

## Enduring Offtake Arrangements Working Group

### Meeting 7

5 April 2006, 10:00 - 13:00

Ofgem's office, 9 Millbank

#### Attendees:

Mark Feather	Ofgem	Agnes Petersen	ILEX
Suzanne Turner	PA Consulting	Phil Broom	GDF
Christiane Sykes	E.ON UK	Mark Freeman	NGD
Lisa Waters	Waters Wye Assoc	Bethan Winter	NGD
Amrik Bal	Shell Energy Europe	Julie Cox	AEP
John Bradley	Joint Office	Steve Rose	RWE npower
Elaine Calvert	National Grid NTS	Robert Cameron-Higgs	NGN
Nigel Sisman	National Grid NTS	Liz Spierling	WWU
Paul Roberts	National Grid NTS	Conor Purcell	ESB PG
Gareth Evans	Total	Helen Bray	CIA
Derek Russell	Viridian	Eddie Profitt	MEUC
Tory Hunter	SGN		

#### Introduction – review of minutes and actions

Mark Feather welcomed the group and asked whether anyone had comments on the minutes of EOWG 6. Eddie Profitt noted an error on page 2 of the minutes and Mark Feather agreed to correct this.

Mark noted that there were no actions from EOWG 6, although stated that there was an ongoing action on NG NTS to circulate the latest version of the ARCA. Paul Roberts indicated that the latest version of the ARCA was available to be circulated. Mark Feather agreed to place it on the Ofgem website under the transmission price control area of work under 'EOWG 7'.

#### March TPCR consultation – Ofgem presentation

Suzanne Turner gave a presentation which provided an overview of Ofgem's initial views on the offtake arrangements as outlined in the March Transmission Price Control Third Consultation document. Suzanne's presentation covered both the proposed enduring offtake arrangements and the incentives arrangements for the transitional offtake period.

Suzanne outlined some of the key principles underpinning the enduring offtake arrangements including:

- ◆ All users – GDNs and TCCs (both existing and new) being required to indicate their future usage of the NTS
- ◆ Commitments should be sufficiently far in advance to advise NTS investment planning
- ◆ That the NTS receives financially firm investment signals with sufficient time to respond thereby reducing the risk of stranded assets.

Suzanne then discussed the qualitative impact assessment performed by Ofgem on the high level options for the enduring offtake arrangements originally outlined

in the December document. Suzanne noted that Ofgem had issued a survey to industry participants in order to inform the quantitative assessment it had originally proposed to undertake for the March document. Suzanne however reported that there were insufficient responses received to undertake a full quantitative assessment of the December options. However, Suzanne commented that sufficient information had been received to enable a qualitative impact assessment to be undertaken.

Suzanne discussed the qualitative impact assessment and outlined Ofgem's preferred approach, namely nodal baselines with a nodal product. Suzanne also indicated that Ofgem did not favour introducing a substitution incentive but preferred an obligation under which the NTS would be required to consider delivering incremental capacity in the unconstrained period through the substitution of offtake rights from nearby nodes before deciding to undertake investment.

Suzanne also discussed Ofgem's preliminary views on the capacity allocation approaches that had been discussed through the EOWG as well as Ofgem's preliminary views on revenue drivers, role and scope of capacity baselines, the interpretation of the 1 in 20 obligation, and buy back incentives. Suzanne described Ofgem's proposed approach to the NTS incentives for the transitional offtake period.

Suzanne also described Ofgem's preliminary views on capacity allocation and product definition issues, noting that Ofgem welcomed further development and discussion of prevailing rights models. Mark Feather added that Ofgem was keen to facilitate debate on the prevailing rights model through the EOWG process. Mark however explained that the nature of the capacity allocation mechanism would ultimately be a matter for UNC consultation processes, to the extent a modification proposal was raised, and that the EOWG was not intended to override or replace such consultation processes.

Following the completion of the presentation there was some discussion of the topics raised.

Christiane Sykes sought clarification of whether the baseline numbers would change in the event that capacity substitution occurred in the long term (as opposed to investment). Suzanne indicated that there would be a change in the baseline numbers across the relevant nodes to reflect the substitution that had occurred. Suzanne stated that it was Ofgem's initial view that substitution would occur through a methodology that the NTS would need to publish and at an exchange rate that would be subject to Ofgem approval.

Tory Hunter sought clarification of when the substitution would occur – in the long term or on a year ahead basis. Suzanne responded that the model set out in the March document related to long term substitution in the unconstrained period. Suzanne said that it may be possible for models to be developed that allow for short term substitution or transfers of capacity across nodes, although in such cases there would not be changes in the capacity baselines.

Steve Rose asked whether short term substitution – in the constrained period – could occur within a 'prevailing rights' model of capacity allocation. Suzanne reiterated that this may be possible to the extent that there was unused capacity at a particular node.

Steve Rose then asked how the 'practical maximum physical' capacity numbers were derived. Elaine Calvert responded that they were based on an analysis of network capability.

