

Modification proposal:	Uniform Network Code (UNC) 0235: Recovery of debt and smearing of revenue via Energy Balancing Neutrality (UNC 0235)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	05 March 2009	Implementation Date:	To be confirmed by Joint Office

Background to the modification proposal

Energy Balancing Neutrality

Under the Uniform Network Code (the 'Code') Balancing Neutrality Charges³ are used as a mechanism to help ensure that National Grid NTS does not benefit from any financial gains or incur any losses resulting from any actions it takes in relation to its energy balancing responsibilities. As well as any gains or losses resulting from the activities of Users in the gas balancing market⁴. A Balancing Neutrality Charge is the difference between the amounts received (receipts) and the amounts paid (payments) by National Grid NTS⁵ with regard to activities in the market.

User Default⁶

All Users are responsible for the financial implications of participating in the gas balancing market. They are also collectively responsible for the financial risk associated with an individual User being unable to meet their financial responsibilities⁷. In the circumstances where Users are in breach of their financial responsibilities, under the Code, National Grid NTS has the ability to terminate those Users⁸. Such Users are defined as being in 'Default'. In these circumstances all remaining Users are liable for the non-payment of the defaulting Users energy balancing debt⁹.

When a User Default occurs, the Balancing Neutrality Account is in deficit by the amount of the energy balancing debt until it is recovered either by a party or by remaining Users¹⁰. The unpaid energy balancing debt of a defaulting User is recovered from remaining Users as a portion of their Balancing Neutrality Charges. These charges

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Further information relating to Balancing Neutrality Charges is outlined in Section F of the code on the Joint Office website at www.gasgovernance.com.

⁴ These include any charges National Grid incurs for undertaking balancing actions and any charges Users incur for being imbalanced. Further information on the charges included in balancing neutrality charges can be found in Section F of the code. Further information on the code can be found on the Joint Office website at www.gasgovernance.com.

⁵ This could also be amounts receivable or payable by National Grid NTS.

⁶ Further information relating to the circumstances that could result in a User Default can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com.

⁷ This responsibility is outlined in Section F of the code. Further information on the code can be found on the Joint Office website at www.gasgovernance.com.

⁸ When a User is terminated, they cease to be a User of the gas balancing system.

⁹ Further information relating to the circumstances that could result in a User Default and the power of National Grid NTS to terminate a User is outlined in Sections X and V of the code. Further information on the code can be found on the Joint Office website at www.gasgovernance.com.

¹⁰ The neutrality bank account is also in deficit in respects to any unpaid User invoices.

comprise two elements: the Basic Net Neutrality Amount and the Adjustment Neutrality Amount. The most relevant Balancing Neutrality Charges associated with the recovery of energy balancing debt are Monthly Adjustment Neutrality Amounts which cover neutrality adjustments associated with balancing charges (whether positive or negative) and associated costs such as interest.

Recovery of energy balancing debt

When a User is invoiced for a Balancing Neutrality Charge, it is assumed that the User will pay the amount specified in the invoice. As such, there is an expectation that this amount will be paid into the balancing neutrality account and because this account is designed to show a balance of zero, this amount is paid to all Users as an aggregate system payment (a 'positive smear'). However, in circumstances where a positive smear has occurred and the defaulting User has failed to pay an invoice the neutrality bank account falls into deficit. To rectify this deficit, National Grid NTS recovers the deficit amount from all remaining Users (a 'negative smear'). Positive and negative smears are processed through Balancing Neutrality Charges.

Energy balancing debt is recovered when the debt remains unpaid *after two months*. In this instance, the debt is charged to all Users as a Balancing Neutrality Charge, regardless of whether these Users were Users at the time the energy balancing debt was accrued. The amount recovered from each User is based on information relating to each User's throughput¹¹ in the month the invoice is created¹², and is not related to the month the energy balancing debt occurred.

The modification proposal

This modification proposal (the 'proposal') seeks to ensure that a defaulting User's energy balancing debt is only smeared across those Users that were defined as Users at the time the energy balanced debt was accrued ('remaining Users'). Additionally, it would mean that the Balancing Neutrality Charges remaining Users are liable to pay would be based on each User's throughput on the days the energy balancing debts were accrued. Any further Balancing Neutrality Charge relating to the recovery of an energy balancing debt if the User was terminated (e.g., applicable interest) would also be charged to all remaining Users on this basis.

