

Modification Report
Commercial Arrangements for combined DN Exit / Entry Points
Modification Reference Number 0105

Version 2.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 9.6.

1. The Modification Proposal

Current Arrangements

In accordance with UNC TPD paragraph B1.2.8, where an Aggregate System Entry Point (“ASEP”) is connected to an LDZ, Users delivering gas at that point are deemed to have utilised capacity in the NTS and, consequently, would have to apply for and hold NTS Entry Capacity to avoid capacity over-runs. At present there are a small number of such connections which account for a relatively small proportion of the gas entering the UK gas network. These entry points are either on-shore gas fields or LNG boil-off connections. Since these entry points are deemed to have used the NTS, they are listed in the NTS Entry Capacity Statement, included in NTS’s Transporter Licence Schedule A, in exactly the same way as actual NTS connections, such as the beach terminals and the Interconnector. Accordingly, all the provisions of UNC TPD Section B, including commercial activities such as capacity auctions and capacity buy-backs apply at these DN System Entry Points. To summarise, whilst physically being attached to the Distribution Network, from a regulatory perspective and contractually, they are treated as being attached to the NTS.

This proposal concerns the development of contractual arrangements for, what is at present, a unique type of system connection point known as Holford. Holford is characterised by being both a combined System Exit and System Entry Point connected to the North West Distribution Network. It is intended that shipper(s) would use the facility as short-term storage which could require the storage facility to be filled and emptied frequently throughout the year. Under the current licensing and UNC arrangements, during its emptying cycle Holford storage facility would be classified as a System Entry Point and shippers wishing to export gas to the Total System would need NTS Entry Capacity. As with other System Entry Points connected to the DN, the quantity of capacity available would be specified in NTS’s transporter’s licence, (although in this case baseline capacity would be zero as the entry capacity would be fully interruptible).

Proposal

In recognition of the physical situation, it is proposed that the UNC is modified to exclude System Entry Points connected to a DN, not specified in the NTS's Licence Capacity Statement, from being deemed to have used the NTS. In this way, much of the complexity of including Holford in the NTS Entry Capacity commercial arrangements would be removed. The connection would still be categorised as a System Entry Point and, as such, gas entering from the connection would still be allocated to a shipper and would form part of its aggregate UDQI and, as such, would still be available for trade at the NBP.

For the avoidance of doubt, with respect to the exit arrangements, (Holford's fill cycle), it is proposed that the facility is treated as a DM CSEP, and would observe all the UNC terms associated with such exit points.

The System Entry Point would be required to have a Storage Connection Agreement, (incorporating Network Entry Provisions), which would deal with the inter-operator arrangements such as restrictions to flow rates and interruption of filling and emptying cycles. It is anticipated that, at least for a transitional period up to 30th September 2007, the System Entry Point at Holford would have no firm capacity rights in respect of both the filling and the emptying parts of the operating cycle.

It is understood that other similarly connected System Entry Points may wish to migrate away from the current commercial arrangement in the fullness of time, but to de-link other such System Entry Points from NTS Entry Capacity would require more significant UNC and transporter licence modifications, particularly if the migration involved the transfer of firm capacity obligations between transporter licences.

We believe that a simple, specific, temporary dis-application of Section B2 (NTS Entry Capacity), as advocated in the proposal, is the appropriate way forward, given the nature of the physical operation occurring at this system point.

Consequences of non implementation

For gas to be able to enter the Total System, Holford would need to be included as a System Entry Point in NTS licence capacity statement and would be given baseline entry capacity. Since it is proposed that the Holford operation is fully interruptible, in terms of both exit and entry, the baseline capacity would be zero.

The inclusion of these points, which have no effect on either NTS SO or TO operations, would seem to be purely a bureaucratic exercise resulting in no benefit to the NTS business.

Accordingly, we would see the adoption of such a regime for the Holford scenario, as being inefficient from both a commercial and a regulatory perspective.

National Grid NTS (NTS) agrees with the Proposer "that non-implementation would require the storage facility to comply with a number of UNC provisions that are probably inappropriate for this type of storage facility, and would require a number of licence changes, both of which would not represent an efficient and economic outcome".

