

DN Sales Development & Implementation Steering Group Minutes

Meeting 16

17 August 2004, 10:00 am – 4:00 pm

Ofgem's office, 9 Millbank

Attendees

Sonia Brown	Ofgem (chair)	Alison Kuck	Centrica
Mark Feather	Ofgem	Richard Street	Statoil UK
Jessica Hunt	Ofgem	Nick Wye	WWA
Jason Mann	Ofgem	Neil Shaw	AIGT
Iain Osborne	Ofgem	Stuart Hunter	British Gas Connections
Roger Morgan	Ofgem	Tory Hunter	SSE
Farook Khan	Ofgem	Martin Kinoulty	United Utilities
Hannah Cook	Ofgem	Sue Higgins	National Grid Transco
Steve Gordon	ScottishPower	Mike Ashworth	National Grid Transco
Charles Ruffell	RWE Npower	Peter Bingham	National Grid Transco
Christiane Sykes	E.ON UK	Alan Raper	National Grid Transco
Duncan Jack	Elxon	Nigel Sisman	National Grid Transco
Mike Young	BGT		

1. Review of items from previous DISG meeting held 3 August 2004

a. Review of minutes

Tory Hunter requested, on Rob McDonald's behalf, that on page four of the minutes, in relation to Transco business rules for credit arrangements, the reference to his views on the incentives for default on the IDN as opposed to the RDN be removed as the statement, as written, does not reflect his intention. Specifically the reference detailed that:

"Rob McDonald stated that if Transco does not separate its business then it is likely that the incentive will still exist."

b. Review of actions

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

- *NGT will report back to the DISG regarding proposed agency governance solution to different scenarios and consider if the proposed solution is workable. NGT to present the paper as agenda item 8.*
- *Gas shippers were to present the proposals regarding credit arrangements to the gas forum for discussion and report back on any conclusions reached to the DISG. This action was carried over to DISG 17.*
- *A request was made that shippers inform Ofgem if they wished to volunteer to assist in the completion of the shipper pro formas. A number of volunteers have approached Ofgem since the previous DISG meeting.*

2. Report from the Workgroups

None of the workgroup meetings were held this week and therefore there was nothing to report.

3. Discussion of views from the gas forum regarding credit arrangements

Sonia Brown stated that at DISG 15 Transco presented a position paper to the group regarding business rules for credit arrangements. At the meeting shippers were asked to present, for consideration at the gas forum, the amended position that Transco had set out in its paper on this issue. Specifically, they were asked to consider the implications that removal of the “one-out-all-out” provision may have specifically considering the proposed arrangements in which each DN would be required to manage its credit risk.

Christiane Sykes responded that she was not aware of any discussions but would speak to Peter Bingham. Richard Street stated that he was not in favour of inclusion of the “one-out-all-out” provision

Action: Sonia Brown suggested that an open action should be placed on all shippers to discuss the implications that credit arrangements proposed by Transco would have for shippers, specifically smaller shippers as concern had been expressed in responses to the Agency and Governance RIA, in this regard. She asked whether anybody would be willing to take responsibility for this action. Steve Gordon said that he would.

Tory Hunter considered that as far as possible a common set of principles with respect to credit arrangements should be adopted by all DNs. Sonia Brown stated that Ofgem would gain an idea of the costs that shippers would face with respect to differences in credit rules adopted, from responses submitted to the shipper pro forma.

Alison Kuck asked whether, in accordance with the paper that Transco presented at DISG 15, if a shipper defaulted against one of Transco’s RDNs it would be terminated from all of the RDNs if they remained one legal entity. Alan Raper responded that if NTS-RDN separation is required then decisions regarding termination from the RDNs will not be followed through on the NTS. However, he said that, in this case, if a shipper was terminated from one RDN, it would automatically be terminated from all. Alison Kuck highlighted that this is where the inequality in the system would exist. Richard Street stated that this principle would also operate in the event that an IDN purchased more than one network and that as long as this treatment is consistent, these arrangements would be fair.

4. SPA workgroup report to DISG

Roger Morgan stated that the presentation was intended to provide an update to the DISG on the progress of the SPAWG so far. He detailed that following the decision reached regarding the Agency & governance RIA, the terms of reference under which the SPAWG operate have been amended to reflect the change in focus towards SPA and the SPAWGs continued analysis of the governed/ ungoverned services. To date the findings of the SPAWG have highlighted that:

- the sale of DNs will not adversely affect the operation of the SPA as long as appropriate risk-mitigation services are put in place;
- the service lines that require DISG consideration and these have been identified through the completion of a shipper/supplier service lines matrix; and

- shippers would like to be given the opportunity to consider the operational impacts that will arise from the Authority's decision to choose option C.

In relation to the service lines identified as requiring consideration by the DISG, SPAWG has tried to devise a classification system to provide a guidance regarding the issues involved. The service lines have been classified on the following basis:

- * means that the service line will not be affected by the arrangements but, due to uncertainty, will require further consideration by the DISG;
- ** means that the service line will require further consideration by the DISG prior to the sale of any DNs;
- X means that the service line may fall away when it is checked against the services included in the xoserve contracts;
- # means that the service is well defined in the Network Code. Therefore it is well established and people fully understand how it operates.

Steve Gordon enquired as to what the difference is between * and ** classifications. Iain Osborne stated that the key difference between the classifications related to whether the requirement to clarify the definition of the service is triggered by the proposed DN sales. Richard Street supported this, stating that further work in this area would contribute to providing a level of comfort to shippers regarding service lines.

Roger Morgan detailed that the SPAWG had undertaken work to classify the service lines into governed and ungoverned services. He stated that ungoverned services comprised a small number of service lines which are not subject to Network Code governance and have not, as such, been codified. In this respect, issues exist regarding the definition of these services and clarity of understanding as to their provision. The services consist of provisions that underpin shipper/ supplier activities, support licensed activities and are critical to the day-to-day operation of the shipper-Transco relationship.

