

Development and Implementation Steering Group Minutes

Meeting 26

16 November 2004, 10:00 am – 2:00 pm

Ofgem's office, 9 Millbank

Attendees

Sonia Brown	Ofgem (chair)	Peter Bingham	NGT
Jessica Hunt	Ofgem	Rekha Patel	ConocoPhillips
Matteo Guarnerio	Ofgem	Sam Parmar	Statoil
Richard Clay	Ofgem	Mike Young	BGT
Nick Simpson	Ofgem	Charles Ruffell	RWE npower
Bryony Sheldon	Ofgem	Martin Kinoulty	United Utilities
Jason Mann	PA Consulting	Nick Wye	Macquarie (WWA)
Sue Higgins	NGT	Tory Hunter	SSE
Alan Raper	NGT	Sebastian Eyre	energywatch
Mike Ashworth	NGT	Peter Bolitho	E.ON Uk

1. Review of items from previous DISG meeting (held 9 November 2004)

a) Minutes

Peter Bolitho asked for a change in section 10 of the minutes of the previous DISG meeting (licence conditions (feedback)). He suggested amending paragraph 4 as follows: "Peter Bolitho detailed that shippers had not agreed to the implementation of some of the relevant shipper conditions..."

Mike Young underlined that in section 5 (Credit), a sentence should be added: "Michelle also confirmed that twelve month credit holdings would continue to be required in relation to LTSEC auctions". Mike also highlighted that in section 8 (Flow flexibility (feedback)), it should be clarified that: "Russell Cooper explained that, subject to willingness to pay, under the proposed arrangements demand for flexibility could be a driver for investment".

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 an update regarding the approach it will follow in relation to the release of the legal drafting for the UNC. Discussed at today's meeting (agenda item 4)
- Transco to provide an update regarding an approximate date on which the legal drafting would be released. Discussed at today's meeting (agenda item 4)

- Transco to respond to the actions placed on them at DISG 20 to undertake a presentation to DISG members regarding credit arrangements. Discussed at today's DISG (agenda item 5)
- DISG members to check all of the issues included on the licence drafting issues list and circulate any comments to Ofgem and to Sue Higgins at Transco. Ongoing. Sue Higgins explained that she had some further comments and the list will be updated

Action: DISG members to check all of the issues included on the licence drafting issues list and circulate any comments to Ofgem and to Sue Higgins at Transco.

- Transco to number the licence conditions that have been drafted, according to the numbers of existing licence conditions that they represent. Ongoing. Sonia explained that Transco have been numbering the licence conditions presented (where possible) according to the numbers of existing licence conditions they represent. She also noted that they will be numbered in the licence consultation document due to be issued on 25 November.
- Sonia also noted that in the previous DISG meeting an action was placed on Transco to update the DN sales roadmap to reflect to reflect the interim arrangements and the timing of the first auctions for DISG 26. Peter Bingham presented a new slide detailing the proposed implementation of exit regime timeline. Sonia noted that some details of the slide may not correct and said Ofgem will discuss this in more detail with Transco. Peter Bingham said that Transco will make sure that the proposed timetable is consistent with Transco's roadmap.

Action: Transco to update the DN sales roadmap to reflect to reflect the interim arrangements and the timing of the first auctions.

Tory Hunter asked when Transco will present their final views on the interim arrangements with respect to the DN (in particular regarding payment flows). Peter Bingham explained that Transco are examining the pros and cons of these issues in order to make an informed decision. He said that this issue will be discussed at the exit development forum in the next few weeks.

2. Update from Exit Reform Development Forum

Peter Bingham explained to the group that on 11 November 2004 the first meeting of the exit reform development forum had taken place. He noted that it had been a well attended meeting. He said that during the meeting Chris Train had given an introductory presentation explaining the objectives of the process, he had given a presentation on the regulatory context and overview, Russell Cooper had presented an introduction to the proposed exit regime products and principles and Nigel Sisman had indicated the proposed way forward on process and time line. Peter noted that the meeting had been participative and interactive and said that there had been several questions on process and on the proposed products and their cost implications. Peter said that in the meeting on 17 November non-contractual technical rules would be discussed, while detailed business rules for the primary product would be discussed on 25 November.

Mike Young stated that the first meeting of the exit reform development forum had been setting the basis for the work going forwards, but he noted that the next level of detail is

extremely important, as only after examining the details of the proposals participants will be able to understand their implications. Mike also noted that participants were reassured from Transco that the transition arrangements would not differ substantially from the status quo.

