Development and Implementation Steering Group Minutes

Meeting 24

2 November 2004, 10:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Sonia Brown	Ofgem (chair)	Tory Hunter	SSE
Jason Mann	PA Consulting	Peter Bolitho	E.ON UK
Matteo Guarnerio	Ofgem	John Costa	EDF Energy
David Ashbourne	Ofgem	Steve Rose	RWE Npower
Sue Higgins	NGT	Rekha Patel	ConocoPhillips
Russell Cooper	NGT	Nick Wye	Macquarie
Steve Fisher	NGT	Julian Bagwell	Macquarie
Peter Rayson	NGT	Julie Cox	AEP
Peter Bingham	NGT	Martin Kinoulty	United Utilities
Sam Parmar	Statoil	Mike Young	BGT

1. Review of items from previous DISG meeting (held 26 October 2004)

a) Minutes

Peter Bolitho asked for two changes in the minutes of the previous DISG meeting:

- In section 4 (customer safeguards under Transco's agency governance arrangements), after the sentence "Sonia replied that in the BSC there are no rules on how elexon manages its subcontracting procedures" he asked to insert: "Peter agreed with Sonia's point but said he was referring to Balancing and Settlement Code Procedures (BSCPs) which set out detailed procedural matters for implementation of obligations by BSC parties".
- In section 5 (Xoserve voting arrangements) he asked to amend the sentence "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" with" Peter Bolitho replied that this was not the case for changes to IT systems, because unlike modification decisions Ofgem does not have the final say".

Russell Cooper said that in section 3 (NTS exit capacity – zonal and nodal models) para 9 the last sentence should be amended to "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 price <u>per offtake</u> rather than <u>per zone</u>".

Peter Bingham noted that in section 5 (xoserve voting arrangements) the sixth sentence should be amended to "He then described the special majority voting, which will be adopted for major decisions defined in schedule 3; it will require a majority of at least <u>two</u> separately owned networks…"

Martin Kinoulty asked to amend the first sentence in the last paragraph of section 10 (Initial draft of licence conditions) as follows: "Martin Kinoulty noted that detailed comments would be made when Ofgem drafting is available".

All the proposed amendments were agreed by Ofgem and the minutes will be changed accordingly.

b) Actions

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

- Transco to provide DISG participants with version of the roadmap which shows interdependencies by DISG 25. Transco provided DISG participants with a version of the map and Peter Bingham said Transco would circulate an electronic version through the DISG mailing list.
- Transco to set up and manage a specific issues list for licence drafting by DISG 25. Ongoing

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

- Transco to report to DISG on availability of legal drafting for certain sections of the UNC. Peter Bingham explained that the DN sales roadmap shows a start date for the work on the UNC legal drafting. He noted that Transco's plan is to develop first the business rules and then proceed to the legal drafting. However, he said that to the extent that it is possible, Transco will attempt to provide the group with some legal drafting before. Julian Bagwell noted that it would be worthwhile to prepare the legal drafting as soon as possible.
- Transco to give a presentation on credit arrangements at DISG 25. Ongoing

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

- Transco to update DISG on duration of IGT contracts for first line emergency response. Peter Bingham said that Transco have extended IGT contracts for first line emergency response for 6 months (until March 2006).
- Transco to provide drafting of conditions, where possible, with reference to the numbers of the current conditions in the licence. Ongoing

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

DTI/ Ofgem joint letter

A copy of a DTI/Ofgem joint letter to the industry on exemption was distributed to DISG participants. Sonia explained that the DTI is attempting to obtain policy clearance with respect to the exemption and the Secretary of State for Trade and Industry is currently minded to grant an exemption. Sonia also noted that Ofgem's consultation document on the exemption will be released shortly at the same time as the Final IA.

Julian Bagwell asked whether this letter confirms the current situation on exemptions. Sonia underlined that the two key elements that emerge from this letter are:

- the Secretary of State is currently minded to grant an exemption. This position however does not fetter the discretion of the Authority or Secretary of State; and
- the exemption will be limited in scope.

2. Feedback on spatial definition of exit rights (DISG)

Sonia Brown asked the group for comments on Transco's presentation on the spatial definition of exit rights, which had been presented at DISG 23. Julian Bagwell stated that for reasons of implementability he supports the nodal approach. Tory Hunter and Martin Kinoulty agreed with Julian.

