Minutes of Review Group 0221
Monday 13 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
Charles Ruffell	(CR)	RWE npower
Chris Wright	(CW)	Centrica
Craig Purdie	(CP)	Centrica Storage Ltd
David Linden	(DL)	BP Gas
Graeme Thorne	(GT)	Canatxx Shipping
Jeff Chandler*	(JC)	Scottish and Southern Energy
John Baldwin	(JB1)	Canatxx Shipping
Paul O'Donovan	(POD)	Ofgem
Rekha Patel	(RP)	Waters Wye Associates
Richard Fairholme	(RF)	E.ON
Ritchard Hewitt	(RH)	National Grid NTS
Roddy Monroe	(RM)	Centrica Storage Ltd
Shelley Rouse	(SR)	Statoil
Tim Bradley	(TB)	National Grid NTS

* by teleconference

1. Introduction

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

2. Review of Minutes and Actions from the previous meeting (25 September 2008)

2.1 Minutes

The minutes of the previous meeting were approved.

DL wondered whether the question raised under AOB had been answered. RH responded that this related to the discussion on novation; a novation type clause was included in the Business Rules for the 0116/0195 Modification Proposals and there was some consideration as to whether to include it in the discussions for Entry. It could be argued, however, as being beyond the scope of this review.

RM reported that this had been discussed with Martin Watson (National Grid NTS) on the Entry Capacity side and that National Grid NTS were having internal discussions. He encouraged interested parties to make their interests known to Martin Watson so that discussions could benefit from the greater focus.

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

2.2 Actions

RG0221/004: RWE (CR) to provide an update on other modification proposals that may be relevant to Proposal 0221.

Update: CR gave an update on relevant proposals at various points in the meeting. **Action closed**

RG0221/005: National Grid NTS (RH) to develop and present alternative principles for requiring security from capacity holders.

Update: Covered under item 4.1 below. **Action closed.**

RG0221/006: National Grid NTS (RH) to review Network Entry Agreements from the standpoint of revising default arrangements.

Update: RH reported that he had discussed this with JB1 and this was related to an issue concerning the connecting of pipelines and whether it would be reasonable to include novation rights in entry requirements for NEAs; it was not considered to be appropriate here and RH was not proposing to include this. **Action closed.**

3. Questions discussed in Session 2: outstanding issues

RH described a simple scenario and explained what would happen to the funded incremental obligated capacity in the event of a party experiencing financial difficulties, becoming unable to meet its cash call obligations, and being terminated under the UNC.

Ofgem and National Grid NTS would discuss the viability of completing or abandoning the project. The obligation to release the capacity remained and another party could purchase this at short notice.

RH explained when revenue recovery commenced. In response to questions, POD confirmed that Ofgem would be unlikely to veto if the NPV test was met; Ofgem did not require National Grid NTS to make known how much it was likely to invest. If the NPV test were triggered National Grid NTS would indicate the bids, the calculations, and the strength of the signal, etc, and after appropriate consideration Ofgem would generally issue a letter of acceptance.

It was confirmed there was a 60 day window from auction bid to allocation.

4. Work Plan: Session 3

TB gave a presentation and the questions raised were considered and discussed at some length. The current arrangements were reviewed (slide 3) and views on the level of liability were sought.

4.1 Question: "What should we be securing against (eg overall project value, revenue driver value, or capacity auction bid value)?"

National Grid NTS had identified 3 potential options:

a) Capacity Auction Bid Value (Actual Revenue)

b) Revenue Driver Value (Allowed Revenue)

c) Overall Project Value.

CR commented that under CUSC, the User's liability steps up to match the curve (slide 3). RM questioned how closely the NPV that was required reflected the reality of the investment, and was National Grid NTS' model a good proxy for actual spend? RH responded that a best estimate would be made of costs and time. However, not many

projects were built so an indication within say 5% of the actual costs was not feasible. On being questioned how the Project Value matched to NPV, RH commented that it was inexact. National Grid NTS followed an industry agreed process and this was the best that could be achieved pre-auction. CR pointed out that there was a split between pre-commissioning and commissioning. RH responded that the costs required were those to be expended prior to the first gas day. In response to a question from RF, CR said that for pre-connects in electricity, the actual costs were secured.

TB described the advantages and disadvantages that had been identified for each of the potential options.

GT requested examples, and how this would be split out. RH said that Project Values were not generally released, other than to Ofgem.

RP raised concerns relating to multiple User scenarios, and questioned that if, for example, one party of three in a project dropped out, would the remaining parties pick up the liabilities? RP thought that looking at an example would help to understand the monetary magnitude involved. RH observed there had been significant debate on the electricity side, and that multiple auction bidders scenarios were the most complex. The Auction Bid Value may be the most clear cut option. In this case should 100% be secured?