SPAWG has put forward a number of recommendations in order to deal with the uncertainty surrounding these issues:

- visibility of agency service scope – clarity on the services that the agency will continue to provide and any changes to the service that are proposed.
- robust escalation procedures to address poor agency service;
- establishment of a user forum which would allow shippers and DNs to discuss changes to the scope of services;
- establishment of a central library of service definitions which would clearly define service lines and the way in which they operate;
- inclusion of some of the service lines within formal governance arrangements.

Peter Bingham asked whether it was intended that the matrix would form an appendix to the Network Code or if an option to codify them in the future would simply exist. Roger Morgan confirmed that it is intended that it will be possible to codify the services in the future. Sonia Brown asked whether it would be open to NGT to suggest that some of the services are codified in the future. Iain Osborne responded that it would be up to shippers to propose that some of these service lines are codified and therefore any action would depend on how important parties considered the issues to be.

Roger Morgan detailed that the SPAWG had undertaken work to classify further service lines as governed services. All of these services are currently included within the Network Code and therefore the SPAWG has assumed that they will form part of the

UNC. However the definition of these services may require further clarification. The SPAWG also had concerns that issues may arise with respect to services only briefly mentioned or included in appendices and the ability to modify these. The SPAWG had two main recommendations regarding the clarification of these services:

- effective governance of the UNC is required in order to support the codification of service lines if required. To ensure this, the governed services included within the matrix should form part of the UNC and where further definition is required, this should be subject to the same modification rules as the rest of the code;
- robust escalation procedure should be in place.

Roger stated that the SPAWG had recommended that further work is required in order to clarify the definitions applied to service lines and to complete the matrix analysis. The SPAWG also recommends that the user forum proposal, in relation to ungoverned services, requires further consideration. In addition, the SPAWG considered that its terms of reference should be amended to reflect the work it is taking forward.

Sonia Brown thanked Roger and Iain for the presentation and asked if there were any questions. Alison Kuck asked if there was a meeting planned to discuss the terms of reference. Roger Morgan believed that it would be sensible to have this discussion at the relevant SPAWG meeting which he would arrange.

Action: SPAWG to report back to the DISG when the actions have been completed.

Iain Osborne considered that the presentation to the group should have highlighted that the issues under consideration are not, in themselves, significant and although he was happy for the SPAWG to continue he did not feel that this was totally necessary. Richard Street agreed that although there are no individual items in the matrix which would cause significant problems, the combination of all of the items may create difficulties.

5. Ofgem report on report for DN business separation

Jessica Hunt detailed that the presentation provided Ofgem's preliminary position regarding the separation required between Transco's RDNs. She stated that although structural separation is inappropriate due to the limited opportunities for undue discrimination that exist between the individual RDNs, Ofgem had undertaken to examine whether legal separation between these entities would be necessary in order to create a level playing field for competitors.

The benefits of such an action would include:

- transparency and ease of comparability with respect to setting the price control and, in the same regard, it may be easier to identify non-compliance and take relevant enforcement action;
- retaining consistency with the structure of the electricity industry;
- helping to ensure that all DNs are treated consistently by Ofgem; and
- simplifying the RDNs licence conditions as provisions specific to individual RDNs would not be required. With respect to the price control if it were necessary to include relevant conditions for each RDN within one licence this would require the development of elaborate conditions.

The costs would include:

- potential for debt restructuring and property transfer costs;
- Potential for operating inefficiencies associated with safety case requirements; and
- Potential for transparency benefits to be undermined if an operating company arrangement is adopted

Jessica stated that the predominant industry view appeared to be that DN-DN separation is not a key issue. However, Transco considered that if it were necessary this would create significant additional debt restructuring and property transfer and operational costs. She stated that Ofgem is of the opinion that DN-DN separation is not necessary and that it will be possible to draft RDN licences to ensure that relevant conditions will continue to apply. She also detailed that Ofgem intends to create a level playing field and will therefore take care to ensure that the licences of both RDNs and IDNs contain equivalent conditions.

Jessica stated that a preliminary position paper regarding DN-DN separation would be circulated this week. She further commented that responses in relation to this issue may be submitted in the context of the consultation on the granting of multiple licences to Transco as the number of licences granted to Transco will depend on the type of separation it is required to undertake. Responses are due by 24 September 2004.

Sonia Brown commented that Ofgem would welcome any views on this issue. She said that Ofgem had looked hard at the costs and benefits of DN-DN separation and believed that the benefits could be delivered through the way the businesses are regulated rather than requiring legal separation which would cause Transco to incur significant costs.

Alison Kuck commented that if Transco retains five of the DNs and the remaining three were owned by a single entity then, given that they would not have separate licences, only two comparators would exist in the industry. Sonia Brown responded that Ofgem had looked into this and were not sure that any clear benefits would be achieved in relation to comparative regulation were further licences to be granted. She considered that relevant licence conditions could be included to enable comparative regulation.

Richard Street asked how Ofgem intended to achieve the benefits of comparative regulation through DN licences. Sonia Brown responded that Ofgem is currently looking into a possible licence structure, specifically with respect to information and accounting requirements. She said that although Ofgem has not achieved all of the relevant objectives yet it considers, from consultations with lawyers, that this is possible. She stated that the licence consultation will provide an initial view regarding the form of the licences and that Ofgem will be interested in working with the DISG to form a clearer idea of what the final structure will look like. Although Ofgem is still working on the licences, any views from the group in this respect would be helpful.

Action: issue closed off of issues log.

6. Comments on Ofgem paper on constitution of the governance entity

Tory Hunter stated that, in the case of a split vote taken by the modifications panel, she was unclear regarding what the appeals mechanism would be. She considered that if the panel doesn't make a recommendation, this shouldn't occlude a party from making an appeal but in the position paper it appears that this would. She said that she didn't want to endorse an approach which would prevent parties from making an appeal.

