



To all interested parties

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value for all customers*

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3 July 2009

## **Development of a methodology to implement National Transmission System (NTS) Entry Capacity Substitution**

We are writing to all interested parties to provide clarification on the principles which we consider should apply to the methodology developed by National Grid Gas (NGG) to implement NTS entry capacity substitution. We remain committed to the introduction of substitution in line with the timetable set out in our December 2008 letter<sup>1</sup>.

Shippers have been aware of the obligation for NGG to implement NTS entry capacity substitution since the Transmission Price Control Review (TPCR<sup>2</sup>) Final Proposals on 4 December 2006. The requirement was described in the Final Proposals document and is set out in NGG's transmission licence<sup>3</sup>. The decision followed a review including consultation and discussion with shippers and NGG on the merits of substitution. In addition, the delay in the introduction of this obligation has provided NGG and industry with an extended time to debate the issues surrounding substitution and to explore credible alternative ways of addressing these issues.

There has been a series of 8 workshops on substitution, run via the Joint Office of Gas Transporters. Ofgem representatives have attended and participated in the workshop discussions. The Authority has also proposed changes<sup>4</sup> to the current licence drafting. We hope these licence changes, if implemented, will provide greater clarity about objectives that substitution should meet (although the proposed changes do not fundamentally change the policy aims or objectives in relation to entry capacity substitution).

Our commitment to the introduction of substitution and to the timetable set out in the December 2008 letter remains unchanged - we would expect NGG to submit an entry capacity substitution methodology to Ofgem by early September 2009 and we would make a decision on the methodology in December 2009.

In September 2008 we wrote an open letter<sup>5</sup> in response to requests from shippers for clarification on the process for the introduction of NTS entry capacity substitution. In that

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<sup>1</sup> Letter from S. Cook, Ofgem to M Ripley, NGG 17 December 2008

<sup>2</sup> TPCR 2007-2012 Initial Proposals (ref 104/06) Section 11; Updated Proposals (ref 170/06) Section 10; Final Proposals (ref 206/06) Section 10

<sup>3</sup> NGG Gas Transporter licence Special Condition C8D paragraph 10

<sup>4</sup> Proposed licence change to clarify substitution licence conditions - (Reference number: 77/09); published on Ofgem's website, 1 July 2009

<sup>5</sup> Letter from S. Cook on The Introduction of NTS Entry Capacity Substitution, 11 September 2008

letter we also set our views on the principles behind the entry capacity regime. A key principle that underpins the NTS entry capacity arrangements is that users face a choice. If users want financially firm rights to use the system they need to purchase them and make a financial commitment to pay for them. The arrangements allow them to secure rights for up to seventeen years into the future through a series of auctions that are held every year. Users can choose not to secure rights and rely on auctions of firm or interruptible capacity that are held for each gas day, but then they face the risk that entry capacity is not available if the system is constrained. The introduction of the substitution regime does not change these choices or risks in a fundamental way, but substitution may broaden the pool of parties who might bid for and secure the capacity at a particular entry point and increase the risk that a shipper who has not chosen to buy capacity is unable to access entry capacity on the day.

National Grid Gas (NGG) has recently consulted informally on three alternative draft methodologies for the introduction of NTS entry capacity substitution. One of these methodologies is a "mechanical" substitution methodology, based on future forecast flows<sup>6</sup>. In their response to NGG's informal consultation many respondents expressed views indicating their support for the "mechanical" methodology. In our view, the "mechanical" methodology is not an appropriate means of rationing available unsold capacity which may be substituted in the event that another shipper signals a requirement for incremental capacity. We believe that using future forecast flows is moving away from the fundamental principles of user commitment set out above, and risks distorting the inputs to the Transporting Britain's Energy process.

We would expect NGG to move ahead and bring forward a methodology which meets the licence obligation, and which is aligned with the principles set out above.

Yours sincerely,



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

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<sup>6</sup> Forecasts based on NGG's published Ten Year Statements and Transporting Britain's Energy (TBE) data gathering process