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

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Dear Adam

**Centrica plc (“Centrica”) and Centrica Storage Limited (“CSL”)
Indication of the CMA’s prioritisation principles in relation 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.

Due to a significant change in circumstance 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 the physical capabilities of the Facility. As a consequence, Centrica and CSL¹ are applying to the Competition & Market Authority (**CMA**) for a review of the Undertakings with a view to possible variations. Application for this variation has been made under cover of a separate letter.

However, as the process for reviewing the Undertakings will require some time to complete, Centrica and CSL consider there is a significant risk regarding its ability to comply with the Undertakings for the 2016/2017 Storage Year. As a consequence:

- (i) Centrica and CSL are proposing a range of measures (set out below) which CSL considers will ensure it can offer the maximum capacity of Rough to the market in a form which is consistent with the physical capabilities of Rough and which is consistent with the spirit of the Undertakings; and
- (ii) Centrica and CSL are seeking that, on the basis of these measures, the CMA implement their prioritisation principles in such a way that it will not take enforcement action against Centrica or CSL for any failure by Centrica or CSL to comply with the Undertakings to the extent such failure is caused by the change in the physical capabilities of Rough.

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.

1. The change in circumstances

1.1. *The physical capabilities of Rough changed*

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 would have 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
- (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 is CSL taking 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 (to inform a decision on any return to operating pressures above 3,000 psi) 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 also 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.

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.

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

1.3. Why is CSL approaching the CMA?

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

- (i) 455 million Standard Bundled Units (**SBU**s). 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.

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 Obligated Capacity, CSL must auction only the unsold capacity (with a nominal reserve price⁴).

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) this is likely to have a negative impact on the price of capacity over time, CSL tends to sell the Obligated 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 change⁵.

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, 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 4.62 TWh 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.

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 2.8

1.4. Limitations on managing the risks associated with unexpected changes in the Facility's physical capabilities for the 2016-17 Storage Year

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, particularly in relation to managing the 2015/2016 Storage Year. However, the resulting changes to the physical capabilities of the Facility are not sufficient to allow CSL to meet its regulatory requirements to sell the obliged capacity.

First, the decrease in the Lower OGA Consent has not offset the reduction in space resulting from the pressure constraint. As noted above, the reduction in the maximum permitted operating pressure of the wells resulted in a 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 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.

By way of example, if CSL is required to offer the MRC of 455 million SBUs ahead of the storage year, then the injection rights associated with these SBUs would be in the order of 7.5TWh greater than what the asset could physically deliver (the mismatch is particularly pronounced during Q3). Further, the residual injection capacity during Q2 (i.e. the period when the physical injection capabilities will exceed the customer's injection entitlements) would only equate to around 1.8 TWh. This means that CSL could not pre-inject sufficient gas to meet customer nominations and therefore it could not ensure there is sufficient gas within Rough (above the Lower OGA Consent) to honour customer nominations. This in turn could place CSL in breach of other contractual obligations under the Deed of Charge and Security Trust Deed⁶.

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 Facilities assumed capabilities) and the Facility's actual capabilities, CSL could seek to manage these risks by amending the SSC. As

⁶ As title and risk to gas transfers to CSL at the storage entry point, these documents provide credit security to customers who have acceded to their terms

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 change⁷.

This process takes a minimum of two months to complete. Further, CSL has already contracted over 51% of the MRC for the 2016-17 Storage Year and has currently contracted capacity under the SSC until the **[20XX/20XX Storage Year]**. As required by the Undertakings and Gas Act, all these 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 current well integrity issue has changed the physical capabilities of the Facility. As noted, CSL expects that sufficient test data (to inform a decision on any return to operating pressures above 3,000 psi) will not be available until the end of the summer 2016 injection season (between September and December 2016), and therefore does not expect that there will be any material change to the current operating envelope of Rough before that time.

For the 2015/2016 Storage Year CSL has absorbed the one-off costs associated with the well integrity issue. However, it does not believe the approach adopted to manage 2015/2016 is a sustainable solution for 2016/2017 or future Storage Years. Further, CSL does not consider that other options for managing the change in capacity, such as further changes to the Lower OGA Consent, changing the SSC, or developing and implementing new products are viable alternatives for managing the 2016/2017 Storage Year.

Finally, should CSL be required to offer the current obliged capacity, as well as significantly harming the financial viability of CSL's business, operating a system of selling capacity that is

⁷ Gas Act 1986 section 19B, Undertakings paragraph 2.5

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 – however such products could not be sold as part of the Minimum Rough Capacity.

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”⁹.

