

DN Sales Development & Implementation Steering Group Minutes

Meeting 12

22 June 2004, 10:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Mark Feather	Ofgem (chair)	Simon Goldring	British Gas Trading
Jess Hunt	Ofgem	Martin Kinoulty	United Utilities
Farook Khan	Ofgem	Richard Street	Statoil
David Ashbourne	Ofgem	Nigel Sisman	National Grid Transco
Nick Wye	Waters Wye Associates	Chris Train	National Grid Transco
Tory Hunter	Scottish & Southern Energy	Sue Higgins	National Grid Transco
Duncan Jack	Elxon	Mike Ashworth	National Grid Transco
Peter Bolitho	Powergen	Peter Bingham	National Grid Transco

1. Review of items from previous DISG meeting held 8 June 2004

a) Review of minutes

Chris Train noted that the minutes of the DISG meeting held 8 June 2004 erroneously referred to the 'National Emergency Co-ordinator' as the 'National Electricity Co-ordinator'.

b) Review of actions

The actions arising at the previous meeting had been discharged as follows:

- ◆ *Transco to develop a more detailed UNC governance model that addresses the issues raised in Peter Bolitho's paper. Transco had completed this action. Paper to be discussed later in the meeting.*
- ◆ *Transco to provide a paper for the next CIWG on arrangements at inter-LDZ offtake points. Paper due Friday 11 June. Transco had completed this action. Paper had been discussed at the CIWG meeting on 16 June.*
- ◆ *Transco to provide detailed information on how the special majority voting system would work and to discuss paper at the next meeting. Transco had completed this action. Paper to be discussed later in the meeting.*
- ◆ *Transco to assess the four proposals for ownership structure, which are:*
 - ◆ *special majority shared ownership (Transco's proposal);*
 - ◆ *equal ownership (Waters Wye proposal);*
 - ◆ *Transco full ownership; and*
 - ◆ *Non executive director with deciding vote (including the option of a shipper non exec).*
- ◆ *Transco to provide a paper for discussion at the next meeting. Transco had completed this action. Paper to be discussed later in the meeting.*

- ◆ *DISG members to consider if there are any other additional SOMSA issues the CIWG need to consider and to provide these to Ofgem by Friday. Ofgem had received comments from both CIWG and DISG members and was considering these comments through the CIWG.*

2. Report from the workgroups

2(a) Report from the Commercial Interfaces Workgroup

Jess Hunt told the group that the CIWG had discussed Ofgem's Offtake Arrangements RIA, SOMSAs and inter-LDZ transfers. Simon Goldring requested more information about when inter-LDZ offtakes would be used. Chris Train said that some of the inter-LDZ connections are valved off and are only used in an emergency.

ACTION: Transco to provide a note to the CIWG on DN-DN inter-operator relationships including inter-operator agreements and further information on the circumstances in which emergency offtakes would be used. To be discussed at CIWG 13 on 28 July.

2(a) Report from the Supply Point Administration Workgroup

Jess Hunt told the group that the Agency Workgroup had been reconstituted as the Supply Point Administration Workgroup and that going forward, this group would focus on SPA issues. She said that at the previous meeting the SPAWG had focussed on developing a forward work plan.

Peter Bolitho expressed his concern that the SPAWG is focussing on subset of the agency issues. In particular, he was concerned that non-codified services would not be properly addressed because the DISG doesn't have expertise to deal with these issues. Peter suggested that it may be appropriate to consider establishing an agency subgroup. Similarly, Simon Goldring said that whilst the goal of reform of SPA is laudable, he was concerned that other aspects of the agency arrangements would 'fall between the gaps'. He suggested that rather than re-focussing the subject matter considered by the group, the AWG should be reconstituted in order to obtain access to a broader range of expertise capable of considering all agency issues. Peter added that whilst SPA is important, it is not expedient and necessary to DN sales, and consequently it should be considered separately.