INEOS Enterprises Ltd (INEOS) believes that "if this modification were not implemented then it is likely to result in either a delay, or denied access to the NBP for Users of the Holford facility". It believes that "this would significantly impact the commercial viability of the facility which could lead to an undermining of security of supply".

EDFT believes that "non-implementation could restrict the operation of storage facilities and be detrimental to Security of Supply".

Proposed Charging Methodology

At present, distribution transportation charges are based primarily on the Supply Point Offtake Quantity, Annual Quantity and actual throughput offtaken for a Supply Point or Connected System Exit Point ("CSEP"). There are no distribution transportation charges relating to the entry of gas into the distribution system. Hence, the charging regime may be summarised as:

- **Connection Charge:** payable by the developer, reflecting the cost of the physical connection to the existing system and any immediate reinforcement requirements or additional NTS exit capacity required. This is similar in principle to the arrangements for new gas demand. In the case of Holford the physical connection assets already exist.
- **Exit Charge:** for gas exiting the DN at Holford it is proposed to apply existing DN CSEP charges. For an interruptible customer (who does not pay capacity charges), this would only be the LDZ CSEP commodity charge.
- **Entry Charge:** at present no charges exist for gas entering the DN and it is not proposed to introduce one, for the proposed transitional period, where the entry arrangement is wholly interruptible.

Scotia Gas Networks (SGN) observes that whilst they “recognise that capacity will be interruptible there will not necessarily be no cost to the system”.

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

Arrangements that allow the offtake and short term storage of gas on a Distribution Network provide an additional tool for shippers to balance their portfolios. Although the service proposed here is wholly interruptible, such an arrangement would have the potential to deliver gas to the Total System at times of high demand and, generally, would provide an additional source of gas to shippers depending on the facility’s operating cycle.

It is of the Proposer's opinion that the additional balancing tool, created largely by utilising existing transportation assets at marginal cost, would further relevant objectives SSCA11.1(a) and (d) of a gas transporter’s licence. We believe that introducing the new DN Entry service would enhance the efficient and economic operation of our pipeline system and the additional balancing tool offered to Users would assist in securing effective competition between relevant shippers and suppliers.

The Proposer has reiterated its belief that “the introduction of a new, simple, easily accessible DN Entry Service, coupled to a storage facility, would enhance the efficient and economic operation of the pipeline system”.

A number of the respondents (Wales & West Utilities Ltd, INEOS, EDF Trading, Scotia Gas Networks & EDF Energy Plc) have agreed with the Proposer that the Proposal would further relevant objectives SSCA11.1(a) and (d) of a gas transporter’s licence.

British Gas Trading (BGT) has “sufficient doubts about this modification’s implications, and the extent to which it facilitates, or indeed harms, the relevant objectives”.

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

The Proposer has suggested that the implementation of this proposal should not have any affect on security of supply or industry fragmentation. Arrangements that allow the offtake and short term storage of gas on a Distribution Network provide an additional balancing tool for shippers.

WWU, INEOS, EDFT, EDFE and STUK have all highlighted that they believe the Proposal will offer potential for improved security of supply giving the opportunity for more gas to enter the system and providing an additional balancing tool. EDFE believes that it “will provide an additional balancing tool to the market, by providing a route to deliver gas to the Gas Distribution Network at times of high demand and so reduce the demand that the GDN may place on the Total System through a substitution effect”. EDFT suggests that “it is important that all sources of flexibility are available to the market” and that “it is in the interests of the industry and consumers that the regulatory/contractual hurdles are overcome in a timely manner to ensure that the Holford storage site is operational during this winter and beyond.” INEOS explains that “the forthcoming winter is expected to be ‘tight’ in terms of the supply-demand balance for gas and therefore any available gas should be encouraged/permitted to operate. INEOS therefore argues that the implementation of this proposal would enhance security of supply.” STUK welcomes the “proposers simplification to the code, allowing the storage facility to be operational for this winter... it is reassuring to see that alternative solutions (other than licence changes are being developed to encourage gas on to the system”. SGN suggests that “storage facilities provide a valuable service, generally bringing gas to the system when the need is greatest.”