CSL therefore proposes:

- (i) a short-term solution, whereby CSL seeks an indication from the CMA that the CMA will implement its prioritisation principles in such a way that it will not take enforcement action against Centrica or CSL for any failure by Centrica or CSL to comply with the Undertakings in the 2016/2017 Storage Year to the extent such failure is caused by the change in the physical capabilities of Rough on the basis that CSL meets its commitments as set out below; and
- (ii) a long-term solution, whereby the Undertakings are permanently amended to allow the CMA to periodically change the MRC and Additional Space to reflect any changes in Rough’s physical capabilities.

This letter constitutes Centrica’s and CSL’s request for an indication of the CMA’s enforcement intentions as envisaged in the short-term solution. As mentioned above, CSL has separately submitted its application for a variation to the Undertakings as envisaged in the long-term solution.

2. CSL’s proposed measures to ensure compliance with the Undertakings to the fullest extent possible following the change in circumstances

2.1. Principles guiding CSL’s proposed measures

CSL proposes applying the following guiding principles in structuring the scope and nature of measures to deliver compliance with the Undertakings for the 2016/2017 Storage Year to the fullest extent possible:

- (i) CSL’s regulatory obligations should be as closely aligned to Rough’s physical capabilities as reasonably possible based on principles of a reasonable and prudent operator and appropriate risk parameters;
- (ii) CSL’s regulatory obligations should be consistent with the efficient operation of Rough;
- (iii) the proposed measures 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 and (d) not materially affecting the CMA’s and Ofgem’s ability to monitor CSL’s level of compliance in the 2016/2017 Storage Year; and
- (iv) the other elements of the Undertakings (such as separation requirements and protecting Commercially Sensitive Information) will remain unchanged.

2.2. CSL’s proposed measures

CSL will implement the following measures to ensure compliance with the Undertakings to the maximum extent following the change in circumstance:

⁹ Gas Act 1986, section 11A(2)

- (i) if, before 1 October 2015, CSL acting as a reasonable and prudent operator who is seeking to maximise the maximum reservoir volume of Rough, anticipates that it is more likely than not to increase the permitted well pressure limit to 3,500 psi or more on or before 1 May 2016, CSL shall sell the Obligated Capacity specified in the Undertakings in accordance with the requirements of the Undertakings and the measures below shall not apply;
- (ii) on or before 31 March 2016¹⁰, CSL will sell no fewer than 340 million SBUs i.e. the new MRC becomes 340 million SBUs. For the purposes of this letter, CSL refers to this new MRC as the **Exceptional MRC** or **EMRC**;
- (iii) on or before 31 March 2016, CSL will sell no less than 0.13TWh of Additional Space;
- (iv) CSL will not sell to Centrica more than the aggregate volumes of capacity below:

| Capacity | Maximum permitted volume |
|---------------------------------|--------------------------|
| EMRC | 25% |
| Space ahead of the Storage Year | 1.146TWh |

- (v) CSL will provide additional ex post reports detailing Centrica’s capacity purchases for the 2016/2017 Storage Year. This report will be updated within 10 Working Days of Centrica purchasing firm capacity with a duration of more than one day.
- (vi) CSL will provide an Annex to its compliance reports for the 2015/2016 and 2016/2017 Compliance Years which details CSL’s compliance against the key aspects of the proposal for managing the 2016/2017 Storage Year. This will include information on:
 - (a) total SBU and AS sales;
 - (b) release and sales of strips of incremental capacity (including maintaining separation of information on asset changes from those managing the hedging programme); and
 - (c) compliance with reporting to Ofgem and the CMA sales to Centrica.

2.3. CSL’s proposed measures and CSL’s principles of relief

CSL believes that the proposed measures above are consistent with Centrica’s and CSL’s proposed principles set out in section 2.1 on the following basis.

2.3.1. Alignment between regulatory obligations and Rough’s physical capabilities

As set out section 1.3 above, the contractual entitlements associated with the SBU do not align with the current physical capabilities of Rough. A particular challenge for CSL is managing the shortfall in injection capabilities relative to the contractual entitlements. Prior to the pressure constraint, the Facility has always had sufficient injection capability to meet entitlements associated with the MRC¹¹.

¹⁰ CSL proposes that paragraph 3.5 of the Undertakings would apply to the EMRC and Additional Space

¹¹ However CSL did need to manage a shortfall in relation to the Facility’s withdrawal capabilities relative to withdrawal entitlements associated with the MRC prior to the pressure constraint.

CSL has identified that it can offer SBUs on the basis that it uses injection capacity which is available earlier in the injection season in order to manage the shortfall in injection capabilities later in the injection season. However, there are physical constraints on the extent to which CSL can use the proposed pre-injection approach to managing the injection shortfall. This is because CSL needs to be in a position to demonstrate it holds customer gas in the reservoir, and offering too many SBUs could put CSL at risk of breaching this requirement. Further, CSL also faces a financial exposure associated with managing the injection shortfall.

