Minutes of Review Group 0221
Tuesday 10 February 2009
held at
Ofgem, Millbank, London

Attendees

John Bradley (Chair)	(JB)	Joint Office
Andrew Pearce	(AP)	BP Gas
Charles Ruffell	(CR)	RWE npower
Chris Shanley	(CS)	National Grid NTS
Graham Thorne	(GT)	Canatxx Shipping
Jeff Chandler (by phone)	(JC)	SSE
John Baldwin	(JB2)	Canatxx Shipping
Louise McGoldrick	(LM)	National Grid NTS
Paul O'Donovan	(POD)	Ofgem
Rekha Patel	(RP)	Waters Wye Associates
Richard Fairholme	(RF)	EON UK
Roddy Monroe	(RM)	Centrica Storage Ltd
Shelley Rouse	(SR)	Statoil UK
Stuart Cook (part)	(SC)	Ofgem
Tim Davis	(TD)	Joint Office

1. Introduction

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

2. Review of Minutes and Actions from the previous meetings

2.1 Minutes (23 January 2009)

Subject to some clarificatory comments, to be provided by CR regarding the electricity regime, the minutes were approved.

2.2 Actions from previous sessions

Action RG0221/018: National Grid NTS to develop possibilities for the three timing options for providing credit: all ahead of the bid window; allowing topping-up within a bid window; providing full credit after closure of the bid window.

Update: Covered under Agenda Item 3. Further consideration needed when the draft Proposal is developed. **Action carried forward.**

ACTION RG0221/022: National Grid NTS (RH) to produce a draft Modification Proposal for discussion at the next meeting.

Update: A draft had been published. **Action closed.**

3. Discussion Draft Modification Proposal(s) reflecting previous discussions

In addition to the draft Modification Proposal, National Grid NTS had produced a supporting guidance document, Long Term Entry Capacity User Commitment Supplementary Guidance Document, which CS ran through. Views on how the arrangements should be split between the Proposal and supplementary document would be welcome. JB asked about the governance which would apply to the supplementary guidance document. CS indicated that National Grid NTS was open to suggestions, but this could either be subject to UNCC approval or be at National Grid NTS's discretion.

GT felt that the proposed process in respect of construction risk would prevent any new projects emerging from smaller independent companies – credit would need to be provided before finance is in place, which could never happen. RM suggested that facing 100% of the potential credit liability may not be a particular barrier if the initial liability was not too onerous. CS emphasised that any requirement would only be needed once ready to bid, not at the start of the development process and hence it is not clear why this extra requirement should deter new projects.

In the context of the User Security Value, GT asked what length of Letter of Credit (LoC) would be sought under option 2a. CS said this would be for a year. RM questioned who would be obtaining the LoC and where the 2.5% average cost had come from. GT supported that this was a reasonable average albeit the lowest cost option. CS explained the figure was an average which a bank had quoted albeit that this would vary between individual organisations. JB2 suggested that as part of the consultation each User should be informed about their potential exposure and hence would be able to estimate their own costs, and provide this as feedback which could inform the final form of the Proposal. CS emphasised that National Grid NTS is keen to capture and understand the costs that would be faced.

RF asked if there would be a minimum rating for the provider of the LoC. CS felt that National Grid NTS would need to assume that any valid LoC was from a reputable provider. RF felt some further consideration of this would be worthwhile, avoiding over-exposure to any single institution.

The scatter diagram in the guidance document showed how £100m of credit requirements would be spread among existing Users based on real data. Some debate ensued since this showed one (relatively high risk) User picking up 34% of the full liability. Requiring the User to secure this level of credit could prevent the project going ahead, which may provide appropriate protection to other Shippers or could be an inappropriate barrier to entry.JB2 felt this showed the merit in looking at two issues separately – credit from existing Users at existing terminals and how to secure credit from those developing new projects at a new entry point. For these, the auction process is unduly complex and they should simply face a cost to purchase capacity which could be underwritten by appropriate credit arrangements. GT emphasised that the problem was that it is impossible to secure finance unless guaranteed entry capacity is already held – being able to get gas into the system is a critical requirement for obtaining credit finance. Hence requiring credit ahead of bidding was a chicken and egg situation. RM agreed this was difficult but emphasised that equally we were looking to avoid getting into a position where, after capacity has been allocated, the bank declines to provide credit.

CS questioned whether timing of when credit is sought, ahead of the auction, was the issue – would being able to top-up credit after capacity is allocated help? JB2 suggested different processes could apply for existing and new terminals. GT felt that a requirement to post credit within 60 days of allocation would be workable – POD identified that a Licence change may be needed to delay the revenue driver being triggered prior to allocations being confirmed were this option to be pursued.

JB2 said an alternative approach would be to continue as now, but to require all Users to have sufficient credit in place at a given date each year. There is no need to link this to an allocation process, which unnecessarily complicates the process. RP felt that the additional information circulated by National Grid NTS had moved the debate forward and revealed potential conflicts such that the debate needed to look at whether the Proposal could unduly discourage independent projects from proceeding.

RM felt there was a real problem of complexity when the potential credit arrangements and their timing were set in other contexts, particularly the debate around substitution, which might in any event lead to a two stage QSEC process. Extending the period prior to allocation would eat into lead times and risk delivery of pipeline projects needed to provide physical capacity. If the standard 42 month construction period was extended, this would be highly undesirable. GT emphasised that Canatxx had faced particular difficulties because of National Grid NTS's requirement that they bid 48 months ahead of need.

