

**Transmission Workstream Minutes**  
**Substitution Workshop 2**  
**Wednesday 07 May 2008**  
**Elexon, 350 Euston Road, London**

**Attendees**

Tim Davis (Chairman)	TD	Joint Office
Amrik Bal	AB1	Shell
Alex Barnes	AB2	BG Group
Andrew Fox	AF	National Grid NTS
Angus Paxton	AP	Pöyry
Charles Ruffell	CR	RWE
Chris Wright	CW	British Gas Trading
Debra Hawkin	DH	National Grid NTS
David Linden	DL	BP
John Bradley	JB1	Joint Office
John Baldwin	JB2	CNG Services
Joy Chadwick	JC1	ExxonMobil
Jeff Chandler	JC2	Scottish and Southern Energy
Julie Cox	JC3	AEP
James Smith	JS1	EDF Energy
Jemma Spencer	JS2	National Grid NTS
Kirsten Elliott-Smith	KES	ConocoPhillips
Leigh Bolton	LB	Cornwall Energy Consulting
Martin Watson	MW	National Grid NTS
Phil Broom	PB	Gaz de France
Peter Dickinson	PD	Ofgem
Paul O Donovan	POD	Ofgem
Richard Fairholme	RF	E.ON UK
Roddy Monroe	RM	Centrica Storage
Rekha Patel	RP	WatersWye
Sofia Fernandez Avendaño	SFA	Total
Shelley Rouse	SR	Statoil

**1. Introduction**

TD welcomed attendees to the meeting

**1.1 Minutes**

The minutes of the meeting held on 08 April 2008 were agreed.

**1.2 Actions**

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

**Carried Forward**

**Action SUB002: Ofgem to clarify licence provisions with regard to vetoing substitution proposals**

See 2.1 below

**Closed**

**Action SUB003: National Grid NTS to clarify licence arrangements for incremental capacity becoming baseline.**

See 3 below

**Closed**

## 2. Licence Obligations

### 2.1 Presentation

POD gave this presentation. He emphasised that there was no hierarchy in terms of all but the last substitution objective. TD asked whether the first objective implied that there should be no exchange rate cap as might be expected to ensure that “substitution minimises costs associated with funded incremental obligated entry capacity”. POD replied that there is a higher level objective of economic and efficient operation and this could run counter to extreme exchange rates being utilised. POD clarified that the 28 days available for Ofgem to direct NTS not to implement includes the seven days for suspension of implementation. The only grounds for rejection in the Licence is lack of adherence to the substitution methodology. On the basis of the information presented **action SUB002 was closed.**

### 2.2 Discussion on Impacts on Flexibility of Methodology and Ofgem’s Veto

AB asked how Ofgem would weigh up any substitution proposals against an economic and efficient obligation. TD suggested that it was the substitution methodologies that would be judged against this test in the first place.

SFA asked about potential destruction of capacity due to substitution with high exchange rates. POD recognised that reductions in investment would occur and therefore a claw-back principle may be needed in the substitution methodology. RM pointed out that just because capacity is not required at a point of time does not prevent it being required at a later date. Substitution could therefore lead to incremental capacity being provided at the donor ASEP through an auction signal. POD clarified that baselines are adjusted to reflect substitution. AP suggested that the engineering solution would be the same, as both substitution and incremental auction signals would be taken into account such that identical flow patterns would be modelled. TD agreed with this but noted that there could be different impacts on price and hence bidding behaviour.

## 3. Entry Capacity Scenarios

MW began by outlining the type of scenarios that National Grid NTS would be considering for the purpose of the Workshop. AF then gave this presentation based on one example. A further, more detailed example would be provided in June. MW emphasised that, to meet the UNC timescales, some of the planning work would need to precede the auction. AB asked about the reference in the presentation to circumstances in which a revision to the allocation would take place. MW replied that this would only occur if Ofgem vetoed the proposed allocation of obligated capacity, which would be before, not after, Users had been notified of their allocations.

MW explained that the baselines would be adjusted five years after the obligation commenced. **Action SUB003 was therefore closed.**

MW explained that investment backed options would be considered once all the substitution options were exhausted. RM thought it would be better if a value could be placed on substitution, including the cost of capacity destruction, against the value of capacity provided by investment. MW responded that, based on the licence, no value would be placed on capacity not booked and therefore it would always be more efficient to substitute.

JB2 identified the risks involved in booking capacity. If capacity is not booked at an ASEP it could potentially be substituted away – even at an adverse exchange rate. One solution would be to gradually increase exchange rates over time and Ofgem might be able to provide guidelines to inform this principle. MW responded that the reason for these sessions is to consider safeguards that could be built into the Entry Capacity Substitution Methodology. TD invited Ofgem to respond on the possibility of setting guidelines on exchange rates. POD replied that Ofgem had decided not to issue any guidance but rather had an open mind in this respect and were looking to see if an industry consensus was achieved. MW identified the potential timeline including the Ofgem approval. AB2 emphasised that clarity on substitution would be required well before March 2009 if there

was a move of QSEC dates from September to March. He also pointed out that waiting for industry consensus was unsatisfactory as the consensus would be more easily obtained if some guidance on the acceptable range was obtained from Ofgem. PD suggested that the group should attempt to place a value on unbooked capacity in order to discern the setting of any exchange rate cap. Ofgem had not to date received any such information that would justify setting a cap.