CSL has undertaken analysis to determine how many SBUs it could sell while not putting itself at risk of breaching other legal obligations. It has also considered the financial exposure created by managing the physical exposure and taken into consideration key requirements of the Undertakings.

CSL has determined that by committing to sell at least 340m SBUs as the EMRC, it will have sufficient injection capacity early in the injection season to manage injection exposure later in the injection season which results from selling this number of SBUs.

By offering this volume of SBUs for the 2016/2017 Storage Year, CSL will also meet its obligation under paragraph 2.2(a) of the undertakings to offer for sale at least 20% of the MRC (i.e. 91m SBUs) on annual contracts.

Further, CSL is proposing to offer at least 0.13TWh as Additional Space for the 2016/2017 Storage Year. This volume is aligned with the volume of injection that is not required for either injection support in relation to the EMRC or for CSL to inject sufficient gas for operational support purposes. CSL may offer this Additional Space as either unbundled space, as a parking product (linked unbundled capacity) or in SBU form.

CSL considers these volumes of SBUs and Additional Space to be appropriate on the basis that by selling the proposed EMRC and Additional Space, CSL is accepting a proportionately higher level of financial exposure in supporting SBUs (the mismatch between Rough's physical capabilities and its contractual obligations to SBU holders) than it faced prior to the pressure constraint (i.e. prior to the constraint, CSL's costs of managing the withdrawal shortfall equates to approximately [£X.Xm] for the 455m SBUs sold, whereas CSL estimates that exposure created by the 340m SBUs is approximately [£X.Xm]).

2.3.2. Rough's efficient operation

As CSL sets out in the *Rough Storage Facility – An Operational Overview*¹², CSL holds stock in the reservoir in line with CSL's regulatory and contractual obligations to ensure the integrity and efficiency of the storage operation and the operation of the SSC. Operational Stock is used for the purposes of fuel gas, to maintain steady flows, to keep flows above sweep rates or for pigging and for customer stock management as a result of outages. CSL estimates that its operational stock requirements equate to [X.XTWh]. CSL also requires sufficient injection capacity to fill the space when it is economical to do so, i.e. to build up Operational Stock during the Summer. Note that should CSL determine that it does not require any part of the operational stock injection capacity, the capacity is offered to the market on either a firm or interruptible basis¹³.

¹² Para 4.1, available at www.centrica-sl.co.uk/files/operational_guide.pdf

¹³ CSL does not allocate available withdrawal for operational purposes. For example, if CSL needs to withdraw in order to maintain the sweep rate this is because customer are not making sufficient nominations and which allows CSL to use that unused capacity

In relation to being obliged to sell more capacity ahead of the Storage Year, CSL notes that the proposed EMRC means that those customers with SBUs could fill up to around [XX.XTWh]. However, they will have some flexibility about how they choose to use that injection capacity (i.e. they may buy more space and fill it or use the optionality to churn their capacity). When this is combined with the proposed level of Additional Space and CSL's requirements for operational stock, the total volumes CSL could be required to fill equates to over 29TWh. This volume is closely aligned with the amount of gas CSL considers is likely to be economic to inject into Rough (i.e. it is economic to inject gas into Rough from mid April to the end of October, when the relevant gas price spreads are greater than the cost of injecting and storing the gas (see Figure 4)).

Given that the SBU holders have some flexibility regarding how they are likely to use their injection, combined with other uncertainties about stock carryover, market conditions and asset performance, CSL should not be obliged to sell more Additional Space ahead of the storage year.

However, in line with current practices CSL will seek to offer all available capacity in Rough on a rolling basis. This process involves the following steps:

- (i) CSL makes an assessment of the likely available capacity and potential options for linking any unbundled capacity;
- (ii) CSL makes an announcement to the market that the capacity is available; and
- (iii) CSL assesses bids and makes offers on a bilateral basis with any counterparties interested in the capacity.

2.3.3. Preserving the fundamental objectives of the Undertakings

(a) Requirement to sell capacity ahead of the Storage Year

CSL is proposing to offer a significant volume of capacity ahead of the Storage Year. As noted above, the 340m SBUs CSL is proposing to sell ensures that CSL will have sold injection rights of around [XX.XTWh]. Further, CSL has committed to selling at least 0.13TWh of Additional Space. CSL considers that given the physical and financial exposures associated with this capacity that it is taking all reasonable steps to maximise the volume of capacity it is committing to sell ahead of the 2016/2017 Storage Year.

(b) Ensuring CSL is able to offer 20% of the MRC (i.e. 91m SBUs) on annual contracts

CSL is required to offer and does sell capacity on a range of durations. As a consequence CSL has sold more than 51% of the MRC for the 2016/2017 Storage Year as part of multi-year deals. However, in order to meet the requirements of paragraph 2.2(a) of the Undertakings, the volume of the EMRC CSL is proposing to sell will ensure CSL is able to offer more than 91m SBUs for the 2016/2017 Storage Year on annual contracts.