Eddie Proffitt asked whether any assumptions had been made regarding entry flows. Elaine responded that assumptions had been made regarding entry flows and supplies onto the transmission network. These assumptions had taken into account entry capacity bookings. In addition, the NTS had taken into account DN flat capacity bookings and exit capacity bookings for NTS direct connects.

Julie Cox sought clarification of how maintenance would be treated. Mark Feather responded that maintenance would be managed by capacity buy backs to the extent that these were necessary.

Julie Cox also noted that the practical maximum physical capacity numbers outlined positive baselines for some interruptible sites and zero baselines for others. Julie asked whether this meant that there had been overinvestment in the transmission network. Julie also sought clarification as to why there were differences between the practical maximum physical capacity numbers set out in the March 06 document from those set out in the February 05 enduring offtake document.

Elaine Calvert responded that investment is inherently lumpy in nature and that changes in exit numbers can also be a consequence of entry investment. Lisa Waters then asked whether the NTS were paid twice for investment at entry and exit. Elaine responded that this was not the case and that entry and exit costs were apportioned to avoid this.

Gareth Evans questioned whether the regime will produce long term user commitments given that pipes have been built to meet the 1 in 20 obligation. Suzanne responded that the regime would make it clear to users that investment would only occur in response to user signals and if long term signals are not generated then it is implicit from this that there is enough capacity.

Tory Hunter then asked how existing interruptible sites would be treated under a prevailing rights model.

Suzanne Turner commented that if you are an interruptible supply point with a baseline of zero and you wish to secure firm capacity you would need to make a sustained long term firm booking of capacity, which would then determine the user's prevailing right. Alternatively, these interruptible sites could choose not to book firm capacity in the long term and seek to buy firm or interruptible capacity in the constrained period, to the extent that it is available.

Tory then questioned how a user with a firm baseline allocated to it would be able to make a decision to book long term firm capacity without understanding the risk of substitution. Tory also asked the NTS how some sites at one supply point have been given firm baselines whereas others have not. Elaine commented that where there is capacity at a supply point that is spare it has been treated as firm whereas where demand cannot be accommodated the baseline for the site has been set to zero.

Nigel Sisman also noted that a potential implication of the EU Regulation was that any long term interruptible product would need to be priced in accordance with the probability of interruption and that at those nodes with "spare" capacity, the price of any interruptible products would be close to the firm price.

There were a number of questions regarding the apportionment of baselines across adjacent nodes.

**Action on EOWG participants:** Following this discussion it was agreed that participants could come back to the next EOWG meeting with questions regarding baseline determination. The NTS would then come back to the following meeting on 3 May with responses to the questions asked.

### **Prevailing rights approach – NTS presentation**

Paul Roberts gave a presentation on the NTS strawman of the prevailing rights approach to capacity allocation.

Paul stated that the presentation had been produced to try to move the debate forwards and capture the EOWG debate to date.

Paul stated the key assumptions that had been made, including common products and registration processes to avoid the scope for undue discrimination and the implementation of a flexibility utilisation product.

Paul outlined that the presentation assumed the application of the “prevailing rights” model in the unconstrained period (which would require notice of any proposed reductions in capacity), with pay as bid auctions applied to ration capacity within the constrained period. Paul stated the proposal that the pay as bid auctions should be subject to a reserve price no less than the current prevailing charge. He further stated that an interruptible product would be available on a day ahead “use it or lose it” basis.

Tory Hunter asked for confirmation that if a user wanted its current capacity rights to remain unchanged, that it wouldn’t need to do anything. Paul confirmed that this was the case.

Paul also clarified that it was assumed that baselines would not have a bearing in the unconstrained period as capacity release would be guaranteed subject to the appropriate financial commitments being made by users (equivalent to the notice period with respect to existing capacity and equivalent to the sustained demand test for new capacity).

Tory Hunter outlined an example of a node with a baseline of 10 units and prevailing rights of 8 units and demand (which was not sustained) from two different users for 3 additional units above the level of prevailing rights. Tory asked how the additional 3 units would be allocated. Paul responded that in this case there would be no pro-rating of the demand and therefore no additional allocation of capacity above the 8 units of prevailing rights in the unconstrained period. Instead, the relevant users would need to attempt to secure the additional units of capacity that they required in the constrained period.

Suzanne noted that it was Ofgem’s intention that baselines would continue to place an obligation upon NG NTS with respect to capacity release, in at least the constrained period.

Suzanne also noted that NG NTS had determined that the rationing of baseline capacity should be left to the constrained period as this could be addressed by the pay as bid auctions proposed in this period. Suzanne noted a concern by NG NTS that the rationing of baseline capacity in the unconstrained period would introduce excessive complexity. However, Suzanne noted that there may be

some middle ground, whereby, in the absence of a constraint for baseline capacity, NG NTS would be obliged to allocate that spare baseline capacity in the unconstrained period, whether there was sustained demand or not. Paul noted that this could be possible but would add complexity.

Tory Hunter outlined a further example where a user has prevailing rights of 100 units and wanted to secure an additional 1 unit of incremental capacity in the unconstrained period. Tory asked how the user would go about doing this. Paul Roberts explained that the user would need to make a sustained commitment to the full 101 units of capacity in the unconstrained period.

