

Commercial Interface Working Group Minutes Meeting 13

28 July 2004, 10:00 am – 2:00 pm
Ofgem's office, 9 Millbank

Attendees

Christiane Skyes	E.ON UK	Mark Sutton	NGT
Adam Whitmore	Deloitte	Beverley Grubb	SSE
Mark Feather	Ofgem (chair)	Russell Cooper	NGT
Jason Mann	PA Consulting	Michael Young	British Gas Trading
Jess Hunt	Ofgem	Liz Pennington	Ofgem
Sam Parmar	Statoil	Sharif Islam	Total Gas & Power

1. Review of items from previous CIWG meeting (held 14 July 2004)

a) Minutes

Mark Sutton requested some changes to the sections on gas quality, calorific values, & connection facilities & measurement. Jess Hunt noted that Julie Cox has requested by email that the minutes record the action on Transco provide to provide further information on the circumstances in which the NTS is able to override control of DN's pressure flow management equipment. Adam Whitmore noted that Jimmy Smith's comment should be recorded as 'DNs have better information than shippers' rather than 'DNs have better information than the market'. Ofgem agreed to make the changes.

ACTION: Transco provide to provide further information on the circumstances in which the NTS is able to override DN control of offtake points at CIWG 14.

b) Actions

The following actions arose at the previous meeting:

- ◆ *Comments on Transco's technical papers presented at previous CIWG to be submitted by 21 July.* Transco has received comments from Statoil (and earlier comments from SSE and British Gas Trading).
- ◆ *Ofgem to consider whether the current gas quality arrangements require further revision as a result of DN sales.* Ofgem's DN sales team is liaising with the Ofgem markets directorate on this issue.
- ◆ *Transco to report to CIWG 13 on:*
 - *the proportion of NTS/DN offtakes that have (a) chromatographs and (b) tracker sites*
 - *the arrangements for measuring density at each offtake;*
 - *the arrangements relating to wet CV gas.*

Transco's paper was due to be discussed later in the meeting.

- ◆ *Transco to report to the CIWG 13 on the arrangements to ensure that the measuring equipment at NTS/DN offtakes do not over-read. Transco's paper was due to be discussed later in the meeting.*

Jess Hunt noted that Transco had an action from the DISG to respond to the issues raised by Nick Wye regarding the proposed shrinkage provider arrangements.

ACTION: Transco to address shrinkage issues at CIWG 14.

ACTION: Transco to respond to comments on various technical papers for CIWG 14.

2. Update from the Development & Implementation Steering Committee

Mark Feather said that at the previous DISG:

- ◆ Ofgem explained its open letter on the indicative timetable which covers also covers the process by which DNs will receive licences.
- ◆ Transco presented a paper on the UNC modification rules. The key outcome of discussion was that the chair should have a casting vote on most decisions, except where the vote relates to an Authority recommendation (in which case there is no casting vote and the recommendation may be split). Another outcome of discussion was that GTs should complete sections in each modification report relating to the impact of the proposal on security of supply, system operations (including electricity interactions), and industry fragmentation.
- ◆ Transco presented a paper on the escalation process that shippers would be able to utilise if they are dissatisfied with the performance of the agency. DISG members were generally comfortable with the proposal.
- ◆ The ongoing discussion of agency governance arrangements came to a landing that there would be an independent director on the agency board, and parties would be able to agree a series of special issues for which a special majority of Transco plus two other votes is required. Transco was asked to stress test this outcome to different sale scenarios.
- ◆ The DISG heard the outcome of the SOMSA discussion from the CIWG. DISG members were generally comfortable with the proposal.
- ◆ Ofgem presented its position on the allocation of pensions liabilities.

3. Transco paper on information flows

Mark Sutton provided an overview of Transco's paper on information flows, and suggested that until the business rules are nailed down, the information should be regarded as work in process.

Mark Feather suggested that the group should consider paper and provide comments going forward. Mark said the important points from Ofgem's point of view were that:

- ◆ information that is currently provided to shippers continues to be provided going forward; and
- ◆ RDNs do not receive discriminatory access to commercially sensitive information ahead of IDNs.

Jess Hunt noted that although the business rules were not finalised, Transco's paper was useful because it could help to identify issues that could potentially give rise to problems if not addressed.

ACTION: CIWG members to provide feedback on any aspect of the information flows that they consider potentially problematic.

4. Transco presentation on the definition of the firm product

Russell Cooper gave a presentation on the definition of the firm product. He said that the presentation builds on Transco's response to the Offtake Arrangements RIA, which suggests that Transco could potentially develop a workable model for capacity allocation. Russell said that Transco prefers Option 2B (in terms of the Offtake Arrangements RIA) to a shipper booking model because it is consistent with their 1 in 20 obligation.

