



**Entry Capacity Substitution  
Methodology Statement  
Formal Consultation Conclusions Report**

**7<sup>th</sup> September 2009**

## Executive Summary

### Introduction

National Grid Gas plc (“National Grid”) is the holder of the Gas Transporter Licence (the “Licence”) in respect of the National Transmission System (the “NTS”). The Licence is reviewed periodically (every five years) in the Transmission Price Control Review (“PCR”). The review is concerned with setting, principally, National Grid’s allowed revenues as the owner and operator of the NTS in Great Britain. At the time of the PCR National Grid’s rights and obligations are reviewed and may be amended.

The 2007 PCR introduced new obligations on National Grid in respect of the substitution of NTS Entry Capacity. Specifically Special Condition C8D paragraph 10 (a) i) (aa) requires National Grid to prepare an entry capacity substitution methodology, in such a manner that is necessary to facilitate the achievement of the entry capacity substitution objectives. This new obligation has been the subject of much industry debate.

Following initial work during 2007 and 2008, National Grid ran a series of workshops to develop understanding of substitution, to consider how it should be implemented and to identify issues and potential solutions. Details of these workshops can be found on the Joint Office website at [www.gasgovernance.com/Code/Workstreams/TransmissionWorkstream/2009/](http://www.gasgovernance.com/Code/Workstreams/TransmissionWorkstream/2009/).

These workshops were followed by an Informal Consultation which commenced on the 15<sup>th</sup> May 2009 and ended on the 5<sup>th</sup> June 2009. The Informal Consultation considered three potential solutions. Consultation documents can be found on National Grid’s website at <http://www.nationalgrid.com/uk/Gas/Charges/statements/transportation/ecms/>.

A further substitution workshop was held, on 7<sup>th</sup> July 2009, where Ofgem expanded on their views on the proposed Mechanical Approach initially expressed in their letter dated 3<sup>rd</sup> July 2009<sup>1</sup>. National Grid also summarised the responses to the Informal Consultation and outlined its preferred solution.

Special Condition C8D paragraph 10 (a) i) (bb) requires National Grid to submit to the Authority for its approval a statement setting out the methodology. In accordance with the Direction issued by the Authority on 17<sup>th</sup> December 2008<sup>2</sup> National Grid is required to submit its proposed methodology statement for approval no later than 7<sup>th</sup> September 2009. Paragraph 10 (f) further requires National Grid to consult interested parties on its proposed methodology statement and to submit to the Authority a consultation report together with its final proposed methodology statement.

In accordance with Special Condition C8D paragraph 10 (f) (ii), on 24<sup>th</sup> July 2009 National Grid initiated its consultation on the proposed Entry Capacity Substitution Methodology Statement and invited views in respect of the proposed statement to be made by 24<sup>th</sup> August 2009. This document sets out, in accordance with paragraph 10 (f) (iii), National Grid’s conclusions on the consultation. It provides a summary of the representations received, National Grid’s response and an indication of whether changes have been made to the statement as originally proposed.

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<sup>1</sup> Development of a methodology to implement NTS Entry Capacity Substitution, Ofgem letter dated 3/7/2009 <http://www.ofgem.gov.uk/CustomPages/Pages/ArchivedPublications.aspx>

<sup>2</sup> Derogation notice to delay the introduction of gas transmission entry capacity substitution dated 17/12/2008 <http://www.ofgem.gov.uk/CustomPages/Pages/ArchivedPublications.aspx?year=2008>

## Responses

Representations were received from the 10 respondents listed below.

E.ON	E.ON UK plc
BP	BP Gas Marketing Ltd
SSE	Scottish and Southern Energy plc
RWE	RWE npower
Chev	Chevron North Sea Limited
STUK	Statoil (UK) Limited
EdF	EDF Energy
Tot	Total E&P UK Limited
BGT	Centrica Group (excluding Centrica Storage Limited)
BG	BG Group

The main responses received relate to:

- **Non-support:** five of the ten respondents stated that they do not support the proposed methodology statement. The remaining five, whilst not specifically expressing an opinion, were also opposed.
- **Scope of consultation:** A number of respondents expressed disappointment that National Grid only consulted on one option, the Retainer Approach. Whilst accepting that the Mechanical Approach has been discounted, they would have liked to see the Two-Stage Auction consulted on. However, the Licence requires National Grid to submit to the Authority for approval a methodology statement, not a range of statements. The Authority will consider the statement submitted and approve or veto it. It will not select a preference from multiple submissions. National Grid is also required to consult on its proposed methodology statement; that is the purpose of the current consultation. Hence this consultation was based on the Retainer Approach because this is the preferred methodology of National Grid bearing in mind the Licence, views expressed by Ofgem, and views expressed by industry through workshops and the informal consultation.
- **Two-Stage Auction:** As noted above, some respondents would have preferred the Two-Stage Auction to have been proposed. Notwithstanding the reasons expressed at substitution workshop 9 for not proposing this approach, some Shippers believe that this methodology could have been implemented.

National Grid has reviewed its decision on the implementation of a two stage auction and still believes that the retainer approach is a superior solution to the implementation of the substitution obligation, as it better meets the needs of all industry parties. However, it is important to realise that the proposed Methodology Statement also facilitates a two stage auction, as it uses, as well as retainers, the level of sold capacity to determine the amount of capacity that is available for substitution.

Any shipper is able to raise a UNC Modification proposal to implement a two stage auction and National Grid would be happy to support the development of such a proposal, which would need to take into account the difficulties expressed by National Grid at workshop 9. It should be possible to implement a revised form of a two stage auction ahead of the first application of the substitution obligation. **Therefore in effect the Methodology Statement proposed encompasses both the “option” and “two stage auction” approaches that were informally consulted upon.**

It should also be noted that in essence shippers already have sufficient information to allow themselves to only bid for capacity once an incremental signal has been received, as National Grid publishes auction information after every QSEC bid window. As the QSEC auction has never gone the full ten rounds, it would be possible for a shipper to review the auction information each day and then place any “necessary” bids once the shipper sees that an incremental bid has been submitted. National Grid could envisage that a targeted UNC Modification proposal could be

raised that would “tweak” this process to improve transparency and create more certainty and shipper response time.

- **Impact Assessment:** A number of respondents raised issues concerned with the impact of substitution rather than the methodology, e.g. system flexibility, security of supply and commodity prices. These issues are outside of the scope of this consultation and would be more appropriate within an impact assessment. However, the scope of Ofgem’s impact assessment would be for Ofgem to decide.
- **Retainer Charges:** Three respondents provided comments on the level of the retainer charge. Whilst others questions the degree of user commitment (essentially the same criterion). The proposed methodology creates the concept of a user commitment through the retainer charge. Within this consultation it is reasonable to argue for or against “full” user commitment, i.e. should capacity be bought to protect it from substitution? However, Ofgem have made clear that there should be an element of financial commitment and National Grid is proposing the retainer charge as a lower cost alternative to the full purchase cost. The actual level of the retainer charge is outside the scope of this consultation being the subject of a separate charging consultation.
- **Longer-term Refunds:** Several respondents highlighted an issue with regard to the operation of the proposed refund mechanism. National Grid believes that the retainer provides a valuable service in protecting capacity that may be needed at an ASEP from substitution. This service comes at a cost, the user commitment, in the form of the retainer charge.

In order to make the retainer product more attractive to Shippers the concept of refunds has been introduced where retained capacity is subsequently allocated. This means that where capacity was genuinely needed, and hence the retainer did not unnecessarily prevent substitution opportunities, there is no cost to Shippers (except lost interest). However, for practical reasons it is necessary to put a time limit on capacity allocations that trigger refunds. National Grid identified months 43-54 as the most appropriate period for allocations to trigger a refund of retainer charges because it is consistent with the default timing for release of incremental capacity and potential substitutions.

Some respondents identified that they have longer term development projects that would not qualify for a refund because first gas flows are envisaged beyond month 54; e.g. first gas no earlier than Oct 2014.

Whilst National Grid does not believe its initial proposals to be discriminatory and recognising industry wish to avoid added complexity, National Grid has reviewed its proposals. We are now proposing that, in addition to existing proposals, a refund can be triggered where capacity is booked in the period Y+5 and Y+6; i.e. for March 2010 auction the periods Oct 2014 to Sept 2015 and Oct 2015 to Sept 2016.

For these proposals to apply the Shipper must “tag” its retainer to a specific year at the time of application. A default of Y+4 will apply. In these cases, to trigger a refund retainer capacity must be allocated to the specific Shipper.

