

## DN Sales Development & Implementation Steering Group Minutes

### Meeting 38

22 March 2005, 10:00 am – 1:00 pm

Ofgem's office, 9 Millbank

#### Attendees

Sonia Brown	Ofgem (chair)	Julian Bagwell	Macquarie
Helen Connolly	Ofgem	Tory Hunter	SSE
Jason Mann	Ofgem	Charles Ruffell	RWE npower
Amit Pathare	Ofgem	Mike Young	Centrica BGT
Matteo Guarnerio	Ofgem	Richard Court	NGT
Matthew Young	Ofgem	Peter Bingham	NGT
Philippa Pickford	Ofgem	Mike Thorne	NGT
Suzanne Turner	Ofgem	Sam Parmar	Statoil
Peter Bingham	NGT	Sue Higgins	NGT
Stephen Parker	CKI		

#### Review of items from DISG meeting 37 (held 8 March 2005)

Sonia Brown asked if anyone had any comments in relation to DISG 37 that had been held on 8<sup>th</sup> March.

#### Review of minutes

Peter Bingham stated that one of the statements on page 2 in relation to voting scenarios under Option C of the panel composition had been wrongly attributed to Stephen Parker, whereas it had actually been Tim Davis. He also suggested that the phrase "the proposal would not be implemented" be replaced by "the proposal would not be recommended" in the same sentence.

Apart from this, there were no other comments.

#### Actions from previous meetings

In relation to the action on Ofgem to check the correctness of terms in Special Condition E6 that relate to the NTS, Sonia stated that it was being handled by the licence workstream. Since there were no further actions from the previous DISG, the next point on the agenda was Transco's presentation on the pricing consultation.

## Pricing Consultation (Transco)

Richard Court presented on pricing issues for the mature regime. Richard stated that he would start with an overview of pricing issues, and then explain the implications for NTS pricing by discussing possible options for the enduring pricing regime that would be ushered into effect in 2008. The main issue for Transco thus involved setting out the long-term capacity options to enable the establishment of reserve prices and promote efficiency without undue favour to parties. A print-out of the slides for this presentation was distributed at DISG.

Richard began by giving a brief overview of three pricing discussion papers:

- NTS Exit Flat Capacity Pricing
- NTS Exit TO and SO Commodity Charging
- NTS Exit Flexibility Charging

On “NTS Exit TO and SO Commodity Charging”, the kinds of questions covered, amongst others, were whether it would be possible to achieve an exact revenue recovery with a TO exit commodity charge as an exit revenue recovery mechanism, or about whether the NTS SO commodity charge should be levied symmetrically on NTS direct connects/DNOs or shippers.

On “NTS Exit Flexibility Charging”, key questions covered whether a commodity charge for flexibility was required, and how it was to be calculated.

Richard then moved to a discussion of the divergence between Long Run Marginal Costs (LRMC) and the administered prices. He explained that there had been several pricing consultations over the years, and that the last major one (PC76) had covered both entry capacity and exit charges. Richard added that this pricing consultation had noted a significant variation between administered prices and LRMCs.

Richard further noted that the LRMCs had moved away from universal charges, and that a ten-year forward looking model that tracked changing supply and demand patterns had identified a range of factors that would affect LRMCs.

In response to a question from Stephen Parker, Richard clarified UCAs as meaning “Unit Cost Allowances”. He then moved to discussing UCA calculation assumptions, illustrated the range of potential UCA/LRMC values in various LDZs, and compared them against existing exit prices, which were on an LDZ basis. The comparison showed potentially large changes for some LDZs, e.g. Wales and West.

Richard then outlined the key questions to be addressed in the pricing consultation. He stated that as the “cake was being recut”, it would possibly result in winners and losers, and hence it would be necessary to assess the impact on all parties. The questions therefore included:

- Should entry follow exit – should reserve prices be set to equal UCA?  
This measure would thus cover not just NTS charges, but also how shippers pass them on to customers.
- Is there a case for de-coupling reserve prices from UCA?

This opposing view was also discussed at previous pricing consultations. Options considered involve installing a constraint on any effective charge change, and introducing this de-coupling as a transitional measure to change in 2007 to align with an entry price update. Richard emphasised that Transco would like to get views on this issue.