Sonia Brown stated that this approach mirrors the views of the Ofgem appeals panel. She considered that the issue surrounding the modifications procedure and related appeals should be discussed further at DISG 17. Sonia further detailed that the DTI is due to consult on this issue and will need to devise robust proposals which will be applicable in the event that the sale of one or more DN does or does not take place. Tory Hunter asked whether this was on the issues log.

Action: Discuss modification procedures and appeals at DISG 17.

7. Transco paper on ownership and governance of the agency

Sue Higgins detailed that the intention of Transco's presentation was to stress test Ofgem's conclusions regarding governance of the agency against different ownership possibilities. She stated that Special majority voting was originally devised to stop abuse of power by majority shareholders and, in this respect, protect smaller IDNs and to also avoid deadlock in the decision making process. She detailed that balancing these objectives would be dependent on the number of independent shareholders created by the DN sales process. Sue set out the Special majority voting rules that would apply in various sale scenarios:

- if only two shareholders were created the special majority vote could only be passed by achieving the agreement of two;
- if three shareholders were created a vote could be won by the agreement of two;
- if four shareholders were created a vote could be won by the agreement of two;
- if five shareholders were created the special majority vote could only be passed by achieving the agreement of 3.

Sue stated that, in each case, the shareholders must hold at least 50% of the shares to pass a special majority decision.

Sue stated that consistent with the conclusions reached at DISG 14, the current shareholders agreement;

- Allows each independent shareholder to nominate one Director per network owned;
- Each independent shareholder has one Director's vote per network owned; and
- Each shareholder can nominate fewer Directors than the number of networks owned, on the understanding that these Directors will retain the shareholders full voting power

The revised proposal regarding governance is that each independent shareholder can nominate one Director per network owned, up to a maximum of two Directors per independent shareholder. In this respect, Transco can only nominate a maximum of 2 Directors. Under this proposal voting rights remain unchanged so that there is one vote per network owned. These revised proposals will contribute to reducing the total size of the Board, reducing the costs associated with Board meetings and stopping any one party from dominating discussions.

In the even that a change in ownership takes places subsequent to the sale of one or more of Transco's networks shares and the right to appoint Directors will move with the ownership of the network assets. Therefore, if Transco sells an RDN these would be sold with a right to nominate a Director whereas if IDNs changed ownership the new owners would assume rights to to appoint Directors.

She stated that special majority voting rules are determined by the total number of independent shareholders in xoserve resulting from changes in ownership. Where there are four or fewer independent shareholders, special majority decisions require the approval of 2 shareholders with 50% of shares and where there are five or more independent shareholders, special majority decisions require the approval of 3 shareholders with 50% of shares.

Sonia Brown highlighted that a key difference was evident between Ofgem's proposal and the proposal presented by Transco, in that the non-executive director would no longer have the ability to vote under Transco's proposal. She stated that under Transco's proposal the non-executive directors role would simply be to control the board.

Nick Wye asked whether the special majority voting rules would remain the same under the two proposals and, if this were the case, he said that he favoured Transco's proposal. For example, if five independent shareholders were created, this would mean that three executive directors, holding 50% or more of the shares, would need to be in favour of the proposal and under Transco's proposals, the shareholders would have to be IDNs instead of a non-executive director.

Neil Shaw stated that the customer transfer program had expressed an interest in bringing iGT processes into the functions of the agency. If this were the case, he asked whether a review regarding governance of the agency would be necessary with respect to iGT involvement. Sue Higgins confirmed that voting rights would need to be considered if iGTs were brought into the agency. Sonia Brown asked whether Transco was aware of the proposals for iGTs to become involved in the functions of the agency. She considered that if Transco were not intending to review the issue of voting rights again until the next price control period it would seem appropriate to make arrangements, with respect to iGT voting rights now.

Sue Higgins asked how iGTs felt about the possibility of becoming involved in the activities of xoserve. Neil Shaw responded that, in general, they were open-minded about the prospect of working with xoserve and could see the advantages to the market of such action. He stated that iGTs would however like more clarity on the issue as they have previously allocated resources for discussions in this regard when there has not been sufficient time available to discuss the issues.

Action: Transco to speak to xoserve in relation to the issue of iGTs becoming involved in agency functions and report back to DISG 17 regarding whether xoserve will be progressing this issue.

Action: DISG group to consider the proposals presented by Transco and provide any relevant comments to Sue Higgins by Tuesday 23 August. Further discussion will take place at DISG 17 if any comments are raised.

8. Transco paper on handling emergencies

Sue Higgins stated that the arrangements detailed in Transco's paper are only intended to address the provision of a first line emergency response service to the NTS following the potential sale of one or more DNs. She detailed that currently Transco provides a dispatch of relevant first line emergency response services to both the NTS and the DNs and that the requirements on this service vary widely between the two systems. While

calls regarding leaks on the DN system are frequently received, calls regarding NTS leaks are rare.

In the event that the sale of one or more of Transco's DNs takes place it will be necessary to arrange for the provision of emergency services on the NTS as staff that currently work in this area will be transferred with the DNs. It therefore appears sensible, given the sparse requirements of the NTS that the DNs should continue to provide a first line emergency response service to the NTS. However, the NTS will continue to provide the core receipt service in order that the requirement for a national number is fulfilled.

To this end, a licence condition will be placed upon each DN requiring it to provide these first line emergency response services to the NTS on an ongoing basis. During the period of the current price control a contract will be put in place between the NTS and the DNs to ensure that the DNs are compensated for the services provided to the NTS. However, in the future it is anticipated that, as the requirements of the NTS are minimal, the DNs should recover these costs as an element of the price control. In the event that the NTS is required to establish a first line emergency response service this would be inefficient as it would require a huge outlay of resources for incidents that are only likely to take place four or five times a year.

