

Gas Transmission Charging Methodologies Forum

Draft Meeting Report: 5 July 2007

This report outlines the key discussions of the thirteenth Gas TCMF meeting held at Elexon, 350 Euston Road, London on 5th July 2007. All supporting material can be found at www.nationalgrid.com/uk/Gas/Charges/TCMF

Attendees

Tim Davis	TD	Joint Office
John Bradley	JB2	Joint Office
Amrik Bal	AB1	Shell
Alex Barnes	AB2	BG
Andrew Beck	AB3	ENI
Alexandra Campbell	AC	E.ON
Andrew Fox	AF	National Grid NTS
Angela Love	AL	Pöyry
Andrew Pearce	AP	BP
Colin Dickens	CD	ExxonMobil
Charles Ruffell	CR	RWE
Christiane Sykes	CS	Statoil
Chris Wright	CW1	Centrica
Clive Woodland	CW2	Centrica
Debra Hawkin	DH	National Grid NTS
Eddie Blackburn	EB	National Grid NTS
Fiona Riches	FR	Argus Media
Graeme Beveridge	GB	ScottishPower
John Baldwin	JB1	CNG Services
Karen Stockdale	KS	PX
Mark Crawford	MC	ScottishPower
Michel Martin	MM	Pöyry
Martin Watson	MW	National Grid NTS
Paul O'Donovan	PO	Ofgem
Paul Roberts	PR	Gaz de France
Richard Fairholme	RF	E.ON
Richard Miller	RM1	Ofgem
Roddy Monroe	RM2	Centrica Storage
Richard Norris	RN	Hess Energy
Rekha Patel	RP	WatersWye
Stefan Leedham	SL	EDF Energy

1. Introduction

TD welcomed attendees to the meeting

2. Report of Previous Meeting

The meeting report of the forum held on 18 May 2007 was agreed as accurate.

3. Review of actions.

30 National Grid NTS to carry out TO Exit cost recovery analysis based on all DN load being firm.

National Grid NTS confirmed that it would include this analysis in its consultation document, which it intended to issue in the autumn. **Carried Forward**

4. Incremental Entry Capacity Release (IECR)

On behalf of Ofgem, PO gave a presentation that outlined its views on Entry Capacity Substitution, the licence changes and Ofgem's expectation that National Grid NTS should seek to put a capacity substitution mechanism in place for winter 2007/8. It had issued an open letter which set out to:

- clarify the need for the introduction of capacity substitution as part of the TPCR agreement,
- address concerns about the interactions between capacity substitution and the IECR, especially the NPV hurdle,
- clarify NGG's role; and
- highlight the process and timetable to enable capacity substitution to be introduced.

TD sought to clarify the current NPV test provisions within the IECR. Whilst passing the test would essentially remove Ofgem's right of veto and thus guarantee Entry Capacity being released at the relevant ASEP, National Grid NTS could still choose to release incremental capacity, even if it didn't pass this test.

CS asked Ofgem why it expected such a complex methodology to be developed and put in place so quickly. PO responded that it was part of the total PCR package accepted by National Grid NTS. AB2 recognised this but still felt that there were a number of complex issues to be addressed and therefore time should be devoted to developing the detail, even if it meant that Ofgem's target was not met.

In respect of the IECR statement itself, AF then gave the presentation, on behalf of National Grid NTS. He highlighted three areas which were new for 2007. These were in respect of investment lead times, Entry Capacity Substitution and adoption of a new charging methodology.

On investment lead times, CR asked about the timing of the "permits", which were proposed as a means of varying from the 42 month default for release of incremental capacity. AF responded that the details still need to be determined but that it was reasonable that any variations should be signalled in advance of the relevant QSEC auction. CW1 referred to consultation document NTS GCM06 "NTS Entry Capacity Reserve Prices" and asked why the reduction in prices, which resulted from the consideration of "spare" capacity, would not be fed into step prices. National Grid

responded that GCM06 could reduce the P_0 price and hence the step prices. The decision to base step prices, for the purpose of the IECR methodology only, on prices calculated at the obligated levels was made in line with consultation responses. It was clarified that no other change to the step price methodology was proposed.

