Modification Report
RG0252 Proposal 13: Removal of DNO Users from UNC TPD V3.3.4
Modification Reference Number 0310
Version 1.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

WWU raised Review Group 0252 "Review of Network Operator Credit Arrangements" in April 2009. This was convened to discuss the appropriateness of the existing credit management arrangements, taking into account the many credit related issues which had occurred since the publication of Ofgems "Best practice guidelines for gas and electricity network operator credit cover" (BPG) document.

This specific proposal seeks to remove the current credit requirement within UNC (V3.3.4) which would lead to the unnecessary 'over securitisation of DNO's from October 2012. Removing this DNO reference would additionally remove the differential treatment which currently exists whereby NGD and NTS are a single entity for credit purposes (and as such NGD are not governed by this credit requirement but the iDNOs are).

The inclusion of this UNC term arose through the implementation of UNC Modification proposal 0195AV "Introduction of Enduring NTS Exit Capacity Arrangements". No justification for its inclusion was in this (0195) proposal, other than all Users were to be treated similarly (except National Grid Distribution) for this specific clause. A series of options were presented to the Transmission Workstream on 03 December 2009 to deal with this anomaly. The option presented in December 2009 included the specific elements within this proposal.

- To remove DNOs from the requirements of V3.3.4 (for the avoidance of doubt Shipper Users will still be subject to this clause).

The effect of this paragraph is to require DNO Users to provide, with effect from 01 October 2012, credit cover equivalent to the cost of twelve months Exit (Flat) Capacity. Currently Users' Value at Risk is defined in Section V, paragraph 3.2.1 (d) (i) and (ii). In this paragraph Value at Risk is defined as the amount invoiced to the User remaining unpaid plus the average daily charge invoiced to the User in the previous calendar month multiplied by 20. Energy Balancing charges are excluded. Normally, therefore, the Value at Risk for a User will be equivalent to the cost of 51 days Exit (Flat) Capacity charges.

To move from providing credit cover for 51 days to credit cover for 12 months will represent a significant increase in costs for DNO Users. The justification for this is not clear as Exit Reform does not involve any great change in the circumstances under which Exit Capacity is sold by the NTS.

The credit cover required for Entry Capacity is already 12 months but this is understandable in view of the greater uncertainly associated with the Entry Capacity auction regime and the need to discourage speculative bidding.

However no such considerations apply to the Exit Capacity regime, and therefore there is no need to increase the current 51 days credit cover for the DNOs.

This Modification proposal therefore proposes that paragraph V.3.3.4 in UNC TPD Section V should be amended to exclude DNO Users from this requirement.

Suggested Text

Proposed Change to TPD V 3.3.4

For the purposes of paragraph 3.3.2(c)(i) and (iii) and the application of Section B3.3.3(f), a User's (excluding DNO Users) Value at Risk shall be treated as including the aggregate NTS Exit (Flat) Capacity Charges payable by the User for each Day in the following twelve (12) calendar months commencing from the first Day of the calendar month following the Day in respect of which the User's Value at Risk is to be determined.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

This Proposal is not classified as a User Pays Modification Proposal as it does not create or amend any User Pays Services.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

This proposal will assist the economic operation of the DN pipeline systems for the iDNOs by avoiding an increase in the cost of operating the systems for which there is no offsetting benefit. The cost will vary depending on the credit rating of the company seeking the cover and the amount of cover required.

EDF Energy agrees with the proposer that in theory implementation of this proposal will avoid the GDNs having to lodge credit to cover the next 12 months of NTS Exit capacity bookings. Were this to require the lodging of a Letter of Credit or deposit deed, this would come at a cost, which would be inefficient for the reasons listed above. However, EDF Energy has not been able to assess the materiality of this benefit. In particular they would note that if the majority of these bookings were to be covered by unsecured credit, then the cost and impact of not implementing this proposal would be marginal. We therefore do not believe that the GDNs have sufficiently demonstrated the benefit of this proposal to judge the extent to which it facilitates this relevant objective.

SGN consider the implementation of this Modification Proposal would better facilitate this relevant objective as it would assist the independent DNOs by avoiding an increase in the operational cost of the pipeline system to which there would be no offsetting benefit.

Standard Special Condition A11.1 (b): so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of

(i) the combined pipe-line system, and/ or

(ii) the pipe-line system of one or more other relevant gas transporters;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;

(ii) between relevant suppliers; and/or

(iii)between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

Implementation would further the GT Licence Code relevant objective of securing effective competition between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers. Removing this UNC requirement would re-instate a level playing field whereby all Distribution Networks were treated the same by National Grid NTS.

Scotia Gas Networks consider the implementation of this Modification Proposal would create a level playing field between DN Operators in relation to the credit arrangements required to be in place for NTS Exit Capacity arrangements and general credit arrangements, thus securing effective competition between

DNOs.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards… are satisfied as respects the availability of gas to their domestic customers;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

Removing this requirement would ensure all Users had similar credit arrangements with all Distribution Networks. Retaining the existing requirement would create a two tier credit arrangement with Users requiring proportionately higher levels of securitisation with the iDNOs compared to National Grid Distribution.

