



Entry Capacity Substitution Methodology Statement: Discussion Draft **Comments from AEP¹**

The Association of Electricity Producers (AEP) welcomes the opportunity to provide comments on this discussion draft at this stage in the development of the substitution methodology.

General Questions

The Association considers that an impact assessment (IA) should be undertaken. We would expect the IA to consider the relative merits of substitution and investment and should explore the consequent impact on competition in gas supply and security of supply including prices both in the near future but also beyond the 5-10 year normal planning horizon. This is necessary since once capacity has been substituted baselines are adjusted on a permanent enduring basis, yet at this time it may not be clear where additional supplies will be landed in order to meet the UK's growing requirement for imported gas going forward. We understand that the underlying capability of the system remains the same after substitution but are still concerned that the commercial framework may limit the attractiveness of the UK as a market for gas when the producer has other options. Hence the potential to impact prices and security of supply. The IA should also consider the potential impact on the availability of exit capacity especially close to entry points that may be donor ASEPs and any further impacts there might be on system operation arising from substitution that could limit the availability of linepack which could restrict NG's operating envelope, impact efficient system operation and the management of customer demand profiles.

The Association agrees that 'economic and efficient' may be interpreted narrowly or more widely. We consider that at some point in the process either in the methodology or at the point of Ofgem approval the wider issues need to be considered for each substitution application, it maybe appropriate for Ofgem to retain a right of veto even where NG has followed the methodology if the outcome may be inefficient or uneconomic.

Q 1 Cost minimization – restrictions on substitution process.

¹ The Association of Electricity Producers (AEP) represents large, medium and small companies accounting for more than 95 per cent of the UK generating capacity, together with a number of businesses that provide equipment and services to the generating industry. Between them, the members embrace all of the generating technologies used commercially in the UK, from coal, gas and nuclear power, to a wide range of renewable energies.

We consider that given the risks of unintended consequences or perverse outcomes from a prescriptive methodology it may be appropriate to include some restrictions on the substitution process in the early years. This could include a limit on the amount of capacity that could be substituted from a donor ASEP to provide some protection from capacity destruction and uncertainty over where future gas supplies may be landed.

Q2 Should NPV test be same for substitution and investment?

At this time we consider for the reasons of avoiding increased complexity the same NPV test should be used for substitution and investment

Q3 42 month lead time

We consider that a standard 42 month lead time should be used to avoid additional complexity. This and the NPV test may be refined at a later date if found to be appropriate.

Q4 Capacity for substitution limited to 90% of baseline

Ofgem has stated that it is not minded to revisit this policy decision until at least the next price control review. Furthermore it may be appropriate to place additional restrictions on capacity that may be substituted, perhaps related to peak flows in recent years and/or to forecasts received as part of the TBE process.

Q5 Single quarter issue

We consider this issue should not be addressed at this time but perhaps reviewed at a later date once there is some experience with operation of substitution.

Q6 Use of zones

Zones are defined based on the use of common assets and so would seem helpful in the assessment process, and in providing shippers with some understanding of likely donor ASEPs.

Q7 Order for assessment

We are not convinced that substituting to the ASEP with the lowest LRD is consistent with the licence condition '*ensuring that entry capacity substitution is effected in a manner which minimises the costs associated with funded incremental obligated entry capacity*'. This would seem to imply that if appropriate signals were received that a more expensive ASEP would have investment made rather than substitution to meet the incremental capacity request, all other things being equal. We suggest this requires further explanation or review.

Q8 Donor ASEPs

The Association considers that additional discretion is needed in the process to avoid unintended or undesirable outcomes. This could be within the methodology itself so that NG can undertake a sense check and/or allowing Ofgem a right of veto in a wider range of circumstances, currently it seems this veto can only be applied if NG does not follow the methodology. This would

not allow Ofgem the ability to influence a substitution application to consider wider issues that the methodology may not be able to address.

Q9 Restrictions on capacity substituted

The Association considers that initially a cautious approach to substitution should be adopted to avoid the risk of unintended consequences. In an example provided at the substitution workshops NG demonstrated how 90 mcm may be substituted to create only 10mcm at Easington. At the start of the substitution process this seems rather extreme and should perhaps be addressed by an exchange rate cap in the low single figures.

Q10-12 Transitional rules

The Association considers that a phased approach to the introduction of substitution is appropriate, but would have concerns about placing a specific end date on these, rather it may be appropriate to review the process after three years, when data could show alternative outcomes that may have arisen if certain restrictions did not apply. We consider that substitution at new ASEPs in specific auctions should not be considered until there has been a regular QSEC auction.

04 August 2008