

## Enduring Offtake Arrangements Working Group

### Meeting 8

19 April 2006, 13:00 - 16:15

Ofgem's office, 9 Millbank

#### Attendees:

Mark Feather	Ofgem	Steve Rose	RWE npower
Matteo Guarnerio	Ofgem	Tory Hunter	SGN
Jason Mann	PA Consulting	Mark Freeman	NGD
Suzanne Turner	PA Consulting	Bethan Winter	NGD
Amrik Bal	Shell	John Bradley	Joint Office
Angela Love	Ilex	Shelley Rouse	Statoil
Phil Broom	GDF	Christiane Skyes	EON UK
Julie Cox	AEP	Avian Egan	BGT
Elaine Calvert	National Grid NTS	Conor Purcell	ESB PG
Paul Roberts	National Grid NTS	Fiona Lewis	EDF
Nigel Sisman	National Grid NTS	Nick Wye	WWA
Helen Bray	CIA	Brian Stoneman	NGN
Roddy Monroe	Centrica Storage	Derek Russell	Viridian
Matthew Snowdon	PA Consulting		

#### Introduction – review of minutes and actions

Mark Feather welcomed the group and asked whether anyone had comments on the minutes of EOWG 7. Julie Cox noted that at the beginning of page 4 the minutes stated that “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”. Julie requested that this should be specified clearly as an outstanding action.

**Action:** EOWG participants to ask questions regarding baseline determination.

It was noted that this action remained outstanding.

#### NTS Exit reform strawman proposal – investment commitment profiles (National Grid NTS presentation)

Nigel Sisman gave a presentation outlining investment commitment profiles under the National Grid NTS exit reform strawman proposal. Nigel noted that in previous meetings EOWG participants explored a strawman proposal that features users having prevailing NTS capacity rights which can only be reduced subject to a notice period. Nigel explained that the objective of the presentation is to inform views about the notice period parameter in the user commitment model.

Nigel explained that under the NG NTS strawman it is envisaged that incremental requests for increases in prevailing capacity entitlements would be received in April each year (“Y”) for capacity required in October at the start of year Y+4 (i.e. users would be required to provide 42 months’ notice). However, Nigel noted that it would still be necessary to consider how an April application window would fit in with other processes.

Nigel then outlined the key stages in delivering NTS investments and noted that they are closely related to the 42 month “window” envisaged in the strawman.

He then presented a graph outlining a typical expenditure profile of the cash payments or financial commitments for pipeline work during the 42 months lead time. The graph showed a typical profile of commitments to pay/use resources, which are typically made before the costs are incurred. Nigel explained that EPIC stood for "Engineer, Procure, Install, Commission", and that Stage 1 represented routing and design work, whilst Stage 2 represented a commitment to a build programme. Nigel noted that the programme outlined assumed a one season build.

Nigel explained that an inability to signal a reduction of a prevailing capacity level might cause inefficient or unwarranted investments. Nigel noted that as the notice period for capacity reductions increases, there is a trade-off between a lesser user ability to provide a more accurate signal and a greater risk of stranded assets.

Nigel noted that, according to the analysis carried out by NG NTS, 91% of costs might be avoided with a 2.5 years notice period (as currently outlined in NG NTS's strawman) for capacity reduction requests. Nigel noted that 77% of costs might be avoided with a shorter notice period of 1.5 years. Nigel asked EOWG participants to consider the relative merits of a 1.5 and 2.5 year notice period.

Julie Cox noted that this analysis assumes that other nearby users would require an increase in capacity which could be accommodated by the spare capacity generated from the capacity reduction. Julie stated that the analysis of costs should take into account the probability of such an event occurring. Nick Wye agreed that, taking into account this probability, on average the costs incurred could be lower than those outlined in the presentation. Nigel Sisman noted that the analysis assumes that NG NTS has already taken a decision to invest.

Julie also noted that there may be a mismatch between the time where a party (such as a generator) is required to make the financial commitment to the NTS and the decision to go ahead with the generation project. Julie noted that for a power station the decision to undertake the project may be made 24/30 months in advance. Therefore Julie noted that the commercial and physical timescales should be aligned.