JB1 observed that option (a) applies to anyone buying Long Term Capacity and the numbers are public, that option (b) was always public, but that option (c) was not, and there may be a need to understand how the first two options were applied. RH saw (a) as extended the current regime to all capacity holders. (b) and (c) would be a change in principle as well as practice. POD suggested that for incremental capacity the Project Value would be zero. However, there would still be the Revenue Driver and the Buyback risk.

At this point in the meeting there was still no clear choice on which option was more favoured; the absence of any associated numbers left RF feeling uncomfortable in terms of making a decision. RM thought all the numbers were available in some form and referred to various sources including the Ten Year Statement. JB1 thought that the TYS included projects and the reasons for them, but not the costs. RH responded that capex was shared with the Regulator and that it was difficult to assess elements of Project Value; transportation charges were of importance to the shipping community.

In response to a question POD outlined the contribution of System Operator and Transmission Operator charging within the National Grid's Price Control and the links to Regulatory Asset Value.

RH pointed out that reinforcement reduces buyback risk. Investments are made a result of the outcome of many auctions and the cumulative effect can change the risk element over time. JB1 reaffirmed that numbers associated with project value are very difficult to assess and provide. National Grid NTS' preference remained the first option, ie Auction Bid Value, which appeared to offer the most logical route to achieve a more appropriate outcome. JB1 observed that he would like to see an applied example based on previous auctions.

RH pointed out that the Revenue Driver comes into effect as soon as the proposal is not vetoed, and that the community needed to be aware that there is a period when the level of underwriting can be below the level of the Revenue Driver.

National Grid NTS then outlined a theoretical scenario.

For option (b) in Year 1 – 25% security might be secured. However as soon as Ofgem decides not to veto the additional capacity application 100% of the Revenue Driver would be fixed. If the User then decides not to proceed the remaining 75% would then be recovered from Users through capacity charges.

RF and CW concluded from this that the stepping of security provided would only be appropriate if the Revenue Driver was also stepped. However, this would require a Licence change and was outside the remit of this Review Group.

CW commented that if auction revenues were above Revenue Drivers then the shipping community should benefit – which did not feel 'right'. POD then outlined the process by which Revenue Drivers are set and concluded that auction revenues could not exceed the Revenue Driver.

JB1 commented that he found the practicality of option (a) quite difficult, and it might be easier to devise a credit regime for one-off sole use connections. RH responded that this was complicated by the likelihood that these connections would be absorbed into network assets and utilised by others. JB1 replied that these could be self-lay and self-operating, and was not comfortable with the shipping community having to absorb costs in the event of default. He suggested that perhaps a different hurdle rate could be applied to this scenario, or it might be more reasonable to view it as a specific connection cost.

RH said that once the "service pipe" is commissioned as part of the NTS, then anyone can potentially connect. However, future users are unknown and a significant section may result in changes.

JB suggested that the issues relating to connection pipelines were scheduled for discussion at a later meeting. JB1 observed that Auction Bid Value is very complicated. The TO/SO commodity and the Day Ahead firm price impacts needed to be addressed.

RH suggested that the community needed to consider whether it required to secure 100% value or a reduced amount.

RF pointed out that a party should be bidding for what it could afford, but there was no wish to over securitise.

When asked about examples, RH said that various projects would give different outcomes and a range of outcomes, ie just meet the NPV test, or exceed it by any amount. However, he asked whether obtaining figures would influence the choice of option.

CR commented that essentially there was a need to secure 100% of the Revenue Driver but this was complicated by the revenue effects.

RH responded that National Grid NTS' need was security to cover the Revenue Driver. If this was to be put in place, the community needed to consider what level of risk it was prepared to accept. RH was prepared to provide numbers for the last two projects, ie auction revenue versus Revenue Drivers, but this would probably show what Shippers would expect anyway.

RM commented that as it was complex and confusing, it would be helpful to see the numbers associated with the auction revenues and Revenue Drivers.

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

JB summarised the outcome of the discussion based on the premise that auction revenue would never exceed the Revenue Driver. If the primary aim were to maximise security to the community, the arrangements should obtain security equal to 100% of the Revenue Driver. If, however, the primary aim was to incentivise new entrants, security should be obtained on the basis of auction bid value. This was recognised by the Review Group.

RH pointed out that National Grid NTS was financially indifferent to the choice of option but it reiterated its support for use of auction bid value. This was because auction bid value was and value to be underwritten would be easily calculated.