Nick Wye commented that he did not understand the rationale behind placing the costs associated with the operation of the first line emergency response services within the price controls of the individual DNs. Tory Hunter also asked whether this type of information should be contained in a commercial contract. Sue Higgins replied that the use of these services by the NTS is so infrequent and slight that it seems unnecessary to establish contracts to capture this. It would also be inefficient for the NTS to set up its own arrangements to deal with emergencies as the cost outlay would be disproportionately large in comparison to use of the system by the NTS.

Tory Hunter considered that this approach contradicts the decision reached in the Roles & Responsibilities RIA. She was of the opinion that to the extent that the NTS is not able to guarantee the provision of a first line emergency response service itself it should have a contract in place to require a third party to provide this service. Sue Higgins responded that the volume of incidents that would need to be dealt with would be tiny relative to the costs and therefore it seemed inefficient. Alison Kuck asked whether the cost of work necessary to be undertaken in the event that problems are experienced on the NTS would be large, and if so how the DN would be expected to deal with this. Sue Higgins replied that the function of the first line emergency response service is to provide incident control only and that any further repairs necessary would be undertaken by the NTS itself.

Tory Hunter enquired as to why it would be necessary to have a commercial contract in place in this instance when other arrangements e.g. SOMSA are contained within commercial contracts. Sue Higgins reiterated that the sums of money involved are so small that they do not warrant the drawing up of a contract and that the operation of a first line emergency response service would be an enduring requirement where others will fall away in the future. Mike Ashworth stated that slight conflicts may occur as it may not always be clear which part of the system a call received is in relation to. Sue Higgins highlighted that most calls are received in relation to the DNs. Tory Hunter said she was surprised to hear that, given Transco's production of a paper regarding geographical boundaries that it would not be possible to identify whether a call received

was in relation to problems experienced on the NTS or a DN. Sue Higgins responded that as most calls in relation to a gas emergency constitute a public safety concern the relevant system operator is under an obligation to reach and secure the affected area within sixty minutes of receiving the call and therefore their key concern is to dispatch an engineer as soon as possible.

Richard Street pointed out that although Sue had claimed that the sums involved would be too small to warrant a contract, Statoil, as a small company, is required to have a contract in place with Transco for the provision of a first line emergency response service. Sue Higgins stated that due to the inefficiency of NTS establishing the service itself this would constitute a way of ensuring that the relevant services would be provided from the DNs to the NTS in the future.

Alison Kuck asked whether an obligation could be placed within the NTS licence which would require it to ensure the procurement of first line response emergency services. Sue Higgins considered that any relevant licence obligation should be placed upon the party that acts to provide the service.

Neil Shaw was of the opinion that another reason as to why Transco wanted the service to be embodied in DN licences is because it does not want IDNs to have the option of non-provision of the service in the future. Sue Higgins stated that such a situation would have implications from a safety perspective and an underlying principle of the disposal of the DNs is that the decision to sell one or more of the DNs would not compromise safety. The issue of safety is important, is not contestable and, as such, the implementation of a licence condition seems to be the most appropriate approach to take. Sonia Brown highlighted that although SOMSA is not contestable either it is a transitional issue and therefore it is not necessary to place it within licence conditions.

Sonia Brown stated that views in this regard should be submitted to the formal licence consultation, to be published by Ofgem in September.

Action: Transco to provide details of the costs incurred by DNs if they were required to provide a first line emergency response service on behalf of the NTS.

Neil Shaw detailed that three contracts currently exist between iGTs and Transco in relation to the provision of a first line emergency response service, the first two of which, all iGTs are party to:

1. call handling/dispatch handling
2. on site attendance, make safe and restoration of supply
3. post-emergency metering contract.

As services 1 and 2 are provided to all iGTs it is more crucial that these are retained. He stated that it is important to understand how these services will be delivered in the event that a DN sale takes place as both iGTs and the HSE need to be assured that iGTs will be able to continue to comply with the provisions referenced within their safety case. He detailed that the iGTs have asked Transco to share the details of its risk assessment but it has been reluctant to do so. Neil highlighted that his main concern related to the effect that the sales would potentially have on these contracts as Transco has previously detailed that 1 would stay with the NTS, while 2 would go to the DN buyers but it now appears that Transco will not be providing service 1. iGTs therefore do not have sufficient details to prepare their safety cases.

Sonia Brown asked whether the group considered that the same issues would apply to iGTs as the NTS i.e. whether the service would be enduring and non contestable and therefore whether the treatment of iGTs should be the same as the NTS. She considered that the iGTs were simply requesting clarity regarding whether a similar licence condition in relation to the first response emergency service would be possible for iGTs. Neil Shaw stated that, given the varied nature and geographical spread of problems experienced it would be relatively difficult for small iGTs to establish an efficient emergency response unit themselves.

Peter Bingham considered that the level of contestability may be a problem and that if an iGT was the sole transporter in a particular new development then this issue may not arise. Neil Shaw detailed that iGTs would require a huge resource to establish a first line emergency response service at varied times and across a vast area.

Sue Higgins had concerns regarding funding of the emergency service in relation to iGTs. She considered that with respect to the NTS, if costs regarding the provision of the emergency service were passed through in the relevant DN's price control and these costs were to be smeared across all consumers this would be acceptable on the basis that all customers use services provided by the NTS. In the case of iGTs this could be viewed as a subsidy.

Alison Kuck considered that the whole issue should be consulted upon as it should not simply be assumed that expenses incurred by the NTS should be captured by DN's. Sonia Brown responded that group members should consider this issue as part of the licence consultation and that if anybody has any views they should submit them to Ofgem in order that the consultation text can be amended to reflect these.

Sonia asked Transco what its view was with respect to the problem outlined by Neil Shaw that iGTs had not been able to gain access to Transco's risk assessment. Peter Bingham replied that Transco would report back to the next DISG in relation to these issues and provide a status and resolution report on the provision of a first line emergency response service and, in addition, with respect to iGTs.

