

Commercial Interface Working Group Minutes

Meeting 4

17th March 2004, 10:00 am – 12:00 pm

Ofgem offices, 9 Millbank

Attendees

Nick Wye	Waters Wye	Peter Bolitho	Powergen
Richard Street	Statoil	Graham Jack	BG Connections
Phil Scott	HSE	Sharif Islam	Total Gas & Power
Bob Bruce	Glenton Bruce Ltd	Steve Rose	RWE Innogy
Nigel Sisman	National Grid Transco	Julie Cox	AEP
Russell Cooper	National Grid Transco	John Houlden	Burges Salmon
Adam Davidson	National Grid Transco	Mark Feather	Ofgem (chair)
Beverley Grubb	SSE	Sonia Brown	Ofgem
Savita Shaunak	EDF Energy	Jess Hunt	Ofgem
Mike Young	British Gas Trading	Jason Mann	PA Consulting
Eddie Proffitt	MEUC		

Mark Feather presented the agenda.

1. Update on the way forward for the DN sales project

Mark Feather explained that there has been considerable debate surrounding the paper at the DISG on the issues of system operator roles and responsibilities and agency and governance. In view of the significance of these issues, Ofgem has decided to develop two RIAs to allow for a full consideration of the costs and benefits of various options for reforms on these key issues. In the event that the Authority authorises further work on DN sales, the consultation process is likely to begin in late April, and will last for 4 weeks. The aim would be to get high level commercial and regulatory framework issue bedded down by July.

At the April Authority meeting a provisional cost benefit analysis, highlighting the output from work done by three consultancies, will be considered. The cost/ benefit analysis will need to be qualified given the two further RIAs.

Sonia Brown commented that the workgroups are part of the consultation process on the RIAs, and that it would be important for people to provide input through this forum.

2. Review of the items from CIWG meeting 3

Mark Feather asked the group if they wished to make comments or corrections in relation to the minutes of the previous meeting.

Peter Bolitho noted that, in relation to the discussion on shrinkage, shippers could accept shrinkage accounts, but needed to be sure that there was no role for DNs in trading energy. He suggested that this might need to be tied down through a license obligation. Jess Hunt said that the Regulatory Architecture working group, which is considering what licence conditions should apply to DNs, had discussed applying Transco's no trading licence obligation to DNs with an exception relating to shrinkage accounts.

In relation to section 4(b), Bob Bruce sought to clarify the record of the previous discussion on substitutability and stated that the conclusion of the Transco analysis was that exit reform was not viable. Bob considered that NGT's presentation was not accurately recorded in the minutes. Mark Feather suggested that in fact this view was reflected later in the document and hence the proposal to change the wording of the minutes was rejected.

Jess Hunt reviewed the actions from the previous meeting. Each action was either complete or to be completed during the meeting, except the action for Ofgem to consider its proposals for universal firm in light of the draft EU regulations. Ofgem's lawyers are considering this matter, however Jess noted that these are draft regulations, and any conclusions would need to be considered in that context.

3. Report from Development & Implementation Steering Group

Mark Feather described Jason Mann's presentation to the DISG covering governance and agency issues, and highlighting the thick and thin agency models. The key issues arising were:

- Most shippers held the view that divergence and fragmentation should be minimised. Thus, they preferred a thick Agency to limit divergence.
- In terms of administrative processes, Ofgem will present back on the allocation of functions in the context of thick/ thin agency models at the next DISG meeting.

Ofgem is in the process of preparing a draft RIA on the roles and responsibilities of DNs. The view from the DISG and workgroups is that there has been sufficient discussion of this topic and therefore, any interested party should raise issues on this matter only if they are new and material.

Sonia Brown explained that the Transco tabled paper on legal separation was not discussed at the meeting. However, the paper is available on Ofgem's website. Any comments on this are welcome and would be picked up at next Tuesday's DISG.

4. Framework for exit reform: Option B

Jason Mann presented Option B looking at exit and interruption arrangements in the future. In analysing Option B and its impact on exit and interruption arrangements, Jason commented that three key licence and Gas Act obligations need to be considered:

- Economic and efficient network development;
- Non-discrimination; and
- Cost reflective charging.

Jason suggested that Option B should be considered in the light of the Ofgem objectives for exit reform:

- Network owner should determine level of interruption;
- Arrangements should not discriminate between users;
- Increase in customer choice;
- Investment signals for network owner and users; and
- Safe and secure pipeline system.

Under option B, shippers would participate in auctions in order to secure short term and long term exit capacity for their customers. The group commented on a number of issues associated with this approach.

