

DN Sales Development & Implementation Steering Group Minutes

Meeting 6

9 March 2004, 9:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

| | | | |
|-----------------|----------------------------|-----------------|-----------------------|
| Russ Ward | Independent Pipelines Ltd | Mark Feather | Ofgem |
| Tory Hunter | Scottish & Southern Energy | Jason Mann | PA Consulting |
| Simon Goldring | British Gas Trading | Paul Whittaker | National Grid Transco |
| Keith Harris | Wessex Water | Mike Ashworth | National Grid Transco |
| Eddie Proffitt | MEUC | Nigel Sisman | National Grid Transco |
| David Ashbourne | Ofgem | Greg King | National Grid Transco |
| Roger Morgan | Ofgem | Nick Wye | Waters Wye Associates |
| Farook Khan | Ofgem | John Costa | EDF Energy |
| Sonia Brown | Ofgem | Peter Bolitho | Powergen |
| Jess Hunt | Ofgem | Neil Shaw | AIGT |
| John Smith | Burges Salmon | Charles Ruffell | RWE Innogy |
| John Houlden | Burges Salmon | Sebastian Eyre | Energywatch |

1. Review of minutes from previous DISG meeting held 2 March 2004

The minutes were tabled at the meeting.

ACTION: Group to provide any comments on the DISG 5 minutes to Ofgem by Friday.

2. Actions from previous meeting

Jess Hunt reviewed the actions from the previous meeting:

- ◆ Transco to prepare a comparison of options for the role of DNs, including how they would operate in the context of a SOMSA, for DISG 6.
- ◆ Transco to consolidate and summarise its existing ring fencing conditions. Ofgem to find out if there have been any recent developments in ring fencing associated with the electricity distribution price control review.
- ◆ Ofgem to clarify various models of the agent. Group to provide further thoughts on functions of the agent at DISG 6.

Each action was complete and due to be discussed later in the meeting.

3. Reports from workgroups

(a) Commercial Interfaces Workgroup

Mark Feather reported that the CIWG had discussed the roles and responsibilities of DNs in the context of security of supply considerations and also network operator incentives. The CIWG had generally agreed that the key issue for most shippers and customers is the level of fragmentation in user interfaces.

Mark said that the group had also discussed NGT's proposals on shrinkage, gas quality and calorific values, and an Ofgem presentation on an option for exit reform.

(b) Regulatory Architecture Workgroup

David Ashbourne said that the RAWG had started its consideration of the uniform network code, and that the group was intending to work its way through a table of key issues.

4. Update on the way forward for DN sales

Sonia Brown indicated that Ofgem has received a number of emails and phone calls from market participants asking for further input and seeking greater clarity on the key issues prior to any Ofgem steer. She said that the workgroups established in January have been successful in identifying two key issues associated with the sales:

- ◆ the allocation of roles and responsibilities between the NTS and DNs; and
- ◆ the development of appropriate governance and agency arrangements for shipper (and customer) interfaces, particularly focusing on supply point administration frameworks.

The discussions that have occurred through the workgroup process have highlighted the importance of these issues to the development of the commercial and regulatory framework. Consequently, Ofgem has decided that it would be appropriate to develop for consultation separate Regulatory Impact Assessments (RIAs) on these two issues. This consultation will enable industry participants to comment further upon the various options that have been developed on these matters. Each of these RIAs would assist in informing the broader RIA being undertaken by Ofgem on the potential sales.

Sonia said that Ofgem intends to issue its consultations on these RIAs following the April meeting of the Authority. The RIAs will be issued if the Authority takes the decision that it is appropriate for work to continue on the DN Sales project. On the basis that the industry has been and will continue to be engaged and consulted on the issues through the work group process, the RIAs will be consulted upon for 4 weeks. This should enable the Authority to reach a decision by July 2004 on these issues, provided that no new material information emerges through this consultation process. Ofgem intends that the workgroups will continue to meet fortnightly and that the discussions will feed into Ofgem's RIAs.

Sonia said that in light of this decision, Ofgem will submit a provisional cost and benefit analysis on potential DN sales to the Authority for its meeting in April 2004.

