

## DN Sales Development & Implementation Steering Group Minutes

### Meeting 8

20 April 2004, 9:00 am – 2:00 pm

Ofgem's office, 9 Millbank

#### Attendees

|                 |                            |                 |                       |
|-----------------|----------------------------|-----------------|-----------------------|
| David Ashbourne | Ofgem                      | Simon Goldring  | British Gas Trading   |
| Farook Khan     | Ofgem                      | Martin Kinoulty | United Utilities      |
| Sonia Brown     | Ofgem (chair)              | Paul Whittaker  | National Grid Transco |
| Jess Hunt       | Ofgem                      | Mike Ashworth   | National Grid Transco |
| Mark Feather    | Ofgem                      | Nigel Sisman    | National Grid Transco |
| Jason Mann      | PA Consulting              | Chris Train     | National Grid Transco |
| Charles Ruffell | RWE Innogy                 | Sue Higgins     | National Grid Transco |
| Tory Hunter     | Scottish & Southern Energy | Nick Wye        | Waters Wye Associates |
| Eddie Proffitt  | MEUC                       | John Costa      | EDF Energy            |
| Keith Harris    | Wessex Water               | Peter Bolitho   | Powergen              |

#### 1. Review of items from previous DISG meeting held 23 March 2004

##### a) Review of minutes

Tory Hunter said that her preference for Option Gamma as a model for the functions of the agency was predicated on the adoption of a BETTA-style approach to the allocation of roles and responsibilities between the NTS and DNs. In the event that Option 1 was adopted in relation to roles and responsibilities, then Tory considered Option Beta to be the most appropriate model for agency. Ofgem agreed to amend the minutes accordingly.

##### b) Review of actions

**ACTION:** *Group members to provide comments (if any) on Transco's paper on the differences between the options for the allocation of roles and responsibilities between the NTS and the DN.*

Sonia Brown said that Ofgem had not received any comments on Transco's paper, and that Ofgem interpreted this to mean that group members were satisfied with Transco's characterisation of the various options.

**ACTION:** *Group members to provide to Ofgem by Monday:*

- ◆ *confidential submissions on the costs associated with multiple credit arrangements;*
- ◆ *confidential submissions on the costs that would be mitigated by having the agency take on the role of directing shippers/suppliers to the correct DN for the purposes of connections;*
- ◆ *any other submissions relating to the issues discussed at the meeting.*

Sonia said that Ofgem has had a number of discussions with industry participants regarding these issues.

**ACTION:** *Group to review the issues log at next meeting.* This action was due to be discharged at the meeting.

### **3. Reports from workgroups**

#### **a) Commercial Interfaces Workgroup**

Mark Feather said that the previous CIWG had considered Transco's proposals for offtake rights and diurnal storage. He summarised the key themes of the discussions as follows:

- ◆ How will diurnal storage be allocated between DNs?
- ◆ Are there incentives on DNs to get their own forecasts right or will DNs have an incentive to overestimate their NTS offtake requirements?
- ◆ What are the planning timelines for DNs and how much discretion will they have on Day 1?
- ◆ Should charging arrangements be established for the use of diurnal storage and on the day flow variations?

#### **b) Regulatory Architecture Workgroup**

David Ashbourne said that the previous RAWG meeting had run through the proposals for the Uniform Network Code and had a thorough discussion of the issues. It had also heard a presentation by David Howdon from Ofgem's metering team, and considered the issues associated with metering.

### **4. Authority decision on DN sales**

Sonia Brown told the group that the Authority has considered the potential sales of DNs at its April Authority meeting. She said that the Authority considers that there is potential for customers to benefit from a sale, and consequently it has given the go-ahead for the next phase of work to continue.

Sonia said that the Authority recognises that there are costs associated with a sale and that there could, as a result, be circumstances in which the potential benefits are not seen by customers. If only one network is sold, or if all the networks are bought by a single buyer, the potential costs could outweigh the expected benefits. In order to protect customers' interests in these circumstances, NGT has agreed in principle to a compensation safety net.

Sonia said that the next phase of work has commenced with the release of two regulatory impact assessments on (1) the allocation of roles and responsibilities between the NTS and DNs and (2) governance and agency.