Russell put forward Transco's proposal in which DNs (and potentially NTS direct connects) would book NTS exit capacity. Capacity would be made available on an unconstrained basis in the long term, and a constrained basis within the 3 year investment planning horizon.

Profiling of capacity bookings

Mike Young asked whether capacity bookings would be made on a flat annual basis or if monthly profiles were permitted. Russell Cooper said that under Transco's model, it would be possible to book a profile within a given year.

Jason Mann noted that from a network operator's perspective, it is more cost reflective to sell capacity in annual blocks because the system is designed to meet peak demand. Russell Cooper said that a flat line booking is more simple from a network operator's perspective, however, it does not provide information about when high demand conditions are likely to occur. He suggested that monthly profiles would help network operators to determine how best to size the system.

Mark Feather noted that if network operators sold capacity in annual blocks they would still receive information if shippers were to unbundle and trade their monthly blocks of capacity.

Adam Whitmore considered that there was a critical question regarding the extent to which investment signals are provided by the interruptions regime and the extent to which investment signals are provided by capacity trading. He questioned whether capacity trading was likely to be effective given that there is limited substitutability between exit capacity at different locations on the network. Adam said that he saw the schedule of prices for interruption as a proxy for exchange rates between exit capacity zones.

Mark Feather said that if, in the future, constraints develop on the network, then shippers might want to trade capacity. Beverley Grubb expressed concern that if shippers are not aware of the dynamics of the network, then their capacity trading activities could create difficulties for network operators.

Mark Feather indicated that it was very important that the network operator released sufficient information to the market regarding the nature of its network (including areas where there are constraints and physical capacity may be limited) so that shippers could efficiently value capacity.

Ability of NTS direct connects to forecast capacity requirements

The group discussed the extent to which NTS direct connects would be able to forecast their capacity requirements in advance. Adam Whitmore said that power stations might know their maximum demand, however, they will not know in advance whether or not they will be despatching in a given month because this decision will depend on the electricity spot price. Jason Mann noted that the network operator certainly wouldn't know in advance whether the power station would be despatching.

Mark Feather commented that some market participants, including generators, may, depending on their risk profile, elect to purchase capacity well in advance to hedge against the possibility of price rises as a result of physical constraints. Mark said that a generators strategy may also take into account short and long term electricity market factors.

Russell Cooper said that power stations could rely on short term capacity release if they were uncertain. He said that the long term booking mechanism is simply intended to provide a supplemental source of information for network planning processes. Adam Whitmore said it was necessary for network operators to strike a balance between information generated through the interruptions process and information generated through other processes.

Daily interruptible product

Russell questioned whether it was necessary for network operators to make available a daily interruptible capacity product if there was also a daily release of the firm product. Mike Young said that the interruptible product could be useful because the network operator is likely to be considerably more conservative when providing the firm product as it may have to buy the product back in the event of a constraint.

Zones

Russell Cooper noted that when the network operator releases constrained exit capacity, it is necessary to develop zones, within which the network operator sells capacity at a uniform price. Russell Cooper said that Transco's engineers were currently working to define a set of exit zones by examining the level of substitutability between capacity on various points on the network.

Jason Mann noted that there is trade off between complexity and investment signals when setting the zones. As the size of the zones declines, the accuracy of the investment signal increases, however the complexity of the regime increases. Mark Feather noted that larger zones may have an advantage insofar as they promote secondary trading of capacity and reduce the complexity of the regime.

Mike Young questioned the point of having a constrained product if it was necessary to simplify the regime so much that the investment signals are lost. He suggested that the appropriate definition of the zones would vary depending on the way in which the

system is configured, and that there could also be seasonal differences associated with having different levels of stress on the system.

Adam Whitmore cautioned against overdrawing the analogy with the entry regime. He said that at any given exit point, it was likely that there would only be one potential purchaser of exit capacity. He said that the potential for market driven investment signals to arise at exit was an order of magnitude lower than at entry.

Russell Cooper said that he had some sympathy with this view. He thought that in most cases it was likely that only the baseline capacity would be bought at the reserve price. Russell suggested that the rationing mechanism would be a good sense check when setting reserve prices, however, it was not likely to be required very often.

Mark Feather said that the issue comes back to the zones by which capacity is allocated. Given that the network is not constrained at present, he questioned the necessity of having small zones as there would be more likely to be larger areas in which capacity is substitutable. Russell said that if zones were too large, network operators would not know where to deliver the gas.

Generating market based investment signals

Adam Whitmore said that because exit capacity is highly specific to a particular location, he was cautious about relying on supply and demand to set prices. He suggested that the NTS exit capacity should be set on a cost-reflective basis and subject to regulatory oversight. He considered that investment signals could be generated through the interruptions regime.