There was some discussion of the pricing of capacity in the unconstrained period. Paul Roberts indicated that reserve prices would need to be established through the Transmission Charging Methodology Forum consultation process. Paul indicated that the NTS would be happy to report back to the EOWG on progress on developing these prices.

Paul Roberts also indicated that capacity would be priced in the unconstrained period on the basis of the prevailing price that applied at the time that the capacity was utilised. Eddie Proffitt indicated that this would create some degree of uncertainty for customers as they would not be able to 'lock in' capacity prices over the long term. Paul Roberts explained that customers should have some certainty as there will be a clear transparent methodology explaining how prices are set and how they may change. Paul also noted that any under or over-recovery due to prices being locked in would also need to be recovered, probably through the commodity charge.

Derek Russell noted that the uncertainty for users may be less as commodity charges would only be levied if a user chooses to flow gas whereas a capacity charge would be levied regardless.

Nigel Sisman noted that it was necessary to distinguish between issues created by the transition to the enduring regime and issues that would endure once the regime was established.

Lisa Waters noted that if a user had committed and paid for capacity that it did not subsequently want then it would not be appropriate for users to pay for the use of that capacity. Paul agreed and noted that, as under the ARCA arrangements, any user that subsequently relinquished capacity for which it had made a financial commitment would face a consequential reduction in their liability to the extent that the capacity relinquished was acquired by another user.

Mark Feather indicated that the NTS strawman placed a critical emphasis on the robustness of the pricing methodology model as well as the importance of transparency regarding network dynamics and operation so that users could appreciate and understand the risks of long term substitution.

Julie Cox asked what progress had been made by the NTS on the expanded flexibility product. Julie commented that it will be important for the slope and single/2 product issues to be understood as this may impact upon shippers'/DNs' systems costs.

Nigel Sisman reported that the NTS was in its fourth week of work on the expanded flexibility product and that its analysis was ongoing. Suzanne Turner stated that Ofgem were intending to issue their Impact Assessment cost survey shortly to inform the June Initial proposals document. Suzanne said that it would

be useful to understand from industry participants the extent of cost sensitivities there may be to a single product or two products (ie flat and flex capacity).

Tory Hunter asked whether it will be possible for capacity to be exchanged between nodes in the short term. Paul Roberts explained that constrained period trading between nodes does not form part of the base model in order to minimise complexity but is something that could be 'bolted on' at a later stage. Julie Cox responded that the transfer of capacity between nodes within a single DN may simply be operational in nature and could therefore be managed on an operational basis as at present. Julie commented that operational efficiencies of this nature should not be restricted.

There was some discussion of the release of the daily interruptible product outlined in the NTS strawman. Paul Roberts explained that the product would be released on the same basis as it is in entry, with the NTS assessing historical capacity holdings against usage of those holdings and using this assessment to determine how much interruptible capacity should be released.

Lisa Waters asked whether additional bundles of firm capacity could be released in the short term. Paul Roberts explained that if capacity became available (eg due to entry investments) it could be released as non-obligated capacity.

Julie Cox commented that the only products that are proposed to be released are daily and annual products, noting that a monthly product is made available in the electricity sector. Paul Roberts responded that the NTS was not intending to propose a monthly product. Paul Roberts indicated that, as with other design issues, there were complexity trade-offs in this area.

Christiane Sykes asked if there would be set times in the day with respect to the on the day allocation of capacity. Paul confirmed that there would and that these would be defined within the UNC. Nigel noted that there were some tricky issues with respect to interruptible services and the accrual of rights within a day.

Amrik Bal asked a further question regarding the interruptible anti-hoarding product. Amrik asked whether there was a notice period that users would need to comply with in order to exercise their firm rights before the interruptible product was released. Paul Roberts explained that the product would operate in the same way as it does in entry – holders of firm capacity rights would simply be permitted to flow against these rights and there would be no notice period.

There was then a further discussion of the operation of the capacity allocation model in the unconstrained period. Paul Roberts explained the concept of the 'reduction notice period' that holders of existing capacity would provide under the prevailing rights model. Paul explained that the concept of a period in which holders of existing capacity rights gave notice that they intend to use such rights would be helpful in avoiding stranded asset risk.

Julie Cox commented that the longer this period is, the more it will create problems for existing users. Julie also commented that where the commitment period for new incremental capacity differed from the 'reduction notice' period, this could lead to distortions in investment signals. Julie commented that there needs to be some debate about the parameters of investment lead times. Mark Feather responded that this was on the agenda for the next EOWG meeting.

Paul Roberts concluded the discussion by stating that it would be helpful to provide comments on the NTS strawman ahead of the next EOWG.

Mark Feather indicated that the NTS slides would be placed on the Ofgem website.

### **Way forward**

Mark noted that the next EOWG session would be held on 19 April following the completion of the Gas Incentives workshop which would focus largely on entry capacity issues.

The agenda for the next EOWG would include investment lead times, treatment of interruption and a session on the proposed cost survey for the June Initial Proposals document.