centrica storage

Centrica Storage Limited
First Floor
20 Kingston Road
Staines-upon-Thames
Middlesex
TW18 4LG
Tel: 01784 415300
www.centrica-sl.co.uk

Mr Adam Land
Senior Director
Competition and Markets Authority
Victoria House,
37 Southampton Row,
London, WC1B 4AD

Cc: Mr Tom Corcut,
Head of Wholesale Gas Policy, Ofgem

18 September 2015

Dear Adam

Centrica plc ("Centrica") and Centrica Storage Limited ("CSL")
Application to the CMA for a variation to the Undertakings

In 2003, following CSL's acquisition of the Rough Gas Storage Facility from Dynegy Group, Centrica and CSL gave undertakings (the **Undertakings**) to the Secretary of State for Trade and Industry pursuant to the Fair Trading Act 1973. Pursuant to the Enterprise Act 2002, the Competition Commission varied the Undertakings in 2012.

As a result of recent changes in the physical capabilities of the Rough Gas Storage Facility (the **Facility**), the obligations in the Undertakings to provide storage capacity in the Facility exceed its physical capabilities. The immediate physical changes to the Facility (brought about because of concerns about well integrity) are consistent with the general change to the nature of the Facility as an aging asset that is likely to require changes to its operating parameters in increasingly unpredictable ways in order to keep it functioning efficiently and safely. As a consequence, Centrica and CSL[1] are seeking that the Competition & Markets Authority (**CMA**) make appropriate variations to the Undertakings to reflect the change in circumstances.

In this letter, Centrica and CSL demonstrate the existence and nature of the change in circumstances affecting the Facility, explain why such change in circumstances should be considered sufficient to initiate a review of the Undertakings and provide proposals for the variations it considers appropriate to address the change in circumstances.

1. The change in circumstances

1.1. The physical capabilities of Rough changed and are expected to continue to change

On 18 March 2015, CSL issued a REMIT bulletin informing the market that it was limiting the maximum operating pressure of the Rough wells to 3,000psi. This limitation had the following effects:

(i) limiting the maximum reservoir volume (the space into which gas can be injected) to between 29 and 32TWh (in 2014, the maximum reservoir volume was 41TWh); and

[1] The Undertakings were given by Centrica plc and Centrica Storage Limited. In this letter, reference to Centrica Storage Limited's obligations should be read as references to these obligations on the part of Centrica Storage Limited and, where the Undertakings impose this obligation on both entities, Centrica plc.

(ii) decreasing injection performance (the rate at which CSL can transfer gas into the Facility).

The limitation was imposed based on a report from CSL's independent Wells Examiner, stating that the Maximum Allowable Annular Surface Pressure of the Rough wells had been calculated to be 3,000 psi.

Figure 1 attached to this letter (and discussed further below) demonstrates the immediate impact of the pressure limitation on each of these aspects of Rough's operations.

1.2. What remedial steps has CSL taken to rectify the pressure limitation?

In response to the pressure limitation, CSL has undertaken the following mitigation measures.

Firstly, following identification of the issue, CSL commenced a testing campaign which included calliper runs to assess the condition of the production tubing and pressure tests on the hangar seals. CSL expects that sufficient test data will not be available until the end of the summer 2016 injection season (between September and December 2016). During this further period of testing and verification works, the maximum permitted operating pressure of the Rough wells will remain at 3,000psi and, consequently, the upper constraint on the reservoir volume will remain (this has constrained the maximum fill level by c.12TWh).

Secondly, CSL submitted an application to the Oil and Gas Authority (**OGA**) to decrease the Lower OGA Consent from -35bcf to -50bcf. The OGA granted this consent on 20 July 2015. The upper OGA consent and the lower OGA consent set, for the purposes of CSL's gas storage licence, the permitted upper and lower limits on the Rough reservoir that can contain working gas for gas storage[2, 3]. The decrease in the lower OGA limit by 15bcf has created the conditions to allow the conversion of 4.62TWh of cushion gas into working gas volume that CSL will use to facilitate its storage operations. For the 2015/2016 Storage Year, CSL intends to use some of this gas to meet customers' injection nominations in periods in which the Facility is physically constrained and it also provides CSL the gas it requires for operational support purposes in Winter.

Figure 2 provides a graphical depiction of the impacts of the pressure constraint and the decrease in the Lower OGA consent on the work volume of the reservoir.

1.3. Impact of having to meet regulatory obligations to sell capacity when the physical characteristics of Rough change unexpectedly

The Undertakings include an obligation to sell a stipulated volume of storage capacity before the start of the Storage Year. This capacity (the **Obliged Capacity**) is:

(i) 455 million Standard Bundled Units (**SBUs**). This quantity of SBUs is called the Minimum Rough Capacity (**MRC**); and

(ii) not less than 1.534TWh of space. This quantity of space is called the Additional Space (**AS**).

[2] The Oil and Gas Authority has now taken over some of DECC's responsibilities in relation to oil and gas production and storage licences. Consequently, in CSL's Operational Overview, these upper and lower limits are still referred to as the Upper DECC Consent and Lower DECC Consent respectively.

