UNC Workgroup 0368 Minutes
Smoothing of Distribution Charge Variation

Monday 25 July 2011
via teleconference

Attendees

Tim Davis (Chair)	(TD)	Joint Office
Lorna Dupont (Secretary)	(LD)	Joint Office
Andy Manning	(AM)	British Gas
Chris Warner	(CW)	National Grid Distribution
Clare Cantle-Jones	(CC)	ENA
Denis Aitchison	(DA)	Scotia Gas Networks
Gareth Evans	(GE)	Waters Wye Associates
Helen Inwood	(HI)	RWE npower
James Stone	(JS)	E.ON UK
Jo Parker	(JP)	Scotia Gas Networks
Joanna Ferguson	(JF)	Northern Gas Networks
John Edwards	(JE)	Wales & West Utilities
Julia Haughey	(JH)	EDF Energy
Simon Trivella	(ST)	Wales & West Utilities
Steve Armstrong	(SA)	National Grid Distribution
Tom Connolly	(TC)	ScottishPower
Will Guest	(WG)	Northern Gas Networks

1.0 Review of Minutes and Actions of the previous meeting

1.1 Review of Minutes

The minutes of the previous meeting were approved.

1.2 Review of Actions

WG0368/0401: Consider and develop a model based on percentages.

Update: Each DN had provided data showing a percentage based approach (see 2.2 below). **Closed**.

WG0368/0402: Look more closely at and develop a model based on revenue.

Update: GE indicated that the data presented would be considered before pursuing this action. **Carried forward**

WG0368/0403: Provide a presentation on the Licence Conditions and the Price Control arrangements, and the ability to under or over recover.

Update: Presentation provided (see 2.1 below). **Closed**

WG0368/0404: Model K and replicate for all networks, and include 'smoothing'.

Update: This had been provided by all DNs. **Closed**

WG0368/0405: Consider how shrinkage alone affects volatility and establish how much of allowed revenue is down to shrinkage.

Update: Provided by the DNs. GE commented that the swings in Shrinkage had been useful to see and hard to avoid. **Closed**

WG0368/0501: DNs to provide the equivalent of NGN's analysis of 0186 forecast accuracy.

Update: This had been provided. **Closed**

2.0 Discussion

2.1 Action WG0368/0403 – Licence Conditions

DA gave a presentation on the Licence Conditions and the Price Control arrangements, and the ability to under or over recover. He stressed that it was not an absolutely comprehensive overview of the subject but contained the key points that were pertinent to the matters under discussion. He outlined the obligations governing charge setting and explained the elements contained within the calculation for Allowed Revenue (this is also where the TMA costs are accommodated). K is in the Licence and only appears once; a definition was presented, and attention was drawn to the potential conflict with Modification 0368 since that requires K to be defined differently.

GE suggested that the amount of K reflected in charges would be bigger or smaller rather than changing anything as defined in the licence. DA responded that he did not think that it could stay in the Licence as it was, but would have to be redefined in the algebra. DA went on to demonstrate this through the effects of under and over recovery, which potentially place a Transporter in breach of the obligation to use best endeavours not to over-recover. A change to the Licence may therefore be required. GE acknowledged DA's argument and that there may be value in having this reviewed under the RIIO discussions - it was not the intention to place the Transporters in an untenable position, and this may need to be 'covered off' elsewhere.

AM questioned if this should be a charging modification or RIIO discussion. TD stated it was a UNC discussion as this modification remained live unless formally withdrawn. GE confirmed that there was no intention to withdraw the modification, whilst acknowledging that RIIO needed to be taken account of at the same time; neither should preclude the other, but each should inform the other. TD suggested that the modification may be implemented without a Licence change – it was unfortunate that Ofgem were not present to participate and more fully inform the discussions and respond to the Workgroup's questions. ST thought the issue might rather be one of governance; the Transporters would not confirm an implementation date until such time as any Licence implications had been resolved satisfactorily, and Ofgem needed to be involved in this.

Returning to the presentation DA outlined the obligations in respect of charge change dates and the disincentives that were in place to discourage the exceeding of thresholds for over recovery, and the K Interest adjustment.

There were no further questions.

2.2 Percentage Based Approach

TD asked the DNs if they had any further views on an alternative approach. The DNs confirmed that they felt considering K alone was unlikely to deliver the benefits that the modification was seeking. If an approach was to be implemented, they felt that looking at the total percentage change was the most likely to be effective.

For Scotia Gas Networks, DA indicated that modelling based on a K maximum 5% real limit had been provided and explained the conclusion that it would accumulate significant under-recovery, which may be unsustainable and would certainly be difficult for SGN to manage. It was suggested changing the 5% to 10% might be more realistic. However, GE commented that 10% was not a real cap at all and offered little value. He accepted that, from a Shipper point of view, the percentage band could work better than focussing on K alone, but either change would be better than the current position. He added that the information provided has been very useful for Shippers and thanked the DNs for their work. He was now inclined to prefer a model based on percentage change limits.

