

Minutes of Review Group 0221
Thursday 11 September 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
Andrew Fox	(AF) National Grid NTS
Benjamin Clair	(BC) South Hook Gas
Charles Ruffell	(CR) RWE npower
Chris Wright	(CW) Centrica
David Linden	(DL) BP Gas
John Baldwin	(JB1) CNG Services
Nick Wye	(NW) Waters Wye Associates
Paul O'Donovan	(POD) Ofgem
Richard Fairholme	(RF) E.ON UK
Ritchard Hewitt	(RH) National Grid NTS
Tim Bradley	(TB) National Grid NTS

1. Introduction and Review Group Operation

JB outlined the role of the Review Group (UNC Modification Rules Section 11), whose work may conclude in a UNC Modification Proposal that may be recommended to proceed to consultation. The duration of the Review Group has initially been set at 6 months, and it is anticipated that the Review Group Report will be presented to the UNC Modification Panel on 19 March 2009.

2. Outline of Proposal

National Grid NTS (TB) provided an outline of the rationale for the Proposal, giving a brief overview of the current Gas Entry Auction and security arrangements and highlighting key issues concerning QSEC credit and the application to Single Entry Point User scenarios.

It was confirmed that the figure of 50% in the NPV Test was part of the existing IECR document.

CW asked what happened to the capacity following the stripping of rights. TB responded that this was resold or made available to other Users.

The group then explored initial ideas on what should be addressed within the scope of the review.

NW suggested that the balance of risk between the Users and the Transporter should be considered.

The issues identified under this Review Proposal indicated a failure broader than the terms of the UNC; a scenario of no capacity, no connection and no Shipper, resulted in a potentially huge liability, driven by the Licence conditions.

It was recognised that some changes to the Gas Transporter Licence may be required. Although these could be discussed within the confines of the meeting, in relation to pertinent and affected areas, licence changes were deemed to be out of scope. RW thought that it might be possible to attempt to influence Licence changes in tandem with any UNC changes, but the immediate task (and preference) was to match the UNC regime with current obligations. POD agreed that a solution needed to be identified and that Licence changes would need to be explored elsewhere. It was recognised that Ofgem would not approve a Modification Proposal that was in conflict with Licence obligations.

NW observed that the relationship needed to be defined and the group needed to understand how this was constrained by the Licence.

It was questioned whether failure to have credit in place actually placed a party in breach of the UNC. RH responded that UNC required a party to have credit in place; there were certain remedies in UNC to address this position. AF added that National Grid NTS would be in breach for not taking away those capacity rights in such a case. The ability for a party to operate its business would be slowly removed by various sanctions. NW asked if this would stop a party from trading at the NBP; RH thought that it would be unable to take gas off or put gas on but could trade. Taking away the capacity for the period concerned alleviates the liability, but it was uncertain whether it affected Exit or not.

In respect of a continuing situation where capacity released in the QSEC Auction is not taken up and not built, POD responded that there would be a negative adjustment in the RAV.

Returning to potential areas to address (Slide 12, point 1) JB reiterated two key questions: Does it place the equivalent level of risks on all parties; does it drive/incentivise expected and responsible behaviour.

POD sought clarification as to whether it covered incremental capacity and associated credit or all credit. JB confirmed that it concerned Transportation at Entry (not Exit) and excluded Energy Balancing credit. It was agreed that Entry and Exit needed to be treated separately.

RH gave an example scenario of two parties at a point, one new and one existing. The new party bids, National Grid NTS build the capacity, and then the existing party 'walks away' leaving National Grid NTS with what is in effect an unnecessary build. An appropriate auction signal may have avoided unnecessary investment. Measures were required to extract appropriate information from new and existing parties in a timely mode to avoid commitment to unnecessary investment.

It was confirmed that 12 months was the period included in the original capacity booking regime and this had not been reviewed since its instigation.

A discussion followed on whether changes should apply retrospectively or prospectively. Current practice is that changes made to the UNC do not affect parties retrospectively. However, arrangements for the utilisation of future capacity can change and this would have a prospective effect. NW pointed out that when a contract was struck it was not expected to change nor have changes applied retrospectively. It was acknowledged that there were various ways of defining retrospective and that the meaning and understanding of 'prospective' and 'retrospective' needed to be more clearly defined so the effects of an application of one set of arrangements or other could be more clearly ascertained.

CR pointed out that two sets of credit rules were undesirable and this was agreed.

JB1 thought it would be hard to go back and change between the current User Option and any future User Commitment principle. CW raised concerns regarding a party being able to avoid/evade liabilities as they fell due. The formation of shell

companies and irresponsible behaviour seemed to be facilitated by the current regime and it would be very difficult to stop this behaviour. Trying to identify and separate out the 'legitimate party' from the 'irresponsible speculator' would be very difficult, and costs resulting from the actions of the latter would be smeared across the rest of industry. As the UNC currently stands, this is a potential risk on the Exit side.