Action: Transco to report back to DISG 17 in relation to iGTs and emergency services.

Nick Wye asked whether iGTs have, in place, a national contract with Transco for the provision of emergency services and an associated payment contract. Neil Shaw responded that they do. Jason Mann asked how the payment mechanism currently works. Neil Shaw detailed that costs are calculated on a per incident basis which has proved to be inefficient and this is another reason why iGTs are suggesting an alternative, more efficient way for the costs could be recovered.

Action: The issues log to note that discussions regarding emergency handling procedures are to be taken forward through the Ofgem licence consultation document.

9. Transco report regarding the title to gas within the network

Mike Ashworth stated that the title to gas is a legal detail in the Network Code which deals with the way in which ownership of gas operates around the network and tries to accommodate the fact that gas doesn't flow instantaneously from production to the end consumer. It essentially details that when shippers introduce gas into the system they pass the title to that gas and the risk associated with it to the relevant party. In the same

respect, when a shipper takes gas from the system the risk and title to the gas is passed is passed back to the shipper.

Mike detailed Transco's proposal that in the event of the sale of one or more DNs, the arrangements outlined would remain the same. In addition, it will be considered that shippers take gas off of the NTS and simultaneously introduce it back into the DN. However, this will not impact on the details outlined.

Jessica Hunt asked what would happen if a shipper went bust and had put gas into the system and not taken it out. Mike Ashworth responded that this would be dealt with through system balancing mechanisms. It is likely that the system administrator would be able to trace the party that entered the gas.

Action: Issue to be closed on the issues log.

10. Transco paper on DN boundaries

Peter Bingham stated that concern had been expressed regarding the fuzzy boundaries between the different DNs particularly with respect to the provision of first line emergency response services. He detailed that Transco has developed some digital maps which indicate clearly where the boundaries exist. These boundaries have been determined on the basis of postcodes. He set out that 99% of network assets are contained within the DN boundaries but that issues exist where the assets of some DNs are contained within the boundaries of others.

He stated that with respect to emergency service provision this would be carried out by each DN within its geographical boundary and therefore DNs may, in some cases, be obliged to secure a site where the assets involved are not actually owned by it. However, the price control calculations will be completed on the basis of the asset base that the individual owns.

Neil Shaw asked whether DNs would be authorised to work on the asset base of networks which they do not own. Sonia Brown replied that this issue is currently being considered as part of the licence consultation. Jessica Hunt asked whether in the event that a DN was called to a site outside of the boundary of its area it would be able to complete work on that site. Peter Bingham confirmed that this would be possible. Sonia Brown asked how costs would be dealt with in this case and Peter Bingham suggested that a mutual arrangement may be established between the DNs which would oblige them to complete emergency works on each others networks.

Stuart Hunter asked whether in instances where the operator has difficulty in identifying the correct DN it may simply send the call to an alternative DN. Sue Higgins responded that in some cases, particularly where a gas leak is identified in an open area, it may be difficult to determine which DN is responsible.

Richard Street pointed out that if a DN experiences a recurring problem with one of its pipelines then it may undertake a more permanent solution but if the wrong DN is called out to that pipeline on a number of occasions it will not have any incentive to do so and will continue to be called out. Mike Ashworth responded that the call centre will endeavour to identify the correct DN.

Sonia Brown enquired as to whether any analysis has been completed in relation to the operation of Transco's call centres given that they will be relied upon to identify the relevant DN when a call-out is received in a post-DN sales environment. Neil Shaw stated that he had previously raised a similar issue relating to the access that system users would have to Transco records. He considered that the most serious question related to how DNs would be assured that they could gain access to the records of other DNs. For example, where a DN is called out in relation to its first line emergency response service and discovers that the affected site is on the boundary of a network owned by a separate party it would need to have information regarding the configuration of that DN in order to carry out work on the system. Neil therefore asked how the availability of this data could be assured especially considering the short time-frame that the operator will have to make the network safe.

Martin Kinoulty considered this problem to be wide-ranging concerning issues relating to work completed on a DN, by the owner of a separate network, which is not sufficient to meet industry standards of good practise. Peter Bingham responded that these services only related to a first line emergency service and therefore would simply require the DN to make safe the relevant equipment. Martin Kinoulty was of the opinion that something would still have to be done to the physical equipment in order to make it safe and this may open them up to a consequential liability.

Sonia Brown stated that this suite of issues would be dealt with through the licence consultation. She also considered that it would be helpful if Transco could prepare a presentation for the DISG regarding how they think these arrangements will work in the new environment. She suggested that if any of the group had questions in relation to these issues, they should email these to Transco in order to make them aware.

Action: Transco to prepare a presentation regarding the way in which the DN boundaries will work in a post-DN sales environment.

11. Ofgem run through of requirements for shipper pro-forma's

Jason Mann stated that the shipper pro forma would be issued to all shippers requesting data in relation to the costs associated with DN sales and will be used to inform the final RIA. He commented that as most of the decisions in relation to DN sales have already been made, the costs detailed by shippers should be relatively well informed. The pro forma has been developed with input from shippers and consists of three parts; the pro forma itself, a guidance document and an assumptions document.

The spreadsheet requests data regarding the implementation and ongoing costs of the sale of one or more DNs on the basis that the decisions reached in each RIA are followed. It also requests that shippers provide a narrative in relation to the principles they have applied when calculating costs. The guidance document provides the basic assumptions that shippers should adopt in completing the pro forma while the assumptions document summarises the conclusions reached in each of the RIAs in order that shippers make cost estimates based on similar assumptions. In addition, the assumptions document details the likely impact that the change in the regulatory framework will have on shippers.

Jason detailed that the deadline for the pro forma is 27 August but set out that, given the shipper input provided, it should be fairly straightforward to complete.

