Commercial Interface Working Group Minutes

Meeting 8

12 May 2004, 10:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Eddie Proffitt	MEUC	Mark Sutton	NGT
Beverley Grubb	SSE	Adam Davidson	NGT
Adam Whitmore	Deloittes	Nigel Sisman	NGT
Sonia Brown	Ofgem (chair)	Michael Young	British Gas Trading
Jess Hunt	Ofgem	Nick Wye	Waters Wye
Jason Mann	PA Consulting	James Smith	EDF Energy
Tim Dewhurst	PA Consulting	Sharif Islam	Total
David Ashbourne	Ofgem	Bob Bruce	Glenton Bruce
Richard Street	Statoil		

1. Review of items from previous CIWG meeting (held 28 April 2004)

a) Minutes

There were no comments on the minutes from the previous meeting.

b) Actions

The following actions arose at the previous CIWG meeting:

1. *Group to email their concerns regarding SOMSAs to Ofgem. Ofgem to collate questions for Transco's response at the next meeting.* Ofgem had not received any responses regarding SOMSAs. Beverley Grubb said that SSE was intending to provide a response. It was agreed that the action would be carried over to next the CIWG meeting.
2. *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.* Ofgem had circulated the outstanding actions to the DISG and CIWG. Transco has subsequently provided a response on the issue of inter-DN offtakes. This paper would be tabled at the next DISG meeting.
3. *Group to provide feedback to Ofgem regarding which issues they consider are important.* Waters Wye had provided a paper setting out certain key issues that they consider to be important. This paper would be circulated to workgroup participants shortly. Transco's response to the paper was scheduled for discussion at the next DISG meeting. Sonia Brown suggested that the action should be an ongoing action on the group.
4. *Interested parties to suggest alternative investment planning process to Ofgem.* Ofgem had not received any suggestions regarding alternative investment planning processes, however it was noted that the policy development process is not at the solutions stage yet. Sonia Brown suggested that the action should be an ongoing action on the group.

5. *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.* This issue will be addressed in Ofgem's Exit & Interruptions RIA, which is scheduled for release in early June.
6. *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).* Ofgem's Exit & Interruptions RIA is scheduled for release in early June.

ACTION: SSE to email their concerns regarding SOMSAs to Ofgem by Friday 21 May. Transco to respond at next meeting.

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

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

2. Update from the Development & Implementation Steering Committee

Sonia Brown told the group that at the previous DISG, Transco had presented their perspective on how the uniform network code governance arrangements would operate under a divested industry structure. As a result of the following discussion, Peter Bolitho had agreed to develop an alternative 'shipper' model. Sonia suggested that shippers should contact Peter if they wished to provide comments.

Sonia said that the DISG had also considered presentations by Jason Mann on the offtake code and the options for exit reform. The exit presentation to the DISG included new key issues and a new option, as suggested at CIWG 7. The DISG had agreed not to discuss interruptions again until the Exit RIA is released (unless material new issues arise).

Sonia asked the group whether they considered that the issues surrounding exit reform had been adequately discussed in the CIWG. Beverley Grubb suggested that the trasitional arrangements should be discussed further prior to the release of the RIA.

ACTION: Eddie Proffitt to submit paper on the transitional arrangements for exit reform by Friday 21 May, to be presented at the next meeting. Beverley Grubb to provide her comments to Eddie.

3. Commercial and regulatory arrangements at the NTS-DN interface

Jason Mann gave a presentation on the NTS offtake arrangements. He set out for discussion three options for the arrangements for MDQ allocation:

- Transco proposal
- DN booking model
- Shipper booking model

Transco proposal

James Smith noted that shippers would send their SOQ information to the agency, rather than directly to the DNs.

Eddie Proffitt asked who would determine the 1 in 20 requirements under Transco's proposal. Jason Mann said that post DN-sales, there would be two parties determining 1 in 20. He said that this process is largely formulaic, however an element of judgement in required and that this is the precisely the tension that Ofgem is seeking to address. Jason noted that under Transco's proposal, the NTS would have the final say on the MDQ allocated to the DN.

Richard Street suggested that the impact on shippers would be significant if network operators' estimates of MDQ requirements are slightly wrong. The group discussed the impact of network operator's demand forecasts on the algorithms that are used to allocate transportation charges between shippers – ie, how SOQs and MDQs are added up, and if they are related to each other.

Nigel Sisman said that the MDQ modelling process starts by considering historical consumption, which is broken down by sector. These figures are then adjusted to take account of the weather. The next stage in the MDQ modelling process is forward looking, and figures are adjusted to take account of economic factors such as general load growth. Finally, the modelling takes into account local intelligence (such as whether any major new loads are expected). All this information feeds into a series of load duration curves. Nigel concluded that that the MDQ process is concerned with estimating the network's 1 in 20 requirements, whereas SOQs are commercial bookings. SOQs are based on shippers' assessment of the weather and their appetite for risk. They are not affected by the 1 in 20 obligation, and consequently MDQs and SOQs are not related.

Nigel said that the MDQ modelling process incorporates subjective factors (such as economic growth forecasts) and consequently there is potential for different opinions between the NTS and DNs regarding MDQ requirements. Consequently, under Transco's proposal, the NTS is not required to build to meet the DN's request for MDQ if it considers that the DN has overestimated its requirements.

Jason Mann noted that this approach had the potential to result in arbitration each year. Nick Wye suggested that this issue raised the question of whether it is appropriate to apply a 1 in 20 standard to DNs under a divested industry structure.

DN booking model

Jason said that under the DN booking model, DNs would stipulate what they believe they need to meet their 1 in 20 obligation, and the NTS would be obliged to provide that level, either through the provision of capacity or through buy backs. There would be an incentive mechanism on the DN to book the correct level of MDQs.

