



National Grid Gas NTS and other interested parties

*Promoting choice and value for all gas and electricity customers*

Your Ref:  
Our Ref:  
Direct Dial: 020 7901 7159  
Email: [andrew.burgess@ofgem.gov.uk](mailto:andrew.burgess@ofgem.gov.uk)

Date: 12 October 2011

Dear Sirs,

### **Notice of approval of the Entry Capacity Substitution Methodology Statement**

Entry capacity substitution (ECS) is a mechanism that facilitates the permanent transfer of unsold entry capacity on the gas transmission system at one or more entry points to meet the demands for capacity elsewhere. This is in the interests of consumers as, by signalling available capacity on the system, it may mean that the need for additional system investment is avoided. The arrangements governing the entry capacity substitution process are contained in the Entry Capacity Substitution Methodology Statement (ECSMS).

National Grid Gas National Transmission System (NGG NTS) has a licence obligation to maintain and develop the ECSMS, and has recently consulted shippers and other interested parties on the methodology. One shipper responded to the consultation and NGG NTS has now submitted a revised ECSMS to Ofgem<sup>1</sup> for approval<sup>2</sup>. At the same time it also submitted a report detailing its response to the points raised by the single respondent to the consultation.

Having regard to the entry capacity substitution objectives<sup>3</sup>, the principal objective and statutory duties of the Authority<sup>4</sup>, and for the reasons set out in this letter, we have decided to approve the ECSMS submitted by NGG NTS. The revised methodology will take effect from 1 November 2011. This letter outlines the background to NGG NTS's submission of the ECSMS and gives reasons for our decision.

### **Background on the application of the ECSMS**

The current ECSMS was initially approved by us on 7 December 2009<sup>5</sup> and the ECSMS was subsequently applied in respect to the March 2010 and March 2011 Quarterly System Entry Capacity (QSEC) auctions. In March 2010, approximately 30 GWh/day of unsold non-incremental capacity was substituted from Teesside, on a 1:1 basis, to meet the need for incremental capacity at Barrow. This avoided £1.21m/year costs (in 2004/05 prices) through the non-application of the revenue driver at Barrow. These costs would have been passed through to shippers and potentially to consumers.

<sup>1</sup> Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem', 'the Authority' and 'We' are used interchangeably in this letter.

<sup>2</sup> Pursuant to paragraph 10 (a) of Special Condition C8D of its Gas Transporter Licence ("the Licence")

<sup>3</sup> Set out in paragraph 10(c) of of Special Condition C8D of the Licence

<sup>4</sup> Set out in Section 4AA of the Gas Act 1986, as amended, most recently by the Energy Act 2010

<sup>5</sup> Authority decision on Gas Entry Capacity Substitution Methodology Statement, 7 December 2009

In the March 2011 QSEC auction, no signals for incremental capacity arose and therefore no substitution occurred. However, prior to the auction a shipper took out a retainer<sup>6</sup> to preserve a total of 97.83 GWh/day at Theddlethorpe for Gas Year October 2014 to September 2015, as a means of protecting this unbooked capacity from being substituted. In this way, the retainer allows the shipper to consider future projects which utilise this capacity, but for which the shipper is not yet ready to commit financially. An equivalent retainer had been taken out in the previous auction.

### **Respondents' views**

NGG NTS received one response to its August 2011 ECSMS consultation. This response suggested that as the methodology remains largely untested as a result of a lack of demand for incremental capacity in auctions held since it was introduced, it should remain unaltered at this time.

The respondent stated that on balance it would prefer information on substitutable quantities to be included in the appendix and also indicated that it supported the principle of a capped exchange rate in the methodology.

The respondent drew attention to the fact that, in the context of RIIO-T1 business plan submissions by National Grid, concerns were highlighted about the future of scarce network flexibility driven by changing flow patterns on and off the NTS and leading to additional investment and increasing constraint management costs. They suggested that excessive substitution would exacerbate this potential problem and it may be timely to review the substitution methodology itself. They suggested that such a review should also consider the appropriateness of the retainer mechanism.

### **NGG NTS response**

NGG NTS proposed no fundamental change to the existing methodology in response to the issues raised by the consultee. In terms of the provision of substitutable amounts, they have introduced a useful footnote to clarify that these are indicative figures with the retainer invitation providing the precise amounts of substitutable capacity at that time. Apart from this amendment and the routine changes of dates, there were no material changes to the methodology.

While acknowledging the respondents' concerns regarding network flexibility, NGG NTS noted that the methodology needed to strike a balance between reduced network flexibility and avoided investment.

NGG NTS considered that unless, and until, the retainer approach is demonstrated to be problematic, it should remain part of the methodology.

### **Ofgem's view and reasons for decision**

This approval letter concerns the ECSMS submitted to Ofgem by National Grid by e-mail of 14 September 2011. Having considered the ECSMS, we note that the methodology has undergone only minor changes compared with that approved by Ofgem on 21 October 2010. We believe that it continues to meet the entry capacity substitution objectives and has the potential to deliver benefits in terms of savings in capital expenditure.

Although only 30 GWh/day has been substituted to date we note that retainers have been used in both auctions since substitution was introduced. On each occasion, close to 100 GWh/day has been retained, thus shippers who value capacity are actively using the mechanism for appreciable volumes of capacity. We consider that this indicates that the mechanism provides an appropriate tool for users to preserve capacity for future needs.

---

<sup>6</sup> A retainer is a low cost means of preserving capacity from being substituted.

We agree with the respondent that the methodology has only been tested to a limited degree. For this reason, we are of the view that the experience of the 2010 and 2011 QSEC auctions has only provided a limited opportunity to use the methodology and so it would be inappropriate to make any major changes to the methodology on the basis of this experience.

Both NGG NTS and the respondent expressed concerns about flexibility on the system. The concerns about any potential interaction between flexibility on the network and substitution were considered in our decision introducing Entry Capacity Substitution<sup>7</sup>. No specific new concerns have been raised and there is no evidence that substitution unduly impairs flexibility. Therefore, we do not consider that there is currently any evidence that would justify reviewing the methodology. Network flexibility issues have been raised in the ongoing process under RIIO-T1 and our view is that such issues are best considered under RIIO-T1.

Finally, we would emphasise the need for NGG to keep the methodology under review to reflect general changes in network conditions and where appropriate make changes to ensure that the substitution objectives are achieved.

### **Ofgem's decision**

Following consideration of the documentation provided and having regard to the entry capacity substitution objectives, our principal objective and statutory duties and for the reasons set out above, we have decided to approve the Entry Capacity Substitution Methodology Statement prepared and submitted by NGG NTS on 14 September 2011.

Yours faithfully,

Andrew Burgess

**Associate Partner, Transmission and Distribution Policy**

**Signed on behalf of the Authority and authorised for that purpose.**

---

<sup>7</sup> Authority decision on Gas Entry Capacity Substitution Methodology Statement, 7 December 2009