Nick Wye asked what the interaction between DISG and the exit reform development forum would be. Peter Bingham said that the main outcomes of the discussions in DISG meetings would be set out in Ofgem's final IA. Sonia, asked by several members, explained that the final IA would be published by the end of the week.

Peter Bingham also presented to the group a slide on Transco's thinking on the commercial framework in the UNC and the NTS/DN operator arrangements. He noted that this slide had been presented to the exit reform development forum. Peter, asked by Nick Wye, said that the legal drafting of the offtake arrangements would be developed at the same time as the exit framework.

Charles Ruffell said that he believed that the rationale for exit reform was to have consistent arrangements for all connectees, and the slide did not reflect this. Mike Ashworth and Sonia Brown said that they believed the slide was not correct. Sonia noted that in the slide several aspects were included among the NTS/DN operator arrangements, while they should be included in the UNC (for example, ramp rates and notice periods or maintenance). Peter Bingham agreed to review this slide.

Action: Transco to prepare a revised version of the slide on UNC NTS/DN operator arrangements and present it to DISG and to the exit development forum.

Peter Bingham explained that the items under the heading NTS/DN operator arrangements are the technical side of commercial arrangements included in the UNC. Sonia said that, for example, the issue of maintenance needs to be dealt with in a transparent way, and the way it is presented in the slide could cause some confusion.

Mike Ashworth said that the slide lists operator issues and not commercial ones. Sonia reiterated that the slide needs to be clarified as it may generate some confusion.

3. Business separation

Jess Hunt gave a presentation on the legal separation between Transco's NTS and RDN businesses. Jess reminded the group that in its August 2004 decision the Authority was minded to require legal separation as well as targeted structural separation. Jess noted that the "minded to" decision was required as a number of detailed implementation issues needed to be resolved. Jess noted that since August, Ofgem has been working on these issues, and a number of potential problems have been identified. She said that Ofgem considers that it is necessary for the Authority to reconsider legal separation.

Jess then explained that there are two ways in which to achieve legal separation: the NTS hive down (Transco's favourite approach) in which the RDNs retain the denomination of Transco plc and the NTS becomes a new company, and RDN hive down, in which the NTS retain the denomination of Transco plc and the RDNs become a new company. Jess noted that Ofgem, in principle, is indifferent between these two options, provided that the interests of customers are protected. However she stated that Ofgem had recognised the need to consider risks and unintended consequences.

Jess said that, having carefully examined this issue, Ofgem identified a possible outcome in which the continuity of gas balancing was not ensured. She noted that this, despite being unlikely, would have very high costs to consumers. These considerations had initially led Ofgem to have a preference towards RDN hived down.

However, Jess explained that if the RDN business is hived down from Transco plc, Transco could incur significant costs associated with debt restructuring, as the majority of assets lie with the RDN business. She noted that, given these implementation problems, the cost of legal separation could potentially be higher than the benefits; therefore the Authority has considered this further information, and has decided that legal separation should not be required and, instead, a set of licence conditions that emulate the benefits of legal separation will be developed. Jess noted that this would be a proportionate response to the risk of undue discrimination between RDNs and IDNs.

Jess listed some potential new licence conditions that could be introduced to emulate some of the benefits of legal separation, in particular to ensure a level playing field for comparative regulation and a robust approach to corporate governance. However, Jess noted that not all benefits of legal separation could be retained, in particular consistency with electricity and reduced complexity.

Jess explained that the Authority position will be set out in the final IA, and the licence conditions to emulate business separation will be developed through DISG discussions and through the consultation on the restructuring of Transco's licence.

Charles Ruffell asked whether the costs of not undertaking legal separation would be included in the final IA. Sonia Brown replied that these costs would not be material given that Ofgem intended to develop a set of licence conditions that emulate the benefits of legal separation. She noted that the benefits of legal separation were not included on the cost benefit analysis. Sonia underlined that structural separation is the key to ensure that benefits are delivered, and the absence of legal separation does not generate a quantifiable loss of benefits.

Tory Hunter asked whether there would be one licence for the NTS and one licence for the RDNs. Sonia said that this may be a transparent solution, but there is a need to make sure that there are no risks and unintended consequences in undertaking this approach.

Answering a question from Nick Wye, Sonia said that this proposal would be included in the informal licence document due to be issued on 25 November. Sonia also noted that the Authority's financial advisors had carefully considered the issues associated with Transco's debt restructuring.

