

Transmission Workstream Minutes
Substitution Workshop 5
Wednesday 05 December 2008
Ofgem Offices, 9 Millbank, London SW1P 3GE

Attendees

Tim Davis (Chairman)	TD	Joint Office
John Bradley	JBr	Joint Office
Andrew Fox	AF	National Grid NTS
Alex Barnes	AB	BG
Angus Paxton	APa	Poyry Energy Consulting
Andrew Pearce	APe	BP
Bogdan Kowalewicz	BK	Ofgem
Charles Ruffell	CR	RWE
Dave Turner	DT	Gassco
Harvey Beck	HB	Ofgem
John Baldwin	JBa	CNG
Jeff Chandler	JeC	Scottish and Southern Energy
John Costa	JoC	EDF Energy
Martin Watson	MW	National Grid NTS
Richard Fairholme	RF	E.ON UK
Roddy Monroe	RoM	Centrica Storage
Rekha Patel	RP	Waters Wye Associates
Stuart Cook	SC	Ofgem

1. Introduction and Status Review

TD welcomed the attendees to the meeting.

SC gave a brief introduction on behalf of Ofgem. He referred to the licence term discussions at the previous workshops and suggested that these should not constrain discussions. He emphasised the high level obligation of National Grid NTS building and operating an economic and efficient system and the general principle that, if a licence term is shown to be contrary to this, then that term can be amended. He also stated that methodologies needed to allow sensible commercial decisions that a Transporter would make and this might mean allowing some discretion. Ofgem would also be willing to consider a transitional path for introduction of substitution, providing a soft landing. He suggested also that the Workshop consider the possibility of an option contract approach, such that Users might signal an anticipated requirement for capacity without taking on the full User commitment obligation.

RM responded to the indication of discretion for National Grid NTS. He believed that Ofgem should be given some discretion rather than National Grid NTS. Whilst SC didn't totally rule out the principle he indicated Ofgem did not want to get into detailed analysis of each substitution which may be needed so that Ofgem could use its discretion objectively. RM acknowledged this but still believed there was merit in Ofgem expanding its modelling capability, which could support discretion.

2. Entry Capacity Substitution

AF gave this presentation on behalf of National Grid NTS. RM asked about timing – if there is capacity available from substitution is it necessary to wait forty two months before it is released? MW responded that he would be happy for the Workshop to consider this but felt it may be appropriate to focus initially on the QSEC process with the same lead time regardless of how capacity was provided – with or without substitution.

National Grid NTS did not believe there was a significant pricing issue associated with substitution. RM did not entirely agree and suggested that there would be certain times when capacity would go to the P_{20} level in order to meet the NPV test. JBa also suggested that if capacity was substituted away from an ASEP like Teesside it might be difficult and costly to get it back – but MW expected that the way in which prices are set meant that, other things being equal, capacity would be available for broadly the same price before and after substitution. BK suggested that some examples that demonstrated the effect on prices would be helpful for the Workshop. MW agreed to produce some typical examples in addition to those presented at this and earlier Workshops.

SUB 015: National Grid NTS (MW) to produce further examples to demonstrate effect of substitution on auction reserve prices.

AF identified three main impacts and asked whether these tracked the main concerns of members. TD responded that issues might arise in respect of fundamental issues, such as the NPV test. APa referred to the potential removal of the 10% retention for AMSEC capacity, which Ofgem had signalled would be considered at the next Price Control Review. The Workgroup agreed that these were valid issues but accepted it would be profitable to go ahead on the current basis for discussion – i.e. other things being equal.

AF then proceeded to a substitution example and the resulting prices. AB asked for an explanation of why the P_0 price would be reduced at the donor ASEP. It was explained that prices were set assuming flow in line with baselines. With a reduced baseline, the gas entering the system at any point would travel less far into the system. As less of the network was used, this would be expected to produce a lower P_0 .

In the example, three of the four donor ASEPs (Hornsea, Hatfield Moor, Theddlethorpe and Bacton) P_0 stayed the same or reduced, whereas the recipient ASEP (Easington) displayed a price rise. There was then a discussion of why one (Hatfield Moor) rose, the main explanation being that this was very close to Easington and there was limited offtake in that part of the country. MW suggested that a better comparison might be with investment rather than substitution, which he believed would show a greater impact at Hatfield Moor. He agreed to generate an example that would demonstrate this effect.

SUB 016: For an existing or further example show the effect on reserve prices if investment had resulted.

AB, whilst acknowledging the general trend on prices, believed that there would be cases with an adverse pricing impact. DT pointed out that certain large developments such as Vesterled, might be considered as marginal in the sense that it may flow primarily when demand was relatively high. While the price to be paid may be the same before or after substitution assuming a flat profile, assuming a peak profile may produce a different conclusion.

