

Development and Implementation Steering Group Minutes

Meeting 23

26 October 2004, 10:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Sonia Brown	Ofgem (chair)	Martin Kinoulty	United Utilities
Jason Mann	PA Consulting	Charles Ruffell	RWE Npower
Tim Dewhurst	PA Consulting	Rekha Patel	ConocoPhillips
Matteo Guarnerio	Ofgem	Peter Bolitho	E.ON UK
Richard Court	NGT	Rob Cross	Statoil
Russell Cooper	NGT	John Costa	EDF Energy
Peter Rayson	NGT	Tory Hunter	SSE
Mike Ashworth	NGT	Julian Bagwell	Macquarie
Peter Bingham	NGT	Nick Wye	Macquarie (WWA)
Ed Bannock	NGT	Sebastian Eyre	energywatch
Mike Young	British Gas Trading		

1. Review of items from previous DISG meeting (held 19 September 2004)

a) Minutes

Peter Bingham clarified to the group some aspects of Nigel Sisman's presentation at DISG 22. He stated that as a result of the proposed offtake arrangements charges would not increase, but would simply have a different emphasis (DN customers would pay higher DN charges but correspondingly lower NTS charges). Peter also confirmed that there would be no reopening of the price controls, but only a potential reallocation of revenue streams. Peter was sorry for any confusion that occurred.

Sonia Brown noted that the minutes reported correctly Nigel's words and therefore would not be amended; however she welcomed Peter's clarification on the issue

Mike Young asked to amend Alison Kuch to Alison Russell in the previous minutes.

Peter Bingham, asked by Tory Hunter, explained that the work on offtake and flexibility arrangements is included in the roadmap distributed at DISG 22. Peter also explained that the work on business rules will be consulted upon by Transco, and following a review of the legal drafting Ofgem will undertake a consultation. Nick Wye asked whether there will be a consultation on the legal drafting. Peter replied that the legal drafting should be relatively uncontentious. Sonia clarified that Ofgem and Transco are still defining the details of the process, and explained that there might be minor changes to the end of the process.

The group had no comments on DISG 21 minutes.

b) Actions

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

- DISG members to provide Transco with comments on agency services agreements by mid November. Transco to consider these comments when preparing an updated paper for discussion at December SPAWG. Ongoing
- Ofgem to update DISG members on the status of the consultation document on incentive arrangements. Sonia explained that the work on incentive arrangements has now been included in Transco's roadmap, and Ofgem will shortly start work on this issue. Sonia stated that Ofgem hopes to issue a consultation document on incentive arrangements in December, but noted that this depends on the interaction with other work strands.
- Transco to report to DISG 23 on the contractual basis of transitional arrangements. To be discussed at the UNC development forum.
- Transco to provide two versions of the roadmap, a "clean" one and one which shows interdependencies. Peter Bingham said that Transco has provided the "clean" version of the roadmap (available on Ofgem's website), and stated that Transco would provide the version of the roadmap showing interdependencies by DISG 25.

Action: Transco to provide DISG participants with version of the roadmap which shows interdependencies by DISG 25

- Shippers to prepare scenarios of possible disputes due to transition between NC and UNC. Transco to report on the scenarios presented. Discussed at UNC development forum and, if not resolved, escalated back to DISG by DISG 26. Mike Young explained that this issue will be discussed at the UNC Development forum scheduled on 3 November.
- DISG members to provide feedback on issues/ questions on the initial licence drafting. Ongoing. Asked by Julian Bagwell, Sonia explained that comments should be sent to Ofgem, and would be forwarded to Transco if they are not marked as confidential.
- Transco to set up and manage a specific issues list for licence drafting. Peter Bingham said that Transco will set up an issues list by DISG 25.

Action: Transco to set up and manage a specific issues list for licence drafting by DISG 25.

2. Update from NGT on UNC workgroup

Peter Bingham listed the sections of the network code that had been discussed in the UNC development forum and those which will be discussed in future meetings. He noted that Transco was publishing minutes of the meeting and said that relevant documents are being circulated by Transco via email. He reminded the group that the next meetings of the group would be on 3 November and 5 November.

Tory Hunter expressed concern that there are sections which had been discussed at the UNC development meeting but need to be reviewed since they interact with issues where a policy decisions has not been reached yet (e.g. offtake code). Nick Wye asked how many sections have been completed. Peter Bingham explained that Transco has developed the relevant sections as far as possible given the information available. Nick

suggested that Transco should provide legal drafting for the sections on which work has been completed (e.g. stand alone sections that are not affected by DN sales). Tory Hunter noted that Transco had undertaken to make the legal drafting available. Peter Bingham stated that drafting had been completed for the business rules, but was not sure about the legal drafting. He said that it seems reasonable to make the legal drafting available to the group, and said that he would check on the status of the process.

