Minutes of Review Group 0221
Tuesday 28 October 2008
held at
Elexon, 350, Euston Road, London NW1 3AW

Attendees

John Bradley (Chair)	(JB)	Joint Office of Gas Transporters
Lorna Dupont (Secretary)	(LD)	Joint Office of Gas Transporters
Alison Chamberlain	(AC)	National Grid Distribution
Charles Ruffell	(CR)	RWE npower
David Linden	(DL)	BP Gas
Graeme Thorne	(GT)	Canatxx Shipping
Jeff Chandler	(JC)	Scottish and Southern Energy
John Baldwin	(JB1)	Canatxx Shipping
Mike Young	(MY)	Centrica
Paul O'Donovan	(POD)	Ofgem
Richard Fairholme	(RF)	E.ON
Roddy Monroe	(RM)	Centrica Storage Ltd
Shelley Rouse	(SR)	Statoil
Tim Bradley	(TB)	National Grid NTS

1. Introduction

JB welcomed attendees to the fourth meeting of Review Group 0221.

2. Review of Minutes and Actions from the previous meeting (13 October 2008)

2.1 Minutes

The minutes of the previous meeting were approved.

2.2 Actions

Action RG0221/007: National Grid NTS to report on the outcome of novation discussions to this Review Group.

Update: TB reported that internal discussions continued and that National Grid NTS had raised this as an agenda item at the next Transmission Workstream meeting (06 November 2008). RM asked whether this indicated an acceptance of the need and a willingness to move it forward. TB acknowledged this. **Action carried forward.**

Action RG0221/008: National Grid NTS to provide numbers for the last two projects, ie auction revenue versus Revenue Drivers.

Update: TB described some figures and explained how they were arrived at (the figures are available on the Joint Office website). **Action closed.**

3. Questions discussed in Sessions 2 and 3: outstanding issues

None were raised.

4. Work Plan: Session 4

TB gave a presentation and the questions raised were considered and discussed.

4.1 Focus Session: "Who/What capacity holders should be captured by these requirements and how should this be assessed?" ie:

(i) by incremental capacity only;

(ii) all new capacity bookings, including obligated;

(iii) all new and existing capacity holdings based on a credit risk assessment; or

(iv) a combination of the above.

(v) Who/How would such a credit assessment be completed and what would be the route for appeal?

TB suggested that the outcome of CUSC Amendment Proposal CAP131 "User Commitment for New and Existing Generators" should be considered alongside this question, as the decision reached for CAP131 may assist the group in arriving at an answer. CR observed that clarity was still required to understand what exactly was being secured. CAP131 separates pre and post connection parties; the charges secured are system charges. For pre connection, security is required against stranding assets; with the Large Combustion Plant Directive (LCPD) there is no stranded risk.

Members commented that each party involved in the CAP131 development and consultation had a different risk profile. Some of the questions in respect of gas included whether the community considered any change as providing pre connection security and whether this should reflect the 8 year NPV test. Is comparing two different regimes of limited value? TB thought more consideration should be given to whether any changes made should be applied solely for incremental capacity or for all elements of capacity.

Some members voiced concerns relating to different classes of Users and issues that may arise in respect of due and undue discrimination, where it was believed that Ofgem's view was grounded on 'the cost to serve'. Referring to CAP131, POD said that Ofgem would be looking at individual risk assessments in relation to Value At Risk (VAR) principles, and safeguarding the actual value at risk in the system. MY referred to the Exit regime under which an existing User would use capacity into the future, but there were concerns regarding incremental capacity and whether a completely new connection would go ahead if security were required from the outset.

Incremental capacity arrangements were designed to place the risk with the Transporter. At Entry, for example, National Grid NTS could choose to invest or face an increased buy-back risk. If the new connection was a Power Station or a DN connection there was very low risk, and there were lead times to step up and step down; perhaps separate mechanisms could be applied to Entry as well? The Transporter does deserve a timely signal if the capacity is not going to be used. Existing capacity and an existing User are likely to represent continued use, whereas a new connection and incremental capacity present a greater risk. POD was not in full agreement with this, and thought it might depend on the magnitude of the capacity.

Different scenarios were then discussed and members pointed out different levels of risks and interactions. JB1 observed that with Substitution it was less valid to distinguish between Users at new and existing ASEPs, and MY commented that in the current Entry regime there was no guarantee of capacity in the future unless it was booked (it could be substituted away).

JB summarised the views so far and observed that the meeting appeared to be favouring (iii). Whether it was new money or existing money and there were no credit arrangements in place then National Grid NTS still has to recover its money. CR used the analogy of a shared insurance policy – should the risk be borne by the community, or by the party triggering the costs; who should underwrite it until it was absorbed into the total System? RM commented that if a party never connects it never pays and the community bears the costs. More examples were discussed, and it was suggested that some money might be recovered through Transfers and Trades. CR thought the community might be better protected if to get the capacity a party had provide a Letter of Credit (LoC) or some other instrument of security. RM pointed out that if the project was abandoned one day before or after connection, the community would still be paying for it.

