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*Promoting choice and  
value for all customers*

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17 December 2008

Dear Mark

**Re: Delay to the NTS Entry Capacity Substitution Obligation**

Thank you for your letter dated 5 December 2008 in which you seek to delay introduction of the Entry Capacity Substitution (ECS) obligation as set out in paragraph 10 of Special Condition C8D of National Grid Gas's (NGG) Gas Transporter licence (GT licence).

In your letter you propose a possible timetable for the introduction of the ECS obligation, whereby the ECS methodology is submitted to Ofgem by 7 September 2009.

Entry capacity substitution was an obligation introduced as part of the Transmission Price Control Review. We are fully committed to the introduction of the obligation and have previously highlighted the benefits it will bring. We consider that substitution is one mechanism through which NGG will be able to operate an economic and efficient system. Substitution will provide an additional mechanism through which the size of the system can be matched to the demands placed on it, to the ultimate benefit of consumers.

A lot of work has taken place to develop a substitution methodology and there has been considerable discussion of the means by which this can be achieved, at several industry workshops. NGG ran an informal consultation in August 2008 on a draft methodology following a series of workshops over the summer, and a Conclusions Report was published in September 2008. Most respondents expressed support for the principle of entry capacity substitution, although there was no clear consensus on a preferred methodology. We recognise concerns that application of substitution, as described in the draft methodology, could have undesirable consequences.

Two previous derogations were permitted in order to allow the development of an appropriate methodology. We are responsive to the concerns expressed and in view of these outstanding concerns we feel that it is appropriate to allow more time for the development of the methodology.

NGG analysis suggests that, at this time, the timing of the introduction of substitution may have limited impact on the level of investment undertaken by NGG. Whereas, allowing time to further develop the methodology will allow a more comprehensive and flexible solution, greater consensus, reinforce user commitment and provide greater transparency about the risks and effects of substitution. On this basis, we are therefore publishing a direction to delay the introduction of the entry capacity substitution in NGG's GT licence. However, if it becomes apparent that the earlier introduction of substitution would have a material impact on the scale of NGG's investments, we would expect NGG to consider what

steps can be taken to expedite the introduction of the substitution arrangements, including on an interim basis. Our direction establishes the following revised timetable:

NGG formally submits the ECS methodology to Ofgem	7 September 2009
Ofgem conducts impact assessment on ECS methodology	Sept - Nov 2009
Ofgem makes decision on whether to approve ECS methodology	December 2009

It is important for all concerned to have certainty about the new timetable for the introduction of entry capacity substitution. We therefore intend to monitor progress routinely throughout the process and as a further measure, require NGG to submit an interim report to Ofgem, no later than 31 March 2009, setting out the progress to date together with NGG's assessment of their ability to ensure that implementation can be achieved as set out in the direction.

In your letter, you indicate that the implementation timetable is dependant on no material IT system changes being required to implement the methodology. We would expect your 31 March 2009 report to contain an assessment of the implication of the possible methodologies on the implementation timetable.

Please find the direction attached to this letter.

**Yours sincerely,**

A handwritten signature in black ink, appearing to read 'Stuart Cook', with a long horizontal line extending from the end of the signature.

**Stuart Cook**  
**Director, Transmission**