

## Commercial Interface Working Group Minutes

### Meeting 9

26 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	Julie Cox	AEP
David Ashbourne	Ofgem	Bob Bruce	Glenton Bruce
Richard Street	Statoil	Steve Rose	RWE Innogy
Christiane Sykes	Powergen	Sebastian Eyre	energywatch
		Phil Scott	HSE

#### 1. Review of items from previous CIWG meeting (held 12 May 2004)

##### a) Minutes

Beverley Grubb and Bob Bruce requested changes to the 'shipper booking model' section of the previous minutes, which Ofgem agreed to make.

##### b) Actions

The following actions arose at the previous CIWG meeting:

- ◆ *SSE to email their concerns regarding SOMSAs to Ofgem by Friday 21 May. Transco to respond at next meeting. This action had been completed and the presentations were due to be discussed during the meeting.*
- ◆ *Group to provide feedback to Ofgem regarding which issues they consider to be important. This was a standing action on the group. Ofgem had received no new submissions since the previous CIWG.*
- ◆ *Interested parties to suggest alternative investment planning process to Ofgem. This was a standing action on the group. Ofgem had received no new submissions since the previous CIWG.*
- ◆ *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. This action had been completed and the presentations were due to be discussed during the meeting.*

- ◆ *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. This action had been completed and was due to be discussed during the meeting.*
- ◆ *Richard Street to assess the shipper booking model. Bob Brown and James Smith to assess the DN booking model. This action had been completed and the presentations were due to be discussed during the meeting.*
- ◆ *Ofgem to further develop the other issues identified in Jason's presentation. Ofgem has been progressing these issues.*

#### **STANDING ACTIONS:**

- ◆ *Group to provide feedback to Ofgem regarding which issues they consider to be important.*
- ◆ *Interested parties to suggest alternative investment planning process to Ofgem.*

### **2. Update from the Development & Implementation Steering Committee**

Sonia Brown told the group that the previous DISG has discussed offtake issues, including appropriate investment standards. The DISG had also considered a paper prepared by Peter Bolitho on the governance of the Uniform Network Code. Transco had indicated that they were willing to accept a number of the points made in Peter's paper and consequently, Transco has been asked to revise their model of UNC model to incorporate points on which there was agreement. Transco had also given a presentation on the governance of the agent. Many members of the DISG had expressed concerns regarding Transco's initial proposal and there was an action on group members to suggest an alternative model.

### **3. Commercial arrangements at the NTS-DN interface**

At the previous CIWG, certain group members had agreed to assess the options for allocating NTS exit capacity put forward by Ofgem. Their assessments were presented to the group.

#### **3(a) Assessment of DN booking model**

Bob Bruce and James Smith gave a presentation assessing the attributes of the DN booking model.

They suggested that a dispute resolution mechanism is required under the DN booking model in order to resolve disagreements in a timely and economic fashion. Jason Mann noted that under this model, DNs would be able to request whatever level of capacity they believe is required. Jess Hunt noted further that the NTS would be able to set prices for offtake capacity in a way that reflects the costs associated with providing the capacity, and consequently prices would be expected to increase at the point where investment is triggered. Nick Wye said that a dispute resolution scheme would undermine the model because NTS is not supposed to be able to say no to a DN's request for capacity. Beverley Grubb said that every commercial agreement needs a dispute resolution scheme of some description.

Jimmy Smith said that he did not expect the DN booking model to increase administrative costs because the model would rely on the same systems as at present.

The group discussed how charges for NTS exit capacity would be passed back to customers under the DN booking model. Jason Mann explained that NTS exit capacity charges would be smeared back to shippers on the basis of the SOQ bookings. He said that the approach is consistent with current practices.

The group discussed the incentive mechanism that would be introduced to give DNs an incentive to book an efficient level of NTS exit capacity. One approach is that DNs could pay a proportion of NTS exit capacity charges rather than directly passing the costs back to shippers. Sonia Brown noted that at this stage Ofgem was only considering the high level principles rather than the detail.

The group discussed the payment of overrun charges under the DN booking model. Bob Bruce suggested that there was potential for undue discrimination between NTS direct connects and DNs because NTS direct connects would be wholly responsible for meeting their overrun charges whereas DNs would potentially be able to pass the costs back to shippers. In addition, he suggested that there was potential for undue discrimination between RDNs and IDNs since an RDN's overrun charges would be paid back to Transco.

The group noted that, as a result of the three year lag associated with building new assets, there would be a transition period before independent DN decision making could be expected to make an impact because Transco has already made decisions for the coming three years.