[3] COUK's production licence and CSL's Storage Licence permit COUK to produce gas from Rough and CSL to operate gas storage in Rough within the parameters of the OGA consent (as amended from time to time). The current OGA consent expires on 19 July 2020 and will automatically end if production compromises well integrity or deliverability

SBUs include space, injection and withdrawal rights. Additional Space only consists of space but CSL has the ability to package this up with injection and withdrawal rights in order to maximise its value to customers.

Paragraph 3.5 of the Undertakings states that if, no less than 30 days before the start of the Storage Year, CSL has not sold the Obliged Capacity, CSL must auction only the unsold capacity (with a nominal reserve price[4]).

The Storage Year runs from 1 May to 30 April and CSL sells capacity based on annual or multi-year contracts. Given market participants' knowledge that CSL can become a forced seller (through the mandated auction process) is likely to have a negative impact on the price of capacity over time, CSL tends to sell the Obliged Capacity reasonably far in advance of the relevant Storage Year. CSL is required to sell this volume using its standard-form Storage Services Contract (**SSC**). The SSC regulates customers' access to the Rough Storage Facility and sets out the quantity of injection, space and withdrawal to which the customer is entitled. In order to change the SSC, CSL is required to run a market consultation and have Ofgem's approval (or deemed approval) to the change[5].

On 18 March 2015 (when the well pressure restriction was announced), CSL had already sold 100% of the MRC and Additional Space that it was required to sell for the 2015/2016 Storage Year. The decrease in the permitted well pressure limit meant that CSL would not be able to meet its obligations to customers under the SSC, i.e. Rough was not physically capable of injecting and storing gas in the quantities that customers were entitled to demand. Figure 3 depicts the mismatch between contractual entitlements associated with the MRC and the Facility's capabilities both pre and post the decrease of the Lower OGA Consent.

To mitigate this risk for the 2015/2016 Storage Year, CSL implemented a space buy-back process and bespoke hedging program to re-align contractual commitments with asset capability. CSL purchased capacity from customers that it had previously sold to them. In total CSL repurchased **[X.XTWh at a cost of £X.X million]**. CSL estimates that the bespoke hedging program has cost around **[£X.X million]** to date.

As noted above, the OGA consent to decrease the lower limit of the reservoir has allowed CSL to convert 4.62TWh of cushion gas into working gas volume. This additional working gas will ensure that CSL can fulfil customer nominations with gas already in the Facility during the period when the Facility does not have the physical capabilities to meet those nominations.

CSL has absorbed these one-off costs in the 2015/2016 Storage Year but it does not believe this is a sustainable solution for future years. As well as significantly harming the financial viability of CSL's business, operating a system of selling capacity that is not asset-backed and then repurchasing it at an inflated price seems to contradict the obligation on storage facility owners in the Gas Act to operate their facilities "in a manner that is secure, reliable and efficient"[6].

As set out further below, part of CSL's response to the unexpected change in the Facility's capabilities was to apply for, and receive, consent from the OGA to increase Rough's reservoir volume by 15bcf by converting cushion gas to working gas. This change had further implications for the Facility's capabilities.

[4] Reserve price to be set at or below the relevant marginal cost (Undertakings, Annex 2, paragraph 1.3)
[5] Gas Act 1986 section 19B, Undertakings paragraph 2.5
[6] Gas Act 1986, section 11A(2)

Managing this current pressure constraint has highlighted the potential challenges of operating a physical asset which is subject to regulatory obligations regarding the volume of capacity that must be sold each year. Although CSL invests extensively in maintaining the Facility, **[spending c. £XXm per year]**, like any physical infrastructure, it is subject to potential changes in circumstances (particularly as the infrastructure ages) which impact on the Facility's capabilities (e.g. as a result of plant failures, necessary changes to operational practice, improvement works and reservoir changes) for the remainder of its life as a storage facility.

In summary, significant changes in Rough's physical capabilities combined with CSL's obligations in the Undertakings can result in significant and unexpected financial cost for CSL. Such an outcome is contrary to the intention of the Undertakings and, in the context of Rough's increasing age and associated operational uncertainty, this should constitute grounds for the Undertakings to be reviewed and amended.

1.4. Limitations on managing the risks associated with unexpected changes in the Facility's physical capabilities

1.4.1. Lowering the OGA consent

As noted above, CSL has received the OGA's consent to increase the size of the Facility and this is one means of partially managing some of the exposure resulting from the well integrity issue. However, as set out below, there is no certainty that this approach will be available or sufficient to offset reductions in the physical capabilities of the Facility in future years.

First, it is unlikely that the change in the size of the reservoir facilitated by any further decrease in the Lower OGA Consent will match any future reduction in space created by a change in the Facility's physical capabilities. For example, in this current situation where managing the well integrity issue has required CSL to reduce the maximum permitted operating pressure of the wells, the resulting loss of space is c.40bcf (c.12TWh), whereas the lowering of the OGA Consent has only increased the working space by 15bcf (4.62TWh).

