 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.
 - Provide sales and operational information to Ofgem and the CMA for compliance monitoring purposes.
12. The undertakings also include an adjustment mechanism which allows Ofgem to increase or decrease either MRC or AS for the next and/or subsequent Storage Years upon the application of CSL or on its own initiative on the basis of the following factors:
- There has been, or will be, a substantial change in Rough Capacity;
 - Provided that the sum of the varied MRC and AS must be at least the Maximum Technical Storage Capacity of Rough (and not more than 31.834 TWh); and
 - The variation as between MRC and AS must be an appropriate offer for customers of CSL.

Change of circumstances

13. On 20 June 2017, following an extensive well testing programme and a review into the feasibility of returning Rough to injection and storage operations, CSL [announced a decision](#) that, as a result of the high operating pressures involved, and the fact that the wells and facilities were at the end of their design life and had suffered a number of different failure modes while testing, CSL could not safely return the assets and facilities to injection and storage operations. CSL said that it intended to make all relevant applications to permanently end Rough's status as a storage facility, and to produce all recoverable cushion gas from the field, which was estimated at 183 bcf. 'All relevant applications' include the current request by CSL to have the CMA revoke the Undertakings. CSL will also have to apply to the Oil & Gas Authority (OGA) to change its storage licence into a production licence.
14. The results of CSL's well testing programme (conducted between March 2015 and June 2017) demonstrated that the Rough wells are susceptible to a range of unpredictable age-related failures and any return to injection operations

would pose an unacceptable health and safety risk. Further, the offshore platforms and the Easington terminal (where gas from Rough is landed) are also showing substantial age-related deterioration. CSL has submitted that the only technically viable option for reducing the risk associated with injection operations to an acceptable level (as low as reasonably practical – ‘ALARP’) is to abandon the existing Rough wells and drill new wells into the Rough field and to substantially rebuild the offshore and onshore assets. CSL has calculated the costs of rebuilding Rough to create a safe facility with broadly similar characteristics and had an independent expert verify these costs. CSL determined that these works would cost in the order of £1 billion and would take around five years to complete. CSL has stated that making the asset safe for injection operations in this way would not be economic.

15. By reason of a change of circumstances, CSL is seeking the revocation of the undertakings.

Consideration

16. Given the parties’ request, we have considered whether to launch a review under paragraph 16 of Schedule 24 to the EA02 of the above undertakings which were made to remedy the competition and other public interest concerns arising from the merger.⁵
17. The CMA is required from time to time to review its remedies and to consider whether a change of circumstances has arisen which makes the remedy no longer appropriate. The CMA has set out in its published guidance⁶ that, in launching a review, the CMA will consider its published prioritisation principles and whether there is a realistic prospect of finding a change of circumstances.⁷ The Guidance reinforces the point that in doing so the CMA will apply its discretion in determining whether ‘a review should take place at a particular point in time’. In this case we have received evidence suggesting a change of circumstance and that a review meets our prioritisation principles.
18. Given the facts set out in paragraphs 13 and 14, we have concluded that there is a realistic prospect that there has been a change of circumstances which makes the remedy no longer appropriate. We now go on to consider our prioritisation principles.

⁵ The Rough undertakings were given under the FTA and the power to vary or release the undertakings arises under Schedule 24 EA02. The relevant undertaking having been transferred to the CMA’s legacy bodies by SI (this is the effect of paragraph 16 of Schedule 24 EA02 as regards the Rough undertaking specified in Schedule 1 to SI 2004/2181).

⁶ [CMA 11](#).

⁷ [CMA 11](#), paragraph 3.10.

Prioritisation Principles

19. With reference to the CMA's [prioritisation principles](#), we consider that a review of the Rough Undertakings should be considered a priority for the CMA for the following reasons:
- **Strategic significance:** This project is a good fit with the CMA's objectives and strategy as it reflects the CMA's statutory duty to keep remedies under review, and is consistent with the CMA's commitment in its recent annual reports on the way it will deal with the remedies it monitors.
 - **Impact:** The CMA considers there are likely to be indirect benefits for consumer welfare by varying or releasing, where appropriate to do so, constraints on the business community in the UK. Moreover, the termination of undertakings that are no longer needed will enable the CMA to focus its monitoring and enforcement resources more effectively on remedies that continue to benefit UK consumers.
 - **Risk and resources:** The CMA considers in light of the evidence provided there is a realistic prospect of finding a change of circumstances which justifies CMA action and that this project can be delivered with proportionate resources.

Decision to launch review

20. On the basis of the evidence available to us the CMA has decided to conduct a review of the Rough undertakings. In reaching this decision, the CMA has obtained sufficient evidence to have established a realistic prospect of finding a change of circumstances in the remedy to be reviewed. Moreover, the CMA has assessed the review of this remedy against its published prioritisation principles and found its launch to be consistent with the principles.
21. The review of the undertakings will be undertaken by a group of CMA panel members, appointed by the CMA panel chair. The group of panel members will be advised by a case team of CMA staff. The CMA will also, as appropriate, seek the advice of Ofgem, the sector regulator of gas and electricity markets in the UK.
22. Further information on the process for conducting a review of an existing remedy is outlined in CMA11 and further information on the conduct of this review will be published on the [case page](#), which will be kept updated.

Stakeholder views

23. Any interested party who would wish to comment on CSL's request to remove the undertakings should provide their views, supported with relevant evidence where possible, in writing to the CMA either by email or by post as set out below.

Robin Kunduchaudhuri
Competition and Markets Authority
Victoria House (6th floor)
37 Southampton Row
London WC1B 4AD

Email: Rough-Undertakings@cma.gsi.gov.uk

Responses should be received by the CMA by **5pm on 31 October 2017**.