Tory Hunter asked whether the additional licences that were published are exact replicas of the existing licence. Sonia explained that the key difference is in the revocation terms, which have been modified in order to allow the Authority to revoke the licences granted in case it did not approve DN sales. Sonia also highlighted that the section 23 document due to be published in November will include the changes which reflect the separation of DN price controls.

4. Process for review of UNC drafting

Mike Ashworth explained there are mainly three areas of work impacting the legal drafting of the UNC:

- Work in the UNC development forum (with system of categorising changes)

- New provisions
- Collateral changes required to accommodate the development of the exit regime

Mike noted that the business rules resulting from the work in the exit development forum had been recently released. As regards the legal drafting, Mike said that Transco aims to prepare a marked up version of the UNC document with the class 1 changes agreed in the UNC development group by the week commencing 29 November. He also said that a more developed legal drafting with some of the class 2 and 3 changes may be distributed in the week commencing 6 December. Mike said that if a special session to go through the changes is required, Transco would be happy to organise it.

Peter Bolitho asked when the majority of legal advice would need to be required by companies. Mike Ashworth said it is the individual companies' choice.

Nick Wye noted that class 2 and class 3 changes may have an impact on the drafting of class 1 changes. Mike Young noted that Class 1 changes are relatively simple, while the later stage of drafting is extremely important. Mike Ashworth said that he would prepare a short paper setting out Transco's position (as explained in this meeting).

Action: Transco to prepare a note setting out the proposed process for UNC drafting

5. Credit termination arrangements

Alan Raper gave a presentation on the UNC termination process. Alan explained that the two options of termination where a shipper is in default are:

- One-out-all-out (any one of the UNC transporters could trigger a system wide termination and a termination by one transporter would be considered to be a default against all transporters); and
- One-by-one (whereby a transporter could only terminate a shipper from its network).

Alan described the pros and cons of the two options as follows:

One-out-all-out

Advantages

- Results in decisive, coordinated action
- Mirrors the situation that exists now
- Sits well with SOLR
- Simple principle, easily implemented

Disadvantages

- Each transporter forced into action at the pace of the fastest
- Portfolios are not always uniformly distributed across all networks and any disproportionate exposure would not be taken into account
- Introduces a mandatory element into the termination rules that currently does not exist

One-by-one

Advantages

- Ring-fences behaviours relating to risk with consequences

- Aligns decisions relating to default with other credit chain activities
- Precipitate action avoided

Disadvantages

- Messy – obligations relating to the NTS (and balancing) retained but not on the terminating network
- Does not sit well with SOLR process – SOLR is a national process that relies on Supplier licence revocation (or potential revocation)
- Would require systems work to facilitate partial SOLR (if introduced) or portfolio depopulation
- May accelerate divergence of credit arrangements as IDNs may perceive they are at greater risk of not being paid if a shipper is in distress

Alan explained that a shipper cannot be a shipper without access to the NTS. He noted that even under the one-by-one approach a NTS termination or an energy termination would result in a shipper being terminated on all networks. He said that most defaults would tend to one-out-all-out in practice, since most are driven by financial failure and this would affect all networks.

Alan said that Transco does not have a strong recommendation, but would tend to a one-out-all-out approach, in particular if general support emerges from DISG.

Nick Wye asked whether this approach is consistent with the scope of the agency services agreements. Mike Ashworth said that the credit termination arrangements described in Alan's presentation were relevant only for transportation charges as energy balancing credit is ring fenced into xoserve. Sonia explained that a SOLR generally arises from energy not transportation. Mike replied that this is what historically has happened but there is no reason why it should not arise from transportation. Mike Young noted that under a one-by-one approach the risk of holding credit with the IDN might be higher.

Nick Simpson said that he was surprised that the discussion on this issue has been going on for such a long period. Nick said that he does not understand how the one-out-all-out option accords with the conclusions of the recommendations for best practice guidelines for gas and electricity network operator credit published by Ofgem in September 2004. Nick said that the approach coming from industry workgroups looking at the issue of credit is one in which each network operator will handle its own credit default arrangements. Peter Bolitho questioned the practicality of locally terminated users. He noted that the one-by-one approach in practice only delays the inevitable and places some DNs (the IDNs) at a potential disadvantage. Peter also noted that the electricity sector (which adopts a different approach) is structured differently. Nick replied that network operators should reach the default by law. He noted that if they cannot recover the money, this will be considered in the price controls. He also noted that there is a key difference between companies that do not want to pay and companies that cannot pay, the latter being the key issue. Alan Raper noted that there are already provisions in the network code that permit different actions, and said that a termination is not necessary. Sonia noted that there are key differences between gas and electricity in this issue, which create perverse incentives against IDNs (as a shipper who is terminated by Transco plc automatically cannot ship to any point on the network, whereas a shipper who is terminated by an IDN could potentially continue to ship to other networks). Martin Kinoulty said that United Utilities strongly supports the one-out-all-out approach as they are concerned about the cost of credit under the other approach. Peter Bolitho also noted that under a one-by-one approach costs would have

