CODE MODIFICATION PROPOSAL No 260
Revision of the Post-emergency Claims Arrangements
Version 3.0

Date: 30/07/2009

Proposed Implementation Date: October 2009

Urgency: Non Urgent

1 The Modification Proposal

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 Proposal).

This Modification Proposal, as with all Modification Proposals, should be read in conjunction with the prevailing Uniform Network Code (UNC).*

Nature and Purpose of this Proposal

a)

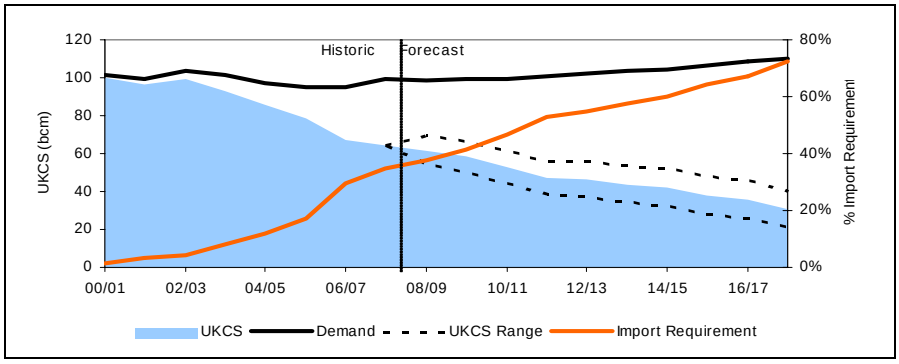
Background to the Proposal

Over the past few years, the gas emergency arrangements within the Uniform Network Code (UNC) have been the subject of extensive industry debate. This has included discussion associated with the projected reduction of the gas supplies sourced from the UK Continental Shelf (UKCS) with the consequence that the Great Britain (GB) market will become more dependent on gas imports from Norway, continental Europe and the global Liquefied Natural Gas (LNG) markets; collectively known in this Proposal as non-UKCS gas supplies.

A related issue raised by the industry relates to the increased GB dependence on non-UKCS gas supplies and the effects this might have should a Network Gas Supply (Gas Deficit) Emergency (GDE) be declared. It is worth noting that in the event a GDE is declared, neither the Network Emergency Co-ordinator (NEC) nor HM Government (including DECC or Ofgem) have any legal vires to direct non-UKCS gas supplies into GB market.

The extent to which GB gas market will become dependent on the future importation of non-UKCS gas supplies is demonstrated by Graph 1 – UKCS Annual Supplies and Demands, and is based on the historic and forecast utilisation of proven UKCS supplies.

Graph 1 – UKCS Annual Supplies & Demands (National Grid - 2008 Annual 10 Year Statement)



In the event of a GDE Users do however have legal obligations under their Gas Act Shipper Licences and ostensibly, the Gas Safety (Management) Regulations (GSMR) to maximise their UKCS gas flows and, where directed, reduce their firm demand-side flows when instructed to do so by the Relevant Transporter under the direction of the National Emergency Co-ordinator (NEC). These safety obligations are reflected within the UNC insofar as Users must comply where directed by the Transporter to maximise UKCS flows and/or reduce demand offtakes and that the Users' (and the Transporter) business interests are subordinate in the event of a GDE.

In February 2009, National Grid NTS, in conjunction with the wider industry, initiated a review of the UNC emergency arrangements with the primary objective of developing, and implementing, robust and well defined revisions that;

Facilitate:

- New and enhanced commercial arrangements so that Users might mitigate the onset or, reduce the potential length and/or severity of a Gas Deficit Emergency and;

- Improved alignment between the Users' Licence/GSMR safety obligations and those of the UNC emergency arrangements.

Provide Users with appropriate incentives to:

- Put in place commercial arrangements prior to a Gas Deficit Emergency occurring;

- Provide additional non-UKCS gas supplies into the GB gas market during a Gas Deficit Emergency by giving confidence to those Users that they will receive an appropriate level of financial recompense based on a market value of the gas supplied;

- Contract for further self-interruption of demand prior to a Gas Deficit Emergency; by giving confidence to those Users that they will receive an appropriate level of financial recompense based on a market value of the gas interrupted and;

- Seek to address their imbalance.

Introduce:

- Full market based transparency and auditability (of costs and prices) through the use of On-the-day Commodity Market (OCM) Physical Market Offers during a Gas Deficit Emergency.

- The ring-fencing of the costs of providing additional supplies/self-interruption of demand

during a Gas Deficit Emergency.

- A revised cost apportionment as a result of amended post-emergency claims arrangements.

We consider this Proposal will encourage additional non-UKCS supply and/or demand-side response during a Gas Deficit Emergency however, this Proposal is not intended to (and cannot) mitigate the issues associated to the future national security of supply e.g. the GB market's increased dependence on gas importation. On balance, we believe that this Proposal (should it be implemented) will represent an incremental step to enhance the existing commercial framework and that it might be considered in a wider, HM Government-initiated review of the UK Security of gas Supply arrangements.

Associated Industry Concerns – User risks

Debates relating to UNC emergency arrangements have resulted in numerous Proposals[1] being raised in recent years. During the development of these Proposals, Users have raised several common concerns which they believed should be considered and addressed within any future revisions to the emergency arrangements.

Common concerns that have been expressed by Users include:

- Market manipulation (of prices).
- Lack of confidence that they will receive appropriate compensation for the gas delivered during a GDE.
- Unconstrained System Marginal Price (SMP) could excessively penalise Users that are unable to respond to an emergency.
- The 'domino effect' associated with credit and securities during an emergency and the potential for multiple User failures.

Emergency Cashout Prices

The industry has previously highlighted concerns that any revisions to the UNC emergency arrangements should not subject Users to disproportionately inflated gas prices during a Gas Deficit Emergency, and that any proposals should consider how the industry exposure to the likelihood of extreme cashout prices for additional gas supplies could be appropriately managed.

National Grid NTS believes that any enhancements to the UNC emergency arrangements are mindful of the balance between providing a cashout price that does not excessively penalise Users who are unable to respond, whilst encouraging additional non-UKCS gas into GB and/or further demand-side reductions during a Gas Deficit Emergency.

A common view expressed by Users is that there is a potential conflict between the UNC commercial arrangements at a time where 'physical' Users are obliged to operate in accordance with their GSMR and Licence obligations, particularly where such commercial arrangements have had no particular alignment to their legal safety obligations.

[1] 044 *"Revised Emergency Cash-out & Curtailment Arrangements" (ECQ)*; 061 *"Facilitating further demand-side response in the event that a Gas Balancing Alert is triggered" (GBA)*; 0149/a *"Gas Emergency Cashout Arrangements: Keeping the OCM open during a Gas Deficit Emergency (GDE)"*

Some Users have raised concerns associated with the risk of the exposure to potentially spiralling cashout prices that might be over-inflated as a result of market behaviours on the OCM during a Gas Deficit Emergency, i.e. some Users have expressed concerns that not all Users carry the same level of risk to spiralling prices. It was highlighted that it is those 'physical' Users that are subject to System Clearing via Energy Balancing Neutrality which carry a greater risk of being exposed to the potential costs of Users defaulting as a consequence of a Gas Deficit Emergency and, that such costs may have been adversely affected by spiralling emergency cashout prices.

