

DN Sales Development & Implementation Steering Group Minutes

Meeting 4

24 February 2004, 9:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Sebastian Eyre	Energywatch	David Ashbourne	Ofgem
Tory Hunter	Scottish & Southern Energy	Mark Feather	Ofgem
Simon Goldring	British Gas Trading	Jason Mann	PA Consulting
Keith Harris	Wessex Water	Paul Whittaker	National Grid Transco
Eddie Proffitt	MEUC	Chris Train	National Grid Transco
Nigel Nash	Ofgem	Mike Ashworth	National Grid Transco
Roger Morgan	Ofgem	Nigel Sisman	National Grid Transco
Farook Khan	Ofgem	Sue Higgins	National Grid Transco
Sonia Brown	Ofgem	Nick Wye	Waters Wye Associates
Jess Hunt	Ofgem	John Costa	EDF Energy
John Smith	Burges Salmon	Peter Bolitho	Powergen
Claire Thomas	Burges Salmon		

1. Review of minutes from previous DISG meeting held 17 February 2004

Simon Goldring said that the minutes did not reflect his view that the different options for the contractual arrangements should not be portrayed as a black and white choice between innovation and consistency. Rather, Simon considered that the issue was more grey, and that innovation and/or consistency were potential outcomes of either approach.

Some group members reported that industry participants had expressed concerns that Ofgem's website was not being updated quickly enough for non-workgroup members to keep abreast of, and contribute to, key decisions.

ACTION: Ofgem to keep website as up to date as possible. As a back-up measure, Ofgem to extend the DISG mailing list so that interested parties who are not group members may also receive DISG papers. Parties wishing to be added to the mailing list should email tracey.hunt@ofgem.gov.uk.

2. Actions from previous meeting

The following actions from the previous meeting were closed:

- ◆ NGT and SSE had collaborated to explore the issues associated with the hybrid model, and were due to present their findings later in the meeting
- ◆ Jess Hunt had circulated Ofgem's slides on the role of DN's and had published them on Ofgem's website.

Jess Hunt indicated that Ofgem had been progressing work to inform its view on the contractual arrangements. Sonia Brown said that the issue would be discussed at next DISG meeting and Ofgem would provide a steer at the meeting 9 March 2004.

Jess Hunt also indicated that the Ofgem DN sales team were liaising with metering team to ensure that issues associated with metering are addressed.

ACTION: Group to discuss contractual arrangements in the context of the agency debate at DISG 5.

2. Reports from workgroups:

a) Commercial Interfaces workgroup

The CIWG meeting held 18 February 2004 discussed the role of the DN and the contractual framework. Mark Feather said that there was some agreement that it is possible to clearly distinguish between energy balancing and constraint management functions. There was also some agreement that innovation and/or consistency could arise under either contractual model. Ofgem agreed to prepare a work program to ensure that all key issues are addressed.

b) Regulatory Architecture workgroup

David Ashbourne reported that the RAWG meeting held 17 February 2004 discussed the role of the DN and the contractual framework, and that similar views had been expressed as in the DISG. He also indicated that the RAWG was meeting later in the day and that the key item agenda was to consider the transmission/distribution licence condition split.

c) Agent workgroup

Roger Morgan said that the key issue arising from the AWG members was the potential for diversity. He said that the group had acknowledged that there are different types of diversity and that some types of diversity would be more costly for customers than others.

Roger also said that the AWG has been working to clarify the role of the agent and that it has identified a number of services provided by Transco to shippers that will not be provided by the agent. The next task of the AWG is to consider what mitigating action can be taken to minimise the risks associated with the agency proposals.

The group discussed how best to progress the contractual arrangements debate and the role of the AWG in that debate. Peter Bolitho said that DISG members should have the opportunity to understand what services will be provided by the agent and what services will not be provided by the agent. David Ashbourne suggested that governance arrangements should be considered as a part of the contractual arrangements.

ACTION: Group to consider agency arrangements at DISG 5.

Some group members indicated that they believed it was premature to discard the passive model (option 2). In particular, Peter Bolitho indicated that he had received feedback from shippers who were not represented on the workgroups that the passive model was preferable because it provides least scope for divergence by DNs.

