

Commercial Interface Working Group Minutes

Meeting 5

31 March 2004, 10:00 am – 12:00 pm

Ofgem's office, 9 Millbank

Attendees

Rekha Patel	Conoco Phillips	Steve Rose	RWE Innogy
Sharif Islam	Total Gas & Power	Julie Cox	AEP
Eddie Proffitt	MEUC	Phil Scott	HSE
Beverley Grubb	SSE	Christiane Sykes	Powergen
Frances Warburton	Ofgem	Russell Cooper	NGT
Sonia Brown	Ofgem	Nigel Sisman	NGT
Jess Hunt	Ofgem	Mike Young	British Gas Trading
Mark Feather	Ofgem (chair)	John Houlden	Burges Salmon
Jason Mann	PA Consulting	Nick Wye	Waters Wye
Pascal Habay	PA Consulting	Savita Shaunak	EDF Energy
Bob Bruce	Glenton Bruce Ltd	Graham Jack	BG Connections

1. Review of minutes from previous CIWG meeting

Ofgem agreed to make a number of changes to the minutes of the meeting held 17 March 2004.

2. Actions from previous meeting

Jess Hunt said that Ofgem was still considering its proposals for universal firm in light of the draft EU regulations.

ACTION: Ofgem to consider whether its proposal for universal firm exit capacity is consistent with the draft EU gas regulation.

3. Report from the DISG meeting on March 23

Mark Feather reported that the previous DISG had focussed on options for the agency and governance structures. Three options were presented:

- ◆ option alpha, which is the model proposed by Transco
- ◆ option beta, which establishes a governance entity responsible for the administration of governance process of network code and transportation charging methodology modifications, and
- ◆ option gamma, which encompasses a broader range of services than the beta option.

Mark indicated that the issues raised in discussion on these options would feed into Ofgem's RIA on agency and governance.

4. Framework for exit reform: Option C

Jason Mann presented a further option for the gas reform process that aimed to capture the discussions to date in the exit reform workstream. The option was modelled on the set of proposed business rules circulated by Transco to exit capacity workstream members on 27 October 2003. Under Option C customers located on DN networks can enter into interruptible contracts either by participating in the application process or the matrix process. As with previous options, Jason assessed the Option C against Gas Act and licence requirement and Ofgem's specific criteria for exit reform.

Application process

Jason described the application process that would be available in relation to DN connected sites under Option C. Shippers would submit an application for interruptible DN capacity for each supply point on an annual basis. It would be mandatory for all existing interruptible supply points to submit an application, and firm customers could choose to submit an application. The applications would nominate the following terms:

- ◆ the number of days of interruption
- ◆ the option discount (ie the price, which is expressed in terms of a percentage discount on their LDZ capacity charges)
- ◆ the exercise fee and
- ◆ the contract duration (between 1 and 5 years).

The option discount is a fixed price that Transco must pay in order to have access to the customer's interruption services and the exercise fee is a sum that the customer receives for each day that they are interrupted. The option discount is capped at 100% of capacity charges, however there is no cap on the exercise fee.

For each supply point, Transco would rank the applications in order of price (lowest discount first) and accept applications until its interruptions requirements have been fulfilled. Sites for which Transco does not accept an application for interruptible capacity would be required to go firm.

If interruptible capacity is undersubscribed then Transco would have the power to apply a default bid to the highest priced applications, where the default bid is the customer's status quo. Transco would go through a process where they apply default bids sufficient interruptible capacity is available to meets Transco's requirements. If a customer that wishes to be firm cannot be made firm due to network constraints, they will be subject to their existing terms for up to three years while Transco undertakes the necessary investment.

The group discussed whether the application process described in Jason's presentation accurately reflected workstream discussions. There was a multiplicity of views regarding the outcome of exit capacity workstream discussions.

Bob Bruce asked how customers would benefit from the application process if shippers make the bids. Jason responded that competitive pressure would force shippers to reflect price discount to the supplier that will pass through to the customer.

