

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

23rd September 2010

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”). Special Condition C8D paragraph 10 (a) i) (aa) of the Licence 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 as defined in paragraph 10 (c).

National Grid is also obliged, under the Licence, to review the methodology statement at least once a year in consultation with relevant Shippers and interested parties.

In accordance with Special Condition C8D paragraph 10 (f) (ii) on 06th August 2010 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 10th September 2010. 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.

Responses

Representations were received from the two respondents listed below.

BG Gas Services – BG
E.ON UK - EON

The main responses received relate to:

- Consideration of the two-stage auction approach
- Understanding the implications of the substitution undertaken following the March 2010 QSEC auction.

Summary of Changes Made

- Appendix one amended to include baselines and substitutable capacity.

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
1 – Two-Stage Auction				
1.1	BG	<p>this consultation has reminded me of the rushed way that substitution was brought in and how the industry was forced down the Retainer route. At the time, the “two stage auction” approach was not ruled out for application in future years and we believe that this should be put back on the table for discussion as soon as possible, as this is likely to provide greater protection to industry investors. Whilst we note National Grid’s reluctance to reconsider this alternative, it isn’t at conflict with the existing methodology and the justification within NGG’s May 2010 document (p9) don’t appear to be valid to re-open the issue. It would seem that this would be best done at the October Transmission Workstream.</p>	<p>National Grid NTS gave serious consideration to the two-stage auction prior to the recent consultation on the proposed methodology statement containing the retainer approach. We consider that keeping the methodology broadly unchanged is appropriate following its successful application in 2010. This view was presented at Transmission Workstream in July and comments/issues were invited: none were received.</p> <p>We re-iterate that a variation on the two-stage auction is available that provides the same advantages. This appeared to be followed in 2010 by some Shippers. As previously suggested by National Grid NTS, Shippers monitored QSEC bidding activity and observed (as evidenced by several Shipper enquiries) the potential for substitution in response to the Barrow signal. These, and other, Shippers were able to bid for capacity at possible donor ASEPs in the next bid window, thereby “influencing the outcome of substitution”</p> <p>National Grid accepts the advantage of a methodology that requires a “full user commitment”. However, previously industry has expressed opposition to a full commitment approach. Hence National Grid sought a compromise with the retainer approach.</p> <p>We also recognise that some Shippers consider</p>	None
1.2	EON	<p>E.ON UK does not believe the current “option” / “retainer” based methodology is appropriate. As we noted in our formal response to the methodology in July 2009:</p> <p><i>“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.”</i></p> <p>Furthermore, Ofgem noted in its decision letter to approve the original methodology, that:</p> <p><i>“We also expect NGG to give active consideration to</i></p>	<p>National Grid NTS gave serious consideration to the two-stage auction prior to the recent consultation on the proposed methodology statement containing the retainer approach. We consider that keeping the methodology broadly unchanged is appropriate following its successful application in 2010. This view was presented at Transmission Workstream in July and comments/issues were invited: none were received.</p> <p>We re-iterate that a variation on the two-stage auction is available that provides the same advantages. This appeared to be followed in 2010 by some Shippers. As previously suggested by National Grid NTS, Shippers monitored QSEC bidding activity and observed (as evidenced by several Shipper enquiries) the potential for substitution in response to the Barrow signal. These, and other, Shippers were able to bid for capacity at possible donor ASEPs in the next bid window, thereby “influencing the outcome of substitution”</p> <p>National Grid accepts the advantage of a methodology that requires a “full user commitment”. However, previously industry has expressed opposition to a full commitment approach. Hence National Grid sought a compromise with the retainer approach.</p> <p>We also recognise that some Shippers consider</p>	None

