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Our Reference:

Your Reference:

Date : 3 th June 09

Dear Andrew

### **Informal Consultation on Entry Capacity Substitution**

Thank you for providing Scottish and Southern Energy plc (SSE) with the opportunity to comment on the above Consultation Document.

SSE are supportive of substitution in principle. However, we consider it very unfortunate that a pricing approach to incentivise long time booking or discentivise short term booking of capacity has not been progressed. We believe this would have been a much simpler and effective solution to encourage long term bookings and hence rectify the current position of Entry capacity costs being recovered by commodity charges. By insisting on substitution first delays of several years have been introduced.

Substitution is a difficult balance between ensuring that assets are used to their most efficient and ensuring that the capacity/infrastructure exists to enable gas to flow into the UK. The impact on wholesale costs through inefficient substitution could cost much more than ensuring that all capacity is used.

We prefer the 2 stage auction methodology for substitution; support partial substitution and recognise the need for a solution to prevent single quarter bookings from stopping substitution.

#### **Paragraph 28**

##### **a. Are there any other factors that National Grid should include in the Base Methodology?**

SSE is disappointed that more transparency regarding the capability and limits of the network has not been made available. If NG NTS is concerned regarding disclosing models/information then we believe the models/information should be made available to Ofgem or to an independent third party to validate data & assumptions.

The base methodology includes the following factors:

- Potential capacity substitutions shall be validated through network analysis.
- The objective of this shall be to ensure that there is no material increase in costs, particularly no increases in the requirement for constraint management actions.

- Analysis shall take into account all existing and future regulatory, statutory, and Commercial commitments.
- Analysis shall primarily, but not exclusively, be undertaken at peak 1 in 20 demand levels and shall be undertaken for a number of gas years starting with the year of proposed capacity substitution. Supply and demand scenarios shall be consistent with the Transmission Planning Code.

**b. Are there any aspects of the Base Methodology that should be excluded or amended?**

SSE has concerns regarding the single quarter booking & exclusion rule. Bookings within the spirit of the shipper licence will be difficult to prove/disprove and something more robust is required. However, not sure what this is.

**Paragraph 52**

**c. Should the substitution methodology use an exchange rate cap to limit the impact of substitution on donor ASEPs?**

Yes

**d. Would the intended benefits of an exchange rate cap be better achieved through implementation of any of the options (Mechanical Approach, Option Approach or Two- Stage Auction) discussed in Section 6?**

Appropriate for all options.

**If an exchange rate cap is used:**

**e. At what level should the exchange rate cap be set? Respondents may consider that a different value is appropriate depending upon other factors of the methodology, e.g. whether any of the options discussed in Section 6 is implemented.**

An exchange rate cap is appropriate in conjunction with a methodology that allows partial substitution. SSE believes a cap of no more than 2:1 should be implemented. However, this number is arbitrary and based on anecdotal evidence from NG NTS that one substitution could exhaust all unsold capacity if caps were not implemented. We have no data or information to suggest that the different methods of substitution should warrant different exchange rates and we believe these caps to be arbitrary and subjective in nature.

**f. Notwithstanding that National Grid is obliged to review the substitution methodology on an annual basis, should the exchange rate cap be set at a low level in the expectation of increasing in future years?**

Yes, until the industry becomes more familiar with the arrangements and can avoid unforeseen consequences.

**Paragraph 59**

**g. Do respondents consider that an economic test is appropriate or necessary for the substitution methodology?**

No

**h. Would an economic test add unnecessary complexity to the process?**

Yes

**i. What benefits, if any, would an economic test provide?**

None.

**If an economic test was introduced**

**j. What parameters should be used for the donor and recipient ASEP values?**

None.

**k. Are there any alternative tests that should be considered?**

None.

**Paragraph 80**

**l. Do respondents prefer the Mechanical Approach over the Option Approach and/or Two- Stage Auction? Why / why not?**

Prefer the 2 stage approach, then optional, lastly mechanical.

**m. What features of the Mechanical Approach do respondents like / dislike; e.g. simplicity, lack of User commitment?**

Dislike: Lack of User commitment. TBE based data open to manipulation. May be overly restrictive for substitution by overstating requirements & leads to unnecessary inefficient investment.

Like :Simplicity.

***n. What criteria should National Grid use to determine the level of protected capacity at each category of ASEP (e.g. beach terminal, storage etc)?***

None of the proposals are satisfactory. TBE is open to manipulation. Historic flows are not reflective of the future. Fixed percentages/quantities are arbitrary/subjective and lack credible explanation.

***o. Is the use of deliverability, or similar, such that substitution is limited to major beach terminals acceptable? Would this be undue discrimination?***

SSE would prefer a methodology that restricted substitution to beach terminals. However, we share NG NTS concerns regarding undue discrimination.

***p. Are there alternative sources of data to the TBE, deliverability that would be reliable, transparent and readily available?***

No comment.

***q. How could a soft-landing be applied to the Mechanical Approach?***

A soft landing might be helpful, but the specifics would need to be developed.

***Paragraph 94***

***r. Do respondents prefer the Option Approach over the Mechanical Approach and/or Two- Stage Auction? Why / why not?***

Prefer the 2 stage approach, then optional, lastly mechanical.

***s. What features of the Option Approach do respondents like / dislike?***

Dislike:.

Like : User commitment, but very limited £315 k per 10 mcm, and then refundable.

***t. Bearing in mind the substitution objectives do respondents believe that it is appropriate that capacity can be protected from substitution with only a relatively small commitment from the User?***

The user commitment does appear low, particularly as it is refunded if capacity is subsequently purchased.

