

Commercial Interface Working Group Minutes

Meeting 7

28 April 2004, 10:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Steve Rose	RWE Innogy	Graham Jack	British Gas Connections
Eddie Proffitt	MEUC	Christiane Sykes	Powergen
Beverley Grubb	SSE	Mark Sutton	NGT
Julie Cox	AEP	Adam Davidson	NGT
Steve Ladle	Total Gas & Power	Russell Cooper	NGT
Adam Whitmore	Deloittes	Nigel Sisman	NGT
Sonia Brown	Ofgem (chair)	Simon Goldring	British Gas Trading
Jess Hunt	Ofgem	Nick Wye	Waters Wye
Jason Mann	PA Consulting	Jimmy Smith	EDF Energy
David Ashbourne	Ofgem	Bob Bruce	Glenton Bruce
Phil Scott	HSE		

1. Review of items from previous CIWG meeting

a) Minutes

Mark Sutton requested some changes to the draft minutes, which Ofgem agreed to make.

b) Actions

The following actions arose at the previous two CIWG meetings:

1. *Transco to provide more detail on how the SOMSA will operate and what services will be covered at the next DISG meeting.* Transco gave a presentation on the SOMSA at the DISG meeting held 20 April 2004.
2. *Ofgem to circulate issues log to CIWG members.* This action has been discharged.
3. *Ofgem to consider whether its proposal for universal firm exit capacity is consistent with the draft EU gas regulation.* Ofgem's Europe and legal teams are currently considering this issue.
4. *Ofgem to summarise and compare the various options for exit reform at CIWG 7.* This action was due to be discharged at the meeting.
5. *Ofgem to clarify the definition of activities described in the agency presentation.* This action was discharged with the release of Ofgem's agency and governance RIA.

Beverley Grubb questioned whether all of the SOMSA issues had been resolved at the DISG, in particular the issue of the extent to which IDNs would have control of activities. Sonia Brown suggested that participants should email Ofgem regarding any outstanding issues associated with the SOMSAs, so that they can be discussed at the next CIWG meeting.

ACTION: Group to email their concerns regarding SOMSAs to Ofgem. Ofgem to collate questions for Transco's response at the next meeting.

Sonia Brown noted that there were a number of outstanding actions on Transco from the RAWG, and that these actions would be circulated to the DISG and the CIWG.

ACTION: Ofgem to circulate outstanding actions on Transco from the RAWG, and to schedule agenda items at the DISG and/or CIWG for Transco to discharge the outstanding items.

2. Update from the Development & Implementation Steering Committee

Sonia Brown told the group that the previous DISG had heard presentations on the Roles & Responsibilities RIA and the Agency & Governance RIA, and that there were high level discussions on the issues. She said that discussion surrounding the Roles & Responsibilities RIA had focussed on economies of scale. Some members of the DISG were concerned about Ofgem's proposed treatment of economies of scale, in particular about the lack of clarity regarding what costs would be passed through at the next price control review. Sonia said that discussion surrounding the Agency & Governance RIA had focussed on clarifying the roles of the agent.

Sonia said that Transco gave a presentation on the SOMSA which was designed to provide further clarity on who was responsible for decision making under the SOMSA, and that Transco has an action on it to provide further clarity about ancillary services.

Finally, the DISG has considered a Transco paper that compares the ring fencing and non-discrimination licence conditions applying in the gas, water and electricity industries. Sonia said that several members of the group considered legal separation to be the first best solution, however, if legal separation proves to be excessively costly, then perhaps alternative mechanisms could be adopted to ensure that directors are required to abide by appropriate standards of corporate governance.

Discussion of broader DN sales issues

Some group members asked if Ofgem had made available any further information regarding the proposed customer safety net. Sonia Brown said that at this time, Ofgem had only publicly released the press release. She added the final RIA on DN sales would consider the matter of the customer safety net, including whether a safety net is necessary. Julie Cox asked whether the final RIA would be consulted upon. Sonia said that as with the Next Steps document, the final RIA would be made publicly available, and any comments would be gratefully received, however there would be no formal request for submissions. Julie expressed her concern that certain key issues would not be covered by the mini-RIAs and consequently there would be no formal opportunity for industry participants to express their views.

ACTION: Group to provide feedback to Ofgem regarding which issues they consider are important.

Eddie Proffitt asked whether the SOMSAs would be likely to become permanent, rather than transitional, if Ofgem does not pass through the costs associated with the establishment and operation of separate IDN area control centres. Sonia Brown

responded that Ofgem will not pass through costs to customers unless it can be assured that the costs are efficiently incurred.

Jimmy Smith asked if the same logic would apply to emergency services. He suggested that there were economies of scale associated with being able to shift manpower in order to respond to an emergency. Jess Hunt suggested that there were no losses of economies of scale associated with emergency services because Transco must already incur these costs. Jimmy Smith suggested that costs would be higher in a divested industry because independent companies would want to make a profit. Sonia Brown said that emergency responses were a part of the forward work program, and that Ofgem has not made a statement on how it will treat this issue.

