

DN Sales Development & Implementation Steering Group Minutes

Meeting 27

16 November 2004, 10:00 am – 12:00 pm

Ofgem's office, 9 Millbank

Attendees

Sonia Brown	Ofgem (chair)	Charles Ruffell	RWE Npower
Hannah Cook	Ofgem	Mike Young	BGT
Peter Bingham	Transco	Rob Cross	Statoil
Russell Cooper	Transco	Tory Hunter	SSE
Julian Bagwell	Macquarie	John Costa	EDF Energy
Martin Kinoulty	United Utilities	Nick Wye	Macquarie/WWA
Alex Wiseman	United Utilities/CKI		

Sonia Brown suggested that the reduced number of attendees at the meeting, it may be appropriate to postpone the presentation, due to be given regarding the Final IA, until DISG 27. The group agreed that this would be a sensible approach especially due to the limited time that they had to consider the document.

Sonia therefore asked whether there were any specific issues, not included on the agenda, that DISG members may wish to discuss. Charles Ruffell raised an issue regarding the legal drafting of the UNC. He set out that although at DISG 27 Mike Ashworth had given a commitment to providing legal drafting for the UNC on 29 November, at the UNC development forum it had seemed less likely that interested parties would be provided with legal drafting by this date. Mike Young clarified that Mike Ashworth had stated that he would provide class 1 changes on 29 November and the remaining changes on 6 December. Sonia responded that she would circulate the email that Mike had sent which would provide the group with confirmation of his commitment to provide the legal drafting on these dates.

Action: Ofgem to circulate Mike Ashworth's note on legal drafting.

Sonia asked the group whether there were any further DN sales issues that they would like to discuss in the available time. Nick Wye set out that he would like a bit more clarity regarding the issues that would be covered in future DISG meetings while Tory Hunter asked for some more detailed information regarding the interim arrangements that would be put in place. Rob Cross set out that in the Final IA Ofgem had stated that it had not included some costs associated with credit and asked for clarification regarding what these costs were. Sonia Brown responded that Ofgem had not included the costs of changing the credit arrangements which were unrelated to DN sales. She detailed that one shipper that had responded to the cost pro forma for the Final IA had included estimated costs associated with changing its credit management process from a ratings process to letters of credit. Sonia clarified that this amendment in credit processes was a result of a separate Ofgem decision unrelated to DN sales and had therefore not been included.

1. Review of items from DISG meeting 26

a. Review of minutes

Tory Hunter requested that a change be made in the minutes under Section 5. She detailed that toward the bottom of this paragraph she had been quoted as saying “Tory Hunter noted that it would be inappropriate for IDNs to have a higher level of credit requirement...” and noted that she had actually said that “it would be appropriate”.

Tory Hunter also requested a change to section 6. She clarified that she had made two points on the issue detailed and asked that the second point be reflected in the minutes. She detailed that she had also “asked for clarification on the IIP and whether the financial incentive had been revoked under this”.

Under Section 6, Julian Bagwell asked where the estimated cost (£50-70K) of carrying out a quality of supply survey had been derived from. Sonia responded that it was Transco’s estimate of the cost of undertaking this survey for its RDNs. However, she suggested that it would be helpful for Transco to clarify these numbers.

Action: Transco to provide clarification regarding the estimate of 50-70K in relation to the quality of supply survey.

b) Actions

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

- 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. Peter Bingham detailed that Sue Higgins had been asked to capture any comments provided and update the list for today.

Action: Transco to update the issues the licence drafting issues list by DISG 28.

- Transco to update the DN sales roadmap to reflect the interim arrangements and the timing of the first auctions. Peter Bingham stated that, to his recollection, this action had been to keep the pre hive-down programme consistent with the overall roadmap and update any information to the extent that any changes are required. In this respect, he considered that it was simply an ongoing action. Sonia Brown responded that some DISG members had requested clarity on issues regarding the sequencing of processes at the end of the roadmap and that Transco had been given an action to do this and bring the updated roadmap back to DISG. John Costa asked whether this action would require Transco to extend the roadmap until after hive-down. Sonia Brown responded that the action would require Transco to include details of the decisions that the Authority would be requested to take, by NGT, between January and hive-down and the sequencing of these decisions. She set out that the interaction of these decisions with the conditions of consent would also need to be included. She detailed that, in addition, some DISG members had requested Transco to provide a version of the roadmap which was contained on one page.

