

DN Sales Development & Implementation Steering Group Minutes

Meeting 1

20 January 2004, 9:00 am – 2:00 pm

City Inn, 30 John Islip Street, Westminster

Attendees

Nick Wye	Waters Wye Associates	Keith Harris	Wessex Water
Mike Pearce	Independent Pipelines Ltd	Peter Bolitho	Powergen
Barry Watkinson	Health & Safety Executive	Kyran Hanks	Ofgem (chair)
David Rees	National Grid Transco	Mark Feather	Ofgem
Paul Whittaker	National Grid Transco	David Ashbourne	Ofgem
Mike Ashworth	National Grid Transco	Iain Osborne	Ofgem
Chris Train	National Grid Transco	Jess Hunt	Ofgem
Tory Hunter	Scottish & Southern Energy	Fergus Collins	Ofgem
John Costa	Electricity de France	Jason Mann	PA Consulting
Simon Goldring	British Gas Trading	John Smith	Burges Salmon
Eddie Proffitt	MEUC	Peter Morris	Burges Salmon

Welcome

Kyran Hanks welcomed the group and indicated that all nominations to the DISG had been accepted ensuring the group comprised a diverse and balanced representation of different interests. Kyran informed the group that for the purposes of the DN sales project Ofgem has appointed PA Consulting to provide economic and project management advice, and Burges Salmon to provide legal advice.

Terms of reference

The group agreed to adopt the draft terms of reference as set out in Appendix 1 of Ofgem's Next Steps document, subject to the following changes:

1. The objective of the group is to be amended to "the objective of this group is to provide guidance to and monitor progress of the *Exit & Balancing Workgroup*, the *Regulatory Architecture Workgroup* and the *Agent Workgroup* in the development of proposed changes to the commercial, regulatory and operational framework *that are expedient and necessary* to support the sale of one or more of NGT's DNs."
2. The fifth terms of reference is to be amended to "Liaise with network code workstreams and other relevant industry groups as appropriate".

Kyran drew the group's attention to the Next Steps document which indicates that there can be no expectation on the part of interested parties arising out of the group process, either as to what the Authority's decision may be, or as to the revised regulatory framework which may be implemented, if the Authority consents to the proposal. Kyran

noted that, Ofgem is working towards presenting proposals to the Authority in April and that the views of the DISG will inform the development of these proposals. Kyran also noted, similarly, no expectations with regard to the views of DISG members should arise from the group process and that the group is merely intended to be a forum for discussion.

Issues log

The issues log (tabled at the meeting) is set out in Attachment 1. Kyran stated that the purpose of the first DISG meeting would be to go through the issues log to ensure that it is comprehensive and accurate. DISG members were also invited to come back to the next DISG meeting with any views they have on the issues log. Kyran indicated that the issues log would be placed on the Ofgem website.

Action 1: Participants to review issues log and provide feedback.

Issues 1-5 Functions, funding, ownership and governance of the agent.

Iain Osborne noted that the proposed functions of the agent relate to both technical and retail market issues. Iain described Ofgem's view that in essence, the issue to be resolved by the agent workgroup is to create a framework for the agent to be in place at the commencement of a post-DN sale regime that permits change.

Issue 6 What separation requirements should apply between Transco and RDNs?

Ofgem reiterated its current view is that the full functional and legal separation of RDNs from NGT is appropriate in order to avoid discrimination between DNs. David Rees indicated NGT has no objective to this in principle, however, it does not wish adopt an approach that results in a higher cost of capital being passed on to end users.

Eddie Proffitt expressed his view that in the past NGT's Chinese walls may have failed to prevent inappropriate flows of information that legal separation may have solved. At the same time, he was also concerned that legal separation may lead to a loss of economies of scale that would ultimately be borne by customers.

Keith Harris suggested that legal separation could lead to benefits for customers as it increases transparency for the purposes of setting the price control.

Action 2: NGT to prepare paper on the separation of RDNs to be presented at DISG meeting 2. This paper would address the impact of separation and its linkages to price control determinations.

Issue 7 Is any other action required to ensure non-discrimination between RDNs/IDNs?

Peter Bolitho suggested that the contractual model adopted in electricity for the purposes of the BETTA project might hold relevant lessons for the potential sale of DNs. It was suggested that a uniform network code with subordinate offtake agreement was a simple, appropriate contractual model. Kyran indicated that it was important to learn

from lessons in the electricity industry. However, he said that Ofgem did not intend to simply emulate the electricity sector.