Mark Feather said that the DN sales project is about to enter a new, more detailed, phase and consequently Ofgem is undertaking detailed project planning to develop a process for resolving agency issues and other aspects of the project. He said that Ofgem's initial preference is to progress agency issues through the DISG, however, careful consideration is required to ensure that issues do not fall through the gaps.

3. Governance of the UNC

Sue Higgins summarised Transco's paper on UNC governance. The paper sets out Transco's position on the constitution of the governance entity, the governance of uniform network code modifications and the administration of charging methodologies, taking into account views expressed in previous DISG meetings.

Peter Bolitho said that the key issue in relation to the modification process is who holds the balance of power when deciding what recommendation the modifications panel should make to the Authority. He said that shippers and transporters should be treated in an equivalent manner. It was noted that both Transco's proposals and the model put

forward by Powergen adopt equal numbers of network operator representatives and shipper representatives on the modifications panel.

The group discussed various mechanisms for holding the balance of power on the modifications panel, including:

- ◆ Gas Transporters appoint a chair who has a casting vote;
- ◆ Ofgem appoints an independent chair who has a casting vote;
- ◆ A customer representative holds the balance of power;
- ◆ If the vote is split then there is no formal recommendation;
- ◆ There is a rolling chair whereby the role of chair rotates around members of the modifications panel.

Mark Feather asked the group for views on whether customers should have voting rights on the panel. Simon Goldring and Tory Hunter suggested that it would be unusual for customers to have a voting right on a contractual arrangement that they are not a party to. They suggested that customers (and also IGTs) should be able to make comments but not vote.

Several DISG members supported the approach where there are equal numbers of network operator and shipper representatives on the modification panel, and if the vote is split then the panel does not make a formal recommendation to the Authority (with the consequence that the Authority's decision is not appealable).

The group discussed mechanisms for incorporating amendments to modification proposals into the modifications process. There was general support for the approach proposed by Peter Bolitho, whereby the proposer would have the ability to incorporate changes into their original proposal during the course of the modification process if information comes to light that leads the proposer to form the view that a refinement is appropriate.

Peter Bolitho suggested that it may be necessary to broaden the scope of the relevant objectives to include some form of cost control provision if an Elexon-style structure was adopted. Mark Feather noted that if network operators fund the agency, then strong incentives would already be in place to control costs. Peter agreed, but suggested that further consideration may be required if the agency arrangements evolve in the future.

The group discussed the extent to which the secretariat of the governance entity would be independent of network operators. Peter Bolitho suggested that it was important that the governance entity's secretariat was fully impartial, and therefore full independence was required.

Chris Train said that Transco's proposals do not include an independent secretariat because Transco believes that accountability drives the efficiency of the process. He said that a further advantage of having network operator staff running the governance entity is that the people dealing with the modification proposals are close to the coal face, which means that they are knowledgeable enough to ensure that proposals are practical and able to be implemented. Finally, network operator staff can be efficiently deployed in accordance with workload.

Peter Bolitho said that DN sales meant that it was necessary to move from having a network code that is effectively owned by Transco. Going forward, Peter thought that the network code should be a shared contract. He noted that this approach worked in the electricity industry under the Balancing and Settlements Code.

Chris Train said that Transco would accept this position, so long as shippers are also accountable for the modifications process. Mike Ashworth noted that Transco is accountable for the delivery and maintenance of the Network Code as a condition of its GT licence. Simon Goldring expressed concern that accountability would be diminished in the presence of multiple network operators.

Tory Hunter expressed the view that if the modification rules are balanced, then it shouldn't matter who performs the administrative functions. Nick Wye said that the key to having balanced governance is to establish appropriate processes which are transparent and allow all interested parties to express their views on a modification proposal. He suggested that a fully separate governance entity with a purely administrative role would unnecessarily increase costs.