Julian Bagwell asked for some clarification on whether the Authority would reserve some ability to approve the final stage of the DN sales process which will take place between hive-down and completion. Sonia responded that there were a number of

issues surrounding this and that one in particular was in relation to incentive schemes and the timing of their implementation. She explained that if Ofgem were not able to consult, in December, on proposals regarding the incentive schemes this may mean that it would not be possible to include related proposals within the Section 8AA formal consultation. She set out that, as such, this may mean that further Section 23 drafting may be required during the period between hive-down and completion. She explained that this may equally be the case if any issues are identified in relation to the Section 8AA formal consultation. In addition, she clarified that a number of other issues could arise.

Julian Bagwell asked whether, if all these issues were resolved, there would not be a need for the Authority to make a decision regarding DN sales following hive-down. Sonia responded that this was Ofgem's current understanding but that the possibility remained that any risk could potentially become a reality.

John Costa asked what the outstanding issues were with respect to incentive schemes. Sonia replied that the incentive schemes would need to be in place for day 1. She detailed that these would relate to the offtake arrangements and that they would be intended to place appropriate incentives on the NTS to release an efficient level of capacity and on the DNs to book this capacity efficiently. She set out that Ofgem would be introducing a one year incentive scheme with the option to roll it over if desired.

Nick Wye pointed out that there would be two arrangements in place with respect to incentive schemes during this period. Sonia agreed.

Action: Transco to keep road map under review – ongoing.

Action: Ofgem to keep DISG informed of any conditions of consent (to be presented at DISG 30).

- Transco to prepare a revised version of the slide on UNC NTS/DN operator arrangements and present it to DISG and the exit development forum. Peter Bingham set out that a new version of the slide was presented at the previous meeting of the exit reform development forum. He detailed that it had since been updated and would be shared with DISG for comments. He clarified that the operator arrangements would include technical provisions while the commercial arrangements would be included within the UNC. Sonia stated that Ofgem were still not happy with the slide that had been presented and set out that even where arrangements are classed as "technical" Ofgem would want these to be referenced in the UNC. She considered that further work would need to be done regarding this issue. Russell Cooper suggested that it might be helpful for Transco to include a couple of explanatory sentences under the headings on the slide to clarify the division of roles. Sonia considered that it might be appropriate for Transco to draft a paper regarding these issues and that it may be helpful to discuss this paper with Ofgem prior to its presentation at DISG. She also stated that once this had been presented to the DISG and members had achieved some further clarity regarding the supporting principles, the paper should also be circulated to the exit reform development forum.

Action: Transco to present a paper regarding UNC NTS/DN operator arrangements to DISG 28.

Tory Hunter asked how the knock-on effects of the decisions reached by the exit reform development forum would be dealt with as these effects were not scheduled within the workplan for the UNC development forum. Peter Bingham responded that the substantive changes to the UNC would be dealt with through the UNC development forum and that this group would pick up any knock-on implications. Mike Young asked whether Section B and I would be dealt with through the exit reform development forum. He set out that this forum would still be responsible for dealing with any knock-on effects, to other sections of the UNC, from the decisions taken by the exit reform development forum. Peter Bingham replied that Transco were currently in the process of going through the UNC and looking at where changes would be required to accommodate the decisions made in relation to exit reform. Mike Young stated that a number of issues had been 'parked' by the UNC development forum in anticipation of the necessary amendments that would be required to reflect the revised arrangements for exit and set out that the number of issues to be addressed, in this respect, would be substantial.

Sonia asked how Transco intended to deal with issues regarding bilateral agreements. Peter Bingham responded that this would be addressed through the exit reform development forum and that it was one of the areas that had been discussed at the previous meeting. Rob Cross asked for clarification as to the form that the bilateral agreements would take. Russell Cooper explained that it would include one page of site specific detail but that the majority of the document would be generic.

- Transco to prepare a note setting out the proposed process for UNC drafting. Sonia set out that Mike Ashworth had stated that he would provide a note to Ofgem setting out his commitment to providing the relevant UNC legal drafting by 29 November. She detailed that Mike had done this and that she would circulate the note to DISG members.
- Ofgem to consider possible perverse incentives emerging from a one-by-one approach on credit termination. Sonia detailed that Ofgem were still considering this.
- Transco to confirm whether the survey on quality of supply is currently conducted on a quarterly basis. Peter Bingham confirmed that it was.
- DISG to provide feedback on licence issues list. Sonia stated that this was an ongoing action.
- Transco to report back to DISG 27 on issues related to flexibility product. Sonia set out that Russell Cooper would be presenting on this today.

