

## Enduring Offtake Arrangements Working Group

### Meeting 6

8 March 2006, 10:00 - 13:00

Ofgem's office, 9 Millbank

#### Attendees:

David Howdon	Ofgem	Shelley Rouse	Statoil
Matteo Guarnerio	Ofgem	Mike Young	Centrica/BGT
Suzanne Turner	PA Consulting	Mark Freeman	NGD
Jason Mann	PA Consulting	Bethan Winter	NGD
Tim Dewhurst	PA Consulting	Julie Cox	AEP
John Bradley	Joint Office	Nick Wye	Waters Wye Assoc.
Mick Curtis	E=mc <sup>2</sup>	Stuart Waudby	Centrica Storage
Nigel Sisman	National Grid NTS	Roddy Monroe	Centrica Storage
Paul Roberts	National Grid NTS	David Ashbourne	Ofgem
Steve Ladle	Total	Steve Rose	RWE npower
Derek Russell	Viridian	Christiane Skyes	E.ON UK
Conor Purcell	ESB PG	Robert Cameron-Higgs	NGN
Eddie Profitt	MEUC	Liz Spierling	WWU
Avian Egan	BGT	Beverley Grubb	SGN
John Costa	EDF energy	Tory Hunter	SGN

#### Introduction – review of minutes and actions

Jason Mann welcomed the group and asked whether anyone had comments on the minutes of EOWG 5. No one had any comments on the minutes of EOWG 5.

Jason then reviewed the actions that were taken in EOWG 5:

- ◆ *NG NTS to confirm whether ARCA user commitment in the transitional period applies only to incremental capacity triggering investment or to capacity offtake by the connectee.*
- ◆ *NG NTS to circulate latest version of ARCA. Ongoing*

#### NG NTS strawman

Paul Roberts gave a presentation on a potential strawman on allocation mechanisms. Paul noted that this strawman is intended to be a starting point for discussion, and noted that this model does not represent National Grid NTS's view, at this stage, of the most appropriate enduring arrangements.

Paul then listed the key assumptions of the model (scope for undue discrimination minimised, regime features a "flexibility utilisation" product, user commitment principle promoted by sustained annual bookings in unconstrained period, duration of constrained period recognises consent process).

Then Paul provided a high level description of the various aspects of the strawman. As regards product definition, the model includes two products defined on a nodal basis ("flat" and "flex"). Paul went on explaining the overrun mechanism and noted that the flex entitlement would be determined by the peak throughput day flex booking plus an expanding element on off-peak throughput days. Asked by Mike Young, Paul noted that the flat overrun would consist of daily offtake compared to the flat entitlement and the flex overrun would be

measured by comparing usage of flexibility over the first 16 hours to purchased rights.

The strawman proposed two types of capacity:

- ◆ firm (flat and flex) sold in annual bundles (via a long and medium term release) and in daily bundles (day ahead and on the day);
- ◆ interruptible (sold only on a day ahead basis).

Paul explained that interruptible capacity would consist of flat capacity only and would be released on a UIOLI basis at the day-ahead stage plus an incentivised discretionary release (subject to risk assessment).

Eddie Profitt noted that this proposal would differ from current interruptible arrangements, under which users can only be interrupted up to 45 days a year. Julie Cox asked what baseline would be assigned to interruptible users. Jason Mann noted that he envisaged there would be no separate interruptible baseline. Suzanne Turner clarified that current interruptible users, under a maximum physical approach, may get zero firm baselines if they are in a constrained part of the network.

Eddie Profitt stated that the consequence of these proposals would be over-investment on the network, as current interruptible users would have to become firm. Mike Young noted that National Grid would sell more capacity, but not necessarily invest. Nick Wye noted that National Grid could buy back capacity.

Nick Wye noted that the assessment of this proposal depends also on the quantities released on a discretionary basis by NG NTS. Mick Curtis stated that this proposal may reflect a shift in philosophy on interruption, as interruption may be seen as a “negative” thing under this model. Nigel Sisman noted that interruption was always intended to be a way to fill pipes when they are underutilised. Eddie Profitt stated that interruptible consumers were previously viewed as providing protection to the system and that customers would not agree with Nigel Sisman’s view.

Nigel Sisman noted that the interruptible service is currently semi-firm, and stated that the proposed short-term product instead would be fully interruptible. Eddie Profitt stated that no one would build a plant on this basis. Suzanne Turner noted that, if a party is happy with, for instance, 320 days of firm capacity and 45 days of interruptible capacity is of value to NG, he would be able to contract long term buybacks with NG NTS. Derek Russell noted that this would be a significant change from the status quo, where any participant can choose to be interruptible. Paul Roberts noted that the proposed approach is similar to the existing approach at entry, with options and forwards for buybacks.