National Grid believes that these additional proposals are consistent with recent developments on exit reform which makes capacity available up to Y+6 and will make the retainer product more attractive to Shippers with long term development projects.

- **Exchange Rate Cap:** National Grid asked for further views on the level of exchange rate cap that should apply to substitution processes. The majority view is in favour of a low cap but we are unconvinced that a cap set at 1:1 is appropriate. Whilst any value is arbitrary, we believe that as Shippers have, in most cases, a low cost alternative to buying capacity it is reasonable to assume that capacity not bought or retained should be used in substitution, and that exclusion on the basis of an exchange rate cap is inefficient. However, to provide a soft landing to substitution a compromise, at 3:1, is being proposed. Whilst ensuring extremely high levels of capacity are not lost it may, in some cases, also prevent any substitution occurring even where clearly advantageous to do so.

### Summary of Changes Made

NB: paragraph numbers relate to the proposed methodology statement after incorporating changes as a result of the consultation.

- Paragraph 22 amended to clarify the availability of capacity previously substituted to/from an ASEP for future substitutions.
- Paragraph 28 added to facilitate “tagging” of retainers to years Y+5 or Y+6 so that retainer charge refunds can be triggered for longer term developments. Further paragraphs (and diagram 1) have been amended as a consequence of the different relevant years for tagged retainers.
- Paragraph 29 added to clarify retainer aggregation processes (in respect of tagged retainers) for the calculation of Substitutable Capacity.
- Paragraph 38 amended to require National Grid to acknowledge requests for retainers.
- Paragraph 39 amended to clarify that all the available capacity for retainers will be available on the first day of the retainer window.
- Paragraphs 39, 41 and 42 clarify rules for pro-rating and rejecting retainer requests when considering the different relevant years of tagged retainers.
- Paragraph 44 has been added to ensure that National Grid notifies individual Shippers of retainers that are granted to them. To accommodate provision of this additional information the deadline for provision of information in paragraphs 43 and 44 has been extended from 7pm to 8pm. This is consistent with similar QSEC publication deadlines.
- Paragraphs 50 and 51 have added new rules for the refunding of retainer charges where capacity has been tagged to Y+5 or Y+6
- Paragraph 52 has been amended such that, where appropriate, retainer charge refunds (in part or full) shall be determined and paid by July in each year. Paragraph 45 amended for consistency. Additional clarity added to calculation of refund quantity.
- Paragraphs 54 and 57 ensure that when a Shipper is allocated capacity that capacity is matched to their retainer, thus “targeting” refunds to Shipper that is allocated capacity.
- Paragraph 59 has been amended so that notification of changes to entry zones will be made before the retainer window.
- Paragraph 64 clarifies that capacity at a donor ASEP may be substituted away even if there is insufficient Substitutable Capacity to totally satisfy the incremental capacity at the recipient ASEP.
- An extra bullet has been added to paragraph 77 to clarify that the process of substitution will stop if the exchange rate cap is exceeded.
- Paragraph 89 clarifies that retainers are available only prior to the regular QSEC auction and will not be available prior to an ad-hoc auction.
- Other paragraphs have been amended slightly to improve clarity.

Detailed comments from respondents and National Grid’s response to these comments are provided in the following table.

No.	Party	Response Quotes	National Grid Response	Proposed changes
<b>1 – In favour / against</b>				
1.1	E.ON	E.ON UK does <b>not support</b> implementation of this proposed Entry Capacity Substitution Methodology Statement.	National Grid notes the lack of support for the proposal.	
1.2	BP	For the reasons listed [below] BP <b>does not support</b> the proposed Entry Capacity Substitution Methodology Statement.	As above.	
1.3	SSE	SSE is not supportive of the proposed Substitution Methodology Statement. .....Particularly, as we believe the Retainer approach to be inferior to the other Substitution methodologies that have been developed.	As above.	
1.4	RWE	We see little merit in the Retainer Approach as currently drafted, but accept that National Grid has complied with its licence obligations in issuing its ECS based upon this approach.	As above.	
1.5	Total	TEPUK <b>does not</b> support the proposed Entry Capacity Substitution Methodology Statement.	As above.	
1.6	BGT	In summary, this response highlights two broad issues. The first, and most important, is that the proposed substitution methodology is either flawed or imperfect in a number of aspects.	As above.	
1.7	BG	BG Gas Services <u>does not support</u> this methodology statement.	As above.	
<b>2 – Principles of Substitution / Retainer Approach</b>				
2.1	E.ON	It is our understanding that the fundamental principle behind the introduction of substitution is to avoid sterilisation of capacity.	Agreed	

		<p>In our view, the ‘retainer’ approach does not achieve this. Rather, it encourages those with the funds available to protect capacity from substitution, regardless of whether or not they want to subsequently buy it.</p> <p>Equally, over the duration of the ‘retainer’ commercial priorities might change and a Shipper may legitimately choose not to subsequently purchase the capacity covered by a ‘retainer’ in a future auction. As a result, an opportunity to substitute and hence to prevent unnecessary investment will have been lost, potentially leading to additional risks and/or costs facing consumers.</p>	<p>National Grid does not believe that Shippers will take out retainers merely to prevent substitution. Retainers will be taken out where Shippers have a reasonable expectation of needing capacity but are not yet in a position to fully commit to buying the capacity.</p> <p>National Grid agrees with this analysis. However, where this occurs the Shipper will not receive a refund of their Retainer Charge. National Grid believes, along with the majority of respondents to previous consultations and workshops, that where there is a reasonable expectation that capacity is required at an ASEP then this capacity should not be substituted away. We believe that it is correct to assume that “reasonable expectations” backed up by a retainer charge is sufficient to prevent substitution. E.On may seek to decrease the risk of retained capacity not purchased by arguing for a higher retainer charge in the separate charging consultation<sup>3</sup>.</p>	
2.2	E.ON	<p>Although National Grid NTS has chosen not to consult on it, E.ON UK believes that the ‘two stage auction’ approach would fit best with the principles underpinning the substitution obligation and the established gas entry capacity auction regime . It is the only approach that affords Shippers a genuine opportunity to influence the outcome of substitution by using existing, familiar tools – i.e. QSEC auction bids. Moreover, it does not permit available capacity to be ‘protected’ from substitution by anything other than a full user-commitment: the only way capacity can be secured under the ‘two stage auction’ approach is to buy it.</p>	<p>National Grid accepts that there are advantages with a methodology that requires a “full user commitment”. This was the basis of the “base methodology” which was consulted on in 2008. However, the majority within the industry have expressed strong opposition to a full commitment. Hence National Grid has sought a compromise with the retainer approach.</p>	

<sup>3</sup> NTS GCM 18 “NTS Entry Capacity Retention Charges” 11Aug2009: <http://www.nationalgrid.com/uk/Gas/Charges/consultations/CurrentPapers/>

2.3	BP	BP is disappointed that after the industry has spent so much time and effort on the important issue of substitution, we may be forced to accept the implementation of an approach that has received the least amount of attention and development time.	<p>National Grid is disappointed that BP have the impression that the retainer approach received less attention and development time than other approaches when so much effort was put into its development.</p> <p>It should also be noted that Industry considered that it was not necessary to have an additional workshop, after workshop 8, and thought that the options were sufficiently developed for the informal consultation.</p>	
2.4	EdF	We welcome the fact that NGG has changed the name of product from “Option” to “Retainer” as it better reflects the product which is not really an option as it can be purchased by any User.	Noted.	
2.5	EdF	We recognise Ofgem’s concerns regarding Shippers not committing to long-term purchases of capacity however we continue to believe that Shippers make investments for the long-term and therefore require capacity on a long-term basis in order to efficiently use these facilities. We believe the risks for Shippers will increase with substitution as it will not be clear for Shippers what their future entry capacity requirements will be four years ahead as the proposals entail. The NTS has different types of Shippers with different commercial requirements and it doesn’t necessary mean that unsold capacity is there to be substituted. Shippers may therefore be put off from retaining capacity, depending on cost, which could create inefficient signals for NGG who may incorrectly substitute away that capacity to satisfy an incremental signal elsewhere. This will neither be efficient or economic. We therefore question how successful this new regime will be and what level of uptake there will be especially if it is cheaper to buy the capacity rather than withhold it from market through the “retainer”. We believe the Transfer and Trades mechanism in the short-term capacity auctions works well ensuring that capacity is not	<p>National Grid recognises the problem for Shippers in identifying their requirements four years in advance, however, it must be recognised that substitution is a response to an incremental signal at another ASEP which is provided 42 months in advance. Notwithstanding this, the retainer approach has been developed to allow Shippers a low cost opportunity to prevent capacity being substituted. If Shippers are not prepared to take out a retainer due to its cost then they are less likely to purchase the capacity, and this capacity would be at risk. The alternative “free ride” via the mechanical approach has been discounted for reasons discussed at length in substitution workshop 9.</p> <p>National Grid recognises that for some ASEPs it is cheaper to buy capacity than a retainer, but a refund is not available to</p>	