In response to a question from RM, TB said that currently National Grid NTS can decide to invest or not and pay for it through buy-back.

MY thought that as long as allowed revenue is deferred for a similar period to that of a project deferral, it could be covered; the risk is still there to deliver something but there is no investment risk.

Further examples were discussed.

JB1 commented that Ofgem might have difficulty approving option (i); it would be difficult to craft a regime to accommodate this equitably and there were too many issues relating to discrimination.

Option (ii) had possibilities.

In consideration of option (iii), JB1 referred to the example of Milford Haven, and identified a higher residual risk associated with this option. It was possible for unscrupulous organisations to rapidly close down their numerous legal entities; it was difficult to apply to existing Users without applying it to everyone as it would need some retrospective action. It may be better to use option (ii) and address residual historic problems separately.

JB1 asked whether bids would be any less if security were required, and MY commented that unless Shippers book capacity, it is not going to be there in the future. This would in turn create more pressure on parties to book longer term. RM commented that higher priced bids would be seen with Substitution, accompanied by heightened activity.

At this point in the meeting options (ii) and (iii) appeared to be the most favoured. JB then questioned whether the meeting was now in a position to further establish a positive movement towards one rather than the other.

POD indicated that he had a leaning towards (iii), but could see arguments for both (ii) and (iii) and thought that neither option should be discarded for the present. JC voiced his concerns relating to retrospective application and how various parties may be adversely affected; with Substitution it was known what was coming, which was easier to plan for and deal with, rather than finding an action or decision already taken could then be impacted adversely by the imposition of a retrospective ruling over which there was no control. There was a short discussion on previously purchased capacity and potential issues.

JB suggested that options (ii) and (iii) could be constructed as alternative Modification Proposals for the industry's consideration. TB commented that National Grid NTS' internal view was more in favour of option (iii) as there was some difficulty in justifying (ii). CR thought the group could be looking at what could be achieved under option (iii). MY observed that there may be misleading signals to a Transporter if a User does not back up its purchases with sufficient credit. TB responded that the Energy Balancing Credit Rules that were applied to the Energy side could eventually result in the Termination of a User where appropriate. UNC TPD Section V was examined to attempt to establish and understand currently recognised default/breach situations. CR added that if a User did not meet its credit obligations, the liability was smeared across the community.

JB1 observed that the question still remained: What issues is the group trying to solve? It needed to mitigate certain risks in the best and most appropriate way; it needed to address current risks, and it needed to address new risks going forward on a non-discriminatory basis.

JB then briefly summarised that there appeared to be support for option (ii) but that further understanding may be required from the point of view of discrimination, which could then lead to option (iii). Achieving consensus for approval for one of the options would be the preferred position, culminating in a Modification Proposal to take forward.

To aid understanding and the decision making process, RM suggested that a comparison table, eg of advantages/disadvantages, be created in respect of options (ii) and (iii).

Attention was then turned towards (v). TB reported that various sources such as the UNC and "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" had been researched. The methods identified for establishing credit ratings and limits were described and discussed.

It was pointed out that credit providers, eg Banks, were rated as well as Users, and exposure was assessed on each level.

RM commented that he had no feel for what disincentive there would be for new entrants; there were significant costs associated with establishing credit assessments and this could create barriers. MY thought it was a question of balance, in terms of the identified risk for the industry versus the entry costs and potential creation of barriers to entry for prospective new entrants. Over-securitisation could result in the abandonment of potential projects.

TB then outlined the issues that needed to be addressed if an assessment was to be carried out at or near the time of the QSEC auction, and these were discussed.

RF suggested that a stepped approach may reduce barriers to entry. MY questioned the nature of the risk - was it a 'real' risk or a 'perceived' risk if no actual investment had taken place; securing against a theoretical revenue treatment was unwarranted, ie risk is on the community because the Transporter is 'due' that revenue. It the Transporter does not make the investment it should not be 'due' that revenue. Security should be related to real/actual investment and the issues that arise when delays occur; should deferment and realignment therefore take place across all areas to make it work. CR pointed out that there would be a risk in linking physical build with the auctions as this had not been linked for some time. JB pointed out that the group had to address what was currently in the Licence not what it would prefer to have.

Looking at the role of assessor of security requirements, it was thought that Ofgem may prefer the credit arrangements to be under National Grid's jurisdiction. The Transporter could operate this if the rules were clear.

If the rules were clear and transparent it was agreed that the reason for appeal would be limited.

4.2 Question: "Should there be different treatment of 'connecting' pipeline as opposed to general reinforcement?"

There was a brief discussion. JB1 was in favour of different treatment but in a non-discriminatory way. CR referred to CAP165 "Transmission Access - Finite Long-term Entry Rights". What you connect to is for a finite period and it includes an 8 year commitment to pay; there were separate arrangements for a local connection but this was then deemed unusable by anyone else. MY observed that shallow versus deep reinforcement was another analogy, and referred to the example of Pembroke to Gloucester where there was an ongoing debate on the electricity side as to what should be deemed 'local'. JB1 said that the regime already recognised two different scenarios and could have two different credit arrangements to support this. Examples of assets were discussed, some of which had not transferred to the Transporter and were therefore not included in the Regulatory Asset Value.

