

Transmission Workstream Minutes
Substitution Workshop 6
Wednesday 07 January 2009
Elxon, 350 Euston Road, London NW1 3AW

Attendees

Tim Davis (Chairman)	TD	Joint Office
John Bradley	JBr	Joint Office
Andrew Fox	AF	National Grid NTS
Alex Barnes	AIB	BG Group
Amrik Bal	AmB	Shell
Angus Paxton	APa	Pöyry Energy Consulting
Bogdan Kowalewicz	BK	Ofgem
Charles Ruffell	CR	RWE npower
Christiane Sykes	CS	Statoil (U.K.)
Chris Wright	CW	Centrica
David Linden	DL	BP Gas
Gareth Evans	GE	WatersWye Associates
Harvey Beck	HB	Ofgem
Iain McCombie	IM	Total E & P
John Baldwin	JBa	CNG
Jeff Chandler	JeC	Scottish and Southern Energy
Martin Watson	MW	National Grid NTS
Richard Fairholme	RF	E.ON UK
Roddy Monroe	RoM	Centrica Storage

1. Introduction and Status Review

TD welcomed the attendees to the meeting.

1.1 Minutes of the Previous Meeting

The minutes of the previous meeting were approved.

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.

and

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

Update: Both actions carried forward until such time as the way forward becomes clearer.

SUB015: Entry Capacity Substitution - National Grid NTS (MW) to produce further examples to demonstrate effect of substitution on auction reserve prices.

Update: MW indicated that a second example would be prepared for the next Workshop
Action carried forward

SUB016: Entry Capacity Substitution - For an existing or further example show the effect on reserve prices if investment had resulted.

Update: See item 3.2 below

Action closed

2. Recap – Ofgem

BK gave this presentation and highlighted the issue of a derogation notice to delay the implementation of substitution to 1 March 2010. RoM recognised the change but queried why this position had arisen and suggested that the process had been less efficient than might have been hoped. Had Ofgem reviewed its level of involvement in the process? BK responded that Ofgem had reviewed this and highlighted the involvement of a Director in the last meeting. Ofgem also believed that development to date had highlighted further complexities that had inevitably affected progress. Ofgem was looking to National Grid NTS to report in March 2009 in order to help track progress towards implementation. AmB suggested increased guidance from Ofgem regarding the acceptability or otherwise of options would be advantageous. BK responded that it is up to National Grid NTS to table the methodology and the current process was appropriate. TD pointed out that Ofgem's review of governance anticipated that major policy reviews might be led by Ofgem and suggested that substitution met many of the proposed criteria to fall into this category.

3. National Grid Presentation

3.1. Timeline

AF gave this presentation that demonstrated how the basic time constraints outlined by BK might be met. He identified the need for four further workshops after this one. AIB queried the timing of UNC Modifications in the process that would be consequent on other changes. AF responded that it was a legitimate way of proceeding and stated that Ofgem would not approve a UNC Modification Proposal if the associated methodology was rejected. RoM asked whether National Grid NTS had considered how pricing consultations might proceed if an Alternative Proposal were raised. MW didn't anticipate that this would be a problem.

3.2. Substitution Example – Prices

AF demonstrated an example of substitution into Easington leading to four other Entry Points seeing a reduction in reserve prices. He also explained why a similar reduction at Hatfield Moor did not occur. The reason was that a changed supply pattern to maintain system balance in the pricing model meant that Hatfield Moor flows travelled "deeper" into the system, and this produced an increase in prices since more of the system was being used.

TD asked whether Action SUB015 might be closed. This was agreed.

3.3. Responses to Substitution Options reviewed on Workshop 5

AF outlined the options presented at the previous meeting and the scores received. It was agreed that all the responses would be published if the respondent gave permission for this.

On Option 3 TD, asked whether there was any feedback on what the appropriate limit might be. AF responded that there had not been any feedback on that point. CW stated that British Gas Trading had marked-down this option because it saw difficulties in deriving limits.

There was some discussion on Option 4 and the circumstances in which Ofgem might make use of discretion. It was pointed out that Ofgem would not be comfortable with exercising considerable discretion. However, it was pointed out that there might be circumstances where a decision in accordance with the methodology would be obviously wrong - it was in this area where an ability for Ofgem to reject substitution would be indicated. There was some discussion on the differences between Options 10 and 11 which National Grid NTS had identified as variants of each other. This was

generally accepted but CW stated that Option 11 should not be dropped as a consequence. National Grid NTS responded that this was not the intention.