This proposal amends the calculation of the Adjustment Neutrality Amount to ensure that the recovery of a defaulting User's energy balancing debt¹³ is only charged to Users that were Users at the time the debt was accrued for the relevant period¹⁴.

¹¹ A User's throughput is based on their unit daily quantity input (UDQI) and their daily quantity output (UDQO). This is the amount of gas Users bring in to (UDQI) and take out of (UDQO) the NTS on a daily basis. Further information can be found in Section E of the code that can be found on the Joint Office website at www.gasgovernance.com.

¹² i.e. two months after the original energy balancing debt was created.

¹³ In addition to the costs associated with this recovery.

¹⁴ The relevant period relates to the days in which the defaulting Users debt was accrued. For further information please refer to section F of the code. Further information on the code can be viewed on the Joint Office of Gas Transporters ('The Joint Office') website at www.gasgovernance.com

UNC Panel¹⁵ recommendation

At the UNC Panel (the 'Panel') meeting on 18 December 2008 the Panel unanimously recommended implementation of this proposal.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 30 January 2009. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR¹⁶. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC¹⁷; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹⁸.

Reasons for the Authority's decision

There were 12 responses to the Joint Office's consultation. Of these, 11 responses supported implementation of the proposal and one response supported the principle of the proposal but expressed concerns that the proposals may adversely affect new entrants and Users with growing portfolios. However, this respondent did not specify how this would arise from the proposal. The views of the Proposer and those expressed by respondents are considered below.

The Authority considers that this proposal will better facilitate relevant objective (d) of Standard Special Condition A11 of the Gas Transporter Licence and is neutral in relation to the remaining objectives. Our reasons for this are provided below.

Relevant objective (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;

Cost targeting

The Authority agrees with the Proposer and those respondents who considered that this proposal would better target the recovery of energy balancing debt and the costs associated with this recovery. Such charges would be levied on those parties that were active at the time that the debt was accrued and would reflect the relative size of the parties' trading positions in the market at that time. Energy balancing neutrality charges currently recover a defaulting User's energy balancing debt from all remaining Users, regardless of their physical throughput at the time the debt was accrued. This would not

¹⁵ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

¹⁷ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

¹⁸ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

be a problem if trading patterns were consistent over time but problems may arise if significant changes occur, for example, if a User defaults on a substantial level of charges, creating material cost spikes which may be problematic for the short term financial management of Users' portfolios. The new approach is more equitable as it is recovering the outstanding balancing debt in a way that reflects Users' actual activity at the time of default and does not create a temporal mismatch of costs for each User.

We note that one respondent considered that there would only be a small improvement in appropriate smearing of energy balancing debt. We also note that the proposal does not provide any estimates relating to the potential cost savings Users could make as a result of the changes implemented by this proposal. However, Ofgem considers that this proposal will ensure appropriate costs are charged to Users on a more targeted basis and therefore is likely to better facilitate competition.

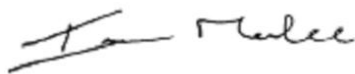
Barriers to entry

Additionally, Ofgem agrees with the Proposer and those respondents that consider that current balancing neutrality arrangements could cause a barrier to entry to parties considering entry to the market. Currently, Users are invoiced for a defaulting User's energy balancing debt that is two months overdue. Any parties that enter the market within these two months are liable to pay a portion of this energy balancing debt even though they were not Users at the time the debt was accrued. Depending on the size of the energy balancing debt this could present a form of barrier to entry¹⁹. This proposal rectifies this situation by only targeting energy balancing debt, and the associated recovery costs, at parties that were Users at the time the debt was accrued.

The Authority has outlined above our reasons for agreeing with the Proposer and those respondents that considered that this proposal leads to a better targeted and more cost reflective balancing neutrality charges. We consider that this would facilitate competition between relevant Shippers and as such better facilitate this objective against the current baseline.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 0235: 'Recovery of debt and smearing of revenue via Energy Balancing Neutrality' be made.



Ian Marlee
Director, Trading Arrangements

Signed on behalf of the Authority and authorised for that purpose.

¹⁹ Ofgem further considers that this would also depend on prevailing market conditions, including the cost of bringing gas in and taking gas from the NTS at the time parties are considering entering the market and other factors.