a disproportionate effect on small shippers. Sue Higgins said that the support for a one-out-all-out position reflects this issue of competitive advantage and practicality considerations. Nick replied that he does not understand what the difference is with electricity. Sonia explained that the key difference is that NGC does not own any DNO. Nick Simpson said the problem is not material since it is not realistic to think that a company would choose where to become insolvent. Sue Higgins replied that a company could default on the IDNs but still be solvent, while it would never choose to do it on the NTS. Nick Simpson replied that if the company is solvent then the network operator can go through court procedures and get all the money (plus interest) back. Mike Ashworth noted that this is not a desirable process as it cannot be quick. Sonia also noted that if the perverse incentive exists, then customers on IDNs would have to bear the costs. Sonia noted that the principles expressed in the document are extremely valuable, but there is a need to understand how these principles apply in the absence of a level playing field where NTS and RDNs are owned by the same group. Sue Higgins also noted that a company deciding whether to go to court does not only consider the financial issue of recovering the money, but has also to take into consideration the fact that it is a long process and require time and resources. Tory Hunter noted that it would be inappropriate for IDNs to have a higher level of credit requirement for the perverse incentives created by the one-by-one approach. Tory asked whether there could be a risk that a network which terminated because of consequential termination might not be allowed to recover any loss through the price control. Mike Ashworth noted that termination involves a significant involvement of the regulator. Nick Simpson replied that the regulator should not be involved in this process, as this is a commercial arrangement. Tory Hunter noted that it would be unacceptable if, irrespective of the chosen route, the IDNs were disadvantaged. Nick Simpson replied that Ofgem will make every effort to ensure that this is not the case.

Sonia noted that if perverse incentives exist, there is a need to take them into account and look at the way the transmission company operates or there will be costs for IDNs.

Action: Ofgem to consider possible perverse incentives emerging from a one-by-one approach on credit termination

Nick Simpson also invited the group participant to read the September 2004 document on credit published by Ofgem.

Nick Wye said that he had read this document and he considered that it was not inconsistent with the one-out-all-out approach. He also noted that the level of detail of the topics discussed goes beyond the issues considered in the September 2004 document.

Sue Higgins said that Transco will need to consider this issue.

6. Standard of performance licence drafting

Richard Clay introduced himself to the group and explained that he works for the quality of supply team at Ofgem. Richard said that Ofgem is looking to introduce a licence condition to require DNs to carry out a quality of supply survey. He noted that the proposed licence condition (based on the wording of Amended Special Condition 36) requires DNs to undertake a quarterly survey covering a range of areas among consumers who have experienced interruptions. He noted that the more detail on this

licence condition can be found in the Regulatory Instructions and Guidance consultation document due to be issued in early December.

Sue Higgins said that she considered the proposed approach is sensible and pragmatic. Sebastian Eyre confirmed that energywatch is happy with this approach and noted that the key principle is capturing the aspects which are important to customers. Sonia Brown noted that input and comments from energywatch on this would be welcome. Tory Hunter asked whether there are financial incentives in place for DNs in this respect. Sonia Brown noted that Transco is already carrying out this survey, and Richard Clay said that it will not be accounted for in this price control.

Sonia noted that the proposed licence condition will be consulted upon as part of the November licence consultation document. Sonia underlined that the results of this survey will be very important to consider when setting financial incentives.

Nick Wye asked whether the survey is conducted on a quarterly basis at the moment. Peter Bingham said that he would look into this issue.

Action: Transco to confirm whether the survey on quality of supply is currently conducted on a quarterly basis

Richard said that Transco's estimated cost of undertaking this survey is around £50-70K per annum.

7. Licence conditions – DISG feedback

Long term development statements

Sonia Brown asked the group to provide feedback on the DN and NTS licence conditions on the long term development statement.