Action: Transco to report to DISG on availability of legal drafting for certain sections of the UNC.

3. NTS exit capacity – zonal and nodal models (Transco)

Richard Court gave a presentation on the spatial consideration for NTS exit capacity definition. Firstly, he explained that when deciding the spatial model to adopt, trade-offs between different objectives need to be considered. Richard explained that there is a range of options for the commercial regime, with at one extreme a national product with full unaffiliated substitutability but with no locational information and no cost reflectivity; at the other end of the spectrum there is a physical party specific (sub-nodal) product with no trading whatsoever and precise information on location and user specific cost reflectivity.

Richard then described some physical characteristics of gas transmission. He stated that the system design is based around peak conditions, noting that the supply sources are well understood by Transco and there is limited scope for supply to move around. He then explained that there is a lack of parallel paths due to low failure rate, and this would lead to “cigar shaped” zones. Richard also explained that transmission capability falls as the average transmission distance increases, and therefore a bigger system would be needed to transmit the same quantity of gas over larger distances. Therefore Richard noted that offtake specific information is important in sizing the network appropriately. After defining a zone (“geographic area in which capacity can be utilised at any of the nodes contained therein (existing or proposed) on an equal basis”), Richard showed some scenarios of incremental demand change within zones (defined as existing LDZ boundaries) and showed a list of HHI indexes. Richard noted that large zones (such as those defined by existing LDZ) would enable unfacilitated trading but large zonal information is not likely to be greatly effective as a commercial tool to signal new capacity requirements or in demand management for solving within zone congestion. He noted that large zones would therefore rely heavily on additional mechanisms for providing nodal information in order to plan and operate the system in line with Transco’s obligations.

Richard explained that Transco has defined a methodology to assess different zonal configuration based on the transmission capability loss assessed in a single pipeline and using “loss rates” to assess the extent of downstream transferability. Richard noted that there might be merits in supporting the transferability of capacity rights between offtake points, but he noted that as a consequence of the substitutability loss Transco would have either to build a bigger system or to buy back capacity. He then showed a summary of Transco’s analysis of the number of zones implied by different exchange rate thresholds and the estimated investment and demand management required. Richard noted that this analysis shows that even with a small number of multi-node zones, significant costs may be incurred if decisions on planning and operation were to be driven by the commercial capacity bookings alone. He said that demand management could be more targeted but there would still be major uncertainties within

the zones and the extent of facilitated trading would be likely to be very limited; however, this would not preclude a facilitated trading process.

Richard then explained the characteristics of a nodal approach, and noted that it would provide scope for clear signals for capacity requirements to promote efficient investment and operation and an effective targeting of demand management tools would emerge. He said that, although unfacilitated trading inter node would not be available, a facilitated process would not be precluded.

After providing a brief summary of the characteristics of the nodal and zonal model, Richard assessed their performance against the exit reform aims. Richard concluded that Transco, in view of their analysis, would recommend a nodal approach with facilitated trading by the SO. However, he stated that it would be difficult for Transco to assess the benefits of trading against the costs and said that he would welcome other views.

Nick Wye asked what the difference between a small zone and a node is. Richard explained that a small zone consists in a small group of offtakes, while a node includes a single offtake point. Russell Cooper noted that under the “small zones” approach some offtakes in geographical proximity are grouped together. Richard Court clarified that the main objective is to define a clear product for the reform of exit arrangements. Sonia Brown noted that this approach resembles in some aspects the approach undertaken in electricity. Peter Bolitho noted that in electricity no significant trading has emerged. Sonia replied that this may partly be due to the definition of product.

Tory Hunter asked whether trading would be facilitated within a zone. Jason Mann explained that there would be facilitated trading through exchange rates between zones, not within zones.

Julian Bagwell asked whether the DNs would be the only parties trading. Russell Copper explained that, for example, a DN could offer capacity to a neighbouring power station. Tory Hunter said that this would imply that a monopoly DN owner trading with a commercial shipper. Russell Cooper said that the first opportunity for parties to book capacity would be through the primary allocation, and after they would have the additional possibility of trading their holdings of capacity. He provided the example of buying peak capacity for one year and then selling part of that capacity to a neighbouring power station.