2. Flexibility product

Russell Cooper detailed that his presentation would look at the implications of offering a bundled product, the Agent Arrangements that would be put in place and the flow flexibility that would be offered at remote points (sites connected to the pipeline that are not owned by the NTS).

He detailed that, at present, direct connects have greater freedom with respect to flexibility than DNs due to:

- internal management control of NTS/DN offtakes; and
- the availability of a bundled product for direct connects.

Russell also set out that notice periods currently apply at all NTS offtakes and that under the current arrangements costs are internalised within Transco.

Russell set out that it would be difficult to highlight actual flexibility costs as these are currently internal to Transco. He presented a slide which illustrated the level of day on day changes for direct connects for the period from October 2003 to March 2004. He highlighted that aggregate demand changes quite substantially from day to day and was subject to high levels of volatility of between +/- 12 MCM. He stated that people within Transco are currently looking at these variations in flow rates.

Russell presented a second slide which illustrated the level of day on day changes for DN's between October 2003 and March 2004. He explained that carrying out the same exercise for DN's had highlighted a range of between +50/-60 MCM as domestic demand drives greater volatility. He set out that this level of volatility would be hard to manage but stated that this would be exacerbated if DN's were allowed greater freedom within day.

Russell explained that Transco were undertaking further analysis looking at within day variations. Once this analysis is complete Transco will be happy to share this with Ofgem and the DISG. However, Russell explained that even the day on day variations had important cost implications. Russell detailed that a key consequence of enabling greater variations for within day fluctuations to support DN demand would be that this would add to NTS SO uncertainties. He set out that this could potentially lead to:

- increasing demand management costs due to greater swings in pressures and linepack availability;
- greater stock and compressor operating costs due to the need to address uncertainties; and
- the need for a larger pipeline system.

Overall, these could all lead to additional costs for customers.

John Costa asked for clarification regarding the issues that exist in relation to the provision of increased flexibility. Russell responded that, at present, Transco exerts more control over DN's than direct connects with respect to flexibility. He explained that if Transco were to ensure no undue discrimination between DN's and direct connects in relation to flow flexibility, it would have two options. Under the first, DN's would need to have a similar amount of freedom as direct connects while under the second, direct connects would need to be managed in a similar way to DN's i.e. more restrictively. Sonia set out that the Ofgem had asked Russell to give this presentation to DISG as shippers favour the concept of a bundled product and Ofgem wanted Transco to explore the costs of providing a product of this nature. She stated that the presentation had clearly illustrated that costs associated with the provision of a bundled product would be higher as these costs are currently internalised within Transco.

John Costa set out that he was under the impression that both DN's and direct connects currently receive a bundled product. Russell Cooper responded that Transco currently restrict diurnal flexibility on the DN's. Jon Costa considered that Transco had previously stated that it would allow DN's more flexibility if they required it. Sonia responded that it was her understanding from Transco that, as far as load growth is concerned, Transco currently allocate flexibility to DN's and then other parties on a first-come-first-served basis. She detailed that, on any day, Transco will meet the needs of other users first and then deal with the needs of the DN's. She set out that if, between the DN's, one requires an increase in flexibility and the others have flexibility available then Transco has the facility to allow the flexibility to be used by the DN that requires it. Russell confirmed that this was the case.

John Costa acknowledged that the provision of a bundled product would be less acceptable following a potential DN sale due to the associated costs but set out that he did not accept that DNs do not currently receive a bundled product from the NTS. Sonia explained that essentially the exchange of flexibility between the DNs at present could be viewed as a type of internal buy back. She detailed that as it is internal to Transco it is not costed or transparent and that this type of arrangement would therefore not be possible following a potential DN sale.

Julian Bagwell considered that at DN level demand is essentially exogenous. He therefore stated a concern that DNs would require flexibility within day and highlighted that this could raise a pricing issue in relation to the within day flexibility product. Russell Cooper set out that the first step to dealing with an issue of this nature would be to create a distinct flexibility product with the availability reflected in the price.