Complexity and Size of Zones

Eddie Proffitt suggested that this option would be widely opposed, as the costs associated with the proposal would be immediately passed on to customers. He suggested that customers aspire for stability and that transportation costs are such a small part of the overall gas bill that complicated arrangements would not be suitable. He did agree, however, that from a theoretical standpoint, Option B did meet the principles highlighted by Ofgem. At a number of subsequent points in the meeting, Eddie reiterated his strong concern that in practice implementation was likely to lead to greater complexity and cost for the industry.

Julie Cox amongst others highlighted the question of the size of zones under this model. Several group members suggested there would be a need for a large number of zones.

Eddie Proffitt and others also suggested that there maybe added complexity in defining zones as there are variable prices to users at different pressure tiers that would need to be considered (domestic vs. I&C customers), and that some customers are connected to different pressure tiers simply due to local network geography.

Sonia Brown highlighted the need to do more work to define the requisite number and structure of zones, and in particular whether zones would need to be defined by both geographically and by offtake pressure tier.

Appropriateness of market solution

Julie Cox said that many participants were unconvinced that a market solution could work. Mike Young added that where there was limited competition there was unlikely to be long-term booking of capacity. Nick Wye added that this option was too theoretical in nature and that it could fail to address the problem of interruptible capacity free-riders.

Sonia Brown said that this option was being considered as part of the process of looking at all options and noted that the issue would resolve the issue of stranded gas network assets that might arise under option A. (Eddie Proffitt noted that it would not address the issue of *customer* stranded assets, however). Julie Cox suggested that there was a requirement to understand how big a problem this was otherwise it might be that this option could be a “sledgehammer to crack a nut” solution.

Ability to meet obligations and principles

Richard Street suggested that this option could fail to meet the obligations described above. In particular, there could be issues around:

- increasing complexity favouring incumbents over new entrants; and
- favouring larger players over smaller ones, as larger players can buy ahead with less risk.

Jason Mann and Sonia Brown both suggested that anti-hoarding measures would be able to address this issue by forcing liquidity into the market. Richard continued to say that one would look for certainty of exit capacity before taking on new customers.

Beverly Grubb asked whether customers would be willing to commit to long-term capacity. Julie Cox noted that it would be the supplier who would contract for capacity, which could confuse the market signals. Sonia Brown suggested that shippers would take a view based on the capacity it wants to book, and could trade (excess) capacity to reflect customer churn, and that churn alone would not create an aggregate increase in the demand for exit capacity in a given zone. Julie Cox asked why shippers would buy extra capacity when they don't necessarily need to.

In response to an issue raised by Julie Cox, Sonia Brown commented that a key question would be to understand whether Transcos 1 in 20 planning standard sat comfortably with this approach.

Nick Wye commented that the high degree of interrelation between NTS and DN could mean that there maybe cross subsidy effects, where the investment cost arising from reaction to investment signals from one region could produce benefits for another region, whilst the costs would be borne in the first region. Thus it is not clear how the NTS/ DN interface will influence owners' decision-making.

Jason Mann and Mark Feather commented that other users do not automatically have the right to use this extra capacity, and that this issue would be affected by the long term marginal cost against which prices are set and the other issues such as the definition of zones.

Richard Street and others suggested that this new option could have an impact on pricing for I&C customers, as there are currently different costs associated with serving domestic and I&C customers, and they are generally on different pressure tiers. Jason Mann explained that shippers would buy capacity on behalf of customers at a zonal level, and prices would then be passed on to reflect the prices of exit capacity within their area. Jason went on say that the issue of zone definition and number of exit points would be key to understanding this issue as well. Steve Rose added that the complexity of process, and increasing numbers of zones within zones could have significant administrative systems costs which could be passed on to customers.

Mike Young also raised the issue of the level at which metering would be required on the system (at the regional level or down to the zonal levels).

Phil Scott questioned whether the complexity of the option would have an impact on the ability to reach an interruptible customer to stop gas usage. Sonia Brown commented that it should not change emergency procedures.

Mark Feather then summarised the proceedings highlighting three key areas for further investigation in terms of costs and implications for option B:

1. Complexity in terms of retail and household competition, definition of zones (geographic, pressure tiers);
2. Treatment of 1 in 20 investment obligations; and
3. Systems implications and registration obligations

Mark explained that the next meeting would examine a third option, which would be the option that has been developed through the workstream discussion. As with the other two options, this will be assessed against objectives and principles as set out in the presentations on options A and B. In response to a question from Bob Bruce, Sonia Brown explained that any alternative options suggested through this consultative process would also be considered but that none had been submitted so far.

Finally, Sonia Brown addressed a question raised by Sharif Islam on the potential for creating a RIA for the exit reform issue. Sonia suggested that Ofgem would review any commitments made, and the appropriateness of undertaking such an exercise.

Next meeting date

The next meeting was scheduled for 31 March 2004.