Eddie Proffitt asked whether the customer safety net would take into account the fact that a significant proportion of the costs associated with DN sales will be incurred up front whereas the benefits will be accrued over the long term. Sonia said that the Authority has a duty to protect present and future customers and that the safety net

would be calculated by subtracting the net present value of costs from the net present value of benefits.

Peter Bolitho asked whether there would be an opportunity for the costs associated with DN sales to be incorporated into the safety net at a later stage if shippers' concerns regarding industry fragmentation are realised. Sonia answered that Ofgem is presently working to form a view as to the likely level of costs and that the decision on the safety net would be based on a conservative view of the one off and ongoing costs using information that is available at the time, and taking into account the regulatory safeguards that have been developed as a part of the DN sales process. Mark Feather added that Ofgem has not yet formed a view on the likely level of costs associated with the potential sales.

#### **4. RIA on the allocation of roles and responsibilities between the NTS and DNs**

Jess Hunt gave a presentation summarising the roles and responsibilities RIA, which had been released that morning.

She said that the RIA assessed the three options for allocating roles that had been discussed at previous DISG meetings. In assessing the different options, Ofgem had considered whether the post-sale industry structure established a relationship between the NTS and DNs that permits each network owner to fulfil its statutory duties, including its duty to develop and maintain an efficient and economical pipeline system. This will depend upon the extent to which the allocation of roles and responsibilities ensures that accountabilities are clearly defined and creates an opportunity for the benefits of comparative regulation to arise.

Jess noted that Ofgem had not assessed the extent to which the various options give rise to additional costs as a result of losses of economies of scale because Ofgem does not intend to pass such costs through to customers at the next price control. Any losses of economies of scale would arise as a result of a commercial decision between the parties and consequently these costs should be factored into Transco and potential purchasers' commercial decisions.

Jess said that Ofgem's analysis suggested that Option 1 has significant advantages in both a qualitative and quantitative sense, and consequently, unless new information arises as a result of the consultation process, Ofgem is minded to support Option 1.

Keith Harris questioned Ofgem's treatment of losses of economies of scale. He said that it was appropriate for customers to receive only the net benefit associated with DN sales, and that potential losses of economies of scale should be factored into the RIA analysis on whether or not to consent to sale. Sonia Brown said that Ofgem has taken a view that it is not appropriate for customers to bear the risk of costs associated with losses of economies of scale and that this was a matter for the parties to a sale.

Keith Harris then sought greater detail on which functions, in addition to DN area control centres, would give rise to losses of economies of scale. He emphasised that it was important to know this as it affects the value of the DNs. Sonia Brown said that at the next price control review, parties would need to make a case that expenditure was efficiently incurred. She noted that diseconomies of scale would need to either feed into the DN sales cost benefit analysis or be considered at the next price control review, and that Ofgem believes it is more appropriate that they are considered at the next price control review than estimated now.

Simon Goldring asked why Ofgem had not considered a 'no change' option as the base case for its analysis. Jess Hunt explained that the purpose of the RIA was to help inform

the development of the regulatory, commercial and operational framework to support a divested industry structure. Consequently, it would not be useful to include the status quo as the base case, since this would not be an option in a post-DN sales world. Jess said that the roles and responsibilities RIA could almost be considered to be a 'mini-RIA' as it informs the development of an alternative to the status quo (ie no sales) that will be considered in a broader RIA on the DN sales proposals.

Peter Bolitho asked whether Ofgem considered the capacity for opex savings associated with each function. Sonia Brown said that Ofgem had carefully considered this issue, and that Appendix 2 of the RIA set out the methodology and assumptions underlying Ofgem's quantitative analysis.