(c) Limit on maximum volume sold to Centrica Group

CSL is proposing that Centrica Group should be entitled to purchase up to 25% of the EMRC and that they can purchase up to 1146GWh of space ahead of the 2016/2017 Storage Year. This figure is based on the adjusting the volume of Additional Space Centrica is permitted to buy in proportion to the reduction in the MRC. CSL considers that given the volume of capacity that Centrica was permitted to purchase for 2015/2016 (i.e. 25% of 455m SBUs) and the

reduced volume of SBUs it is permitted to purchase under this proposal for 2016/2017 Storage Year, that there is a risk that it may require space to manage the transition between Storage Years if there are high levels of carry-over. There is a risk that if Centrica was limited to only the 0.13TWh of Additional Space CSL is proposing that it should be obliged to sell, that if the winter is mild and there is a high carry-over that Centrica may not be able to purchase sufficient space to manage their gas holdings.

Further, in the event that Centrica purchases both its full entitlement of the EMRC and the 1.146 TWh of space ahead of the storage year, under these arrangements it would still hold proportionately less injection and space than it could have held prior to the limitation on Rough's physical capabilities as a result of the pressure constraint. This is a result of both the current constraints on the Facility's capabilities combined with CSL's requirements to pre-inject gas to honour the EMRC (see Appendix 1).¹⁴

However, there is a risk that Centrica could purchase a far greater proportion of withdrawal capacity during peak demand periods, which therefore would limit other parties to interruptible services if Centrica does not use that capacity. Given this potential risk, CSL will provide Ofgem and the CMA with an additional ex post report detailing Centrica's capacity purchases for the 2016/2017 Storage Year. This report will be updated within 10 Working Days of Centrica purchasing firm capacity with a duration of more than one day.

CSL considers that as most firm withdrawal is likely to be sold at least one month ahead of the space being used, that providing Ofgem and the CMA with these reports will allow them to identify and challenge any purchasing activities by Centrica they consider may not be aligned with Centrica's requirements for storage capacity from Rough.

(d) Compliance monitoring

CSL considers that as all Obligated Capacity for 2016/2017 will be sold under the SSC and all other capacity in Rough will continue to be sold under Ofgem-approved contracts, that the systems and reporting arrangements already in place should be sufficient for the CMA to monitor CSL's compliance with the Undertakings.

As noted above, CSL is proposing to provide Ofgem and the CMA with reports relating to the volumes of capacity purchased by Centrica Group for the 2016/2017 Storage Year.

In addition, in order for the CMA and Ofgem to review CSL's compliance with the measures set out in this letter, CSL will also provide Ofgem and the CMA with an annex to its compliance reports for the 2015/2016 and 2016/2017 Compliance Years summarising how it has complied. This annex will include information on:

- (i) total SBU and AS sales;
- (ii) release and sales of strips of incremental capacity (including maintaining separation of information on asset changes from those managing the hedging programme); and
- (iii) compliance with reporting to Ofgem and the CMA sales to Centrica.

¹⁴ This submission has been prepared in accordance with the provisions of the Undertakings to protect Commercially Sensitive Information. It has been prepared by CSL and not shared with any part of Centrica Group involved in Centrica's gas supply, shipping, trading, storage procurement or asset operations activities (Centrica Energy and British Gas).

3. Application of the CMA's prioritisation principles

3.1.1. Impact on customers

CSL considers that the measures it is proposing in order to demonstrate it is taking all reasonable steps to ensure compliance with the Undertakings should minimise any potential negative impacts on CSL's customers and the market more generally.

CSL considers this to be the case because it is offering a significant volume of SBUs for the 2016/2017 Storage Year. This will allow existing and potential customers the ability to purchase capacity at Rough. This is likely to be of particular benefit to existing customers that generally only contract capacity at Rough on an annual basis.

In addition, as CSL has previously set out in this letter, the share of Rough's capacity that Centrica Group can purchase under the proposed measures equates to a relatively smaller share of the available injection and space than it could have purchased prior to the pressure constraint. In relation to withdrawal, CSL's commitment to provide Ofgem and the CMA with reports on Centrica's capacity purchases should mitigate concerns that Centrica will be able to distort the market by buying excess withdrawal capacity. This measure should ensure that competitors of Centrica in up- mid- and down-stream markets will be no worse off in relative terms.

Further, CSL also notes the impacts of the overall reduction in the volume of Rough capacity available for the 2016/2017 Storage Year may be having a limited impact on the wholesale gas market in Great Britain. CSL has drawn this conclusion from observing that Summer-Winter spreads (i.e. the basis for valuing long range storage services) is currently trading at 14 year lows (see Figure 5) and that these spreads have not widened following information that CSL would maintain the current pressure constraint on Rough until at least September 2016. CSL considers that one driver of the downward trend in spreads is the increased competitiveness of the flexible gas market in GB since 2002.