		squandered and that the NTS capacity is efficiently used.	capacity purchases.  Whilst we accept that the Transfer and Trade mechanisms work well we believe it is only relevant to substitution to the extent that it could be used, to a limited extent, to regain capacity at an ASEP from where capacity has been substituted.	
2.6	SSE	The implementation of Substitution was to avoid sterilisation of capacity and consequently ensure efficient investment. SSE is supportive of this principle but does not believe that the Retainer methodology achieves this. The Retainer approach allows Users to pay a nominal fee for capacity that is not cost or value reflective and removes that capacity from any subsequent substitution consideration. However, the Retained capacity can subsequently remain unpurchased and unused. Consequently, a potential opportunity to Substitute and avoid future unnecessary investment will have been lost, leading to additional costs for customers.	National Grid agrees with this analysis. However, substitution is a balance between protecting capacity (via retainers or other means) with potential loss of substitution opportunities against substitution of unsold capacity which is subsequently wanted. The retainer approach with its charges and refund mechanism is an attempt to reach that balance.	
2.7	RWE	<i>Rights Acquired</i> Although the retainer prevents capacity being used to satisfy incremental requests at another ASEP, the risk of that capacity being allocated to meet an incremental signal at that ASEP remains. This makes it difficult to assess the value of paying the retainer fee. This problem is exacerbated where a developer wishes to acquire capacity in the future, but may need to take out a retainer at early QSECs to prevent the capacity being substituted ahead of their requirements. Having to commit early will represent a barrier to certain projects and may not actually result in the capacity being protected in any case.	As explained by SSE in 2.6 above, a retainer may result in substitution opportunities being lost if the retained capacity is subsequently not needed. It would seem inefficient and uneconomic if retained capacity could not be allocated at the specific ASEP and this resulted in another Shipper triggering incremental capacity and possible investment only for the retained capacity to prove un-needed.  Where capacity is allocated to another Shipper a refund will be made, and in respect of longer term projects National Grid is proposing change to the refund mechanisms to address this point.	See section 8 for proposed changes to refund mechanisms.

2.8	RWE	<p><i>Substitution hierarchy</i></p> <p>For both within and outside zone substitutions, we believe that the methodology should recognise the amount of unsold capacity at each ASEP, so those with a greater level unsold would contribute more to the requirement. Certain ASEPs are more vulnerable to being donors than others simply due to where they are located on the network and how they interact with other ASEPs. All ASEPs should face an equal likelihood that their substitutable capacity may be reallocated and introducing additional criteria based on levels of un-booked capacity, rather than pipeline distance alone, will lead to a more equitable and efficient outcome.</p>	<p>Within zone National Grid will focus on the ASEPs with best exchange rates. Whilst we sympathise with the proposal to share the loss of capacity amongst potential donor ASEPs this would be less efficient.</p> <p>Outside of zone, pipeline distance is the criterion used because of the limited time available to analyse all ASEP exchange rates. Using pipeline distance is a reasonable assumption for most efficient ASEP.</p>	
2.9	STUK	<p>NGs Entry Capacity Substitution Methodology Statement describes the Retainer approach, allowing Users to pay a retention fee to protect the capacity at an ASEP from substitution for 12 months. STUK believe that this option will be of little use to those wishing to invest in the UK and as the retainer offers no rights to the capacity and will give little confidence to Shippers that capacity will be available to them in the long-term. As discussed during review group 0221, the current 42 month investment lead-time associated with the release of long-term NTS Entry capacity is already a high hurdle for some developers to meet with investment decisions and project certainty difficult to assess this early in the process. If a Shipper was able to take the decision on the volume of capacity and at which ASEP to purchase a retainer, it is likely that they would be in the position to participate in the QSEC auctions making the retainer unnecessary</p>	<p>See response to 2.7.</p> <p>It has been suggested by various Shippers during the substitution workshops that capacity should be protected from substitution whilst projects are being developed because these Shippers are unable to commit to buying capacity. National Grid has developed the retainer approach as a low cost alternative (for most ASEPs) to buying capacity. Where a Shipper is unable to identify the location and/or quantities they require, potential substitution opportunities could be lost on the basis of incomplete data. Hence requiring a user commitment to protect capacity from substitution ensures that more robust data is used.</p>	
2.10	STUK	<p>As a major importer of natural gas to the UK, Statoil (UK) Ltd, STUK is interested in the maintenance of a stable, efficient and economic entry capacity regime. STUK have participated in the long term entry capacity reservation process since its inception and have played an integral part in the development of the regime, booking capacity at both new and existing terminals. We have expressed our</p>	<p>Noted.</p>	

		commitment to the UK market by purchasing long term entry capacity until 2022; with a view to potentially committing even further in the longer term should the regulatory conditions remain favourable.		
2.11	Tot	As a general comment TEPUK supports the principle of a transmission system which is appropriate to demand for entry capacity and which is run in a cost efficient manner. Still we believe that moving capacity away from an entry point may lead to capacity destruction and could potentially be costly to consumers, hence substitution should only be allowed after taking into consideration reasonable and future expected demand for entry capacity.	Substitution will move capacity from where it may not be needed to where it clearly is. This should save on investment costs. However, Shippers must indicate future capacity requirements by either buying the capacity or, where this is not possible, taking out a retainer. As pointed out by STUK (see 2.9) Shippers may be unable to confirm precise requirements. In this case, unless the Shipper makes a commitment, it would be inefficient to invest elsewhere when capacity could be substituted.	
2.12	Chev	It is only as progress is made towards the development phase of a project that it becomes feasible for a developer to make any financial commitments related to that project. Given our understanding of the maturity of West of Shetland development progress, we believe that West of Shetland participants would be unlikely to be able to take out retainers at St Fergus in January 2010.	If WoS Shippers want to protect capacity from substitution they must buy it or buy a retainer. If a retainer is taken out a refund may be made if the capacity is later bought. (See section 8 for proposals to extend the scope for refunds).	
2.13	BGT	Page 6, section 10, there is a statement that “ <i>At the effective date of this statement no substitutions have been undertaken...</i> ”. We question the accuracy of this statement. Whilst it may be true to say that no substitutions have taken place <u>under this proposed methodology</u> , we are of the opinion that the significant baseline revisions (cuts) that took effect at the last price control enabled implicit substitutions to take place where investment would otherwise have been required. One case that stands out to us, as the primary user at Barrow, is the loss of Barrow capacity, and the coincidental requirement for capacity at the (yet to be completed) Fleetwood storage facility.	The revision of baselines was an exercise undertaken as part of a package of changes, including substitution, that were introduced at the time of the last TPCR. The subsequent review was a separate process that only increased baselines. Substitution of capacity, as defined in the Licence, and to which the proposed methodology statement relates, has not been undertaken to date.	

2.14	BGT	<p>Page 11, paragraph 31. We do not agree that the arrangements set out at paragraph 31 are appropriate. Any user who is minded to take part in this “retainer” approach will do so based upon their own perceived needs for future capacity at an ASEP, and their perceived threat of that capacity being substituted away. Such a user will take into account what they know about likely gas developments until the next opportunity to buy capacity and/or take out a retainer.</p> <p>It is not clear, however, why users will not have the ability to respond to the calling of an ad-hoc auction by taking out a retainer at that point. Ad-hoc auctions by their very nature could happen at any time during the capacity year, and may not have been “on the radar” when users were considering the need for a retainer ahead of a scheduled QSEC.</p>	<p>It is proposed that a retainer is valid for 12 months. National Grid believes that potential ad-hoc auctions will not come out of the blue due to these projects being widely publicised.</p> <p>Whilst there may be a small probability of new projects appearing without warning we believe that the added risks do not warrant the added complexity.</p>	
2.15	BGT	<p>Page 11, paragraph 36. We do not consider that it is appropriate for “<i>retainer requests to be considered as received</i>”. It is not unusual for faxes not to arrive, or to be printed and then mislaid. In the absence of a suitable systematised process, we believe that a robust process is required in order to provide users with confidence that their retainer request has been received and acted upon appropriately.</p>	<p>National Grid will acknowledge receipt of retainer requests.</p>	<p>Para 36 (now 38) amended to acknowledge receipt of retainer requests.</p> <p>New para 44 added to inform Users of retainers granted.</p>
2.16	BGT	<p>The methodology does not make clear whether all capacity available at a specific ASEP in the forthcoming QSEC can be “retained” on the first day that the retainer window opens, or whether 50% of that available capacity is can be retained on the first day, with the other 50% plus any left over from day one being available for retention on the second day.</p>	<p>It will all be made available on the first day.</p>	<p>Para 37 (now 39) amended to aid clarity.</p>
2.17	BG	<p>Whilst we understand that NGG will be revenue neutral under the Substitution methodology, we are concerned about the potential inefficiency of capacity being substituted away from a particular terminal where there are future demand signals. There is a very credible scenario where capacity could be substituted away one year, (in the absence sufficient “retainer” bids), only for a couple of years</p>	<p>National Grid agrees that the scenario outlined could occur. Equally there is potential for capacity to be protected from substitution (via whatever means) which contributed to the need for investment elsewhere. This investment could prove inefficient if the protected capacity is</p>	