## **5. RIA on agency & governance**

Jason Mann gave a presentation summarising the agency and governance RIA, which had also been released that morning. Jason said that the RIA considers six options for governance and agency:

- ◆ *Option A – Transco's initial proposal.* This is the split of activities which was proposed by Transco and which gives the Agent responsibility for supply point administration, gas balancing cash collection and credit management, transportation invoicing and certain other functions.
- ◆ *Option B – Introducing a 'Governance Entity'.* This is the Option Beta of previous discussions. There are two alternatives within Option B – one where transportation and distribution charges cash and credit collection would be included in the scope of the Agent, and another where the responsibility rests with the network owner.
- ◆ *Option C – Including AT-link and RGTA.* Option C arose following the workgroup discussions in which some shippers expressed a view that it was desirable to transfer all UK-link systems to the Agent to protect against the risk of future inefficient fragmentation.
- ◆ *Option D – Allocating systems with responsibilities.* Ofgem has developed an alternative option where the existing AT-link system is split between the agent and the NTS depending on whether it is used for operations or settlements processes.
- ◆ *Option E – Including RGTA systems with the NTS and AT-link with the agency.* Under Option E, the NTS retains responsibility for the RGTA systems, however, AT-link would become an agency function.
- ◆ *Option F - Broadest agency.* Under this broad version of the agency, the agency would manage the RGTA and AT-Link systems, transportation cash collection and credit arrangements. In addition, it would take on the activities of connections and metering.

Jason told the group that the RIA assesses the costs and benefits of the various options in relation to the following key issues: cost mitigation, funding, effect on competition and accountability.

In relation to Option A, Tory Hunter noted that the function of 'demand estimation' had been moved to be a function of the NTS, whereas in previous discussions it had been considered to be a function of the agent. Jason Mann said that this change had been made as a result of discussions with Transco which had given rise to further clarity of the nature of the function. Tory suggested that there is a lack of clarity regarding the

proposals, in particular in relation to accountability. Mark Feather responded that the agency & governance RIA defines each function, explains who does what under each option and assesses each option in relation to accountability.

Peter Bolitho sought further clarity on whether Option D entails that AT Link would be split down the middle. Sonia Brown said AT-link contains information that both Transco and shippers use operationally and, additionally, information that is used in the settlement process. Consequently, Ofgem has developed an alternative Option D, whereby the existing AT-link system is split between the agent and the NTS depending on whether it is used for operations or settlements processes. This option goes to the heart of allocating functions in accordance with accountabilities. Sonia said that Option D represented a long term goal. Peter suggested that since there is no clear distinction between operations and settlements processes, Option D would be difficult to put into practice.

Mark Feather explained Ofgem's view that the 'no agency' option was most likely to give rise to benefits in terms of quality of service due to the effect of comparative regulation, and the potential for competitive service provision. He suggested that as the options move away from the 'no agency' option towards a monopoly service provider, there are fewer opportunities for quality of service improvements.

Jason Mann said that Ofgem was awaiting respondents' views on the costs and benefits. However, on the basis of currently available information, Ofgem was minded to support either Option B1 or Option E.

Sonia Brown noted that the governance entity was established separately to the agent in order to secure non-discrimination. She said that the role of the governance entity was secretarial. It ensures that all modification proposals are dealt with in a non-discriminatory manner.

Peter Bolitho asked whether there would be one uniform network code (UNC) and a single modification process. Sonia said that the proposals contemplated a UNC, however it may be necessary to have one page short form network codes applying to each network operator. She said the agency and governance RIA considers the high level role of the agent, however a lot of important detailed work is required on these issues.

Sonia Brown said that submissions on the two RIAs were due on 17 May, however, group members were encouraged to raise issues with Ofgem prior to this either for discussion at the DISG or, if necessary, in confidence.

**ACTION:** Group members to consider the issues raised in the agency & governance and roles & responsibilities RIAs.

## **6. NGT presentation on SOMSAs**

Sonia Brown said that the previous CIWG meeting had raised residual concerns about the allocation of roles and responsibilities between the NTS and DNs on Day 1 after a DN sale as well as going forward. Consequently Ofgem had asked Transco to provide further information about the extent to which the DN has discretion under the SOMSA arrangements.

Chris Train summarised Transco's additional note on SOMSAs, which builds on the paper provided to DISG 3.

