

Transmission Workstream Minutes

Substitution Workshop 9

Tuesday 07 July 2009

Elaxon, 350 Euston Road, London NW1 3AW

Attendees

Tim Davis (Chairman)	TD	Joint Office
Alex Barnes	AB	Gazprom
Andrew Fox	AF	National Grid NTS
Adrian Kirkby	AK	Centrica Storage
Bogdan Kowalewicz	BK	Ofgem
Chris Wright	CW	Centrica
David Linden	DL	BP Gas
Emma Hayes	EH	BG Group
Harvey Beck	HB	Ofgem
Iain McCombie	IM	Total Gas & Power
John Bradley	JB	Joint Office
John Baldwin	JBa	CNG
John Costa	JC	EDF Energy
Martin Watson	MW	National Grid NTS
Richard Fairholme	RF	E.ON UK
Rekha Patel	RP	Waters Wye Associates
Stuart Cook	SC	Ofgem
Sofia Fernandez Avendaño	SFA	Total Gas & Power

1. Introduction and Status Review

TD welcomed attendees to the meeting.

1.1. Minutes of the Previous Meeting (07 April 2009)

The minutes of the previous meeting were approved at the Transmission Workstream meeting on 07 May 2009, and no further comments were offered.

1.2. Actions from Previous Workshops

Action SUB001: Ofgem to consider producing a document, prior to the first substitution auction, setting out its rationale for approving substitution applications.

SC indicated that he had not been aware of this action BK said that Ofgem had published draft licence condition and an open letter regarding conditions which the methodology should meet, but which he did not believe fundamentally changed Ofgem's position as opposed to providing additional clarity. TD suggested this did not address the action which the Workstream had raised, which was regarding criteria underpinning decisions on substitution applications, not any decision on the methodology. SC was unclear what else Ofgem might usefully provide and expressed the difficulty of making a comment until the methodology was agreed. AB and MW outlined some scenarios where the presence of a rationale would be helpful, such that the industry could have confidence regarding outcomes prior to entering an auction. SC suggested that National Grid NTS might take such matters into account prior to sending a substitution application to decision. AB also emphasised the need for balancing the desire to avoid uneconomic investment with ensuring the system is sufficient flexible to meet customer needs. This indicated that something other than relying purely on QSEC commitments was required. SC suggested that criteria could be made clear to National Grid NTS prior to it making any substitution applications. CW raised the aspect of security of supply and the importance of preventing wholesale capacity destruction. JBa responded that he would expect security of supply criteria to be part of National Grid

NTS' methodology. SC undertook to provide clarity regarding decision criteria by including this within the intended Regulatory Impact assessment.

Action Carried Forward

Action SUB005: Ofgem to Consider and report back whether it is able to model the effect on gas prices of various substitution scenarios.

Update: SC confirmed that impacts on gas prices would be included in the Regulatory Impact Assessment.

Action Carried Forward

SUB017: Develop and present generic cost profiles based on recent projects.

Update: MW repeated his view that this be closed because this would have no relevance to the remaining options. This was agreed. **Action Closed**

2. Consultation Results

AF reported the results of the consultation. There were fourteen responses, twelve of which were in favour of the mechanistic approach and two in favour of the two-stage auction. All of the second choices, where expressed, favoured the option approach. All except one wanted an exchange rate cap and most of these believed the cap should be close to 1:1. There was a range of responses to the concept of partial substitution and the use of an economic test, but the economic test was considered to be complex. There was general support for the use of zones and National Grid NTS considering reserve price discounts. MW identified that the responses were on the website, and a consultation report will be added shortly at:

www.nationalgrid.com/uk/Gas/Charges/statements.

3. Any Other Business

3.1. Ofgem Open Letter

SC referred to the Open Letter published the previous day expressing Ofgem's concern at the mechanistic option, which they would not be able to accept. Ofgem did not believe it was appropriate to rely on Transporting Britain's Energy (TBE) data, but acknowledged that there was support for this. The key concern was that the data would not be robust and knowledge that it would be used in the substitution process could influence the data provided. TD asked what new information had arisen to enable Ofgem to reach this view at this late stage in the process, and SC explained that consultation responses had provided additional information.

CW referred to the use of TBE for setting baselines and asked what the difference was such that it was sufficiently robust for that exercise but not for substitution. SC responded that the repeated nature of the substitution process was the main difference. JBa outlined the nature of the TBE process which led him to conclude that there was little scope for gaming - the data provided into the TBE process was increasingly fixed and predictable, and National Grid was well placed to identify any gaming with information about major developments inevitably being well documented and in the public domain. He also expressed doubts about whether the option process would be of value as companies would not be able to raise the finance so far ahead of the development process. AB questioned whether User Commitment, as currently understood by Ofgem, should be the overriding criteria. IM supported the view that there were other ways of establishing User Commitment.

SC responded by repeating that TBE data was not as robust as had been expressed. He also stated that whilst User Commitment was central to the regime, it was not the only criteria that Ofgem applied. JBa then outlined the potential operation of the LNG market, which did not fit in with a User Commitment principle. There was a possibility that ship loads would go elsewhere if it was too difficult to get onto the NTS because of no certainty regarding entry capacity availability. He also suggested that there pricing

and substitution issues were intertwined, but SC responded that Ofgem saw the two issues as separate.

SC emphasised that substitution had been included as part of the Transmission Price Control Review (TPCR) proposals and was well known to Shippers. AB acknowledged that the principle of substitution was in the Transportation Price Control Review proposals, but pointed out that the provision was somewhat vague. There had been a number of discussions about the need to change licence provisions which, with National Grid's interpretation, provided insufficient flexibility. The Workshops had been useful in clarifying how the process might work in practice and avoid unintended consequences which may not have been envisaged based on the TPCR proposals.