John Costa clarified that he had been looking at this issue from a no-sale point of view while DISG had been looking at it from a DN sale point of view. Sonia replied that in terms of the Final IA Ofgem had created a post-sales world which it had compared with the current baseline. She detailed that the current baseline may not be the most efficient way of allocating flexibility and that therefore, following a potential DN sale, additional efficiencies may be achieved.

John Costa considered that the current arrangements may be the best way of dealing with flexibility. Sonia responded that at present, with respect to the allocation of flexibility, Transco makes a decision regarding the party that would value the flexibility the most and allocates the available flexibility to that party. She stated, however, that Transco may not actually have the best foresight in this respect. She therefore detailed that, in a sales scenario, it may be more appropriate to price flexibility in such a way as to enable the NTS to reach efficient decisions in this regard. Russell Cooper also stated that there was nothing to determine that the way that Transco currently allocates flexibility would be the most efficient way going forward. He explained that setting a price for the flexibility would allow Transco to allocate it without discriminating between any particular party and set out that if there were limited availability then the costs should be reflective of this.

Russell Cooper detailed that an allocation agent would be recommended at locations where more than one user is able to obtain the flow flexibility product. He stated that this would include locations where there is a Shared Supply Meter Point (SSMP), storage or interconnectors. He set out that the purpose of the agent would be to apportion flows at both the end of the day and at 22:00 hours. He explained that default arrangements would be proposed where this were not the case (in accordance with prevailing nominations).

Rob Cross asked whether flexibility would need to be bought at an aggregate level of flow for users of SSMP. Russell responded that these users would need to buy the correct shape but that they would likely be unsure of what this shape would be. Mike Young asked for clarification regarding what the role of the agent would be. Russell responded that the agent would be responsible for the purchase of flexibility in line with contractual arrangements put in place. Julian Bagwell asked whether the agent would hold the title to the flexibility product and whether, in this respect, the user would simply have a related contract with the agent. Russell confirmed that this would be the case.

Russell detailed some of the other arrangements which would be put in place and these included:

- no cost at pressure controlled offtakes. Where the NTS SO causes flow flexibility to be used it would absorb the cost;
- where NTS SO is the operator. Revised contractual terms would be required to pass on costs to parties that take flexibility; and
- proposal to net off inputs and outputs at storage sites, limiting occurrences when flow flexibility would be required.

Russell explained the current problem associated with flow flexibility offered at remote points (sites on the NTS pipeline that are not owned by the NTS). He detailed that the ideal location for the meter would be at the NTS boundary as this would enable flexibility to be taken by each party from within its own pipeline. He detailed that this is not always the case and that in some locations, in which the meter is not on the NTS boundary, the pressure and flow is not controlled making measurement of flow difficult. He therefore stated that measurement in this case would be calculated taking into account connecting pipelines and that as there are many sizes and pressure effects it would be appropriate to tailor solutions for each case. He set out that in any event this measurement issue would need to be resolved before 2008.

John Costa asked whether Transco would have access to meters at remote points. Russell responded that Transco would only have access to its own meters on the NTS. John Costa asked how Transco overcomes problems associated with metering at shared connections. Russell replied that although Transco still only measures on its own pipeline, in these cases, there are two distinct flows and this allows the flow to be measured.

Russell detailed that NGT was concerned that new operating strategies could lead to an increase in the use of flow flexibility with a consequential increase in costs for operation of the NTS. He set out that NGT have proposed the use of an allocation agent wherever more than one user could be offtaking gas from the NTS. In relation to remote meters, Russell stated that NGT's initial proposal was that the placing of meters was the primary concern of users and that it would welcome views on whether, and if so how, flow flexibility business rules should provide offsetting treatment for meters that are not located on the NTS boundary.

Tory Hunter asked whether Transco would be giving this presentation to the exit reform development forum and Russell confirmed that he would work the details into his presentation.

3. Interim Arrangements

Russell Cooper explained that during the transitional period direct connects would not see any change in the process other than the application process to become firm. He detailed that at present customers are subject to lead times for connection and that although at the beginning of the transition period the presumption will be that direct connects can re-categorise as firm subject to economics and safety, Transco would be endeavouring to reach a position of unconstrained allocation. He set out that re-categorisation may be considered to be uneconomic if the revenue received from the connection is less than the costs that the NTS would be subject to. He stated that the NTS should be incentivised to connect through the growth features in incentives over

the short-term and that if the NTS chooses not to connect a party it would have to have a good reason for not doing this.