Eddie Proffitt said that such incentive schemes would encourage DNs to take more risks when making investment planning decisions, since they would be penalised for gold plating their network. He felt that over-investment is better for consumers than under-investment, because constrained capacity has a much larger impact on the price of delivered gas than Transco's investment program. James Smith noted that overrun charges would discourage DNs from under-booking NTS capacity. Jason Mann said that Eddie was effectively arguing that network operators should build to a level above the 1 in 20 requirement. Sonia Brown said that the DN booking model incentivises the DN to deliver whatever level of investment has been established by public policy to be the efficient level, and at present the efficient level is considered to be 1 in 20.

James Smith noted that, unlike Transco's proposal, the DN booking model did not provide indicative prices for NTS capacity beyond 3 years. He considered that this information would be useful to DN investment planners.

The group discussed how NTS overrun charges would be attributed under the DN booking model. The key issue was how to separate financial responsibility for NTS overruns caused by shippers consuming above their SOQs from NTS overruns caused by the DN's miscalculation of MDQ requirements. It was noted that it is relatively straightforward to identify when a daily metered site has exceeded its SOQ and financial responsibility can be allocated accordingly. However, there is a lack of transparency regarding non daily metered consumption.

Mike Young noted that, depending on how such overruns were treated, there was a potential for discrimination between NTS direct connects (who must bear the full cost of NTS capacity overruns) and DNs (who could potentially be exposed to only a proportion of overrun charges, with the rest being allocated to shippers).

Under the DN booking model proposed in Ofgem's presentation, the DN pays for 5% of NTS capacity charges and 95% is passed through to shippers. This arrangement gives DNs the incentive to book an efficient level of NTS capacity. Adam Whitmore suggested that an incentive scheme whereby DNs purchase 100% of capacity would provide simple and more powerful incentives. Jason Mann noted that this approach has the potential to give rise to very complicated price control issues.

ACTION: Adam Whitmore to prepare a paper that describes an approach where 100% of NTS capacity charges flow through the DNs and how it differs from Ofgem's approach. Due Friday 21 May, to be discussed at the next CIWG meeting.

Beverley Grubb asked how the interruptions regime would be incorporated into the DN booking model. Sonia Brown said that the model was still being developed, however one potential approach would be to include a target level of interruption costs within a DN incentive scheme.

Sharif Islam asked whether the DN would be aware if its request for NTS exit capacity triggers a requirement for investment on the NTS. Jason Mann said that the DN would be subject to an incentive scheme in which it would be exposed to forward looking NTS LRMC curves. Potentially, the DN may prefer to contract for interruption rather than trigger investment on the NTS. Sharif Islam noted that since neighbouring DNs may benefit from an NTS upgrade triggered by one DN, there was potential for strategic behaviour by DNs when they request MDQs. Jason Mann confirmed that DNs would all submit bids at the same time.

Shipper booking model

The group discussed the implications of requiring shippers to book NTS capacity three years in advance under the shipper booking model.

James Smith said that this would be problematic because shippers won't know whether they will retain the customer for three years. Sonia Brown noted that the model contemplated a secondary market where shippers could trade NTS exit capacity. Some group participants considered that this would increase costs as a result of additional administrative complexity and because shippers may add a mark-up when they sell their

capacity. Some members of the group were also concerned about the liquidity of the secondary market for capacity. Nick Wye suggested that diversification of portfolios means that the shipper booking model would favour large shippers over small ones. Ofgem noted that these issues reflected the state of competition in the retail market.

James Smith suggested that larger shippers may be unwilling to sell capacity if they lose a single large customer because they've gained other customers elsewhere, for instance because new customers were connecting in the same NTS exit zone. If the new shipper is unable to purchase capacity for its single large customer, it could potentially face overrun charges. Consequently, the model could inhibit competition since shippers would be unwilling to bid for a customer if there is doubt as to whether they can get access to the required capacity.

Beverley Grubb noted that shippers would not have the access to the information that would enable them to include the loads of new connections in their assessment of capacity requirements three years in advance. Consequently, network operators would need to have some role in determining capacity requirements, because they know where new connections are planned.

James Smith asked whether shippers would be required to book capacity to a 1 in 20 standard under the shipper booking model. Jason Mann said that this was one potential outcome. Sonia Brown said that another potential outcome could be that there is no 1 in 20 and that instead, shippers would book the amount of capacity that they consider their customers require. She said that the shipper booking model is based on the premise that market participants have a better understanding of what customers want than monopolies. Eddie Proffitt said that the shipper booking approach would drive customers to demand direct contracts with network operators, and that direct contractual arrangements could potentially be desirable from a customer perspective. Bob Bruce and Jimmy Smith considered that it was not feasible for shippers to carry the 1 in 20 obligation given the pace of change in the supply market.

The group acknowledged that the shipper booking model has broad implications that went beyond the relationship between the NTS and the DN. In particular, it was noted that the shipper booking model would entail major reform of the exit and interruptions arrangements. Sonia Brown agreed that the issues are highly interlinked, and that is why Ofgem is progressing exit reform as a part of the DN sales process.

Beverley Grubb said that her concerns associated with the shipper booking model were the same as those expressed at the CIWG meeting on exit capacity auctions, namely, the potential for problems arising from excessive market power, complexity and administrative costs. Sonia Brown noted that the proposals in this case were different because NTS capacity is more liquid than DN capacity, and consequently there is more potential for substitution at the NTS level.

ACTION: Richard Street to assess the shipper booking model. Bob Bruce and James Smith to assess the DN booking model. Papers due Friday 21 May.

ACTION: Ofgem to further develop the other issues identified in Jason's presentation.

Next meeting

The next meeting will be held at Ofgem's offices on Wednesday 26 May.