

**Transmission Workstream Minutes**  
**Substitution Workshop 3**  
**Wednesday 11 June 2008**  
**Elxon, 350 Euston Road, London NW1 3AW**

**Attendees**

Tim Davis (Chairman)	TD	Joint Office
John Bradley	JBr	Joint Office
Alex Barnes	AB	BG
Andrew Fox	AF	National Grid NTS
Bogdan Kowalewicz	BK	Ofgem
Charles Ruffell	CR	RWE
Christiane Sykes	CS	Statoil UK
Clive Woodland	CW	British Gas Trading
Debra Hawkin	DH	National Grid NTS
David Linden	DL	BP Gas
Dave Turner	DT	Gassco
John Baldwin	JBa	CNG
Jayne Reader	JR	Chevron
Leigh Bolton	LB	Holmwood Consulting
Martin Watson	MW	National Grid NTS
Phil Broom	PB	Gaz de France
Richard Fairholme	RF	E.ON UK
Richard Miller	RMi	Ofgem
Roddy Monroe	RMo	Centrica Storage
Rekha Patel	RP	Waters Wye Associates
Stefan Leedham	SL	EDF Energy

**1. Introduction and Status Review**

TD welcomed the attendees to the meeting.

**1.1. Minutes from the Previous Meeting**

The minutes of the meeting held on 07 May 2008 were agreed.

**1.2. Review of Outstanding 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 SUB004:** 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

See item 2 below

**Closed**

**Action SUB005:** BK presumed this was an action regarding reserve prices, but it was confirmed that the action related to gas prices – with the suggestion that Ofgem apply the same methodology as when they considered Modification Proposal 0006. BK agreed to consider this and report back whether Ofgem is able to model the effect on gas prices of various substitution scenarios.

**Carried Forward**

## 2. National Grid NTS Methodology Walk-Through

AF gave this presentation. DT asked about the assumption in respect of spikes from single quarters and whether bids in a single quarter might prevent substitution. MW explained National Grid NTS' thinking on this, which they were not planning to preclude, and emphasised that the example assumed no subsequent spikes. CW asked whether there are constraints elsewhere which might impact the ability to substitute capacity. MW responded that, at the terminal level, National Grid NTS were focussing on Easington where local constraints were an issue. AB asked about the process for incorporating obligated capacity into the baseline. MW responded that the process is that Ofgem set the baseline through their Transmission Price Control Review proposals.

JBa questioned why the order of recipient entry point is determined by revenue driver, and identified an example where there may be a high revenue driver that may have a low associated requirement for physical works. In response, MW identified a low revenue driver but with substantial works, but suggested that a rule was needed and NTS felt the revenue driver was a sensible starting point. TD asked whether anybody might put forward a different approach instead of considering the lowest revenue driver first. JBa agreed with the general approach for the first auction but suggested that reconsideration would be needed for subsequent auctions.. There was discussion on whether this approach would indicate an annual methodology change, which a number of attendees felt was undesirable. MW believed it could be a parameter rather than methodology change. AB and DT believed that it would create uncertainty and make investment offshore less attractive if the parameters were to change. TD asked if capacity destruction should be the criteria rather than using a proxy of lower revenue driver. MW agreed with the principle but saw difficulties in practice - the lowest revenue driver principle determined the order in which incremental signals were analysed and considered for substitution but all such signals would need to be analysed under the alternative, and this was not possible in the time available following an auction.

JBa stated that it would be helpful to include a matrix of all pipeline distances in the methodology. This was accepted. The walk-through was then suspended so that JBa could make a presentation (see 3 below).

Following JBa's presentation, AF resumed the National Grid NTS presentation. MW explained that the 1 in 20 peak had been modelled, and stated that better exchange rates usually result from a reduction in one ASEP than a pro-rated reduction in two or more. MW also explained that for modelling purposes, if incremental capacity was released at the recipient ASEPs, this would lead to an increase in flow at that location which would need to be balanced by reduced flows elsewhere.

There was discussion of the results that indicated an average exchange rate of 9. DT suggested that this effect of significant capacity destruction was surely not envisaged when the licence obligation was introduced and therefore the principle should be re-examined.

RMo suggested that either an exchange rate cap should apply or, alternatively, Ofgem should have the ability to reject a substitution proposal even if the methodology had been properly applied. CW suggested that an alternative might be tripling the reservation for AMSEC from 10% to 30%. BK agreed to consider this alternative but cautioned that, being part of the Price Control Review package, such a change would not be regarded as trivial by the Authority.

**Action SUB 006: Ofgem to consider the case for increasing the percentage of baseline capacity held back for shorter term auctions.**

AF then turned to the pricing impacts on reserve and step prices. In response to a request, AF suggested that only about 16 mscmd at Easington could be found from substitution – any more would require investment. National Grid NTS did not have the

complete summary of donor ASEPs but the additional capacity would be substituted primarily from Bacton and Teesside.