Second, although decreasing the Lower OGA Consent creates additional space in Rough, it also changes Rough's injection and withdrawal capabilities. The impact on injection and withdrawal is depicted in Figure 3 attached to this letter. In summary, there is increased injection in the early part of the injection season but the change to single train operation starts earlier than it would be based on the operating envelope for an NRV ranging from -35bcf to 60bcf. This reflects that injection rates have to be curtailed in order to keep the well pressure to no more than 3,000 psi. Withdrawal rates continue to deteriorate as the reservoir empties. This reflects that withdrawal rates decline as pressure in the reservoir declines. This creates a challenge for CSL to meet customer entitlements under the SSC (where it is compelled to supplement mismatches between the reservoir capabilities and customer entitlements using gas purchased on the market). This means that CSL cannot offer the capacity created by decreasing the Lower OGA Consent in SBU form without significantly increasing the mismatch between customer entitlements and Rough's physical capabilities and having to try to absorb the increased financial exposure and costs this requires.

1.4.2. Amending the SSC or introducing new products

As CSL's exposure to financial risk and costs is caused by the discrepancy between regulatory/contractual obligations (based on the Facility's assumed capabilities) and the Facility's actual capabilities, CSL could seek to manage these risks by amending the SSC. As noted above, in order to make any change to the SSC, CSL is required to run a market consultation and have Ofgem's approval (or deemed approval) to the change[7].

---

[7] Gas Act 1986 section 19B, Undertakings paragraph 2.5

This process takes a minimum of two months to complete. Further, CSL has often contracted capacity on long-term deals. CSL has currently contracted capacity under the SSC until the **[20XX/20XX Storage Year]**. As required by the Undertakings and Gas Act, all these long-term deals are based on the standard terms of the Ofgem-approved SSC. The contractual changes required as a result of a significant reduction in available capacity would constitute a substantial change to the terms customers currently benefit from under the SSC. CSL would expect that existing customers would strongly object to any changes to the SSC which reduced the value of the product they have already purchased. As a result, any consultation on changes to the SSC on this basis could reasonably be expected to (i) involve complex arguments with market participants focused on individual circumstances rather than the market wide benefits (ii) encounter strong opposition from existing customers (which could result in the proposed amendments being rejected in whole or in part) and/or (iii) a compensation mechanism for existing customers resulting in financial loss to CSL.

The Undertakings envisage CSL introducing new products and contracts to sell Rough capacity. In response to an unexpected change in the Facility's physical capabilities, instead of trying to amend the SSC, CSL could seek Ofgem's consent to sell a proportion of Minimum Rough Capacity in the form of 'Non-SBU Products' it develops (see Undertakings, paragraph 2.3(b)). While such an approach has the benefit that CSL could develop products that accurately align to the asset's changed capabilities, it could not necessarily be implemented quickly. New products must be (i) fully developed (including assessing technical/commercial feasibility and market appetite), (ii) consulted on (with respect to the terms and conditions used to sell the products and with respect to implications for the Undertakings), (iii) approved by Ofgem and (iv) supported by system changes (such as IT/trading) and process changes (such as additional compliance reporting requirements). CSL's experience is that these processes would take between 6 to 18 months.[8]

1.5. Summarising the case for a change in circumstances

The operating envelope of Rough has changed since CSL has taken ownership of the Facility. Since taking ownership of Rough, CSL's investment in the asset has increased the physical capabilities of the Facility. Indeed, the Undertakings were designed to incentivise investment in the Facility. However, the Facility is also aging. The Rough offshore facilities and Easington terminal have been producing and processing gas from the mid-1970s and then were transformed into an operational storage facility in 1985. Despite CSL's on-going capital expenditure in maintaining the Facility, there is always a risk that the physical capabilities of the facility will decline and that in some cases the decline may be significant.[9]

As demonstrated by the well integrity issue, the costs associated with managing the exposure created by having to sell the Minimum Rough Capacity (as 455m SBUs) and Additional Space can be significant and potentially unsustainable. Further, the means currently available to Centrica and CSL to manage a change in Rough's physical capabilities are very unlikely to be sufficient to reduce CSL's financial and regulatory exposure associated with the Undertakings to acceptable levels.

---

[8] Note that CSL may, in some circumstances, be able to construct products by bundling space, injection and withdrawal under the SSC. In such cases, it may not be necessary to consult on the terms or make other consequential changes to systems and monitoring arrangements.

[9] By way of comparison, CSL notes that in 2013 SSE introduced changes to its Storage Service Contract to manage injection and withdrawal capacity exposure associated with the Hornsea Storage Facility. Further to this, in March 2015, SSE announced that it was mothballing 33 per cent of Hornsea's withdrawal capacity, and reducing its usable space by 23 million cubic metres (mcm) (or 9 per cent) due to the costs of operating, maintaining and upgrading the older withdrawal plant.

Given the above, CSL considers that it is appropriate to vary the Undertakings to provide some mechanism within the Undertakings to allow the capacity that CSL is obliged to sell ahead of the Storage Year to be reviewed and changed in response to changes in Rough's physical capabilities.

