Minutes of Review Group 0221
Thursday 26 February 2009
held at
ELEXON, 350 Euston Road, London NW1 3AW

Attendees

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

1. Introduction

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

2. Review of Minutes and Actions from the previous meetings

2.1 Minutes (10 February 2009)

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: National Grid NTS provided a presentation covering this use (see Agenda Item 3). **Action closed.**

3. Further Discussion of Draft Modification Proposal

CS explained that that all the information was now in the Proposal rather than details being in a separate document. He then presented on the timing options, including an assessment of their pros and cons, for providing security, explaining that the draft Proposal is based on security being acceptable provided it was in place prior to allocation taking place. Users would be informed what their expected allocation would be, but this would be subject to credit being provided and Ofgem not vetoing any Proposal.

On the range of options for when credit must be provided, GT questioned what would happen if security had been provided but Ofgem then vetoed the release of incremental capacity. CS confirmed that any security would be released were that to happen. GT remained concerned that obtaining credit would be difficult if there had been no final allocation of capacity, such that only providing credit at the end of the process looked attractive.

Under Option 1, providing security in advance of the QSEC auction, TD questioned if the uncertainty regarding how much credit to be provided could be overcome by using a fixed price, and hence the credit to be provided being volume based rather than dependent on auction outcomes. CS indicated that NTS had concluded this would not be effective for incremental capacity and that treatment of earlier commitments would need to be cleared. CW felt that including an ability to top-up prior to allocations largely addressed the uncertainty issue. CR suggested that the aim was to produce a hurdle so the precise calculation was a second order issue.

Under Option 2, providing security ahead of allocations being confirmed, RM asked when notification of preliminary allocations would be provided and whether there would be any impact on other allocations if credit was not provided. RH said that the allocations would not be reopened, nor the prices, for other preliminary allocations. RM felt this provided a gaming opportunity. GT emphasised that the key problem remained that capacity would not have been finally confirmed such that it may not be possible to obtain credit – banks like certainty.

Option 4, a hybrid of Options 1 and 2, involved providing a minimum commitment in advance (a bid bond), which would be non-refundable if sufficient credit were not provided at the next stage. GT felt this would be unreasonable for a new project which failed to go ahead and NTS had not invested – why should there be a significant cost to the developer? DL felt you should only bid if interested in bidding and this was how bid bonds are used elsewhere in Europe. It was not unreasonable to face the cost of the bid bond and lose this if you did not follow through and bid in the auction. CW felt that the approach could deter traders as opposed to project developers.

DL questioned whether a credit check approach may be an alternative – getting confirmation that, subject to conditions precedent, financing was in place before being allowed to bid.

Option 3, providing credit after the QSEC auction (which would run as now), removes the key barrier to entry since financing and credit would not be precluded since capacity had not been formally allocated. However, this retained the existing issue that this was a free option, with no firm commitment prior to bidding.

Option 5, a hybrid of 1 and 3, would require a commitment in advance and final credit cover based on the final auction outcome. A key concern raised by National Grid NTS was that failure to provide credit at the end of the process could mean a need to re-run the auction. It was agreed that this was undesirable and should not be provided for in any option.

JB asked if any of the options could be ruled out at this stage. RP suggested that the practicality of any of the options was crucially dependent on the amount of credit cover sought. RH said that the worst case Letter of Credit cost was £2.5m, based on 7% of a £36m commitment.

It was suggested that Option 3 is no improvement on the status quo. JB2 disagreed and felt it would address the case where allocations had been made prior to the incremental baselines being reflected in the Licence such that National Grid NTS would not get incremental revenue. However, it was clarified that this was not the case and incremental revenue would still be due.

JB2 was concerned that the real problem the Group was seeking to address was when SO revenue was involved and that the solutions needed applying to TO revenues as well in order to be non-discriminatory. However, there should also be an objective not to lock out all independent developments out of the market, and there was a risk that all of the solutions being put forward had the potential to do this.

The Group recognised that amending the Licence may be necessary to address the issues. It was suggested that this could be a key conclusion from the Review Group and that the UNC should be left unchanged pending any change to the Licence. The change to the Licence would be for Ofgem to confirm that allocations were approved and would not be vetoed prior to any credit being provided. In addition, the Licence would provide for any incremental revenue only to be triggered if credit was subsequently provided. POD asked if these issues could be addressed through an IECR change rather than through a Licence change, for example, providing for conditional Ofgem approval subject to credit being in place within, say, 30 days. RH suggested an alternative would be to remove the Ofgem veto from the Licence.

CW suggested the root of the problem was that the Licence provides for National Grid NTS to receive allowed revenue in circumstances where there is no investment required. Since that root cause cannot be addressed by the UNC and credit requirements, the Group was struggling to find a clean or easy solution. RH emphasised the fundamental Licence principle that National Grid NTS should invest only when economic and efficient to do so, and should be incentivised to encourage this.

RF asked if the UNC could be changed such that there is no longer a free option for bidding, which he felt was the biggest issue – it should not be possible to walk away if you fail to provide credit 12 months in advance as under the existing regime. It was accepted that this was a different issue which required a different solution, and National Grid NTS confirmed that they believed this was addressed in the draft Proposal.

The group discussed a letter received from Gazprom providing helpful feedback on the draft Proposal. It was agreed that Gazprom had highlighted some key concerns about how risk should be assessed and how the Proposal was seeking to address it. GT said that the Canatxx example was not a credit problem but a planning issue and quantifying risks such as arise from planning was inevitably hard to quantify with any confidence.

Looking at previous defaults, the level of cost was felt to be potentially low as capacity purchased would be offered for sale and the difference in revenue was all that was at risk. However, for new projects which trigger incremental revenue and do not proceed, there may be no other Users such that the community would face a significant cost.

RH felt that the key was to reduce risk by ensuring that a deposit was paid in advance to demonstrate commitment. Others were concerned that the options requiring a significant sum in advance would effectively drive independent developers out of the market. There was an element of consensus that moving to the Option 3 approach result would be a step in the right direction, especially if accompanied by a Licence change to deliver certainty from Ofgem ahead of credit being provided.

Turning to the draft Proposal, it was suggested that the element dealing with the existing provisions in B2.2.16 should form a separate, free standing, Modification Proposal. JC suggested again that the Proposal should be based on 10% of the calculated amount rather than 20%, and RP in particular supported lowering the amount. The Group agreed National Grid NTS should include this lower value in the Proposal at this stage.

It was clarified that where a project credit adjustment was involved (UPR reduction), this would be applied at ASEP level and applied uniformly to all Users. Concerns were expressed about the practicality of the proposed process for UPR assessments and their timescales. Given this, there was agreement from the Group that the UPR element, while desirable in principle, should be removed. Given this, the credit rating element would need to be adjusted, and RH suggested, as a starting point, broadly doubling the numbers, such that the starting point for the total credit cover being sought would be about £50m.

Based on CS's description of the default trigger process if a shortfall emerged in credit provided, CW asked if any upgrades would similarly trigger a reduced credit requirement. RH clarified that this would only be taken into account when credit was next required.

RH emphasised that this would be a User Pays Modification Proposal, as set out in the draft Proposal, and that any system costs would be allocated to Users.

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

- It was agreed that a further meeting would be arranged for 6 March and that revised draft Proposal(s) would be issued by National Grid NTS no later than 3 March in support of this. The Joint Office would also produce a draft report for discussion at the meeting.

5. Any Other Business

None raised.

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)	Presented 26 February **Closed**

* Key to action owners

CS – Chris Shanley