JB2 said that the key was a licence change such that National Grid NTS would not receive additional revenue for projects that did not go ahead. A process is needed to keep National Grid NTS whole but avoid the whole value of revenue allowances being triggered. RM felt that any adjustment might be accommodated through a logging up process without needing a licence change.

RM was concerned that introducing processes which differed between new and existing ASEPs could create perverse incentives, and that unpicking allocations in light of a failure to post credit would open up a wide range of issues and complications – especially in light of substitution.

It was agreed that the National Grid NTS draft process, with credit posted in advance, potentially works for existing points. It was also recognised that this did not work well for new entry points, when posting credit within 60 days after an auction process may be appropriate. But the two were potentially incompatible and the implications for the Gas Transporter licence and revenue drivers also merited consideration.

CS agreed to look at whether National Grid NTS could accommodate flexibility and allow posting of credit, say, 60 days after the initial allocation of capacity. This would apply to new ASEPs while the draft Proposal as circulated would apply to existing ASEPs. CS also suggested looking at some examples to see the impacts of different options. JB2 suggested that further consideration should be given to an annual credit check rather thank linking this to the QSEC process. RM suggested that National Grid NTS should also consider how any revised process would interact with substitution proposals.

CS urged all to provide feedback on the appropriate factors which should be applied in the calculations set out in the draft guidance document, which would impact the total level of credit to be provided and potentially the impact for specific Users.

CS then turned to the draft Modification Proposal. RP questioned how changes could be made to the percentages if contained within the guidance document rather than this being subject to a Modification Proposal. CS indicated that National Grid NTS had an open mind on where the percentages should sit and the governance which should be applied to the guidance document. JC expressed a preference for more to be within the UNC rather than less. RF agreed, since a change in credit requirements could impose a significant cost on Users and so would quite rightly be subject to the full UNC change process.

JC suggested that there was merit in considering a lower level than 20% as set out in the draft Proposal, especially in the present financial climate, and asked if 10% would be appropriate. SR questioned why the full auction period had been included rather than limiting the calculation to the initial years as previously discussed. CS indicated that National Grid NTS could cut the cake a number of ways to achieve the same level of total exposure and would welcome views on the appropriate way forward. RM said there would be a cost to the consumer which could be higher than the 2.5% quoted for a LoC, especially if new independent projects were deterred. GT felt this was particularly inappropriate since the nature of project finance meant new projects brought forward on this basis were likely to be lower risk than existing Users.

JB asked if the conclusion was that for new entrants at new ASEPs, a licence change was necessary for progress to be made. POD confirmed that if the group concluded that a Licence change was needed, Ofgem would be willing to look at this.

4. Allocation of actions for next Session (Thursday 26 February 2009)

CS agreed to bring revised documents and some further analysis of some scenarios to the next meeting. However, he would be relying on others to provide feedback if any substantive change to the draft was to be made. RP suggested that the Proposal should be revised to incorporate more of the detail presently in the guidance document. JB encouraged all to go back to the list of questions which had been published in the previous set of minutes and provide answers. These were:

1. Should the Modification Proposal look to address any issues with the current regime or be implemented in parallel?
    - The current short term entry capacity security arrangements look at the future 12 months capacity charges for QSEC (Year 1) and this may conflict with the long-term capacity arrangements using Year 1 as part of our Auction Bid Value calculation.
    - For the short term capacity arrangements, if a User does not provide sufficient security there capacity lapses and they are not invoiced. For long-term capacity it is our proposal to re-call all capacity if security is not maintained. Are these two approaches appropriate?
    - Should any security obtained for long-term capacity be taken into consideration as part of the security required for the short-term capacity/transportation invoicing arrangements?
2. With the above in mind, what years should be used to calculate the Auction Bid Value (for example we are currently evaluating the benefits of using years 3, 4 & 5)?
3. Is it appropriate to use a risk assessment process to amend the calculated Auction Bid Value to reflect the risk of the User?
4. Should the current risk assessment elements be used and if so what percentages should be applied to the Auction Bid Value derived [the percentages below are the NG current view, following Fridays discussion]?
    - Fixed amount (%) - 30%
    - User Credit Rating – 20%
    - Project Risk – 40%
    - Community impact – 10%

5. Any Other Business

None raised.

6. Diary Planning for Review Group

The next meeting of the Review Group (Session 11) will be held at 10:00 on Thursday 26 February 2009, at Elexon, 4th Floor, 350 Euston Road, London NW1 3AW.

ACTION LOG – Review Group 0221

Action Ref	Meeting Date	Minute Ref	Action	Owner*	Status Update
RG0221 018	07/01/09	3	Develop possibilities for the three timing options for providing credit: all ahead of the bid window; allowing topping-up within a bid window; providing full credit after closure of the bid window.	National Grid NTS (CS)	To be considered as part of draft proposal
RG0221 022	07/01/09	4	Produce a draft Modification Proposal.	National Grid NTS (RH)	Presented 10 February **Closed**

* Key to action owners

RH – Ritchard Hewitt

CT – Claire Thorneywork

CS – Chris Shanley

DL – David Linden