

CODE MODIFICATION PROPOSAL No. 0125

"Introduction of new balancing neutrality charge for cost of residual balancer collateral on the OCM"
Version 3.0

Date: 1 December 2006

Proposed Implementation Date: 1 February 2007

Urgency: Non-Urgent

Proposer's preferred route through modification procedures and if applicable, justification for Urgency

(see the criteria at http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2752_Urgency_Criteria.pdf)

National Grid NTS raised a new topic at the Transmission Workstream meeting on 5 October 2006, supported by presentations from APX Gas Ltd and National Grid NTS. With the support of the Transmission Workstream, National Grid NTS proposes that this Modification Proposal be sent directly to consultation following the UNC Modification Panel meeting on 16 November 2006. National Grid NTS also requests reduced timescales of 10 days for consultation. The implementation date of 1 February 2007 is proposed to align with the forecast requirement to place collateral with the Trading System Operator, APX, by 1 January 2007.

Nature and Purpose of Proposal (including consequence of non implementation)

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.

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.

Basis upon which the Proposer considers that it will better facilitate the achievement of the Relevant Objectives, specified in Standard Special Condition A11.1 & 2 of the Gas Transporters Licence

National Grid NTS believes this Modification will 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.

Any further information (Optional), likely impact on systems, processes or procedures, Proposer's view on implementation timescales and suggested text

a) Proposed implementation timetable

National Grid NTS proposes that this Modification Proposal be implemented from 1 February 2007.

b) Proposed legal text

To be provided.

c) Advantages of the Proposal

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

d) Disadvantages of the Proposal

None identified.

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

National Grid does not believe the proposal to have any such implications.

f) The implication for Transporters and each Transporter of implementing the Modification Proposal, including

i. implications for operation of the System

If not implemented, the role of Residual Balancer will not be appropriately funded.

ii. development and capital cost and operating cost implications

National Grid does not anticipate any such costs.

iii. extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs

N/A

iv. analysis of the consequences (if any) this proposal would have on price regulation

National Grid does not believe this Modification Proposal would have any consequences on price regulation.

g) 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

National Grid does not anticipate any changes to the level of contractual risk as a result of this Modification Proposal.

h) 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

We do not believe there to be any impact on the UK Link System.

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

National Grid NTS believes that it is appropriate to seek to recover the costs of collateral required to support the role of the Residual Balancer by socializing this cost across the User* community through an additional element of the balancing neutrality mechanism. This additional element will 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.

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, dependant upon the method of collateralization used.

National Grid NTS does not anticipate a requirement to recover any additional administrative costs as a result of the requirement to put in place this collateral.

The procurement of the collateral required will be completed under auspices of the Procurement Guidelines (PG) Document and reported on within the annual PG report. Any required changes to the PG Document will be made should this proposal be implemented.

Code Concerned, sections and paragraphs

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Changes will be required to the Uniform Network Code, Transportation Principal Document, Section F, paragraph 4.6 for Balancing Neutrality Financing Adjustment.

Proposer's Representative

Ritchard Hewitt

Proposer

National Grid Gas plc (Transmission)

Signature

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