CSL has included a more detailed explanation of the impacts on customers in a confidential annex to this letter.

3.1.2. 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 it be required by the Undertakings to offer services for the 2016/2017 Storage Year that exceed the physical capabilities of the Facility there is a risk that CSL will not be able to meet its regulatory obligations under the Gas Act and EU Gas Regulation.

3.1.3. Risk

By not prioritising enforcement against Centrica and CSL for breach of the Undertakings should they comply with the measures set out in this letter, 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.

3.1.4. Resources

CSL considers that as its proposed measures will not require significant additional resources for monitoring compliance for the 2016-17 Storage Year that there should not be a significant change in the resources the CMA is required to expend on monitoring Centrica and CSL compliance with the spirit and intent of the Undertakings.

4. Timing and next steps

CSL's obligation to auction unsold MRC and Additional Space in April before each Storage Year with a nominal reserve price is well known to market participants. Consequently, to prevent CSL from having to sell 2016/2017 capacity as a distressed seller, it needs to start implementing its sales strategy in October 2015. CSL would therefore be grateful if the CMA could expedite its consideration of how it is likely to prioritise enforcement should CSL act in accordance with the measures set out in this letter but breach the Undertakings due to stated restrictions on the Facility's capacity.

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

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 (the -35 Scenario)

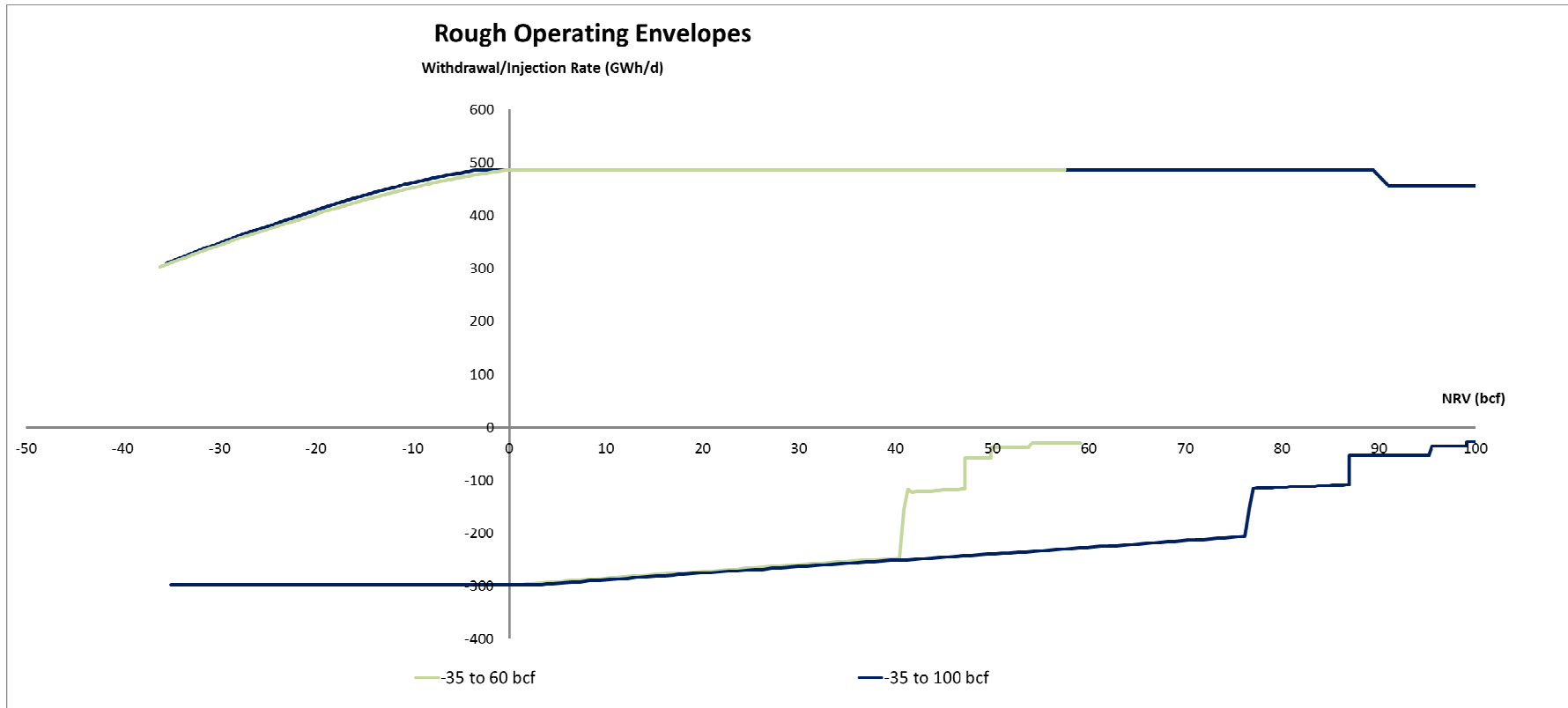


Figure 2: Rough Working Volume

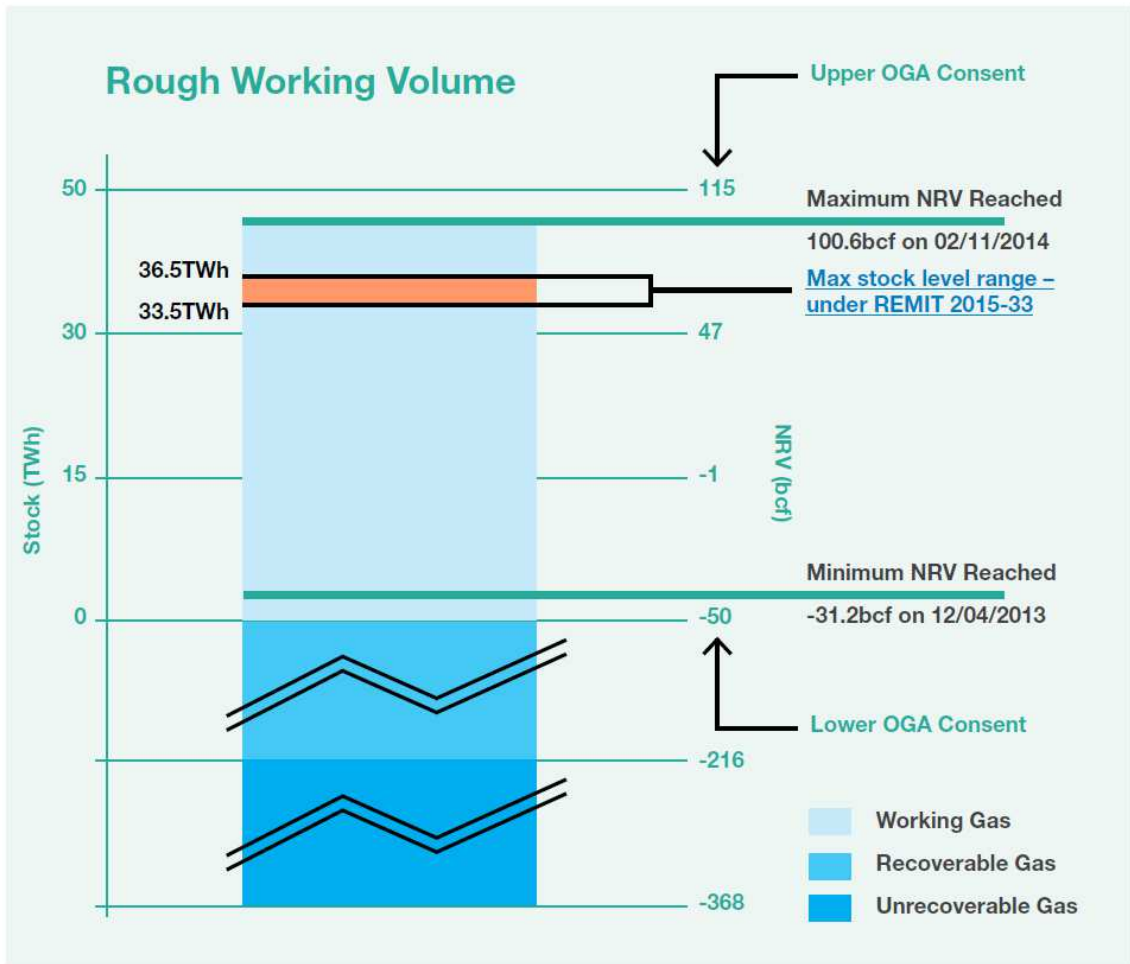


Figure 3: Rough's physical capabilities in the -50bcf Scenario

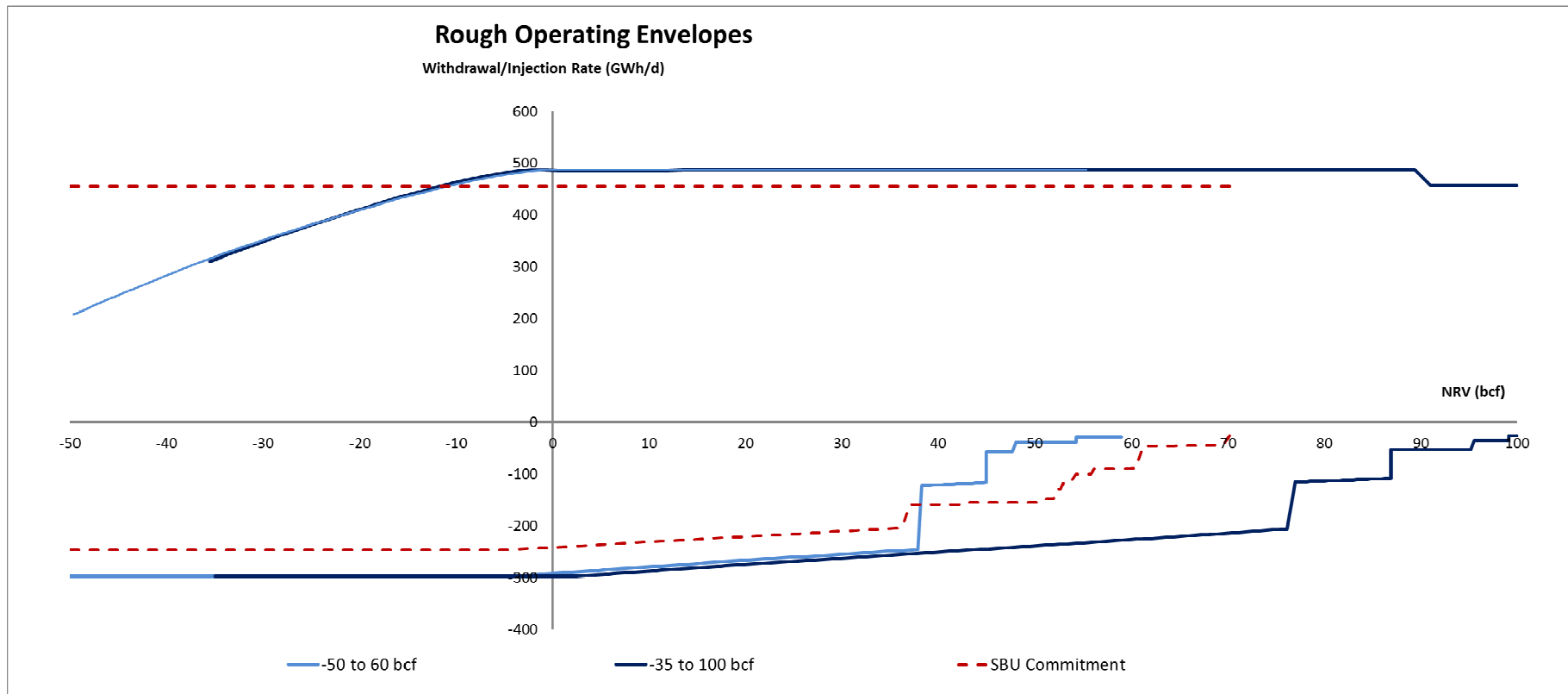
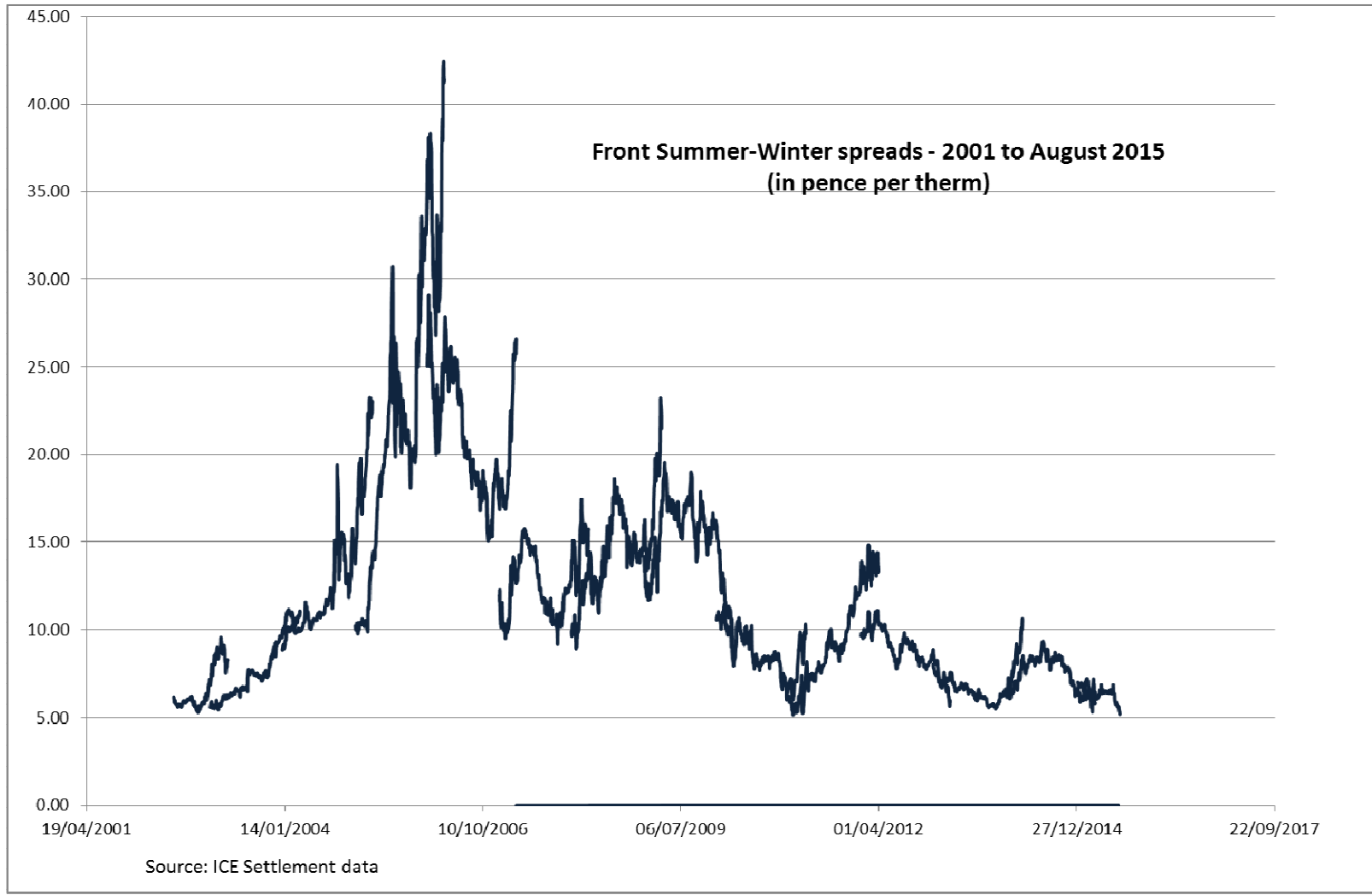


