Transmission Workstream Minutes

Entry Capacity Baseline (3)

Wednesday 12 September 2007

Elexon, 350 Euston Road, London NW1 3AW

Attendees

Tim Davis (Chair)	TD	Joint Office
Alex Barnes	AB	BG Group
Anusha De Silva	ADS	Heren Energy Consulting
Angela Love	AL	Pöyry Energy Consulting
Angus Paxton	AP	Pöyry Energy Consulting
Bogdan Kowalewicz	BK	Ofgem
Chris Bennett	CB	National Grid NTS
Colin Dickens	CD	ExxonMobil
Charles Ruffell	CR	RWE Npower
Clare Temperley	CT	Gas Forum
Chris Wright	CW	British Gas Trading
Elaine Calvert	EC	National Grid NTS
Graeme Thorne	GT	Canatxx Shipping Ltd
John Baldwin	JB1	CNG Services
John Bradley	JB2	Joint Office
Kirsten Elliott-Smith	KES	ConocoPhillips
Karen Stockdale	KS	PX Ltd
Leigh Bolton	LB	Cornwall Energy Associates
Matt Golding	MG	National Grid LNG
Mike Piggin	MP	TPA Solutions
Martin Watson	MW	National Grid NTS
Neil Dewar	ND	UBS Investment Bank
Phil Broom	PB	Gaz de France
Peter Dickinson	PD	Ofgem
Paul O'Donovan	PO	Ofgem
Richard Fairholme	RF	EON UK
Roddy Monroe	RM	Centrica Storage
Rekha Patel	RP	Waters Wye
Richard Street	RS	Statoil
Sofia Fernandez Avendaño	SFA	Total
Steve Gordon	SG	ScottishPower

1. Introduction and Status Review

TD welcomed all attendees to the meeting.

2. Previous Meeting

2.1 Minutes

These minutes were accepted.

2.2 Matters Arising

National Grid NTS had published its investment update. PD confirmed that 100% of the free increment was allocated by Ofgem when setting the proposed baselines.

3. Matters for Further Discussion

3.1 Reconsultation and Substitution

EC gave this presentation (available from the Joint Office website) on behalf of National Grid NTS.

National Grid NTS had looked at options within two broad possibilities: retaining the aggregate baseline proposed by Ofgem and enshrined in the existing Licence obligation (8,814 GWh/d); or increasing the aggregate baseline. It was emphasised that these were possible modelling assumptions and National Grid was not offering a view as to which, if any, was its preferred approach.

The first starting point was to reflect the already committed obligated allocation of 6,900 GWh/d, leaving 1,554 GWh/d to be allocated. Resulting baselines based on four ways of allocating these unallocated capacity rights were presented:

1. Previous obligated levels
2. Average 2005 Ten Year Statement
3. 2006 Ten Year Statement
4. Maximum Flow over Winters 2005/6 and 2006/7.

TD asked for views on whether any of the four allocation methods were clearly more or less appropriate than others. The meeting expressed reluctance to exclude any without further thought and analysis.

The first starting point, obligated allocation, was based on sold capacity, plus 20% at sold out ASEPs. An alternative starting point would be to add back the 20% reserved for short term auctions at all ASEPs. EC presented the 8,400 GWh/d which would initially be allocated to each ASEPs on this basis, leaving only a further 414 GWh/d for subsequent allocation.

SFA asked whether Ofgem was going to consult on the basis of all these options or not. BK stated that it could not respond on this until it had considered the full analysis undertaken by National Grid NTS.

AB stated that he was unable to give a view on the merit of the options when there is the possibility of substitution occurring - the risks were that much greater.

EC went on to present a third potential starting point, based on maximum flow over the last two winters, but capped at the current baselines. This gave 7,802 GWh/d leaving 1,012 GWh/d to be allocated.

In response to AB, BK stated Ofgem were working on the basis of publishing a November consultation paper. National Grid NTS intended to produce a conclusions document in two weeks, which would summarise options, and on which Shipper views would be welcome. TD asked whether there was a deadline for responses which would fit in with Ofgem's timetable. SFA asked whether respondents could assume that all these options were physically possible. EC responded that some analysis was still required but National Grid NTS believed that all the options were realistic.

To illustrate the impact of setting baselines in excess of 8,814 GWh/d, EC suggested National Grid Gas NTS would require an increase in its allowed revenue to fund additional capital expenditure of the order of £275m in order to be able to honour the baselines applying prior to the 2007 TPCR. RM questioned why the previous baselines could not be honoured – had there been a shortfall in investment? CB explained that in so far as there was lower than forecast capital expenditure, this underspend was returned to Shippers through the price control review process. AB asked why the investment was not made. CB responded that National Grid only invested if it was efficient to do so. AB expressed concern that National Grid NTS had measured efficiency on the basis of auction signals which had not been forthcoming because this was not rational for Shippers under the baselines provided for in the previous price control period – significantly changing the rules from one price control to the other with little notice and without the full picture being considered caused the difficulties which the industry was now wrestling with.

EC then outlined an alternative measure of the cost of increasing the aggregate level of baselines, based on higher buy-back exposure rather than higher capital expenditure. The upper end of the range of incremental risk modelled for this alternative was around £90mpa for Teesside alone, with a mean of around £20mpa. RM suggested this was a result of the network now being much tighter than five years previously and asked for an indication from National Grid NTS on how the network had effectively been reduced in size as a result of investment decisions. National Grid NTS agreed to consider how information could be usefully presented. AB pointed out that to provide the type of user commitment which Ofgem now said would have indicated that capacity was required at Teesside, Users would have needed to make the auction commitment in September 2004. At that stage, however, there was no indication that baselines would have been cut and, as would be expected, bidders relied on the prevailing regime. If the regime change had been signalled by Ofgem, Users may well have provided a different signal and a significant user commitment.