- How much alignment is needed with entry auction pricing?  
The basic question here was whether to target a specific revenue split, e.g. 50% entry/ 50% exit.
- The other question was whether to use a 6mcm increment to calculate marginal costs.

Richard asked if there were any further questions that merited discussion in the pricing consultation. Nick Wye suggested that Transco could assess the impact of changing the increment on prices. Richard replied that he did not expect it to be significant, but would explore whether it could be included in the Discussion Paper.

Julian Bagwell asked whether the model enabled a long-term assessment of the balancing of supply and demand, given the expected changes in supply/demand patterns. Richard replied that the model calculated investment costs.

Richard then discussed further questions for the pricing consultation as relating to:

- Pricing of Daily NTS exit flat capacity & day-ahead interruptible NTS exit flat capacity – current proposed business rules suggest that unsold base-line capacity be sold as interruptible capacity
- Incremental pricing – whether it should be based on entry model
- Removal of interruptible transportation credits
- Removal of constrained LNG credits – whether it would be part of the commodity transaction for capacity

Richard then asked if there were any further questions from his presentation.

Charles Ruffell asked how one obtained the UCA from the LRMC. Richard replied that while a simple explanation would be difficult, the LRMC was in units of pence per kilowatt-hour (p/kwh), while the UCA was a revenue driver. The conversion to UCA thus involved moving from a volume based measure to a capacity based measure.

Tory Hunter had a question on how UCAs could be calculated without a constraining balance between entry and exit. Richard replied that the answer to this would be quite technical. He stated the approach involved first calculating the marginal costs on entry and exit of the expected capacity. If these marginal costs did not match, then they would be scaled to get 50% of revenues from locational signals. He added that Transco's analysis had been to let them run naturally, which would result in a 65:35 split between exit and entry respectively.

Tory replied that Transco had still not shown what the knock-on effect on entry costs would be. Richard agreed, and stated that Transco could include a question in the Discussion Paper on how to update entry.

Nick Wye stated that the Discussion Paper could discuss the outputs from these different options. Tory asked whether the status quo involved a 50:50 split between exit and

entry. Richard confirmed this, and Mike Young too stated that his understanding was similar.

Julian Bagwell revisited the issue of rebalancing supply and demand, and asked if it was expected to lead to an increase in prices. Richard replied that it would not. Mike Young stated that this would come back to the issue of price control. Richard added that while capacity charges were expected to rise, the commodity charges were expected to fall; so overall, price control was expected to be achieved.

Nick Wye asked if positive and negative charges would be discussed. Richard replied that they would.

No further questions were raised. Sonia Brown stated that if people had any further questions on this issue, Richard Court would be the point of contact at Transco. Richard affirmed this, and stated that he would be setting up a meeting on 8<sup>th</sup> April to take up issues and questions.

The discussion then moved to the presentation on interim incentives by Ofgem.

### **Interim Incentives – licence drafting (Ofgem)**

Jason Mann delivered the presentation on interim incentives. Jason started by highlighting the agenda for his presentation as providing an overview of interim NTS & DN incentive proposals published in the March document (for which responses are due on 8<sup>th</sup> April – to go into the formal section 23 consultation planned for May, and a run-through of licence modifications. He indicated that comments on these modifications would be discussed at a subsequent session.

Jason then presented an overview of current NTS incentives (defined up to 2006/07), and stated that the interim incentives proposed two significant changes from current incentives. Firstly, parameters would be set to 2008/09 (i.e. to cover the interim period, ending on 30 September 2008). Secondly, Ofgem proposed establishing a “buy back” mechanism, to cover the cost of any buy-backs the NTS may need to undertake as part of the interim offtake arrangements. Jason noted that Transco had indicated that the expected level of necessary buy-backs under the interim arrangements was zero (hence this was the “target” level adopted in the proposals).

Jason also described the options for buy-back parameters included in the Initial Proposals. In particular, he described that one option presented a deep collar, combined with a 50% sharing factor (and that this was consistent with the maximum annual level of buy-back Ofgem considered Transco may be required to undertake in the interim period).

Nick Wye asked why the “> 15 days” interruption target increases through 2007/08 and then decreases for 2008/09. Jason replied that he thought that this was consistent with the expected changes in the load pattern of interruption.