In conclusion, James Smith and Bob Bruce suggested that the DN booking model was quite a good model because it would be invisible to shippers in terms of billing etc, but still allows DNs to manage their own systems.

### **3(b) Assessment of shipper booking model**

Richard Street gave a presentation assessing the attributes of the shipper booking model. He suggested that I&C shippers would be likely to overbook NTS exit capacity under the shipper booking model because they can't diversify their load as well as a DN can. Consequently, Richard considered that shippers would be likely to book NTS exit capacity at the same level as their SOQs.

Richard suggested that I&C shippers would be likely to try to tie customers into long term contracts in order to protect their capacity rights. He further suggested that the shipper booking model added an extra layer of complexity to the contracting process because suppliers would need to be able to procure capacity for their customers as well as offering favourable supply terms. Consequently, Richard suggested that the shipper booking model could potentially have a negative effect on supply competition. Eddie Proffitt expressed concern that suppliers might avoid certain types of customers, particularly those who traditionally switch suppliers regularly.

Richard Street suggested that, to a limited extent, domestic shippers would be able to take advantage of diversification, however, such shippers would be likely to be conservative when booking NTS capacity because they are unfamiliar with capacity requirements and storage availability. Mike Young suggested that there could potentially be an inconsistency in approaches to risk between portfolios because all shippers would bear the costs of one shipper adopting a high risk strategy.

Richard Street said that it is not possible for shippers to accurately predict their portfolio three years ahead. Consequently, they would need to buy speculatively on the basis of their marketing plan. He suggested that there was a risk that the market for capacity would become illiquid because shippers would hoard capacity. Further, he suggested that incoming shippers may have no choice but to purchase exit capacity from outgoing shippers, in which case there would be an opportunity for the outgoing shipper to exploit their market power. Richard suggested that use it or lose it provisions (UIOLI) would be ineffectual in the exit capacity market because reconciliations would occur months, or even potentially years, after the transaction has occurred.

Bob Bruce suggested that the shipper booking model would create a barrier to entry for new suppliers. Richard noted that new suppliers might find it necessary to book their exit capacity rights three years in advance based on their marketing strategy. Eddie Proffitt noted that it was more likely that new entrants would purchase capacity from existing shippers. Richard added that the shipper booking model would also create a barrier for existing suppliers seeking to take on new customers.

In conclusion, Richard said that in his view, the shipper booking model would add a lot of extra complexity and would be likely to increase overheads. He further suggested that it was unlikely that there would be a large appetite for traded capacity rights and consequently, the market for capacity was unlikely to be liquid enough to offer true market prices.

### **3(c) NTS capacity charges revenue flows**

In response to an action from the previous meeting, Adam Whitmore had prepared a paper that considers a variation of the DN booking model whereby 100% of NTS revenue flows through the DN. Given that the group is still assessing the high level models, Sonia Brown suggested that the CIWG postpone consideration of this issue until a later point in the policy development process.

## **4. Transitional arrangements to accompany exit reform**

Eddie Proffitt gave a presentation on the arrangements that could be introduced to ease the transition for customers who are currently interruptible but find that their services are no longer required once exit reform has occurred. He suggested that the arrangements should differentiate between those customers who are 'freeloading' off the current arrangements, and those customers who entered into interruptible contracts with the expectation that they would be interrupted. He noted that at present, customers can request to be interruptible immediately after they have started flowing firm gas.

The group discussed the extent of the freeloader problem. Eddie Proffitt estimated that up to 25% of existing interruptible customers entered into contracts knowing that they would not be interrupted. Julie Cox said that even if this was the case, ultimately, an efficient outcome is reached because Transco doesn't need to invest for those customers. She noted that NGT's Winter Operations Report suggests that in a severe winter, all interruptible customers would be required to be interrupted for up to 16 days.

Eddie Proffitt suggested that customers who are left with stranded assets as a result of a rule change could mount a legal challenge. Jason Mann noted that physically, such assets are already stranded because if the assets were actually required, then the network operator would not require the interruptible customer to go firm. It was

suggested that there was an information asymmetry problem because the customer incorrectly believes that they would be required on a 1 in 20 severe winter.

Consequently, Eddie proposed different treatments be adopted for customers with and without standby equipment:

- ◆ interruptible status of sites without standby equipment is retained for a minimum of two years
- ◆ more generous transitional arrangements to apply to customers with standby equipment, eg grandfather rights or a glide path.

Nick Wye questioned whether Eddie's proposal for a two year transition period for customers without standby equipment was necessary.

Beverley Grubb suggested that the transitional arrangements should contemplate customers who become significantly less interruptible under the reformed arrangements as well as those customers that are required to go firm.