Issues 8-10 Impact of DN sales on metering, connections and performance obligations

David Rees suggested that statutory obligations that currently rest with Transco (for example, minimum customer service standards) may need to be passed on to DNs.

Action 3: NGT to prepare paper on metering to be presented at DISG meeting 2 or 3.

Action 4: NGT to prepare paper on connections to be presented at DISG meeting 2 or 3.

Action 5: Mark Feather to seek advice within Ofgem on what issues are likely to arise with regard to performance standards and to report on the outcome at DISG meeting 2.

Issue 11 How should independent gas transporters (IGTs) be accommodated within the reforms?

Eddie Proffitt expressed the view that it would be desirable to incorporate IGTs into the UNC. There was discussion of the extent to which IGTs could be incorporated into DN sales-related reforms.

Mike Pearce said that IGTs already have experience of providing supply point administration services and of operating under an offtake code. He expressed the view that in the short term, IGTs should be represented in the ownership of the agent with a view to having the agent assume IGT SPA functions after a transitional period. He also said that there should be an opportunity for IGTs to come under the UNC to some extent, whilst recognising that in some areas it is appropriate to encourage innovation. Mike suggested that IGTs anticipated major licence changes flowing from the DN sales process.

It was agreed that each workgroup should consider how IGTs should be accommodated within reform proposals.

Action 6: NGT to meet with IGTs and connections services providers to further develop proposals. NGT to prepare paper on IGTs for DISG meeting 3.

Issue 12 How much will it cost to implement the reform proposals - in particular, how much will it cost to update IT systems?

Kyran Hanks suggested that the issue of costs would be discussed at the DISG in order to ensure that appropriate costs were incorporated into future versions of Ofgem's RIA analysis. Simon Goldring suggested that the timing of IT systems changes would have a major impact on potential costs. Keith Harris suggested that a new entrant that purchased a DN would also require time and money in order to be in a position to assume its DN role.

It was agreed that the DISG should consider the readiness of shipper systems interfaces to accommodate any proposed reforms.

Issue 13 What provisions should be in the offtake agreement?

It was agreed that the policy issues should be discussed at the EBWG and the policy proposals would be provided to the RAWG for drafting.

Action 7: Jess Hunt to circulate NGT's draft offtake code business rules and put them on Ofgem's website. NGT to give a presentation on its proposed business rules for the offtake code at the first meetings of the EBWG and the RAWG.

Issues 14-18 Contractual and pricing arrangements for exit and interruptions

Peter Bolitho suggested that the issue of allocating responsibility for managing interruptions becomes much simpler if the regime successfully differentiates between energy balancing driven interruptions and network constraint driven interruptions. It was agreed that the EBWG should consider the question of whether it necessary to distinguish between energy balancing and network interruptions.

The group discussed how the work of the EBWG would interrelate with the work of the existing network code exit capacity workstream. Kyran suggested that the exit capacity workstream should cease to exist, however this was a matter that the EBWG would consider at its first meeting. Nick Wye pointed out that there are a number of outstanding action items on NGT from the exit capacity workstream and it would be unfortunate if NGT was not obliged to carry them out.

Tory Hunter suggested that it was important to keep the interruptions management model as simple as possible in order to avoid making DNs into mini system operators. Kyran Hanks pointed out that some potential buyers wish to operate their DN in a relatively sophisticated way and that the potential for evolution could be important.

Mark Feather suggested that the proposals developed by the EBWG should have regard to the principles developed last year by the Exit Advisory Reform Group. Kyran Hanks said that Ofgem intended to remove the universal firm obligation from Transco's licence as a part of the current SO incentives review.

Issue 19 What effect will a sale have on pre-existing connections contracts? (NExAs, ARCAs, NTS network entry capacity agreements, interconnector agreements, storage connection agreements.)

Mike Ashworth said that since connections contracts generally relate to a specific supply point, the rights and obligations associated with them would move to the relevant DN. He also indicated that there were not a large number of such contracts.

Peter Bolitho said that it would be inappropriate to start from an assumption that changes to connections contracts were required.

Issues 20-23 Gas balancing and linepack arrangements

David Rees suggested that all energy balancing should occur at the NTS level. Some participants suggested that there should be an administered pricing system for transfers

of gas between the NTS and the DNs, however, there should be no commercial linepack service.

Issues 24 - 26 Shrinkage and gas quality arrangements

There was discussion of the extent to which shrinkage has already been unbundled as part of the LDZ separation review. NGT indicated that shrinkage and gas quality are addressed in its draft offtake code business rules. (See action 7.)