		<p><i>whether enhancements to the Methodology or other methodological approaches would be better suited to meeting the licence objectives. We would expect this consideration to include all aspects of the methodology..."</i></p> <p>With this in mind, we do not believe National Grid NTS has given sufficient consideration to developing alternative approaches since approval of the methodology in 2009 and therefore should look at developing a two stage auction-based methodology immediately, given the complexities involved.</p>	<p>the retainer approach to be complex. Experience in 2010 has shown the process to be extremely simple. We do not believe a two-stage auction would be as simple to run.</p>	
2 – Entry Substitution in 2010: Teesside ASEP				
2.1	BG	<p>We note that the methodology was successfully applied earlier in the year with a retainer put in place at Theddlethorpe and capacity substitution from Teesside for incremental capacity requirements at Barrow from 2015. As previously stated, BG accept the efficient application of a substitution methodology where future usage of capacity at a particular terminal is unlikely to be required, but remain very concerned about the process where capacity is being transferred from a terminal that could reasonably be required in future years. Given the prominence of security of supply, we would note that following the substitution, the baseline capacity at Teesside is now below the nameplate capacity of CATS (Central Area Transmission System), let alone the import capability provided by RWE's Teesport LNG regas capability.</p>	<p>We recognise the concerns expressed. However, the capacity substituted from Teesside was unsold. CATS and Teesport shippers can protect the baseline quantity by buying capacity up to that level or by utilising a retainer.</p> <p>The implication of BG's comment is one of support for the Mechanical Approach which would protect capacity up to forecast supply levels not sold levels. This approach does not satisfy the user commitment requirement stated by Ofgem.</p>	None
3 - Entry Substitution in 2010: Project Cost and Revenue Drivers				
3.1	BG	<p>NGG list indicative project costs for incremental capacity volumes within the QSEC documentation (Appendix 3, Annual Invitation to Participate letter dated 15/2/2010).</p> <p>From the data provided, it would appear that 30GWh/d incremental Barrow capacity would cost around £100k yet</p>	<p>Whilst we do not believe this question is relevant to substitution, as any perceived discrepancy between project cost and revenue drivers would be apparent irrespective of substitution. For clarification, project costs are determined through the transport model which calculates these costs based on a single</p>	None

		the justification given by Ofgem for substituting the capacity, was that National Grid would earn over £6m in a five year period from the incremental investment at Barrow. I understand that the Revenue Driver is set within your Licence, but I do not understand how project costs and allowed returns have become so detached and would welcome your explanation on this.	supply/demand pattern, however the revenue driver is determined based on network analysis taking into account a range of supply/demand patterns. In addition to this revenue drivers were set based on a set of assumptions at the 2007 PCR and should be viewed as a package over the whole PCR period, whereas the transport model uses current flow assumptions.	
4 – Entry Substitution in 2010: Donor ASEPs				
4.1	BG	Furthermore, we believe that the Substitution methodology should add an explanation where incremental capacity signals then occur at the transferor terminal. So using the Project costs in the quoted table, Barrow for 30GWh/d would be circa £110k, yet the same capacity at Teesside would indicatively cost £10.2m. If, in next year's auction NGG received an incremental signal for 30GWh/d at Teesside (ie over an above the existing baseline), how would NGG treat the investment and what would happen to their allowed revenues? We would argue that in this example, that NGG should really undertake the investment at the most efficient location (in this example Barrow) and be rewarded with the corresponding Revenue Driver. I suspect the reality would be different under the existing IECR, so we would welcome NGG's explanation on how this would be treated and whether you believe the existing approach is correct or needs to be modified.	National Grid NTS will always respond to incremental entry capacity requests with the most economic and efficient solution. In the scenario outlined, it is possible that any investment undertaken to provide 30 GWh/d at Teesside would be the same as that that would have been required at Barrow a year earlier. However, supply / demand patterns will have changed and other infrastructure may have been commissioned, so this is not a certainty. Irrespective of the project undertaken, in response to a signal at Teesside National Grid would receive the revenue driver appropriate to Teesside and, after 5 years, a rate of return on the actual investment. This principle would also apply in the event of the initial substitution being from Barrow to Teesside. This approach to funding is a feature of the current price control.	None
5 – Appendix 1				
5.1	BG	With regard to Appendix 1, it would be helpful to include the Baseline and Substitutable Capacities within the table.	Substitutable Capacity is not known until after the QSEC auction closes and the remaining	Revisions to appendix 1

			<p>unsold capacity excluding any retainers taken out is known. Prior to the auction, the unsold capacity is published in the QSEC invitation letter. We believe that this is the most appropriate location for this information.</p> <p>However, we believe it would be a useful addition to the methodology statement to include baselines and substitutable capacity (assuming no further capacity sales) for each ASEP.</p>	
5.2	BG	<p>We would also suggest that Fleetwood entry point would be better placed within the Northern Triangle rather than North West Corridor, because there is significant unutilised capacity at that entry point and much of the capacity was created for that point by reduction of baseline capacity at Barrow. If you do not agree with this approach, it would be helpful to understand why not.</p>	<p>The Barrow baseline capacity was adjusted as part of a baseline review that was completed on the NTS as a whole.</p> <p>All entry points have some interaction as a result of being part of a meshed system and this interactivity generally increases with proximity; therefore zones have been created to group those with the greatest interactivity. The location of Fleetwood and system connections is such that it is more interactive with the other North West corridor entry points than with the Northern Triangle entry points in terms of sharing infrastructure requirements. For this reason we believe that it is more suitable for Fleetwood to remain in the North West Corridor rather than be moved to the Northern Triangle. It should be noted that because Fleetwood has a baseline of zero, i.e. available capacity is all incremental capacity, there cannot be any substitution from this ASEP.</p>	None