TD expressed disappointment that Ofgem had been repeatedly requested to indicate throughout the development process whether there were any options which would not be acceptable as a matter of principle, but this indication had only been forthcoming on the day previous to this meeting. In addition, National Grid NTS had indicated that the two stage auction process could not be implemented by the time required in the Licence, leaving the industry with only one option on which very little attention had been focussed. MW identified the process by which the options had been consolidated and suggested that a two-stage auction could be applied at a later stage. RK acknowledged this but was concerned that this ambiguity simply led to increased uncertainty.

Asked whether the impact assessment would look at all the options, SC responded that any Regulatory Impact Assessment would only consider the Proposal before Ofgem and not other options. SC reconfirmed that use of forecast flows was their major concern, and stated that it was particularly the mechanistic element of using TBE data that could not be accepted. Ofgem did not, however, preclude use of information other than TBE by National Grid NTS in making substitution proposals.

3.2 National Grid NTS Presentation

AF presented National Grid's proposed way forward, explaining that the two stage auction process could no longer be implemented for the 2010 QSEC process because of interactions with the credit arrangements in Modification Proposals 0246, 0246A and 0246B. Attendees suggested that the potential implementation of a UNC Proposal should not of itself prevent the adoption of a two-stage auction. Discussion then reverted to the desirability of the Regulatory Impact Assessment considering the merits of options other than that put forward by National Grid NTS, which Ofgem said was not consistent with their obligation to assess the proposal put to them. CW reminded Ofgem that they had committed to assessing a number of options in the Regulatory Impact Assessment for Modification Proposals 0246/A/B, including those discussed previously in the associated Review Group. SC responded that the approach adopted for a UNC Modification Proposal would not necessarily apply to a methodology statement.

AF then ran through the timeline for any two-stage auction. The difficulty was that to fit the whole process within a single month, Stage 2 would have to be opened prior to the Stage 1 allocations being made. There was, however, a possibility that timescales for dealing with credit issues could be reduced in subsequent years. SC suggested that National Grid NTS could also compress some of their timescales by applying additional resources to the internal processes. MW responded that it was not just a question of resource numbers but also governance issues, and that a level of expertise and knowledge was required. MW accepted, however, that if none of the 0246 Proposals were implemented, the two-stage auction would be practicable.

AF then ran through the option approach which will be put forward by National Grid NTS. There was some debate surrounding what was meant by the option, what rights it provided, and hence whether it had value and would be sought by Shippers. MW felt the approach offered a clear option – the option to prevent substitution – although it was not an option to buy capacity and there was no exercise concept.

RP disputed the statement that National Grid NTS did not need to use discretion under this approach by referring to examples given earlier where judgement would be needed. DL agreed that the approach was simple but not that it was transparent, particularly if several Users acted to protect positions. JC suggested that the commitment was one way only – the User would commit but not the Transporter. JBa saw some merit in principle in the approach but suggested that money should be returned to the original option holder if an additional option holder came along. He also believed that there was an underlying pricing issue. MW responded that it was a compromise by which the User would provide a measure of commitment but not the full capacity commitment which would otherwise be needed to avoid the risk of substitution.

It was clarified that the option would be renewable each year. There was some debate on whether National Grid NTS would be able to identify unrealistic options which were taken out with a view to foreclosing the market. National Grid NTS clarified that taking an option would not prevent all the available capacity being sold at that ASEP – the option would only come into play, and only be billed for, if unsold capacity remained. The option would only prevent substitution from that ASEP, not prevent capacity sales nor reserve capacity for future purchase by the User taking out the option.

AF clarified that the Proposal envisaged no payment being collected, and no option issued, if the available capacity was bought in the subsequent QSEC process. Equally the option holder would receive a full refund if he subsequently purchased the capacity in respect of which an option was bought. However, there would be no refund if a different User purchased the capacity. A number of potential alternatives were raised, which National Grid NTS undertook to consider.

Asked about information provision, National Grid NTS clarified that it would publish information on what options were taken at each ASEP.

In terms of next steps, the Methodology would be issued for formal consultation in July, seeking responses in August. The methodology may be refined in light of consultation responses, but MW did not envisage any major changes would be feasible – these would require additional consultation, which was not possible in the time available. A formal proposal would be out to Ofgem in early September, with the Regulatory Impact Assessment being issued in time for Ofgem to decide whether to accept the methodology within three months of receipt. A Transportation Charging Methodology consultation would be progressed in parallel, but National Grid NTS did not envisage any UNC Modification Proposal being necessary.

4. Diary Planning

National Grid NTS agree to present the intended methodology at the August Transmission Workstream and to arrange a further Substitution Workshop during the consultation period if Workstream attendees felt that would be worthwhile.

Action Log – Substitution Workshop: 07 July 2009

Action Ref	Meeting Date(s)	Minute Ref	Action	Owner	Status Update
SUB 001	08/04/08	3	Ofgem to consider producing a document, prior to the first substitution auction, setting out its rationale for approving substitution applications	Ofgem (BK)	Carried Forward
SUB 005	07/05/08	4	Consider and report back whether it is able to model the effect on gas prices of various substitution scenarios.	Ofgem (BK)	Ofgem identified that gas price impacts would be included in the Regulatory Impact Assessment Carried Forward
SUB 017	07/01/09	3.4.2	Develop and present generic cost profiles based on recent projects.	National Grid NTS (MW)	No relevance to the remaining options Closed