Alison Kuck asked whether the assumptions document detailed the timescales that shippers should assume. Sonia Brown responded that shippers are requested to provide cost data assuming compressed timeframes and to set out the timescales that they have assumed as part of the commentary. She was of the opinion that if people explained the assumptions upon which they were basing their cost data in the narrative this would allow further detail to be requested by Ofgem if it were necessary.

In relation to requests regarding an extension of the deadline, Sonia detailed that the deadline had been set to allow Ofgem sufficient time to complete effective analysis and obtain maximum informational value from the data. Analysis needs to be completed bearing in mind the assumptions upon which shippers have based their costs in order that accurate conclusions can be drawn.

12. Ofgem report on decision for NTS separation

Jessica Hunt stated that if a DN Sale takes place new commercial incentives will arise providing for the NTS to confer undue advantages onto its RDNs. If this is the case, the benefits of comparative regulation could be limited. Through business separation Ofgem will seek to limit the scope for discrimination by the NTS in favour of the RDNs.

Option 1 was proposed by Transco which includes the development of a set of non-discrimination conditions and partial informational and operational separation. Option 2 builds on option 1 and requires full operational and informational separation and, further to this, option 3 requires legal separation of the entities. An alternative option has also been proposed by Ofgem and includes targeted structural separation and legal separation. Compliance with this option would need to be demonstrated through a compliance plan signed off by the Authority.

The main costs of such separation include:

- significant costs may be imposed on Transco although the to which these costs will be passed through to customers is limited;
- the risk that rules will become detailed & complex and this will make them costly to administer, make compliance difficult to monitor and demonstration of a licence breach difficult.

The main benefits of such action include:

- risk of undue discrimination would be reduced as the opportunities for information sharing would be less, it would remove individuals from situations where disclosure may occur and it would limit the opportunities for NTS-DN staff to develop close relationships;
- establishes a transparent interface between businesses as separate boards would be created and contracts would be formalised.

In submissions to the offtake arrangements RIA, nine out of twelve respondents favoured option 3, full legal & structural separation, while one supported Option 1, and another supported Option 2. In Transco's submission to the offtake RIA it detailed its preference for an amended version of Option 1 (incorporating further structural separation) as it considered that opportunities for undue discrimination are limited. Transco further stated that it did not consider option 3 to be 'fit for purpose' as it would not protect against undue discrimination but was of the opinion that targeted structural separation may deliver an appropriate degree of separation and mitigate risk of undue discrimination, without incurring excessive cost.

The offtake decisions document detailed that the Authority is minded to adopt option 4 – legal plus targeted structural separation. It considered this to be a proportionate mechanism for establishing a level playing field and that it aligns with the requirements that apply to other energy businesses. This decision was detailed as ‘minded-to’ as implementation issues associated with legal separation are still being resolved.

Richard Street addressed Transco by asking why they did not consider option 3 to be ‘fit for purpose’. Peter Bingham responded that they considered full legal and structural separation to be out of proportion with the action required. Sonia Brown stated that Ofgem intended to target the structural separation in certain ways. She detailed that Ofgem had examined relevant examples in electricity and found that, in certain areas, some functions continued to be shared between the separated entities and therefore business separation would only need to be undertaken where opportunities for discrimination exist. Richard Street asked whether Ofgem could provide details of these areas. Sonia Brown responded that an external auditor will be contracted to work up a separation plan and the areas in which separation is required will be detailed in relevant licence conditions.

Nick Wye enquired as to why the DISG had not been included in the consideration of an option involving targeted structural separation. Peter Bingham replied that the recommendation was made by Transco as part of its response to the offtake arrangements RIA. Nick Wye expressed his disappointment that the proposals had been amended without consultation with the DISG. Sonia Brown replied that while the RIA was out for consultation, further work was completed by Ofgem in relation to whether the proposed arrangements were ‘fit for purpose’. She said that, in particular, examples in which legal and regulatory resources were shared were examined and, as such, Ofgem considered that targeted structural separation would be more appropriate. Alison Kuck enquired as to what structural separation actually means. Sonia Brown responded that information relating to the detail of the separation currently remains confidential but the Authority has been provided with all of the relevant information and considers that targeted and legal separation would be the most appropriate approach. Alison Kuck was of the opinion that even in relation to targeted separation, a certain level of detail should be publicly available. Sonia Brown replied that the specifics of the separation documents are currently confidential but that Ofgem will ensure that the appropriate level of detail is available in the future.

Nick Wye asked when the relevant detail will be available. Sonia Brown responded that this would be most likely be in the first week of September and that Ofgem will ensure that it utilises the DISG meetings to capture all necessary information.

13. Ofgem report on decision on offtake arrangements

Jason Mann stated that there were three key aspects of the offtake arrangements decision which included NTS exit capacity rights, Diurnal storage and governance.

Jason detailed that in relation to the allocation of rights to NTS exit capacity four options were considered in the RIA:

- the NTS booking model;
- the DN booking model;
- shipper and DN booking model; and
- shipper only booking model

Ofgem set out in the offtake decision document that each option had associated costs and benefits:

- Option 1 was the lowest cost model but had the potential for undue discrimination as Transco would have the ultimate decision regarding the allocation of exit capacity between RDNs/IDNs. Under this model DN may over-request capacity and an increased chance of interruption may be evident;
- Option 2 would potentially help to decrease the level of undue discrimination. It would also place an incentive scheme on DN which would help to achieve efficient capacity requests and may help to reduce the level of regulatory interruption.
- Option 3 would enable shippers to signal the value that they place on exit capacity although it would be complex and costly to administer.
- Option 4 would provide the sharpest investment signals to the NTS and help to promote competition. However, it had significant issues in relation to security of supply and would signal the largest divergence from the status quo.

In responses submitted to the offtake arrangements RIA:

- concern was expressed under option 1 regarding the potential for undue discrimination;
- option 2 would create a reduced risk of discrimination and would involve less complexity than options 3 and 4 but the incentives involved would be complex;
- option 3 would be costly and complex with the benefits overstated in the RIA and poor investment signals; and
- option 4 had serious security of supply issues and the investment signals may be damaging to retail competition.