In discussions on the substitution analysis timeline, it was clarified that Ofgem's twenty eight days veto period applied to the IECR methodology not just the substitution element. JeC mentioned the effect of planning changes on the forty two month timeline. MW responded that while the current Planning Bill may be beneficial to the risk element, it would not shorten the timeline.

MW then continued the presentation, outlining four high level choices for substitution decisions. MW expressed a concern in using non-market information as a number of projects do not reach fruition. RM suggested that with long lead-time projects there was often certainty at a number of trigger points. AB suggested that the four choices were not mutually exclusive – a combination might be worth considering. MW acknowledged this.

National Grid NTS then handed out option evaluation sheets and invited members to complete them as the presentation proceeded. RF responded that he would prefer to complete these later end email them to National Grid NTS. MW responded that National Grid NTS would welcome these at any point prior to the next Workshop although

receiving them sooner rather than later would facilitate an analysis of the views expressed.

There was then discussion on the following options:

Option 1 – Literal Interpretation of Substitution Obligation – as per the methodology previously proposed and published by National Grid NTS. There were no comments on this other than restatement of previous concerns.

Option 2 - Limits on Quantity Available for Substitution. It was recognised that National Grid NTS may need to have an independent mechanism to protect Users' interests if discretion applied. TD suggested that the scores in National Grid's matrix may reflect the quantity limits and respondents might usefully indicate whether they were assuming loose or tight limits. This was acknowledged.

Option 3 – National Grid NTS Discretion: DT pointed out the difficulty of National Grid NTS deciding between competing projects. He would be more comfortable in giving a limited scope for discretion within clearly defined rules.

Option 4 – Ofgem Discretion. It was recognised that Ofgem was uncomfortable in taking on this role. RM suggested that Ofgem discretion would be more appropriate if it was given a range of options to choose from, rather than total discretion. MW stated that National Grid NTS would want predictability in the event of veto when part of the forty two months lead-time would be taken. APa suggested that National Grid NTS could go ahead with preliminary work on the basis that a veto would not apply. MW did not agree with this due to the planning risks involved. AB suggested that most decisions would be clear-cut and therefore National Grid NTS would often know when and where it needed to invest. Whilst acknowledging the risks of Transporters and Users, he considered that any bias should be slightly towards investment because the consequences of insufficient capacity might be severe. BK expressed the concern that exercise of discretion, whether by National Grid NTS or Ofgem, should not act in a discriminatory manner - an example might be that extending the process for provision of capacity discriminated against new ASEPs.

Options 5 - Simple Economic Test. JBa stated that it was hard to score this because of the sub-options developed. MW responded that at this stage the main aim of this process was to identify the front runners and so exclude some options from further development. APa was concerned that simple economic tests might not prevent unintended consequences.

Option 6 – Exchange Rate Cap/Economic Test Combination. TD asked whether there was an exchange rate cap option on its own. MW responded that there was not but it would be considered if respondents considered there was value in developing this. MW suggested that project value definition would be included in the methodology statements. RM asked whether there was a temporal affect on exchange rates. He pointed out that recent Trades and Transfers were at 1:1. MW responded that extending these exchange rates to long term substitution might not be valid.

Option 7 – Option to Buy. It was pointed out that, contrary to the presentation, an option fee did not need to be cost reflective. MW acknowledged this but there was a need to derive an appropriate fee. APa asked whether this should prevent an economic decision. MW responded that options may not prevent substitution but instead place the ASEPs with options to the back of the queue. APa challenged the practicality of this as Users may take options at a number of ASEPs.

Option 8 – Sub Reserve Prices. It was recognised that there would be fundamental impacts from this option.

Option 9 – Early Warning System. RM suggested that this need not be highly subjective as there were a number of planned projects in the public domain. AB believed that this was asking for National Grid NTS to act as a collator of information. It

was recognised that National Grid NTS should not be expected to release confidential information.

Option 10 – Two Stage Auction. The initial reaction to this was positive. MW suggested that this option could be combined with a cap.

Option 11 – Previous BGT Proposal. This could be considered as a variant on Option 10 but with twelve months between auctions.

TD asked whether there were other options that members might put forward. Members asked for an opportunity to consider this. DT suggested that we might consider retaining the draft methodology but incorporating some of the benefits of some of the other options.

RM asked for Ofgem's reaction to the options tabled so that the Workshop need not proceed in a direction that would not prove acceptable. BK responded that Ofgem had reservations with both Option 1 and Option 4 but did not wish at this stage to exclude either.

3. **Actions from Previous Workshops**

TD identified that the following actions had been carried forward.

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

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

It was agreed that these should be carried forward until the way forward was clearer.

4. **Next Steps**

AP handed out the timeline for development.

The next meeting of this Workshop will take place at Elexon on 7 January 2009.

Action Log – Substitution Workshop: 05 December 2008

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)	
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)	