2. CSL's proposal for changing the Undertakings

2.1. Principles guiding CSL's proposed measures

CSL has applied the following guiding principles in structuring its proposed amendments to the Undertakings:

(i) the proposed amendments will preserve the following fundamental objectives of the Undertakings: (a) requiring CSL to sell storage capacity in Rough ahead of the Storage Year; (b) ensuring storage capacity is offered for sale on an annual basis; (c) placing a limit on the volume of capacity that can be sold to Centrica Group; (d) incentivising investment in the Facility; and (e) not materially affecting the CMA's and Ofgem's ability to monitor CSL's level of compliance throughout the duration of the Undertakings;

(ii) the proposed amendments are restricted to capacity requirements and will be the minimum required to ensure compliance with the Rough Undertakings. CSL will not seek changes that are merely desirable or ancillary;

(iii) the proposed amendments will provide the flexibility to ensure CSL and the CMA can respond to any further changes in Rough's physical capabilities on a timely basis; and

(iv) the changes should not require consequential changes to the SSC and thereby mitigate the impact on existing customers.

2.2. CSL's proposed amendments to the Undertakings

The following section summarises the key amendments CSL is proposing should be made to the Undertakings. CSL has provided a track changes version of the Undertakings to show all the changes it proposes should be made to the Undertakings (i.e. including consequential changes such as in definitions) in Appendix 1.

2.2.1. Amending the volume of Obliged Capacity

As noted above, the regulatory requirement to sell (rather than offer) the Obliged Capacity ahead of the Storage Year can result in significant exposure for CSL when there is a significant reduction in the physical capabilities of the Facility.

Given this, CSL considers that the most straightforward mechanism for addressing a significant reduction in the Facility's physical capabilities is to provide the CMA with the ability to reduce the number of SBUs that constitute the Minimum Rough Capacity and to vary the volume of Additional Space.

Similarly, CSL considers that the CMA should have the power to increase the MRC and Additional Space above the reduced level should there be a material improvement in the physical capabilities of Rough provided that any such increase should not exceed the historic definition of the Minimum Rough Capacity and Additional Space (i.e. the CMA could not increase the MRC above 455 million SBUs, or require CSL to sell more than 31.854TWh of space before the start of the Storage Year). This is consistent with the principle that Centrica Group should retain a commercial incentive to invest in Rough.

In circumstances where the Obliged Capacity is reduced, CSL continues to have obligations under the Gas Act 1986 and EU Gas Regulation to offer all available capacity to the market. CSL currently meets these obligations and will continue to do so. Further, CSL considers that the information it is already required to provide Ofgem and the CMA under the Undertakings (for example monthly sales reports) provides a comprehensive mechanism for Ofgem to monitor and challenge CSL if it considers that it is not offering available capacity on a non-discriminatory basis.

2.2.2. Sales within the Storage Year – 'Further Additional Space'

CSL is also proposing that capacity currently classified as 'Further Additional Space' (**FAS**) would be incorporated into Rough's 'Incremental Capacity' and that the all references to FAS be removed from the Rough Undertakings.

FAS is currently defined as:

> '*that space into which gas can be injected over and above the Minimum Rough Capacity and Additional Space, which can only be quantified and sold during the Storage Year, but excluding space created through Incremental Capacity*'.

Based on asset capabilities and sales data from 2005/2006 (i.e. before CSL made significant investments to increase the physical capabilities of Rough and created Incremental Capacity) CSL has determined that the first 0.59TWh of Space sold after 1 May each storage year should be treated as FAS for reporting purposes.

CSL considers that the definition of FAS set out above could be interpreted prior to the point at which the physical capabilities of the Facility were equal to or greater than the physical capabilities when Centrica acquired Rough. However, once the physical capabilities of the Facility are reduced to levels below those at the point of acquisition (such as during the 2015/2016 Storage Year) then the definition has no feasible interpretation.

CSL considers that this proposed amendment to the Undertakings does not have any implications for complying with the spirit of the Undertakings as it would not change the capacity CSL is obliged to offer. This is because the provisions that currently apply to FAS in the Undertakings are the same as those that apply to Incremental Capacity. Further, as noted above, CSL is obliged to offer all available capacity under the Undertakings, Gas Act 1986 and EU Gas Regulation.

The proposed changes will have no impact on customers or the market more generally because CSL makes no distinction between FAS and Incremental Capacity when it is marketing capacity. From the market's perspective CSL is offering available capacity either ahead of the Storage Year or during the Storage Year.

Finally, the only time CSL draws a distinction between the types of space is when it is meeting its reporting obligations under paragraphs 9 (Verification of Additional Space and Further Additional Space) and 10 (Individual Capacity Sales) of the Undertakings. As CSL may be in a situation where it will not be unable to determine the appropriate volume of space to be classified as FAS it cannot feasibly comply with these reporting requirements. This also means that Ofgem and the CMA will not be able to monitor and assess compliance with these relevant requirements.

2.2.3. *Changes to the 'Specified Capacity'*

CSL is proposing that a 'substantial change' to the MRC and/or AS by the CMA should be added to the list of circumstances in paragraph 3.6 of the Undertakings which would trigger a right on the part of Centrica Group to apply to Ofgem for, or for Ofgem to initiate, a change to the amount of the MRC and AS that can be sold to other parts of Centrica.[10]

The capacity that CSL can sell to other parts of Centrica is defined as the 'Specified Capacity' in the Undertakings. The current Specified Capacity is set as a percentage of the MRC (currently set at 25%) and a specific volume of the AS (currently set at up to 1534GWh).

