# Modification Report
# "Introduction of new balancing neutrality charge for cost of residual balancer collateral on the OCM"
# Modification Reference Number 0125

Version 3.0

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

The Amended Proposal is as follows:

"*Where capitalised words and phrases are used within this Modification Proposal, those words and phrases shall usually have the meaning given within the Uniform Network Code (unless they are otherwise defined in this Modification Report). Key UNC defined terms used in this Modification Proposal are highlighted by an asterisk (*) when first used. This Modification Proposal, as with all Modification Proposals, should be read in conjunction with the prevailing UNC.*

National Grid appointed EnMo (now APX Gas Ltd) as the On the Day Commodity Market (OCM) Trading System Operator*. At the time of appointment, EnMo was not required to be regulated by the Financial Services Authority (FSA) and achieved this exemption through the designation process. The Appointment Contract in place between National Grid and EnMo required EnMo to consider application and registration as a Recognised Investment Exchange.

Credit for the OCM was originally provided via four means: long term cash deposit; standby letter of credit; own rating or parent rating. The latter two options were backed by credit insurance taken out by APX.

Recently, APX has decided to apply for FSA authorisation, which requires full collateralisation of all its markets, including the OCM. APX also believes that the implementation of the Markets in Financial Instruments Directive (MiFID) in the UK from November 2007 will change the rules for determining whether a product is an investment. Currently a product delivered within 7 days is not deemed to be an investment, but MiFID is expected to reduce this window to 2 business days. APX has concluded that some APX products, including certain OCM trades, will be classed as investments and therefore will require collateralisation. As such, if the current OCM products are to be retained, collateralisation of the OCM will be required irrespective of the market operator employed.

APX changed the OCM Market Rules from 1 September 2006 to reflect the new credit approach. As a result, National Grid NTS, along with all other OCM Market Participants*, is required to provide collateral for its trades on the OCM in its roles as Shrinkage Provider* and Residual Balancer.

As the Residual Balancer role is completed on behalf of and funded by the community, this Modification Proposal* seeks to pass through the costs of the collateral required for trades undertaken by the Residual Balancer to the community. It is proposed to achieve this cost pass through by adding a new element to the balancing neutrality mechanism such that a daily proportion of the prevailing annual cost is allocated to all Users on each Gas Day* in the month that these costs are incurred, in proportion to the User's throughput.

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If this Modification Proposal is not implemented, National Grid NTS will be unable to recover the costs incurred in providing the required collateral for trades taken in its Residual Balancer role in an appropriate manner. National Grid NTS believes that costs associated with providing a Residual Balancing service should be borne by all active Users, given the nature of the Residual Balancing role and the benefit it provides to the community as a whole.

For clarity, the collateral required by the Shrinkage Manager will be accounted for separately and is not included within this Modification Proposal."

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

The Proposer believed that implementation of this Modification Proposal would better facilitate the achievement of the Relevant Objective in 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…"* by appropriately targeting the costs of completing the Residual Balancing role in proportion to Shippers' throughput, thereby sharing those costs equitably across the Shipper community and facilitating effective competition between relevant Shippers.

Some respondents agreed, although there were requests for transparency on the scale and assignment of costs.

TGP disagreed, believing there were more appropriate, less complex cost recovery mechanisms.

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

The implementation of this proposal should not have any effect on security of supply, operation of the Total System, or industry fragmentation.

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

**a) implications for operation of the System:**

No implications for operation of the System have been identified.

**b) development and capital cost and operating cost implications:**

The costs of collateral for the Residual Balancer role, based on historic use and dependent on gas costs and the extent of the Residual Balancer role, are currently estimated to be c.£30k to £50k per annum.

Some respondents expressed concern about the ability of Shippers to validate where costs were being incurred and the uncertainty that costs have been incurred efficiently.

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

It is proposed to pass through the costs of the collateral required for trades undertaken by the Residual Balancer to Users by adding a new element to the balancing neutrality mechanism such that a daily proportion of the prevailing

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annual cost is allocated to all Users on each Gas Day, in proportion to the User's throughput.

In opposition to this mechanism, TGP argued that allowed revenue in the next Transmission Price Control Period would be more appropriate. NG UKD highlighted an existing UNC provision (TPD F4.5.3(a)(v)(2)) that they believe already permits cost recovery such that implementation of this Proposal is unnecessary.

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

No consequences on price regulation have been identified.

**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**

The Proposer stated there would be no changes to the level of contractual risk as a result of implementing this Modification Proposal. However, TGP argued NG NTS' contractual risk would be reduced.

**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**

The Proposal does not require any change to the UK Link System

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

Were this Modification Proposal to be implemented, the costs of collateral for the Residual Balancer role would be recovered from Users. Based on historic use and dependent on gas costs and the extent of the Residual Balancer role, these are currently estimated to be c £30k to.£50k per annum, dependent upon the method of collateralisation used. The Proposal envisages recovering the costs through an additional element of the balancing neutrality mechanism. This additional element would comprise a daily proportion of the prevailing annual cost of collateral, which will be apportioned to all Users on each Gas Day, in proportion to the User's system throughput in the month that the costs are incurred.

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

No such implications have been identified.

**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**

- Costs would be allocated in a manner that would better facilitate the achievement of the Relevant Objectives.

**Disadvantages**

- Users would face additional costs
- The proposed cost recovery mechanism is more complex than a price control revenue mechanism.

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

Three respondents supported implementation of the Proposal, one gave qualified support, three were not in support, and one was neutral.

| Organisation | Abbreviation | Position |
|---|---|---|
| British Gas Trading | BGT | Qualified Support |
| EON UK | EON UK | Supported |
| National Grid NTS | NG NTS | Supported |
| National Grid UKD | NG UKD | Neutral |
| RWE Npower | RWE | Not in support |
| Scottish & Southern Energy | SSE | Not in support |
| Statoil UK | STUK | Supported |
| Total Gas & Power | TGP | Not in support |

In addition to issues raised elsewhere in this report, RWE expressed concern about a potential scenario where the Residual Balancer's provision of collateral might be exhausted outside office hours.

## 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

National Grid's Procurement Guidelines and its reporting arrangements would need to be considered.

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

The Proposal was for implementation from 1 February 2007.

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

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

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

At the Modification Panel meeting held on 18 January 2007, of the 8 Voting Members present, capable of casting 9 votes, 9 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

**18. 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

## 19. Text

**UNIFORM NETWORK CODE – TRANSPORTATION PRINCIPAL DOCUMENT**

**SECTION F – SYSTEM CLEARING, BALANCING CHARGES AND NEUTRALITY**

*Amend paragraph 4.5.3(a) to read as follows:*

"(a) the sum of the following amounts:

(i) ……….;

(ii) ……….;

(iii) ……….;

(iv) ……….;

(v) ……….;

(1) ……….;

(2) ……….;

(vi) ………. in respect of Days in month m; and

(vii) the amount of any costs, expenses or other amount incurred by National Grid NTS in providing security and/or collateral to the Trading System Operator (pursuant to the Trading System Arrangements) in respect of Market Balancing Actions taken or to be taken by National Grid NTS and paid in month m."

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For and on behalf of Relevant Gas Transporters:

**Tim Davis**
**Chief Executive, Joint Office of Gas Transporters**

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