Jason suggested that the application process helped Transco to meet its licence obligation to maintain an economic and efficient pipeline system because Transco could

choose between offers for interruption services. However, its advantages were limited because the price cap applying to the option discount could distort price signals. (He noted, however, that there was no cap on the exercise fee.) Jason also noted that transitional arrangements could be considered to be discriminatory because it prolongs the period for which interruptible customers receive a discount even though their interruptible services are not required. He also noted that Option C did not resolve the difference in the treatment of new customers and existing customers when allocating capacity. He suggested that a mechanism which establishes long term signals for exit capacity had advantages in terms of both the efficient and economic operation licence obligation and the non-discrimination licence obligation.

Mark Feather gave an example. He said that if Transco was required to undertake substantial investment in order to provide capacity for a power plant, and the power producer were to cease activity after only two years, then Transco would be likely to incur costs. Consequently, it was appropriate for Transco to enter into a long term capacity contract with the power producer in order to reduce the risks associated with stranded assets.

Russell Cooper said that the issue of long term signals had only been raised by Ofgem relatively recently, and consequently the workstream had not sought to address it. Mark agreed, and said that the issue had become more important a result of the Langage decision, which requires Transco to adopt a shallow connection policy. Russell noted that mechanisms to create long term signals could be added to Option C, just as they had been added to Options A & B.

Beverley Grubb expressed doubt as to whether Options A & B would provide accurate long term signals. Julie Cox agreed that 1-in-20 investment planning obligations was the key driver of investment decisions.

Matrix process

Jason then described the matrix approach that would be available to DN customers wishing to be interruptible under Option C. In this case, Transco publishes a matrix of no. days/percentage discount packages that it is willing to offer and customers who wish to ensure that they are interruptible may choose to participate in process. Transco would allocate a price/day package to the customer according to its requirements.

The group discussed whether the matrix approach described in Jason's presentation accurately reflected workstream discussions. Again, there was a multiplicity of views regarding the outcome of exit capacity workstream discussions.

Julie Cox noted that considerable further work is required to develop a matrix model. She suggested that the model described as Option E in the joint industry paper was an appropriate starting point. (The joint industry paper was tabled at the meeting.) Under this approach, Transco must meet a shipper's request for a reduced number of days interruption within three years.

Nigel Sisman said that Transco had envisaged that the process would run for one year ahead and that there might be problems associated with creating multi-year products through a matrix approach.

Eddie Proffitt said that it was inappropriate to consider transitional arrangements as a disadvantage that is specific to Option C because transitional arrangements could be

equally be applied to both Options A & B. Sonia Brown agreed to consider transitional arrangements in isolation from the discussion of the merits of each option.

Julie Cox asked whether Ofgem intended to undertake a comparative analysis of the options. Sonia Brown responded that this will be done at a later stage, however, at present Ofgem is focussing on the key characteristics of each option and on how they met the objectives stated at the beginning of the presentation.

The group debated whether universal firm exit capacity facilitates security of supply. Ofgem considered that since the proposals created more accurate investment signals, Transco would have a better understanding of investment requirements which would enhance its ability to meet its 1-in-20 obligations. Eddie Proffitt disagreed because in his view, a scheme with reduced interruptible capability is inherently more risky regarding the security of supply.

Eddie also suggested that security of supply could not be separated from the issue of the availability of the gas commodity through supply/ demand energy balancing. Nigel Sisman said that interruption for energy balancing purposes undermines prices on the on the day capacity market. He suggested that interruption for energy balancing purposes should be considered separately from interruption for constraint management purposes.

NTS interruption model – turn down contracts

Jason went on to describe the approach for NTS interruption arrangement as discussed in the workstream and adopted under Option C. The main feature of this approach is that customers who are connected to the NTS and wish to be interruptible would engage in a tender for interruptions three years in advance. Successful tenders would enter into turn down contracts with NGT. All customers would, therefore, pay firm NTS capacity charges.

Nick Wye argued that interruptibility on the DNs and NTS are linked and should not be assessed independently of each other. He considered that it was far more sensible to consider the DN and NTS arrangements together.

There was some discussion of whether the arrangements for pricing of the interruption contract under the application process and the matrix approach would be in the form of a discount to the transmission charge, or simply specified in a £'s option and exercise format. After some consideration, it was agreed that the previous exit workstream discussions had not finalised a view on this. Hence, for the purposes of clarification, it was agreed that:

- under the application process, discounts for being an interruptible customer would be specified in the form of £s. This would be a £s option fee and a £s exercise fee
- under the matrix approach, discounts for being an interruptible customer would be specified as a percentage discount to the firm distribution capacity charge for that customer.