Sonia Brown asked about the treatment of the schedule of planned maintenance under the SOMSA. Chris Train explained that there was a dialogue between the NTS and DN

about the appropriateness of the maintenance schedule at the NTS interface. Mike Ashworth added that there was a network code requirement to co-ordinate maintenance in order to minimise disruption. Sonia asked why this issue was dealt with in the SOMSA, rather than under the network code or offtake code. Chris Train said the DN area control centre operator (who would be Transco under the SOMSA) needs to co-ordinate with the operatives in the field and the NTS. The role of the DN area control centre (ACC) operator is to communicate maintenance information, however the DN owner would be responsible for identifying the need to maintenance to be undertaken.

Mark Feather asked about the potential for DNs to override decisions made under the SOMSA. Chris Train said that responsibility for decision making lies with the DNs.

Eddie Proffitt asked how much it would cost for an IDN to establish a separate ACC. Chris Train answered that an IDN could only establish a separate ACC if it could obtain the relevant safety case approvals from the HSE. Eddie Proffitt suggested that the SOMSA arrangements had the potential to develop into a second agency. Chris suggested that in his view, this would be a worst case scenario because there are benefits to IDNs associated with establishing their own ACCs. Sonia Brown noted that Ofgem did not intend to pass through to customers any additional costs associated with the establishment of separate DN ACCs.

Chris Train said that Transco was bound to abide by the terms of the SOMSA as it is reflected in the safety case.

Sonia Brown and Nick Wye asked for more information about the ancillary services provided under the SOMSA.

**ACTION:** Transco to provide more information about the ancillary services provided under the SOMSA.

## **7. Discussion of NGT paper on separation of NTS from DNs**

Sue Higgins said that the paper had been prepared as a flow on from previous discussions at DISG 4. It describes the non-discrimination provisions that already apply to Transco, and compares them to the provisions applying in the water and electricity industries. She said the purpose of the paper was to aid discussion of whether existing licence provisions are already sufficiently strong to protect against unscrupulous parents.

Keith Harris noted that the paper contained an error – contrary to the information provided in the paper, the requirements relating to investment grade credit ratings apply to water. He suggested that perhaps it could be possible to impose a licence condition which relates directors' duties to each DN, rather than to establish a separate legal entity for each DN.

Nick Wye raised the issue of compliance monitoring and enforcement. He said that whilst Transco's offtake code proposals were rule-based, it might be difficult for Ofgem to identify discriminatory behaviour under the offtake code if market based solutions were adopted.

**ACTION:** Group to provide comments, if any, on Transco's paper. Transco to identify the flow on effects that the retention of a single legal entity would have on other areas of the regulatory framework.

## **8. Forward work plan**

Sonia Brown said that Ofgem had distributed an open letter on exit the previous evening, which states that Ofgem intends to issue a RIA on exit reform. This RIA will

assess the options for exit reform discussed in the CIWG, and will also consider the issue of transitional arrangements. It will be conducted prior to the removal of the universal firm obligation from Transco's licence.

Sonia said that Ofgem also intends to release a further RIA that considers the operational and commercial interface between the NTS and DNs. This document will consider the commercial arrangements at the offtake and also the regulatory arrangements including separation, non-discrimination and incentivisation.

These documents are intended to be released in early June, and consultation is expected to conclude by the end of June.

Sonia said that initial discussions at the CIWG suggested that a lot of work was required in relation to the offtake arrangements and consequently that this would be the major focus of the groups over the next few weeks. Sonia also said that Ofgem had decided to postpone further RAWG meetings until after the major decisions on roles and responsibilities and agency and governance in order to focus Ofgem and industry resources on these other issues.

Ofgem expects that a decision will be made on agency and governance and roles and responsibilities at the end of May. Sonia noted that further work is also required in relation to the detail of the agency and governance arrangements over the next few weeks.

Ofgem expects that this phase of work will be completed by the end of July. It inform the Authority's final decision on the proposed sale, which is expected in the second half of 2004.

Tory Hunter commented that it would be helpful for Ofgem to produce a project plan. Simon Goldring commented that participants needed to receive the minutes more quickly if they are to have any value.

## **9. Forward work plan**

The group reviewed the issues log. The group provided comments on issues 18, 27, 50, 56 and 62A. Ofgem agreed to amend the issues log accordingly.

**ACTION:** Ofgem to circulate revised issues log.

## **Next meeting**

The next meeting will be held at Ofgem on 4 May 2004.