CSL considers that it is appropriate that Centrica Group should be able to apply for a change to the volumes of the Specified Capacity if there is a reduction in the MRC or AS. Likewise, Ofgem should be entitled to initiate a change in these circumstances. This is consistent with the intent of paragraph 3.6 of the Undertakings which is about recognising that the Specified Capacity should be subject to change when there is a substantial change in circumstances.

Further, CSL considers that the proposed amendment protects the objectives of the Undertakings of ensuring there is sufficient capacity available for market participants other than Centrica on two grounds. First, the provision would allow Ofgem to independently take the decision to review and change Centrica's Specified Capacity should there be a significant reduction in the Facility's physical capabilities. Secondly, Ofgem would need to approve any increase to the Specified Capacity sought by Centrica.

2.3. CSL's proposed amendments and its guiding principles

2.3.1. *Principle (i): Preserving the fundamental objectives of the Undertakings*

(a) <u>Requirement to sell capacity ahead of the Storage Year</u>

CSL's proposed amendment to the Undertakings, allowing the CMA to change the MRC and AS provides the market with comfort that Centrica and CSL will be required to sell a significant volume of the Facility's physical capacity ahead of the Storage Year. CSL considers that this volume should be consistent with the physical capabilities of the Facility – any mismatch imposed by regulation:

(i) could negatively affect CSL's financial viability;

(ii) potentially conflicts with CSL's obligations as a duty holder under the Gas Act to operate the facility "in a manner that is secure, reliable and efficient"; and

(iii) is contrary to the purposes of the Gas Act, which was intended to ensure gas storage owners such as CSL have, as their principal purpose, the provision of physical storage capacity.

CSL also considers that the Gas Act and EU Gas Regulation provide further protection to the market (over and above the protection enshrined in the Undertakings) that CSL will offer all the Facility's available capacity to the market. When these obligations are combined with CSL's reporting requirements under the Undertakings it should provide the CMA, Ofgem and the market comfort that there is sufficient oversight for CSL's regulators to identify and act if they consider capacity is not being made available.

[10] CSL is proposing that, in line with the principles of minimising changes to the Undertakings, Ofgem should maintain the responsibility for amending the Specified Capacity.

(b) *Ensuring storage capacity is available on an annual basis*

CSL has not proposed any change to the provisions which require CSL to offer 20% of the MRC on annual contracts. This ensures that a consistent and sufficient portion of Rough's capacity is available for new entrants to the gas market and/or for smaller customers that may not have sufficient capital to enter into longer term agreements.

(c) *Limit on maximum volume sold to Centrica Group*

As noted above, the limit on the volume of capacity that CSL can sell to Centrica Group remains. Ofgem can periodically instigate or approve changes to this limit to appropriately reflect changes in Rough's characteristics. The original intent of the provision remains unchanged.

(d) *Compliance monitoring*

The amendments CSL is proposing will not have any substantive change on compliance monitoring. CSL considers that while a change to the MRC or AS and Specified Capacity may require some updating of CSL's internal system limits and controls, they should not require changes to the underlying systems and monitoring arrangements.

2.3.2. Principle (ii): Minimising changes to the Undertakings

CSL considers that its proposed amendments to the Undertakings are the minimum changes necessary to address the regulatory and compliance challenges which are a consequence of a reduction in the physical capabilities of Rough while also maintaining the spirit of the Undertakings. This is demonstrated in Appendix 1, which sets out the specific amendments to the Undertakings CSL is proposing. It is clear from this document that CSL is not seeking changes that are merely desirable or ancillary to addressing a change in the physical capabilities of the Facility.

Of all the options available to CSL within the prevailing regulatory and contractual context, CSL also considers that the amendments it has proposed are the most appropriate, balancing the new requirement of responsiveness and flexibility with the continued protection of market participants through the implementation of the Undertakings to the fullest extent practicable.

2.3.3. Principle (iii): Providing flexibility to address changes in the facility's physical capabilities on a timely basis

The mechanism CSL has proposed for the CMA to change the MRC and AS is consistent with the arrangements in paragraph 3.6 of the Undertakings that were agreed as appropriate for the 'Adjustment mechanism to 'cap'' (the amount of MRC and AS Centrica is permitted to purchase).

CSL considers that this proposed provision requires Centrica and CSL to provide the CMA with sufficient technical information upon which the CMA can make a determination as to whether the changes in the physical capabilities of Rough are sufficient to justify a reduction to the MRC and AS. The CMA would have a month to consider Centrica and CSL's application. A month should be sufficient time to review and challenge the information provided, but also ensure that CSL will be provided with a response in sufficient time to change commercial and operational strategies in line with the assets capabilities.

The fact that the CMA can refuse Centrica and CSL's application to amend the MRC and AS, or make an adjustment to the MRC and/or AS independently of any application by Centrica and

CSL provides sufficient safeguards against Centrica Group making spurious applications or providing insufficient technical information in its application for the CMA to make its determination.