We believe there is a consensus within the industry that the greatest risk of exposure to the costs incurred as a result of imbalance positions arising from a Gas Deficit Emergency is largely attributed to those predominantly physical 'demand-side' Users. National Grid NTS has however undertaken analysis (Graphs 2a/2b) that indicates it might be more appropriate to attribute the greater risk of imbalance cost exposure to the predominantly physical 'supply-side' Users who sell the majority of their supplies into GB at the NBP.

As can be determined from the analysis, 5 Users account for approximately 75% of physical demand but are included within 39 Users that provide approximately 47% of physical gas supplies to meet UK demand.

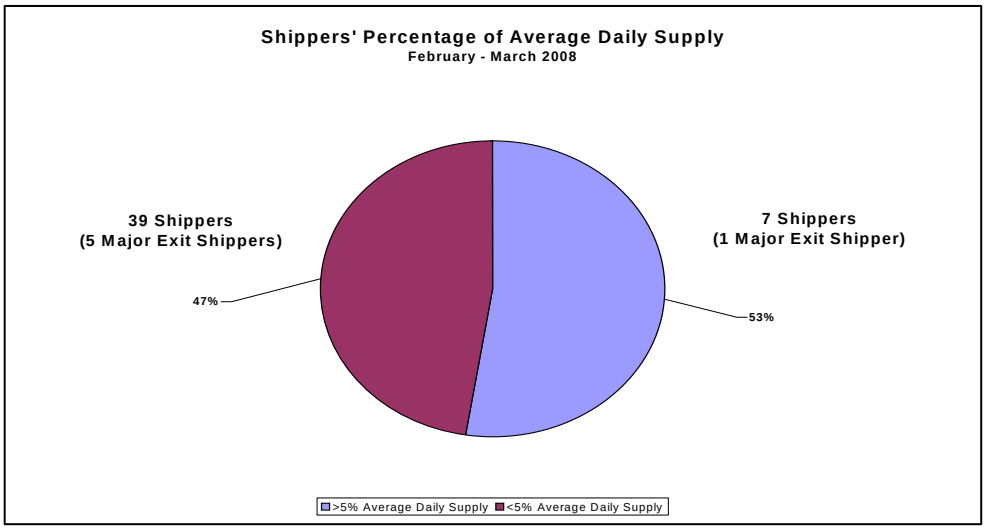
National Grid NTS understands that those predominantly 'demand-side' Users acquire a greater proportion of their supply requirements through the use of trading and bilateral contracts at the NBP. We are also aware that for the purposes of NBP gas trading through the standard NBP '97 contract, trading parties cannot claim 'Force Majeure' in the event of a National Gas Supply Emergency.

From the analysis (Graphs 2a/2b) and the terms of the NBP '97 contract, it might be inferred that where a Gas Deficit Emergency is the result of a supply-side failure, for example, a beach terminal failure, then an affected 'beach supply User' might have greater exposure to System Clearing costs.

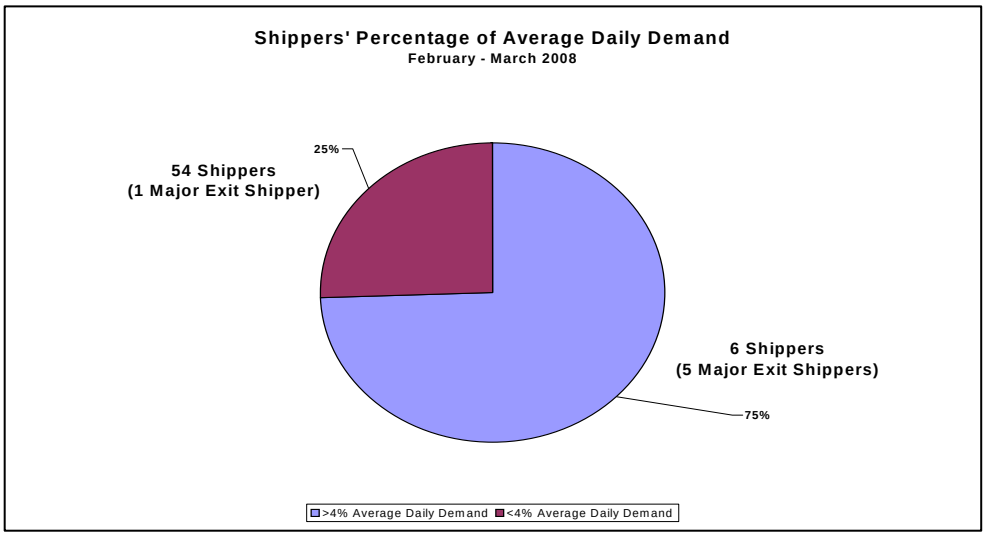
We believe that in the event of a Gas Deficit Emergency, those predominantly 'demand-side Users' that source their supplies through NBP gas trade contracts may have less risk of exposure to System Clearing costs. This risk might be further mitigated through the contracting of self-interruption of demand prior to the NEC declaring a Gas Deficit Emergency Stage 3 (Firm Load Shedding).

During recent Emergency Claims Workshop discussions, it was suggested that Demand-side Users may not be able to place Physical Market Offers that will be reflective of the amount of gas made available to the system during a Gas Deficit Emergency. We would like to clarify that the purpose of the post-emergency claims process is to provide Users with an ability to recover any financial losses that they might have incurred as a result of providing additional supply (or firm demand-side reduction) to the Total System. We understand that to a greater extent, much of the gas required for NDM portfolios may have been sourced at the NBP well in advance of a Gas Deficit Emergency. In these circumstances, it might be considered that the Emergency Cashout Price (frozen SAP) is a closer proxy to the price at which the gas (for NDM portfolios) was initially procured and financial losses are therefore mitigated.

Graph 2a - Determination of the Users - Entry/Exit Split;



Graph 2b - Determination of the Users - Entry/Exit Split;