Peter Bolitho asked about the transition between current arrangements and the date in which long term arrangements will be in place. Peter Bingham said that it would be helpful to discuss these issues at the next meeting. Sonia explained that the transition issue is on the agenda for DISG 25 and, if Transco cannot prepare a presentation by then, needs to be discussed by DISG 26.

Action: Transco to present on the proposed "go live" of offtake arrangements and on the transition towards the long term arrangements (on agenda for DISG 25).

Tory Hunter asked whether the proposed baseline for the offtake points would be zero. Russell Cooper explained that the baseline would reflect the physical capability of the network.

Russell Cooper, answering a question from Steve Rose, explained that the firm baseline quantities in Transco's licence are currently set on aggregate for NTS direct connects, and will need to be established on a nodal basis.

John Costa asked how the baselines will change. Russell Cooper explained that, in case of a new power station, the baseline would be set at zero, and signals from the long term capacity allocation would need to emerge. Possibly an IECR type test would need to be set up, and there would be incentives on the NTS to release incremental capacity. Russell also said that there might be some slight changes to the baseline quantities published in the licence. Sonia explained that work is starting on this issue and the detailed proposals will be developed at a later stage.

Sonia noted that, given feedback from DISG participants and that the proposal on spatial definition is a NGT recommendation, Ofgem is happy to work on the nodal approach.

3. Temporal definition of exit rights

Russell Cooper gave a presentation on the temporal consideration for the NTS exit capacity definition. He explained that the aim of the presentation is to determine at what level of granularity capacity should be offered. Russell explained in its presentation that the adopted temporal definition needs to promote the ability for users to demand an appropriate quantity of exit capacity, but also to ensure the economic and efficient development, maintenance and operation of the system and to be cost reflective. He explained that two possible options for the commercial regime would be:

- allocation of rights in a 12 month block with also day ahead and within day allocation;
- allocation of rights in a 12 monthly bundles with also day ahead and within day allocation.

Russell described the present NTS exit arrangements, and he noted that most of them are approximately annual arrangements. He then said that the new arrangements would be expressed in the form of a daily firm financial right, which would be bundled into monthly or annual (or other) blocks. He noted that there would be an expectation that the licence will identify a baseline quantity, which will be reflective of maximum capability and would not be profiled, but would be a single annual quantity. Russell explained that the majority of exit capacity costs is assumed to be driven by behaviour at peak and he noted that there would be a low incentive to profile off-peak demand. Russell explained that large parts of northerly areas are subject to a minimal transportation charge, and this would reduce incentives for off-peak profiling in that area. Therefore NGT suggested that the key purpose should be to understand user requirements at peak periods. Russell then explained that all DN demand follows a similar profile, with peaks in winter months. On the other hand, he noted that firm demand of direct connects is relatively stable during the year (except, for example, the Bacton interconnector, which has a counter-cyclical profile); therefore a limited number of parties would benefit from demanding a sub-annual product. Russell explained that a monthly product may create a large amount of unsold baseline in off-peak periods; therefore the need to develop additional allocation processes may emerge. Russell also noted that, with a monthly allocation, the bidding process may become more complex since additional periods need to be considered and differing prices would be set for each period. Russell also noted that with monthly booking revenue might be slightly less stable and this may lead to less predictable year on year price adjustments. Russell also said that both with annual or monthly blocks the incentives to register capacity at year ahead stage are undermined if obligations to offer capacity at zero price remain active until the gas day. He noted that remedies to this problem might include earlier gate closure or application of common reserve prices. As regards demand management, Russell noted that a monthly allocation may lead to lower level of capacity being allocated long-term, therefore leading to a reduced ability to contract on a forward basis. On the other hand, Russell noted that an annual allocation process would be more likely to have a "full" release during the annual capacity auction and would therefore lead to a better ability for Transco to contract on a forward basis. Finally, Russell compared the efficiency of signal of a monthly capacity allocation process with that of an annual allocation process. He said that both allocation processes provide indications of peak demand, but a monthly capacity allocation would also provide some off-peak information. After assessing the two models against the exit reform aims, Russell said that Transco would recommend an annual approach as they are unsure of the benefits gained from sub-annual booking of capacity. He noted that the number of users who would benefit from a monthly product seem to be few, and a sub-annual product appears to introduce complexity and pricing volatility for limited additional benefit.

