

Transmission Workstream Minutes
Substitution Workshop 7
Tuesday 10 February 2009
Ofgem Offices, 9 Millbank, London SW1P 3GE

Attendees

Tim Davis (Chairman)	TD	Joint Office
John Bradley	JBr	Joint Office
Alex Barnes	AIB	BG Group
Amrik Bal	AmB	Shell
Andrew Fox	AF	National Grid NTS
Andrew Pearce	AP	BP Gas
Bogdan Kowalewicz	BK	Ofgem
Charles Ruffell	CR	RWE
Chris Shanley (2.3 onwards)	CS	National Grid NTS
David Turner	DT	Gassco
Graham Thorne (2.3 onwards)	GT	Canatxx
Harvey Beck	HB	Ofgem
John Baldwin	JBa	CNG
Jeff Chandler*	JeC	Scottish and Southern Energy
Louise McGoldrick (2.3 onwards)	LM	National Grid NTS
Martin Watson	MW	National Grid NTS
Richard Fairholme	RF	E.ON UK
Roddy Monroe (2.3 onwards)	RM	Centrica Storage Limited
Rekha Patel	RP	WatersWye Associates
Shelley Rouse	SR	Statoil UK

* by teleconference

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: **Action Carried Forward**

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

Update: **Action Carried Forward**

2. National Grid Presentation

AF gave this presentation and began with a timeline for development.

Three broad options now remained

- The Mechanical Approach (Options 2 and 6)
- Option Model
- Two Stage Auction

To set the scene for the three options AF went through the Base Methodology. One of the changes suggested was to prorate the capacity released by ASEPs in the same zone.

2.1. The Mechanical Approach

AF expressed some reservations in using the Transporting Britain's Energy (TBE) as the main criteria, but National Grid NTS had nonetheless developed this option. Whilst the principle might have merits, issues arose in the application of these principles. National Grid NTS was suggesting an indicative exchange rate cap of 5:1. AF then navigated the flow chart and compared it with the base case described earlier. MW pointed out that there would be occasions when the sold level was higher than the TBE level in which case the higher of the two would apply. RP asked how stable the Entry Zones would be. MW responded that they are not expected to change, other than to incorporate the introduction of new ASEPs.

AF then showed examples of sold capacity vs TBE peak flows on the same table. Both Milford Haven and Isle of Grain had a higher sold than TBE level. Also TBE does not have any specific data for storage facilities. Some data was available from Platts which had been used to give an indication of deliverability, which could conceivably be used in place of TBE data at storage sites - National Grid NTS would not use Platts data but instead develop its own were this approach adopted. JBa pointed out that even sold levels would not necessarily be utilised. Users may wish to secure the maximum deliverability to match their plant capacity but the physical requirement may not materialise in practice. TD pointed out that Rough is treated differently from other storage sites in that there was full data for Easington, including Rough. MW responded that it is these sort of complications that tend to undermine the principle.

TD pointed out that, in its favour, there was certainty and transparency incorporated in published TBE data. A few attendees were concerned with the possibility of TBE data becoming skewed if respondents knew that it would influence substitution potential at individual ASEPs.

JBa pointed out that following this mechanical approach would mean that only three ASEPs (St Fergus, Teesside and Bacton) would have capacity available for substitution in the short to medium term. DT expressed caution that for certain offshore projects the ASEPs have not been finally decided – more than one option might exist. Should substitution be restrained at both these ASEPs or just at the “most likely”? AIB suggested that a role might be identified for DECC but MW didn't believe that it was practical to involve DECC in the process. CR suggested that numbers might be settled for a price control period but MW responded that things can change quickly.

2.2. The Option Model

AF began by outlining the principle, emphasising that it would not give the User rights to capacity – just a guarantee that it would be available in an auction. He then went on to outline three variants: simple option, option with an economic test and option/exercise. National Grid NTS had rejected the third variant as it was complex and might extend timelines. The meeting agreed to the exclusion of the third variant. TD identified that, in essence, the first variant differed from the mechanical approach as it would allow Users to signal a specific volume instead of relying on TBE data.

2.2.1. Simple Option Model

The option invitation would be issued with the QSEC invitation. The option window would be open in early March for a QSEC Auction later that month. DT expressed concern that options might need to be taken out for, say, five successive years – given the time taken for decisions to go ahead with potential projects - and that this would be considered restrictive in comparison with other European Entry Points.

AF then suggested a level of pricing for the Options. In addition, National Grid NTS suggested that, to reflect the financial commitment, a lower exchange rate cap was applicable than with the mechanical approach. It was therefore suggesting an exchange rate cap of 4:1.

AIB asked whether the option fees would be refunded when the ASEP capacity was booked. National Grid NTS responded that it was not suggesting a refund. AmB believed that a refund of fees would be appropriate. AIB asked how option revenue would be treated. MW responded that National Grid NTS recognised these issues would need to be resolved but had not developed the proposal to cover this aspect at present.

2.2.2. Option Model – Economic Test

AF began by identifying the timelines associated with carrying out an economic test. The values at the two ASEPs would be based on the Revenue Drivers. TD pointed out that this meant the Option Value does not influence the economic decision. AF then went through the flow-chart, highlighting the decision box where the Economic Test applies.

The general opinion was that, if an option approach was adopted, options should be available to any developer, not exclusively Users. All present other than SSE and National Grid NTS considered that the option fee should be refundable if the capacity were subsequently booked by the option holder. National Grid NTS clarified that it had not excluded the possibility of a refund.

2.3. Two Stage Auction

This would give a second opportunity to obtain baseline capacity after the possibility of substitution had been identified. To avoid unduly extending the QSEC timeline, National Grid NTS suggested a reduction from a maximum of ten to five rounds for the initial auction. Attendees pointed out that seven-round QSEC auctions had occurred and so a reduction may not be appropriate. Gemini allocations would be made within two weeks of the close of the first stage of the auctions, which would precede Ofgem approval. However, National Grid NTS believed that an Ofgem rejection was unlikely provided the IECR methodology was followed.

The second stage would be triggered if incremental capacity was to be allocated, such that substitution may occur, and would offer baseline capacity only using AMSEC functionality, in three discrete pay-as-bid rounds (with capacity remaining unsold carried forward into the next round). MW explained that placing allocations on Gemini would assist the management of the two stages. MW acknowledged the need to publish the results of each round in the second stage so that Users knew how much capacity was available. MW questioned whether rules should be written to deal with the possibility of strategic bidding at this stage, such as booking a single quarter, which may prevent substitution. TD suggested that any rules on appropriate behaviour or otherwise would be potentially complicated and it may be better to rely on Ofgem to use its Licence and Competition Act powers to investigate any suspect bids after the event.

There was a discussion on the need to run baseline auctions following an ad-hoc auction which triggered incremental release. TD suggested, as an alternative, that ad-hoc auctions could trigger a full QSEC covering all ASEPs. MW believed this would be

complex to administer. He was also reluctant to consider a “no substitution” rule with ad-hoc auctions.

3. Next Steps

TD asked for attendee’s views on the three options. There was some backing for the two stage auction and also for the mechanical approach if a way was found of obtaining robust TBE type data. JBa and AIB suggested that a combination of two-stage and mechanical approach may be best.

AF identified the need to receive feedback on the options, information required, examples and details.

4. Date of Next Meeting

The next meeting of this Workshop will take place 7th April 2009 (venue to be notified).

Action Log – Substitution Workshop: 10 February 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 017	07/01/09	3.4.2	Develop and present generic cost profiles based on recent projects.	National Grid NTS (MW)	Carried Forward