3.4. Review of Options for further development

As a result of this review, National Grid NTS proposed proceeding with Options 7 (Option Model), 10 (Two Stage Auction) and a combination of 2/6 (Limits on Quantity/Exchange Rate Cap/Economic Test Combination). This was agreed on the basis that add-ons might also be considered eg Ofgem Discretion/BGT Proposal once the main options had been developed.

3.4.1. Option Model

AF identified a possible way in which this might work in practice. RoM asked whether an option at an ASEP should prevent that capacity being made available at a QSEC auction. National Grid NTS responded that this was not suggested. It would only inhibit substitution away by essentially placing this capacity to the “back of the queue”. TD asked where such capacity was still required for substitution what should happen. AF responded that the User with the option might be given the opportunity of exercising that option at reserve price so giving it the same status as capacity purchased in an auction.

The meeting then proceeded to discuss the issues for consideration. MW identified that if an exchange rate cap was in effect, the end of the queue could be reached quickly in the QSEC auction process. AIB saw the benefit of this Option as buying extra time but in some cases this wouldn't be the case. There was some discussion on whether buying Entry Capacity for a single quarter may be just as economic an option for preventing substitution as this option model. APa expressed the need for clarifying windows of opportunity. There was some concern that the approach may lead to an additional auction prior to the QSEC. JBa acknowledged that this process might be complex but nevertheless he identified three projects that, in theory, might benefit from this approach. CS identified a fourth project.

JBa suggested that if other approaches and safeguards were developed, this option might become unnecessary. His clients would be looking for the ability to prevent release at QSEC as well as transfer away.

MW suggested that National Grid NTS would consider the views expressed and respond by presenting a more developed modelled at the next meeting. This was agreed.

3.4.2. Two Stage Auction

AF suggested that this should be incorporated within the current QSEC process timescales, including allowing for an Ofgem veto. However, in response to questions, National Grid NTS could not recall an instance where Ofgem had rejected any proposal to release incremental capacity. AIB asked how adhoc QSECs are triggered. MW responded that they are initiated at a User's request which make them to a degree unpredictable. TD suggested that given the second stage, each adhoc would become a full QSEC process if incremental capacity were triggered. This would remove some of the benefits of the adhoc auction. RoM suggested instead that adhoc auctions should not trigger substitution. Some of the members saw some issues with this approach. An alternative was for the substitution to be triggered only at the following full QSEC Auction - similar to the BGT proposal.

TD asked for views in terms of the appropriate interval between the two auction stages. JBa identified problems with pipeline construction lead-times if the interval were too great. MW suggested that to keep projects on-track, National Grid NTS might incur considerable costs. RoM suggested that a week's interval is practicable but Users would need to be prepared. TD suggested that only where

incremental capacity was offered would the second stage be necessary. MW did not totally agree with this but the meeting felt it to be the best basis for development.

RoM asked for information on how much money was committed during the first year. MW was reluctant to share individual costs as they might be misleading but was willing to share generic cost profiles.

Action SUB 017: National Grid NTS (MW) to develop and present generic cost profiles based on recent projects.

3.4.3. Combination: Economic Test

AF went through the main thoughts and concerns with this option. Members found it difficult to respond without having an appreciation of the magnitudes involved. MW commended an approach based on the Licence Revenue Driver - the reduction in this element of allowed revenue was the main benefit to Users from substitution.

4. Next Steps

National Grid NTS would be continuing to develop all three options for the next Workshop.

5. Date of Next Meeting

The next meeting of this Workshop will take place at Ofgem's Offices on 10th February 2009.

Action Log – Substitution Workshop: 07 January 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)	Carried Forward
SUB 015	05/12/08	2	Produce further examples to demonstrate effect of substitution on auction reserve prices.	National Grid NTS (MW)	Further example produced. Recognised that an example based on Teesside should be provided. Carried Forward
SUB 016	05/12/08	2	For an existing or further example show the effect on reserve prices if investment had resulted.	National Grid NTS (MW)	Closed
SUB 017	07/01/09	3.4.2	Develop and present generic cost profiles based on recent projects.	National Grid NTS (MW)	