Mark Feather summarised the key issues, which were:

- ◆ who should employ the staff of the governance entity?
- ◆ who should generate the recommendation if the panel is deadlocked?
- ◆ who should employ the chair of the modification panel?

ACTION: If group members have new issues that they would like to consider further contact Ofgem.

Charging methodology

The group discussed the extent to which changes to the distribution charging methodology would be co-ordinated.

Peter Bolitho said that the timing of changes to the charging methodology has important cost implications for shippers, and consequently a mechanism should be established to ensure that changes are introduced in a co-ordinated fashion. Chris Train said that although Gas Transporters should only consider the relevant objectives in the context of their own networks, Ofgem is required to consider the relevant objectives in a national context. Consequently, Ofgem would be able to exercise its veto if a DN's proposal was likely to give rise to shippers costs due to timing problems.

Peter Bolitho suggested that this could result in a situation where Ofgem vetoes beneficial proposals simply because operators have not put forward their proposals at the same time. Peter Bingham and Nick Wye suggested that in practice this would be unlikely to occur because DNs would have an incentive to co-operate.

Richard Street suggested that Ofgem could vary the implementation associated with a change to a DN's charging methodology. Simon Goldring noted that this would entail a change to Ofgem's veto powers. Mark Feather commented that any requirement to co-ordinate changes to the charging methodologies assumes, of its very nature, that all DNs accept the change applying to their networks. Mark commented that this may not be the case as the proposed governance and agency arrangements each DN would have the ability to develop its own methodology. Mark therefore commented that he did not think that Peter's suggestion of a co-ordinated process would be workable in all cases.

There was also a discussion of the timing of changes in DNs prices. Nick Wye suggested that if network operators were required to introduce changes in a co-ordinated manner, it would also be necessary to relax the Gas Transporter's Special Licence Condition s28B (which require transporters to use best endeavours to set charges at a level that does not exceed their maximum allowed revenue). Mark Feather said that he believed that Ofgem would be very unlikely to relax SLC 28B, and

consequently it was likely that any requirement for co-ordination would, at best, be a reasonable endeavours requirement.

ACTION: Ofgem to circulate the RAWG 7 paper on charging methodology.

4. Governance of the agency

The group agreed to postpone discussion of this issue until the next meeting.

5. Structural separation of Transco's NTS and RDN businesses

Sue Higgins described Transco's paper on business separation, which explains Transco's existing arrangements in relation to each form of structural separation.

Information separation

Transco's paper describes each system that is currently shared between NTS and DN. Sue said that there was no commercial advantage to be derived from sharing the majority of the systems that are currently shared by Transco's NTS and DN businesses, and where in cases where IDNs require access to a system, Transco would provide access through the Front Office Managed Service Agreement (FOMSA). Over time, these systems would be migrated to the IDNs systems.

The group asked Transco to provide more information regarding the proposed FOMSA arrangements. Chris Train said that the FOMSA was an interim arrangement for the use of front office systems. It would relate to systems for workflow and asset management and asset planning, including mains replacement and digitisation. Sue Higgins added that the purpose of the FOMSA was to ensure a smooth transition from Transco to new owners – it takes into account the fact that new owners will need time to learn to operate the systems that they inherit.

Sue Higgins said that, in Transco's view, there are four shared systems where restriction of access is required. She suggested that the scope of the information sharing was small, controllable and related only to a small number of employees. With the exception of the four systems that Transco proposed to separate, Transco considers that information sharing via IT systems could be addressed by a Code of Conduct. Sue noted that the Code of Conduct would also apply to support staff who provide services to both the NTS and DN businesses.

Richard Street asked whether Transco's proposals for information separation would be subject to audit. Sue Higgins said that Transco would be likely to accept this, particularly given that the requirements would be embedded in a licence condition.

Operational separation

Sue Higgins said that there was recognition of the separate NTS and DN roles within Transco, and Transco's NTS and DN businesses were already subject to a substantial degree of operational separation. She listed those support services which Transco proposes should continue to be provided jointly on grounds that the relevant staff do not have access to commercially sensitive information.

