

Transmission Workstream Minutes
Substitution Workshop 8
Tuesday 07 April 2009
Elaxon, 350 Euston Road, London NW1 3AW

Attendees

Tim Davis (Chairman)	TD	Joint Office
Lorna Dupont	LD	Joint Office
Andrew Fox	AF	National Grid NTS
Bogdan Kowalewicz	BK	Ofgem
Chris Wright	CW	Centrica
Craig Purdie	CP	Centrica Storage Ltd
David Linden	DL	BP Gas
David Odling	DO	Oil and Gas UK
David Turner	DT	Gassco
Emma Hayes	EH	BG Group
Fraser Ashman	FA	Wingas
Harvey Beck	HB	Ofgem
John Baldwin	JB	CNG
Jeff Chandler	JeC	Scottish and Southern Energy
Martin Watson	MW	National Grid NTS
Nicola Robinson	NR	DECC
Rekha Patel	RP	Waters Wye Associates
Roddy Monroe	RM	Centrica Storage Limited
Shelley Rouse	SR	Statoil UK
Sofia Fernandez Avendano	SFA	Total Gas & Power
Steve Rose	SR1	RWE npower

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. **Action Carried Forward**

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

Update: Incorporated in National Grid NTS' presentation. **Action Closed**

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

Update: Production would be dependent upon which option was chosen. **Action Carried Forward**

2. Feedback from Workshop 7

AF reported on the feedback from Workshop 7. Three responses had been received and the comments from these and the Workshop were taken into account to refine the options.

All three models would provide a good range on which an Impact Assessment may be carried out.

3. Timeline

The timeline was revisited and explained.

4. Further refinement of options

4.1 The Mechanical Approach

AF explained this approach. The TBE peak day forecast could be used for beach terminals and maximum deliverability for storage sites and LNG. It was noted that most LNG and storage ASEPs fell outside the scope for substitution because they had incremental capacity; when this capacity moved to baseline it may then be available for substitution. The conclusion was that this approach effectively limits substitution to specific beach terminals. An exchange rate cap of 5:1 was suggested; this was a fairly high level because virtually no action would be required from the Shippers to protect capacity – only that above TBE levels might be substituted. No economic test was suggested within this approach. In response to a question from TD, MW confirmed that a single number would be used for protected capacity each year; it would not be varied.

An example was then presented in table format demonstrating the capacity available for substitution. SR1 questioned the correctness of the figure for Theddlethorpe; this was agreed to be an error and would be corrected. CW asked if National Grid NTS had any concerns regarding the TBE forecast being influenced to protect baselines and avoid substitution. MW responded there was a degree of risk but this was not a big concern; he would be surprised to see the cooperative approach change.

DT questioned how the 5:1 exchange rate was generated. AF responded that there was no particular logic – it feels reasonable. DT pointed out that at the previous meetings, it was suggested that a soft landing would be involved, but the outlined approach generated worries as a 5:1 cap would not represent a soft landing. MW acknowledged this but suggested that using TBE peak forecasts provided a relatively soft landing. However, all the numbers will be part of the consultation and more feedback would be welcomed. DO supported DT's view and suggested that it might be better to start cautiously with a smaller exchange rate and build in appropriate review points to assess fitness for purpose. MW responded that if capacity was available above the TBE peak level, it could be argued that it should be used whenever possible and hence substituted away.

CW asked if National Grid NTS had an element of discretion inherent in this approach. MW affirmed this in terms of generating the TBE numbers, and added that on storage and LNG facilities he would be happy to make the numbers rule based using whichever source others felt appropriate.

JB pointed out that TBE forecasts are volatile. There are 3 principal entry points where forecast demand at peak is variable - Bacton Interconnector, St Fergus and Teesside. Modelling the balance of supply and demand gets quite fraught and at times must be a very difficult call for National Grid NTS. It was suggested that some agreed methodology may be appropriate involving Ofgem, DECC and National Grid NTS. DT emphasised that the methodology should take into account security of supply risks. Several fields have variable profiles and can only support GB gas supplies if entry

capacity is available - if substitution is applied, there may not be sufficient gas to meet a range of scenarios.