Charles Ruffell asked whether the document to be presented to the Authority in April was the same RIA as was promised in the December Next Steps document. Sonia said that the cost benefit analysis would consolidate existing versions of the RIA, however, it will be qualified to the extent that it should ultimately be further informed by the

outcome of the consultation on the two RIAs on allocation of roles and responsibilities and governance and agency issues.

Keith Harris asked whether the proposed way forward meant that consent would be given in July 2004. Sonia responded that the objective was to reach a decision on the key issues by July. Given implementation issues (such as the preparation of the new network code and licences), any consent would not follow until some later point.

5. Governance and the role of agency

Jason Mann gave a presentation on the allocation of shipper interface functions between the NTS, DNs and agency.

The group discussed how the Transco proposal for agency would work in practice. Mike Ashworth explained that under Transco's proposals, the agent is responsible for carrying out certain functions, however, financial and legal responsibility lies with NGT. In relation to invoicing, Mike said that the agency would carry out the administrative functions associated with sending out invoices, but that each DN would collect and manage their own revenue flows.

Peter Bolitho said that it was useful to distinguish between the creation and management of data, and actual settlement activities. He also suggested that the settlements process should lie with the agency and that data created by the NTS and DNs could flow into the settlements process.

The group agreed that it was important to consider the allocation of legal responsibilities as well as considering who performs the various functions in considering governance and agency issues.

ACTION: Ofgem to refine its shipper interfaces presentation, in particular by clarifying where legal responsibility for performance lies in relation to each function.

Peter Bolitho said that under Powergen's broad approach, all money flows (including settlements and trading on the NBP) would go through the agency. Risks associated with non-payment would be apportioned between network owners, and part of the agent's role would be to administer the risk. Mike Ashworth suggested that some form of clearing house role should be considered as this would place the risk with the party who is best able to manage it.

Sonia Brown broadly described an option where a central settlements entity issues the invoices associated with entry auctions and the OCM and it also responsible for certain governance functions. She said that the group needed to explore the various options in more detail so that they could be fully assessed as part of Ofgem's governance and agency RIA.

The group discussed a model of governance for charging methodologies and the network code whereby the modification process is administered the agency, but responsibility for policy development lies with the network owners.

Keith Harris said that a central settlements entity was acceptable, so long as policy decisions and policy ownership sits with networks.

Sebastian Eyre said that it was also important to consider whether the functions were carried out in a cost effective manner, having particular regard to transactions costs. Jess Hunt suggested that this would depend on the ownership and governance of the agency.

Simon Goldring said that it was important to be clear that the model being discussed was more than just an expanded version of Transco's original proposal, because the central settlements entity would perform different types of functions.

Peter Bolitho suggested that a governance methodology modelled on the SPAA could be appropriate for the central settlements entity. He also presented to the group a chart that depicts Powergen's views of the potential costs and benefits associated with a DN sale. He said that it is possible that the benefits of a sale could exceed the costs if there was no industry fragmentation. However, Peter said that if fragmentation occurs then the costs increase at a much faster rate than the benefits.

Peter Bolitho proposed that the agent should be responsible for administering the modification process associated with the distribution charging methodology, however the methodology itself would be owned by DNs. It would be possible for a DN to propose a different methodology in its own area. If this occurred, Ofgem could decide whether fragmentation was efficient or inefficient, and presumably proposals would have a greater probability of approval if they did not create fragmentation. Peter considered that the advantage of this approach was that all changes would be administered in accordance with a single process and would have the associated visibility, but divergence would not be precluded.

Sonia Brown noted this model differed from the current approach in that DNs would be able to propose changes that would amend the charging methodologies of all DNs, rather than just their own. Some group members suggested that it would be desirable for shippers and customers to also have the opportunity to propose changes to the charging methodologies.

Eddie Proffitt argued that if a change to the charging methodology was considered desirable in one part of the country, then it should also be likely to be desirable across the whole country. He suggested that any DN should be able to propose changes, however, all changes should apply across the country under a single charging methodology.

Nick Wye noted that an approach where a single interface sits with Transco will provide the same amount of protection against fragmentation as an approach where the interface sits with the agency. Peter Bolitho said that he preferred the role to sit with the agent because he considered that approach to be more robust over the long term.

ACTION: Group members to email Ofgem if they have any further detailed points to make on governance and agency.