The group discussed the potential for transitional arrangements to ensure that network operators have access to sufficient level of interruption. It was suggested that problems could arise if the network operator is not offered sufficient interruption to meet its network requirements and it doesn't have enough time to build in order reinforce its network.

Julie Cox suggested that it may be necessary to retain the mechanism of the transitional arrangements in perpetuity if there is a risk each year that the network operator might require an interruptible customer to go firm. Jess Hunt suggested that this risk would be reduced if customers entered into long term interruptible contracts, thereby assuring that their decision to invest in standby capacity is worthwhile. Eddie Proffitt noted that customers would be unwilling to enter into long term supply contracts and consequently they need to be able to contract directly with the network operator.

Julie Cox expressed the view that it was necessary to discuss the duration of interruptible contracts at the CIWG prior to the release of Ofgem's RIA. Sonia Brown said that this was unlikely to occur and that the RIA does not assess particular proposals. Rather, it assesses the high level case associated with exit reform. Sonia said that detailed consideration of the business rules would be required at the point where the modification proposals are introduced.

Richard Street said that at a high level, it was important to recognise that many interruptible customers have invested in standby capacity. Nick Wye said it was also important to recognise that such customers were benefiting from a cross subsidy, and that it was necessary to find out what the size of the problem is. Sonia Brown agreed that this was precisely the issue that Ofgem's RIA seeks to address.

## **5. System Operation Managed Services Agreements (SOMSAs)**

Mark Sutton described the two papers that Transco had prepared on SOMSAs, one of which related to information flows and one that related to decision making under the SOMSAs.

Beverley Grubb said that SSE's primary concern regarding the SOMSA is that the DN is accountable for the daily operation of the network, but their only tool is the summer

and winter operational plans. Beverley questioned whether this arrangement was adequate given the importance of accountability. She noted that the allocation of roles and responsibilities under the SOMSA was similar to Option 3 in Ofgem's Roles and Responsibilities RIA. Mark Sutton said this was not the case, because under the SOMSAs the DN owner will be setting out the way in which the DN will be operated on a daily basis.

Mark Sutton said that the inputs to the operational plans define how the networks will be operated. Beverley Grubb asked whether there was much deviation from the operational plans over the course of a day. Mark Sutton said that there was some deviation from the plan, but that it was just minor tweaks around the edges. He added that operational plans could be revised on a daily basis if necessary. Sonia Brown noted that the SOMSA is not designed to be an enduring set of arrangements and rather it is a mechanism for moving to a post DN sales structure.

The group discussed the extent to which the SOMSAs would be made publicly available. Transco indicated that the SOMSAs would be normal contract and consequently would not be made publicly available. Phil Scott noted that the SOMSA would be described at a high level in the safety case, however, the safety case is not a public document. He added that when a SOMSA expires, the DN would need to re-submit that part of their safety case. Julie Cox asked whether a sale could be delayed by getting safety case approval. Phil said that this was possible, and that timing of HSE consent was contingent upon the quality of the information provided by Transco.

Eddie Proffitt asked whether the people who operate the area control centre at Hinckley would need to operate under different rules for different DNs. Mark Sutton confirmed that this would be the case, and that this occurs at present.

Eddie Proffitt noted that if all DNs were being operated out of a single control centre, there was a risk that RDNs could pass confidential IDN information back to the NTS. Sonia Brown said that the issue has not been considered at this stage because the key flow of information was from the NTS to the DNs.

Mark Sutton said that Transco envisaged that the Operational Forum would be an avenue for ensuring non-discrimination by the NTS. Transco had not yet formed view on the role of IDNs within operational forum.

Nick Wye questioned whether Ofgem should be involved in the SOMSA process to ensure that IDNs and RDNs really are being treated in a non-discriminatory manner. Sonia Brown suggested that if group members thought that additional regulatory safeguards should be made available under the SOMSA – for instance, if group members thought that Ofgem should have a direct role in regulating the SOMSAs – then they should come forward with proposals.

**ACTION:** Group member to put forward proposals for additional regulatory safeguards around the SOMSAs. Papers or presentations to be provided to Ofgem by Friday 11 June.

## **6. Waters Wye paper on emergency procedures and other issues**

The group agreed that this item should be considered at the next DISG meeting.

## **7. Unmetered inter-LDZ transfers**

Transco tabled a paper that sets out Transco's position on unmetered inter-LDZ transfers. In response to a question from Richard Street, Nigel Sisman confirmed that there are no unmetered NTS-DN offtakes.

### **Next meeting**

The next meeting will be held at Ofgem's offices on Wednesday 16 June.