Simon Goldring noted that legal staff were included within Transco's list of shared support services, and questioned Transco's position that legal staff would not have access to commercially sensitive information. Sue Higgins said that the relevant staff are professionals who are accustomed to dealing with these types of arrangements.

Some members of the group considered that it was overly simplistic to suggest that a Code of Conduct would have the same effect as structural separation, however, Tory

Hunter said that rigorous non-discrimination conditions in the licence would be sufficient. Sue Higgins suggested that it would be unusual if Transco was prevented from sharing its support functions. Simon Goldring noted that a requirement for separation of legal and regulatory staff was imposed when Centrica acquired its storage assets. Chris Train said that the circumstances in this case were different because the businesses involved were competitive rather than monopolies.

Nick Wye noted that the separation requirements applied to Dynergy had been less strict than those applied to Centrica because there were fewer market power concerns in relation to Dynergy. He said that if commercial arrangements are established at the NTS-DN interface then Transco would be the dominant player, both as the owner of the NTS and as the owner of the majority of DNs. He said that in such circumstances he would be very uncomfortable if business separation was not required as the dominant player would effectively be able to contract with itself. Nick said that one impact of a market-based solution in relation to the offtake arrangements is that it potentially increases the incentives for discrimination because it creates an unregulated income stream.

Chris Train said that the offtake arrangements would be very transparent, and consequently it would not be in Transco's interests to attempt to confer an undue advantage on its RDN business.

Sue Higgins said that Transco considered the opportunities for discrimination between IDNs and RDNs to be very small. She said that the offtake arrangements would effectively reduce the potential for discrimination and consequently it was necessary to have regard to the materiality of the problem when developing solutions to the risk of undue discrimination. Mark Feather said there was potential for significant discrimination in relation to within day operational decisions and longer term capacity pricing decisions.

The group discussed the level of costs that Transco would incur if required to undertake business separation. Nick Wye questioned the materiality of the costs associated with business separation. He suggested that if a regime that is dominated by Transco is implemented, then further evolution would be frustrated going forward. Jess Hunt said that the Offtake Arrangements RIA sets out Ofgem's view that legal separation is very unlikely to have any significant effect on Transco's future price controls. Chris Train said that Transco does not agree with Ofgem's view. Jess said that Ofgem had not sought to quantify the costs associated with structural separation, however, if business separation is required, Ofgem considers that the implementation costs that Transco incurs in order to separate its NTS and RDN businesses should not be passed through to customers.

Physical separation

Simon Goldring asked whether the NTS or DNs currently operate the DNs' Area Control Centres (ACCs). Chris Train explained that the DNs' ACCs are currently run by the NTS, however, going forward, all ACCs will be consolidated into a single control centre Hinckley and will be run by Transco's DN business.

The group discussed the practical implications of introducing requirements that rely heavily on non-discrimination licence provisions rather than formal separation requirements. Richard Street noted that would be very difficult for Ofgem to enforce such provisions as it would be difficult to prove that undue discrimination has occurred. Martin Kinoulty said that in the case of British Gas, non-discrimination licence obligations were introduced and a compliance officer was required. He noted that these requirements ultimately had the effect that British Gas chose to separate. Peter

Bingham added that requirements that have been introduced in relation to metering - including a compliance officer, a duty to report, and codes of conduct – has resulted in physical separation.

To conclude the discussion of structural separation, Mark Feather asked the group whether there are any particular aspects of Transco's proposals that members considered might cause problems if they remain shared between Transco's NTS and RDN businesses. Chris Train offered to clarify the functions of various systems mentioned in the paper if necessary.

ACTION: Group members to examine Transco's note on structural separation and provide comments. Comments due Friday 2 July.

Next meeting

The next meeting will be held at Ofgem's offices on 7 July 2004.