Jason then discussed the incentives in relation to CLNG, stating that they had not changed in form or scope, but had only been extended for two years from 2007 to 2009. He added that the incentive targets for these two years were lower than historical

targets, and were consistent with Transco's recent significant outperformance of their target in recent years.

Moving to the next slide, Jason explained that the incentives in respect of foregone charges and exit investment had also been extended by two years. This concluded the discussion of NTS incentives.

Jason then moved to DN incentives, which he described as being newly designed and based around the interim offtake arrangements. He added that these had been discussed several times at DISG. Jason outlined the objectives of the DN incentives and proceeded to describe the licence modifications required to support their introduction. The key objective is to ensure that DNs request an efficient level of incremental offtake rights each year (to mitigate the potential rational tendency for DNs to over-request offtake rights in the event that they bear no cost for doing so). He stated that the key part of licence drafting enabling the introduction of the incentives is a new formula defined for interim incentive payments (DNExCIR<sub>t</sub>).

Jason stated that DN incentive targets have three components; a target for flat capacity, a target for flexible capacity and a target for expected level of cost of interrupting connectees for greater than 15 days. He added on the following slide that performance measures would be based upon actual volumes allocated, and at actual (outturn) prices.

Charles Ruffell questioned on what basis target costs for > 15 day interruption had been allocated to the DNs, given that they had been taken out of the current price control. Jason replied that they had been allocated on a standard pro-rata basis, but would check on the exact methodology used and report back to DISG.

Suzanne Turner noted that the > 15 day interruption target that had previously been within Transco's GT licence had been a single aggregate target for all 8 DNs.

Tory Hunter noted that the disaggregated targets for the > 15 day incentive stated within the consultation document did not add up to the aggregate target that was previously within the licence. Jason replied that he would look into this and get back to DISG.

Nick Wye asked, in relation to the allocation of the > 15 day incentive target across DNs, if some networks would have more stretching incentive targets than others. Mike Young supported Nick's view, stating that if it were a straight read across different DNs, then that would result in the different levels of incentives for all networks. Jason stated that he would come back to DISG on the allocation method employed.

Peter Bingham added that the costs of > 15 day interruption were not significant. Suzanne Turner added that it was her recollection that, in the previous financial year, this number had been zero, while for the prior year, it had been in the region of £100,000, which would not be significant when considered across 8 networks.

Jason stated that the other point to note was that future review of interruptions at the DN level was scheduled for 2006.

**Action on Ofgem:** to respond to questions from Charles Ruffell, Nick Wye and Tory Hunter.

The next slide Jason presented outlined how targets would be determined for flat capacity and flexibility. Jason outlined that the proposed price to be used for both flat and flexible capacity was the same; outturn exit charges. Sonia Brown stated that this was in order to ensure that the reference price would not be discriminatory (i.e. designed to ensure that the price paid by DNs and direct connects for flexibility would be the same in the interim period). The next slide listed two changes – to the statement of interruption, and the determination of adjustment.

Jason then passed over to Suzanne Turner to list the additional changes proposed to the price control conditions as part of the May section 23 licence consultation.

Suzanne stated that there had been a few typos and minor clarifications planned to the price control licence drafting, which had been picked up as part of the review, and which she would flag. She noted that all revision marking was relative to the 14 February licence consultation drafting and that, whilst the majority of the changes would be proposed as part of the May section 23 consultation, a couple of the typos may be corrected as part of the section 8AA/section 23 direction scheduled for 25 April. Going through the list of proposed changes:

- Special Condition E2A – Suzanne noted that where new terms have been introduced as a result of the interim incentives licence drafting, new definitions had been introduced as appropriate
- Special Condition E2B (Page 22) – Suzanne noted that there were a number of instances in both the DN and NTS price control drafting where definitions of sigma terms were incorrectly phrased as there was an imbalance between definitions and what was being defined, and that whilst this was an issue with pre-existing licence drafting, Ofgem was proposing to correct this within the May section 23 licence consultation
- Special Condition E2B (Page 23) – Suzanne pointed out a number of typographical areas or formatting changes and particularly highlighted a proposed tidy up of the definition of DNK<sub>t</sub>. Suzanne explained that there was some superfluous text caveating the application of the formula for t= 1 that was not necessary given that a number had already been specified for t= 1 in 4(a)(i) (i.e. the year commencing 1 April 2004). Suzanne stated that Ofgem proposed to delete this superfluous text as part of the May section 23 licence consultation.