2.3.4. Principle (iv): Minimising changes to the SSC and the impact on existing customers

CSL considers that while existing customers should not receive benefits at the expense of potential customers or customers that are not able to contract long term, the rights of existing customers (acquired before any change to Rough's capabilities) also need to be respected. Existing customers have agreed to purchase a product from CSL with a given set of characteristics and these characteristics are not legally capable of arbitrary and unilateral change. As noted above, CSL considers that there would be significant challenges if it were required to consult on changes to the SSC. Instead, CSL considers that it is more appropriate for the MRC and AS to be adjusted so that CSL can offer as much capacity as it can to all market participants (existing and potential) in a form that is aligned with the physical capabilities of the Facility without the need to change existing contractual rights.

For this reason, CSL has proposed amendments to the Undertakings that do not require consequential changes to the SSC.

3. Application of the CMA's prioritisation principles

The following sections explain why Centrica and CSL consider that their request for a variation to the Undertakings is consistent with the CMA's strategic priorities.

3.1. Impact on customers, the market and end consumers

In 2011, the Competition Commission[11] (now the CMA) came to the conclusion that an important point of differentiation of Rough from other sources of flexible gas supply was the Rough flows were more responsive to price signals than other sources of supply. For Rough to continue to be utilised in line with price signals it is important that the services CSL offers are principally physically backed. In contrast, should CSL be expected to offer services that cannot predominately be met through the utilisation of the Facility's physical capabilities, then CSL will be required to enter the market more to cover the resulting exposure from customer entitlements not being aligned with what the asset can deliver. Perversely, this may create the situation where CSL has to compete to deliver the gas that its customers are nominating.

Given this, CSL considers that the amendments it is proposing will ensure that it can deliver services from Rough that its customers want, namely, physically-backed storage capacity that can flow in line with prevailing price signals.

CSL also accepts that under the proposed amendments, there may be periods during which physical constraints mean it will not be able to offer as much capacity in a form that existing and potential customers may desire (i.e. customers may prefer SBUs (which cannot be physically backed)) to another form of linked unbundled capacity – that is a combination of injection, space and withdrawal (which can be physically backed)). However, in order to maximise revenues, CSL has an incentive to offer the available capacity in a form that will have the most value to customers. This incentive should mitigate the risk of undue harm to customers as CSL will be seeking to ensure that the physically backed services it does offer will also be of value to those seeking Rough capacity.

---

[11] Competition Commission (2011) *Review of the Undertakings given by Centrica following its acquisition of the Rough Gas Storage Facility – Final Report*.

Further, by maintaining Rough’s role in the wholesale market, i.e. as a physically-backed long range storage facility, CSL considers that the changes will not result in any unnecessary distortions to the wholesale gas market, which in turn means no adverse consequences for end consumers.

3.2. Strategic Significance

CSL understands that the Energy Market is a strategic priority area for the CMA. Further, CSL also notes that in its recently published Provisional Findings of its Energy Market Investigation the CMA has not found any features in wholesale gas markets that lead to an adverse effect on competition.

CSL considers that in order to maintain the integrity of the wholesale energy market in GB that it is important to ensure that participants in the energy market can comply with the relevant legislation and regulations that are intended to maintain the efficient functioning of the market. As noted above, CSL considers that should CSL be required by the Undertakings to offer services that are not aligned with the physical capabilities of the Facility that there a risk that CSL will not be able to meet its regulatory obligations under the Gas Act and EU Gas Regulation.

3.3. Risk

By allowing the proposed amendments to the Undertakings, CSL considers that it will ensure that any enforcement action that the CMA may be required to take for non-compliance with the Undertakings will be in relation to an action which is against the spirit and intent of the Undertakings, rather than as a result of CSL not having the physical capabilities to reasonably meet a regulatory requirement.

3.4. Resources

CSL considers that as its proposed amendments to the Undertakings will not change the existing arrangements and therefore resources required for monitoring Centrica and CSL’s compliance.

On behalf of Centrica and CSL, I would like to thank you for considering this application. Should you wish to set up a meeting to discuss the content of this application or require any further information, please contact [contact details redacted].

Yours sincerely

Grant Dawson
Chairman, Centrica Storage Limited
General Counsel & Company Secretary, Centrica

Figure 1: The reduction in Rough's physical capabilities due to the reduction in well pressure to 3000psi prior to the decrease to the Lower OGA consent (i.e. -35bcf)

