

The Joint Office, Relevant
Gas Transporters, shippers and other
interested parties

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Dear Colleague

Re: The Review of the “Incremental Entry Capacity Release (IECR) Methodology Statement” 2007 and Consultation on “The Entry Capacity Substitution Methodology Statement”.

Special Condition C15 of National Grid’s Gas Transporter Licence in respect of the NTS, “the Licence”, sets out obligations to prepare and annually review the Incremental Entry Capacity Release (IECR) Methodology Statement. As part of the review, National Grid NTS is obliged to consult with shippers on proposed changes. On the 8th May 2007 National Grid NTS provided notification of its proposed changes to the IECR Methodology Statement and invited views on those revisions. A subsequent letter, dated 23rd May 2007, invited views on two specific issues relating to the proposed IECR.

Special Condition C8D of the Authority’s proposals for National Grid’s Gas Transporter Licence in respect of the NTS¹ sets out obligations to prepare and submit for approval by the Authority a capacity substitution methodology statement setting out the methodology that National Grid NTS will use to carry out capacity substitution. In addition, National Grid NTS is obliged to consult with relevant shippers and DN operators prior to submitting the initial statement or revising the methodology. On the 18th May 2007 National Grid NTS provided notification of its proposed Entry Capacity Substitution Methodology Statement (ECS) and invited views on the proposal.

In the IECR consultation letter of 8th May, National Grid NTS described the likely impact that Entry Capacity Substitution would have on the release of incremental capacity. Specifically it stated

“The Authority’s proposals for the Licence include a new obligation in respect of the substitution of NTS Entry Capacity. This condition will require National Grid NTS to use reasonable endeavours to undertake capacity substitution where proposing to release capacity incremental to the prevailing level of

¹ Notice Under Section 23(3) of the Gas Act 1986 Ofgem ref 151/07 and NGG NTS Proposed Licence Mods Ofgem ref 151b/07.

obligated entry capacity. This is intended to promote the economic and efficient sizing of the NTS by seeking to minimise the amount of investment that is required to satisfy incremental demand. Unsold capacity could be identified as suitable for substitution from “donor” locations where it appears not to be required due to the absence of signals in the long term (QSEC) auctions.

The release of incremental capacity will not be affected by this new condition; release will still be subject to the tests defined in the methodology statement. However it will impact on whether National Grid NTS invests to meet the incremental demand and may impact on the availability of capacity at the donor locations in future auctions.”

National Grid NTS believes that the proposals outlined in the above consultations meet the requirements of the Licence. However, in subsequent discussions between Ofgem and industry players it has been suggested that Entry Capacity Substitution could be used to facilitate the release of incremental capacity without the need to pass the economic test detailed in the IECR. This was the subject of an Ofgem open letter dated the 22nd June 2007 and was also raised by a respondent to the ECS consultation.

In order to gauge industry opinion National Grid NTS presented, at the Transmission Charging Methodology Forum (“TCMF”) of 5th July 2007, a review of the IECR and potential options for a “relaxed” IECR test where Entry Capacity Substitution is possible. The attached table shows the options presented together with National Grid NTS’s opinion on the advantages and disadvantages.

National Grid NTS welcomes comments on the four, and any further, options. Specifically respondents should identify which, if any, option they support and which they prefer.

Responses should arrive at National Grid by 17:00 on 23rd July 2007. They should be sent to:

Jan Gascoigne
NG House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

Alternatively they can be sent by e-mail to:
box.transmissioncapacityandcharging@uk.ngrid.com.
and copied to
debra.a.hawkin@uk.ngrid.com

Yours sincerely

Andrew Fox

Table 1 – Potential options for alternative incremental entry capacity release mechanism where Entry Capacity Substitution is available.

Options	Description	Advantages	Disadvantages
<p>1. Current proposal in the IECR. (with review next year)</p>	<p>Substitution only applies where the current IECR test is passed. Experience is gained of the process and in reviewing its impact revised proposals may be brought forward for next year.</p>	<p>Provides a degree of stability ahead of this year's September QSEC. Allows time to fully consider and consult on the implications of changing the IECR test. Trade and transfer provides a route to manage the requirement and ensure the efficient and economic use of the system</p>	<p>The existing IECR test may create a barrier to entry for some projects. Trade and transfers may not provide the certainty that some projects require.</p>
<p>2. Extension of transfers (i.e. option 1 plus transfers for the shorter period)</p>	<p>It could be possible to extend the proposed capacity transfer process to cover the 42 month investment lead time. This would allow quarterly periods of capacity to be transferred, driven either through the QSEC or separate auction.</p>	<p>Allows capacity to be moved for a defined duration with no long term capacity destruction. Medium / long term capacity available for increased demand at the donor or for further transfers.</p>	<p>Significant development work required to determine transfer rates for each quarter. More distant transfers increase uncertainty. Short term implementation would be problematic. The transfer process is largely ex-ante unlike substitutions. Does not meet the objective of avoiding investment as it occurs within investment lead times.</p>
<p>3. Lower NPV test</p>	<p>Incremental capacity could be released where auction signals do not meet the 50% NPV test provided that the incremental capacity can be satisfied through substitutions.</p>	<p>Satisfies greater User demand for release of capacity where needed. Can be a simple test to apply where no investment is required. Transparent. Provides clarity of requirements before bidding in auctions for new ASEPs</p>	<p>Usually the ASEPs where substitution opportunities exist are not known in advance so bidding against a lower test would not guarantee release of capacity. A different test would need to apply where there is a mix of investment and substitutions; potentially confusing. Additional post QSEC network analysis. Need to distinguish between bids (i.e. existing test vs lower test, and bids satisfying the lower test). Lower test may be satisfied without long term bookings, so capacity may be substituted away again in the longer term. This would create greater uncertainty by maximising capacity movement and potential destruction.</p>

<p>4. Lower User commitment (with conditional auction bids)</p>	<p>Incremental capacity is only released where the current IECR test is passed, but where incremental capacity is met through substitution the relevant User commitment could be reduced according to conditions within placed bids. $P_0 - P_n$ prices remain unaltered.</p>	<p>User commitment aligned to associated investment risk. Still provides certainty on capacity being released</p>	<p>Complicated with significant impact on systems. Reduces User's allocations, with the potential for the capacity to be substituted away during the period of the original bookings contained within the placed bids. Provides no benefit to "marginal" developments.</p>
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