The offtake arrangements decision document concluded that a pure option 2 approach for allocation of NTS capacity should be adopted as this would reduce undue discrimination between IDNs, RDNs and NTS connectees. Governance arrangements will be established to support the possible evolution of an approach allowing DN shippers to signal their exit capacity requirements.

Tory Hunter commented that she was not sure how this system would work in practise. Sonia Brown responded that the NTS will be required to deliver the exit capacity requested by the DN. Three years out the system will be unconstrained and therefore it is only in the short-term that available exit capacity will be constrained as systems will need to be constructed to accommodate unconstrained requests. DN will be responsible for meeting their 1 in 20 obligations for their customers.

Martin Kinoulty asked whether a decision on option 2A/2B had been made as yet. Jason Mann responded Ofgem had not yet made a decision on this. Sonia Brown highlighted that a suite of issues exist in relation to this and that Ofgem is hoping to get cost details in this regard from the shipper pro forma.

Jason Mann detailed that diurnal storage referred to the flexibility that exists within the NTS and the way in which it allocates this to users. The RIA detailed two approaches:

- Option A – closest to the status quo. This option follows a planning approach in which diurnal storage is allocated to DN by the NTS. This approach would be easy to implement but includes the possibility of undue discrimination;

- Option B – a market based approach. This would reduce the potential for undue discrimination by allowing the price to be determined through investment signals. This would however, cause increased complexity.

The majority of respondents preferred the adoption of option A which most resembles the status quo and considered that option B would be potentially costly and complex and could undermine the central balancing mechanisms.

The Authority concluded that option A would be inappropriate due to the risk for undue discrimination and the absence of a mechanism to allow users to signal the value that they place on flexibility. The Authority has given Ofgem four weeks to develop an alternative model. It is anticipated that, under the alternative option, NTS flexibility would be allocated to DNs where requested and where flexibility is scarce it would be allocated on a market based approach. This would capture the benefits of option B while avoiding undue discrimination.

Nick Wye asked whether the alternative approach would constitute an administered approach to flexibility and where such flexibility is scarce this would be allocated through a market based approach. Jason Mann confirmed that where the NTS is unable to deliver all of the capacity requested, it is necessary to allocate the capacity available without undue discrimination. Peter Bingham asked whether it would be possible to allocate this capacity using a rule-based approach. Sonia Brown stated that the Authority has indicated that it wants to implement market-based arrangements and that these will be worked up into recommendations to be discussed at the next DISG meeting. Charles Ruffell asked how Ofgem plans to deal with scarcity locationally. Sonia Brown detailed that the spatial dimension is not something that has been decided upon as yet but which Ofgem will be considering.

Richard Street enquired as to how users of the system were expected to predict their system requirements a year in advance. Jason Mann responded that users would have to outline a long-term commitment in order for the NTS to be able to provide diurnal storage. Richard Street detailed that he understood why DNs would like flexibility in the system, but the way the NTS is configured means that the amount of linepack available will change each year (or within year). He asked how the NTS will have advance knowledge of how much capacity is available. Peter Bingham responded that flexibility is a by-product of the NTS investment plan and commercial incentives exist on the NTS to provide this flexibility if its needed.

Jason Mann detailed that two options were proposed in the offtake arrangements RIA:

- Option 1 – all offtake arrangements are governed under the UNC and all signatories to the UNC are therefore able to propose modifications;
- Option 2 – governance under an offtake code which consists of a network agreement between operators.

This is an area that received significantly less comment in the responses. He detailed that since the RIA, further discussions have been entered regarding the development of a composite approach. Under this approach, single governance arrangements and rules would be established for the UNC and the offtake code, although different parties would be signatory to each. The benefit of such an approach would be that changes to current arrangements would be minimised. Sonia Brown stated that further work needs to be completed in relation to this model and that potential users of this framework need to signal their requirements as Ofgem does not want the governance arrangements that are

implemented to limit the evolution of the market if this is so required. Jason Mann commented that the Authority wishes to explore the hybrid approach detailed and procure legal advice in relation to it.

14. Ofgem report on decision on interruption arrangements

Jason Mann set out that three approaches were discussed in relation to the alternatives for allocation of exit capacity.

- Status quo – in this approach prices would be administered and allocated on a first come, first served basis;
- Unconstrained approach – all users receive the capacity they requested at an administered price and where the NTS is not able to meet capacity demands it will buy back unused capacity;
- Constrained approach – capacity allocated on the basis of willingness to pay.

In the long-term all capacity will be allocated on an unconstrained basis and therefore the options detailed are only short-term. The costs and benefits associated with each option are as follows:

- Under option 1 users can elect to become interruptable. This is the least cost option but has potential for undue discrimination. It has a lack of investment signals as customers only commit for one year and also incorporates a risk of stranded assets.
- Under option 2 availability is consistent with the capacity of the network. No undue discrimination exists between users but the risk of stranded assets remains.
- Option 3 incorporates 'use it or lose it' signals. Long-term booking of capacity mitigates the risk of stranded assets. No undue discrimination is evident.

Responses received in relation to the options for exit capacity highlighted that:

- Option 1 was preferred as respondents did not consider that exit reform was necessary as a part of the DN Sales process;
- Option 2 was favoured by one respondent who considered that it would increase customer choice and was more cost reflective;
- Option 3 was preferred by Transco but others highlighted that it would be costly and complex and would not encourage investment signals.

The Authority concluded that non-discrimination provisions should be in place. At the NTS level the Authority considered the constrained approach to be most appropriate while at a DN level the Authority decided to maintain the status quo as it did not perceive that a reform of the arrangements would be necessary as part of DN sales.

Jason stated that two options were put forward in relation to interruptions contracting.