ACTION: Ofgem to give a more detailed presentation on agency, which considers:

- ◆ responsibilities for activities (as well as who actually carries out the activities); and
- ◆ where the systems will lie within the broader agency model, including where changes will arise.

6. System operator responsibilities and contracting framework

Nigel Sisman circulated a revised version of Transco's SO responsibilities and contracting framework paper which had been amended to incorporate feedback from some shippers. Nigel indicated that the document should be considered purely as a discussion document rather than a decisive description of the various options.

The group discussed Nigel's presentation on the roles of DN.

Paul Whittaker said that gas is not pushed onto the DNs from the NTS, rather, it is pulled from the network by consumers. Peter Bolitho expressed the view that the NTS was still the dominant player.

Transco was unsure about how the allocation of roles would work under option 2, because if the DN's role was solely to construct, build and maintain, then the staff required to fulfil the DN field operations would not be available. Sonia Brown said that Ofgem envisaged that the DN owner would conduct field operations under instruction from GBSO. The DN owner would also receive instructions from the GBSO regarding investment and maintenance requirements. Sonia also said that under option 2, liability for failure would depend on: (a) whether the GBSO planned adequately and (b) whether the DN adequately carried out its instructions.

Keith Harris suggested that the DN's role under the passive model was no different to that of existing infrastructure service providers like Jarvis.

John Costa suggested a variation on option 3 where the DN retained responsibility for investment planning and maintenance planning but without contracting for interruption. John considered that this option had more merit than option 2. Jason Mann suggested that with under John's model, the DN would have decision making power over only half of the options for constraint management.

Nigel Sisman concluded that the relative merit of the various options depends on where you believe the synergies arise – between control room operations or between field work and the control room. Nigel said that Transco believed that the synergies between the field work and the control room were most important, and that was why it supports option 1.

Peter Bolitho suggested that in effect, option 3 was simply the SOMSA arrangements formalised in the offtake arrangement. He said that he was not convinced that option 3 is significantly more complicated than option 1. Paul Whittaker said that the fundamental difference was the assignment of responsibility. Under the SOMSA arrangement, the DN has responsibility for system operations, however, they have a contract that enables Transco to carry out their instructions in the control room.

The group members discussed the safety implications of the SOMSA. Sonia Brown said that it was the DN's responsibility to ensure that the SOMSA effectively discharges its safety obligations. Keith Harris said that there have been huge arguments in other industries about who is responsible in the case of failure. In practice, he said, obligations tend to become blurred. Consequently, it is of utmost importance that accountabilities are clearly defined, and that this is very difficult to achieve under option 3. He said that the SOMSA is only intended to be a transitional expediency whilst new IDN owners develop the capability to operate their own control rooms.

John Costa asked how DNs would be able to make decisions to instruct under the SOMSA if they did not have the capability to operate their own control rooms. Transco said that the IDNs will purchase the relevant staff as part of the sale, including the head of networks and the network planning engineers. The only aspect of system operations that is not included in the sale is the area control room. At present, these network staff give instructions which are executed by the area control room.

Nick Wye suggested that it was in the shippers' interest to have clear delineation of responsibilities.

Nigel Sisman asked the group about the significance of the interactions between energy and capacity, and how much influence this interaction should exert over the choice of operating model. He said that Transco considers that interactions are overstated: they are an issue in theory, but in practice, they do not arise to any significant degree. He added that unless something dramatic happens to the system, such interactions are unlikely to be material going forward.

The group thanked Nigel for preparing tables which were considered to be a useful contribution to discussion.

Sonia Brown told the group that Ofgem did not intend to table the issue of roles and responsibilities of DNs again unless new factors arise. She said that if group members wished to comment on the allocation of roles set out in Transco's responsibility matrices, then they should email their comments to Ofgem in the form of DISG papers. Ofgem would only table papers for further discussion if they raised material new issues that would benefit from such discussion.

ACTION: Group members who wish to discuss new issues associated with the roles and responsibilities of DNs, including comments on Transco's responsibility matrixes, should email their comments to Ofgem in the form of a DISG paper.

7. Legal separation

Transco tabled a paper on legal separation, however, the group decided to postpone discussion on this issue until the next DISG.

8. Next meeting

The next meeting will be held at Ofgem on 23 March 2004.