Suzanne stated that many of the other changes to Special Condition E2B related to the interim incentives that Jason had already mentioned.

- Special Condition E3 (page 47) – Suzanne stated that a previous reference to “Transco plc”, whilst appropriate within the IDN licences for the period between hive-down and share sale, would not be appropriate beyond share sale, and that, as such, it was Ofgem’s intention to change this to “the licensee” as part of the May section 23 consultation
- Special Condition E6 (page 60) – Suzanne noted that, in addition to the changes that had been outlined at the last DISG meeting to ensure consistency of approach of the existing licence reporting requirements, that this drafting had been further modified to reflect the proposed interim incentives drafting.

Sonia Brown stated that for NTS and DN incentives, Ofgem was looking for comments as soon as possible – she warned of the possible time/resource crunch in the last two

weeks of April. Suzanne also stated that the May section 23 was the “mop up” and therefore that the opportunity to correct further issues ex post would be limited.

Suzanne continued with proposed changes to the NTS licence conditions:

- Special Condition C8B (page 12) – small typo that will be picked up (t greater than 4 should say t greater than or equal to 4)
- Special Condition C8B (page 35) – Suzanne noted that the formula shown in revision marking had been reformatted and had not changed in content
- Special Condition C8B (page 44 & 54) – Suzanne noted that there were three cross-reference errors where references to Standard Special Condition A5 stated the title of Standard special Condition A4
- Special Condition C8B (page 97) – Suzanne noted that a modification to the definition of the term  $BBC_{d,t}$  was proposed to reflect payments made by the DNs to the NTS regarding buy back costs for embedded entry points
- Special Condition C8B (page 105) – Suzanne noted that minor change were proposed to introduce Isle of Grain and Milford Haven (she noted that these changes were not DN sales related, but given the change of status of the terminals that this change was thought appropriate)
- Special Condition C8B (page 108) – Suzanne noted a small modification to the definition of  $GC_t$  to reflect payments from the s to the NTS regarding CV shrinkage incurred by the NTS due to DN actions

### **Special Condition C15 (page 168)**

Suzanne explained that certain clarifications were proposed to the drafting of Special Condition C15. Suzanne explained that an exit equivalent of C15 was proposed to be introduced and it was Ofgem’s intention that, as far as possible, the wording of these two conditions should be consistent. Furthermore, in the process of developing this new condition, it had become apparent that certain clarifications to C15 would be helpful. Suzanne noted that these clarifications were in revision marking in particular noted that wording introduced to clarify the interaction between paragraphs 5, 6 and 7.

The equivalent condition for exit would be proposed as a new condition (Special Condition C18 (page 180)) which would mirror the text of revised C15, now dealing with “exit” instead of “entry”, with further modifications as follows:

- paragraph 2 will refer to a new date (1<sup>st</sup> June)
- number of earlier references to gas shippers will now also refer to DN operators
- paragraph 3 includes a provision for an ex-ante audit and this would be modified such that the that Authority could consent that such an ex ante audit should not apply to the interim arrangements
- paragraph 7b(ii) – introduces a requirement for an ex post audit such that an audit is still conducted for the interim arrangements, and that such a requirement could continue to apply for the enduring arrangements

Sonia asked the shippers to revert with comments in accordance with the time-table of the interim incentives document. She asked if there were any more questions or comments for Jason or Suzanne. As there were none, she declared a break, after which the meeting would continue with a discussion of responses to Transco’s UNC consultation.

## Overview of Stage 1 responses to UNC consultation (Transco)

After the break, Peter Bingham gave an overview of the Stage 1 responses to the UNC consultation conducted by Transco. Peter stated that Transco had had a good response (about 10 respondents had come back with their views), given the two week timescale. He added that they had received several comments that were extremely useful. Peter stated that it would be worth stepping through each document to give an overview.

Starting with the Agency Services Agreement (ASA), some respondents had sought clarity on how it would work. But the industry generally appeared to be comfortable that it includes all the relevant service lines.