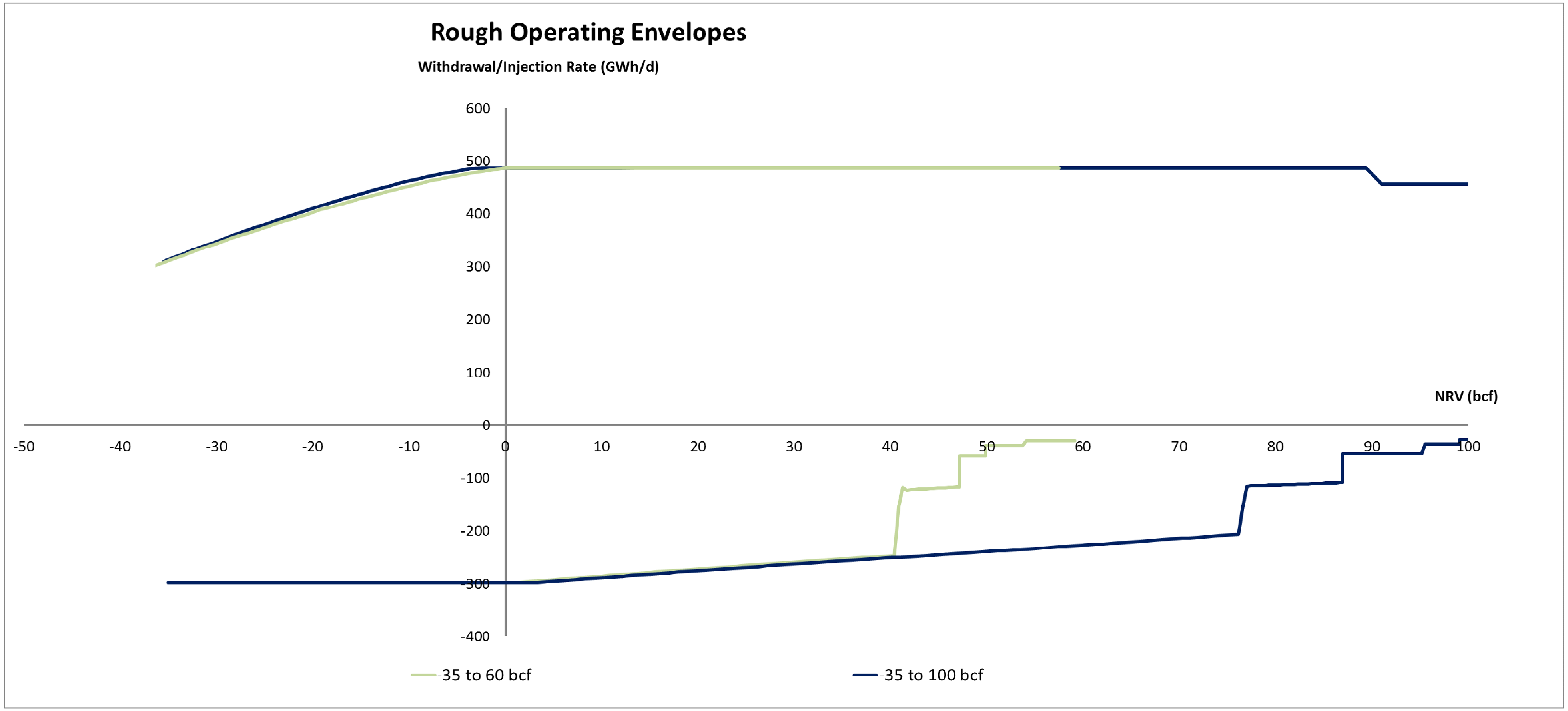


Figure 2: Changes to the Rough Net Reservoir Volume

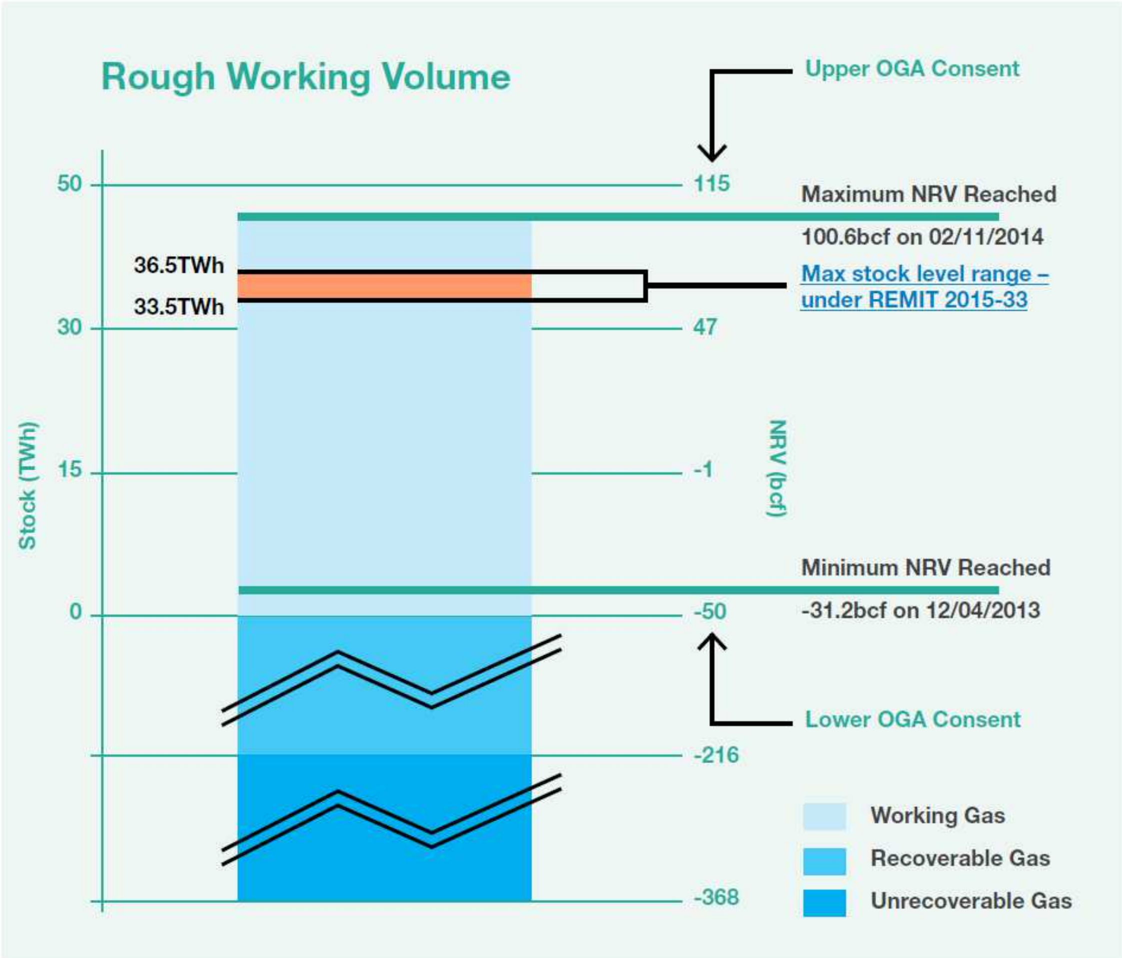