MW commented that, being TBE based, there was no User Commitment behind the protected capacity. RM questioned if storage projects without planning permission would not be included in TBE or maximum deliverability figures; there were concerns about having to put bids in before a facility's set up had been completed. DT added that new pipelines have the same issues. DO observed that National Grid NTS need to be able to use a range of information in a timely fashion in order to strike the right balance.

The process envisaged under the Mechanical Approach was then described and explained through means of a diagram. Substitution will be satisfied from within zone first, then from outside of zone. Asked why the recipient ASEP with the lowest revenue driver was considered first, MW responded it was because this should require the least investment; each one had to be looked at separately and then one after the other in order.

4.2 The Option Model

AF outlined the principles of the approach. The Shipper would identify what it wanted to protect and take out an option, which then takes that capacity out of the equation for substitution. AF explained that a party would not be reserving capacity but rather avoiding substitution, so the same fee would apply to all. If the capacity were bought, the relevant reserve price for capacity would apply irrespective of the option. A lower exchange rate of 4:1 was proposed, on the grounds that action was required by Shippers to prevent substitution, and some user commitment was needed. There was a brief discussion on the cost of 'units' of reservation and whether this should be the same for all. AF suggested the approach was simple and consistent with the amounts paid for pre-works agreements. MW added that it may be possible to open up the option to include project developers as well as Shippers, but this may add complexity to the refund process.

CW asked when payment of the option cost was required and MW said that it would be invoiced shortly after the option was taken out.

It was reiterated that the option was to signal and prevent substitution taking place, and was not an option on the capacity itself; in effect a 'protection fee'. The Option Model provided a low cost approach to making sure that capacity remained available, involving a degree of user commitment, but there was no guarantee that parties would get capacity.

An example was provided, comparing the option and single quarter costs. In most cases the option price was considerably less than buying a single quarter as a means of protecting capacity from substitution, with a refund potential as well. AF then recapped on the process that would be followed through this model.

4.3 Two Stage Auction

This option was a means to prevent capacity being substituted from a particular ASEP by allowing Shippers an opportunity to respond to perceived vulnerability of certain ASEPs when incremental capacity had been requested elsewhere. It would give a second opportunity to obtain baseline capacity after the possibility of substitution had been identified. The associated timeline was displayed and explained. Some Licence changes might be required. There were time constraints relating to QSEC that may lead to very cramped periods between each of the 5 stages at the beginning of the month.

RM questioned whether enough time was allowed for a Shipper to review its credit position and put new arrangements in place if necessary. It was thought that, if

Modification proposal 0246 were implemented, after each round an assessment would be made of a Shipper's credit position and a bid may be rejected, before moving on to the next round. If sufficient credit was not in place, all of the Shipper's bids would be cancelled at that point; additional credit could not be applied retrospectively.

It was questioned how a Shipper might determine if an ASEP was vulnerable; would there be a list? MW advised that information produced prior to an auction may help. The lower down the list of potential donors the ASEP appeared, it was increasingly dependent on the actions taken at those points above it.

A lower exchange rate of 2:1 was proposed since a full financial commitment from a Shipper was required. SR1 observed that exchange rates could be similar but not necessarily the same within zone, and MW added that some could be higher than the cap. RM asked if it would be possible for a Shipper to calculate the exchange rates. MW said that there would be a methodology that sets out the calculations, but it was doubtful whether a Shipper would be able to replicate it. Ofgem may have the expertise and systems to do the analysis; this was difficult as it was looking at 42 months out to consider demand/supply levels. It would be consistent with how National Grid NTS ran the network, and it could be independently audited. On being asked whether exchange rates would be published, MW said that exchange rates would be affected by a party booking capacity and were therefore subject to change and would not be published in advance.

RM suggested thinking about combining some elements from this Two Stage Auction Model with the Mechanical Approach. MW argued that the more the elements were mixed the less likely any hybrid was to be acceptable, and what was needed was something that was acceptable to most parties. National Grid NTS still intend to consult on the Options and review feedback, and would not entirely rule out a mixed variant.