Adam Whitmore noted that IDNs would need to incur a certain level of expenditure in order to gain the benefits of DN sale, and consequently such expenditure should be considered to be efficiently incurred. Sonia Brown said that Ofgem would seek to give as much certainty as possible, however, there were limits.

Steve Ladle noted that the Agency & Governance RIA does not mention the issues associated with the governance of the UNC, such as whether a single UNC or short form network codes would be adopted. He asked whether this was because it has been discounted or because Ofgem is still considering the issue. Sonia Brown said that Ofgem considers UNC governance to be an important issue, and it will be addressed as part of the detailed work on DN sales. She noted that governance issues, including modification rules, would be discussed at the next DISG meeting.

Steve Rose also asked for further information regarding the derivation of Figure 9 in the Agency & Governance RIA. He noted that it wasn't clear how any of the lines shown in Figure 9 could be derived using the cost estimates that RWE Innogy provided to Ofgem. Sonia Brown said that she was unable to provide any further information because Ofgem has an obligation to protect the confidentiality of information provided to it.

Steve Ladle asked why the costs associated with establishing a governance entity were not estimated in the Agency & Governance RIA. Sonia Brown said that Ofgem believes that there is potential for Transco to discriminate under its initial proposals and consequently, Ofgem believes that it is beneficial to have a governance entity. Ofgem would expect the costs associated with establishing the governance entity to be met within Transco's existing price control review, and ongoing costs post 2008 will be considered at the next price control review.

Julie Cox suggested that additional costs could arise in 2008, because the governance entity will need to recruit additional expertise over and above those people currently residing within Transco. She expressed concern that some of the costs associated with DN sales were being 'swept under the carpet' on the basis that they should be considered at the time of the next price control review, and consequently there was a risk that costs to customers would increase at that time. Sonia Brown said that Ofgem is not seeking to sweep any issues under the carpet, and requested that group members identify to Ofgem any potential costs or issues that they consider to be in danger of being overlooked.

Jimmy Smith suggested that further regard should be had to the costs associated with establishing independent area control centres. Sonia Brown said that since any costs arising from losses of economies of scale would arise out of Transco's commercial

decision to sell one or more DNs, Ofgem will not allow additional costs associated with losses of economies of scale to be passed through to customers. As such, DN purchasers will need to factor any such costs into its purchase decision.

Offtake Code

Jason Mann gave a presentation on Ofgem's view of the key issues associated with Transco's initial proposals for the Offtake Code.

Potential for discrimination between DN offtakes and NEXA offtakes.

Nick Wye questioned whether discrimination could be eliminated given that NEXA contractual arrangements are already in place. Sonia Brown suggested that new arrangements could apply to future contracts, or alternatively there could be scope for existing contracts be renegotiated to be on standard terms.

Adam Davidson said that at present, all NTS direct connects have NEXA arrangements in place, however some customers' NEXAs are based on older generic contracts than others. He suggested that the issue of whether the existing NEXAs were discriminatory rested on whether the differences between contracts were due or undue.

Nick Wye noted that the terms of the NEXAs were flexibly applied by Transco, but that there may be greater incentives on Transco to discriminate in the presence of IDNs. However, Nick said that it was not a good idea to restrict Transco so much that it is unable to operate its system efficiently.

Jimmy Smith said that NEXAs should be considered separately to DN sales. Jason Mann responded that it was necessary to consider NEXAs because if a fee paying relationship between the NTS and DNs is introduced then discrimination could arise. Adam Davidson suggested that NTS direct connects would be unwilling to renegotiate the NEXAs.

MDQ determination

Beverley Grubb asked whether the Transco's proposed arrangements with respect to investment planning were intended to be an interactive process between the NTS and DNs. Jason Mann said that in his understanding, Transco was proposing an interactive process however the NTS would have the final say. Sonia Brown noted that there is a whole raft of issues to be considered, including who should bear financial responsibility if the DN requests an inefficient MDQ. She said that Ofgem would welcome alternative proposals to those put forward by Transco.

ACTION: Interested parties to suggest alternative investment planning process to Ofgem.

Diurnal storage

The group considered the arrangements for diurnal storage. Eddie Proffitt suggested that Ofgem's previous proposals for a market for linepack had been comprehensively rejected by industry.

A number of participants agreed that transfers of linepack between the NTS and the DN should be priced. Jimmy Smith noted that diurnal storage is a liquid asset which moves and changes, and consequently it would be very difficult to develop a set of administered rules that would be capable of preventing discrimination.

Nick Wye observed that a number of issues associated with the offtake arrangements lend support to the view that Transco should be required to legally separate its RDN businesses from its NTS business. Sonia Brown said she understood this view, however she cautioned against over-reliance on business separation as a solution to discrimination issues. She suggested that robust procedures and correct commercial incentives are also required to ensure an efficient non-discriminatory outcome for consumers. Mark Sutton responded that Transco was unable to behave in a discriminatory manner because all the relevant information was transparent and in the public domain.