4.2 Question: "How far in advance of the capacity release obligation should security be required?"

Moving on to slide 7, which portrayed the timeline TB explained that prior discussions had identified the need for change. Responding to DL, TB confirmed that checks were made to confirm there were no sanctions in place against a bidding entity.

The financing of projects was discussed. GT pointed out that a lead time of 42 months would significantly lengthen a project's progress, and there would be colossal barriers to entry for any new entrants.

CR explained briefly how this was covered on the electricity side. RH observed that it was stepped, ie 25%, 50%, 75%, 100%., whereas on the gas side it was 12 months prior to securing the auction bid which gives effectively 50% or more of the Revenue Driver.

GT commented that a party would not bid for capacity until all was in place and the project was fully financed. There would then be a long waiting period for National Grid NTS to deliver the capacity. A movement of the current security timeline to the left hand side of the graph would preclude most organisations except very large players. It was also remarked that Letters of Credit may need to be fully cash backed, and that different projects needed different timelines, eg gas storage projects which need to take account of a specific injection season.

It was remarked that, from a project financer's viewpoint, it would appear to be preferable for the community to cover the risk, whereas from the community's and National Grid NTS' viewpoints the risk needed to transfer to the most appropriate party.

4.3 Question: "What level of security should be provided during this period and, for example, should it be flat or stepped across the period?"

In response to JB's question, CR said that electricity securitisation tries to follow the S curve.

From his standpoint as a project consultant GT observed that requiring security earlier than currently would have an adverse effect.

RF wondered if there was justification for having Revenue Drivers from Day 1. RH responded that income does not start until the first gas day. However, Revenue Drivers are flat from the day when Ofgem decides not to veto the proposal.

GT explained that a project could be built and operational in 36 months, but if there was no capacity; a party needed credit lines to bid and it would then take 42 months (ie 6 months remaining idle) to begin operating with the delivered capacity. It was against a financier's 'rules' to advance credit earlier on what would be seen to be an incomplete project.

CW asked if the S shaped curve was more acceptable to a financier; GT said no because, as there was no capacity made available, there would be no credit lines. Bankers were not keen to advance money before knowing that the project was viable.

To assist the situation RH suggested the concept of a 'post auction allocation credit assessment period'. POD also outlined its 28 day approval period, which could include a credit check as part of the process.

CW observed to Ofgem that the UNC is intrinsically linked with the Licence aspect – and asked how fixed the Revenue Driver principles are in National Grid NTS' licence. How much do the Licence obligations need to be awry for them to be reviewed with the Price Control? It appeared that the Review Group was attempting mitigation of what may in fact require a more extensively ranging review. POD said that it would take the best part

of 9 months to get something changed in the Licence but that he would pass on the view of the group.

GT and RM reiterated the concern that obtaining security at earlier stage would cut-out independent parties and suggested that this is incompatible with development of competition and obtaining supply security.

JB1 suggested that a way needed to be found to reduce allowances to new entrants without excluding them; either a consistent set of rules to ensure that everyone was treated the same and had to provide the same levels of security at the same time, or an individually tailored approach set within a basic framework. It was commented that some Letter of Credit requirements might very well preclude any projects being built.

POD suggested that the idea of a 28 day approval period be followed up.

TB completed the presentation by summarising the advantages and disadvantages associated to Incremental capacity triggered: [X%] of Liability (Bid or Driver or Project Value) secured across investment period in either Flat or Stepped Profile, all of which had surfaced in the foregoing discussions.

5. Other relevant industry proposals (if any)

None.

6. Allocation of actions for Session 4

JB read out the items included for discussion in Session 4. (Please refer to the Work Programme for further details).

RH advised that National Grid NTS will attempt to put together a 'straw man' for Session 8.

7. Any Other Business

None raised.

Diary Planning for Review Group

The next meeting of the Review Group (Session 4) will be held from 10:00 – 13:00 on Tuesday 28 October 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 5 Monday 10th November - 13.30 – 16:30

Session 6 Thursday 27th November – 13.30 (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 004	25/09/08	3.1 and 3.4	Provide an update on other modification proposals that may be relevant to Proposal 0221.	RWE (CR)	Update given **Closed**
RG0221 005	25/09/08	3.2	Develop and present alternative principles for requiring security from capacity holders	National Grid NTS (RH)	Presentation given **Closed**
RG0221 006	25/09/08	3.2	Review Network Entry Agreements from the standpoint of revising default arrangements.	National Grid NTS (RH)	**Closed**
RG0221 007	13/10/08	2.1	Report on the outcome of novation discussions to this Review Group.	National Grid NTS (RH)	
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)	

* Key to action owners

RH – Ritchard Hewitt, CR – Charles Ruffell