On the Joint Office Governance Arrangement Agreement (JGAA), Transco had received numerous comments from shippers and buyers. Buyers recognised that the JGAA imposes obligations on each of them. There were therefore a few remarks on who picks up liabilities, etc.

Peter indicated that Transco was proposing to log each comment made, and expand on this template on every point raised, adding that where a change would be required to be made in the UNC, they would flag how that specific comment has led to the change. Referring to a specific comment made by a potential purchaser in connection with the JGAA, Peter stated that as this purchaser is planning to adopt a “sub-contracting” business model, it would have to be accommodated.

On the Interim capacity statement, Peter stated that there had been several comments on the detailed legal text, typos, etc, adding that general comments on the UNC itself were of that nature.

Peter further stated that shippers had shown the greatest amount of interest in making specific comments on mod rules, and that these comments involved a high level of technical details. He added that Tim Davis was working through all comments and editing rules accordingly.

Peter identified the big issue for respondents as being the move away from the 9:2 to 5:5 panel.

On the Offtake Arrangements document, Peter stated that most of the comments were received from potential purchasers, and that some key concerns were about agreements being NTS specific, e.g. maintenance. Peter affirmed that this would be addressed by coordinating the maintenance plan.

Sonia Brown emphasised that one this was a mid-point in the 5 week consultation period on the UNC. She reiterated that it was very important that people understand this point, and that further comments could be received by Transco at any point in the period. The other important point was that there were clearly some outstanding issues – e.g. signing arrangements for the short form code. She requested Transco to say a few words on how they intended to manage this process.

Sam Parmar had raised a concern regarding the signing arrangements for the short form code. Peter Bingham replied that Chris Train had in the first instance sent a letter to the

industry indicating that the arrangements for the short form code would need signing, and would subsequently write to all shippers individually. Peter explained that the purpose of the first letter was to identify the right people for the second tranche of individual letters, and that Denton Wilde Sapte would now write individually.

Stephen Parker asked what would happen in the event that signatures could not be provided, to which Peter replied that effectively there would be no transportation arrangements until then. Sue Higgins suggested that delegates with “powers of attorney” to sign these documents be identified as a back-up.

Mike Young raised the issue that in Centrica, the open letter had gone to the corporate centre, and not to the network code team, which had created problems, and emphasised Peter’s earlier point about finding the right person in each organisation. The other issue he sought clarification was on the understanding that while Centrica had effectively signed up to the NTS and RDN codes (by reason of having signed the old Network Code), they would have to sign up to the IDN short form code.

Stephen Parker asked Transco which third party agreements they were referring to. Sonia conjectured that it could possibly mean metering. Peter Bingham stated that the metering organisation was approaching suppliers, but added that he would get back with definite answers to this question. Sonia suggested that it would be helpful for NGT to put together a table on its website.

**Action on Transco:** Table to be published on website for shippers to obtain clarity on what they need to sign to, what they have to sign to, and what they may choose to sign to, and clarity on when they’ll be expected to sign.

Sonia asked if there were any other concerns on the UNC consultation. Stephen Parker had an issue on whether Transco would be actually able to incorporate these changes. Sonia replied that the five week consultation process was the equivalent of the Section 23 notices, and thus there would be a degree to which all responses would be incorporated. For example, while some changes would not be material, others would be important but perhaps not for day 1 – thus Transco would need to distinguish between these categories. Sonia noted that this would be the only consultation that gives opportunity for responses. Peter Bingham agreed, and welcomed responses.

As there were no further comments, Sonia asked Philippa to lead the discussion of the statements required to be submitted by Transco under the GT licence.

### **Statements required under the GT licence (Transco)**

#### **Business separation statement (SC C20)**

Philippa started this section of the meeting by outlining to members that there was an error on the agenda and that A33 would be discussed at the next DISG meeting. Philippa began with the discussion of the Business separation statement prepared pursuant to paragraph 2 of Special Condition C20, which Sue Higgins was to prepare and present to DISG.

Sue Higgins introduced this statement as one that set out within NGT separation between the NTS and the RDN licensee to ensure that licence requirements are met.

In a quick run-through of the document, Sue explained the items covered in the various sections.

