Modification Report
To Enhance Section X of the UNC Transportation Principal Document to improve the Energy Balancing Further Security Process
Modification Reference Number 0315
Version 2.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

Background

The Energy Balancing Credit Committee (EBCC) keeps under constant review the credit arrangements in Section X of the UNC Transportation Principal Document. It has identified a weakness in the existing rules in respect of Further Security Requests. Further Security Requests are raised following a number of breaches of a User's Secured Credit Limit.

Modification 629 implemented 14th May 2003 introduced provision to the UNC in respect of Further Security Requests, its primary aim being to encourage Users to maintain the appropriate level of Security to cover its Energy Balancing activities. Following operation of these provisions since this time, analysis of the number of instances of such requests has evidenced an issue in respect of repeated failures. Some Users have received a number of Further Security Requests within a short period of time demonstrating that insufficient Security is held.

The rules currently do not prevent a User from simply 'topping up' their Security to meet their short term requirements. This means that where a User is running a persistent imbalance the Energy Balancing Rules do not act as adequate incentive to ensure that the User maintains the appropriate level of Security to accommodate the level of their Energy Balancing activities and avoid repeated Cash Calls and Further Security Requests.

The EBCC considered various solutions to this problem. On the 23rd October 2009 the EBCC met and agreed this proposed solution as the most appropriate. Corona Energy agreed to adopt the proposal and raise it as a UNC modification.

The proposal aims to extend the provisions of Section X2.10 to make provision for the utilised value (Cash Call Limit) of the User's existing Security held to be scaled back by a percentage, initially proposed to be 20%, to act as an incentive to break the cycle of repeated failure through the Cash Call and resulting Further Security Request process. Further it aims to incentivise the User to maintain the correct level of Security to accommodate the level of its Energy Balancing activities.

It is further proposed that the provisions of Section X2.4 and X2.2 be amended to provide for the relationship between the User's Cash Call Limit and Secured Credit Limit to be revised to facilitate such scale back.

The EBCC credit experts discussed various levels of scale back that could be implemented. There was unanimous agreement that a level of 20% was the most appropriate as it was believed to be a sufficient incentive without being punitive. It was also recognised however that this level would require monitoring and could require changing in the future if evidence suggested the level was set too high or too low.

The Proposal

The current provisions require the User to maintain Security at the peak level of indebtedness for a period of no less than 90 Days from the date of any FSR issued (providing that conditions of UNC Section 2.3.5 have been met). It is proposed to extend the provisions in Section X2.10 so that the utilised value (User's Cash Call Limit) of the User's Security will be scaled back by a percentage (initially to be set at 20%) as soon as is reasonably practicable following the 3rd FSR within the 28 day measurement period. The resulting revised Cash Call Limit will remain in place for a minimum period of 12 months (re-basing period)

Any 3rd FSR in a new '28 day measurement period' that takes place within the duration of the 're-basing period' will trigger a further percentage reduction (again initially proposed to be 20%) in the User's Cash Call Limit and a new re-basing period' will commence.

Once any re-basing period' has expired and the User has not had any further FSRs, a subsequent Cash Call will commence a new '28 day measurement period'.

Once any re-basing period' finishes, without any further re-basing periods' being triggered, any Security held may be returned at the User's request providing that conditions of UNC Section x2.3.5 have been met and the User's Cash Call Limit is revised accordingly.

The Proposer believes that this proposed change draws on the learning from Transportation Credit Arrangements where similar actions are taken in accordance with V 3.3.2 where a User fails to comply with a request for increased Security within a defined period of time.

In order to facilitate the scale back it is further proposed that the provisions of section X2.4 and X2.2 be amended to provide for the relationship between the User's Cash Call Limit and Secured Credit Limit to be revised.

The simple example in the table below aims to demonstrate how this would operate in practice by using £100 as the value of Security provided by the User.