Jason Mann and Sonia said that the primary allocation of capacity under the nodal approach would be potentially more important than under the zonal approach. Sonia explained that under the nodal approach NGT would establish the costs for each nodal point, while under the zonal approach the prices would be averaged in each zone. Sonia also clarified that NGT’s approach is a “hybrid”: it would maintain signals from the allocation of primary capacity, and then would facilitate trade through a set of published exchange rate. Peter Bingham said that the proposed approach would optimise the investment decision on a facilitated basis. Sonia, asked by Rob Cross, said that the primary allocation would consist of releasing some baseline capacity. Russell Cooper reiterated that a problem of the zonal model is the aggregation of information as zones become larger. Answering a question by Charles Ruffell, Russell explained that some cost reflectivity would be lost as zones become larger, and said that Transco would need to amend its Transcost model to produce prices per zone rather than per offtake point.

Russell, asked by Rekha Patel, explained that the zones should change as the topology of the network changes, but changing the conformation of zones on a frequent basis might not be appropriate. Rekha stated that under the nodal approach the problem would not disappear and the risk of changes in exchange rates would exist. Jason Mann said that the risk of changes in exchange rates can be managed entirely by purchasing capacity long term.

Peter Bolitho asked to what extent the exchange rate values would change. Richard Court said that a balance between having constant changes and a fixed exchange rate schedule needs to be found. Sonia explained that Ofgem would want the exchange rates to be transparent and visible, and therefore Transco will need to publish them. Russell Copper agreed with Sonia. Julian Bagwell stated that a DN would want to understand the degree of permanence of exchange rates.

Sonia, asked by John Costa, explained that the exchange rates in a nodal model would be set between nodes. Sonia also confirmed to Rob Cross that this approach would need related incentive schemes (e.g. buyback incentives). Sonia explained that there are already exit capacity baseline quantities published in the Licence, and these should be considered as a starting point, since Ofgem does not want an unduly complicated process, particularly before the next price control.

Jason Mann, asked by Nick Wye, explained that DN and NTS direct connect shippers would buy capacity from the nodes they were connected to. Sonia also clarified that the definition of the temporal product is on the agenda for DISG 24.

John Costa asked what additional signals this approach provides relative to the status quo. Richard Court stated that capacity holding will provide signals and will ensure that firm financial commitments are undertaken. Sonia explained that under a regulatory point of view the proposed arrangements will make sure that there will be no undue discrimination. Sonia, asked by Charles Ruffell, explained that capacity holdings will provide financial rights similar to those in place with entry capacity arrangements.

4. Customer safeguards under Transco's agency governance arrangements

Ed Bannock gave a presentation addressing shippers' questions on xoserve. Ed listed the key aspects of the xoserve model, and explained that shippers had raised some concerns. Ed said that some shippers were concerned that they might propose a new IS system which will improve the level of service and the investment may be refused; he said also that some shippers were concerned that a modification which is raised against the interests of the majority of shippers may be pushed through. Ed explained that in both scenarios the modification process prevents the interests of any party from being ignored and notes that Ofgem makes the decision on the approval, while xoserve is only instructed to make changes. Ed also noted that the particular concern raised by shippers with respect to potential xoserve refusal to invest in new efficient system is addressed by the existence of GT licence obligations, the capability of raising a Network Code modification by tighter specificity of service definitions and the presence of user groups. Ed also noted that in the proposed UNC modification process shippers have various input opportunities and reminded all groups that all parties can make a direct representation to Ofgem if they are unhappy with the process.

Peter Bolitho raised some concerns about the Gemini project. He noted that the process is still driven fundamentally by Transco and parties are not involved directly in it. He noted that there are procedural matters which could be critical and they are still decided

by Transco. Ed replied that shippers always have the possibility to raise a modification. Peter said that the process did not seem sufficiently robust and he compared the approach with the procedural matters set in the BSC. Sonia replied that in the BSC there are no rules on how elexon manages its subcontracting procedures. Peter, asked by Sonia, said that he had concerns on the governance of AT-link. Ed explained that this is a different issue and this debate is already on the agenda of the transporters group. Ed said that Transco would inform the governance group on the outcome of this debate.