CW and JC3 expressed the hope that Ofgem's decisions would take into account the likely affects on security of supply and gas prices. We don't, for instance, want to make it difficult to accept additional Norwegian imports.

It was suggested that Transfer and Trades would still be available to make adjustments if substitution resulted in capacity that didn't reflect flow requirements. AB2 responded that companies do not make long term investments based on Transfer and Trade availability that, by its nature, is short term.

RP asked for the worked example in June to include the impact on all affected ASEPs. National Grid NTS agreed to consider this. National Grid NTS suggested that if two ASEPs required substitution, priority would be given to the lower revenue driver of the two. MW explained that revenue drivers in this instance are a proxy for investment costs.

The ranking order for donor ASEPs would be determined by pipeline distance (closest first). Whilst National Grid NTS were not able at this time to indicate the effect on the three donor ASEPs in the worked example, it would attempt to do so at the next Workshop. JB2 questioned whether pipeline distance was the correct criteria and suggested some examples that would indicate different criteria. MW agreed to consider this as part of the June presentation.

MW outlined the steps that might follow an Ofgem veto. He expressed the hope that the substitution methodology would be precise enough to preclude a veto. JC3 and JB2 were unsure whether a methodology could be developed with the level of precision needed. MW believed that this was achievable and pointed out that its previously proposed methodology was very mechanical.

JC3 pointed out that there were interactions between entry and exit capacity. Discussions might be taking place in respect of a new exit point but it would only be safeguarded if capacity were committed. MW accepted the point but suggested that at any time there are a number of projects under discussion so it would be difficult and even discriminatory to take account of some of these and impractical to take account of all. TD pointed out that National Grid NTS had indicated that network analysis would be conducted that could include assumptions on load growth.

MW confirmed that the Transportation Model would provide information to underpin the NPV test. AF identified that National Grid NTS intended to demonstrate the effect of substitution on reserve prices.

MW identified that whilst National Grid NTS had highlighted the potential problem of a booking for one quarter obstructing substitution it wasn't expecting to make specific proposals in the methodology to overcome this. AB2 recognised that the rules could be amended if this proved to be a problem but emphasised that certainty was required and this was hard to reconcile with annual changes to the methodology.

#### **4. Next Steps**

National Grid NTS suggested that the next stage on 11 June 2008 would be to table a full worked example and walk through the draft methodology. RM was happy to endorse the example of 10 million standard cubic metres per day but would also like to see the levels explored where major destruction of capacity would result. MW believed that the example would demonstrate these types of effect but was prepared to increase the increment if necessary. It was agreed that the example would continue to be based on Easington.

The action was therefore as follows:

**Action SUB 004: National Grid NTS to provide a further worked example based on substituting in 10 million standard cubic metres of capacity at Easington ASEP. This example should track the impact on all donor ASEPs and be extended if necessary to demonstrate potential extreme exchange rates**

CW suggested that, as Ofgem had been able to model the effect of implementation of UNC Modification 0006, it should also be able to model the effect on gas prices of substitution. Ofgem agreed to consider this.

**Action SUB 005: Ofgem to consider and report whether it is able to model the effect on gas prices of various substitution scenarios.**

## **5. Diary Planning**

The next Substitution Workshop meetings have been arranged for 10:00hrs on 11 June 2008 at Elexon's offices and 09 July 2008 at Ofgem Millbank. (Details of future meetings may be found on the Joint Office website at: [www.gasgovernance.com/Diary](http://www.gasgovernance.com/Diary)).

**Action Log – Substitution Workshops: 07 May 2008**

<b>Action Ref</b>	<b>Meeting Date(s)</b>	<b>Minute Ref</b>	<b>Action</b>	<b>Owner</b>	<b>Status Update</b>
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 (POD)	Transferred from TCMF
SUB 002	08/04/08	3	Ofgem to clarify licence provisions with regard to vetoing substitution proposals	Ofgem (POD)	Presentation given <b>Closed</b>
SUB 003	08/04/08	3	National Grid NTS to clarify licence arrangements for incremental capacity becoming baseline.	National Grid NTS (MW)	National Grid NTS clarified provisions <b>Closed</b>
SUB 004	07/05/08	4	Provide a further worked example based on substituting in 10 million standard cubic metres of capacity at Easington ASEP. This example should track the impact on all donor ASEPs and be extended if necessary to demonstrate potential extreme exchange rates	National Grid NTS (MW)	
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 (POD)	