Users Security	Cash Call Limit	Proposed Scale Back	Revised Cash Call Limt
£100	£85 i.e 85% in accordance with prevailing rules x 2.4	20%	£68
£100	£68	20%	£54.40
£100	£54.40	20%	£43.52
£100	£43.52	20%	£34.82
£100	£34.82	20%	£27.86

NB: Please note a more detailed example has been attached that shows the effect of implementation of this modification where a User is running a persistent imbalance on its inputs and outputs and this results in repeated Cash Calls and FSR's. (Appendix 1 V2)

For the avoidance of doubt, this proposal does not affect the Users right to appeal a FSR or Cash Call via existing processes, but introduces a new right of appeal to challenge the calculation of the revised Cash Call Limit. Further it should be noted that this proposal does not affect National Grid NTS's ability to consult the EBCC in relation to any function required under section X of the code in the event that a User is unable to satisfy the requirements of the revised processes proposed.

Suggested Text

Section 2.10.13 Further Security Request

In the event where a User is issued a 3rd Further Security Request within the 28 day measurement period, the User's prevailing Cash Call Limit shall be scaled back by a percentage determined in accordance with the Energy Balancing Credit Rules. A notice in a form set out in the Energy Balancing Credit Rules advising the User of the revised Cash Call Limit will be issued to the User as soon as reasonably practicable following such event, such revised Cash Call Limit shall remain in force for a period of not less than 12 months (re-basing period) from the issue date of the notice.

2.10.14 Where the User considers that the revised Cash Call Limit has been calculated erroneously the User may not later than 12:00 Hours on the Business day following issue of the notice appeal such notice specifying in as much detail as is possible the User's reasons for so considering.

2.10.15 In the absence of an appeal considered in X2.10.14 in the event of any subsequent issue of a Further Security Request during the re-basing period the User's Cash Call Limit will again be reduced by a further percentage as determined in the Energy Balancing Credit Rules and a new re-basing period will commence following the issue of a relevant notice

Section 2.4.1

For each User the Cash Call Limit is the amount determined by National Grid NTS in accordance with the prevailing provisions of the Energy Balancing Credit Rules and section X2.13 not exceeding 85% of the User's Secured Credit Limit, elected by or assigned to the User in accordance with this paragraph 2.4 as the limit on its Outstanding Relevant Balancing Indebtedness.

Section X2.2.3 The amount referred to in paragraph 2.2.2 is the amount for the time being of the Security the User has provided unless the provisions of X2.10 have been applied.

2 User Pays

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

There are no additional xoserve operating costs associated with this Modification proposal as provisions for charging is within the Agency Service Agreement. Were any costs to be identified then it is proposed that this modification should not be user pays as it relates to a service that is provided under the GT's licence and is therefore a core service.

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

Under prevailing Energy Balancing Arrangements it is believed that the cost associated for the recovery, provisions are within the Agency Service Agreement. Were this not to be the case then it is proposed that the costs of this modification should be borne initially by the GT and recovered through the neutrality smear in line with other costs that relate to Energy Balancing credit such as credit checking such as banking charges.

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 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 sub-paragraph (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 sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

We believe that this change will enhance the Gas Transporter's compliance with Standard Special Condition A15 "Agency".

Section 3 states that where these services are provided by a common service provider the contract with this agent shall be based on the following principles

(i) "such services and systems shall be established, operated and developed on an economic and efficient basis."

This change will have little or no cost impact but will improve the performance of the process by minimizing the financial risk to other code Users of another User defaulting. This change therefore improves the economy of the process.

National Grid NTS agrees that under the prevailing arrangements that require them, acting on behalf of the community, to repeatedly issue Cash Call Notices and Further Security Requests is inefficient and not economic, therefore they would agree that introducing a mechanism which may reduce the level of notices and requests being issued could represent an improvement in respect of Standard Condition A11.1 (c).

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;

(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 of this Modification would (in comparison to the existing process) affect a User who is repeatedly cash called within a 28 day measurement period and therefore receives 3 or more Further Security Requests. This User would either be required to provide a greater level of Security or would fall below their Cash Call Limit and would be referred to the EBCC to solve their credit issues (see example in Appendix 1 v2).

Either of these outcomes would reduce the risk to other code Users of the failure of a single code User. This minimises the financial risk to Users and therefore reduces the costs of being active in the gas shipping market.

The EBCC believes however that Users would be aware of the rules and upon receipt of a second FSR, would provide sufficient Security rather than risk a 20% reduction in the utilised value of their security (Cash Call Limit). This change would therefore act as an incentive against the 'topping up' behaviour previously described.

