

Draft Modification Report
Recovery of Debt and Smearing of Revenues via Energy Balancing Neutrality
Modification Reference Number 0235
Version 1.0

This Draft Modification Report is made pursuant to Rule 9.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

Uniform Network Code (UNC) referenced Sections are to the Transportation Principal Document except where stated otherwise.

This proposal is one of three Proposals put forward by members of the Energy Balancing Credit Committee (EBCC) in order to address issues highlighted as a result of recent unprecedented events in financial markets and the failure of Lehman Brothers Commodity Services Inc

As a result of the failure of Lehman Brothers Commodity Services Inc, a debt will, over the course of time, be mutualised across portfolio Users, whilst at the same time National Grid NTS will continue to pursue such debt with the appointed insolvency practitioner in line with the EBCC's instruction via the route of Directed Recovery Steps.

Nature

It is proposed that in respect of charges set out in Section F4.5.3 (a) (ii) that were payable two months previously but were still outstanding on the last Day of that month, these will be recovered as follows:

- That portion of the Monthly Adjustment Neutrality Amount will be calculated in respect of each Day that the Defaulting User failed to make payment in respect of any of the charges listed in Section F4.5.3 (a) (ii).
- In accordance with current UNC provisions, these portions will be allocated and charged to each User in the ratio that the sum of the relevant UDQIs and UDQOs for that User, on that Day, holds to the sum of the relevant UDQIs and UDQOs for all relevant Users. For clarity, this Modification Proposal does not seek to amend the way that debt is currently mutualised between Users.
- For the purpose of this calculation, "relevant User" will not include the Defaulting User.
- These charges will be billed as Ad-hoc Neutrality under the "**ADS charge type**" within the Energy Balancing Invoice.

It is further proposed that any Monthly Adjustment Neutrality Amounts or Adjustment Reconciliation Neutrality Amounts incurred as a result of Directed Recovery Steps initiated in respect of such debts, will also be paid or charged to relevant Users as set-out above; i.e. as ADS charge types based on UDQIs and UDQOs in respect of Days where the User failed to make payment.

Purpose

By implementing the above changes, a potential inequity that currently exists will be removed. This inequity is described in the following paragraphs.

The Balancing Neutrality Charges payable by each User or by National Grid NTS, in respect of each Day, are calculated from the Balancing Charges, and other non Transportation charges, payable by all Users on that same Day. No distinction is made on whether those charges are expected to be paid or not. As a result, where a User fails to pay such invoice, the energy balancing neutrality bank account would be in deficit equal to the value of such invoice until such time as it was paid by that User or recovered from all Users as outlined below.

In simple terms, this means that all relevant Users receive a share of the Aggregate System Payments, which include the charges payable by Users that subsequently fail to pay their invoices. These Aggregate System Payments are, typically, slightly greater than the Aggregate System Receipts so that Users receive a small net benefit. The magnitude of this benefit is unlikely to change due to the fact that the Aggregate System Receipts include a substantial amount of charges payable by a Defaulting User.

However, when this User fails to pay these charges, and the resultant debt becomes more than two months overdue, it then becomes one of the items charged to Users as Monthly Adjustment Neutrality Amounts. These amounts are charged to Users as Balancing Neutrality Charges and billed via the “**CNU charge type**” based on the relevant UDQIs and UDQOs for the month to which the invoice relates, which is two months after the month in which the Defaulting User incurred the unpaid Balancing Charges.

Such provisions are covered in Sections F 4.5.3 and F6.5, which detail the determination of the Monthly Adjustment Neutrality Amounts and Adjustment Reconciliation Neutrality Amounts respectively.

These current arrangements may be considered inequitable, as the basis upon which each User’s Balancing Neutrality Charge is determined will change in line with its Daily throughput as expressed in its relevant UDQIs and relevant UDQOs. For example, if a User failed to pay an invoice for charges incurred on a very cold Day towards the end of Winter, it might be recovered from Users based on average throughputs in warm conditions two months later.

In addition, there may have been movements in Users’ Supply Point portfolios that would be reflected in the UDQOs for that month, including new Users entering the market. The prospect of substantial charges for new Users due to a default that occurred prior to their registration may be considered as a barrier to entry of new Users. Conversely, such arrangements may also prolong the timeframe by which Users wishing to Voluntarily Discontinue were bound.

The inequity outlined above may be further compounded as any amounts recovered and costs incurred by National Grid NTS as a result of Directed Recovery Steps in relation to the original debt carried out in accordance with Section X 3.4 are classed as additional Monthly Neutrality Adjustment Amounts, which in turn are paid or charged to the relevant Users in accordance with F4.5.4 based upon the month in which National Grid NTS either makes or receives payment via CNU charges on the Energy Balancing

Invoice.

2 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;

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

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

The potential inequity that results from the current application of the code may be a barrier to entry and may discriminate unduly against smaller Users. By removing this potential undue discriminatory aspect, implementation would be expected to facilitate the achievement of this relevant objective.

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (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, by removing a potentially inequitable aspect of the current provisions, and in turn removing a potential barrier to entry, would be expected to facilitate the achievement of this relevant objective.

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

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

3 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.

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

a) Implications for operation of the System:

No such implications have been identified.

b) Development and capital cost and operating cost implications:

No such implications have been identified.

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

No costs are anticipated to be incurred as a result of implementation of this Proposal.

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

Not applicable.

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 such consequence has been identified.

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 such implications have been identified.

7 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)

Users may wish to amend their invoice checking processes in order to reflect these changes in Balancing Neutrality calculations.

Development and capital cost and operating cost implications

Operating costs for the remaining Users resulting from a User Default will be more equitably shared as a result of implementation.

Consequence for the level of contractual risk of Users

The current contractual risk facing new Users or Users that change their portfolio would be reduced or eliminated.

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

- Would remove the potential barrier to entry for new Users having to bear the cost of a User's failure prior to their accession to the UNC.
- By smearing both the original revenues and consequential recovery and associated Directed Recovery Costs on the same basis, implementation would remove the current potential financial inequity.

Disadvantages

None identified.

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

Written Representations are now sought in respect of this Draft Report.

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 for works would be required as a consequence of implementing the Modification Proposal.

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

Proposal could be implemented with immediate effect following direction from Ofgem.

16 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.

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

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

Representations are now sought in respect of this Draft Report and prior to the Transporters finalising the Report.

For and on behalf of the Relevant Gas Transporters:

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