The group agreed to adopt John Costa's suggestion to ask the EBWG and the RAWG to consider the issue of who has title to gas in the network.

Issue 27 Should current arrangements between Ofgem and NGT be formally incorporated into the offtake agreement? (Eg gas testing practices)

Action 8: Jess Hunt to seek advice within Ofgem on the nature of the current arrangements and to report on the outcome at DISG meeting 2.

Issue 28-29 Emergencies and other co-ordinated activities

Eddie Proffitt noted that in the electricity industry, obligations to co-ordinate in emergencies had not been complied with. Simon Goldring suggested that it may be useful to liaise with the DTI on this issue.

Action 9: NGT to give presentation on emergency handling procedures at DISG meeting 2.

Issue 30 Is NGT current procedure used to separate NTS and LDZ boundaries appropriate in the context of a DN sale?

The group agreed to adopt Simon Goldring's suggestion to ask the EBWG to consider what allocation and metering arrangements need to be in place at the NTS/DN interface. NGT indicated that allocation and metering arrangements are addressed in its draft offtake code business rules. (See action 7.)

Issue 31 What mechanisms should be adopted to ensure that the NTS & DNs co-ordinate planning & investment?

Tory Hunter said that responsibility for investment lies with the network owner, and that the BETTA model is relevant in this context. Mike Pearce said that it was important that the planning process takes into account all network load increase, including load increases on downstream networks. He also suggested that the process should be transparent so that downstream parties are able to understand why a decision to invest or not to invest has been made.

NGT indicated that network planning procedures are addressed in its draft offtake code business rules. (See action 7.)

Issues 32-42 Financial issues

Mark Feather provided background regarding issues 32-42, which are financial issues that may affect, among others, potential buyers of a DN. These issues will be considered within Ofgem, and discussed at the DISG as appropriate. It was decided that a question relating to the governance of distribution charging methodologies should be added to the issues log.

Action 10: Mark Feather to check with Andrew Walker regarding the scope of his letter about the mains replacement expenditure cap.

Issue 43 Is Ofgem up to date with DN sale-related developments at the HSE and vice versa?

Action 11: NGT's presentation on emergencies at DISG meeting 2 to include information about the HSE process.

Issue 46 What is the process for issuing and approving licences for the new DN businesses?

Fergus Collins indicated that Ofgem is having internal discussions regarding the process for issuing and approving new licences, and that this process would be affected by the manner in which NGT disposes of the DNs. The group agreed to adopt Simon Goldring's suggestion to ask Ofgem and the RAWG to consider how to recover DN licence fees.

Issues 47-48 Network code arrangements

Action 12: Jess Hunt to circulate NGT's discussion document on changes to the network code UNC and put it on Ofgem's website. NGT to give a presentation on its proposals for the UNC at the first meeting of the RAWG.

Issue 49 What should be the process for modifying the network code? Should NGT retain administrative responsibility?

Peter Bolitho suggested that there was a risk of delays if the issue of governance was opened up too widely. He suggested that NGT could initially retain responsibility for administering the governance process, with a structure that enables a subsequent transfer of the function to the agent.

Issues 51-55 Licensing arrangements

Action 13: Ofgem and NGT to develop proposals on the separation of distribution and transmission licence obligations. These proposals will be presented at the RAWG.

Issue 56 What governance procedures should apply to the offtake agreement?

Peter Bolitho suggested that BETTA provided an appropriate model. In this case, customers would not be involved in modifying the offtake code, as their rights are backed up in the UNC. There would, however, be a requirement for transparency. In this model, the DNs would not be able to propose changes to the UNC as they would effectively be a sub-contractor to NGT.

Issue 57 What governance procedures should apply to the credit rules for distribution charges?

Paul Whittaker suggested that the credit rules should be discussed in the context of developing the UNC. Peter Bolitho commented that large assumption was being made that DNs would be responsible for charging.

Action 14: Peter Bolitho to prepare paper regarding appropriate lessons from BETTA, in particular lessons relating to credit rules, which will be provided at DISG meeting 3.

Next and subsequent meetings

The group decided that it was appropriate for the other groups to commence before the next meeting of the DISG, and consequently the next DISG meeting will be held on Tuesday 3 February. DISG members were invited to attend the first meeting of the RAWG so that they could be present for NGT's presentation on its proposals on the UNC and offtake agreement. This meeting will be held on 27 January.

Action 15: Mark Feather, David Ashbourne to initiate meetings of EBWG and RAWG. (AWG meetings have already commenced.)