European versus UK Market Prices and their effect on gas flows into the UK

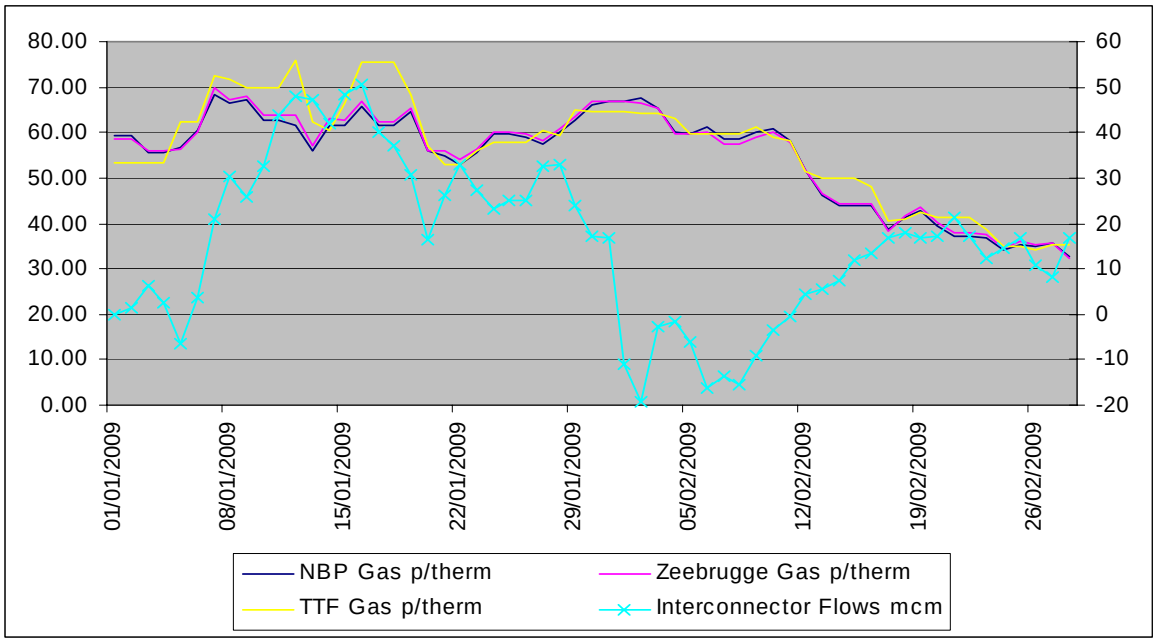
During a Gas Deficit Emergency we would expect that a proportion of non-UKCS gas made available to the UK would flow from Continental Europe. A view has been expressed that gas from Continental Europe would flow into the UK where the NBP market price was sufficiently greater than prices available in European markets. National Grid NTS has undertaken some analysis for the winter period January/February 2009, when the Interconnector (IUK) was primarily in export rather than import mode. We believe that this analysis demonstrates that there is a correlation between whether or not gas is imported into the UK by comparing the UK gas market price with European market prices.

The analysis focuses on a period where the UK was importing high levels of Norwegian gas supplies however, Users were also withdrawing UK storage stock (Short Range and Medium Range).

The first graph shows the NBP, TTF (Title Transfer Facility - Dutch market) and Zeebrugge (Belgium market) gas prices over the January/February period. It can be observed that there was a level of correlation between the NBP and Zeebrugge market prices; we would have expected the Zeebrugge price to be higher than the NBP given that IUK was in export-mode to Zeebrugge. What is interesting is that it appears it was the TTF price which was driving the IUK behaviour; where the

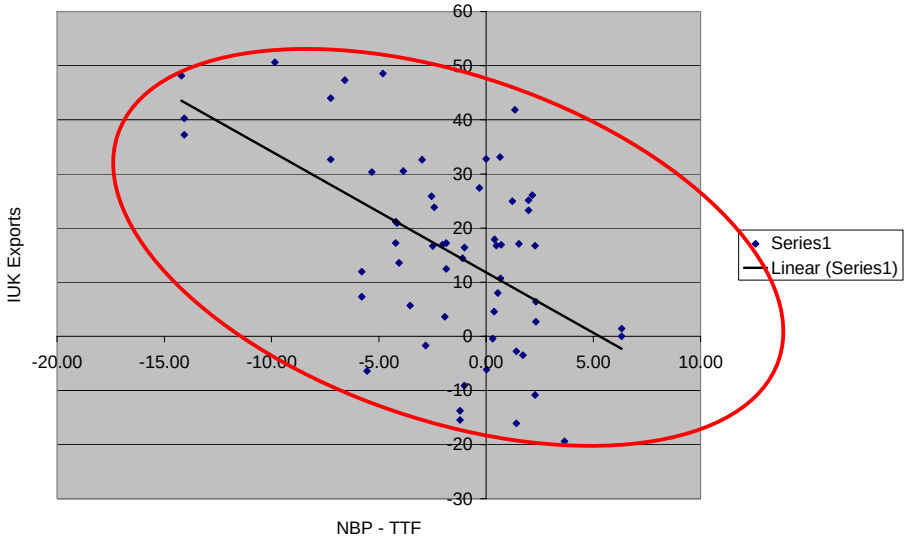
TTF price was higher than the NBP price then IUK was primarily in export mode, it was only where the NBP price was higher than TTF that the IUK either reduced its export flows or, reversed its flow into the UK.

Graph 3a – Market Prices versus Interconnector Flows



The second graph shows a key driver was the European contracted price and the need for Continental Europe to supply its shortfall (Russian/Ukraine issue) in January. Interestingly, it appears that the NBP would have required an approximate 5p/therm price advantage to produce a zero export flow to the Continent. Looking at the trend line, there is no difference in the relationship between the high UK gas prices and after, when the UK gas prices collapsed.

Graph 3b – Correlation between NBP prices levels and its influence on IUK Interconnector Flows



Whilst the decline of the UKCS gas supplies will be mitigated through new, diverse sources of supply, it appears that the interaction of the UK and European gas markets might lead to the UK having a greater role as a 'transit country' for non-UKCS supplies whose final destination is

influenced by market arbitrage opportunities e.g. price differentials. This certainly seems to be supported by the events experienced during January/February 2009 when a Russian-Ukraine gas supply issue occurred; the effects of which restricted the ability of several Member States' to source gas for their own national demands.

We believe that any revisions to the post-emergency arrangements should afford Users with an opportunity to recover any financial losses for sourcing additional non-UKCS supply that is (where appropriate) reflective of other gas markets. As illustrated within tables 3a and 3b, during a Gas Deficit Emergency, we would anticipate that Physical Market Offer prices for additional non-UKCS gas into the UK are likely to be influenced by other markets.

Energy Balancing Credit Cover during a Gas Deficit Emergency

National Grid NTS considers that the proposed improvements in the transparency of the prevailing emergency claims arrangements with the provision of potential 'emergency claims' information (prices and quantities) to the market during a Gas Deficit Emergency may facilitate improvements in the management of Energy Balancing Invoice security cover.

Following discussions with xoserve, we understand the availability of potential 'emergency claims' information during a Gas Deficit Emergency may afford the Energy Balancing Credit Manager (EBCM) with an opportunity to enhance its monitoring and management of credit and security assessments; this may mitigate the likelihood of the 'domino effect' in respect of User defaults that might otherwise arise as a consequence of a Gas Deficit Emergency.

Prevailing Emergency Claim Arrangements

During a Gas Deficit Emergency Stage 2+, Users are required to maximise supplies into the Total System. The emergency claim arrangements were introduced in recognition of Users' concerns regarding possible financial loss that they may suffer associated with the requirement to maximise beach supply over-and-above that required to fulfil their contracted demand.

Once the NEC has declared a Gas Deficit Emergency Stage 2+, and should the User subsequently have a surplus Daily Imbalance, this surplus is currently cashed-out at the frozen System Average Price (SAP) for that Gas Day. Due to this SAP price being frozen this price may not reflect the market value on the Gas Day for increased supplies indeed it may be too high or too low.

From the inception of the UNC, Users that are able to help the Total System by providing supply during an emergency over-and-above that which is required for their supply and demand balancing purposes, have raised concerns associated with the lack of clarity and certainty associated with the post-emergency claims arrangements. These Users believe that under the prevailing arrangements, there is a risk that any action they take to either increase supply or reduce demand in order to help the Total System during an emergency, may leave them facing a financial loss.