E.ON UK considers promoting a reasonable and prudent approach by Shippers to managing their energy balancing credit position, the impact of this Modification Proposal should be to enhance market confidence that the risk of Shipper default (and the potential industry liabilities) is being managed effectively. This should promote confidence in the market, improving investor confidence and the willingness of parties to enter the market, thereby securing effective competition between Shippers.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (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 sub-paragraphs (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.

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

The implementation of this proposal should not have any affect on security of supply, operation of the Total System or industry fragmentation.

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

a) Implications for operation of the System:

No implications have been identified.

b) Development and capital cost and operating cost implications:

No costs 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 have been identified. However where any additional costs are identified will be added as a new element to the Balancing Neutrality mechanism based upon additional FTE required to maintain process.

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

No consequences identified.

6 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 requirements have been identified.

7 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 requirements have been identified.

8 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)

No adverse administrative and operational implications identified. However, this will be monitored regularly if implemented and discussed at the EBCC meeting.

Development and capital cost and operating cost implications

No development costs identified.

Consequence for the level of contractual risk of Users

This proposal would reduce User's contractual risk as it will reduce the risk of Users defaulting on an unsecured debt.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers,

producers and, any Non Code Party

Implication identified would be on Users to provide additional Security where the trigger has been met.

10 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 implications identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Users will be encouraged to provide adequate Security at all times.
- Will maintain Users confidence that risk of default is being managed effectively.

Disadvantages

- Adds a level of complexity to the arrangements.

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

Organisation	Representation
British Gas Trading	Supports
Corona Energy	Supports
EDF Energy	Supports
E.ON UK	Supports
First Utility	Not in support
National Grid NTS	Offered comments
RWE Npower	Supports
ScottishPower	Supports
Spark Energy	Offered comments
SSE	Supports

In summary, of the 10 representations received, 7 support, 2 offered comments and 1 opposed the modification proposal.

British Gas considers Modification Proposal 0315 is measured in its approach. It places an incentive upon shippers to remain cognisant of their energy balancing securitisation levels relative to their day to day energy trading position; to anticipate reasonable longer term securitisation requirements; and to top up and maintain their securitisation at the required level. In doing so, British Gas considers implementation of 0315 will help to prevent behaviours which, as far as they are aware, were unintended when the current rules were implemented, and thereby help to limit the exposure of the shipping community in the event of a shipping business failing.

British Gas agrees that requiring the appropriate level of securitisation to be in place in the longer term, reinforces the established "polluter pays" principle in relation to energy balancing. This directly affects competition between shippers, in that it will limit the likelihood of larger unsecured energy balancing debt smears in the event of a shipper business failing. It should also be remembered that the same smaller players who may struggle to produce acceptable security will themselves be subject to their share of an energy balancing smear in the event of a shipper failure, and this, if extensive, could destabilise or even jeopardise their business.

Corona Energy agrees that the threat of Ofgem action could be an incentive for good behaviour; it believes this strengthens the case for this proposal. The Shipper concerned would have already demonstrated by persisting in its behaviour after two previous FSRs, that it was unconcerned of the risk of the loss of its licence. This proposal represents a proportionate solution to the issues involved and that it will incentivise Shippers to provide and retain sufficient security.

E.ON UK concludes previous Shipper failures leading to termination under the UNC suggest that there is no pattern to the nature or type of Shippers involved. What is established is that there is a proven risk in the event of a Shipper's failure for very significant energy imbalance charges to be accrued, which must be recovered from all physical Shippers.

E.ON UK does not expect this proposal, if implemented, to have any day-to-day operational impact for the vast majority of Shippers. They expect the Transporter's agent to work with Shippers who may be approaching their third FSR in 28 days to encourage them to post additional credit voluntarily before the utilised value (Cash Call Limit) of the User's existing Security held is scaled back. Noting that the EBCC is also expected to be consulted and kept up to date where appropriate, which provides additional safeguards that actions taken by the Transporter's agent are in the best interests of the whole energy balancing community.