Operational flows

Jimmy Smith noted that not all charging would flow from the NTS to the DN – some would flow from the DN to the NTS. Jason Mann agreed that this was the case, and said that the key issue was how to arrive at a price. Sonia Brown noted that pricing arrangements reduce the risk of discrimination, because the same product can be offered to all connections.

Nick Wye agreed that there was potential for discrimination and consequently a standard pricing methodology was required. Nigel Sisman agreed with the principle, however he said that it was necessary to consider how it would work in practice, as the arrangements had the potential to become complex.

Adam Whitmore asked Ofgem about the process it intended to adopt in order to resolve the issues associated with offtake arrangement. Sonia Brown answered that Jason's presentation was intended to give CIWG members the opportunity to understand Ofgem's current thinking on the main issues associated with the offtake arrangements. She said that Ofgem is trying to stimulate industry debate on these issues, and that there was no fixed process for providing input. She suggested that parties wishing to express their views could arrange with Ofgem to hold bilateral or multi-party meetings, prepare papers for discussion at a future CIWG meeting, or simply email Ofgem to raise issues. Adam Whitmore asked whether Ofgem intended to have a formal process. Sonia said that Ofgem was preparing a document that considers all of these issues, which is scheduled to be released in early June.

Options for exit reform

Jason Mann gave a presentation on the various options for exit reform. He said that the options that Ofgem intended to consider in the RIA were:

1. No change option
2. Network owner determined interruption, which has two variants:
 - A Tenders for interruption
 - B Matrix approach
3. Exit capacity auctions.

Option 2B Matrix

The group discussed how the matrix would be populated. Sonia Brown suggested that the network operator would decide how to populate the values in the cells according to the needs of its network.

Eddie Proffitt suggested that there would be a risk that inefficient investment could be incurred under the proposed matrix model if there was no flexibility for Transco to amend the number of days interruption according to its requirements. For instance, if a customer nominated 45 days, and Transco only required 10 days, Transco might prefer to invest rather than pay for 45 days (in order to make the customer firm) even though both parties could have been satisfied with a contract for 10 days. Sonia Brown noted that Julie Cox’s suggestion that customers nominate a series of cells could resolve the issue.

Adam Whitmore said that it was not clear how the signal for efficient interruption would flow between the NTS and DN. Jason Mann said that either the NTS could contract for interruption on DN sites, or the NTS could contract with DNs for deviations from its offtake profile (in which case the NTS interruptions requirements would be caught under commercial arrangement between operators, and the DN would have the obligation to interrupt). Jimmy Smith said that it was important that any contractual arrangements ensure that the NTS gets the reduction in flows exactly when it is required.

Option 3 Auctions

Julie Cox asked whether Ofgem has considered whether its proposals for exit capacity auctions were consistent with the EU directive requirement that third party access to services should be delivered on the basis on pre-defined tariffs.

ACTION: Ofgem to consider whether its proposals for exit capacity auctions were consistent with the EU directive requirement that third party access to services should be delivered on the basis on pre-defined tariffs.

Comparison of options

Jason presented the following slide, which shows Ofgem’s initial assessment of the advantages and disadvantage of the various options.

	Option 1	Option 2A	Option 2B	Option 3
Network owner determined interruption	✗	✓	✓	✓
Non-discrimination	✗	✓	✓	✓
Customer choice	✗	✓	✓	✓
Investment signals to network owners	✗	✓	✓	✓
Investment signals to users	✗	✗	✗	✓
Electricity market interactions	✗	✓	✓	✓
Safe and secure pipeline system	✓	✓	✓	✓

Jimmy Smith suggested that the matrix approach could give investment signals to users, for instance if their application is rejected. Jason said that slide intended to refer to more long term signals to end users, such as siting decisions. He agreed to amend the slide to make it clearer. Sonia Brown noted that Options 2A and 2B delivered some

improvement in investment signals to customers over the status quo, but the signals were not as good as under Option 3.

Beverley Grubb suggested that Ofgem should develop its comparison of the options beyond ticks & crosses, since, without weighting, ticks & crosses do not provide a full set of information. She also asked whether Ofgem intended to consider a matrix only approach (given that Option 2B is a matrix plus tender approach). She noted that the matrix only approach that had been put forward by a group of CIWG members at CIWG 5 has a number of different features to the matrix proposed in Option 2B.

In relation to the interactions with electricity markets, Beverley Grubb noted that site sharing and buddying arrangements already exist. Sonia Brown said that NGT has expressed the view that these arrangements could be enhanced. Some group members expressed the view that such arrangements involve fundamental issues that cut across all three of the options.

ACTION: Ofgem to add a matrix-only option to its RIA. Ofgem to consider in its RIA the additional key issues suggested in the joint industry paper on further options for exit reform (tabled at CIWG 5).

Steve Rose suggested that the matrix-only option should permit the DN to nominate a shorter number of days than the shipper asks for.

Next meeting

The next meeting will be held at Ofgem's offices on Wednesday 12 May.