This was considered by Ofgem in it's decision letter for; *Modification Proposal 0149 dated 19th October 2007- 'Gas Emergency Cashout Arrangements: Keeping the On the Day Commodity Market open during a Gas Deficit Emergency'* in which Ofgem indicated that;

"We do not consider that the UNC Section Q post emergency claims procedure provides sufficient economic incentive for Users to buy gas not already contracted above the frozen cash-out price, since at best they can only recover their costs, whilst exposing themselves to uncertainties surrounding the outcome of the claims process."

National Grid NTS concurs with the view that prevailing post-emergency claims arrangements should provide the requisite definitions, clarity and certainty that are required to facilitate User confidence that costs for providing additional supply and/or self-interruption of demand during a Gas Deficit Emergency should be settled in a clearly defined and timely manner.

The prevailing arrangements associated with the derivation of the Emergency Cash Out Price and the Post-Emergency Claim Arrangements are as follows:

Emergency Cashout Prices

- Users' Daily Imbalances are cashed-out utilising the *frozen* prices (Stage 2) on the following basis;
    - deficit imbalance – shippers cashed-out @ SMP Buy
    - surplus imbalance – shippers cashed-out @ SAP

Post-emergency arrangements - Claims

- UNC Section Q section 4.2.6 states; *Where a User (the "claimant") believes that it will suffer a financial loss by reason of being paid only the relevant price in respect of any gas delivered to the Total System on a Day during a Gas Deficit Emergency (at Stage 2 and higher) (but not in respect of a quantity of gas which exceeds the amount of the claimant's Daily Imbalance if any under paragraph 4.2.2(a)):"*
- The Claimant is required to submit a claim.
- The Claimant is required to provide details regarding the basis for the claim.
- Claim(s) only relevant to gas over-delivered by that User during the Gas Deficit Emergency (surplus Daily Imbalance).
- National Grid NTS will appoint an independent claims reviewer.
- The Claimant will make available information and cooperate with the claims reviewer.
- Recommendations of the independent claims agent will require oversight and subsequent approval by the Authority.
- Payment to claimant and recovery of costs through Balancing Neutrality.
- Following consultation with Authority, and the Claimant, Under Condition A11(18) the Authority may approve the claim, National Grid NTS will pay the Claimant the amount advised by the Claims reviewer.
- National Grid NTS will recover any cost for claims as if it were a Market Balancing Action Charge payable to National Grid NTS, recovered through neutrality (ref Q4.2.5), therefore smeared over User throughputs on the relevant Gas Day (within the Gas Deficit Emergency).
- National Grid NTS will recover the fees and costs of the claims reviewer through Monthly Adjustment Neutrality Costs.

Nature of the Proposal

This Proposal considers the introduction of improvements that will bring greater clarity and definition to the UNC post-emergency claims arrangements. This is of benefit to the wider community by providing greater transparency of the potential costs to the industry and, allowing Users to assess and manage their commercial exposure that might arise from a Gas Deficit Emergency, in a timely manner.

This Proposal seeks to implement the following 3 areas of change to the prevailing post-emergency claims process (defined in UNC section Q 4.2.6):-

1. Introduction of criteria for submitting and receiving payment for Post-Emergency Claims

- The aim of the Proposal is to facilitate the processing of post-emergency claims within approximately 4 months of the Gas Deficit Emergency day.

- In order to submit a post-emergency claim for a Gas Day, a User will be required to have posted its additional supplies and/or demand-side reduction (quantity and price) as offers to sell on the OCM Physical Market during the corresponding Gas Deficit Emergency Day.

- Where a Physical Market Offer is taken as a trade the offer will be cleared through existing OCM rules and processes and therefore, will not be eligible for progression through the revised claims arrangements.

- Any Physical Market Offers remaining on the OCM at the end of each relevant Gas Day (of the Gas Deficit Emergency) may be submitted as post-emergency claims. However, only up to and including the quantity of gas over-delivered by that User for each relevant Gas Day (within the Gas Deficit Emergency), may be claimed e.g. the User's surplus Daily Imbalance for the relevant Gas Day.

- All submitted claims will be subject to a mechanistic validation process e.g. does the claim have a matching posted OCM offer, timing, location, quantity, price etc.

- Where a User's claimed quantity is greater than its User's Daily Imbalance surplus quantity, the claimed quantity will be scaled back to its Daily Imbalance quantity.

- All submitted claims will have an initial volume/price comparison assessment against a trigger (as detailed in **Appendix 4 – Proposed Business Rules** and **Appendix 5 – Economic Price Assessment Trigger**).

- All claims below the trigger will be considered to have 'passed' an economic test determining that such costs are deemed to have been economically incurred.

- All claims above (or crossing) the trigger will be required to undergo a further economic price assessment, under the direction of the Authority.

- Subject to the mechanistic validation process and the economic assessment, Users will receive payment for their claims less the emergency frozen SAP price for the relevant GDE day.

2. Introduction of revised processes for the recovery of post emergency claims costs

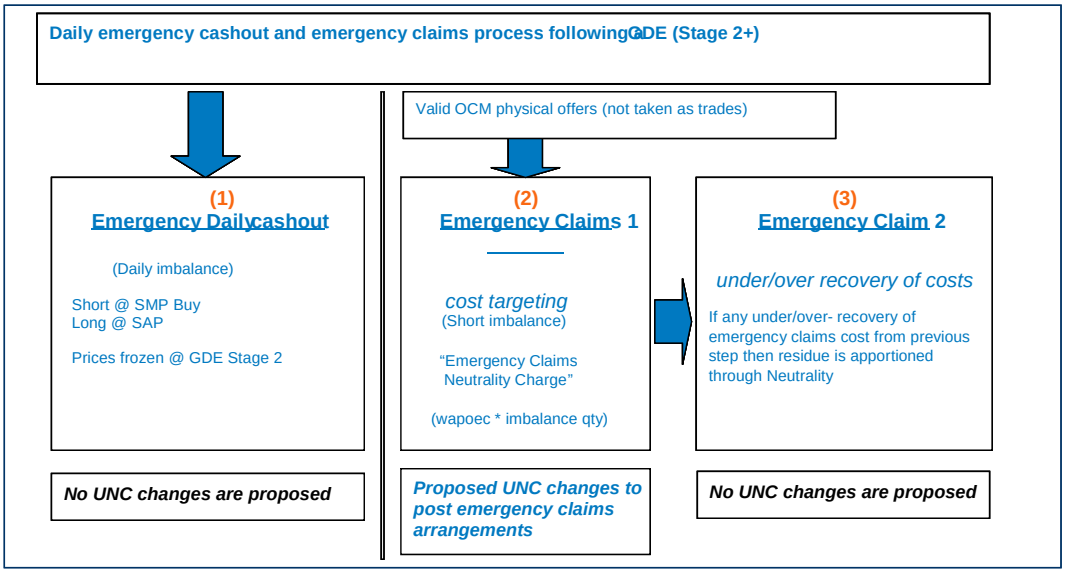
- It should be noted that this Proposal does not seek to make any changes to the derivation of the prevailing emergency cashout prices as defined within UNC Section F2 (frozen at Stage 2).