**Action on Transco:** In respect of the organisational structure set out in Appendix 1, Transco has to publish this diagram on its website.

Philippa stated that Ofgem would appreciate feedback on this statement as there was no equivalent statement in electricity. She then moved the discussion to the statements that would need to be reproduced by Transco in respect of the NTS and the RDN licence, and which Mike Thorne would present.

Mike Thorne stated that while he was not a business expert on these statements, he would focus on giving an overview on the same. He added that Transco had spent a considerable amount of time and effort in preparing these statements, and that where these statements had been produced for the distribution business, Transco would clone them in respect of each licensee (5 versions). He further stated that prices would also be cloned, and left for buyers to change.

#### **Charging related statements (SSC A4, SSC A5 etc.)**

The charging related statements presented included the transmission charging statement, transportation charging methodology and distribution charging statement (that also incorporates methodology)

Steve Parker asked when the 4B Metering statement would be presented. Mike Thorne stated that this would be ready shortly.

Stephen Parker asked if the corresponding documents submitted by the purchasers would also require Ofgem approval. Philippa replied that if they were to be similar in form, then no re-approval would be needed, but if however their content were to change, then re-approval would be required. Philippa added that the licence also had provisions in certain areas for consent not to require re-approval, in which case the licensee, if it so desired, could apply to the Authority for its consent. Sue Higgins asked if this could be done on the back of the LRI identification and application exercise currently underway between Transco and Ofgem. Philippa confirmed that they could go into the required LRI register.

Sue further stated that if the IDN company number were to be put in the application that Transco file, then the consent/approval would get carried across with change in ownership, as it would relate to the company number which would stay the same. Philippa agreed that all that would be needed in this case would be to let the Authority know that the company names pertaining to the company numbers were being changed.

**Social obligations statements (SSC A20, SSC A22, SSC A23)  
Emergency services related statements (SSC A8)**

Mike Thorne stated that this requirement could be satisfied by providing a single document, which had already been signed off by energywatch about 3 weeks prior to DISG, thus leaving only Ofgem approval to be acquired. Mike added that this statement covered all the generic information that was required, and that Transco had been advised by several bodies on its language, formats, etc.

Mike stated that this document would be a generic one for both the NTS and the DNs (even though DNs did not have domestic customers).

Peter Bingham stated that the idea was for new owners to brand, format and publish this for their customers, as it would be confusing for this document to be issued by Blackwater and then by the new owners. Mike Thorne added that this was a transporter requirement.

Philippa asked if Transco had a letter from Energywatch confirming their approval of this approach. Mike Thorne replied that he would check, but in his understanding, the interaction with Energywatch was more on the lines of an informal dialogue.

**Action on Transco:** To confirm if they had secured formal approval of approach from Energywatch.

**System management related statements (SC C5, SSC D5)**

Mike Thorne stated that the NTS versions of the SMPS had already been submitted to Ofgem. He added that the DN version distributed at DISG 38 was being presented for the first time, and that it would be sent formally by the end of the week after Easter. He further stated that the DN SMPS would be slimmed down versions of the NTS SMPS, as a limited number of system management services would be bought by the DNs until exit reform. Mike stated that barring a few tweaks, they were almost ready, and hoped that Transco would not need to go through the normal 28 day consultation in respect of these statements.

Philippa replied that internal Ofgem colleagues might have a slightly different view on procurement guidelines.

Mike Thorne stated that the current version that Transco produces is solely for the NTS, and that there was an understanding between Transco and Ofgem that it would not cover the DN side, which meant that in its current form, it would address little of the new system management services that DNs would need in 2008.

**Allocation / attribution statement (SC C9, SC E3)**

Mike Thorne presented a copy of the current allocation/attribution statement, and added that since the new one would not be due until the end of June, it would not constitute an issue for hive-down.

Philippa asked for any comments to be forwarded to Mike Thorne.

**Any other issues**

Philippa added that other outstanding statements included the meter charging statements, the SSC A33 statement (describing practices, procedures and systems), and the condition 4B connection charging methodology and principles statements for each network. She stated that these could be tabled for the next DISG, but requested for them to be forwarded to Ofgem sooner rather than later.

As there was no further business, the DISG meeting was declared closed.