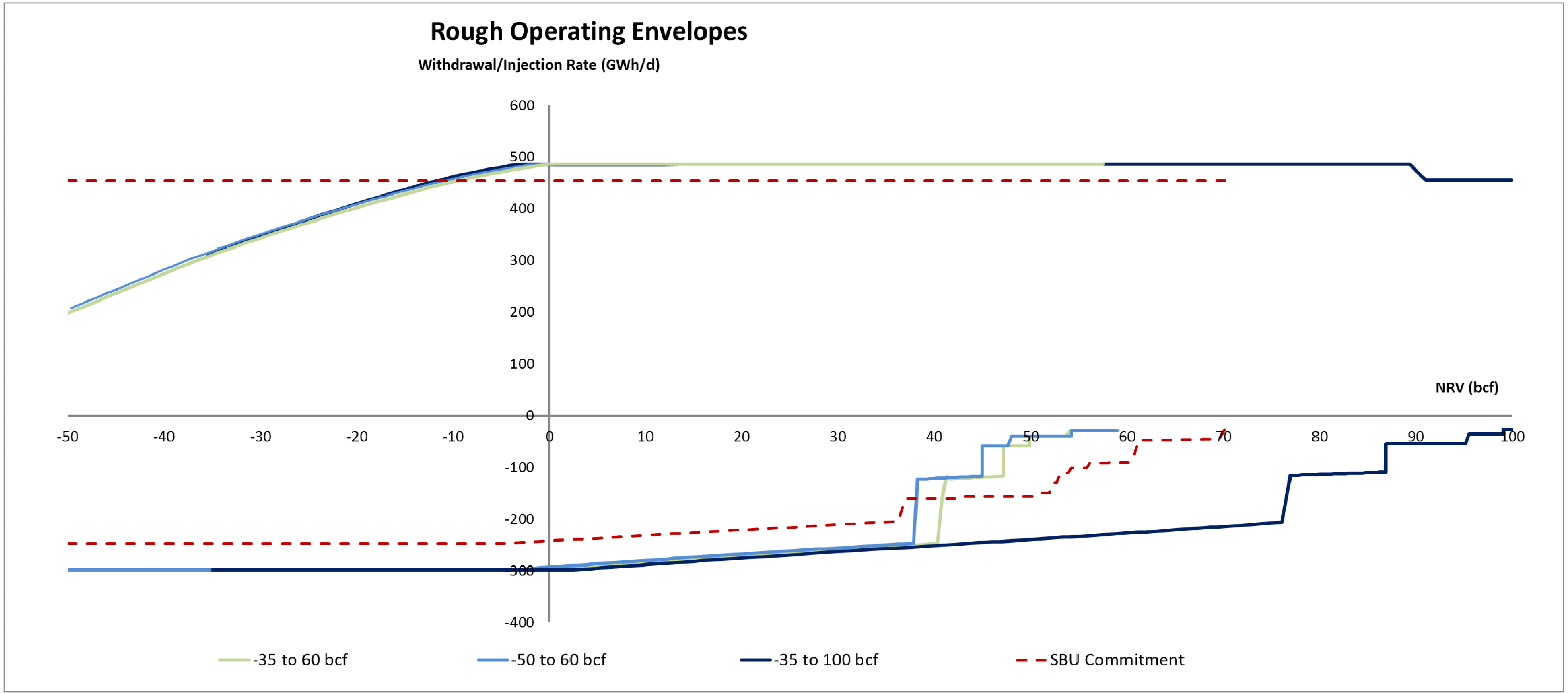


Figure 3: Rough's physical capabilities in the -50bcf Scenario



Appendix 1: Proposed changes to the Undertakings (provided separately)