Nigel Sisman explained that under the strawman if participants decide not to go ahead at a later stage they would only incur the costs of four years of capacity. Julie suggested a potential alternative approach under which parties do not undertake a full commitment 4 years in advance, but commit only a fraction of the cost initially and the full commitment at a later stage.

Steve Rose asked whether all projects require the same timescales (42 months). Nigel Sisman replied that for exit projects this appears to be a reasonable timescale for investments of a larger scale.

Julie Cox reiterated that a useful approach would be to have a two stage decision process, with a smaller commitment initially which would allow users to maintain the option to build at a later stage. Julie suggested that the second decision point may be before the stage 2 EPIC contract as outlined in the timetable for delivering NTS investments presented by Nigel and that a connectee may want to defer its decision and keep its options open at this stage.

Julie Cox suggested that there is a need to consider whether the physical timetable is different between different types of connectees.

Jason Mann noted that the proposed regime should be simple and transparent and suggested that this should be taken into account in the development of the regime.

Nigel Sisman, in response to a question from Tory Hunter, explained that lead times in investment undertaken to deliver flat capacity and flexibility are the same, given that they both require pipeline investment. Tory stated that this should be clarified, as flexibility is a by-product of flat capacity. Suzanne Turner clarified that on the peak day, flexibility should not be a by-product of flat capacity.

Steve Rose noted that the model presented assumes that capacity is made available at the beginning of the gas year, effectively adding another year to the process in the event of a summer commissioning date.

Suzanne Turner explained that under the regulatory framework NGG would be incentivised to provide capacity earlier through the application of revenue drivers upon project delivery where this is of value to the connectee. The connectee could also agree to pay NGG more in order to obtain capacity at an earlier date. Paul Roberts noted that an extra quarterly or monthly product could be introduced but this may add complexity to the regime.

Tory Hunter questioned whether it was necessary to move away from the current ARCA arrangements. Paul Roberts replied that NG NTS strawman maintains the ARCA principles and that the proposed arrangements would not be very different from those currently in place.

Derek Russell and Christiane Skyes questioned why a four year commitment was proposed by NG NTS for new capacity when a three year period was under consideration as part of TANIF. Suzanne Turner noted that there is a spectrum of potential commitments that participants may make (from zero to 45 years), and noted that in other situations (e.g. electricity), much larger commitments are required.

Suzanne Turner reiterated that as regards investment lead time Ofgem's view is that there should be a default arrangement, but participants could deviate from this default arrangement if they reach a bilateral agreement with NG NTS.

Nigel asked again participants whether they would favour a 2.5 years or a 1.5 year notice period for surrender of capacity. Nick Wye suggested that 2.5 years seems an excessive notice period.

Some participants suggested that the notice period could be determined on a case by case basis. Nigel Sisman explained that the notice period required would not be directly related to the costs incurred in any individual case.

In the context of financial commitments required, Julie Cox noted that the issue of whether the consumer or the shipper pays in case the consumer goes bust has not been resolved yet. Jason Mann noted that it depends on how the shipper has backed off its liabilities.

Mark Feather concluded the discussion noting that the NTS had received numerous comments and ideas on an important element of the strawman and that it would be up to the NTS to consider these ideas. When asked, Mark responded that Ofgem did not have a view on whether 1.5 or 2.5 years was appropriate, but that Ofgem would also take on board the comments received.

## **NTS exit reform strawman proposal – implications for interruptible product (National Grid NTS presentation)**

Nigel Sisman explained that EOWG have explored a strawman proposal that features firm capacity rights that can be obtained on a “prevailing” right basis in longer lead times or via “finite” rights that might be obtained within investment lead times.

Nigel then explained in more detail how the prevailing firm rights would work in practice and noted that the regime is structured to encourage longer term applications if capacity in excess of prevailing rights is required. Nigel then explained how the shorter term “firm” annual applications would work and, in particular explained that there would be a mandatory release (i.e. NG NTS would need to release capacity in the short term up to an “obligated level”) and there would also be scope for a higher discretionary release.

