

Enduring Offtake Arrangements Working Group

Meeting 11

28 June 2006, 14:00 - 16:30

Ofgem's office, 9 Millbank

Attendees:

Mark Feather	Ofgem (chair)	Avian Egan	Bord Gais Eireann
Matteo Guarnerio	Ofgem	Angela Love	Prory Energy
Andrew Pester	Ofgem	Eddie Profitt	MEUC
Suzanne Turner	PA Consulting	Julie Cox	AEP
John Costa	EDF	Angus Paxton	Prory Energy
Amrik Bal	Shell	Liz Spierling	WWU
Nick Wye	WWA	Roddy Monroe	Centrica Storage
Mike Young	Centrica	Bethan Winter	NGD
Steve Rose	RWE npower	Mark Freeman	NGD
Christiane Sykes	E.ON UK	Nigel Sisman	NG NTS
Gareth Evans	Total	Paul Roberts	NG NTS
Shelley Rouse	Statoil	Bali Dohel	SGN
John Bradley	Joint Office	Beverley Grubb	SGN
Helen Bray	CIA	Sharif Islam	Total

Introduction – review of minutes and actions

Mark Feather welcomed the group and noted the key issues to be considered:

- Ofgem's TPCR Initial proposals document, in particular, the gas offtake proposals and impact assessment (Ofgem presentation);
- Current flexibility position & complementary/alternative ways forward (National Grid NTS); and
- NTS Exit flexibility capacity definition (National Grid NTS).

Mark stated the deadline for responses to Ofgem's TPCR Initial proposal document is 24 July 2006 and highlighted an Ofgem seminar on 5 July to discuss the TPCR proposals in general.

Mark asked whether anyone had comments on the minutes of EOWG 10. Angela Love and Shelley Rouse asked to be added to the participants list. Nick Wye asked that the fourth paragraph on page four is amended to "Peter Bolitho questioned whether the proposed approach gives DNs the opportunity to obtain non-obligated flexibility to the detriment of directly connected customers. Nick Wye stated that the model is very similar to the NG NTS model".

Mark announced that Andrew Pester recently joined Ofgem's enduring gas offtake team.

TPCR Initial proposals - gas offtake proposals and impact assessment (Ofgem presentation)

Suzanne Turner gave a presentation on Ofgem's Transmission Price Control Review Initial Proposals, focusing on the proposed gas offtake arrangements and relevant draft impact assessment.

Enduring Regime

Suzanne provided an overview of the proposed enduring offtake arrangements and highlighted the importance of developing a framework within which all NTS users (both existing and new) are required to indicate their future usage of the NTS providing financially backed signals sufficiently far in advance to advise NTS investment planning. Suzanne noted that these arrangements should: improve investment signals; provide greater clarity over the level of commitment required to secure capacity; and increase transparency of offtake arrangements. Suzanne noted that the third TPCR consultation document identified a model with nodal baselines, nodal product and substitution obligation on NGG NTS and this remains Ofgem's current position.

Suzanne noted that the NGG NTS strawman, which was outlined in more detail in the third TPCR consultation, proposed that both flat and flexibility products should be offered to all NTS users, and included an expanding flexibility product. Suzanne added that in the third TPCR Consultation Ofgem stated a preference for the expanding flexibility product. However, Suzanne noted that the results of the NGG NTS analysis were not conclusive on the conversion factor and explained that NGG NTS is reconsidering the definition of NTS exit capacity products.

Suzanne said that Ofgem still consider compliance with NGG NTS's 1 in 20 obligation could be achieved by investing in line with user commitments signalling peak aggregate demand. Eddie Profitt added that by requiring interruptible customers to go firm arguably may give worse investment signals to the NTS and lead to unnecessary investment. Suzanne noted that NGG NTS indicated that most of the network, apart from the South West, is unconstrained, and is expected to require interruption only on a number of sites on the South West Quadrant. Eddie then questioned the need of enacting reform, given that most of the network is unconstrained. Mark noted that while there is currently sufficient capacity on the network, it is important to put in place a set of enduring arrangements which will be able to react as appropriate to potential future constraints on the NTS.

Suzanne noted that baselines should be determined on a nodal basis and act as both the revenue driver 'trigger' as well as defining obligations for capacity release by NGG NTS. Suzanne noted that Ofgem continues to propose a substitution obligation and that a similar proposal now exists at entry, which should ensure that NGG NTS maximises use of spare capacity. Suzanne noted that Ofgem still considers baselines should be derived on a practical 'max phys' basis. Suzanne noted that there are currently no baseline numbers for the enduring period as NGG is still developing the final proposals for product definition in the light of its flexibility analysis.

Suzanne noted that Ofgem still considers that enduring baselines should be consistent with the transitional level, but may be adjusted to reflect changes in the product definition. In addition, Suzanne explained that Ofgem's initial proposal is to adjust upwards nodal baselines for five interruptible sites in the South West quadrant, and provide NGG NTS with an additional revenue allowance to remunerate it for the efficient costs of contracting for interruption of these sites. Suzanne noted that Ofgem

considered that this approach was more suitable for these sites, as NGG NTS had indicated that SOQs at these interruptible sites could be delivered on most days of the year without any need for additional investment. Julie Cox said that the £65m per annum assumed capex in the impact assessment seemed excessive. Julie also questioned the need for DN related NTS investment. Suzanne said that the impact assessment estimation of annual capex was based on forecast information used in the price control process which informed Ofgem's proposed revenue driver derivation.

Julie asked what account is taken of entry investments that may lead to changes in exit capacity levels. Suzie responded that entry investment is tracked through the entry revenue drivers and that the June consultation document includes proposals to ensure that exit baselines increase to the extent that exit capacity is generated by entry investments undertaken.

Suzanne continued her presentation and said Ofgem believes that the revenue drivers should be contingent upon user commitment and should apply to all load related capital expenditure. Suzanne added that Ofgem's initial proposal is that the revenue drivers should accrue on contractual (rather than physical) delivery of capacity, which is consistent with the arrangements for entry and incentivises NGG NTS to make efficient trade-offs between investment and interruption. Suzanne said that Ofgem proposes to specify zonal drivers for increments below 15GWh/day in size. Suzanne explained that an 80% factor has been applied to the revenue drivers for the Pembroke and Grain power saturations. Suzanne then explained that this reflects the fact that under some scenarios it may be efficient for NGG NTS to enter into contracting solutions rather than to reinforce the network in order to deliver capacity at these sites. Suzanne invited comments on this approach.

Suzanne noted that Ofgem does not intend to introduce a sliding scale incentive for operational buy backs. Suzanne added that the revenue from the sale of non obligated and interruptible capacity would be subject to a sliding scale incentive, with a 50% sharing factor and cap. Suzanne also explained that contrary to the NGG position, Ofgem proposes that the obligation for NGG NTS to offer for sale all baseline capacity continues up to and including the gas day.

Suzanne asked for views on the proposals for enduring offtake by 24 July. Suzanne requested that respondents clearly indicate who they are representing within their submission.

Transitional Regime

Suzanne explained that the transitional proposals remained largely unchanged from the third consultation paper in March and outlined the proposed targets and parameters for the NTS incentives in the transitional period.

Draft Impact Assessment (IA)

Matteo Guarnerio gave a presentation on Ofgem's 'Transmission Price Control Review: Draft Impact assessment'. Matteo said that Appendix 17 includes a draft IA of the proposals outlined in the third TPCR consultation. Matteo noted that the initial assessment of net benefits to customers was between £20m and £67m in present value terms. Matteo explained that this was a conservative estimate because cost estimates were often 'worst case' in nature. Ofgem used a variety of methods to extrapolate cost

submissions and the most conservative approach was used to inform the 'low case' net benefits. Matteo added that only three benefit categories were quantified, while other benefits were assessed on a qualitative basis. Matteo stressed that this was a draft IA and that Ofgem plans to perform at least one further impact assessment, which will be informed by more detailed drafting by NGG NTS of potential business rules or UNC text.

Matteo noted that under the enduring arrangements, NTS users who are signatories to the UNC will no longer need to enter into ARCAs to reserve capacity. In response to a number of questions, Suzanne explained that the reduced incidence of ARCAs will result in cost savings associated with, for example, the negotiation of disputes and the handling of such disputes by Ofgem. Julie Cox questioned the validity of the potential ARCA cost saving, based on the limited number of ARCA disputes to date. Mark said that the past is not necessarily a good guide to the future occurrence of ARCAs under the current transitional arrangements, particularly given that the concept of DN ARCAs had only recently been introduced. Following this there was a discussion on the nature of ARCA commitments in the transitional period. As part of this discussion, Mark emphasised that the level of any ARCA commitment in the transitional period should be based on a risk assessment and will not necessarily represent a one year commitment in all cases. As such, Mark said that the transitional arrangements could lead to disputes occurring over the levels of such commitments, and that with numerous power station developments in progress such disputes may increase going forward.

Nick Wye questioned the usefulness of the IA, in particular, highlighting the cluster analysis of present value costs to shippers per offtake and the sample size. Suzanne said that Ofgem has undertaken the IA in response to industry demands and that the analysis has been informed by the responses received. Suzanne added that the cluster analysis was used only to inform some scenarios in the draft IA.

Steve Rose sought clarification as to whether the costs incurred by the NTS and DNs as a result of the enduring arrangements could not be passed through to customers. Suzanne confirmed that such costs are a cost of the DN sales transaction and should be borne by GT shareholders rather than customers.

Helen Bray also indicated that in her view the costs assumed for transmission connected customers were too low and that more detailed business rules were needed for customers to accurately assess their possible costs.

Suzanne said she would welcome views from respondents concerning the underlying data and assumptions of the draft IA.

Current flex position & complementary/ alternative ways forward (including NTS Exit flexibility capacity definition) - National Grid NTS presentation

Nigel Sisman gave a presentation describing some background to the two papers that were circulated to the EOWG, entitled: 'NTS Exit Flexibility Capacity Definition' and 'Current Flex Position & Complementary/Alternative Ways Forward'.

Nigel Sisman noted that following extensive network analysis there appears to be little scope for the 'expanding flex product' concept. Nigel stated discussions with DNs have shown that the requirements for 'flex capacity' may be higher than can be guaranteed by

the NTS. Nigel concluded that the product definition may generate risks of unwarranted signals and inefficient investment, resulting in artificially inflated requirements arising because of the DN users inability to signal diversity within their bookings. Therefore, Nigel stated that it may appropriate to reconsider some of the underlying principles. Nigel noted that there may be a low probability that NTS investment is required for the next price control period and it may be better to contemplate a potential rationing mechanism, such as pay as bid auctions, of available flow flexibility. Nigel added that if circumstances change, then it may be appropriate for NGG NTS to discuss a potential way forward with Ofgem and users.

Nigel stated that NGG NTS considered that separate flat and flex products should be developed. Nigel noted that no change to the flat processes would be envisaged, while there would be a long-term constrained release of circa 22mcm of flex. In addition, Nigel stated that, to better reflect DN diversity, it may be appropriate to define zonal principles for the flex product.

In particular, Nigel proposed seventeen 'flexibility zones'. Nigel highlighted a number of potential approaches to the apportionment methodology which are set out in more detail in the paper. These approaches are based on a key principle that the 'sum of zonal availabilities equals national availability'. Nick noted that the allocation of the zones is critical and asked whether there would be competition within the proposed zones given that in most cases only one single player would purchase capacity within a zone. Nigel acknowledged that larger zones may help to mitigate market power issues, but explained that there are physical constraints on the network which may prevent broader zonal definition.

ACTION POINT: Nigel agreed to produce a map of the 17 zones which will be placed on Ofgem website.

Steve Rose asked why NGG NTS had discounted the auctions plus methodology in determining how much flex they can release. In response, Nigel said there were too many uncertainties as to whether this could be guaranteed.

Sharif Islam asked whether a prevailing rights model could be applied to flex. Nigel questioned how prevailing rights would be established or quantified. Nigel also said that if this was based on existing exit capacity levels then the NTS would not be able to meet these levels on a guaranteed basis to DNs and DCs, although more capability may become known close to the point of gas flow.

Nigel said the key issues surrounding the longer term application processes were:

- Will DNs be able to secure capability to avoid unwarranted investment?;
- Who will hold flex capacity after initial releases?; and
- How will shorter term access to flex capacity be managed?

Nigel said he would also welcome views from the EOWG concerning: the merits of pursuing zonal concepts to mitigate risks of unintended consequences including investment; the adoption of a seventeen zone framework; and the preferred basis for attributing capability to zones.

Nigel highlighted the potential for user demand for 'flex' holdings to exceed national availability, but noted two possible mitigation factors: shorter term applications for 'flex'

capacity bookings or an OPN based application process and the physically/financially firm concept. Nigel explained that NGG NTS may potentially sell separate types of capacity: a 'physically firm' product (effectively underpinned by physical assets) and a 'financially firm' complement, which may be less firm in the context of coincident flexibility utilisation and would be subject to some form of guaranteed curtailment when necessary. Nigel asked whether the physical/ financially firm concept is of potential use to users and what information might be necessary to support the user assessment of the product.

Avian Egan and Julie said it would be difficult to assess the proposed arrangements in the absence of specific data including reserve prices. Christiane Sykes noted that NExAS are currently determining the amount of flexibility available to users. Nigel replied that NExAS only specify technical requirements such as allowed ramp rates. Beverley Grubb noted that the DCs currently have no requirements to lock into long-term capacity, unlike the DNs who need long-term guarantee for capacity due to their safety case requirements. Mark said that as part of the DN sales process it was agreed that future enduring offtake arrangements should provide equivalent (and non discriminatory) access requirements for DCs and DNs and that therefore all categories of users should have the opportunity to secure capacity through short and long term allocations. Mark indicated that it should not be assumed that DCs will always restrict their requirements to the short term and that if constraints arise some DCs may book longer term and should have the ability to do so. Julie noted that the principle of non discrimination may drive the debate toward a set of arrangements which are too complicated. Julie also noted that the DNs have different obligations to the DCs. Nick stated a preference for maintaining the status quo with regard to gas offtake arrangements. Nick said that the NTS proposals do not add anything. Nigel responded that the release of a financially firm product would enable users to make commercial decisions with certainty in advance as opposed to waiting until close to gas flow.

As outlined at the last EOWG, Julie highlighted an alternative approach to the allocation of flexibility in the short term. Julie proposes an allocation mechanism by which everybody would submit their Offtake Profile Notices (OPNs) as they currently do. NGG NTS would then make an assessment of whether it can accommodate the requests. If it cannot accommodate all requests, then the OPNs would be rejected and participants would enter into a pay as bid auction mechanism to allocate capacity to those who value it most. Julie noted that there may be allocation issues within day. Julie noted that this would be more a constraint management tool rather than an allocation.

Beverley Grubb noted that the zonal product would help DNs manage diversity. Beverley also said that it is important to consider requirements of different NTS users and noted that the 'pay as bid' auction may drive inefficiencies as it still does not signal likely investment costs for each increment. Nigel noted that it may not be economic or efficient for the NTS to invest specifically for flexibility. Therefore available flex should be delivered efficiently to users and consequently the use of a 'pay as bid' auction is required to determine who values the capacity the most. Suzanne noted that the difficulties associated with setting revenue drivers for incremental flex and stated that investment for flex in the NTS was not being ruled out but would be considered on a case by case basis.

Beverley Grubb asked about the status of the 'expanding flexibility' product. Nigel reported that following substantial network analysis by NGG NTS they concluded that

such a product design does not provide efficient signals for network investment and does not allow for an efficient assessment of capacity buy backs.

Nigel asked participants to give further consideration to the benefits of introducing a financially firm product, which he indicated would address a wide range of the concerns raised with current arrangements.

Other business and date of next meeting

Mark noted that the next EOWG meetings will be held on 12 July (14.00 - 17.00) and 26 July (14.00 - 17.00) subject to confirmation.

The above meetings will be held at Ofgem.