Russell explained that in relation to DNs Transco is currently investigating the merits of two possible options. These options are:

- DNs book capacity to May 2005; or
- DN shippers book capacity and receive the appropriate capacity from the network.

In relation to the first option, Russell set out that the DNs ability to obtain capacity is the same as that of the direct connects. He detailed however, that Transco has a concern that the option may impact on systems.

Russell explained that, under the second option, booking of capacity would remain with the shippers but detailed that there was a problem with this option in that it may be difficult for shippers to ascertain the level of offtake capacity that DNs would require. He stated that it would be necessary for shippers to assume a baseline requirement to allocate at each offtake and develop a procedure for DNs to apply for additional capacity.

Tory Hunter asked, under the option 2 approach, how the NTS would price capacity. Russell set out that DNs would register capacity for a 12 month period and that the NTS would need to create a pricing methodology to pass these costs to DN shippers. He stated that a question remained as to whether the billing process would be initiated with a new invoice or an NTS invoice, although he clarified that in either case a new supporting invoice would also be required.

Nick Wye asked for clarification that there would be no change, under either option, for NTS direct connects. Russell responded that there would be a change in the process for users requesting additional capacity. Sonia set out that although the options were designed with the intention of implementing minimal change, it would also be necessary to ensure that Transco would not discriminate between users. Nick Wye asked why Transco were looking into the possibility of implementing an option which would require shippers to book DN capacity. Russell explained that Transco were simply looking at all of the options. Sonia also stated that Transco would need to satisfy interested parties that it had looked into all of the available options. Sonia detailed that, from the perspective of a direct connect, very little would change during the interim period but that for DNs the interface and incentive issue would need to be resolved.

4. Future DISG agendas

Sonia set out that she would envisage future DISG meetings to focus primarily on licence conditions. She detailed that Ofgem would also be bringing proposals in relation to incentives to DISG, as well as discussing possible approaches with potential DN purchasers.

John Costa asked, in terms of capacity being built now, how this would be captured within the baseline. Sonia responded that this was a key issue that Ofgem were looking into. She explained that Ofgem were looking at the definition of the baseline and trying to resolve the associated issues. She stated that once this was complete, the proposals would be brought to DISG with the proposals regarding incentives.

Sonia set out that Ofgem would give its presentation regarding the Final IA at DISG 28. She explained that participants had been given an extra week to go through the document itself in order to allow an informed discussion to take place at the next DISG. She suggested that it would be helpful if DISG members could look through the presentation on the Final IA and identify any areas that they would like clarification on so that responses to these enquiries could be included within the presentation for DISG.

Sonia detailed that Ofgem would be issuing the licence document by the end of the week. She clarified that it was a big document and that it was composed of two main parts:

- A formal Section 23 notice which intended to break-up the price controls into an NTs price control, an RDN price control and four IDN price controls, to be reflected within each of the licences. She clarified that this would form a 28 day consultation;
- The remainder of the document would be looking at the substantial modifications necessary at the Section 8AA consultation. She detailed that this would be substantial in view of the fact that nearly every condition in the licence would be changing.

Sonia stated that where issues remain in relation to the Section 8AA consultation, Ofgem will consult on these through DISG. She outlined that if the timing for the Section 8AA informal drafting were to become too tight Ofgem intended to split the document and publish the Section 23 notice this week and the Section 8AA drafting the following week. She clarified, however, that the intention was to publish both parts together. Sonia highlighted that interested parties would have slightly longer to comment on the Section 8AA drafting but that NGT and buyers would still be required to respond within 28 days.

Sonia therefore detailed that incentives and restructuring of the licence would be the two big topics that would be discussed at future DISG meetings. She set out that the majority of the meetings would focus upon the licence and attempts to refine the proposals and related drafting for the Section 8AA consultation. She explained that Helen Connelly had been appointed as the new project manager responsible for managing the restructuring of the licence. Sonia stated that Helen was in the process of developing a project plan in this regard in relation to the issues and that this plan would be broken up and brought to DISG meetings according to themes within the licence to allow the relevant parties to attend the meetings that are relevant to them.

Sonia outlined that Ofgem would need to reach a point where it was no longer considering new policy issues following the consultation on the Final IA. She set out that once this position had been reached it would be possible to solely consider the changes necessary to be made to the licence. Sonia also clarified that Ofgem would want to go through the responses received in relation to the Final IA on a bilateral basis.