		later, there to be incremental demand signals at the donor terminal. This could require further investment, potentially at higher cost, than if the investment had occurred where the original demand signal had come from.	subsequently not needed. The retainer approach tries to bridge these two conflicting scenarios by requiring a modest user commitment before capacity is protected.	
2.18	BG	Substitution of capacity is efficient where the future usage of capacity at a particular terminal is unlikely to be required, but is potentially inefficient where capacity is likely to be demanded at higher levels in a future period. Our understanding is that whilst Ofgem will have scrutiny on any substitution that NGG propose, there will be little or no discretion (assuming that NGG have followed the methodology), and in the absence of a User commitment, capacity destruction will occur.	The difference between efficient and inefficient substitution, as described by BG, presents a problem that the retainer approach tries to resolve. It allows Shippers to flag, at relatively low cost, where capacity will be needed, hence avoiding “uneconomic” substitutions.  In the absence of a user commitment capacity substitution may occur. Whether or not this constitutes capacity “destruction” depends upon whether the capacity is needed or not. In the absence of the user commitment it will be considered not needed.	
2.19	BG	As the exchange rates move away from 1:1, we would expect greater scrutiny to be applied on whether there is a real long term benefit from substitution occurring rather than denying the incremental investment to take place.	National Grid has an obligation to review the methodology annually.	
2.20	BG	We are concerned that the “retainer” won’t be actively used given the product “definition” (ie giving the purchaser of the retainer no rights other than to keep capacity at the ASEP for some future user, being refunded if such capacity is sold at the forthcoming QSEC auction). We believe that the retainer should provide some rights to first call on that capacity in the final round of a QSEC auction, whereby the auction could be closed without the ability to respond to the new signal.	It would be perverse if retained capacity could not be allocated at the specific ASEP and this resulted in another Shipper needing to trigger incremental capacity and investment being incurred only for the retained capacity to prove un-needed. Hence it is reasonable that the retainer attaches no rights to buy or reserve capacity.	

3- Impact Assessment				
3.1	E.ON	As regards the impact of substitution on wholesale gas markets, we note that if a Shipper is short of capacity at a specific ASEP, taking out a 'retainer' is effectively flagging to the market that this Shipper is a distressed buyer, potentially resulting in price spikes. Given this concern, we welcome Ofgem's commitment to undertake analysis of the likely impact of this substitution methodology on gas and capacity prices as an integral part of its Regulatory Impact Assessment.	National Grid agrees that the impact of the proposals and substitution in general is outside the scope of this consultation and resides with Ofgem's impact assessment. However, we disagree that taking out a retainer is a sign of "distress". The retainer allows Shippers to identify, by providing a commitment, capacity that they may require and so should be excluded from substitution.	
3.2	BP	In a number of our previous responses on this subject, we have mooted our support for the principals of substitution. However, we also continue to believe that substitution may unnecessarily remove flexibility from the market, harming both competition and security of supply.	These issues are outside the scope of this consultation.	
3.3	SSE	Substitution is a difficult balance between ensuring that assets are used to their most efficient and ensuring that the capacity/infrastructure exists to enable gas to flow into the UK.  The impact on wholesale costs through inefficient substitution could cost much more than the savings made by ensuring that all capacity is used.	Agreed.  This issue is outside the scope of this consultation.	
3.4	RWE	The proposed Entry Capacity Substitution Methodology Statement (ECS) under consultation is based upon the "Options Approach" and does not consider either of the other two potential methodologies that have been developed. Ofgem's open letter <sup>4</sup> notwithstanding, we believe that these alternative methodologies must be considered as part of any Impact Assessment given their level of development. It is unreasonable to exclude them	It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.	

<sup>4</sup> Development of a methodology to implement National Transmission System (NTS) Entry Capacity Substitution, July 2009

		and the principles of each methodology should be assessed. In light of the clarification provided by Ofgem <sup>5</sup> on how the substitution obligation interacts with other statutory duties and licence obligations on National Grid we think it is entirely appropriate that National Grid should use broad assessment criteria to inform its investment decisions and nothing should be ruled out at this stage.		
3.5	RWE	Although we have consistently supported the principle of substitution, this has been tempered by our concerns about capacity destruction and the consequent reduction in the flexibility of the NTS. With declining UKCS supplies and the key role that new gas-fired generation is expected to play in the medium term, it is vital that GB has access to gas from international markets. We are therefore keen to avoid policies that undermine security of supply and may introduce additional market uncertainty that adversely affects investment in new energy infrastructure. On this basis, our preference would be for the Impact Assessment to consider scenarios of the effect on commodity prices caused by reduced access to capacity on peak days and the impact on GB consumers. A starting point might be the impact on winter prices caused by the temporary reallocation of capacity after the first transfer and trade auction.	It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.	
3.6	RWE	We agree that it is important to avoid stranded capacity and unnecessary infrastructure cost, but prefer an approach based upon retaining flexibility but with progressive reallocation of capacity in light of enduring evidence that such capacity is not required. The UKCS is in decline, with the UK becoming increasingly reliant upon imported gas. Given the importance in the GB generation mix of gas-fired stations in the medium term, it is important to maintain investor confidence in the UK as a place to land gas, including LNG, import pipelines and marginal UKCS fields. In process terms, we strongly believe that all options should	It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.	

<sup>5</sup> Informal consultation on National Grid Gas's National Transmission System (NTS) Gas Transporter licence condition with respect to Entry Capacity Substitution, July 2009

		be considered as part of Ofgem's Impact Assessment, which needs to demonstrate the benefits of implementing substitution. At this stage, we remain to be convinced of the benefits that introducing substitution in the form proposed ahead of the 2010 QSEC allocations will deliver.		
3.7	STUK	As the UK moves towards a Low Carbon economy the emphasis on gas imports has again come into focus with gas seen as the natural bridging fuel for renewable electricity generation. The recently published 'Wickes report' suggests that to ensure security of supply the need for <i>"Our regulatory structures to be stable to enable partners to make strategic commitments to the UK market"</i> , STUK believes that the implementation of the substitution obligation and the retainer methodology creates unnecessary and unacceptable levels of uncertainty in the UK entry capacity regime which could have a detrimental effect on security of supply.	These issues are outside the scope of this consultation.  National Grid believes that the retainer approach provides an opportunity for Shippers to protect capacity that they may require in the future. Hence, if Shippers take out retainers, or buy capacity, there should be minimal impact on security of supply.	
3.8	Tot	TEPUK supported the development of the Mechanical Approach along with most industry players, and we were alarmed at the sudden change of direction caused by Ofgem's letter dated July 3 <sup>rd</sup> 2009. We believe that the forthcoming Regulatory Impact Assessment must address all three models and their possible effect on gas and entry capacity prices. We believe this analysis is vital and will highlight which model provides the best cost-benefit balance for industry and consumers.	It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.	
3.9	Tot	TEPUK and others are currently developing new reserves in the West of Shetland area with gas delivery expected via a pipeline to St Fergus in 2014. With this in mind we are concerned to ensure that any proposal which might substitute entry capacity away from terminals where future gas is expected but for which no long term commitment signal has yet been made takes into account these future gas flows. We do not believe the Retainer model is appropriate for this and we are disappointed at the way the Mechanical Approach was suddenly discarded ahead of the Impact	It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.  For the formal consultation National Grid can only propose one methodology. The retainer approach is considered by National Grid as best meeting the aspirations of the majority of industry players whilst presenting a reasonable expectation of being approved by Ofgem. See also section	