Chris Train said that the passive model was actually the maximum change model, in terms of being furthest away from current Transco practices.

Keith Harris said that buyers who were interested in managing their network would not find option 2 attractive.

Sonia Brown said that Ofgem will consider the various options in the context of achieving maximum consumer benefits, however, as a preliminary view option 2 does not appear to benefit customers because it does not provide scope for the benefits of comparative competition to arise.

3. DN roles and responsibilities: hybrid model (SSE & Transco)

Nigel Sisman described the results of NGT and SSE's efforts to provide more detail on how the NTS/DN interface would operate under the hybrid option (option 3). He said that the key issues were allocating responsibility for (1) setting/reserving NTS exit capacity and (2) system management.

Under option 1, the DN is responsible for both functions. The DN function is an active control and management process taking account of the ability to flow gas through the interface and the loads that will be available to use for SO purposes. Under option 3, the integrated GB SO (the NTS) has opportunities to optimise short term synergies.

John Costa said that it is appropriate to assess the costs and benefits of each model relative to the current model. Chris Train said that the option 1 represents the status quo.

Some group members did not agree that option 1 represented the status quo. They suggested that in practice, investment and planning decisions are made well in advance of day to day system operation decisions, and that on the day the SO faces fixed parameters and must simply use available tools as occurs under option 3. Chris Train responded that if the SO is not responsible for maintenance then they have an incentive to make inefficient operating decisions. Tory Hunter argued that it is possible to codify the relevant parameters.

Paul Whittaker said that whilst the DN can codify parameters in advance of day allow others to operate its network, it cannot adapt these parameters to real time issues such as water in pipes. He suggested that codifying SO operating parameters under option 3 would be far more detailed and complex than codifying the NTS/DN interface under option 1. Finally, Paul added that responsibilities in the event of system failure are clear under option 1 but are not clear under option 3.

Keith Harris said that it is necessary to let managements manage by granting them independence – otherwise there is no point to the exercise. Keith said that comparative competition has worked in other industries, and consequently option 1 is a sensible starting point.

Eddie Proffitt said that transportation charges are small compared to gas prices and that the upheaval associated with DN sales is not worth it unless the benefits of superior performance are passed through to all customers.

Simon Goldring expressed his concern that shippers and suppliers will need to deal with multiple parties when things go wrong.

Paul Whittaker said that Transco wants to maintain so far a possible a set of arrangements which allows Transco and shippers to maintain existing systems. He said that Transco's model sought to free up DNs to manage as they wished, but also to bind

them to a common set of communications and contractual protocols in order to maintain consistency.

Keith Harris stated that the water model, where Wessex contracts with other companies to deliver bulk water to other points, works reasonably well and was not particularly complicated.

Sonia Brown then asked each group member to state their position on the most appropriate role of the DN.

Chris Train said that Transco supported option 1 because:

- ◆ It provides scope for comparative competition to generate benefits to customers
- ◆ It gives DNs direct control over both investment in infrastructure and system operation, which is critical in driving efficiencies
- ◆ It provides a 'cleaner' relationship when the system is under stress.

Eddie Proffitt said that he preferred option 3 (in combination with a uniform network code) because he considers that this approach will minimise disruption to customers.

Keith Harris said option 1 is preferable because it permits the benefits of comparative competition to arise. He asked the group: Unless you are prepared to give comparative competition the chance to work, why bother? He considered option 3 to be overly complex.

Nick Wye expressed a preference for option 1 because he considered the liabilities to be unclear under option 3, which could potentially create additional costs for DNs. He further stated that he did not agree with SSE's view that there is potential for confusion in differentiating between energy balancing and constraint management.

John Costa said that his view was driven by his objective to have an outcome which involves fewer contractual relationships for shippers/suppliers, and that there was a need to pin down the pertinent details of how either model would work in practice. He said that he was not convinced that either model would generate benefits for customers, however, he preferred option 3 because he considers that this approach will minimise opportunities for divergence.