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

Inter-operator agreements would be put in place to ensure the filling and emptying cycles at this facility do not adversely affect the operation of the relevant distribution network’s system.

INEOS believes that “due to the directional response of flows to demand conditions , the operation of the Holford facility would assist the local Transporter.”

SGN suggest that it may “help reduce NTS’s role as a residual balancer.”

b) development and capital cost and operating cost implications:

Following clarification from the Proposer, the SME can confirm that no anticipated development and capital cost and operating costs implications are anticipated as a result of implementation of this Modification Proposal. This facility would be created as an entry

point in the same way as other DN entry points would be accommodated on UK Link systems.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

No cost recovery mechanism is required.

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

No such consequences on price regulation have been identified.

NTS “believe that the arrangements suggested in the proposal could be introduced without a change to the National Grid NTS’ transportation charging methodology statement.”

5. 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

No additional obligations under the UNC would be placed on Transporters as a result of implementation of this Modification Proposal and consequently, the relevant transporters would not have any additional contractual risk.

The inter-operator arrangements, contained within a Storage Connection Agreement, will include the terms and conditions for the offtake and entry of gas to the System.

6. 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 systems implications have been identified.

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

No such implications have been identified by the Proposer.

INEOS has suggested that “this Modification Proposal would permit the Holford facility to be commercially viable for the forthcoming winter by allowing it access to the NBP.” INOES then asserts that “users should then benefit from the additional flexibility which should reduce the marginal cost of gas acquired for balancing purposes”.

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

This Proposal allows a new entry point to be connected to the system without a requirement to modify the NTS Licence.

The facility owner may be able to realise potential benefit from its asset.

INEOS comments that it “would permit the storage site to be commercially viable for the forthcoming winter which will benefit the facility owner and also consumers during a period when the gas demand/supply balance is expected to be tight.”

9. 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 such consequences have been identified.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Facilitates inclusion of a site with, at present, unique physical properties within existing UNC arrangements.
- The nature of these short term arrangements facilitates timely operation of this site whilst also allowing for any changes to the enduring regime following recommendations made as a result of the Ofgem Consultation “New entry arrangements for connecting to the gas distribution network”. Both EDFT and INEOS believe that the Proposal is consistent with Ofgem’s aspirations.
- Facility owner is able to realise a potential benefit from its asset.
- The facility may be able to provide shippers with an additional balancing tool. INEOS suggests that the additional flexibility provided by the facility will reduce the cost of balancing and therefore the price of wholesale gas.

Disadvantages

- None identified by the Proposer.
- INEOS, NTS and SGN highlight that existing DN entry facilities are subject to a different arrangement, which is an inconsistency which they deem to be undesirable. In the Proposal the Proposer suggests that the site has, at present, unique physical properties. SGN highlights that potential concerns in this respect “are likely to be short lived” and NTS suggests that “there may be a case for treating Holford

differently as an expedient measure for a short term basis only until long term arrangements can be developed for DN entry points.”

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

Representations were received from the following nine parties:

| Organisation | Abbreviation | Position |
|----------------------------|---------------------|-----------------|
| British Gas Trading | BGT | Not in Support |
| EDF Energy | EDFE | Supports |
| EDF Trading | EDFT | Supports |
| INEOS Enterprises | INEOS | Supports |
| National Grid Distribution | The Proposer | Supports |
| National Grid Transmission | NTS | Supports |
| Scotia Gas Networks | SGN | Supports |
| Statoil (UK) | STUK | Supports |
| Wales & West Utilities | WWU | Supports |

Several respondents agree with the transitional nature of the Proposal. The Proposer asserts in its representation that the “term arrangement is appropriate, given the desire to make the facility, that these arrangements would support, operational ahead of the forthcoming winter and the possibility that a DN Entry service may be the subject of further development during the next 12 months. A time-limited implementation provides a compromise that would meet both of these aspirations.” NTS “agrees that the proposed arrangements should only apply on a transitional basis (until 1 October 2007), as any longer term arrangements would have to take into account, and be suitable for, all existing DN entry points in addition to any other potential new DN storage developments. Furthermore, with the proposed introduction of the NTS enduring exit arrangements for 2007, it is likely that the commercial arrangements beyond 1 October 2007 would need to be reviewed to ensure consistency with the proposed new exit arrangements.”