DT pointed out that there were difficulties that stemmed from having different regulatory bodies that appeared to have conflicting strategies. DECC was in favour of keeping options open as much as possible which implied a flexible NTS. Ofgem appeared to have different ambitions for the NTS – to be smaller rather than larger - and this issue needed to be reconsidered. He firmly believed that DECC should take a more active part in the debate.

At this point, having looked at all three Options, MW stated that the Option Model and the Mechanistic Model were relatively simple, whereas the Two Stage Auction Model would be much more complex for National Grid NTS to implement.

TD then asked DECC and Ofgem to advise the meeting if they were of the opinion that any of the Options put forward were clearly unacceptable at this stage. BK responded that Ofgem had set out some principles that it expected to be applied to a network, that these had not changed, and there was nothing further to add. Ofgem had expected a clear range of Options to be developed for parties to consider and this expectation had been met.

TD then summarised that there were clearly issues with the Two Stage Auction Model, eg a fundamental change of the auctions and the potential effect on two other Modification Proposals; with the other two models there appeared to be less issues, as these involved minimal charges and no major system changes.

5. Worked Examples

AF then outlined and explained a number of worked examples applying and demonstrating the effects of the different models.

In response to a question MW said that Ofgem had indicated that there will be a licence consultation on its IECR veto criteria, how it looks at what is done and if the approach remains fit for purpose.

The intent of the Mechanical Approach was to offer reasonable protection and the application of this resulted in protection of everything that was foreseen in TBE.

There was a discussion on what would happen if requirements were not fully met by substitution but could be in part. MW indicated that National Grid NTS saw the outcome as either being all capacity requirements being met by substitution or none. Attempting to enable different funding mechanisms to be reflected through the Revenue Drivers was too complex at this stage. RM observed that this was not necessarily going to achieve the most economic solution. DO and TD agreed out that an element of discretion at the back end of the process may help around the cut off points such that partial substitution could be permitted if it were evident that this was the appropriate solution..

JB quite liked the Mechanical Approach, but was concerned that this may not be acceptable to Ofgem and hence suggested it could be built upon, for example by allowing partial substitution. DT questioned the 5:1 exchange rate cap and suggested it should be lower, making this option more acceptable..

TD pointed out two issues; that TBE numbers are absolutely critical and different judgements are centred round these; and that any exchange rate cap is arbitrary. JB added that 'all or nothing' seemed to be overprotective, and that any option favoured would have to be made palatable to Ofgem.

TD asked if the meeting felt the mechanical approach should be amended to allow partial substitution. DO commented that it demonstrated the risks of high exchange rates and serious consideration should be given to starting at 1:1, and moving from there only if appropriate – the worked example demonstrated that quite large quantities of capacity could be lost quite quickly.

AF then summarised the conclusions drawn from the application of the other options. JB observed that the Option Model was susceptible to not actually working; it carried forward much of the old methodology, and there was quite a high risk that no one may bid; the 'reserve fee' was quite crucial.

3. Next Steps

RM thanked AF and complimented him on providing a good presentation that made the three Options relatively clear. MW indicated that National Grid NTS could bring forward the informal consultation to allow for more time before the formal consultation commenced, and would review the timeline. In response to a question from TD as to whether further analysis was required by Ofgem, HB said was happy to see an informal consultation go ahead with no further analysis being required.

MW had noted the views expressed throughout the meetings that it was inappropriate to keep defunct projects in the TBE and adopting this approach would improve the TBE data; he would feed this back to the TBE Team. He pointed out that TBE was there for a set purpose and not solely for substitution and wondered would it be better to separate the two areas with some clear rules about which projects should be included when looking at protecting capacity from substitution.

It was agreed that no further meetings were necessary prior to the consultation being initiated. However, if any party had specific questions, AF and MW indicated they would be happy to try and address these.

Action Log – Substitution Workshop: 07 April 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. Closed
SUB 017	07/01/09	3.4.2	Develop and present generic cost profiles based on recent projects.	National Grid NTS (MW)	Production would be dependent upon which option was chosen. Carried Forward