Minutes of Review Group 0221
Friday 23 January 2009
held at
Elexon, 350 Euston Road, London NW1 3AW

Attendees

John Bradley (Chair)	(JB)	Joint Office
Andrew Pearce	(AP)	BP Gas
Charles Ruffell	(CR)	RWE npower
Chris Shanley	(CS)	National Grid NTS
Chris Wright	(CW)	Centrica
David Linden	(DL)	BP Gas
John Baldwin	(JB2)	Canatxx Shipping
Paul O'Donovan	(POD)	Ofgem
Rekha Patel	(RP)	Waters Wye Associates
Ritchard Hewitt	(RH)	National Grid NTS
Roddy Monroe	(RM)	Centrica Storage Ltd
Tim Davis	(TD)	Joint Office

1. Introduction

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

2. Review of Minutes and Actions from the previous meetings

2.1 Minutes (07 January 2009)

POD emphasised that his concerns recorded toward the end of the minutes (*POD was concerned that some of the exclusions may be unreasonable – for example, excluding parent company guarantees could unnecessarily increase cost for the industry)* were not an Ofgem policy view but rather reflected an issue which he felt would need further consideration. Subject to this clarification, the minutes of the previous meeting were approved.

2.2 Actions from previous sessions

Action RG0221/015: National Grid NTS (CT) to confirm whether the 2% of RAV unsecured credit limit applied to security providers as well as Users.

Update: RH confirmed this was the case. **Action closed.**

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 will be needed when a draft Proposal is discussed. **Action carried forward.**

ACTION RG0221/019: BP (DL) to bring further details about auction bonds to the next meeting.

Update: Covered under Agenda Item 5. **Action closed.**

ACTION RG0221/020: National Grid NTS (RH) to present on proposed TAR credit arrangements at the next meeting.

Update: RH advised that TAR had not reached a stage where credit options were being considered. However, the understanding was that the RG0221 approach could be applied to TAR. **Action closed.**

ACTION RG0221/021: National Grid NTS (CS) to refine the straw man taking account of discussions to date.

Update: Further thoughts were covered under various agenda items. Future development will be in the form of a Modification Proposal. **Action closed.**

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

Update: In light of further work undertaken, RH asked for this to be carried forward **Action carried forward.**

3. Discussion of Process Flow Diagram

National Grid NTS had provided a flow diagram to help illustrate how the strawman was expected to operate in practice. CS raised the issue of when credit must be provided and the implications of allowing additional credit to be provided during the QSEC auction process.

JB2 questioned the practicality of providing capacity in advance – credit providers are likely to want to see evidence of capacity rights existing prior to being willing to provide credit. RH felt that the regime was clear for a new, single User, ASEP which should be sufficient to reassure credit providers that capacity rights could be acquired for a known cost. It was accepted, however, that this would be more difficult for existing entry points – which JB2 mused may imply discrimination.

CS suggested that, once credit was in place, most Users would not be required to provide significantly different levels of credit from year to year. However, JB2 remained concerned about new Users and new ASEPs – the proposal may work in 95% of cases, but it would be inappropriate if the arrangements created a major problem for the remaining 5% (effectively excluding some from the market). He felt there would be merit in looking at the electricity transmission approach for new connections which required credit to be provided once a firm connection date had been offered. CR explained that, under the electricity final sums approach, the user has to provide sufficient credit to cover the actual cost of expected construction works, with the level of credit reflecting the investment cost and so being increased over time. If the connecting project ceases to proceed, the liability for incurred grid investment costs crystallises and credit may be called. RH emphasised, however, that the TAR (electricity Transmission Access Review) proposals envisaged a revised approach such that this would no longer apply.

RM asked whether adoption of a two stage QSEC auction process, as discussed with regard to Entry Capacity Substitution, created a time lag in the process which would provide a window in which additional credit could be provided. CS suggested that it may be better to provide the bulk of credit cover in advance, but to permit topping up after the auction provided, say, 80% of the required credit value had been provided in advance.

