

The Joint Office, Relevant
Shippers, Gas Transporters, and other
interested parties.

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Dear Colleague

**Discussion on “The Entry Capacity Substitution Methodology Statement”
Supplementary Questions**

Special Condition C8D of National Grid Gas plc's (“National Grid”) Transporter Licence in respect of the NTS (the “Licence”) sets out obligations to prepare and submit for approval by the Authority, by 6th January 2009, an entry capacity substitution methodology statement setting out the methodology that National Grid will use to carry out entry capacity substitution. In addition, National Grid is obliged to consult with relevant Shippers and interested parties prior to submitting the statement for approval.

National Grid recognises that the substitution obligation represents a significant change to the entry regime and is therefore keen that Shippers and other interested parties are fully aware of these consequences and understand the rationale for the development of the substitution methodology in the form that it will ultimately be proposed. To achieve this National Grid has run a series of workshops. However, before undertaking the formal consultation described above, National Grid wishes to capture the views of interested parties. Hence, on 7th July 2008 National Grid invited views on its draft Entry Capacity Substitution Methodology Statement (discussion draft v0.2) and specifically asked for views on a number of questions. These questions were intended to capture the key issues surrounding the implementation of the substitution obligation.

A copy of the discussion document and cover letter can be found on National Grid's website and the Joint Office website at:

<http://www.nationalgrid.com/uk/Gas/Charges/statements/transportation/ecms/>
<http://www.gasgovernance.com/Code/Workstreams/TransmissionWorkstream/2008Meetings/>.

A further substitution workshop was held on 9th July 2009 with the objective of reviewing the questions raised thereby giving attendees an opportunity to obtain, where necessary, further clarity on specific questions, or to request that additional questions be raised.

This letter responds to the feedback from the workshop, providing additional clarification and supplementary questions. These are detailed in the appendix. In addition workshop participants, although outside the scope of the methodology statement, requested that National Grid gather views on the wider impact of capacity substitution. National Grid has therefore also included these questions.

Responses to these questions, and to the initial discussion document, should arrive at National Grid by 17:00 on 4th August 2008. They should be sent to:

Andrew Fox
National Grid
Transmission Commercial
NG House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

Alternatively they can be sent by e-mail to:

box.transmissioncapacityandcharging@uk.ngrid.com.

Please ensure that they are copied to andrew.fox@uk.ngrid.com

Any further questions can be directed to Andrew Fox on 01926 656217 or to me on 01926 655023.

Yours sincerely

Martin Watson
Gas Charging and Access Development Manager

Appendix 1

Entry Capacity Substitution Methodology Statement: Discussion Draft

Supplementary Questions

Q4 – Question 4, raised in the initial document, seeks views on whether more capacity should be withheld from the substitution process thereby increasing the quantity of capacity available for medium and short-term bookings. The current quantity held-back is 10% in accordance with National Grid's licence. A number of options were put forward for comment.

National Grid would like consideration to be given to two additional options:

- Capacity available for substitution could be limited to that in excess of the peak daily flow identified within the TBE forecasts (from 42 months onwards).

Some participants believe that the substitution process should not move capacity away from ASEPs where it is required even though Shippers have been unable to confirm this requirement through long term capacity bookings. This may be because the capacity is (may be) required for new projects under development or for supply flexibility. Whilst acknowledging these concerns National Grid has previously expressed concern that this option could undermine the TBE process if some contributors are incentivised to overstate future flows at particular ASEPs.

- Capacity available for substitution could be limited to that in excess of the peak daily flow for the previous year (or 2 years) where this is lower than the quantity of unsold capacity.

This option would avoid the problems associated with using forecast values and may provide a greater level of capacity retention for the medium and short term compared to the draft methodology. However, historical gas flows are not always reflective of future capacity requirements, particularly considering the decline in UKCS gas.

National Grid would welcome views from respondents on these additional options.

Q11 – Question 11 asks respondents for views on whether a transitional rule excluding stand-alone auctions for new ASEPs should be applied. This would mean that capacity would not be available to be substituted from an ASEP until Shippers at that ASEP had had an opportunity to obtain it. National Grid would welcome views on whether this proposed transitional rule should be a permanent rule. For the avoidance of doubt, incremental capacity requests at new ASEPs in the "regular" QSEC auction would initiate the substitution process.