Simon Goldring said that there is not sufficient shared understanding of the detail of how Transco's model (option 1) would operate in practice. He questioned whether DN sales was required since presumably the benefits of comparative competition will already arise as a result of the separation of the LDZ price controls. Simon preferred option 3 on grounds that it appeared to be 'safer' for shippers/suppliers.

Tory Hunter preferred option 3. She said that she does not believe that it precludes comparative competition, and that it is more efficient for the entire network to be operated as a single entity. Further, she considered that option 3 was likely to lessen complexity for shippers.

Peter Bolitho said that there was scepticism among shippers as to whether option 1 could avoid fragmentation, and consequently he preferred option 3. He added, however, that so long as the contractual arrangements are resolved satisfactorily, then he was not so concerned about the outcome on the options debate.

ACTION: Ofgem to provide a steer on the role and responsibilities of the DNs at DISG 5.

4. Separation of RDNs from NTS business

Sue Higgins described the issues set out in Transco's paper on separation between NTS and RDN businesses. She said that under Transco's proposals, the Offtake Code will govern the operational relationship between the NTS and the DNs, including the investment and capacity provision process, maintenance, and daily operations. The Offtake Code would apply to all DNs and Ofgem approval would be required for modifications. Further, Transco proposes to would the Operational Forum in order to provide industry players with the opportunity to enquire about NTS decisions regarding decisions taken on specific days and in relation to specific events on the system.

In addition to the Offtake Code, Transco proposes to adopt a number of additional measures prevent discrimination, including information ring fencing, structural separation (separate executives and separate CEOs, separate planning tools and processes, and separate information systems), and new licence conditions that require

Sue expressed concerns that legal separation may affect Transco's cost of capital because a significant proportion of its assets (ie its distribution assets) will be shifted into separate legal entities. Transco believes that legal separation will increase the restrictive covenants required by holders of Transco bonds, which would increase costs associated with their debt book and decrease their future structural flexibility.

There was a discussion surrounding the extent of legal separation: does Transco envisage that all RDNs would exist in a single legal entity that is separate from the NTS or would each RDN have a separate legal entity? Paul Whittaker said that Transco intended to operate all RDNs as a single entity. He said there is no leakage of commercially sensitive information between DNs (as opposed to between the NTS and DNs), and that it is more efficient to operate all RDNs under a single management structure.

Keith Harris said that in the absence of pre-existing considerations legal separation is the optimal approach, because the presence of independent directors makes a significant difference to what actions the directors are prepared to accept. He accepted, however, that there may be pre-existing considerations in Transco's case.

David Ashbourne pointed out that regardless of whether legal separation is required, each business will be required to separately submit audited regulatory accounts.

Paul Whittaker said that legal separation is a relatively limited tool for controlling preferential dealing, and that Transco's current flexibility of debt is useful. He considered that the most important forms of business separation were those outlined in section 1 of Transco's paper.

Keith Harris asked whether Transco would be prepared to evolve to an independent financial structure. Paul Whittaker said he was not able to comment on that issue since it was a matter for Transco's Treasurer.

Peter Bolitho said that there was a track record of internal separation working successfully. Eddie Proffitt said that he did not believe that internal separation was effective. He said that without legal separation of each RDN, the gains from comparative competition would be halved.

David Ashbourne said that the suite of ring fencing licence conditions would be further reviewed as a part of the DN sales process. Keith Harris said that financial licence conditions cannot be applied equally to RDNs if they are a single entity. He argued that an integrated RDN is highly unlikely to stand alone if its parent is in trouble.

Peter Bolitho suggested that the refinancing costs incurred by Transco as a result of legal separation were not relevant insofar as they should not be passed through to customers.

Sonia Brown said that group members should consider the issues arising in Transco's separation paper, and provide any written comments on the additional costs and benefits associated with legal separation by Friday.

ACTION: Group members to consider the issues arising in Transco's separation paper, and provide written comments on the additional costs and benefits associated with legal separation by Friday.

Next meeting

The next meeting of DISG is scheduled for Tuesday 2 March, at Ofgem's offices.