Steve Rose asked why users would book capacity ten years in advance under a nodal approach with the baselines currently in place. Russell Cooper replied that long term booking of capacity would offer price certainty and provide Transco with investment signals. Some members of the group noted that users which did not require incremental capacity could secure their capacity holdings by purchasing capacity year by year. Sonia Brown noted that in that case users would not be certain of having some capacity, since there might be some substitutability between nodes and this may be reflected when setting baseline quantities. Sonia also noted that baseline quantities are currently set on a LDZ basis, and more work needs to be done in order to understand how they will be set in a post DN sales regime. Peter Bolitho noted that the proposed regime may in effect take away users' existing right to rebook the capacity purchased in previous years.

Russell Cooper noted that for the choice of baseline quantities several factors will need to be considered, among which the ten year statement, technical factors, and whether or not the arrangements will replicates those in place in the entry capacity regime.

Sonia Brown said that also exchange rates will have a role in these arrangements and will need to be published. Steve Rose questioned the possible costs of publishing a matrix of exchange rates between nodes. Russell Cooper said that Transco would adopt facilitated trading regardless of the temporal approach adopted.

Sonia welcomed new entrants' and other interested parties' views on this issue and reminded the group that it is likely that these arrangements will be codified through industry codes and will be subject to modification processes.

Action: DISG participant to provide comments on Transco's proposed temporal approach by DISG 25

Peter Bolitho noted that in most cases an approach with annual plus daily allocations may be sufficient for users to optimise their position. Nick Wye said that for the moment an annual allocation process is probably simpler.

Nick asked whether daily interruptible capacity would be released. Sonia noted that under the proposed arrangements an unconstrained amount of capacity may be released at a day ahead stage. She explained that the product released would not be a universal firm type product. Several members of the group responded positively to this proposal.

4. Definition of offtake flexibility / diurnal storage in the offtake arrangements (Transco)

Steve Fisher gave a presentation providing an overview of Transco's proposed approach to flexibility. Steve said that flexibility had been discussed in Ofgem's previous RIA, and Transco had presented an original flow flexibility product to DISG, but NGT's thinking has moved on. After presenting a high level overview of Transco's original proposal, Steve described the revised NGT proposal, which has the following main characteristics:

- the new proposal removes the link to the exit capacity product, and it would therefore enable a year round flexibility product and effective management;
- the proposed flexibility product is required for rates taken greater than an end of day measurement (allocation)/24; and
- the cumulative volume would be taken at 22.00

After providing some examples on how the revised product would work, Steve said that it would have the same effect as the original product on a peak day. Steve Fisher also said that Transco believes that the DNs will still be required to book their capacity to meet their 1 in 20 obligation and that the DN will request the NTS exit capacity from the NTS, which will look to satisfy such requests (subject to any economic criteria being met). Steve said that at present DNs "book" their capacity based on their peak day flow and "book" a flexibility product to meet their peak hourly requirements to meet any difference between their capacity booking and their peak hour daily requirement. He noted that the revised product allows the DNs to indicate both their end of day and within day requirements, thus providing information to the planning process.

After providing a high level overview of the characteristics of the revised flexibility product and some examples, Steve concluded that NGT recommends the revised flow flexibility product because it identifies a distinct flexibility product, it enables effective management of the products and provides information for planning and developing the transmission system.

Peter Bolitho noted that users may need to buy this product despite having purchased a sufficient amount of MDQ. Russell Cooper explained that both DNs and NTS direct connects need to have the possibility of obtaining flexibility in a non-discriminatory way. Russell Cooper, asked by Julie Cox, explained that this product would generate SO revenue.

Steve Rose asked how a potential overrun regime would work. Russell Cooper explained that this still needs to be discussed; overrun payments may need to be set at multiples of the price of capacity, or alternatively at some multiple of demand management costs. Russell, asked by Steve, confirmed that the flexibility product would apply only to the exit regime.

Nick Wye asked what the role of 22.00 is in this proposal. Russell Cooper explained that it is the moment of maximum stock depletion on the system. Julie Cox noted that demand may change from what was expected. Russell explained that in that case the user could renominate its end of day quantity.