RM said that the QSEC process was already complex and explaining this to bankers in order to secure credit was problematic. Adding complex credit rules would make this worse. Hence incorporating a credit requirement in the window between auctions in a two stage auction process was preferable, such that the likely outcome of the auction would be clearer. RH did not feel this would work as it would leave the problems unresolved for the second round, or in circumstances where there was no second round.

JB2 argued that a different process may be needed for new Users if credit was to be required since obtaining credit tends to be contingent on holding capacity. What was required was a binding undertaking from National Grid NTS that capacity rights would be allocated, and this assurance could then be secured. CS suggested that the level of commitment requested was the problem and hoped the concern would be addressed as the presentation proceeded since the Group could consider what was a reasonable minimum level of security to seek ahead of an auction – not 100% of the full value of bids. RM said that this could work if it was clear how much credit was required – this would allay concerns about uncertainty regarding the level of credit that was required, for example because of not knowing the price at which an auction would clear. RP supported RM's point arguing that renegotiating credit if a higher level was required in light of the auction outcome would not be a quick and easy process. CS suggested that cash could be provided relatively quickly and replaced by letter of credit later.

TD suggested that certainty could be provided by basing all credit calculations on a single price, say the reserve price. DL questioned whether this was appropriate since it could leave the community significantly under-secured. However, JB2 felt the suggestion had merit because it provided certainty and still delivered what he felt was the main objective of requiring a significant, but not unduly onerous, commitment to be made.

CS clarified that, under this approach, there would be no need to increase credit cover provided volume bid for were within the level of cover provided – the provided credit cover would effectively be volume based albeit terminal dependent. DL questioned whether this would lead to over-securing by all, with a consequent cost to the industry and consequently customers. For example, credit may be provided for a planned volume despite allocations being lower if bids proved to be unsuccessful. It was recognised that this was the case, but the lowest cost option of requiring no credit had to be offset by the risk of default. POD indicated that it was possible Ofgem would undertake an Impact Assessment in order to look at and assess trade-offs such as these. It was recognised that this could have timing implications as to whether any change to the credit arrangements could be in place ahead of the next QSEC auction.

RH said a lead time for implementation would be needed in light of the need to put credit in place, and asked for an indication of how long should be allowed. The Group suggested that the earlier the notice given the better, so that parties could work out the implications for themselves and the effort needed to secure the necessary credit. This should usefully provide part of the consultation process as the Modification Proposal proceeds with National Grid NTS writing to all capacity holders to explain their potential liability once the shape of the proposal is clearer.

JB2 still felt it important for this suggested approach to work that a form of entry ARCA would be provided in order to give credit providers the necessary confidence that capacity rights would be allocated. Without this, new entrants may find it impossible to obtain credit and so would be excluded from the process and the market. RM supported this and emphasised that the auction process and perceived regulatory risk is a key impediment to new entrants and that we should seek to avoid anything which made this worse.

JB2 questioned the suggestion that the only acceptable credit instruments were either a letter of credit or cash on deposit. The proposed approach was a big move from the present position, and effectively requiring cash was an extreme approach which could be a step too far. CS agreed that the acceptable instruments would need to be considered. However, these were the instruments which were generally acceptable in a range of circumstances. The costs of providing this credit needed to be set against the potential benefits.

Continuing with the process flow diagram, it was recognised that security would be needed to provide credit in advance of any existing security expiring – if the security is to be relied on, it needs to be available when a shortfall occurs if any risk is to be mitigated.

CS suggested that any assessment of QSEC credit requirements on an ongoing basis could be taken into account as part of the existing arrangements as specified in the UNC, or could be operated in parallel. POD suggested that there could be value in consistency. CS indicated that National Grid NTS intended to look further at this with a view to proposing a way forward.

4. France-England Electricity Interconnector Auctions (IFA) Access Rules

CS presented an overview of the IFA credit arrangements. It was recognised that these auctions were short term compared to the QSEC issues, but some parallels exist.