- Users that incurred a deficit Daily Imbalance for a relevant Day within the GDE will initially be apportioned the costs of valid post-emergency claims to the extent of their imbalance quantity; based on the Volume Weighted Average Price (p/kWh) of all valid Emergency Claims (VWAPEC) multiplied by the User's deficit Daily Imbalance quantity (kWh).

  Please note: *It is possible that the full costs of all valid emergency claims for a relevant Gas Day* ***will not*** *be smeared over those Users with deficit Daily Imbalances on the day(s) of the Gas Deficit Emergency; but such targeted costs will be recovered based on the volume weighted average price of those emergency claims multiplied by the extent of a User's deficit Daily Imbalance quantity.*

- Any under-over recovery of emergency claims costs will be apportioned across all Users, based on their throughput (UDQI plus UDQO) as a proportion of all Users' total throughput on the relevant Gas Day of the Gas Deficit Emergency through the Balancing Neutrality adjustment process as defined within the UNC Sections Q4.2.4 and F4.

Graph 4 – Overview of the effects of the proposed changes in respect of the recovery of Claims costs;



We have assessed how this Proposal will affect Energy Balancing Neutrality and the associated cash-flows in the event that post-emergency claims are processed - please see **Appendix 1 (1a/1b) – Cashflows and over-recovery /under-recovery examples**.

We have also provided a comparison summary of the existing emergency claims arrangements and those new elements that will be introduced in the event that this Proposal is implemented – please see **Appendix 6: Identification of New Elements (UNC Section Q 4.2.6)** for details.

3. Introduction of emergency claims information provision during and post, the Gas Deficit Emergency day

The Market Operator and National Grid NTS will provide;

Within the GDE Day

- Indicative volume weighted average prices of all physical market offers

Post GDE Day

- Details of all post-emergency claims submitted.
- Volume Weighted Average price of all validated Post-Emergency Claims (VWAPEC).

Use of the OCM as a 'potential emergency-claims' bulletin board.

National Grid NTS believes that during a Gas Deficit Emergency, it should be assumed that all those Physical Market Offers posted on the OCM ***will*** be delivered to the Total System. In this situation, we believe that the OCM should be considered as akin to a 'potential emergency-claims' bulletin board.

The market may not be able to distinguish those Physical Market Offers (other than through price) that would provide additional (non-UKCS) supplies and/or self-interruption to say, those extra UKCS supplies (or demand-side reduction) being provided under NEC instruction.

We do not consider however that the requirement to distinguish Physical Market Offers in this manner is necessary. One objective of this Proposal is to encourage those Users, with a physical capability, to register any available 'surplus' gas as Physical Market Offers on the OCM for those Users who might wish to address their deficit imbalance.

During a Gas Deficit Emergency, a Physical Market Offer may either be accepted by a User that has made a commercial decision to address its deficit imbalance position or, where such offers are not accepted, they may form the basis of a post-emergency claim. In the latter case, the cost of a post-emergency claim will, in the first instance, be recovered from Users that had incurred deficit Daily Imbalance positions on that Gas Day.

We believe that notwithstanding a Physical Market Offer is cleared through the OCM as a trade or, becomes a potential post-emergency claim; the use of the OCM in this manner will facilitate a timely restoration of normal commercial arrangements.

Price Transparency

We note that in its decision letter to Modification Proposal 0149, Ofgem responded to several Users' concerns relating to gaming issues and instances where monitoring of such activity would be difficult to identify or prove;

"*Ofgem has powers under the Competition Act to investigate and take action against anti-competitive conduct. We think that the current focus of attention should be on putting in place arrangements that provide appropriate commercial incentives under emergency arrangements on the assumption that Users do not behave in this way and seek to game the rules, in the knowledge that Ofgem has the necessary powers to intervene, if necessary.*"

We believe the changes contained within this Proposal will facilitate greater transparency of prices and the potential costs associated with the value of gas during a Gas Deficit Emergency.

This Proposal may afford the community and Ofgem with an ability to monitor any potential post-emergency claims on an 'ex-ante' basis and thus enable the industry, not only to calculate exposure to after-the-day costs associated with a Gas Deficit Emergency, but also to ensure that any concerns associated with 'gaming' may be addressed in a timely manner.

We consider that the increased transparency that will be provided by the proposed indicative volume weighted average price and, the economic assessment price trigger (see below) might afford Users that wish to place their additional gas supply and/or demand-side reduction on the OCM with an opportunity to:-

- price their additional gas taking into consideration other User's Physical Market Offers and;
- assess whether any subsequent post-emergency claims might be approved (for payment) without any further recourse for an economic price assessment.

As previously suggested, we consider that greater transparency of the prices and the potential costs during a Gas Deficit Emergency may facilitate improvements in the Energy Balancing Credit Manager's ability to improve the efficiency of managing and monitoring the wider community's credit risk exposure.

Appointment of a Claims Reviewer

This Proposal seeks to appoint the Transporters' Agent as the Claims Reviewer; to become responsible for the 'mechanistic' elements of the post-emergency claims validation process. We note that xoserve has indicated that it would welcome such an undertaking as the post-emergency claims validation process will enhance the monitoring and management of Energy Balancing Credit exposure that might arise as a consequence of a Gas Deficit Emergency.

Claims Submission - data provision

The proposed revisions will require the User to provide specific data with each submitted post-emergency claim, the requirements of which are detailed within Section 3.3 of the Business Rules (please see **Appendix 4 – Proposed Business Rules**). As part of this specified information the User will be required to provide a justification for the level of the claimed price, which should be based on costs (which may include opportunity costs) of providing the gas to GB. Where opportunity costs are being claimed for, the information submitted may include (where appropriate) a reference to the market to which the price may have been considered linked e.g. a neighbouring European gas hub. The justification will be considered in the event that the claimed price exceeds the 'trigger level' and thus requires an additional economic assessment.

Claims Validation Process

We believe that any revisions to the post-emergency arrangements should afford the opportunity for Users to recover any financial losses for sourcing additional non-UKCS supply that is reflective (where appropriate), of other gas markets. As illustrated within tables 3a and 3b in the event of a Gas Deficit Emergency occurring, we would anticipate that prices posted on the Physical OCM, Market for additional non-UKCS supplies into the UK are likely to be influenced by other markets.

It is proposed that the claims validation element of the post-emergency arrangements is undertaken on a 'mechanistic' basis with the validation rules clearly defined, agreed and transparent..

The mechanistic validation of the post-emergency claims will check; the User has provided all mandatory data in the correct formats (within the required timescales), the claim had a corresponding posted Physical Market Offer for the relevant Gas Day, the location (Gemini meter reference) is associated to the User e.g. the User is a Registered User at that meter point, it is a valid meter 'type'; and, timing e.g. a User cannot claim for a Physical Market Offer that had been posted after the NEC had declared either a Stage 4 (Demand-side reduction) or a Stage 5. Upon any failure of this validation, National Grid NTS will inform the User that the post-emergency claim has been rejected and provide the reason as detailed in **Appendix 4 - Proposed Business Rules**.

National Grid NTS also proposes that all post-emergency claims that pass the mechanistic validation process have a price test based on their prices against a 'trigger'. In respect of any post-emergency claim that is above (or crosses) the trigger, there will be a requirement for an additional 'economic' price assessment. We propose that such an undertaking will be carried out under the instruction of the Authority.

