

DN Sales Development & Implementation Steering Group Minutes

Meeting 5

2 March 2004, 9:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Russ Ward	Independent Pipelines Ltd	David Ashbourne	Ofgem
Tory Hunter	Scottish & Southern Energy	Mark Feather	Ofgem
Mike Young	British Gas Trading	Jason Mann	PA Consulting
Keith Harris	Wessex Water	Paul Whittaker	National Grid Transco
Eddie Proffitt	MEUC	Kim Salmon	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
Jonathan Jones	Burges Salmon	Neil Shaw	AGT
Charles Ruffell	RWE Innogy		

1. Review of minutes from previous DISG meeting held 24 February 2004

Keith Harris said that the comments attributed to him in the draft minutes went further than the views he expressed at the meeting. Keith's original comments were made subject to an assumption that there were no pre-existing considerations, whereas there may be pre-existing considerations in Transco's case. Jess Hunt agreed to amend the minutes accordingly.

2. Actions from previous meeting

Jess Hunt reviewed the actions from the previous meeting. She said that Ofgem was seeking to keep its website as up to date as possible, and as a back-up measure, had added the Gas Forum and Julie Cox to its distribution lists.

Ofgem had received a number of written comments regarding Transco's separation paper, and those that were not confidential had been published on the Ofgem website.

The following actions were due to be completed later in the meeting:

- ◆ Ofgem to provide a steer on the role and responsibilities of the DNs
- ◆ Group to discuss the contractual arrangements and the agency model.

3. Reports from workgroups

(a) Commercial Interfaces Workgroup

There was no CIWG meeting last week.

(b) Regulatory Architecture Workgroup

David Ashbourne said that the RAWG had an initial look at NGT's existing licence, and went through it with a view to separating out conditions that apply to transmission, conditions that apply to distribution and conditions that apply to both. In the absence of a high level steer on the industry framework, the group had moved forward on the basis that many points of detail would require the same solution regardless of which approach was adopted. David said that the meeting had been very productive, and had produced a list of important licence conditions and a list of new conditions that would need to be introduced.

4. DN roles and responsibilities: Ofgem

Sonia Brown said that Ofgem was unable to give a steer on the DN roles and responsibilities this week. This was because Ofgem received a significant number of emails, phone calls and correspondence suggesting that industry needed more time to consider the various options. In particular, it was considered that there were two particular aspects of the operating model that require further consideration:

- ◆ security of supply; and
- ◆ ensuring that the DNs and NTS have the correct incentives to operate their networks in an efficient manner.

Peter Bolitho asked whether this meant that option 2 was still being considered. Sonia said that no options were foreclosed, and Ofgem was happy to listen to all views.

The group discussed the security of supply implications of the various options.

Paul Whittaker said that it was incorrect to equate DN system operation with the activities of the central control room. Rather, system operation includes a broad range of activities that are carried out at a local level. Transco considers that Option 1 gives a single entity clear responsibility for the full range of decisions associated with DN system operation, which should ensure security of supply. Transco considers that options 2 and 3 could lead to a lack of accountability because it is not possible to distinguish between the effects of control room decisions and the effects of decisions made at a local level. Further, Transco considers that incentives to manage costs should be in the same place as the operational decision making process. The alternative is that it could be necessary to establish complicated contractual arrangements that govern offtake by offtake decisions at a highly localised level.

Tory Hunter suggested that there would be a lack of clarity in accountability under Transco's SOMSA proposals. Mike Ashworth responded that that DN and NTS responsibilities under the SOMSA were clearly defined in the safety case.

Transco added that the key issue for consideration is what occurs when the network falls outside the operating parameters. Transco's view is that decisions should be made by the person with detailed on the ground knowledge of how the network operates, not by a person in a control room 100 miles away; this is what occurs at present. They suggested that area control room staff do not have the same amount of knowledge as the head of network, and it is the head of network who is (and should be) responsible in the case of failure.

Peter Bolitho said that shippers were concerned that an active DN regime is more likely to create incentives for divergence as DNs will be motivated to seek to change industry rules.

The group considered whether a more passive DN model gave rise to a clear allocation of responsibilities.

Keith Harris suggested that option 2 (the passive DN model) could blur accountabilities because the DN could attribute network failure to poor instructions from the NTS. As the DN would do everything under instruction, they would have no incentive to do things well. He said that in any business, the way to get management to perform well is to give them the ability to make decisions and be accountable.

Neil Shaw said that unlike the NTS control room, DN central control rooms account for only a small proportion of the DN's control units. Only the high pressure tier of DN (the LTS) is controlled by the DN control rooms. Lower pressure tiers are controlled by local engineers using equipment located in local depots. He said that DNs will have a large role in managing the system regardless of who controls the centralised system control room.

Tory Hunter said there are likely to be significant benefits associated with having one operator managing the transport of gas across entire network. She suggested that if problems arise, it is better to have one entity looking after the entire country.

Paul Whittaker said that in practice this cannot occur because the person in the control room cannot be responsible for last the few kilometres where the network breaks from high pressure. He argued that there will inevitably be a break in responsibility at some point and that NGT wants to retain the status quo. He suggested that other break points are much less easily defined.

Neil Shaw suggested that going forward, it would be useful for the group to consider a structured risk analysis. It was agreed that Transco would prepare a comparison of options 1, 2 and 3 that considers various operational aspects of the models, and includes worked examples of how the network will operate under stress. Sonia Brown requested that Transco also provide further clarity with regards to its SOMSA proposals, including who is responsible in the case of system failure.

ACTION: 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.