Beverley Grubb said that if DNs were making long term exit capacity bookings, they would also want to be able to value long term interruption at the same time. Otherwise, the network operator would not be able to make efficient investment decisions.

Adam Whitmore said that bookings at the majority of NTS exit points would be dominated by DNs, whose decisions would be driven by their 1 in 20 obligation. He suggested that there would be limited opportunities for DNs to participate in buy back tenders because they are driven by peak demand. Consequently, he considered that whilst it might be possible to influence capacity bookings through the buy back price, this influence would be limited.

Russell Cooper said that in reality, NTS capacity was likely to be sold at the administered reserve price in most cases, which means that it would be important to ensure that reserve prices are set judiciously.

Secondary trading

Russell Cooper explained that under Transco's proposal the NTS would sell capacity at a fixed price within a given zone, and that capacity within a given zone could be traded. In addition, it would be possible for capacity to be traded between zones using an exchange rate mechanism. He noted that the differences in primary capacity prices between zones could help to determine the exchange rates.

Adam Whitmore noted that exchange rates could create opportunities for arbitrage between zones, which could potentially generate confusing price signals for network

operators. Russell Cooper said that it was important that the network operator knows where to deliver to, and consequently a gate closure concept might be required for secondary trading.

DN exit capacity booking

Russell noted that under Transco's proposal, capacity booking on the DNs would effectively remain unchanged. Beverley Grubb asked whether long term interruptions contracts would be available on the DNs. Russell Cooper said that Transco did not propose to introduce long term rights on the DNs because of the major systems changes that would be required.

5. Transco paper on DN-DN inter-operator relationships

Mark Sutton summarised the Transco paper on DN-DN inter-operator relationships.

Jason Mann noted that since Transco did not propose to charge for flows through DN-DN offtakes, DNs could potentially use DN-DN offtakes to avoid NTS exit capacity charges. The group considered whether the flows were sufficient to have a significant commercial impact if a DN chose to exercise their maximum entitlements to flow gas through DN-DN offtakes. Mark Sutton noted that under Transco's proposals there would be an agreement that defines the circumstances in which DN-DN offtakes may be used.

ACTION: CIWG members to raise any further issues regarding DN-DN offtakes with Transco.

Mark Feather said that if no new issues were raised, Ofgem would seek to wind up the discussion of DN-DN offtakes at the next meeting.

6. Transco paper on offtake code measurement and CV issues

Mark Sutton summarised the Transco paper on offtake code measurement and CV issues, which responds to questions raised at CIWG 12.

Prevalence of tracker sites

Mark told the group that there were 93 sites that were fitted with chromatographs (including 6 NTS sites) and 34 trackers sites (all of which were located on the DNs). Mark explained that in order to estimate density in the absence of a chromatograph, a tracker measures relative density, and then a CV that has been measured elsewhere is applied. Mark noted that a change to the assumptions made about level of CO₂ in gas had caused the adjustment that affected shippers last year.

Mike Young suggested that it may be appropriate to undertake an Invoice Quality Review in order establish a line in the sand in the event that future adjustments are required post DN-sales. He noted that the previous Invoice Quality Review occurred in 1998.

Mark Sutton expressed the view that to the extent that adjustments are already dealt within the network code, no requirement for change is created as a result of DN sales. He acknowledged that there could potentially be a fragmentation issue, however, this

would require a change to the UNC (or potentially the Offtake Code) and the modifications process would apply.

Mark Feather asked Centrica to prepare a paper for CIWG 14 that explains why Centrica considers that an Invoice Quality Review is desirable in the context of DN sales.

ACTION: Centrica to provide paper to CIWG 14 regarding the need for an Invoice Quality Review.

Safeguards to prevent over-reading

Mark Sutton said that Ofgem has vires over metering standards and there is an annual independent audit of meters. He noted that last year's density adjustment arose as a result of this audit. Mike Young said that a sample of 15-20% of meters is physically checked each year, and that historically the tendency has been for errors to be under-reads not over-reads. He noted that more rigorous monitoring of flows had been adopted as a result of the density adjustment.

7. Review of CIWG issues log

The group reviewed the issues log and suggested some minor amendments, which Ofgem agreed to make. Transco agreed to provide further information on its arrangements for non-statutory gas quality parameters (Issue 31A) at CIWG 14.

ACTION: Transco to prepare paper for CIWG 14 on non-statutory gas quality parameters.

Other business

In response to a question from the group, Ofgem confirmed its intention to release decision documents on the Offtake and Interruptions RIAs. Mark Feather said that the decision documents were likely to be released on the Interruptions and Offtake arrangements in the second week of August.

Next meeting

The next meeting will be held at Ofgem's offices on Wednesday 11 August.