RM clarified that his request for analysis of the impact of movement in the baseline total was primarily a request for greater transparency on the 8,814 GWh/d and not particularly a request to revert to the previous baselines. CB responded that National Grid NTS felt it best to base its analysis on specific scenarios. TD pointed out that the Network would not be physically able to flow any more gas irrespective of the level at which baselines were set. RM accepted this but believed that Users needed confidence in the modelling result and this could only be achieved by improvements in transparency.

JB2 did not believe that reversion to previous baselines would serve any purpose – he acknowledged that Teesside did not need that level of baseline but still contended that the cut was too great. It would be more helpful to track the increases on the 8,814 GWh/d system capability figure in future years and how this related to the capital projects on the System, entry points where no additional source of gas has been identified and the associated revenue drivers. This would reveal the presence of network bottlenecks and the investment required to relieve them, which he suspected would be south of Teesside and much lower than £275m. CB responded that in principle National Grid NTS would be willing to analyse and publish other scenarios which were specified. EC cautioned that this type of analysis might require more than two weeks to complete and therefore could not guarantee that this would be included in the forthcoming report to Ofgem.

The meeting supported both RM's request for more information on buy-back risk and how it would vary with different aggregate baseline quantities and JB2's request for information on bottleneck resolving capital projects. TD asked whether the meeting would support including the 2007 QSEC auction results in the starting point of National Grid NTS' analysis. The general consensus was that this would be useful. CB responded that National Grid NTS would not be able to include this within the consultation timetable but would seek to identify the implications once the auction results were available. AB and SFA agreed this would be useful but, as there was an uncertain context for the auction, this would limit the reliability of the signals generated.

AB reminded the meeting that there had been three major changes to the entry capacity regime which should to be considered as a package and all elements reconsidered - reduced baselines, reduced percentage of baselines held back and the prospect of baselines being substituted away. TD acknowledged this but stated that progress had to be made from the starting point of the current price control review settlement. In response to questions, however, PD confirmed that changes to the current 10% held back for shorter term auctions might also be re-considered as part of Ofgem's re-consultation.

3.2 The Treatment of Spare/Sterilised Capacity

MW gave this presentation. Firstly, he summarised the licence requirements with respect to substitution and indicated that National Grid NTS was working towards implementing substitution for June 2008. Reviewing the responses to the consultation undertaken on the options presented at earlier Workshops, MW pointed out the lack of consensus other than a preference to hold back more than 10% for short term auctions. National Grid NTS was not going to address comments on Transfers and Trades at this meeting, but would be doing so shortly as part of the development of an enduring solution.

Whilst there was no consensus on which option of the five previously presented was preferred, National Grid NTS had decided to expand Option 2 for the purpose of illustrating the next level of detail. MW explained that the logic of Option 2 was that it does involve a less stringent NPV test because investment is not required when substitution is possible.

AB asked how there could be substitution for incremental capacity. MW explained that the concept was that National Grid NTS should consider substituting before investing for incremental capacity.

MW asked about the treatment of new entry points and whether they should be able to benefit from substitution between June 2008 and the September 2008 QSEC. He asked whether this would be discriminatory against existing entry points.

MW went on to outline a scenario where obligated capacity had been purchased in one quarter only, thereby preventing substitution and asked whether this was appropriate. A solution might be time limiting the substitution but the Licence does not currently allow this. RS suggested that the solution for a short term User requirement might be different from that applied to an ongoing requirement. MW believed that this emphasised the need for time-limited substitution and was requesting Users' views on this. AB stated that any solution needed to recognise current offshore developments in small fields which could be flowing seasonally – a single approach did not fit all needs.

Turning to exchange rates, there was general consensus that excessive exchange rates should not be allowed but a lack of consensus on what constitutes excessive. RM recognised the importance of this but argued that considerations of magnitude should apply.

AB cautioned that excessive exchange rates would sterilise capacity, which might not be booked when substitution occurs but could be potentially useful in the future. He was concerned that this might prevent development of substantial new sources of gas as the higher NPV test would apply subsequently. MW acknowledged this but pointed out that substituting the capacity back might be possible.

Illustrating Option 3, MW put forward a "sliding scale" for substitution, as suggested at the previous Workshop. He also outlined the possibility of limiting substitution based upon the fourth highest quarterly booking in 2 consecutive years and/or historical usage.

CB stated that all these options would be included in National Grid's report on the Workshops. National Grid would also review and update their proposed timeline. JB2 expressed the view that there should be supporting examples, such as the effect of additional gas at Isle of Grain, including the consequences for investment and revenue drivers.

Ofgem indicated that views from Shippers on National Grid's report would be welcome and would be taken into account in their forthcoming consultation document. AB asked about the scope of this and whether it would consider the whole entry regime. PD pointed out that the principle of substitution had been clearly identified, consulted upon and the Authority had decided that it should form part of the regime. AB acknowledged this but maintained that only the principle was accepted and analysis and consultation was required on specific ways in which the principle might be adopted.

CW asked whether capacity surrender would form part of the substitution model. MW agreed that it should be considered and National Grid NTS would be doing so.

4. Any Other Business

None raised.