Economic Price Assessment Trigger

During the Emergency Arrangements Workshop held on 24th June 2009, EDF Energy presented a number of options on which a trigger might be based. However, there was no consensus within the Workshop as to which option might be utilised to set the trigger. National Grid NTS has since carefully considered all the options presented and, those concerns and issues that arose during the Workshop.

The purpose of the trigger is to establish a price-level at which the majority of any post-emergency claims will be considered valid (thus deemed approved) with those claims priced above the trigger requiring further economic assessment. We believe that utilising a percentage of the volume of offers outstanding will afford those Users that wish to place Physical Market Offers on the OCM to assess how they might wish to price their additional gas supplies and/or demand-side reduction in comparison to other Physical Market Offers on the OCM during a Gas Deficit Emergency. We believe that these changes to the claims process may facilitate greater confidence in the market that Users will be able recover their costs, associated with provision of additional supply or demand side response to GB gas system, within a prescribed timescale and, without having to undergo a post-emergency claims review.

Please see **Appendix 4 - Proposed business rules** and **Appendix 5 – Economic Price Assessment Trigger** for an example of how we propose the trigger will work.

Review of Post-emergency Claim prices

We have considered the concerns and, the request for clarification raised during the Workshops in relation to those post-emergency claims that might require a further economic price assessment. In order to mitigate these concerns, we have provided additional business rules (**Appendix 4 – Proposed Business Rules**) that seek to implement a robust framework around the economic price assessment rules e.g. timelines for the submission and review of such claims.

Development of Economic Price Assessment guidelines

In the Emergency Claims Workshop (24th June 2009) it was recognised that although the proposed changes, if implemented, may provide improvements in the transparency and robustness of the Emergency Claims process, there were some concerns expressed that the post-emergency claims process may further benefit from greater clarity and understanding of the economic price assessment. We agree that further clarity of the post-emergency claims processes may be achieved through the development of guidelines that clarify the process of determining the economic price assessment of Post Emergency Claims submissions, which are above the 80% validation trigger.

It is therefore our intention to facilitate industry workshops during October 2009 whereby we will work in conjunction with Users and Ofgem to consider and develop such guidelines. It is not proposed that these guidelines will form part of the UNC or referred to within the UNC..

Settlement of Post-Emergency Claims

We propose that all valid post-emergency claims for a relevant Gas Day within a Gas Deficit Emergency (where it is contained within a Billing Period) are progressed through the revised post-emergency arrangements (Neutrality) in a single batch (invoicing month). In the event that a Gas Deficit Emergency extends over multiple Billing Periods, there will be a difference in the settlement periods for those Gas Days (post-emergency claims) prior to, and post, the Billing Periods. This ensures that claims are settled and detailed within the existing invoicing arrangements.

As detailed in **Appendix 4 – Proposed Business Rules**, with the introduction of a six day timescale for post-emergency claims to be submitted, the requirement for the Daily Imbalance closeout (at M+15), a one-month turn-around for the economic price assessment, and, due to the nature of the energy balancing invoicing cycle; we believe that it will take approximately 4 months for the settlement of validated post-emergency claims.

Information Provision

As detailed in **Appendix 4 – Proposed Business Rules** , we propose providing the following information to Users and the wider market including:

- indicative OCM volume weighted price of all Physical Market Offers during the Gas Deficit Emergency; provided by the Trading System Operator (APX Gas Ltd).
- all submitted post-emergency claims giving details of the price, volume, and justification of the price (with-holding the identity of the Claimant);
- all rejected post-emergency claims giving details of the price, volume, and justification of the price and the reason for rejection (with-holding the identity of the Claimant);
- all valid post-emergency claims paid giving details of the price*****, volume*****, and justification of the price (with-holding the identity of the Claimant);
- Final volume weighted average price, trigger (volume), total volume, total cost.

***** where relevant, the original price and/or volume and the scaled-back price and/or volume.

Cost-targeting of Post-emergency Claims

This Proposal will apply a volume weighted average price (VWAPEC), derived from all validated post-emergency claimed prices and volumes associated to each relevant Gas Day within a Gas Deficit Emergency.

We believe that the introduction of the proposed revisions put in place appropriate incentives for Users to appropriately manage their imbalance positions. Where a User fails, or is unable, to make appropriate arrangements, it faces the risk of incurring additional charges (in the event it has a deficit Daily Imbalance on the relevant Gas Day) being applied that reflect the costs of the post-emergency claims associated with additional gas ‘supplied’ during the relevant Gas Day during the Gas Deficit Emergency.

We note that concerns have been raised associated with the introduction of the targeting of costs in that such arrangements may penalise a User that has been placed in a deficit Daily Imbalance position through circumstances which are out of its control. In particular, concerns were raised

associated with the consequences of a User with a small deficit position, for example, a User with a 1 kWh deficit Daily Imbalance might be targeted with a high proportion of the costs arising from a Gas Deficit Emergency. During the Gas Emergency Arrangements Workshops, we have clarified that in this situation the User will be charged 1 kWh multiplied by the VWAPEC and not the whole costs arising from all valid post-emergency claims. It is proposed that any remaining costs after the initial 'targeting' will be apportioned across all Users (based on System throughput) through Energy Balancing Neutrality (**see Appendix 2 – 1 kWh deficit imbalance example**).

Emergency Curtailment Quantity (ECQ) interactions and the Post-Emergency Claims process

The Emergency Arrangements Workshop has discussed concerns associated with the interactions of the Emergency Curtailment Quantity (ECQ) and the proposed changes to the post-emergency claims process. A view was expressed within the Workshop that implementation of both arrangements was not necessary and indeed, the changes contained within this Proposal should replace the ECQ arrangements.

We have carefully considered this view however, on balance, we believe that this Proposal will compliment, rather than replace, the ECQ arrangements in as much as the Proposal will encourage Users to facilitate additional self-interruption arrangements with their demand-side customers.

Under the prevailing UNC provisions, the ECQ arrangements are applied where a User has been instructed to switch a site off either during Stage 1 (interruptible load) or Stage 3 (firm load). Where the User has been instructed to take a site off during Day 1 of a Gas Deficit Emergency, the User will receive an ECQ so that the quantity 'interrupted' maintains its imbalance position.

For Day 2+ of a Gas Deficit Emergency, Users may submit a 'P70' to National Grid NTS that indicates a site has been 'self-interrupted' and thereby avoid an ECQ from being applied for that particular site for that Gas Day.

We believe that this Proposal will provide Users and their end consumers with a framework through which they may be appropriately recompensed for the cost of self-interruption, whilst both this Proposal (if implemented) and the ECQ might encourage Users to further contract for self-interruption prior a Gas Deficit Emergency occurring.