There was discussion on likely behaviour in the QSEC auctions. The possibility of responding to the uncertainty created by substitution by seeking higher long term auction bookings was raised. National Grid NTS suggested that next year's QSEC auctions which would be the last opportunity to book long term capacity prior to the application of the substitution methodology – with substitution possible for capacity remaining unsold as a result of that auction. JBa qualified this and suggested that the introduction of a new ASEP might mean that this year's auction would be the last opportunity. JBa asked that National Grid NTS clarify whether it intended conducting any QSEC auctions for new ASEPs prior to the 2009 QSEC auctions.

**Action SUB 007: National Grid NTS to advise the Workstream of likely QSEC auctions for new ASEPs to be conducted prior to the 2009 QSEC auctions.**

### 3. Allocation of Baseline Reduction in the Substitution Methodology

JBa began by highlighting the need to understand the National Grid NTS allowable capex. He believed that there may be underutilisation of capital, such as pipelines taking gas from St Fergus, but this could not be implied from baselines. MW outlined the process and impacts followed if a new entry point were introduced, including the revenue drivers and the asset base. There was discussion on how the avoided capex savings from substitution could be quantified. JBa suggested that five years' SO income might give the maximum saving. MW agreed this was a possible measure of the benefit but felt it would exaggerate the effect and therefore would be of minimal use.

RMo asked whether National Grid NTS had calculated an exchange rate cap figure that would drive an economic and efficient outcome. MW responded that it was difficult to do so as substitution might still be more efficient than investment even if the exchange rate were high.

JBa then went on to identify the potential impact of substitution in light of a selection of real projects. At Whitehill, the difficulty was in identifying the nearest ASEP in absence of published pipeline distances and the exchange rates that might apply from Theddlethorpe, Bacton or Northern Triangle ASEPs. He then moved on to Saltfleetby and saw this was a good case for substitution as Theddlethorpe was geographically close and potentially unconstrained, but a single quarter booking at Theddlethorpe could prevent this. With Bletchingley, the question arose as to whether National Grid NTS would substitute capacity if the exchange rates were high, and JBa asked if Ofgem would veto any proposal with a high degree of capacity destruction. TD emphasised that Ofgem would have no right of veto under the Licence if the methodology were followed – whatever the exchange rate. BK emphasised that Ofgem remained open minded on exchange rate caps.

Baines was an example of an Irish Sea project. Whilst this would indicate substitution with Teesside, under the current methodology substitution with Partington would seem to be a better solution. JBa suggested that SO costs should therefore be taken into account. MW said that such evaluation would be based on forecasts which would be an uncertain basis on which to make decisions. With Portland, Avonmouth capacity should be available but there is uncertainty on whether Bacton or Dynevor Arms would be the next in line.

MW agreed to advise on pipeline distances to assist further analysis. He confirmed that pipeline distance gave a good indication of which exchange rates would be most favourable.

**Action SUB 008: National Grid NTS to publish a matrix of relevant pipeline distances between ASEPs.**

#### 4. Next Steps

A number of attendees believed that the whole principle of substitution should be re-examined. The view expressed was that these details had not been thought through when the licence was modified. TD asked whether this was a possibility. BK reiterated that a licence change would not be a trivial matter for the Authority as it was part of the Transmission Price Control Review proposals.

Following these discussions, National Grid NTS will be producing a consultation document on the methodology.

It was felt it would be helpful for Ofgem to form an initial view on the draft methodology and the issues raised and to outline these at the next meeting. BK agreed to consider this.

**Action SUB 009: Ofgem to consider presenting an initial view on the draft methodology and the issues raised at the Substitution Workshops.**

MW asked whether any further information was required. JBa asked whether a scenario impacting Teesside could be developed, but National Grid NTS could not commit to do this work by the next meeting. RF asked what the effect would be of an exchange rate cap of two. MF agreed to analyse this but believed it would amount to no substitution at Easington.

**Action SUB 010: National Grid NTS to rework the Easington scenario on the assumption that an exchange rate cap of two existed.**

National Grid NTS agreed to the following action:

**Action SUB 011: National Grid NTS to calculate SO revenue impacts per 1 mscmd of new ASEP capacity as a consequence of each of the projects outlined by JBa.**

#### 5. Diary Planning

The next meeting will be held on 9<sup>th</sup> July at Ofgem's offices 9 Millbank

**Action Log – Substitution Workshop: 11 June 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)	<b>Carried Forward</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)	Worked example produced <b>Closed</b>
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)	<b>Carried Forward</b>
SUB 006	11/06/08	2	Ofgem to consider the case for increasing the percentage of baseline capacity held back for shorter term auctions.	Ofgem (BK)	
SUB 007	11/06/08	2	National Grid NTS to advise the Workstream of likely QSEC auctions for new ASEPs to be conducted prior to the 2009 QSEC auctions.	National Grid NTS (MW)	
SUB 008	11/06/08	3	National Grid NTS to publish a matrix of relevant pipeline distances between ASEPs.	National Grid NTS (MW)	
SUB 009	11/06/08	4	Ofgem to consider presenting an initial view on the draft methodology and the issues raised at the Substitution Workshops.	Ofgem (BK)	
SUB 010	11/06/08	4	National Grid NTS to rework the Easington scenario on the assumption that an exchange rate cap of two existed.	National Grid NTS (MW)	

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