***u. Should the Option Approach be made available to non-Users? If so how should it be applied?***

Yes, not known.

***v. Is the option fee set correctly?***

The user commitment does appear low, particularly as it is refunded if capacity is subsequently purchased.

***i. Is it correct to have the same fee for all ASEPs?***

This values all capacity at the same value which is not correct as entry capacity reserve prices differ at ASEPs. Arguably this is not cost reflective.

***ii. Are the minimum reserve price and 8 year period appropriate parameters for setting the option fee; i.e. is a fee set at approximately £300,000 for 10 mcmd correct?***

The user commitment does appear low, particularly as it is refunded if capacity is subsequently purchased.

***ii. Are refunds in the circumstances described appropriate?***

By refunding the option fee, the option not to substitute effectively becomes free.

***w. Should the option fees and refunds be dealt with through TO charges? If not, how should they be accounted for?***

TO entry charges seem appropriate although more price volatility will be created by the above proposal.

***Paragraph 106***

***x. Do respondents prefer the Two-Stage Auction over the Mechanical and Option Approaches? Why / why not?***

Prefer the 2 stage approach, then optional, lastly mechanical.

**y. What features of the Two-Stage Auction do respondents like / dislike?**

Like: Full User commitment, but only commit once incremental capacity signalled & substitution likely.

**z. Bearing in mind the substitution objectives, do respondents believe that it is appropriate that capacity can only be protected from substitution if the Shipper makes a commitment to buy the capacity?**

Yes

**aa. Do respondents consider the timeline to be an issue, e.g. would five (or less) stage 1 auction bid windows create a problem?**

No less than 5.

**bb. Bearing in mind the level of commitment required, do respondents think that this proposal would encourage Shippers to obtain capacity for a discontinuous quarter (see section 7.1)? If so, is this a problem?**

Single quarter bidding might be an issue. SSE have concerns regarding the single quarter booking & exclusion rule. Bookings within the spirit of the shipper licence will be difficult to prove/disprove and something more robust is required. However, not sure what this is.

**Paragraph 117**

**cc. Do respondents believe that single quarter bookings present a problem that requires specific rules to prevent them?**

Yes

**dd. Would single quarter bookings only be a problem with a specific substitution methodology, if so which?**

No. believe this is an issue regardless of methodology. However, as the User commitment cost to prevent substitution is higher under some methodologies than others there may be a greater incentive to user single quarter bookings as a means to prevent substitution.

**ee. What is the preferred action, if any, to prevent single quarter bookings?**

**Paragraph 124**

Not sure of ideal solution. Minimum booking of 1 quarter per annum? Do not agree that discontinuous single quarter bookings should be prohibited as this booking pattern may be required by seasonal storage that only books in Q1 of every year.

**ff. Do respondents believe that the substitution methodology should only allow substitution to proceed where an incremental signal can be met fully from substitution?**

No strongly disagree. Partial substitution is important. Depending on methodology & exchange rate cap we might not see any substitution if partial substitution is disallowed. This will not result in efficient use of the network.

**gg. Should partial substitution be allowed for specific options outlined in Section 6?**

Partial substitution should be allowed in all cases to ensure efficient usage of the network.

**hh. Should partial substitution be considered as an element of a soft-landing to be introduced at a later date?**

Possibly

**Paragraph 129**

**iii. Do respondents believe that the use of entry zones in the substitution methodology is appropriate? Or**

SSE understands that intra zone exchange rates will be more efficient than inter zonal and should therefore be more efficient in determining substitution. This efficiency & lack of discrimination is furthered by considering all within zone ASEP donors simultaneously. However, there will be occasions where ASEPs outwith the zone will be physically closer than ASEPs within zone. This might be less efficient but how frequently will this occur ?

**jj. Should the methodology be applied purely on nearest donor ASEP?**

See comments above.

**kk. Do respondents favour pro-rating within zone?**

Yes, sharing the burden of substitution within zone could be argued as less discriminatory.

**Paragraph 139**

***II. Whether respondents favour a soft-landing?***

***mm. If so, what parameter(s) should be used?***

There may be merit in restricting exchange rates. However, if an initial exchange rate of 1:2 or 1;1 is already in place there may be no further benefit.

SSE do not support a soft landing based on:

Limiting substitution to within zone.

Reducing protected levels for mechanical approach i.e. 90 % of TBE

***nn. Over what period should a soft-landing apply?***

One year

***oo. Are there any other ways that a soft-landing could be introduced?***

No comments

***pp. Should a transitional rule be included to ensure that substitution is introduced first to a regular QSEC auction?***

Yes, we should avoid application to an ad-hoc auction where the industry might not be prepared.

***Paragraph 143***

***qq. Notwithstanding the current position, National Grid would welcome views on whether proposals should be put forward to amend the Licence to facilitate a pricing structure which incentivises long term entry capacity bookings.***

SSE consider it very unfortunate that a pricing approach to incentivise long time booking or disincentivise short term booking of capacity has not been progressed. We believe this would have been a much simpler and effective solution to encourage long term bookings and hence rectify the current position of Entry capacity costs being recovered by commodity charges. By insisting on substitution first delays of several years have been introduced.

***Paragraph 163***

***rr. Do respondents have any concerns or comments regarding aspects of the Base Methodology not discussed above?***

Substitution is a difficult balance between ensuring that assets are used to their most efficient and ensuring that the capacity/infrastructure exists to enable to flow into the UK. The impact on commodity costs through inefficient substitution could be much more than ensuring that all capacity is used.

If you would like to discuss any of the above points please do not hesitate to contact me.

Yours sincerely

Jeff Chandler  
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Energy Strategy