Potential scaling of a Claimed Quantity

Scaling-back

It is proposed that where a Physical Market Offer has not been accepted but is submitted by a User as a post-emergency claim, the quantity claimed will be validated against the User's Daily Imbalance Quantity for that Gas Day. In the event the claimed quantity exceeds the User's relevant Daily Imbalance surplus quantity, the claimed quantity will be scaled-back to the User's relevant Daily Imbalance quantity. Where a User submits multiple post-emergency claims for a relevant Gas Day within the Gas Deficit Emergency and the aggregate claimed quantity exceeds the User's relevant Daily Imbalance surplus for that Gas Day, the aggregate claimed quantity will be scaled-back by removing the highest priced claimed quantities first. We propose that in respect of information provision during a Gas Deficit Emergency, the OCM indicative volume weighted average price of emergency claims (VWAPEC) will display the 'maximum' financial exposure to the community with any subsequent scaling-back serving to reduce this exposure.

Scaling-up

It has also been suggested during an Emergency Arrangements Workshop that it may be appropriate to 'scale-up' a claimed quantity where it is below the User's relevant Daily Imbalance surplus

quantity. National Grid NTS has carefully considered this suggestion however, on balance, we believe that scaling-up has the potential for perverse incentives to arise from the revised post-emergency arrangements. Adopting this approach might illicit behaviour whereby a User only places a Physical Market Offer with a minimum quantity with an expectation that any subsequent claim will be scaled-up to its relevant Daily Imbalance surplus quantity. Whereas scaling-back might reduce the potential exposure to Energy Balancing Neutrality charges that result from the recovery of such costs, scaling-up might increase the risk to the community above the cost which was estimated (based on the OCM indicative VWAPEC).

We believe that scaling-up may give rise to some Users claiming for quantities of gas, which might not have resulted in financial loss. We therefore consider that scaling-up is neither efficient nor economic as it might unnecessarily increase financial exposure and Energy Balancing Neutrality costs in the absence of providing any meaningful benefit to the Total System during a Gas Deficit Emergency.

Placing and accepting Physical Market Offers

National Grid NTS recognises that many Users may be unfamiliar with the processes required to post and accept OCM Physical Market Offers. We believe that it may be appropriate for Users to undertake refresher training in order to become familiar with both the OCM and 'Gemini' systems, processes and procedures. We will address any User's requirements for familiarisation of these processes through the facilitation of User workshops from October 2009.

Nomination/OCM Physical Renomination processes

Nominations/OCM Physical renominations - interaction

During the Emergency Arrangements Workshop some attendees believed that it would be useful if the Proposal provided some clarification of the Nomination processes associated with Physical Market Offers being placed on the OCM physical market. The prevailing UNC arrangements for the Nomination process required for Physical Market Trades that have been accepted on the OCM are provided within Section C, Section D and Annex D1 of the UNC.

We wish to take the opportunity to clarify that the requirement to provide an OCM Physical renomination will only be arise in the event that a Physical Market Offer was accepted as a trade by a User.

We do not propose making any changes to the prevailing Nominations/Renominations and OCM Physical Renomination rules that are contained within UNC Sections C and D.

In the interest of providing clarity to the nominations processes in these Sections, we have provided examples in the attached **Appendix 3 – Nominations interactions**.

Nominations/OCM Physical renominations – flow-rate changes

There has also been a question raised within the Emergency Arrangements Workshops relating to the existing UNC provisions relating to OCM physical renominations and the requirement to effect a flow-rate change under the proposed arrangements given the OCM will effectively be utilised as a 'bulletin board' during a Gas Deficit Emergency Stage 2+. National Grid NTS has considered this question and received a Legal view that the existing UNC provisions do not require any amendments.

Potential requirement for a Regulatory Impact Assessment

Given that this Proposal is seeking to introduce provisions that will initially target the costs associated from valid post-emergency claims against a sub-set of Users i.e. those which incurred a deficit Daily Imbalance on a relevant Gas Day, there may be a requirement for Ofgem to undertake a Regulatory Impact Assessment. Any proposed implementation date assigned to this Proposal must be mindful of the scope and duration that any such Regulatory Impact Assessment may require.

b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)

Not applicable

c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.

The changes contained within this Proposal have been discussed within the main Transmission Workstream on several occasions since Summer 2008 and, in a number of Emergency Arrangements 'Workshops' (sub-group of the Transmission Workstream). We therefore recommend that this Proposal should proceed to Consultation.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

National Grid NTS believes there are User Pays elements to this Proposal i.e. the introduction of a new economic price assessment trigger and the application of a new Post-Emergency Claims Charge (please see Appendix 6 - Identification of New Elements (UNC Section Q.4.2.6) for details).

In the interests of gaining the benefits outlined within this Proposal at the earliest opportunity, National Grid NTS has decided not to seek to recover the implementation costs of these new elements through the User Pays arrangements..

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

Not applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

Not applicable.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

Not applicable.

3 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

Standard Special Condition A11. 1 (a) the efficient and economic operation of the pipe-line system to which this licence relates:

If implemented, the proposed changes will provide greater clarity and definition of the post-emergency claims process.

We believe that:

- the introduction of such provisions may provide Users with an enhanced opportunity to better manage their supply and demand balance during an emergency;
- the proposed transparency of the emergency arrangements will afford those Users that have a physical capability, to assist in the mitigation of a Gas Deficit Emergency;
- the changes may further encourage non-UKCS gas supplies into GB market as a User will have greater confidence that it will receive an appropriate level of financial recompense based on a prevailing market rate and;
- such actions may result in the restoration of normal commercial arrangements in a timely manner and this may therefore improve the efficient operation of the Total System during a Gas Deficit Emergency.

This Proposal, if implemented, seeks exclusive use of the OCM Physical Market to register offers that are eligible for submission as post-emergency claims. We consider that determining the values of claims in this manner may mitigate the risk of prices spiralling, as a result of the improved market transparency and auditability of such prices. National Grid NTS considers that this may demonstrate an improvement in the economic operation of the Total System during a Gas Deficit Emergency.

We believe that the proposed changes might better align the UNC arrangements to those of the Users' legal safety obligations (Shipper Licence/GSMR) during a Gas Deficit Emergency and that this may also demonstrate an improvement in the operation of the Total System during such an emergency.

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraph (a) to (c) the securing of effective competition between shippers, suppliers and DN operators:

We believe that the proposed changes will demonstrate improvements in competition between Users during a Gas Deficit Emergency. We consider that through the provision of improved transparency of prices, utilising the OCM as a post-emergency claims 'bulletin board' and, with greater clarity in the UNC emergency arrangements, Users might be better placed to manage their financial exposure that might arise as a consequence of a Gas Deficit Emergency.

Users will have an opportunity to utilise a framework to manage their exposure to any costs (prices) arising from a Gas Deficit Emergency in an environment where such commercial arrangements are better aligned to, and may complement, their legal safety obligations (Shipper Licences / GSMR).

We believe that facilitating an improved framework for Users to manage supply/demand imbalance may reduce the occurrence of User-defaults as a consequence of a Gas Deficit Emergency, thereby reducing the cost implications on all Users. This, we consider demonstrates an improvement in competition between Users as it may reduce uncertainties in the costs arising from the Gas Deficit Emergency.

A11. 1(f) the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.

We note Users' concerns that the prevailing UNC emergency arrangements lack the definition and clarity required to provide them with the confidence that will enable them to recover their costs associated to any incurred financial losses. These financial losses might be incurred as a consequence of placing additional gas supply onto the Total System during a Gas Deficit Emergency. We believe that, if implemented, this Proposal provides the definition and clarity required and thus, the Proposal promotes efficiency in the administration of the UNC.