DA commented that Ofgem's latest suggestions on the way in which inflation and incentives might impact allowed revenues should make allowed revenues more predictable, and make collected revenue more closely aligned with allowed revenue. This may negate the need for any UNC modification. GE agreed that on some levels it will improve, but vulnerability to movements of cost bases, consumption and shrinkage would remain. Shippers need as much predictability as possible; smoothing RPI and stabilising SOQ movements should ensure less volatility. Having said that, GE noted that huge movements had been seen in SOQ, reflecting the current poor economic climate; Project Nexus improvements may help, but the impacts of this major recession remain somewhat uncontrollable.

SA commented that collars and caps were not always effective and can create an on-going accumulation problem. He felt it might be better to look at any fundamental issues that could be fixed to improve the degree of predictability, although this may not help stability. GE thought that improvements in stability would also be welcomed as this affected long-term forecasting/pricing strategy, etc. He suggested considering potential options for a cap around forecasting rather than year ahead predictability, and DA suggested this could be linked to notice periods – a higher cap if a longer notice period is provided? GE stated he was open to discussions on what might be considered reasonable with respect to caps and collars – he still sees them as giving benefits to the industry in relation to avoiding the largest swings; and he was more than happy to have them linked to RPI. While DA believed that a cap is possible, he emphasised that it would need a mechanism to enable periodic adjustment to deal with any accumulation, ie when specific conditions to be met. GE was not convinced about this aspect, with constant changes in caps and collars undermining the solution.

For National Grid Distribution, SA indicated that similar information based on 5% real and 5% absolute and smoothing K had been provided and explained the conclusions; the accumulated under recovery figures were unsustainable and more thought would be required before considering the application of caps and collars. He suggested that lagging might be more help on the predictability issue, while caps and collars would better aid stability. His view was that having more control over input factors was fundamental and improvements in this area should be given greater consideration.

Wales & West Utilities (WWU) and Northern Gas Networks (NGN) had also modelled the various options with similar results. JE believed that smoothing K only improved the situation marginally. However, real caps would have present a significant cash flow issue. Having looked at the modelling, he would not like to proceed along the cap and collar route, but would prefer to improve predictability.

GE remained open to all suggestions. He would, however, expect any under/over recovery to be put into the costs that Transporters are allowed to recover which would mitigate the adverse impacts that the DNs had pointed out.

2.3 Next Steps

TD reported that the Ofgem Modification Panel Representative had suggested that related issues are being considered as part of RIIO. If a modification is progressed, therefore, it is unlikely that Ofgem would decide whether or not to agree to implementation until the RIIO outcome is clearer. Against this background, Ofgem had suggested that a Workgroup Report in December 2011 was likely to tie in with Ofgem's timetable for decision-making.

In light of the Ofgem view, GE believed there was time to revise the modification to incorporate an approach with caps and collars, and to consider the inclusion of parameters to deal with the effect of extraordinary events. He would consider what an appropriate cap/collar might be and what might constitute an 'emergency reopener', and associated changes to the process. DA observed that receiving a draft of any revised proposal for comment would be appreciated.

The following actions were agreed:

Action WG0368/0701: (SA) Look at the fundamentals of forecasting issues with a view to providing more predictability

Action WG0368/0702: (GE) Revise the modification in light of discussion

3.0 Any Other Business

None raised.

4.0 Diary Planning for Workgroup

The Workgroup agreed to meet during the first half of September 2011, subject to completion of actions and provision of materials 5 business days ahead of the meeting. The meeting arrangements will be notified nearer the time.

Action Log: Workgroup 0368 - 25 July 2011

Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
WG0368/0401	13/04/11	4.	Consider and develop a model based on percentages.	All DNs	Closed
WG0368/0402	13/04/11	4.	Look more closely at and develop a model based on revenue.	Total (RD/GE)	Closed
WG0368/0403	13/04/11	4.	Provide a presentation on the Licence Conditions and the Price Control arrangements, and the ability to under or over recover.	Scotia Gas Networks (DA)	Closed
WG0368/0404	13/04/11	4.	Model K and replicate for all networks, and include ‘smoothing’.	Northern Gas Networks and Wales & West Utilities (WG and JE)	Closed
WG0368/0405	13/04/11	4.	Consider how shrinkage alone affects volatility and establish how much of allowed revenue is down to shrinkage.	All DNs	Closed
WG0368/0501	16/05/11	2.	Provide the equivalent of NGN’s analysis of 0186 forecast accuracy	All DNs except NGN	Closed
WG0368/0701	25/07/11	2.2	Look at the fundamentals of forecasting issues with a view to providing more predictability	National Grid Distribution (SA)	For discussion at September meeting
WG0368/0702	25/07/11	2.2	Revise the modification in light of discussion	GE (on behalf of Total)	For discussion at September meeting