5. Proposed alternatives for exit reform: Options D and E

Julie Cox circulated a document presenting two alternatives developed by a group of CIWG members following the previous CIWG meeting. The paper had been prepared in response to Ofgem's comments.

Option D is a minimum change option. Under this option, there is virtually no change from the current arrangements and customers retain the ability to choose whether to contract for firm or interruptible supply. Julie suggested that Option D should be the base case against which the cost and benefit of all other options should be evaluated.

Julie suggested that Option D must be economic and efficient, or else Transco would already be in breach of its licence. She further noted that the extent of the cross subsidy between customers created as a result of the existing exit regime has not been quantified. Finally, she said that the option was cost reflective insofar as Transco's current exit charges are cost reflective.

Eddie Proffitt stated that the Chemical Industries Association and the Major Energy Users Council supported Option D.

Beverley Grubb asked Ofgem whether it intended to publish a regulatory impact assessment on exit reform. Sonia Brown said that Ofgem had published a way forward document which states that all significant decisions will be made by the end of July and that Ofgem is keeping under review whether further RIAs are required. She added that the decision on whether to conduct an additional RIA lies with Ofgem's executive committee.

Julie then presented Option E, which she believed represented a compromise between the network operated interruption and customer choice. Option E approach seeks to overcome the difficulties faced by a number of customers in deciding how to value interruption.

Mark Feather stated that Options D and E are useful contributions to the exit reform debate, and that Ofgem would reflect on them prior to presenting a summary and comparative analysis of the various options at a future CIWG meeting.

ACTION: Ofgem to summarise and compare the various options for exit reform at CIWG 7.

6. Ofgem initial thoughts on the agency arrangements

Jason Mann presented the initial thoughts of Ofgem regarding the arrangements for the agency following discussions held at DISG meetings:

- ◆ Demand estimation should be undertaken by the agent since it is principally a settlement function.
- ◆ Transmission and distribution charges cash collection and credit arrangements should be undertaken by the respective network owners.
- ◆ Connections would not be an activity of the agent. Eddie Proffitt asked for further clarity on the definition of connections activities. Jason Mann said that in the context of the agency debate, connections activities referred to the point of contact for a supplier wishing to provide a new connection to a customer.

Ofgem considers that there is no value in creating an additional interface with the agent.

- ◆ Metering would not be an agent activity on the basis that RGMA is expected to be introduced in a few months' time. Costs associated as a result of RGMA should not be attributed to DN sales.
- ◆ A governance entity would be formed to act as a secretariat for the network code and transportation charging methodology modifications process. The NTS and DNs would retain responsibility for the development of the code and charging methodologies, such as working up the policy proposals.
- ◆ RGTA/AT Link would remain under Transco and therefore would not be part of the agent. Ofgem formed this view on the basis that the system was principally an operational tool used by Transco in its role as residual energy balancer. The governance entity would chair the UK Link Committee.

Jason indicated that the agency and governance entity would both be funded through the price control, at least until 2007/08. Ofgem considers that it is appropriate to establish two separate entities in order avoid conflict of interest. Bob Bruce suggested it would be necessary to carefully consider how to ring fence the governance entity from other areas of the network operators' businesses.

Julie Cox asked for clarification on the definition of activities summarised in the boxes on the graph displayed in the presentation. Mark Feather replied that the clarification will be made available on the web and circulated to groups members.

ACTION: Ofgem to clarify the definition of activities described in the agency presentation. Ofgem to circulate:

- ◆ Presentation on options for agency
- ◆ Presentation on agency from DISG 7
- ◆ Transco presentation to Agency Workgroup on 20 February.

Sonia Brown said that the presentation reflected the current status of thinking of Ofgem's DN Sales team and was being shared with CIWG members for transparency and with the objective of collecting comments and reactions either immediately or later by e-mail.

Julie Cox requested that the document presented by Jason be circulated electronically.

ACTION: Sonia invited the group members to provide any comments on Ofgem's initial thoughts by Friday 2 April.

6. Next meeting

The next CIWG meeting will be held at Ofgem on April 14.