John Costa asked how this approach would provide better information than the status quo. Russell Cooper explained that the proposed approach would enable Transco to know how much flexibility is required and to have long term investment signals.

Peter Bolitho asked what the interaction would be with NExA agreements, which specify limits on ramp rates, flow rates and renominations. Russell replied that ramp rates and notice period are other aspects of the flexibility product and he reiterated that the product on offer has to be non-discriminatory; Peter Bingham said that Transco has a licence obligation to operate in a non-discriminatory manner. Peter Bolitho noted that the proposed approach may discriminate against a power station connected to the NTS, since a power station connected to a DN would not need to enter the proposed arrangements. Peter Bingham replied that the obligation on the licence is to operate in a non-discriminatory manner towards the connectees of that network. Jason Mann also noted that a power station connected to a DN would need to pay distribution charges.

Tory Hunter noted that the proposed approach represents in effect "universal NExA". Sonia said that Mike Ashworth had on several occasions explained Transco's view on the status of NExAs that they did not confer rights on users of the NTS. Therefore she asked the group if there was any disagreement on this. Peter Bolitho said he was interested in raising the issue of NExAs and said that the group should consider their existence and interaction with the proposed agreements.

Action: DISG participants to raise comments to Ofgem on interaction between NExAs and proposed flexibility arrangements by DISG 25.

Peter Bolitho explained that NExAs specify a minimum tolerance level. Russell Cooper explained that Transco's proposal initially includes an allowance for a tolerance level of 3%.

Russell, asked by Tory Hunter, explained that there is appropriate metering on the system in order to monitor the offtake behaviour.

John Costa noted that the end of day quantity is based on the allocated level of flexibility and he asked how this will be known beforehand. Russell Cooper replied that users are in a better position to take a view on this than the system operator.

The group then discussed some details of the proposal, and in particular whether users would not have to pay for some offtake profiles. Russell Cooper explained that if the effect on linepack is zero at 22.00 then the user would not need to purchase additional flexibility.

Nick Wye asked whether the pricing of the product would be standard or locational. Russell explained that work needs to be done on this issue, and he noted that charging of the product is interrelated with overruns.

Peter Bingham noted that the system is capable to accommodate some level of flexibility, and for this level the cost is expected to be zero. As demand for flexibility increases above that threshold, then the provision of additional flexibility would have a cost. Peter Bolitho asked if costs would remain small in case flexibility is used as currently. Peter Bingham said that it would depend on the level of demand, as currently there is no additional investment on the NTS for flexibility needed by the DNs.

John Costa said that he remembered from a past DISG that DNs use 60% of all linepack and suggested that this may be discriminating. Russell Cooper said that John was referring to a different issue (i.e. flexibility within DN's own system).

Sonia, asked by Julie Cox, noted that it is likely that there would be baseline quantities for the flexibility product.

Action: DISG participants to provide comments on Transco's proposed approach to offtake flexibility

5. Licence conditions (Transco) – LNG; non –prejudicing operation of networks

Transco provided group participants with drafting of licence conditions on LNG and non-prejudicing of the network. The group agreed to discuss this issue at the next meeting.

Action: DISG members to discuss licence conditions on LNG and non-prejudicing operation of networks at DISG 25

Sue Higgins explained that the licence condition on LNG storage would be a standard condition in the NTS licence. Sonia Brown considered that it should be a special condition. Mike Young noted that there are circumstances where LNG storage issues would be related with DNs. Sue Higgins agreed with Mike, but said that this licence condition does not cover this. Sonia, asked by John Costa, confirmed that this would be a new licence condition.

Tory Hunter noted that it is confusing to introduce a standard special condition to the NTS and DNs. Sue explained that this is the only way to make the private CLM process work.

6. DN sales timeline (with interdependencies)

Peter Bingham noted that the timeline provided to the group was self-explanatory, and explained that an electronic copy would circulate to DISG members.

7. AOB

Sonia Brown explained that the following issues are on the agenda of DISG 25:

- Connections
- Update from UNC developemnt forum
- Standards of performance
- Credit
- Exit reform development forum
- Feedback on temporal definition of exit rights
- Feedback on flow flexibility
- Getting to day 1
- Feedback on licence conditions presented at DISG 24
- Update on progress with IGT issues