		<p>Assessment.</p> <p>We believe that before the substitution methodology is finally adopted Ofgem must assess and compare the impact for all three models (“Mechanical”, “Two-stage” and “Retainer”), as this will allow the industry and consumers to ensure that the model which best promotes the economic and efficient development of the NTS is implemented.</p>	5 “Scope of Consultation”.	
3.10	Chev	<p>As we have stated in our previous responses on this subject, we are one of a number of companies currently involved in exploration activity to the West of Shetland where the estimated reserves represent around 17% of the UK’s remaining oil and gas<sup>1</sup>. We remain concerned that the introduction of entry capacity substitution could result in West of Shetland gas resources becoming stranded due to lack of entry capacity at St Fergus.</p>	See 3.9 above.	
3.11	Chev	<p>Given the complexity and lack of transparency in National Grid’s network model, it is quite possible that implementation of the proposed methodology could lead to unexpected consequences. This is particularly true when the implications of other recent changes to the entry capacity regime are taken into account (eg adjustment of baselines, capacity Transfer and Trades, reduction in capacity withheld from the QSEC auctions, etc). The situation is further complicated at St Fergus given National Grid’s recent proposal to remove part of the St Fergus feeder pipelines from natural gas service in 2013 to facilitate CO2 transportation.</p> <p>In light of the above, it is imperative that Ofgem’s forthcoming Impact Assessment should not just be limited to this proposed methodology but should be widened to cover all aspects of the entry capacity regime, its implications for West of Shetland developments and any interaction with current carbon capture and storage proposals.</p>	<p>It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.</p> <p>Although any regime change could lead to unexpected consequences, National Grid believes that discussions and presentations at substitution workshops have demonstrated likely outcomes.</p>	
3.12	BG	<p>Embarking on the “retainer” route is likely to result in a loss of overall system flexibility and a consequential adverse impact on security of supply. Furthermore, we remain to be</p>	<p>The retainer approach will only result in loss of flexibility etc if Shippers do not take them. Hence it is substitution, not the</p>	

		convinced of the perceived consumer benefits from this move and would highlight the adverse impact of capacity squeezes (eg St Fergus July 2001; Easington 2007/8 and 2008/9) have had on the efficient operation of the market. The danger to the consumer remains one of not having enough spare capacity, particularly as future UKCS investment tends towards short/medium term incremental offshore developments.	specific approach, that provides the benefits and risk identified. These issues are outside the scope of this consultation.	
3.13	EdF	EDF Energy supports the idea of Substituting or transferring entry capacity where possible to improve and optimise the efficient use of NGG's Transmission System. However, we have always maintained that it is Ofgem's responsibility to ensure that NGG invests and maintain its network efficiently by allowing or disallowing the right level of investment. Substitution, whilst a potential solution, may end up creating more risks for Shippers and consumers with capacity being eroded where needed. This comes at a time when declining gas supplies from the North Sea will be replaced with imports at many of the same terminals where capacity may seem in decline today but not tomorrow.	These issues are outside the scope of this consultation.	
<b>4 – Retainer Charges</b>				
4.1	RWE	<i>Level of Retainer</i> We agree that the retainer needs to strike the appropriate balance between providing a meaningful level of commitment and not being seen as unduly penal. Given our observations above, we support Option B but would like to state that even this approach leads to a level of retainer cost that is inconsistent with the rights the retainer conveys.	The level of retainer charge is outside the scope of this consultation but will be considered as part of the GCM018 consultation.	
	BGT	we believe that the proposed methodology is fundamentally flawed. National Grid has a Transporter licence obligation to offer capacity products, the price of which is not arrived at through an auction, on a cost reflective basis. In order to meet that requirement, it appears that the fee for a retainer should be based upon the actual cost to National Grid of offering the product. This is likely to amount to a small	The level of retainer charge is outside the scope of this consultation but will be considered as part of the GCM018 consultation.	

		administration fee only - we fail to see how a figure in the order of £32,000 per mcm of capacity reflects an actual cost. Indeed, given the significant difference between the proposed fee and the actual cost to NG, we would argue that the use of an arbitrary figure without proper underlying justification is likely to give rise to unintended consequences.		
	BG	We favour the Commitment Method B if this [the retainer approach] is the eventual route the industry have to follow.	The level of retainer charge is outside the scope of this consultation but will be considered as part of the GCM018 consultation.	
<b>5 – Process</b>				
5.1	BP	We also feel that a number of questions need to be asked regarding the process of consultation and methodology selection. As an example, the fact that the two stage auction approach was discarded on the basis of a modification proposal raised by National Grid (Mod 246) is totally unacceptable.	<p>It is a Licence requirement that National Grid develops and proposes to the Authority a substitution methodology. So the final decision on the proposal rests with National Grid, bearing in mind that it must meet the aspirations of the Authority in order to be approved. Notwithstanding this National Grid undertook to look at a range of options and to develop them in conjunction with the industry.</p> <p>As discussed in the Executive Summary, National Grid has reviewed its decision on the implementation of a two stage auction and still believes that the retainer approach is a superior solution to the implementation of the substitution obligation, as it better meets the needs of all industry parties. However, it is important to realise that the proposed Methodology Statement also facilitates a two stage auction, as it uses, as well as retainers, the level of sold capacity to determine the amount of capacity that is available for substitution.</p>	

			<p>Any shipper is able to raise a UNC Modification proposal to implement a two stage auction and National Grid would be happy to support the development of such a proposal, which would need to take into account the difficulties expressed by National Grid at workshop 9. It should be possible to implement a revised form of a two stage auction ahead of the first application of the substitution obligation.</p> <p><b>Therefore in effect the Methodology Statement proposed encompasses both the “option” and “two stage auction” approaches that were informally consulted upon.</b></p> <p>It should also be noted that in essence shippers already have sufficient information to allow themselves to only bid for capacity once an incremental signal has been received, as National Grid publishes auction information after every QSEC bid window. As the QSEC auction has never gone the full ten rounds, it would be possible for a shipper to review the auction information each day and then place any “necessary” bids once the shipper sees that an incremental bid has been submitted. National Grid could envisage that a targeted UNC Modification proposal could be raised that would “tweak” this process to improve transparency and create more certainty and shipper response time.</p>	
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5.2	EdF	<p>In terms of process it is disappointing to note that two of the three options which Ofgem were going to consider as part of their Impact Assessment have been disregarded as viable mechanisms, especially after all the work that went into developing them and so late in the process. However, at the same time we believe that Ofgem and NGG have been open and transparent in providing this early warning that the “Mechanism and Two-stage model” would not be viable options as this has and will save industry time in developing them further.</p>	<p>See 5.1 National Grid can only put forward one methodology to the Authority for approval. We must consult on this methodology. Hence it is not available for National Grid to consult, formally, on all options. That is why we ran an informal consultation first.</p> <p>However, it is a matter for Ofgem to decide whether more than one option can be considered as part of their Impact Assessment.</p>	
5.3	Chev	<p>Moving on to this specific consultation, it is unfortunate that we only have one methodology to comment on. Given Ofgem’s view (reference Stuart Cook’s letter dated 3 July 2009) that the “mechanical” methodology is not appropriate, we would have expected both the remaining methodologies (the “option” – now retainer – approach and the “two-stage auction” approach) to be issued for formal consultation.</p>	See 5.2	
5.4	Chev	<p>It is extremely disappointing that the two-stage auction approach has now also been dismissed at this late stage, solely due to National Grid apparently being unable to implement it in the time available. Given the length of time that substitution has been under discussion, it would seem sensible for Ofgem to relax the implementation timetable in order to ensure the best outcome can be achieved.</p>	<p>See 5.2. Relaxation of the timetable to implement substitution is a matter for Ofgem.</p> <p>See also comment on 2-stage auction in 6.5.</p>	
5.5	BGT	<p>It is extremely disappointing that, after months of constructive work and real progress between National Grid and Shippers, we arrive at a position where the industry is presented with a <i>fait accompli</i> in the form of this proposed methodology. We recognise that this is primarily Ofgem’s doing through its announcement that it expects to consider only a methodology(ies) which includes some form of “User Commitment”.</p> <p>That announcement, made by way of an industry open letter</p>	See comments above and 6.5.	

		dated 3 July 2009, was the first such indication from Ofgem that the clear front runner – the “Mechanical Approach” – which attracted overwhelming industry support, would not be an acceptable methodology for substitution. It is puzzling to us why an industry regulator, who has been repeatedly asked to provide early guidance if it believes matters are not progressing along acceptable lines, should attend and take part in such an extensive development process covering many months, without giving any insight whatsoever into its thinking on a fundamental point such as User Commitment. At the very least, such action (or inaction) must be viewed as grossly inefficient.		
5.6	BGT	Given that it was never the preferred option, the “retainer” (to give it its new name) has not received the amount of attention, and therefore development, that is necessary in order to instil confidence that it is fit for purpose. Rather, we now seem to be in a position whereby development will need to take place as part of this final consultation process, and following that through trial and error with those who are successful in understanding the process and persuading their financial controllers to put up cash in order to “retain” capacity.	National Grid is disappointed that BGT have the impression that the retainer approach received less attention and development than other approaches when so much effort was put into its development.  It should also be noted that Industry considered that it was not necessary to have an additional workshop, after workshop 8, and thought that the options were sufficiently developed for the informal consultation.  However, National Grid has continued to refine the retainer approach based on the recent comments from industry participants.	
5.7	BG	Given that all the options haven’t been fully considered, we are reluctant to comment on the specifics of the methodology because we disagree with how it is being introduced.	Three well developed options were considered with the informal consultation. At workshop 9 it was explained why the final proposal would be based on the retainer approach.	