The ease of obtaining a Shipper Licence was discussed and it was questioned whether credit vetting formed part of that process. POD thought that this was included. Accessions to the UNC included a credit vetting process. JB1 suggested that the group could usefully consider the differences between electricity and gas licence applications and credit arrangements. The group could also review new projects on the electricity side and gain an understanding of the financial commitments. RH agreed that the group should perhaps look at what had been debated by the electricity industry such as CUSC Amendment Proposal 131 "User Commitment for New and Existing Generators" and learn from this.

Action RG0221/001: National Grid NTS to arrange for a presentation on CAP131 to be made at the next meeting; if internal CAP131 expert unavailable National Grid NTS to contact CR who has offered to give a high level presentation.

NW said that he would like to gain a better understanding of what actions National Grid NTS currently take in response to perceived signals. National Grid NTS was open to the risks of buyback depending on the auction signals and the action taken.

NW also pointed out that adjustments to the current regime will increase the cost for the community. CW was not convinced of this; there was a need for Users in general to trade off a high financial risk (5 years of SO revenues) against greater securitisation at the time of bidding for capacity. RH said that there was a need to improve the existing regime and that a balance needed to be struck, bearing in mind that in recent years not much in the way of costs has been smeared back across the community in respect of spurious projects.

POD supported this view; there seemed to be valid concern that an irresponsible Licence holder could make a bid, not follow through, and then costs incurred would be spread across the community. An inherent danger had been identified and warranted further discussion.

3. Review Group Process (Work Plan)

A draft Work Programme was discussed. NW emphasised that in order to identify the work required to improve the current arrangements the group needed to gain an understanding of the whole framework and the wider context.

JB1 mentioned that under the Licence a Shipper may raise an Income Adjustment Event and this had been referred to by Tim Davis (TD) in the substitution workshops. This needed to be clarified.

(Post meeting note: TD has responded that in the Gas Transporter Licence (under SO revenue), there is the following paragraph: "Where any shipper considers, and can provide supporting evidence that, in respect of formula year t, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then that shipper may give notice of this event to the Authority.")

A discussion on substitution followed, centred on whether capacity substituted to a subsequently 'defaulting' ASEP would revert to the original ASEP and the effect this would have on the exchange rate. It was suggested that this scenario may need to

be recognised within the substitution methodology, rather than be addressed by the Review Group.

It was questioned if different credit arrangements would be required in respect of AMSEC Auctions. Security would need to be provided to support a bid. It was concluded that capacity is a single product; it would be too complex to have different credit arrangements in place for different auctions.

NW would like to see greater consideration given in the Work Plan to the identification and assessment of risks and some changes were made to the document.

BC commented that he was surprised that all aspects of the Shipper Licence and the associated application process were not reviewed on a regular basis. From the standpoint of South Hook Gas he would like to be able to answer the following questions: whether anything booked in the past should be affected; what sort of tools would be required in the future, as he needed to understand the position and what might be expected of his organisation in the future.

In terms of questions to be answered, a draft Work Programme was produced, taking account of members' suggestions; members requested that it be appended to the Terms of Reference (once these had been discussed and agreed).

Action RG0221/002: National Grid NTS to produce a timeline describing and explaining the changes that have happened to risks that have triggered the bringing forward of this Review Proposal.

Action RG0221/003: Work Plan: Joint Office to liaise with the Proposer and review the draft Work Programme, and produce an appropriate Work Plan for the next meeting.

4. Consider Terms of Reference

The draft Terms of Reference were reviewed and amended as agreed and the draft "questions to be addressed" would be attached. The draft Terms of Reference will be presented for consideration at the September UNC Modification Panel meeting if the Panel agrees to take it as late business.

A copy of the revised Terms of Reference (v1.0) are available to view or download from the Joint Office web site at: <http://www.gasgovernance.com/Code/Reviews/Rev0221/ToR/>.

5. Diary Planning for Review Group

Having identified and recognised the potentially high workload that the group will need to undertake, it was proposed that the group meet twice a month.

Two meetings have therefore been scheduled as follows:

- 25 September 2008 13.30 – Elexon, 350 Euston Road, London NW1 3AW (following the Distribution Workstream);

(Post meeting note: it was established that an opportunity does not exist to hold a session after the Transmission Workstream on 2 October 2008)

- 13 October 2008 10.00am – Elexon, 350 Euston Road, London NW1 3AW.

Subsequent meetings will be arranged as the progress of the work of the group dictates.

6. Any Other Business

None raised.

ACTION LOG – Review Group 0221

Action Ref	Meeting Date	Minute Ref	Action	Owner*	Status Update
RG0221 001	11/09/08	2.0	National Grid NTS to arrange for a presentation on CAP131 to be made at the next meeting; if internal CAP131 expert unavailable National Grid NTS to contact CR who has offered to give a high level presentation.	National Grid NTS (RH)	
RG0221 002	11/09/08	3.0	National Grid NTS to produce a timeline describing and explaining the changes that have happened to risks that have triggered the bringing forward of this Review Proposal.	National Grid NTS (RH)	
RG0221 003	11/09/08	3.0	Work Plan: Joint Office to liaise with the Proposer and review the draft Work Programme, and produce an appropriate Work Plan for the next meeting.	Joint Office (JB) and National Grid NTS (RH)	

* Key to action owners

RH – Ritchard Hewitt, JB – John Bradley