Figure 4: Volume of gas likely to be injected into Rough in the 2016-17 (c.28-29TWh)

[REDACT IMAGE]

* Marginal Spread refers to the difference between the price for Dec 16 and the relevant month (e.g. Marginal Spread in April equals $P_{\text{Dec}'16} - P_{\text{Apr}'16}$)

Figure 5: Summer-Winter Spreads since 2001



Appendix 1: Centrica's Potential Capacity in Rough permitted by the Undertakings

**Maximum Storage Capacity available to Centrica pre-pressure constraint (Capacity based on 2014/15 Storage Year)
(25% MRC, 1534GWh of Additional Space, 100% of Incremental Capacity)**

| | Total Available Space | SBU | Additional Space | Injection Support | Op Stock | Incremental Capacity | Available to Centrica | Centrica % Maximum |
|--------------------|-----------------------|--------|------------------|-------------------|----------|----------------------|-----------------------|--------------------|
| Space (GWh) | 40,700 | 30,300 | 4,398 | | 2,345 | 3,657 | 12,766 | 31% |
| Withdrawal (GWh/d) | 485 | 455 | | | - | 30 | 144 | 30% |
| Injection (GWh/d) | 305 | 160 | | - | 26 | 119 | 159 | 52% |

**Maximum Storage Capacity available to Centrica 2016-17 Storage Year
(25% EMRC, 1146GWh of Additional Space, 100% of Incremental capacity)**

| | Total Available Space | SBU | Additional Space | Injection Support | Op Stock | Incremental Capacity | Available to Centrica | Centrica % Maximum |
|--------------------|-----------------------|--------|------------------|-------------------|----------|----------------------|-----------------------|--------------------|
| Space (GWh) | 33,625 | 22,642 | 126 | 5,761 | 2,345 | 2,752 | 9,558 | 28% |
| Withdrawal (GWh/d) | 485 | 340 | | | - | 145 | 230 | 47% |
| Injection (GWh/d) | 305 | 120 | | 90 | 26 | 69 | 99 | 33% |

The above figures are based on theoretical maximum volumes of capacity Centrica could purchase (i.e. they are not based on Centrica's historical purchases or purchasing intentions for the 2016-17 Storage Year).

Further, injection and withdrawal represent maximum physical capacities. As shown in Figures 1 and 3, the maximum injection and withdrawal rates available varies based on the volume of gas in the reservoir.

The change in Rough's physical capabilities as a result of the well integrity issues have changed the volumes of capacity that Centrica could purchase. In particular, the relative shares of injection and space have decreased but the relative share of peak withdrawal has increased. CSL notes that any capacity purchased by Centrica would be subject to the use it or lose it (UIOLI) provisions in the SSC. Further, Centrica and CSL have proposed to provide Ofgem and the CMA with additional reports to ensure they can monitor how much capacity Centrica is purchasing in Rough.

Confidential Annex

Impact on customers

[Section Redacted]