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Dear Bob,

Modification Proposals
0310 'RG0252 Proposal 13: Removal of DNO Users from UNC TPD V3.3.4' raised by Scotia
0311 'RG0252 Proposal 13a: Removal of DNOs as Users from UNC TPD V3 and V4' raised by Wales and the West

Thank you for your invitation seeking representations with respect to the above Modification Proposals. This response is on behalf of National Grid Transmission.

National Grid Transmission offers modification proposal 0310 qualified support, however it does not support 0311, for the reasons outlined in this response.

UNC Modification Proposal 0310 raised by Scotia will if implemented remove Distribution Network Operators (DNOs) from the requirements of V3.3.4 (our understanding is that the proposal intends that Shipper Users will still be subject to this clause), and we agree with the proposer that in this regard the Shipper Community are not at financial risk from a DNO default. This view is provided on the basis of our understanding of the Energy Act Administration Arrangements, which we believe provides sufficient assurance that the industry would not be left with outstanding debt with regards to future dated exit capacity bookings as the result of a default DNO.

However, we only offer qualified support to the concept of the removal of the requirement for the DNOs to securitise 12 months of NTS Exit Capacity charges, as although the removal of DNOs from V3.3.4 only appears to be a sensible proposal, it does create a situation where National Grid Transmission has different credit requirements for Shippers and DNO's and as such the Proposal creates the potential for discrimination between these Users.

Although UNC Modification Proposal 0311 has been raised by Wales and the West Utilities as a Proposal in its own right, it is accepted as being an alternative to 0310. UNC Modification Proposal 0311 goes beyond 0310 by also removing the DNO's requirements to put credit in place to cover any outstanding invoices. National Grid NTS believes that the current credit securitisation requirements outlined in V3 and V4 should remain in place so that any outstanding invoices are appropriately covered. As part of 0311 a number of points were raised by the Proposer in support of the Proposal and our response to these elements is as follows;

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Removal of independent Distribution Networks securitisation requirement

The Wales & West Utilities (W&W) Proposal 0311, will remove DNOs as Users from UNC TPD V3 and V4. This means that the DNOs will not be required to provide credit cover for the 12 months of NTS Exit Capacity charges as per V3.3.4 and for circa 51 days of NTS Exit Capacity charges and pension charges.

As stated earlier National Grid Transmission believes that the Energy Act Administration Arrangements provide some assurance with regards to future dated long term exit capacity commitments, as these arrangements act as a "DNO of last resort" mechanism and as such any incoming DNO would be committed to pay for the NTS exit capacity booked by the original DNO from that point in time.

However, it is our view that the Energy Act Administration Arrangements would not provide any assurance with regards to any outstanding invoices (for exit capacity already utilised and pension charges) relating to the period that the original DNO experienced difficulties. These outstanding invoices could become classed as a bad debt to National Grid Transmission and may ultimately be passed onto Shippers and their customers. We appreciate that pass through of such bad debt is subject to National Grid Transmission meeting both the criteria as set out in section 4 of the Best Practice Guidelines for gas and electricity network operator credit cover (2005) and gaining Ofgem approval.

National Grid Transmission believes that the current credit securitisation requirements should remain in place for the circa 51 days of NTS Exit Capacity charges and pension charges, to maintain the ethos of 'responsible credit' and to help mitigate the risk of the outstanding invoiced amounts being passed onto the Shipper Community and ultimately end consumers. We also believe that the current credit arrangements being applied are consistent with the best practice guidelines.

Treatment of the independent Distribution Networks differently to National Grid Distribution

In their Proposal W&W states that they believe that the removal of the requirement for DNOs to securitise against DN Pension and Exit charges are justified due to the perceived inconsistencies in respect of securitisation between National Grid Transmission and the different DNOs.

National Grid Transmission and National Grid Distribution are one legal entity (National Grid Gas Plc) for credit purposes and therefore it is not possible for National Grid Distribution to provide security to National Grid Transmission. Any externally perceived difference in the treatment of the credit provisions between DNO Users are as a result of this position and not as a result of National Grid Transmission choosing to treat National Grid Distribution differently to the other DNOs.

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Removal of unworkable DN Termination facility in UNC V4

W&W state that Proposal 0311 will lead to the removal of the unworkable DN Termination facility in UNC section V4. Although little information is provided in the Proposal to support this statement, National Grid Transmission remains of the view that a DNO, as a User, can be terminated from the UNC, in the same way that a Shipper User can be, if they breach the credit arrangements as specified in Section V. Although National Grid Transmission recognises that a "DNO of last resort" is likely to take over the terminated DNO's activities this may still occur as a result of the original DNO being terminated.

Removal of unintended credit consequences of Modifications 0116, 0127, 0195AV

The Wales & West Utilities' (W&W) Proposal 0311 states the implementation of Proposal 0195AV 'introduction of Enduring NTS Exit Capacity Arrangements' built largely on aspects of Modification Proposal 0116. The Proposer believes the subsequent implementation of 0195AV carried forward the unintended consequences of implementing Proposal 0127 (after 0116 and before 0195AV), which introduced DNOs as a User. This chain of events has resulted in all Users, including DNO Users, being required to pay NTS Exit charges and also required them to provide the necessary security to National Grid NTS. The Proposer believes these consequences were never intended and therefore should be removed. National Grid Transmission disagrees with this statement; we believe the exit capacity credit regime introduced by 0195AV was intended to mirror the existing credit arrangements for entry capacity, which applies to <u>all parties</u> in an equitable manner.

It should also be noted that the Decision letter relating to 0195AV advocated that robust Credit arrangements must accompany and underpin the 4 year User Commitment applicable when applying for incremental Exit Capacity. DNO's are no different to other Users in this respect, as their incremental Capacity requests will trigger the same level of investment as a similar Shipper request. Whilst both 0310 and 0311 could be viewed as weakening this User commitment, for the reasons set out above, we believe 0310's effect is mitigated by the Energy Act Administration Arrangements. The effect of 0311 however has no such mitigation and as such we believe this proposal is at odds with the principle of the User Commitment promoted by 0116V and 0195AV.

Removes potential increased security cost pass through to Shippers

The Proposer of 0311states that they believe their maximum unsecured value for credit will be significantly lower than required and therefore lead to Shippers having to provide higher levels of security to DNOs. The analysis carried out by National Grid Transmission suggests that the requirement to provide credit cover for the circa 51 days of NTS Exit Capacity charges and pension charges (excluding the 12 months exit capacity charges) would be met by DNOs via Unsecured Credit [1] (assuming they maintain the credit rating as per their licence) and therefore we do not believe that they will incur additional costs as a result of the existing arrangements.

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[1] Unsecured credit is a proportion of the Maximum Unsecured Credit Limit extended to a User by the transporter as calculated in accordance with the table set out in Section V paragraph 3.1.3 or 3.1.4 as appropriate. Users with an approved credit rating from Standard and Poor's or Moody's of BB- or above will be provided with an unsecured credit limit of between 15% and 100% of the Maximum Unsecured Credit Limit (2% of the relevant transporters Regulatory Asset Value).

In summary National Grid Transmission, offers qualified support for modification proposal 0310, however does not support 0311, for the reasons outlined above.

Please let me know if you require any further information to enable preparation of the Final Modification Report.

Yours sincerely

Beverley Viney