CR described the processes that could follow a bid in the QSEC Auctions. For the local connection, specific security and charging could be required from the bidding party. For any reinforcement in the wider NTS, this would be recovered through Transportation charges. However this raised the question of where do you demarcate between the local and the NTS asset?

It was pointed out that on some occasions different arrangements had been made and those associated with Milford Haven were discussed. It was thought important to gain a greater understanding of this example and the circumstances that warranted the difference in treatment, including how risks were reduced/transferred, and the principles as to how the basic entry charge(s) get adjusted.

Action RG0221/009: National Grid NTS (TB) and Ofgem (POD) to investigate and report on the background and circumstances supporting the decisions made in respect of Milford Haven.

JB1 suggested there might be one credit rule for reinforcement of the NTS and another for connections. Security should apply to the level of commitment made. This principle was agreed and it was identified that this should added to any business rules developed by the Group.

4.3 Question: "Should any revision to security arrangements be applied to previous auction allocations that are yet to reach the capacity release date?"

TB pointed out that all parties were aware that the UNC does frequently change following appropriate consultation and that sufficient lead time for a change is generally afforded to parties to enable implementation. There was a brief discussion.

MY and RF were concerned that an increase in the severity of credit rules and changes to windows would require significant changes to the amount of credit needing to be held.

The default lead time was 42 months and it was rare for anyone to signal in advance of this; MY commented that, wherever an increase in capacity has been signalled, it has been around 40 months.

RF thought that it was better it should be applied to new auctions/projects now to allow companies to plan for it without receiving any nasty surprises.

Some parties felt that this could change the whole economics of a project; others would be more comfortable with a middle way if one could be defined.

RF observed that reviewing old auctions and credit limits was not an immediate option, but a phased approach might work better.

In discussing costs, MY observed that £490 million was the Price Control TO revenue and he assumed that half of this would be for Entry; £245 million. Currently National Grid NTS holds security for 12 months; the cost of holding that level of security for 8 years forward is significant. POD said that he understood the figure to be £220 million but this comprised both commodity and capacity charges of which 60 – 70% came through the commodity charges. The question then arose as to whether you want to secure for both revenue items or only capacity.

Referring back to a potential action on National Grid NTSRM suggested that timings be added (eg 12 months, 5 years?) and also an indication of cost to the industry to implement any changes. The Group agreed that it would be helpful that National Grid NTS's analysis of options should take into account these timing options, whether the current credit arrangements were appropriate and the effect of proposed pricing changes.

It was therefore agreed that the Action discussed earlier should be extended to read:

RG0221/010: National Grid NTS (TB) to create a comparison table setting out the advantages and disadvantages of options (ii) and (iii) and include a discussion on other aspects associated with the choice.

5. Allocation of actions for Session 5 (10 November 2008)

JB read out the items included for discussion in Session 5. (Please refer to the Work Programme for further details).

6. Any Other Business

None raised.

7. Diary Planning for Review Group

The next meeting of the Review Group (Session 5) will be held from 10:00 – 13:00 on Monday 10 November 2008, at Elexon, 4th Floor, 350 Euston Road, London NW1 3AW.

Future meetings have been arranged as follows (all at Elexon, 350 Euston Road, London NW1 3AW.):

Session 6: Thursday 27th November – 13.30 onwards (following the Distribution Workstream)

Session 7: Wednesday 10th December - 10.00 – 13:00

Subsequent meetings (Sessions 8, 9, 10, 11, and 12) will be arranged as the progress of the work of the group dictates.

For further details of the content of each Session please refer to the Work Programme.

ACTION LOG – Review Group 0221

Action Ref	Meeting Date	Minute Ref	Action	Owner*	Status Update
RG0221 007	13/10/08	2.1	Report on the outcome of novation discussions to this Review Group.	National Grid NTS (RH)	To be discussed at the Transmission Workstream **Carried Forward**
RG0221 008	13/10/08	4.1	National Grid NTS to provide numbers for the last two projects, ie auction revenue versus Revenue Drivers.	National Grid NTS (RH)	**Closed**
RG0221 009	28/10/08	4.2	Investigate and report on the background and circumstances supporting the decisions made in respect of Milford Haven.	National Grid NTS (TB) and Ofgem (POD)	
RG0221 010	28/10/08	4.1 and 4.3	Create a comparison table setting out the advantages and disadvantages of options (ii) and (iii) and include a discussion on other aspects associated with the choice.	National Grid NTS (TB)	

* Key to action owners

RH – Ritchard Hewitt

TB – Tim Bradley

POD- Paul O'Donovan