Q12 – In addition to the proposal for new ASEPs, do respondents consider it necessary to apply any other transitional rules? And over what timeframes would the transitional rules apply?

Clarification Notes

Use of zones

In respect of question 6 National Grid is asking for views on the benefit of using zones to group ASEPs as part of the substitution assessment process.

The draft methodology considers donor ASEPs primarily in order of increasing pipeline distance from the recipient ASEP. The variation from this principle is that donor ASEPs within the same zone as the recipient ASEP are considered before any ASEPs in other zones. Zones are groups of ASEPs that utilise common parts of the NTS and hence are considered by National Grid to offer more favourable exchange rates. As an example, Barrow as a recipient ASEP would consider Teesside, Glenmavis and St Fergus as donor ASEPs before the closer ASEPs at Fleetwood, Partington, Cheshire are considered.

National Grid is seeking views on whether a simpler methodology without zones, i.e. solely based on pipeline distances would be preferable.

Donor Order

Question 9 presents possible options for placing a restriction on the quantity of available capacity that is substituted, e.g. by applying an exchange rate cap. A further option is to consider several (or all) potential donor ASEPs together rather than in sequence; thereby sharing the impact across donor ASEPs. National Grid suggests that this could lead to a sub-optimal solution, i.e. some donor ASEPs that offer a less favourable exchange rate would be used before more favourable ASEPs are exhausted. National Grid recognises that the “sharing” principle would not lead to sub-optimal solutions where the donor ASEPs considered simultaneously gave the same exchange rate, however this would not be known until the analysis was undertaken.

Notwithstanding this, National Grid would appreciate views on whether grouping donor ASEPs for analysis would be a preferred option. Respondents may wish to consider any rules that might be applied for grouping donor ASEPs, e.g. limited to zones.

General Questions

At the last substitution workshop participants raised a number of additional questions relating to areas outside the scope of the entry capacity substitution methodology. Although unlikely to impact on the development of the methodology it was felt that obtaining respondents' views on these issues would be beneficial to Ofgem in considering these wider issues.

A – Ofgem have indicated that they may undertake an Impact Assessment (“IA”). A decision has not yet been taken on whether to undertake an IA or, if one is undertaken, the scope. Workshop participants believed that it would be useful, in informing Ofgem’s decision making, to gather industry opinion. Hence National Grid would welcome views on whether an IA is needed before capacity substitution is implemented and what the scope of an IA might include.

B – In the workshops, and specifically in question 1, reference has been made to “economic and efficient”. National Grid has interpreted this from a system perspective, i.e. a low exchange rate would be considered economic. Also, the avoidance of the need for investment through substitution, even if this was as a result of a much higher exchange rate, would be considered economic. An alternative view would be that to substitute capacity from an ASEP when that capacity may be required in a subsequent QSEC auction would be uneconomic. In addition, “economic and efficient” could be viewed from a wider perspective, e.g. how it impacts on UK plc (see C and D). National Grid would appreciate views on what criteria could be included in any assessment of “economic and efficient” in respect of substitution.

C – In the workshops National Grid has demonstrated how the methodology might materialise in terms of reduced availability of capacity at donor ASEPs. Respondents are encouraged to identify whether, and to what extent, substitution will impact on security of supply.

D – National Grid has provided through the workshops examples of how substitution may impact on entry capacity charges. However, workshop participants have suggested that substitution may have a greater impact on gas prices to the consumer. National Grid would welcome views on whether consumer prices will be affected by implementation of the methodology as currently drafted.

Respondents are requested to provide a rationale for their views and should attempt to quantify any impacts.

E – Following the QSEC auction National Grid will assess whether it has received a signal to release incremental entry capacity. Where there is a signal, National Grid will determine, in accordance with the substitution methodology, whether to meet the incremental requirement through substitution or investment. National Grid will then, as required by its licence, submit its proposals to Ofgem for approval. Ofgem has limited scope to reject the proposals: specifically where Ofgem believes that National Grid has not followed the methodology. Some workshop participants considered that the draft methodology may lead to unexpected consequences, which National Grid and Ofgem would be obliged, having adhered to the methodology, to accept. National Grid would welcome views on whether Ofgem should use discretion to over-rule National Grid’s proposals for release of incremental obligated entry capacity. It should be noted that National Grid has limited time to submit its proposals to Ofgem. Hence any revisions required as a result of Ofgem using its “discretionary” powers to veto could result in capacity allocation not being made.