MW then gave a presentation on the options for testing whether incremental capacity should be released through Entry Capacity Substitution. The current default was the NPV test, used for guaranteeing the provision of Entry Capacity as a result of the existing auction processes, would also apply if substitution was possible.

RM2 expressed concern with the current Entry Capacity Substitution proposals. If capacity were sold-out at an ASEP for as little as one quarter, it would not be eligible for substitution. MW acknowledged that this would probably be the case. CW2 was less concerned at this prospect as he would expect the proposed Transfer and Trades mechanism to overcome the problem.

EB outlined some of the criteria that should underline selection of substitution bids and the way this differed from the existing QSEC auctions. The length of the commitment term might be more crucial than the bid price if this would result in the highest revenue outcome. JB1 responded that there was a more fundamental difference between capacity secured in the existing auctions and that resulting from substitution. Whilst the Entry Capacity auctions were designed to promote efficient investment in system capacity, substitution would be designed to promote better use of the system in place and reduce the need for investment. A test that might be appropriate for justifying investment would, therefore, not necessarily be appropriate for justifying substitution.

MW acknowledged that a combination of short term Transfer and Trades and the existing set of auctions might be closer to the optimum than if these mechanisms were supplemented by Entry Point Substitution. AB2 agreed with this statement and emphasised that one of the problems with substitution was its long term nature. Other attendees agreed that this was a problem.

To demonstrate how a Substitution Mechanism might work, MW presented three scenarios where substitution might play a role.

- 1 Incremental Capacity required at a Declining Terminal
- 2 Incremental Capacity required at a New Entry Point
- 3 Small Incremental Capacity Demand at an Existing Entry Point

Addressing Scenario 1, JB1 expressed the concern that addition of a substitution mechanism would increase the risks associated with parties that intended to introduce new sources of gas supply at these locations. Currently, such parties have carried out an assessment of the rate of decline and the likelihood of competing sources of supply at that location. This would lead them to conclude, with some certainty that there was adequate physical capacity to receive the new source of supply. However, if Entry Capacity Substitution were adopted, any spare capacity associated with decline of existing supply sources might, in the absence of a major financial commitment by the prospective new source, be transferred elsewhere.

MW then reviewed four potential options for introduction of substitution. In defence of the status quo, AB2 stated that the current IECR test does reduce the risk of capacity, which might be used in the future, being substituted away. It was identified that if Ofgem were able to set-out the general rationale, it would use for approving (or rejecting) individual substitution applications, this might provide a degree of certainty for Users.

Action 37: Ofgem to consider producing a document, prior to the first substitution auction, setting out its rationale for approving substitution applications.

JB2 asked what the implications for changing from the GCM01 basis of charging to that put forward in GCM06 would be for Bacton. EB responded that there would be no effect. JB2 concluded this emphasised the risk for Bacton Users that existing Entry Capacity would disappear through substitution.

TD summarised the discussion that each of the four alternatives identified in MW's presentation had substantial disadvantages and asked whether any attendees believed, nonetheless, that one of these, or any other alternative, should be pursued. PR believed that the presentation of option 4 could be amended to make it more acceptable and therefore this option might be worth pursuing. CW2 suggested a further option for the QSEC auction processes to be revised to take into account substitution first. TD and MW saw difficulties with this approach.

TD asked whether Option 1 (do nothing but review for next year) might, given the lack of time to develop a better option, be the preferred approach. It was clarified that substitution would still occur if the NPV test was met and could be proposed where even if it was not. There was some sympathy for this view.

5. TO Entry Revenue Over Recovery Mechanism

EB began by pointing out that recent AMSEC auctions would justify adjusting the TO Commodity Charge to near zero. If transfers and trades were adopted, the income arising from the associated auctions and the RMSEC process would open the prospect of over recovery.