5. Auction Bid Bonds

DL presented an overview of bid bonds. If there is a default, the bond is used to fund the cost of running a new auction at which the capacity can be offered to others. The value of the bond is the cost of running the auction, not the value of the capacity. This could be applied to the NTS by requiring a fixed deposit from each bidder in an auction – with all facing the same deposit. This would be far simpler than needing to look at allocated capacity on a Shipper by Shipper basis, and taking account of each Shipper's specific credit worthiness.

DL felt this approach was potentially more proportionate to the risk than the approach put forward by National Grid NTS. RM felt that a commitment of, say, £1 or even £2m, would be sufficient to deter truly speculative behaviour – albeit that it could also impact on project timescales if some developers could not obtain credit sufficiently far in advance of a QSEC auction. It was agreed that it would be worth looking at the impact the bid bond, or the alternative, more complex, approach might be expected to achieve and at what cost. POD suggested looking at historic examples to inform this, such as TXU and Enron in order to gauge how different the outcome might have been. However, a concern remained that the bid bond would not cover the value at risk – one possibility would, therefore, be to adopt a hybrid approach combining elements of both approaches i.e. requiring a fixed deposit to allow parties to bid, the credit to be provided based on the auction outcome.

6. Analysis of User Impacts

CS explained that National Grid NTS had developed a tool to assess the impacts on Users were the proposal to be adopted, and this process had revealed some issues. A discussion ensued on the amount of liability covered for a hypothetical case. National Grid NTS asked in particular for feedback on the suitability of a Parent Company Guarantee being used as security, which is used by a few Users at present – with JB2 suggesting it would be sensible to retain the present arrangements.

DL noted that there was a push towards encouraging user commitment and hence long term bookings, and observed that the proposals worked against this and discouraged long term bookings.

JB2 felt it important to step back and reconsider what the objective was – dealing with both new entrants at a single ASEP, looking to develop a new project, and with incumbents managing a portfolio of bookings. The impact of the timing when credit is called for needs to be worked through and also the level of commitment to be able to bid. Adopting the possibility of seeking a bid bond ahead of the auction, which would present a significant but not insurmountable barrier to bidding, and then seeking higher credit to reflect actual allocations could make it possible to secure credit – credit providers would have the necessary assurance that capacity rights had been obtained.

7. Allocation of actions for next Session 10 (Tuesday 10 February 2009)

RH offered to draft a Modification Proposal for the next meeting which will provide a focus for debate and enable discussion to move forward. RH also asked all to respond with views on the following specific questions:

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%

8. Any Other Business

None raised.

9. Diary Planning for Review Group

The next meeting of the Review Group (Session 10) will be held at 13:00 on Tuesday 10 February 2009, at Ofgem offices, 9 Millbank, London SW1P 3GE (following Substitution Workshop 7).

Future sessions have been arranged as follows:

Session 11: 10:00 on Thursday 26 February 2009, at Elexon, 4th Floor, 350 Euston Road, London NW1 3AW.

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

ACTION LOG – Review Group 0221

Action Ref	Meeting Date	Minute Ref	Action	Owner*	Status Update
RG0221 015	27/11/08	4.1	Confirm whether the 2% of RAV unsecured credit limit applied to security providers as well as Users.	National Grid NTS (CT)	Confirmed **Closed.**
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 in light of draft proposal
RG0221 019	07/01/09	3	Provide further details about auction bonds.	BP (DL)	Presented 23 January **Closed**
RG0221 020	07/01/09	3	Present on proposed TAR credit arrangements.	National Grid NTS (RH)	Presented 23 January **Closed**
RG0221 021	07/01/09	3	Refine the straw man taking account of discussions to date.	National Grid NTS (CS)	**Closed**
RG0221 022	07/01/09	4	Produce a draft Modification Proposal.	National Grid NTS (RH)	To be presented 10 February

* Key to action owners

RH – Ritchard Hewitt

CT – Claire Thorneywork

CS – Chris Shanley

DL – David Linden