- Matrix approach – provides a menu of different combinations of prices and interruptions on different days, from which the customer can select their preferred combination and submit this to the NO.
- Tender approach – customers offer contracts to NOs setting out the combination of prices and days that they prefer. The NO then selects the most economic offers to ensure that they meet security standards.

These options were broken down into combinations of the above options:

- Pure matrix in which customers choose combinations of prices and days from a published menu. This option is simple but arguably reduces investment signals as customer choice is restricted;

- Simplified pure matrix in which customers can choose a number of days from a published menu. This is the simplest approach but has minimal investment signals;
- Customers tender to provide interruptible services. This approach would allow users to provide good investment signals but would be costly, complex and may discourage participation.
- Tenders plus matrix – customers can choose to tender or to pick combinations from the published matrix. This may however, distort tenders and although investment signals are provided, this is in a costly way.

Respondents considered that the matrix approach was simple, low cost and encourages participation and therefore the majority preferred the simplified pure matrix. The Authority concluded that, at the NTS level, a tender approach would be most appropriate given the adoption of a constrained approach with respect to arrangements for exit capacity.

In relation to transitional arrangements Jason detailed that there were two key issues:

- distributional concerns – some customers would no longer be interrupted under the new arrangements and therefore it may be necessary to implement a glide path to allow them to adapt to this.
- market power issues – in order that NTS is able to meet its capacity rights some interruptible users are crucial. Therefore certain NOs may be tempted to increase their prices to agree to remain interruptible.

Jason stated that the Authority concluded that transitional arrangements would not be implemented as the NTS was the only party subject to reform under the arrangements.

Richard Street asked Ofgem to confirm that no transitional arrangements would be put in place. Sonia Brown responded that they had looked into the powers available to Ofgem under the CA98 and had been persuaded that, under these powers, if a customer were found to be abusing a monopoly situation Ofgem would have powers to address this. She stated that price controls in this respect would not be appropriate given the distortions that they would create.

Jason summarised the proposals for the group stating that, at the NTS level, there would be an unconstrained level of exit capacity in the long-term while in the short-term capacity would be constrained by the limits of the system. At the DN level, the status quo will be retained until April 2006 when reform will be implemented.

Richard Street asked whether customers will have to book capacity that they anticipate they will need. Jason Mann responded that parties can choose to buy firm capacity at the three year, one year or day ahead stage or could choose to buy an interruptible product on the day and take a chance that the capacity may not be available. Sonia Brown stated that this arrangement will give customers choice and flexibility. Christiane Sykes asked whether parties will be able to buy a firm product on an 'on the day' or a 'day ahead' basis. Sonia Brown replied that if the capacity is available Transco will release as much as it can but it will also introduce an alternative interruptible product and in the event that some parties have requested more firm product than they require Transco will operate buy-backs.

Alison Kuck asked that if key sites needed extra capacity in order to continue operation whether their capacity requirements would override those of others. Jason Mann responded that in such a situation it would depend on whether the necessary capacity

was available. Charles Ruffell asked whether problems will occur in cases where the NTS cannot respond to capacity demands. Mark Feather responded that if the demand for capacity increases the prices will increase correspondingly. However, if the system is largely unconstrained it could be anticipated that prices will mirror administered prices. Therefore if Transco failed to invest in capacity within a certain area then the price of capacity in that area may increase.

Richard Street suggested that if capacity is unconstrained people may choose to buy it on the day before as prices will remain low. Sonia Brown responded that this may be feasible except where a new entrant buys up all the available capacity.

Tory Hunter asked whether shippers or NTS connectees would be responsible for booking exit capacity. Sonia Brown responded that it would be necessary to answer questions regarding governance before this issue could be addressed.

Richard Street highlighted that individuals will make decisions regarding their future capacity requirements based on the prevailing conditions in the environment but these will change over time. Sonia Brown replied that the individual would be responsible for deciding which products they wanted to purchase – as more options are available it may be easier to book the right amount of capacity.

15. Any other business – UNC development process

Peter Bingham detailed that Transco are intending to undertake a review of the Network Code which will be necessary to develop a UNC within the designated timescale. The business tracker provides details of all of the changes necessary in relation to the Network Code and highlights that there is a huge volume of work to do to get to a finalised UNC. A letter is to be sent out to all interested parties in early September to initiate the UNC development process. The project will follow a similar structure to a Network code workstream with papers regarding the UNC tabled and developed into issues reports.

He detailed that the programme of work is expected to take two months with issues of a similar nature grouped together at certain meetings in order that individuals with the relevant expertise can attend the appropriate meetings. It is also proposed that certain issues are initially discussed at the DISG and then set out in a paper to the UNC development meeting.

Sonia Brown stated that the workgroup will also be reporting back to the DISG to gain a steer on certain issues. Ofgem has been considering how the DISG can work to make progress on these UNC issues and is of the opinion that more frequent meetings may be a possibility. Ofgem therefore propose that the CIWG should cease to run and instead the DISG should move to a weekly meeting in order that it can provide a steer to the UNC process.

Alison Kuck asked whether detailed work will be carried out by the DISG in relation to the UNC development process. Sonia Brown replied that the DISG will provide a steer on the big policy decisions with the UNC development meetings tasked with developing the finer aspects of the UNC. Richard Street asked if the DISG would run every week. Sonia responded that it would be nearly every week. Ofgem have noted that there are similar attendees at the DISG and CIWG every week and if they were combined a broader range of issues could be considered.

Martin Kinoulty asked if the next DISG would take place on 7 September. Sonia Brown stated that Ofgem would be looking to hold the next DISG on 24 August when it would be possible to start looking at some of the UNC issues. Alison Kuck asked whether the agenda could be available early so that it could be arranged for the most appropriate people to attend. Sonia Brown detailed that Ofgem are trying to develop four-week rolling agendas although these may change as the time gets closer.

Action: Ofgem to keep a rolling update of meeting agendas to ensure that all attendees are aware of the issues to be discussed.