6 – Scope of Consultation				
6.1	E.ON	We are also concerned to see key questions being asked about the substitution methodology at the final consultation stage (such as an appropriate exchange rate level), which leads us to believe that it is under-developed and risks having unintended consequences, if implemented	Notwithstanding changes proposed as a result of the consultation, National Grid believes that the methodology, as consulted upon, was adequately developed. Whilst a consultation is a consultation on the entirety of the proposed methodology it is not unreasonable to bring to the attention of consultees specific issues, especially those that have previously proved contentious.  It should be noted that exchange rate caps were consulted upon as early as May 2007 <sup>6</sup>	
6.2	E.ON	We do not believe that National Grid NTS presenting only the 'option' / 'retainer' approach as the culmination of over two years of intensive industry work does justice to the efforts invested by all parties in developing a workable process for entry capacity substitution.  We believe that a satisfactory compromise for the majority of parties involved would have been for National Grid NTS to consult on both the 'retainer' and 'two stage auction' approaches as part of this final consultation. However, this possible way forward seems to have been ignored and hence we are unable to offer our support for this Entry Capacity Substitution Methodology Statement, as drafted.	See 5.1.	
6.3	SSE	We are disappointed that the substantial effort invested by the industry has been curtailed with only one method of substitution being put forward for consultation.	See 5.1	
6.4	BP	Questions remain regarding the retainer length and exchange rate cap, while the concept of partial substitution has made a sudden reappearance.	Proposals have been made and consulted upon as part of this consultation.	

<sup>6</sup> Consultation on "The Entry Capacity Substitution Methodology Statement" dated 18<sup>th</sup> May 2007 which can be found at: <http://www.nationalgrid.com/uk/Gas/Charges/archive/> .

6.5	SSE	<p>SSE believe the 2 Stage Auction methodology should be implemented and is a better solution for the following reasons:</p> <ol style="list-style-type: none"> <li>1. It will make use of the existing QSEC process and avoid the added complexity of retainer payments in a regime that is already too complex which creates a barrier to new entrants.</li> <li>2. Users will only have to bid for existing capacity to protect capacity from substitution once an incremental capacity has been signalled. The Retainer method is less efficient as Users lack certainty and will have to make untargeted retainer payments due to lack of transparency about future investment signals.</li> <li>3. The User commitment to buy capacity is more cost reflective being based on the ASEPs specific reserve price, rather than an arbitrary, low value and generic retainer payment.</li> </ol>	See 5.1.	
6.6	SSE	<p>Considering the wide spread industry preference for a methodology other than the Retainer approach (Conclusions Report to the May 2009 Informal Consultation on Entry Capacity Substitution 10 July) we question whether the views of industry have been appropriately considered. We question whether an informal consultation that rules out solutions supported by the industry before the final consultation, excluding these options from further consideration and any subsequent Impact Assessment would constitute due process.</p>	<p>See 2.2 and 5.2</p> <p>It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.</p>	
6.7	STUK	<p>STUK would like to take this opportunity to express its disappointment that following many months of discussion and consultation the approach favoured by the industry to facilitate the implementation of NTS Entry Capacity Substitution, the mechanical approach, was not able to be developed further and will not form part of any impact assessment to be performed by Ofgem. Although not in support of NTS Entry Capacity Substitution, STUK have been active members in discussions and working groups related to the development of an acceptable methodology</p>	See 6.2.	



		<p>for entry capacity substitution for two years and have been advocates of the Mechanical Approach believing that it offers the best level of compromise between allowing NG to maximise the use of the existing transmission system and giving Shippers some assurance that the capacity they require for long term investment projects will remain available.</p> <p>It is unfortunate that the publication of a letter from Ofgem giving guidance on what it believed was an appropriate methodology for rationing the volumes of unsold capacity that may be used for substitution arrived so late in the process (after 8 meetings), giving the industry little option than to develop the 'Retainer' approach in order for National Grid to fulfil its licence obligations.</p>		
6.8	BGT	<p>It is also disappointing that the clear second favourite methodology – the two stage auction – has at the last minute been identified as unimplementable within the Ofgem prescribed timetable. We believe that with proper development the two stage auction approach offers real benefits over the mandated "retainer" option in terms of simplicity, accessibility, and likely uptake.</p>	<p>See 5.1</p> <p>It should also be noted that only 2 respondents supported the two stage auction, whereas the retainer approach was generally people's second choice after the mechanical option, where a view was expressed.</p>	
6.9	BG	<p>We consider it regrettable that the industry seem to being forced down the route of a "retainer" and that other alternatives have been precluded at the 11<sup>th</sup> hour.</p>	<p>See 6.2.</p>	
6.10	BG	<p>The TBE process is highly respected across the industry as the benchmark for supply / demand and the information is corroborated by NGG with other industry experts, not just producers. The existing information has underpinned the current capacity Baselines and should not be ignored in reflecting future expected supplies. If it is, then potentially this trusted process will become less useful in future.</p>	<p>National Grid believes the Ten Year Statement and TBE process are important and well regarded processes within the industry. Despite earlier concerns that substitution may lead to the overstating of future supplies, and hence undermining of the TBE process, we believe that processes are sufficiently robust to withstand any such overstatement. However, the reasons for not progressing with a TBE based approach were discussed at substitution workshop 9.</p>	

<b>7 – Future Development</b>				
7.1	E.ON	We are alarmed by National Grid’s previously floated idea that the ‘two stage auction’ approach could be implemented in future years and that the ‘retainer’ approach could be considered an interim measure. In our view, this would add significant regulatory uncertainty to an already complex entry capacity regime. For instance, if the retainer were to be extended to cover multiple years, how would this fit with a two stage auction covering the same periods in future years?	National Grid’s consultation relates to the proposed methodology statement only.  National Grid has an obligation to review the methodology every year and any proposals for future years will be subject to separate debate and consultation.  See also 6.5.	
7.2	SSE	SSE does not agree with NG NTS that the 2 Stage Auction methodology could be implemented at some later date. This will create regulatory uncertainty and have unforeseen consequences, possibly delaying investment in storage and import infrastructure. It is preferable to take the required time to implement the best solution first time round rather than rush through an inferior solution to meet an arbitrary deadline.	See above.	
7.3	EdF	we believe that a retainer longer than one year’s worth of capacity should be developed to decrease the risks on Shippers who want to retain capacity for a longer term. It will also increase the likelihood of it being taken up.	See 8.1 and 8.2 proposed changes to the Methodology Statement.	
7.4	BG	We believe that Storage operators and Interconnector Operators should be in a position to purchase Retainers if they wish.	There was little support for this proposal in the informal consultation.	
<b>8 – Refunds</b>				
8.1	EdF	In terms of refunds we welcome the fact that a refund will now be given to the User who took out the retainer regardless of whether he ends up buying the capacity in the QSEC or AMSEC auction. This will make it a more desirable product increasing the potential of uptake. However we would expect refunds to be done immediately after the retained capacity has been signalled for purchase at a specific ASEP through either a QSEC or AMSEC auction for	National Grid appreciates the expectation that refunds should be made immediately that retained capacity has been allocated and is proposing a change such that where a refund (in part or full) is due this will be made following the relevant QSEC or AMSEC auction. As refunds may be determined after QSEC rather than after	Para 45 (now 52) amended such that refunds will be calculated and paid annually in July. For consistency paragraph 40 (now 45) has been amended for