5. Xoserve voting arrangements (Transco)

Ed Bannock provided a review of xoserve's Board voting arrangements. He said that ownership, control and accountability will be shared by the four parties. Ed explained that there will be four classes of voting: simple majority, special majority, written consent and unanimity. He said that together these voting classes are designed to deliver effective decision making and protection against undue influence by any one network owner. Ed said that the simple majority voting, which will be adopted for all decisions except those defined in Schedule 3 and allows one vote per network owned, has been designed to avoid deadlock in decision making. He then described the special majority voting, which will be adopted for major decisions defined in schedule 3; it will require a majority from at least three separately owned networks, and a vote representing at least 50% of voting shares. He noted that the special majority board voting has been designed to prevent Transco from taking major decisions unilaterally and would prevent a single minority party from causing deadlock, since it avoids requirement for unanimity. Ed then described the written consent voting, which will be adopted for major decisions defined in Schedule 3 and requires written consent from at least three independent shareholders and consent from a cumulative holding of at least 50% of voting shares. Ed said that it was designed to avoid undue influence from Transco in major decisions. Finally, Ed explained the process of unanimity voting, which will provide minority interests with the right of veto on fundamental shareholder decisions, in particular for changes to the shareholder's agreement and Schedule 3 updates. Ed said that unanimity voting will require written consent from all shareholders.

Sonia reminded the group that all modifications must go through an Ofgem decision and said that xoserve has only an implementation function. Peter Bolitho replied that this may not be the case for changes to IT systems, since Ofgem is only an attendee to the UK link committee. Mike Ashworth replied that it is only an implementation committee.

Ed, asked by Martin Kinoulty, explained that special majority board voting and written consent require the same threshold, but the latter is a written vote. Julian Bagwell noted that with the simple majority voting Transco has effectively veto power over the other owners. Sonia said that buyers knew the arrangements that were in place and agreed by signing up, and asked for shippers' views.

Peter Bolitho asked about Ofgem's proposal of having an independent director with voting rights. Ed replied that that approach has not been adopted. Tory Hunter noted that under the simple majority voting Transco effectively makes the decision. Ed replied that the approach adopted caters for differences in views between the directors of transmission and distribution of NGT.

6. Credit arrangements (Transco)

Transco sent an email to DISG members explaining that they would be unable to deliver on time on this issue. Therefore a presentation has been rescheduled for DISG 25.

Action: Transco to give a presentation on credit arrangements at DISG 25.

7. Contractualisation of transitional arrangements (Transco)

To be discussed at the UNC development forum.

8. Report on progress relating to IGT issues (Transco)

Peter Bingham said that Transco had provided IGT with new contracts extending the first line emergency response service. Sonia asked whether the extension would be for 6 or 12 months. Peter said that he would check and report back to DISG.

Action: Transco to update DISG on duration of IGT contracts for first line emergency response

Peter also said that Transco had a successful seminar with IGT in which the process to be followed by IGTs for their safety cases was explained.

Sonia noted that the responses to the informal licence consultation document regarding whether to regulate repair and restoration services were mixed. Sonia said that Ofgem's way forward will be included in the document to be issued on the 25 November.

Sonia also noted that there had been comments about competition in connections, and she noted that ensuring that there is a level playing field is an important issue not only for IGTs but also for Ofgem. Sonia said that this issue will be taken forward in the licence document, and there also may be a presentation to DISG.

9. CV methodologies (Transco)

Peter Bingham discussed a paper prepared by Nigel Sisman on CV methodologies. Peter explained that there are three bases that can be used in respect of CV determination and to apply in charging zones, and said that the paper concludes that transporters are able to elect which of the three options it can use for CV determination purposes within each charging zone. Peter said that comments from DISG participants on this issue should be addressed to Nigel Sisman and copied to Ofgem.

10. Initial draft of licence conditions (Transco)

Transco provided the group participants with the initial drafting of two (one NTS and one DN only) special conditions on Licencee's procurement and use of system management services. In addition, a Standard Special Condition on prohibited procurement activities and a NTS only Special condition on additional permitted procurement activities were presented to the group.

Mike Ashworth provided the participants with an overview of the drafting of these conditions. Sonia noted that the distinctions between NTS and DN in the procurement activities conditions are due to the fact that DN balancing management is restricted to capacity balancing while the NTS balancing management includes energy balancing.

Sonia said that views on the drafting of these conditions would be welcome, in particular on whether these conditions reflect the split in roles and responsibilities between the DNs and the NTS.

Julian Bagwell asked Transco to provide, where possible, an indication on where the new conditions lie in the current licence document.

Action: Transco to provide drafting of conditions, where possible, with a reference to the numbers of the current conditions in the licence

Martin Kinoulty noted that detailed comments should be made when Ofgem drafting is available. Sonia reiterated that it is important for Ofgem to receive views on the drafting of licence conditions, and reminded the group that, although Transco is providing initial drafting of the condition, this is an Ofgem led process and Ofgem will review in detail Transco's drafting.