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

We believe that if implemented this Proposal may provide greater clarity and improvements in the commercial arrangements for the provision of additional gas during an emergency, we anticipate that this may encourage non-UKCS gas into GB market and, facilitate further self-interruption on demand-side arrangements.

Whilst a potential increase in supply during a Gas Deficit Emergency may demonstrate an enhancement to the safe operation of the Total System, we recognise that such additional supply *may* only be 'on the margins' of the quantities required to alleviate a Gas Deficit Emergency. Nevertheless, National Grid NTS believes that in the event this Proposal is implemented, it will demonstrate an improvement to the prevailing arrangements.

5 The implications for Transporters and each Transporter of implementing this Modification Proposal, including:

a) The implications for operation of the System:

We believe that if implemented, the Proposal might improve the operation of the Total System during a Gas Deficit Emergency, such that it may encourage greater supply and demand side response. We believe that this may result in the restoration of normal commercial arrangements in a timely manner.

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

xoserve has indicated that new systems and processes will be required in order to introduce the economic price assessment trigger and the application of the new Post-Emergency Claims Charge. In the interests of gaining the benefits of this Proposal at the earliest opportunity, National Grid NTS has decided not to seek the recovery of these costs through the User Pays arrangements.

c) Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:

As detailed in 5a above, National Grid NTS is not proposing to recover the

implementation costs through the User Pays arrangements.

d) The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

We believe that this Proposal will improve the definition and clarity of the emergency claims process provided in UNC Section Q. The improved clarity and definition may mitigate the potential contractual risks of the Transporter under the UNC.

6 The extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)

Not applicable

7 The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users

Other than those elements proposed in **Appendix 6 – Identification of New Elements**, we do not anticipate any systems development requirements for the implementation of this Proposal.

If implemented, this Proposal will require the following changes to operational processes/procedures;, for example:

- OCM Physical Market Offer data is required to support the post-emergency claims validation process.
- Energy Balancing Credit Management (EBCM) to validate and process all post-emergency claims.
- EBCM to calculate and credit Claimant for valid post-emergency claims.
- EBCM to calculate and recover Claims costs through Balancing Neutrality in accordance with the proposed rules.
- Provision of reporting, relevant to the revised emergency arrangements.

8 The implications for Users of implementing the Modification Proposal, including:

a) The administrative and operational implications (including impact upon manual processes and procedures)

We anticipate that Users may need to review amend their Emergency Arrangements to align with the revisions that are outlined within this Proposal.

b) The development and capital cost and operating cost implications

We are unaware of any development and capital/operational costs and would request that respondents advise of such in due course.

c) The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

We believe that providing greater clarity and definition of the post-emergency claims arrangements may mitigate some of the uncertainties associated with payment for any financial loss incurred by Users for providing additional gas to the Total System during a Gas Deficit Emergency.

We consider this may mitigate some of the Users' contractual risks associated with such uncertainty that might arise as a consequence of a Gas Deficit Emergency.

9 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, any Non-Code Party)

If implemented this Proposal will require the OCM Market Operator (APX Gas Ltd) to support certain elements;

- The provision of certain Physical Market Offer data.
- Provision of *indicative* volume weighted average prices during the Gas Deficit Emergency.

APX Gas Ltd has stated that the required changes to implement this Proposal can be achieved without the need for system changes and therefore, do not anticipate any development or capital cost implications.

APX Gas Ltd has indicated that the provision of Physical Market Offer data (as outlined within this Proposal) to National Grid NTS/Transporter Agent will require a 1 month consultation with its Members to discuss an amendment to their OCM Market Rules. APX Gas Ltd has indicated that it does not expect any significant issues arising from this consultation.

10 Consequences on the legislative and regulatory obligations and contractual relationships of the Transporters

We note that this Proposal, if implemented, does not require any material changes to the NEC Safety Case nor, impinge on Users' safety obligations to comply with their Licence / GSMR (NEC instructions) in the event of a Network Gas Supply Emergency.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal not otherwise identified in paragraphs 2 to 10 above

Advantages

- The prevailing emergency cashout prices remain unchanged – frozen at Stage 2.
- Addresses those expressed concerns of, and improves, the clarity and definition of the UNC post-emergency arrangements.
- May encourage additional non-UKCS gas supplies and/or promote further self-

interruption of demand to be delivered to the Total System during a Gas Deficit Emergency. Provides Users with greater confidence that they will receive payment, which appropriately reflects the cost of such gas.

- Where appropriate, enables Users to recover their costs of providing additional supplies/self-interruption of demand with a linkage to a transparent 'market value', for example, price referenced to an adjacent European gas market.

- Enhances the existing incentives for Users to put in place commercial arrangements that might address a deficit imbalance prior to, and during, a Gas Deficit Emergency.

- Utilisation of the OCM as a 'bulletin board' in this manner will provide greater market transparency and price discovery as Users are able to assess their potential exposure to costs prior to any post-emergency claims being submitted.

- May increase the likelihood that a User, with its additional gas registered as a Physical Market Offer during a Gas Deficit Emergency, has the offer accepted and cleared through the normal APX Gas Ltd processes – rather than have the offer progressed as a post-emergency claim through Energy Balancing Neutrality.

- 'Ring-fences any costs that might arise as a consequence of a Gas Deficit Emergency.

- Spreads the risks associated with credit issues across the 'normal' daily cashout mechanism (frozen cashout prices at Stage 2) and the revised post-emergency claims arrangements (Energy Balancing Neutrality up to four months after a Gas Deficit Emergency has occurred).

- Enables the Energy Balancing Credit Management to better monitor and manage credit/security provisions during a Gas Deficit Emergency.

- No changes are required to the NEC Safety Case, nor does this Proposal impinge on the Users' ability to comply with their safety obligations (Shipper Licence/GSMR (NEC Instructions)).

Disadvantages

- The initial cost-targeting of post-emergency claims against Users who may not be in control of events might be deemed punitive.

- Utilisation of the OCM Physical Market during a Gas Deficit Emergency in this manner may be viewed by some Users as unduly discriminatory against those not subscribed to the APX system or who have no ability to register physical renominations.

12 Summary of representations received as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)

None yet received

13 Detail of all other representations received and considered by the Proposer

None yet received

14 Any other matter the Proposer considers needs to be addressed

None

15 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal

- Draft Proposal to 6th August 2009 UNC Modification Panel (extraordinary) - recommend to consultation
- Final Mod report to 17th September Modification Panel
- Ofgem decision September/October 2009
- Implementation October 2009

16 Comments on Suggested Text

17 Suggested Text

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document Section Q 4.2. and Section S 2.4

Section(s)

Proposer's Representative

Claire Thorneywork - National Grid NTS

Proposer

Steve Pownall - National Grid NTS

Appendices

Appendix 1 – Cashflows and over-recovery / under-recovery examples

Appendix 2 – '1 kWh' deficit imbalance - example

Appendix 3 – Nominations interactions - examples

Appendix 4 – Proposed Business Rules

Appendix 5 – Economic Price Assessment Trigger – example

Appendix 6 – Identification of New Elements (UNC Section Q.4.2.6)