		a portion or all of the retained quantity. We would also expect interest will be applied and refunded also given the fact that NGG's methodology indicates that the period could be as long as 42 months from when the retainer was taken out.	AMSEC as initially proposed invoices and refunds will be made in July.  National Grid will be neutral in regard to retainer charges and refunds. Hence, if paid, any interest would be paid by other Shippers through TO commodity charges. National Grid is not proposing to pay refunds with interest.	invoices to be raised by July.
8.2	RWE	We welcome the proposal to trigger refunds irrespective of which party acquires capacity and this partly ameliorates the risk is of early commitment. However, as refunds will only be triggered by the allocation of capacity in a 42-54 month period this reduces the incentive to make commitments that fall outside that window. Shippers may have a legitimate requirement for capacity that begins beyond month 54, but to make an early commitment inevitably means that retainer is not refunded. We suggest that the approach be modified such that the proposed 42-months tagging for refunds is extended.	National Grid recognises the concerns of longer term players and is proposing extending the scope for refunds. We are proposing that Shippers can "tag" a retainer to years Y+5 or Y+6 (Y+4 is the default). Where long term capacity is tagged and subsequently bought; in the long term (i.e. in a QSEC and more than 42 months away) and by the Shipper with the retainer; a refund will be made.	New paragraphs added 28: to create "tagged" retainers; 50/51: to define scope for "tagged" refunds.  Consequential changes New paras 28/41/42 Amended paras 34 (now 36) 42/43 (now 47/48).  See also executive summary.
8.3	STUK	STUK would also question the limiting of the ability to triggering a retainer refund, to the 12 months following the capacity release date. This would mean that a Shipper that books long term entry capacity from Y+6 to Y+16 would not qualify for a refund on its retainer purchase whilst those purchasing a single quarter in Y+4 would. It would seem more appropriate for a refund to be triggered during the entire period to which the retainer applies (16 years); this would also encourage those Shippers that are able to signal their long term requirements to do so.	See 8.2 above.  National Grid believes that it would be impractical to extend retainers to Y+16. Y+6 should be sufficient for most, if not all, developments and is consistent with changes to the exit regime.	See 8.2 above.
8.4	Tot	<b>Retention Fee Refunds</b> We believe that the current drafting of the Retention Fee Refunds (41-49) penalizes Shippers who participate long term. If a Shipper took a retainer in the 2010 QSEC for	See 8.3 above.	See 8.2.

		10mscm and then in the 2011 QSEC bought that same volume for flows from 2015 onwards, this Shipper would not get a refund under the proposed regime. Limiting the refunds for flows between Oct. 2013- Sept.2014 is detrimental to Shippers who get involved ahead of time and goes against Ofgem's favoured Shipper behaviour of making long term commitments. We would like to see a system where a Shipper buying entry capacity in the 2011 QSEC gets refunded regardless of when the flows take place.		
8.5	Tot	Currently if two Shippers take a retainer for 10mscm in the 2010 QSEC, and only one of them buys that capacity in the 2011 QSEC, both of them will get a prorated share refund (47). We believe that it is appropriate to prorate when a third party buys that capacity but if two Shippers have retainers and only one of them buys the capacity, this Shipper should be refunded the full amount of its fee.	Although it adds complexity to capacity tracking / allocation processes for National Grid we are proposing to target capacity allocated to Shippers against capacity retained by them. Hence prorating as described by Tot will not occur except in the case of third party allocations.  However, where organisations have more than one Shipper account (short code), allocations made with a different Shipper code to that under which the retainer is made shall be treated in the same way as other third party allocations.	New paragraph 57 added to target refunds to Shippers allocated capacity.
8.6	Chev	One concern we have with the proposed methodology relates to the process for refunds. In the example given in the consultation document, a refund will only apply in respect of a retainer taken out in January 2010 if capacity is allocated at the relevant ASEP for at least one month or quarter in the period October 2013 to September 2014. This approach penalises those Users that are aiming, in good faith, to reserve capacity for a project with a start date beyond September 2014. Based on the current drafting, even if a User that has taken out a retainer subsequently procures an equivalent amount of capacity for a period beyond September 2014, that User will not receive a refund. One solution to this could be for National Grid to refund the	See 8.4.	See 8.2.

		retainer if the User that originally took it out procures an equivalent amount of capacity at the relevant ASEP at any point in the future.		
8.7	BGT	Page 12 and 13, section headed "Capacity Retention Fee Refunds". As far as we can see, neither this methodology nor the associated charging methodology GCM 18 make provision for interest to be added to any refunds given to users for retainers that they have paid. It is our understanding that refunds could happen a matter of years after the original retainer was paid by the user. Holding tens of thousands of pounds for a period of years without paying any interest would appear to represent a benefit to National Grid; this is a benefit that should be returned to the user(s) who paid the retainer.	See 8.1.  Under the proposed charging mechanism National Grid will be revenue neutral and gains no benefit from delaying refunds.	
8.8	BGT	Page 12, section headed Capacity Retention Fee Refunds. It does not seem equitable that no refund will be granted if protected capacity is bought in an RMTTSEC auction. That could lead to NG selling all of the baseline capacity at an ASEP, and retaining all paid retainer fees. This would lead to a TO over-recovery at the relevant ASEP compared to a "non-retainer" world, and further underlines the deficiencies identified above in respect of cost reflective nature of this proposal.	National Grid believes that it is appropriate to exclude RMTTSEC from the refund mechanism due to the complexity of interactions with surrendering, transferring, and trading of capacity.  National Grid believes that the sums involved, (i.e. the absolute cost of retainers, high probability of refunds through QSEC / AMSEC) means that the impact on TO over-recovery will be minimal.	
8.9	BGT	There is also no reference to progressive refunds, which we assume means that National Grid does not intend to make them. By "progressive" we mean that a refund is issued to the user immediately following the sale of any part of the capacity that has been protected by a retainer fee. If we are correct in our belief on this point, we do not consider this to be appropriate as it will lead to a further benefit to National Grid (especially in the light of the apparent lack of interest payments on retained fees) versus a detriment to the retainer payer.	See 8.7	See 8.1.

8.10	BGT	Page 13, paragraph 47. We are puzzled why, when calculating a refund, that refund will be based upon the proportion of the <u>total</u> capacity covered by retainers that the user holds (i.e. implied at all ASEPs), rather than in proportion to the user's retained capacity at the specific ASEP in question. Should this paragraph have the words "...at the relevant ASEP" added to the end of it?	The intent of the paragraph is to relate refunds to retainers at the relevant ASEP.	Para 47 (now 54) amended as proposed by BGT to clarify refunds relate to allocations / retainers at the relevant ASEP.
<b>9 – Information Provision</b>				
9.1	EdF	We agree that NGG undertake network analysis to validate capacity substitutions in order to avoid incremental risk by proposing capacity substitution where this results in the capability of the NTS being reduced below that required. However we also believe that this network analysis should be shared with the industry as it would be beneficial for Users to have a view of capacity demands on the system. This will allow them to make efficient choices over whether to reserve capacity if there is a risk that it might be substituted elsewhere. We believe that NGG has the incentive and the information and therefore little risk in getting their actions wrong when it comes to investing efficiently. Publication of this information will also help Users understand and validate how the exchange rates have been calculated.	The Licence requires National Grid to publish the impact of substitution on each ASEP. This information should assist Shippers to decide whether to take out retainers prior to the next QSEC auction.	
9.2	BGT	Page 12, paragraphs 39 and 40. The methodology does not include any step to advise individual users, ahead of the issuing of an ad-hoc invoice, of the amount of "retained capacity" they have been successful in securing, and their cost liability arising from placing the retainer in the event that no capacity is bought. This information will not be evident from what National Grid intends to publish, in the event that a number of users take out retainers equal to or exceeding all available capacity at an ASEP. It is not appropriate for users to have to wait months for this information.	In addition to the information listed National Grid is proposing to inform individual Shippers of retainers granted to them, the quantity and the ASEP. This will be provided after each stage of the retainer window.	New para 44 added to inform Users of retainers granted.