Mick Curtis noted that, if NGG receive a signal sufficiently in advance and users pay for the capacity, it would make more sense for NGG to invest. Jason Mann replied that it would be more appropriate for NGG to buy back rather than invest where the cost of buying back rights was lower than the cost of investment. Suzanne Turner noted that it would be appropriate for Ofgem to ensure that National Grid did not invest where this was not necessary.

Nick Wye noted that the model presented is conceptually clear, but may fall down because of lack of competition at the nodes, and result in concerns regarding market power. Beverley Grubb noted that the cost of exit capacity and the cost of buybacks need to be dynamic.

Paul Roberts noted that the strawman needs to be looked at in the context of incentives. Tory Hunter expressed a concern that a solution similar to entry is being undertaken, and she said that she is not convinced that the issues to be addressed at exit are the same as at entry.

Suzanne Turner noted that revenue drivers are needed to incentivise capex efficiency and to provide sufficient remuneration for investment. Suzie noted that it should not be expected that NGG would look at revenue drivers to decide where to invest. In particular, Suzie noted that Ofgem's initial view is that the revenue drivers should be decoupled from the pricing mechanism.

Beverley Grubb noted that each year there would be a different set of numbers and tradeoffs. Paul Roberts said that he was not sure why this would be different from the status quo. Beverley replied that at the moment there is not a commercial regime in place, and, for instance, there is access to a certain and limited amount of interruption. Jason noted that participants may be able to contract buybacks with NGG and obtain a fixed number of firm days a year, if this is of value to NGG. Some participants then noted that the proposals would have the same effect as the status quo, and questioned the need for reform. Paul Roberts noted that the key difference is that under the proposals a common set of arrangements would be developed for all users.

Paul then provided some worked examples of the capacity release mechanism. Paul noted that in the unconstrained release, a request would be allocated if individual bookings provide a sustained signal for 4 years. Paul, asked by Beverley Grubb, confirmed that users would need to provide a four year signal even if the capacity is already available. Several participants expressed concerns at the fact that users would need to provide a four years signal up to eight years ahead. Mike Young stated that he would understand this concept if it were only applied to incremental capacity, but not to existing capacity.

Paul Roberts, asked by Chrissie Skyes, noted that there could be a possibility of pro rating capacity requests in the unconstrained period if there are multiple users and if each user does not provide a sustained demand signal.

Julie Cox asked how new connections would be treated under this model. Paul Roberts explained that users would be able to reserve capacity via committing to pay four years of capacity charges.

There was then a discussion about lead times. Jason Mann noted that NGG were proposing a 4 years lead time, which would be increased from previous assumptions mainly due to changes in the consents process and that Ofgem did not necessarily agree with this proposal. However, Jason noted that the discussion on lead times was not the focus of this meeting and that this could be discussed at another date.

Chrissie Skyes questioned whether the proposed arrangements may have an impact on investment on the system and on security of supply. Jason noted that NGG would have obligations to deliver specified baselines.

Beverley Grubb questioned the need of having a long user commitment (4 years) for existing users. Paul Roberts noted that existing users would still receive the capacity they request, provided that other parties do not request it. Mike Young noted that it is not realistic to require existing users to commit eight years in advance. Paul Roberts replied that the parameters presented are only indicative. Julie Cox noted that this may be an excessive requirement, given that most of the investment costs are incurred in the year before delivery.

Paul Roberts then discussed other aspects of the strawman, such as the constrained release of capacity and the substitution of capacity.

Tory Hunter noted that Ofgem would still need to do an assessment of the investments undertaken at the time of the price control review, so she questioned whether the proposed model was necessary.

Jason Mann, asked by Beverley Grubb, confirmed that the strawman is an initial point for discussion.

There was then some debate on the substitution mechanism and how it could work in practice.

### **Shipper contracting and interaction with capacity allocation mechanisms**

Mike Young circulated a paper outlining some thoughts on shipper contracting and the interaction with capacity allocation mechanisms. Mike noted that, assuming that a user commitment model is introduced, the question should be who the user making the commitment is. Mike noted that DNs could take a commitment as their relationship at each offtake is enduring. However, Mike noted that it would be more difficult for shippers to make a commitment as they do not have an enduring relationship at direct connects.

Mike noted that a potential solution is that user commitment could be provided by the consumer. This could be done by means of some form of reservation undertaking from the consumer. Jason Mann asked how this approach could fit with the UNC. Julie Cox noted that developers can currently enter into ARCAs. Mick Curtis noted that users would still need to nominate a shipper and if they do not do so, a liability would need to be called.

Tory Hunter noted that the shipper would still need to have an actual capacity booking. Mike Young replied that there would need to be an undertaking given by the end consumer. Beverley Grubb noted that this principle is recognised in the ARCA. Beverley also noted that there might be difficulties in keeping track of the various commitments.

Julie Cox noted that making sure that the consumers provide this undertaking may be an issue. Julie noted that Helen Bray had sent around a note stating that there are diverse opinions as to whether sites would want to purchase their own capacity, but it was agreed that this should be an option but not mandatory.