EDF Energy disagrees with the proposer that implementing this proposal would ensure that the same credit arrangements were applied to Shippers by iDNs and NGD. Currently the UNC does not differentiate between credit requirements on iDNs compared to NGD, with the same arrangements applying regardless of the GDN owner. EDF Energy therefore do not believe a two tier credit regime currently exists, and so this proposal will have no impact on this relevant objective.

Scotia Gas Networks considers implementation of this Modification Proposal would simplify the arrangements relating to credit for all Distribution Networks within the UNC and would also ensure Users had similar credit arrangements with all DNOs. The retention of the current process would create a two tier credit arrangement between DNOs.

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

No such implications identified.

b) Development and capital cost and operating cost implications:

No such implications identified.

c) Extent to which it is appropriate to recover the costs, and proposal for the

most appropriate way to recover the costs:

No additional cost recovery period is proposed.

d) Analysis of the consequences (if any) this proposal would have on price regulation:

Not applicable.

6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The contractual risk to National Grid NTS (from the non NG Distribution Networks) theoretically increases, however Transporters broader Licence obligations in terms of indebtedness and required investment grade requirement etc more than compensate for this.

7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No changes have been identified.

8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

No implications have been identified.

Development and capital cost and operating cost implications

To be advised by Users.

Consequence for the level of contractual risk of Users

The only theoretical (increased level of) risk rests with National Grid NTS with the proposal.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No implications have been identified.

10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No consequences have been identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Ensures DNOs are not over securitised in respect of potential charges to National Grid NTS.
- Removes differential treatment between NG Distribution and other
- DNO's in respect of credit arrangements with NG NTS. Removal of over securitsation will reduce costs for shippers (and consumers)

Disadvantages

- Decreases securitisation for National Grid NTS in respect of NTS capacity charges booked by some GDNs.

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Organisation	Response
BGT	Supports
EDF Energy	Supports
E.ON UK	Not in Support
First:utility	Supports
National Grid Distribution	Comments Offered
National Grid NTS	Qualified Support
Northern Gas Networks	Supports
RWE Npower	Comments Offered
Scotia Gas Networks	Supports
ScottishPower	Supports
SSE	Supports
Wales & West Utilities	Supports

In summary, of the 12 representations received, 8 supported implementation, 1 offered qualified support, 2 offered comments and 1 opposed implementation of the Proposal. Of those expressing a preference between Modification Proposals 0310 and 0311, 1 expressed a preference for 0310 and 4 expressed a preference for 0311.

EDF Energy note that as part of their undertakings, Ofgem requires all network owners to maintain an investment grade credit rating with Ofgem publishing guidance on “appropriate” gearing levels to ensure that this is maintained. Given this level of scrutiny EDF Energy believes that the risk of a GDN “failing” is limited and so securing the next 12 months of exit capacity bookings is inappropriate.

E.ON UK is concerned implementation of this proposal would create different credit requirements for Shippers and for DNs, but without a convincing justification for this. This raises the potential for undue discrimination between Users, which Ofgem will need to consider in formulating its decision.

National Grid NTS offer qualified support to the concept of the removal of the requirement for the DNOs to securitise 12 months of NTS Exit Capacity charges, as although the removal of DNOs from V3.3.4 only appears to be a sensible proposal, it does create a situation where National Grid NTS has different credit requirements for Shippers and DNOs and as such the Proposal creates the potential for discrimination between these Users.

RWE npower is concerned that there is insufficient information within the Modification Proposal in order to offer support or rejection. RWE npower appreciate that DNOs may perceive the current text within the UNC as providing differential treatment. However, the Modification does not provide sufficient information to draw conclusions as to whether this treatment is justified. The Modification Proposal itself states, “the justification for this [increased cover requirement] is not clear” thus RWE npower would like further clarification as to why this text was included in the UNC before a decision is made.

ScottishPower supports Proposal 0310 on the basis that there are no significant issues in terms of DNO security for such capacity bookings, as adequate protection already exists via the Energy Act 2004. As such to retain the current provisions would simply result in unnecessary levels of over- securitisation being maintained.

Wales & West Utilities considers the implementation of Proposal 0195AV “Introduction of Enduring NTS Exit Capacity Arrangements” was built largely on aspects of Modification Proposal 0116. Sandwiched in between these proposals was Modification Proposal 0127 “Introduction of a DN Pensions Deficit Charge” which referenced DNO Users for invoicing and credit purposes. The subsequent implementation of 195AV carried the unintended consequence whereby NTS Exit charges were automatically deemed a DNO User charge requiring securitisation with National Grid NTS. This was never intended, and is viewed as unjustified and unnecessary. Similarly, should any future DNO charge be introduced, it should not automatically be subject to the general User rules, unless specifically warranted.

In summary, Wales & West Utilities consider there will be no increased costs for iDNOs through increased security arrangements based on current charging levels and methodology outlined in this Proposal.

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

It is suggested that this Proposal be implemented on 1st October 2010 to coincide with the implementation of the other credit proposals being considered in this timeframe. Should this date not be achievable, then implementation could take place immediately following an Authority direction.

17 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity

Markets Authority in accordance with this report.

20 Text

For and on behalf of the Relevant Gas Transporters:

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Chief Executive, Joint Office of Gas Transporters