He then went through the history of charging methodologies that had addressed this issue and highlighted that all proposals based upon a negative TO commodity charge had been vetoed.

EB clarified that the 10% trigger in PC65 equated to about £50m – any less than that might go into K, although some discretion might exist within the NTS Charging Methodology about when to apply the PC65 mechanism. He then outlined the process for distributing the excess revenue and the issues National Grid NTS had with this. JB1 said it would be helpful to know the likely figures for this winter so that Shippers might be guided in their view on the Trading and Transfers Modification Proposal. National Grid agreed to develop some further data but emphasised that they were hoping to develop a methodology in any case and wanted Shippers to address the principle, rather than concentrate on the impacts.

Action 38: National Grid NTS to consider publishing data on forecast over-recovery amounts following the recent AMSEC auctions, taking into account the potential income from trade and transfer auctions,

AB2 asked whether a simple change to allow a negative TO charge would overcome all the issues raised by National Grid NTS. EB responded that some issues would remain as there were difficulties in forecasting the degree of over-recovery in order to set any negative charge and the two month lead time required to set the TO Commodity charge rate.

Turning to its proposals, EB stated that National Grid NTS would favour:

- a trigger related to the existing licence provisions i.e. 4% in any year or 6% over two years,.
- a credit to offset buy-back costs only,
- immediate application (the current mechanism spreads any credit over the remaining formula year); and
- with effect from summer 2008, a winter only TO commodity charge.

Discussion then took place on the implementation timescale and AB1 commented that there would not be much resistance to introduction of a charge reduction at less than two months notice. He also expressed preference for charge adjustments targeted at Entry rather than a K adjustment, which would apply equally to Entry and Exit. JB1 summarised the response of the meeting that National Grid NTS's suggestions were along the right lines.

National Grid NTS agreed to issue the consultation within two weeks.

6. Update on Current Pricing Consultation and Discussion Papers

EB then gave an update on the following:

6.1. NTS GCD04 Entry Capacity Discounts

Five responses had been received; two in favour of removing discounts, two against and one providing comments. Given that removing discounts might increase the risk of over-recovery at this time National Grid NTS had, therefore, decided to leave this consultation open and not seek implementation prior to winter 2007/8.

6.2. NTS GCM06 Entry Capacity Reserve Prices

This consultation is with Ofgem for decision. A decision is due by 11 July 2007.

6.3. NTS GCM04 Exit (Flexibility) Capacity Reserve Prices

Ofgem had decided not to veto this proposal.

7. Future Pricing Consultation and Discussion Papers

7.1. SO Storage Commodity Charge

National Grid NTS intended to issue a further discussion paper within the next two months. RM identified that the Storage Operators Group had been discussing the subject and whilst it saw no reason to hasten to a solution, intended to submit a paper for discussion at a future TCMF. He identified that it would be useful for this group to receive data from National Grid NTS that illustrated how, historically, use of storage had affected compression costs. EB agreed to discuss this further with RM but identified that such data was not readily available.

7.2. UNC 0116V (Exit Reform) Related Charges

EB referred to the approval of Modification Proposal 0134V “Publication of Nodal NTS Demand Forecast” and stated that National Grid NTS would be releasing the associated spreadsheet data when the auction price data is released.

8. Any Other Business

None. No date was set for the next meeting of the TCMF

Action Log

No.	Date Raised	Description	Status	Comments
30	01/02/07	National Grid NTS to carry out TO Exit cost recovery analysis based on all DN load being firm.	Carried Forward	National Grid confirmed that it would include this analysis within the consultation document to be issued Autumn 2007
37	05/07/07	Ofgem to consider producing a document, prior to the first substitution auction, setting out its rationale for approving substitution applications	Open	
38	05/07/07	National Grid NTS to consider publishing data on forecast over-recovery amounts following the recent AMSEC auctions, taking into account the potential income from trade and transfer auctions,	Open	