Three respondents disagree with the transitional nature of the proposal. EDFT believes that “the modification should be made to the principal document and replaced by the long term arrangements when these have been approved. If the long term arrangements are not implemented by 1 October 2007 we would expect the interim arrangements to roll-on.” STUK “do not however believe that it is appropriate for a cut off date (sunset clause) as suggested in this modification, to be introduced into the code as the proposed arrangements will remain appropriate until any further reform causes them to naturally fall away.” INEOS also believes that it is inappropriate to specify “1st October 2007 as the end date for these arrangements.” Their “understanding is that when the long term arrangements are introduced, via a UNC modification, the interim arrangements will be superseded. In the event that there is a delay in the implementation of the long term arrangements beyond 1st October 2007, then the interim arrangements should be allowed to continue.”

STUK agrees “with the proposer that including this site as a System Entry Point in the NTS licence (giving it baseline capacity of zero) would have no effect on either NTS SO or TO

operations and have no benefit to the NTS business, and is therefore inefficient both regulatory and commercially.”

BGT has highlighted that the “draft legal text does not appear to us to limit the effects of this modification only to that site. Instead, the limitation applies only to existing sites which are listed in Table A2 of Schedule A to NG NTS’s Transporter Licence.” Following clarification from Proposer the SME can confirm that there was no intention to limit the effects of this Proposal to the Holford facility between now and the introduction of an enduring solution.

BGT wonders “whether there is scope for existing DN connected entry points to seek a disapplication of the prevailing regime in order to migrate on to these proposed UNC arrangements”. Following clarification from the Proposer the SME can confirm that the Proposer believes that discussion surrounding disapplication of the prevailing regime would be a discussion for the parties to which the Licence obligations apply.

BGT expresses concerns and suggests that the proposal sets an “unwelcome precedent for any enduring regime, particularly when” it “believes that the effects have not been exhaustively researched.”

12. 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.

13. 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.

14. 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.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

As no system changes are anticipated, implementation of this Modification Proposal could be effective immediately following the Ofgem decision date.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

There are no implications relating to implementing this Modification Proposal upon existing Code Standards of Service.

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

At the Modification Panel meeting held on 21 September 2006, of the 8 Voting Members present, capable of casting 10 votes, 9 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

19. Text

Transition Document Part IIC

Insert the following as new paragraph 1.1.6:

“1.1.6 TPD Section B2

Notwithstanding the provisions of Section B1.2.8, the provisions of TPD Section B2 shall not apply to any LDZ System Entry Point (a “**New LDZ System Entry Point**”) that is not listed in Table A2 of Schedule A to the National Grid NTS’s Transporter’s Licence. In respect of any New LDZ System Entry Point, the type and quantity of entry capacity that will be offered, the method by which such capacity will be offered and subsequently allocated, and the rules relating to the use of that capacity will be set out in a separate agreement (a “**Bilateral Agreement**”) between the relevant Transporter and the operator of the Delivery Facility connected to the System at the New LDZ System Entry Point. The relevant Transporter may make it a condition of any User being allocated or holding capacity at a New LDZ System Entry Point that such User enters into or accedes to an Ancillary Agreement setting out the terms of the use of the relevant System for the purposes of delivering gas at the New LDZ System Entry Point.

Any references in the Code to Section B2 shall, for the purposes of a New LDZ System Entry Point, be deemed to be references to this paragraph 1.1.6, the provisions of the relevant Bilateral Agreement and/or the relevant Ancillary Agreement as the case may be.

For the purposes of the Code, the Available Firm NTS Entry Capacity in respect of a New LDZ System Entry Point shall be zero (0).

The provisions of this paragraph 1.1.6 shall cease to apply at 06:00 hours on 1 October 2007.”

Subject Matter Expert sign off:

I confirm that I have prepared this modification report in accordance with the Modification Rules.

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive Joint Office of Gas Transporters

Signature:

Date :