Paul Roberts noted that NGG lawyers stated that it would not be appropriate to include ARCAs in the UNC, because ARCAs are not a transportation agreement, and do not allow to register capacity, but only to reserve capacity.

Jason Mann noted that the discussion was useful and a potential way forward may be developed. Mike Young noted that, whilst an approach may be developed for DNs and direct connects, he was not sure who the relevant party would be with interconnectors and storage sites. Mick Curtis suggested that a lead agent may be appointed (which could be a separate agent or a lead shipper/user). Avian Egan expressed some concerns with the concept of a lead shipper due to financial security issues.

### **Allocation of capacity**

Tory Hunter gave a presentation outlining an alternative approach to the allocation of capacity. Tory noted that the models presented so far at the EOWG focused on user commitment for new and existing capacity. However, Tory stated that it would be appropriate to step back and consider whether this extent of user commitment is effectively required for existing capacity.

Tory then explained her understanding of the objectives of exit reform. These were to provide signals for new investment, allow DNs to make appropriate trade-offs, introduce a mechanism to allocate capacity in the constrained period, protect the interest of consumers.

Tory then explained the main principles and assumptions of the allocation mechanism, and proposed an allocation mechanism by which existing capacity rights are maintained on a rolling basis, but suggested that an annual application window is introduced to increase capacity holdings for the unconstrained period. Under this approach, all requests up to baseline would be allocated and would require an ARCA commitment to back physical investment. In this annual allocation window users may be also able to decrease their capacity holdings for the unconstrained period.

Tory also proposed that the annual application window is used to increase the capacity holdings for the constrained period (noting that capacity may be allocated on a pro-rata basis if necessary) and to decrease the capacity holdings for the constrained period (releasing capacity for allocation to other users). Tory added that the OPN process would provide an opportunity for users to increase capacity holdings at the day ahead stage and within day if capacity is available and subject to pro rating.

Finally, Tory noted that the extent to which the model applies equally to DNs and DCs and the appropriate incentives necessary should be considered.

Julie Cox noted that the user commitment, in order to avoid most of the costs incurred, may be as little as one year, depending on the cost profile of investment required. Beverley Grubb also questioned the extent of a potential stranded asset risk.

Jason Mann noted that issues would arise when unnecessary investment to accommodate new customers is undertaken. Julie Cox noted that this issue should be addressed under this model, and reiterated the concept that one year commitments should cover most of the investment costs.

Tory asked how many times this has been an issue to date. Jason Mann noted that asymmetric information between NGG and the regulator meant it was unlikely that such issues would come to light but that if better information is provided to NGG regarding the future use of the network then this would allow NGG to invest in a more efficient manner. Jason noted that users are best placed to indicate their capacity requirements and to inform NGG's investment decisions. Julie Cox noted that the investments required are likely to be substantial but infrequent projects, and questioned whether the proposed extent of reform was necessary.

Nigel Sisman noted that the two models presented were both versions of the same general model with different parameters. He noted that in this model (presented by Tory) a different treatment of new and existing capacity is proposed: for incremental capacity, users are required to provide a commitment for a number of years, while for existing capacity users have a prevailing right, but users have a right to reduce their capacity holdings, subject to a notice

period. Under this model, NGG would plan on the basis of signals from incremental capacity, and the community would underwrite the risk that existing connectees discontinue offtake capacity.

Paul Roberts noted that the model presented by Tory is not dissimilar to some of the approaches outlined by NGG. Eddie Profitt noted that one of the key principles of the model presented by Tory is prevailing rights.

Tory Hunter again questioned whether directly connected customers would be able to commit eight years in advance. Jason Mann noted that the model presented is not dissimilar to some of the models presented by NGG.

As regards the proposal of pro-rating capacity requests in the constrained period, Julie Cox noted that this is only an important issue for interconnectors and storage sites, where it is likely that there would be multiple users competing for capacity.

Julie Cox asked whether the obligation to release all available baseline would remain up to the day ahead stage in the NG model. Jason Mann replied that the working assumption is that the obligation would stay in place.

### **Way forward**

Jason Mann noted that the third price control document is expected to be released towards the end of March. Jason noted that in this document Ofgem would provide its initial views on a number of price control issues. Jason noted that some of the issues raised during the debate should be captured in the March document, and highlighted that Ofgem's views outlined in these document would only be preliminary views and there would still be scope for more discussions.

Jason noted that the next EOWG session would be held on 5 April, and as part of this session some of the material included in the March document would be reviewed. Nigel Sisman noted that the NGG strawman would be ready in the next few weeks. Jason Mann, asked by Tory Hunter, explained that the issues raised by Tory's presentation will be taken into consideration as part of the March document. Some participants highlighted that Ofgem should not just publish NGG's strawman as part of the March document, as the same weight should be given to all models. Jason, asked by some participants, stated that interruption arrangements will be discussed at another date, potentially at the next EOWG.