5. Separation of RDNs from NTS

Keith Harris said that Transco's paper does not give enough detail about the issues involved in separation. He said business separation was not only about preventing cross subsidies, but also about ensuring the DN's financial viability and managerial independence. As a starting assumption, Keith considered that legal separation is generally appropriate because effective ring fencing requires corporate governance procedures to be in place. However, he said that it may be appropriate to have transitional arrangements in this case. Keith emphasised that legal separation may also be important in ensuring that asset owners can through time finance themselves and meet their obligations.

Russ Ward asked how ring fencing requirements would apply if Transco remains a single entity. He suggested that the Board's sign off on accounts would be less meaningful because a level of detail would be lost. He also considered that it could be more expensive to get an appropriate level of detail if there was no legal separation.

Paul Whittaker said that at present, accounts are signed off for different parts of the business separately. He did not believe that legal separation would result in a net benefit for consumers.

Keith Harris said that in the absence of legal separation IDN costs will be more obvious and transparent than RDN costs. He argued that this could mean that IDNs are subjected to tighter price controls than RDNs.

Nick Wye suggested that the starting position should be that legal separation is best, and that it is up to NGT to demonstrate that legal separation is not appropriate. In the absence of further information, he considered that the group was not in a position to understand which model is best.

It was suggested that the group needs further information on:

- ◆ the costs of corporate financing/loss of flexibility associated with legal separation
- ◆ the costs associated with establishing appropriate corporate governance procedures
- ◆ the benefits of legal separation, including the efficiencies flowing from greater transparency

The group discussed whether existing licence conditions established a sufficiently robust financial ring fence. Keith Harris expressed the view that the existing licence conditions in energy are not strong enough to prevent damage if a highly geared company went bankrupt. However, he also stated that the need for legal separation may be reduced through effective licence regulation and governance structures.

ACTION: Transco to consolidate and summarise existing its 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.

Sonia Brown said that once the group had a better understanding of existing ring fencing conditions, it would be necessary to consider what further requirements should apply. She also said that Ofgem intended to get an independent expert in corporate finance to examine the bonds issue.

6. Report from the agency workgroup

Transco's proposal for the agent

Kim Salmon gave a presentation on the purpose and rationale of the agency. Under Transco's proposal, the agency acts as subcontractor to the networks for the provision of a range of services, including the provision and maintenance of a supply point register, recording and calculating transportation volumes and providing transportation invoices. The agency group is debating the activities which are not formally covered by the network code and developing arrangements to ensure that they remain in place.

Under Transco's proposals, changes to shipper systems are predominantly associated with invoicing. Shippers will receive one 'thick' invoice, and separate thin invoices for each network. The thick invoice would be the same as what shippers receive at present.

Some shipper representatives preferred an agency model where all shipper services are bundled in one place so that shippers have an assurance of continuity. They considered that a bundled approach at the outset would allow for greater flexibility in the future. In particular, they thought that settlements should be central, and that the agency should be responsible for managing the governance arrangements of the network code.

John Costa said that in future, DN owners and shippers will want to be involved in the ownership of the governance arrangements. Paul Whittaker said that the NTS would not be able to discriminate in its management of modification proposals because the process is completely transparent.

Keith Harris asked how shares in the agent would be allocated between network owners. Paul Whittaker said that each RDN, IDN and the NTS would get a share, and the precise allocation of voting rights would be calculated in proportion to the number of supply points per network and the services it receives in respect of those supply points.

Peter Bolitho asked where the governance arrangements for charging methodologies would lie within Transco's proposed framework. He said that it is crucial to shippers that these are consistent, and consequently Powergen has proposed that the administration of changes to charging methodologies is part of the agent's role.

Paul Whittaker said that governance of charging methodologies was a licensing issue, and that a licence condition which requires DNs to adopt uniform proposals doesn't necessarily need to be administered by the agent. Peter Bolitho said that the process needs to be co-ordinated, and that a semi-neutral administrative system would fall within the agency role.

Sonia Brown concluded that there were two options for the governance of charging methodologies: central management or a licence requirement. She said that both options have pros and cons and the issue needs to be considered further at future meetings.

Agent workgroup progress update

Nigel Nash gave an update of the progress of the agent workgroup. He said that Transco was working on a matrix of service lines that identifies how services are governed and provided at present, and how they will be governed and provided in the future. The group had identified a number of risks associated with the agent proposal:

- ◆ Service definition – the network code is not comprehensive
- ◆ Costs – divergence, credit, development and maintenance of new interfaces
- ◆ Loss of accountability
- ◆ Are standards of service adequately defined?
- ◆ Additional complexity – relationship with DNs

The group had also identified a number of mitigating actions:

- ◆ Central credit arrangements
- ◆ Single point of contact for all shipper/supplier services
- ◆ Shippers/suppliers to obtain a stake in the agent
- ◆ Governance: all agent services defined, subject to robust service standards
- ◆ Unified escalation routes.

The group discussed whether the agent should have a broad or narrow role. Key functions which could be attributed to the agent, but are not included in Transco's proposal, are the credit arrangements, receiving payments, and governance of the network code. The group also discussed who should own the agent, and identified four options:

- ◆ Transco only
- ◆ Transco and IDNs
- ◆ Transco, IDNs and shippers/suppliers
- ◆ Independent ownership.

John Houlden asked where contractual liability would lie in terms of performance of services under the network code. Mike Ashworth said that the agent is not a contracting party to the network code. He said that it could be possible to create a new licensable activity for the agent and make it a party to the network code, however, this would entail much larger structural changes than currently proposed by Transco.

Sonia Brown said that Ofgem would prepare a table that shows the differences between Transco's model and broad model for next week's DISG. She asked the group to be prepared to provide any further thoughts on the functions and role of the agent.

ACTION: Ofgem to clarify various models of the agent. Group to provide further thoughts on functions of the agent at DISG 6.

Next meeting

The next meeting will be held at Ofgem on 9 March 2004.