10 – Exchange Rate				
10.1	SSE	SSE believes exchange rate caps are appropriate in conjunction with a methodology that allows partial substitution. SSE believes a cap of no more than 2:1 should be implemented. However, this number is arbitrary, subjective and based on anecdotal evidence from NG NTS that one substitution could exhaust all unsold capacity if caps were not implemented. We have no data or information to suggest that the different methods of Substitution should warrant different exchange rates.	<p>Opportunities exist for Shippers to prevent loss of capacity by buying it or taking a retainer. If capacity is not so identified it seems reasonable to assume that it has no value and can be substituted at any exchange rate.</p> <p>National Grid is concerned that a low exchange rate may prevent substitution taking place, or may restrict it to within zone, when there are otherwise sound opportunities to move capacity.</p> <p>However, National Grid appreciates concerns that substitution without an exchange rate cap would destroy aggregate system capacity and so has attempted a compromise at 3:1, recognising that this value is arbitrary.</p>	
10.2	RWE	Within zone, substitutions will be on the basis of most favourable exchange rate first, subject to a cap of 3:1 or better. This cap will also apply out of zone and for both, our preference would be for a lower exchange rate. The Impact Assessment should present some sensitivity analysis around the level of cap. As it is now proposed to include partial substitutions to satisfy incremental capacity requirements, adjusting the exchange rate would only change the balance between substituted and funded incremental capacity.	<p>See 10.1 above.</p> <p>It is a matter for Ofgem to determine what should be considered as part of their Impact Assessment.</p>	
10.3	STUK	STUK supports the use of an exchange rate cap to avoid excessive capacity destruction on the system. The issue of system flexibility is currently under review by NG and the industry therefore the true impact of creating of a ‘tighter’	See 10.2 above.	

		system which could cause disruptions to supply and demand, is not yet fully understood. With this in mind STUK believe that the proposed arbitrary exchange rate of 3:1 does little to minimise the risk of capacity destruction and STUK would support the use of a 1:1 to best avoid shrinking the system to a level where it is unable to adapt to short term changes in supply and demand patterns or until the use of and requirement for system flexibility is better understood.		
10.4	Tot	<p>The Methodology states its intention is to promote the economic and efficient development of the NTS. We believe that removing capacity away from an entry point without regard for the future expected flows at that entry point is not in line with this overriding principle. The methodology proposes an exchange rate of 1:3 which will lead to the destruction of entry capacity and reduction of the NTS. We believe that an exchange rate of 1:1 should apply during the current price control and until there is more understanding of the risks and any unintended consequences of this new licence obligation.</p> <p>The draft methodology goes even further, allowing for the subsequent substitution of capacity which has been substituted to an ASEP, if it remains unsold (22.b). We believe that this kind of substitution should only take place on a 1:1 exchange rate, as anything different would allow for the unlimited destruction of NTS entry capacity. As an example, 60mscm at St. Fergus could become 20mscm at Teesside and then 6mscm at Bacton. This can not be considered an economic and efficient development of the NTS, especially considering that any savings will only affect 2% of the consumer's bill.</p>	See 10.1.	Where incremental capacity that has been released through substitution is no longer needed it is reasonable that the capacity should be available for substitution to another ASEP. If it is available then it ought to be available on the same basis as any other substitutable capacity.
10.5	Chev	With regard to exchange rate caps, we believe these have an important part to play in ensuring the introduction of entry capacity substitution has a "soft-landing". To minimise the risk of unforeseen or unintended consequences as the substitution process "beds in", a 1:1 exchange rate cap should initially apply (ie substitutions should not be	See 10.1.	



		permitted where the capacity substituted away from a donor ASEP is greater than the amount of capacity created at the recipient ASEP). Over time this could be increased to something closer to National Grid's proposed 3:1 exchange rate.		
<b>11 – Miscellaneous</b>				
11.1	BG	As a participant within Oil & Gas UK we are concerned that the recent correspondence between Malcolm Webb and Alistair Buchanan has not resolved our own, and seemingly other producers significant concerns on substitution.	This issue is outside the scope of this consultation.	
11.2	Tot	<b>Held-Back Capacity</b> The Methodology states that capacity not offered in the QSEC auctions (the 10% held-back) will not be available for substitution. We take this opportunity to highlight how important it is to hold-back some capacity from the QSEC auctions. The last TPCR reduced this amount from 20% to 10% of TO Baseline and we believe that the introduction of Substitution makes it crucial that this 10% is maintained through future TPCR. The Trades and Transfers process does not reduce the need for the 10% holdback as it provides no guarantee that any capacity will be available for trades.	Ofgem have been clear in substitution workshops that the 10% withheld will not be adjusted in the current price control.  Any changes considered for the next TPCR will be subject to appropriate industry consultation.	
11.3	BGT	Page 9, paragraph 22 b) and c). 22 b) states: - <i>“Capacity that has previously been substituted to an ASEP will be available for substitution where future quantities of that capacity are unsold”</i> . While 22 c) states: - <i>“Capacity that has previously been substituted from an ASEP will not be available for substitution”</i>  These statements are not clear, and appear to contradict each other. In order for capacity to be substituted <u>to</u> an ASEP, it must have been substituted <u>from</u> an ASEP. Effectively it is the same block of capacity (albeit possibly a different volume at the recipient due to the application of an	National Grid believes that this statement is clear. Paragraph 22b relates to capacity at a recipient ASEP, whilst 22c relates to the donor ASEP. 22c means that if capacity is substituted away from an ASEP it will not be available to be substituted away in future year (nor will it be available for allocation).	Clarification to 22b and 22c added to distinguish donor and recipient ASEPs.

		exchange rate). Whilst we understand the statement at 22 b) and agree that this has been a long standing aim of substitution, 22 c) seems to state the opposite, i.e. where capacity has been moved from an ASEP, it is then protected from further substitution.		
11.4	BGT	Page 14, paragraph 51. National Grid proposes to publish any revisions to entry zones ahead of each QSEC auction. We are concerned that any such alterations need to be known about by users ahead of the opening of the retention window. This is because users will make a decision about capacity retention based upon their expectations of their expected future requirement for capacity at an ASEP and the likelihood of that capacity being substituted away; the entry zone that each ASEP finds itself in has a direct bearing upon the likelihood of substitution and will therefore affect a user's decision. Publication after the retainer window will result in either retainers being paid where they are not necessary, or retainers not being put forward where they should have been.	Agreed	Paragraph 51 amended to state that changes to entry zones will be confirmed prior to the retainer window.
11.5	BGT	Page 15, paragraph 59. We find this paragraph vague. It refers to avoiding ... <i>incremental increase in risk</i> . It is not clear whether this refers to increase in National Grid's capacity buy-back risk, or risk that capacity that can reasonably be foreseen as being required but has not been booked, is substituted away from where it is needed. Similarly, the same paragraph refers to avoiding ... <i>the capability of the NTS being reduced below that required</i> . Again, it is not clear whether the capability in question is the capability to maintain buy-back risk levels, or the capability to accommodate all reasonably foreseeable requirements for capacity at all ASEPs, or indeed some other definition of capability.	It refers to the risk of not being able to meet obligations to make capacity available (at entry and exit connections) and hence includes buy-back risk.  This refers to the capability required to meet existing commitments; regulatory, commercial and statutory.  This is clarified in paragraph 60.	None
11.6	BGT	Page 15 and 16, section on Donor ASEP Order, Network Analysis, and Substitution Analysis. It is not clear from these sections whether, in the event that the first donor ASEP considered cannot fully satisfy the substitution requirement,	Where capacity can be moved within the exchange rate cap it will be even if this does not fully satisfy the incremental capacity release.	Paragraph 56 (now 64) amended to clarify donor ASEP substitutions will be

		that ASEP is left untouched and the next possible ASEP is considered for the full requirement, or whether whatever capacity can be removed from the first considered ASEP is removed, with the balance then sought from other ASEPs.		aggregated where insufficient substitutable capacity exists at previous donors.
11.7	BGT	Page 16, paragraph 69. We believe there needs to be a third bullet point to the effect that... <i>or an exchange rate of 3:1 has been exceeded?</i>	Agreed	Paragraph 69 (now 77) amended as proposed by BGT
11.8	BGT	Page 18, paragraph 80. For the purposes of completeness, we suggest clarifying within this paragraph that there will be no option to place a retainer ahead of an ad-hoc auction.	We believe that this is not necessary, however additional clarity will be added.	New paragraph 89 added to give clarity requested.
11.9	BGT	Page 18, paragraph 81. If we have understood paragraph 80 and 81 correctly, we would suggest amending paragraph 81 to read "... <i>where capacity can be obtained at all ASEPs excluding the specific ASEP that has triggered the ad-hoc auction.</i> "	The transitional rule is intended to ensure that substitution does not commence with an ad-hoc auction for a new ASEP. The additional text proposed by BGT is unnecessary as it is not possible for "the specific ASEP that has triggered the ad-hoc auction" to be included in, or excluded from, an earlier auction.	