Nigel then presented the proposed capacity release mechanisms close to the gas day. Under the proposed approach, there would be a firm release of capacity day ahead and within day, and an interruptible release of capacity at the day-ahead stage only. Nigel explained that the release of interruptible capacity would consist of a mandatory release on a UIOLI basis and that any additional release would be discretionary.

Nigel then outlined the implications of the proposed strawman for current interruptible offtakes. In particular, Nigel explained that there would be no explicit long term interruptible service, but that long term interruption would be delivered via long term buybacks of firm capacity rights by National Grid NTS.

Tory Hunter questioned what capacity would be offered at currently interruptible sites where no firm baseline is assigned.

Nick Wye stated that the discretionary release of interruptible capacity should be clarified and asked what incentive NG NTS would have to release additional capacity on a discretionary basis. Nick also expressed a preference for a zero reserve price for interruptible capacity. Suzanne Turner noted that the EU regulations require interruptible products to be priced in proportion to the probability of interruption.

Mark Feather noted that it may be possible to reward the NTS through its buy back incentive for sales of interruptible rights (where interruptible capacity is sold at a price exceeding zero).

Julie Cox noted that an effect of the proposal could be cycling of interruption. She explained that if the system is relatively unconstrained one generation of customers may eliminate their back up systems in the expectation of not obtaining long term interruptible capacity via buybacks, and this may not be an efficient outcome, as, when the system becomes more constrained, they may want to be interruptible but would not have the necessary back up systems. Mark Feather noted that the ability of customers to make informed decisions about back up fuel will depend on the release of information regarding system capability and the risks of buy-back and interruption given demand for capacity.

Suzanne Turner stated that it would be interesting to analyse the costs of back up systems and stated that it may be that many connectees currently maintain back up fuel although it is not necessary. Helen Bray replied that back up fuel is often needed for energy purposes.

Tory Hunter asked what the timing of the process and in particular of the implementation of the buyback arrangements and their interaction with the booking process would be. Nigel Sisman explained that the buyback arrangements could be in place before the capacity applications are received by NG NTS. Tory Hunter asked whether the buybacks would be agreed on a bilateral basis. Nigel explained that participants who do not want firm capacity should talk to the NTS. However, Nigel noted that whether NG NTS would enter into buybacks with those customers may depend on their location on the network. Nick Wye noted that there may be an information asymmetry issue as NG NTS would be better informed on the likelihood of interruption and therefore would have stronger negotiation power.

Julie Cox questioned how operational buybacks would work and their interaction with NG NTS's statutory obligations in respect of planned system maintenance. Mark Feather noted that it may be worth exploring this issue at the next EOWG.

**Action:** NG NTS to present at EOWG on operational buybacks and their interaction with NG NTS's statutory obligations for system maintenance.

### **Impact of enduring gas offtake reform: draft impact assessment (Ofgem presentation)**

Suzanne Turner gave a presentation providing an overview of the data pro forma cost survey, which was published on Ofgem website on 18 April 2006. Suzanne noted that the third TPCR consultation outlined high level proposals for offtake arrangements and incentives. Suzanne explained that Ofgem intends to include a quantified draft Impact Assessment of these proposals in the June 2006 initial proposals consultation (with a further impact assessment to be undertaken once details of the arrangements have been developed further).

Suzanne explained that separate pro-forma templates have been prepared for:

- ◆ Shippers and transmission connected customers; and
- ◆ Gas transporters and the agency.

Suzanne noted that the pro-forma consists of three documents: spreadsheet, guidance note and assumptions paper. Suzanne then outlined the main characteristics of the spreadsheet and provided some high level guidance for completing the pro-forma.

Suzanne noted that many aspects of the proposals outlined aimed to reduce complexity and costs relative to previous models assessed and that it would be interesting to see if such simplifications did lead to lower costs.

Finally, Suzanne explained that the deadline for completion is Monday 15 May 2006.

Julie asked if respondents could express a view as benefits. Suzanne said that the cost proforma already asked for benefits in the form of avoided costs. Suzanne stated that Ofgem proposed to conduct separate benefits analysis but would welcome any views on this.

### **Way forward**

Mark noted that the next EOWG session would be held on 3 May.