Nick Wye asked whether the NTS should be obliged to provide other gas transporters with a copy of the statement (as required in the DN conditions). Sonia noted that the conditions require the DNs to prepare their statement and provide the NTS with a copy. The NTS then prepares a statement which includes the information received from the NTS; this statement would be publicly available.

Martin Kinoulty asked whether this statement would be of a similar size to the 10 year statement currently published. Sonia noted that at present Transco's 10 year statement primarily focuses on transmission issues, and the IDNs' portions would therefore be smaller. Sonia said that it is necessary that the information provided in the statement is at least as accurate and detailed as what is currently provided.

First line emergency response

Sonia stated that Neil Shaw had sent an email to the group setting out his position that IGTs need an emergency service that covers also repair and restoration and not exclusively the make safe part. However, she noted that this position is not particularly relevant to the condition discussed at this meeting which relates to the NTS emergency service provision. Sue Higgins said that Neil's view had been noted and had been correctly minuted in the previous DISG meeting.

Sonia said that Ofgem has taken into account all views emerging from the responses to the informal licence consultation document into account, and the way forward on IGTs will be set out in the document due to be issued on 25 November.

Sonia said that if there were any further comments, they should be sent to Ofgem and Transco (Sue Higgins). Tory Hunter asked when a draft copy of the agreement referred to in the DN condition would be available. Sonia replied that a draft copy would be circulated to DISG after the publication of the November licence document.

8. Licence issues list – DISG feedback

Transco confirmed that the licence issues list has been updated and would be updated again following the discussion. Therefore DISG will discuss this at a future meeting.

Action: DISG to provide feedback on the licence issues list

9. Interaction between NExAs and proposed flexibility arrangements – DISG feedback

Peter Bolitho recognised that NExAs do not confer rights or obligation, and therefore questioned their purpose. Sue Higgins explained that the use of NExAs avoids inserting technical and commercially sensitive matters in the Code. She noted that NExAs contain details that shippers do not need to know unless they are supplying, and in that case they would be aware of them through a supply contract. Sue explained that NExAs do not guarantee an entitlement for minimum standards, but simply set out the relevant parameters.

Peter Bolitho noted that initially shippers were doubtful as regards the introduction of NExAs. Peter Bingham replied that they are helpful in safeguarding the operation of the network. Peter Bolitho said that it may be worthwhile contractualising these agreements and transform them in a genuine requirement for minimum standards.

Sonia noted that the terms within NExAs will be incorporated within the UNC, and if NGT will not be able to deliver, it will have to buy back. Sue Higgins noted that while this previously was a commercial matter, now it is being commercialised and therefore will increase the transparency of the process. Sue noted that it is not clear that the current parameters (which were provided as a minimum on a voluntary basis) will be guaranteed going forward. Jason Mann noted that this is due to the fact that DNs have equal access as other connectees.

Rekha Patel asked what would happen to legacy contracts. Sonia Brown replied that it was her understanding from Transco that there are no legacy contracts in place anymore.

As regards flexibility arrangements, Sonia noted that there will be an incentive to trade off flexibility on their network with flexibility on the NTS. Nick Wye noted that he had great concerns on the pricing of the flexibility product.

Peter Bolitho expressed some concerns he had regarding flexibility:

- shared supply meter points
- measurement of flows (not at the premises): Peter noted that the actual gas flowing depends also on Transco pressure differential
- the allocation of flexibility at interconnectors and CSEPs.

- Flow control at points where it is managed by Transco on behalf of other operators (e.g. the Irish interconnector).

Sonia asked Transco to consider this list of issues and to get back to DISG.

Action: Transco to report back to DISG on issues related to flexibility product (DISG 27).

Nick Wye noted that it is important to know what the baseline pressures will be as soon as possible.

10. Any other business

Sonia said that Ofgem had asked Transco to prepare a security of supply report on DN sales. She noted that the document will be presented at DISG and comments from participants would be welcome. She said that the document will be prepared by NGT, presented by NGT at DISG and published on Ofgem website. She also noted that comments would be taken into account and the relevant material will be provided to the Authority to inform its decision on DN sales.

Peter Bingham clarified that it would not be a complete winter outlook document, but it would be focusing on the difference between the current and the proposed arrangements.

Sonia, asked by Mike Young, explained that the DTI consultation document would hopefully be issued by the end of the week, together with Ofgem's Final IA. Sonia noted that responses on the final IA will be summarised and a summary of responses will be provided to the Authority. Sonia said that Ofgem intends to check with respondents that their views have been portrayed correctly. Sonia also asked respondents to add one paragraph to their submission summarising their response.