First Utility is concerned that small suppliers without an Approved or Independent Credit Rating are required to post cash, rather than being able to provide a Parent Company Guarantee or Letter of Credit as large suppliers are able to do and places them at an immediate disadvantage in this respect. They are concerned that implementation of this Modification could potentially create a vicious circle whereby a small supplier with no option other than to post cash is then required to post even more cash as a result of this Modification. This would then reduce the funds available to that supplier for operational day to day running of the business which may then cause further difficulties.

First Utility would also like to make the point that small suppliers are often exposed to imbalance due to the difficulty of acquiring non standard clip sizes in the market, as well as the difficulty in trading short term due to counterparty credit requirements. In instances where small suppliers are able to find a counterparty, which will assist them in hedging their risk, they are once again required to post cash in order to be able to do this.

First Utility is concerned that in the event that a small supplier were to become insolvent, the resulting reallocation of imbalance costs across the sector would be negligible. They therefore feel that the effect of this Modification upon small suppliers would be disproportionate to the risk to the rest of the market of their insolvency and might even hasten that insolvency in certain circumstances. Overall, First Utility considers the implementation of this Modification to be a barrier to entry, which could seriously affect small suppliers' ability to compete in the UK market.

National Grid NTS are mindful that whilst the Proposal seeks to introduce an incentive, which encourages a User to put in place sufficient security to cover its energy balancing activity, the Proposal cannot guarantee a User will behave in this manner. They note that if the changes fail to incentivise Users' putting in place appropriate levels of security there may be a risk that the proposed changes introduce greater complexity, and potentially introduce costs, in the absence of any positive benefit through reduction in the amount of administration National Grid NTS is required to undertake as part of Energy Balancing Credit management.

RWE npower considers the Proposal would reduce the risk to Users if a User were to persistently run an imbalance. There is the potential in energy balancing for significant debts to accrue quickly, which needs to be dealt with efficiently and effectively to ensure that a large bad debt is not passed through to all Users. By obtaining 3 Further Security Requests within a 28 day period, gives a User an appropriate amount of time to respond and increase their cover. A 12 month re-basing period also seems appropriate such that it will give other Shippers the security that the industry is better protected against other Users' debts.

Spark Gas Shipping is concerned that it would have been significantly affected by these proposed new rules if these had been in operation earlier. Adding as a small supplier and a new entrant into the energy supply market, Spark Energy does not have access to Parent Company Guarantees or Letters of Credit. Large suppliers do have access to these forms of security and Spark is therefore at an immediate competitive disadvantage, as all their security requirements must be covered by cash.

Spark Gas Shipping considers restricted cashflow is probably the most important factor affecting the success or otherwise of a new company. Having cash tied up in security cover means they have less cash to allocate to other issues which could improve the efficiency, stability and growth of their business.

Spark Gas Shipping explains the new rules state that any extra security required after a third Further Security Request must be held by xoserve for a minimum of 12 months. It appears to be grossly unfair that xoserve would retain a large amount of cash for a further year when future imbalance indebtedness bears no resemblance to past indebtedness. The provision of cash as security imposes an extra cost on small suppliers, which they are not able to pass through to customers.

SSE considers the UNC does not prevent a User from simply "topping up" their Security to meet their short-term requirements. This means that where a User is running a persistent imbalance the Energy Balancing Rules do not act as adequate incentive to ensure that the User maintains the appropriate level of Security to accommodate the level of their Energy Balancing activities and avoid repeated Cash Calls and Further Security Requests.

13 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.

14 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.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing the Modification Proposal.

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

It is recommended that this proposal be implemented immediately following agreement by Authority.

17 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.

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

At the Modification Panel meeting held on 18 November 2010, of the 10 Voting Members present, capable of casting 11 votes, 4 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel did not recommend implementation of this Proposal.

Members considered the report was in the correct form and discussed whether or not to recommend implementation of the Proposal. They did not determine that new issues had been raised that justified seeking further views from a Workstream or Development Work Group, with no votes cast in favour.

Members agreed that the Proposal sought to tighten the credit requirements when repeated cash calls are issued. This could be seen as introducing more appropriate credit arrangements that would reduce risk and so facilitate competition. However, it could also be argued that this is a step too far and that it will deter entry and not further competition. In particular, it had been argued that implementation would be more likely to disadvantage smaller players.

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal not to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

20 Text

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters