Modification Report
The Introduction of a Balancing Neutrality Adjustment Charge for Cost Recovery Associated with Rating Services
Modification Reference Number 0336

Version 3.0

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

National Grid NTS has raised this Proposal on behalf of the Energy Balancing Credit Committee.

In light of the unprecedented events in financial markets and the failure of Lehman Brothers Commodity Services Inc (in September 2008), the Energy Balancing Credit Committee (EBCC) has carried out a review of both the Energy Balancing Credit Rules (EBCR) and the Uniform Network Code Section X - Energy Balancing Credit Management. This review identified potential areas where, through the effective management of energy balancing credit, controls could be further enhanced in order to minimise Users' exposure to avoidable financial loss.

During these reviews the Energy Balancing Credit Committee (EBCC) expressed concerns associated with the increased occurrence of downgrading in ratings of Financial Institutions, which provide security to Users for energy balancing purposes. Since 2008 over 60% of the Financial Institutions, currently providing security, have been downgraded.

During the EBCC meeting (10 October 2008) members of the EBCC discussed ways through which the risks associated with the downgrading of company ratings may be mitigated. It was suggested that there was merit in exploring the procurement of credit risk information services provided by Credit Rating Analytic Services from third parties. These services provide a daily status report of all company ratings. The Energy Balancing Credit Manager advised that the provision of such information introduced significant improvement in:

- accuracy associated with the daily monitoring of company ratings; and
- streamlining the risk management processes; and
- cutting down the number of man hours required to carryout monitoring processes, which had been introduced in response to the dramatic changes in the economic climate following the failure of Lehman Brothers Commodity Services Inc

During the EBCC meeting 20th March 2009 members were advised of National Grid NTS Agent's intention to procure a subscription to the credit risk information services provided by Moody's and Standard and Poors services. Furthermore it was bought to the attention of the EBCC that as these subscriptions represented the procurement of new services National Grid NTS had not made any provision for, and therefore does not have funding for such services within its agreed Price Control.

© all rights reserved

The EBCC recognised that under the prevailing financial climate such a service was necessary as a matter of urgency and therefore agreed that the cost of such services should be recovered through the neutrality process, as the risk associated with the downgrading of company ratings is a risk borne by Users through the neutrality process.

At the meeting on 20th March 2009, EBCC Members agreed that the UNC Proposal would be required to be financed from Energy Balancing Neutrality. Members were also advised of the annual costs for the two subscriptions. No objection was raised.

As a consequence of the views expressed by the EBCC National Grid NTS has raised this Modification Proposal, which seeks to fund subscription costs, associated with services provided by Credit Rating Analytic Services from third parties, through Energy Balancing Neutrality. This Proposal seeks to introduce UNC provisions, which facilitates the recovery of associated costs through Energy Balancing Neutrality.

The EBCC considered that this may ensure an efficient and robust method of monitoring the ratings on a daily basis. Additionally it noted that this may better align company rating assessment processes with the Energy Balancing Credit Rules.

If this Modification Proposal is not implemented, National Grid NTS's Agent will be unable to recover costs incurred for the provision of adequate risk assessment on behalf of the community. It is proposed that the costs associated with providing a robust risk monitoring and assessment process should be borne by all active Users, given the nature of the Risk Management role xoserve performs and the benefit it provides to the community as a whole.

Suggested Text

Amend paragraph 4.5.3(a) to read;

'(viii) The amount of any cost incurred by the National Grid NTS Agent for the procurement of credit risk information services provided by Moody's and Standard and Poors.'

2 User Pays

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

This Proposal seeks to fund subscription costs, associated with the procurement of third party Credit Rating Analytic Services, through Energy Balancing Neutrality. The utilisation of such ratings services represents a change to xoserve services, and therefore must be considered under the User Pays remit. However, since no User Pays Service is to be created, this is not classified as a User Pays Proposal.

xoserve have already initiated the process changes required to facilitate the provision of the rating services, as such there are no additional xoserve operating costs associated with the implementation of this Proposal.

© all rights reserved

Costs for the procurement of the ratings services will be recovered through existing balancing neutrality functionality.

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

Prevailing Energy Balancing arrangements - 100% Shipper Users in proportion to their system throughput.

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

Cost for the services will be recovered as an Adjustment Neutrality Amount in accordance with UNC Section F4.5.

Whilst agreeing that the risk is borne through the neutrality process and this route may be the most appropriate route through which to recover costs, RWE npower was of the view that Users should not always be called upon to absorb costs and there may be circumstances under which it would seem more appropriate that these are not passed on to Users.

EDF Energy questioned whether there might be a decrease in xoserve's operating costs in relation to having this additional analytical service to assist it in more accurately gauging a party's creditworthiness, in which case an associated decrease in any User Pays costs might be expected.

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

The service costs for the procurement of the Ratings Services are approximately £40K per annum. No ACS change is required in respect of this Proposal.

3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): ***the coordinated, 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 (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;***

© all rights reserved

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

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;***

There would be no adverse impact on competition.

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 (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) 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.***

Ensuring National Grid NTS can recover properly incurred costs would represent efficient implementation and administration of the UNC.

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

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

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

a) implications for operation of the System:

There are no implications for operation of the System.

b) development and capital cost and operating cost implications:

The prevailing costs of providing the rating alert services by the required companies are £40,000 pa, based on recent quotations. Moody's £28,218 pa, Standard & Poor's $16,700 pa for 2 years.

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

© all rights reserved

It is proposed to pass though the costs of the Service contracts required to effectively manage Financial Institutions risks assessment to Users by adding a new element to the balancing neutrality finance adjustment such that the prevailing annual costs of procuring the service are allocated to all Users, in proportion to the User's throughput.

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

No consequences have been 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 consequence is anticipated.

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 changes to systems would be required as a result of implementation of this Proposal.

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)

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

Development and capital cost and operating cost implications

No implications have been identified.

Consequence for the level of contractual risk of Users

No consequences have been identified.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No implications have been identified.

© all rights reserved

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 consequences have been identified.

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

Advantages

- Allows recovery of properly incurred costs
- Allows closer and more up-to-date scrutiny of User's creditworthiness
- Reduces financial exposure faced by the industry from a defaulting User

Disadvantages

- An additional cost for Users to bear – ongoing but not a substantive material cost, which is mitigated by the benefits of the service

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

Representations were received from the following parties:

Organistaion	Position
British Gas	Conditional Support
EDF Energy	Supports
E.ON UK	Supports
First Utility	Supports
National Grid NTS	Supports
RWE npower	Supports
Scottish Power	Supports
SSE	Supports

In summary, of the 8 representations received, 7 supported implementation, and 1 offered conditional support of the Modification Proposal.

British Gas' reservation in respect of this proposal relates to comments suggesting

© all rights reserved

that a facility may already exist for National Grid, with Ofgem's approval, to recover the cost of the relevant service from shippers without the need for this modification. They would like reassurance that that avenue has been fully explored prior to this modification being implemented. Implementation of this proposal where another route already exists for cost recovery would, in their view, be detrimental to the efficient administration of the UNC.

EDF and E.ON express concern about the time taken to raise this proposal and the subsequent expenditure.

E.ON also express concern that the proposal does not accurately reflect all EBCC discussions. They believe National Grid NTS have not explored the option of approaching Ofgem to consider an adjustment under its licence to recover the costs incurred, which would have circumvented the need for this Modification Proposal. Before implementing this proposal, E.ON urge Ofgem to consider whether the licence route is more suitable than a Modification Proposal.

E.ON UK also note that it is unclear in this proposal how the 2009-10 costs will be dealt with and whether this proposal is seeking a retrospective adjustment through neutrality, or is only prospective.

RWE npower pointed out that the suggested legal text did not capture that the third parties that provide Credit Rating Analytic Services may be subject to change. It might be prudent at this point to make appropriate changes to the proposed text such that were any of the providers to change a subsequent Modification Proposal would not be required.

National Grid NTS advise that its final legal text will not refer to specific companies i.e. Moody's and Standard and Poors, but will instead be generic as suggested in the business rules i.e. "for the procurement of Credit Rating Analytic Services from third parties". National Grid NTS considers this to be more efficient as it will enable National Grid NTS Agent to procure these services from other third parties without having to raise a further Modification Proposal.

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

No such requirement has been identified.

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

No such requirement has been identified.

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

© all rights reserved

Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes)

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

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

The Panel considered Modification 0336 on 16 December 2010.

The Panel Chair summarised that the modification seeks to allow National Grid NTS' costs of acquiring credit rating services to be recovered from Users. The information is acquired to support energy balancing credit management, and the modification deals solely with funding, seeking to target costs on those who benefit from the services provided.

Some Members questioned whether modification of the UNC was necessary for these costs to be recovered, and suggested that it was inconsistent with efficient administration of the UNC to introduce a specific funding route when a generic route already exists. However, it was recognised that the possible inefficiency had been crystallised by the raising of the modification.

Nine Members voted in favour of recommending implementation, and one did not. Therefore the Panel determined to recommend implementation of Modification 0336.

Panel's view of the benefits of 0336 against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) 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.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition:	While the costs are not material,

© all rights reserved

(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.	targeting costs on those who benefit from the associated service is consistent with facilitating effective competition.
e) 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.	None
f) Promotion of efficiency in the implementation and administration of the Code	Ensuring National Grid NTS can recover properly incurred costs is consistent with facilitating efficient implementation and administration of the UNC.

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

20 Text

TPD, SECTION F - SYSTEM CLEARING, BALANCING CHARGES AND NEUTRALITY

Amend paragraph 4.5.3(a) to read as follows:

"(a) the sum of the following amounts:

(i) … ;

(ii) … ;

(iii) … ;

(iv) … ;

(v) … ;

(1) … ;

(2) … ;

(vi) … ~~.~~; ~~and~~

(vii……. and paid in month m~~.~~ and

© all rights reserved

(viii) the amount of any costs, expenses or other amounts payable by National Grid NTS for the provision of Credit Rating Analytic Services procured from third parties in accordance with Section X.2.2.6 (c).”

TPD, Section X – Energy Balancing Credit Management

Amend paragraph 2.2.6 to read as follows:

“2.2.6

(a) A User's Secured Credit Limit may also be revised, in accordance with the Energy Balancing Credit Rules, save where either paragraph 2.2.6(b) or (c) applies, on notice of not less than 30 Days (or any lesser period agreed by the User) to the User:

(i) at intervals of approximately 12 months;

(ii) where any published credit rating of a provider of security is revised downwards;

(iii) where (but without prejudice to any requirement of the Energy Balancing Credit Rules) any instrument of Security expires or is determined;

(iv) where at any time National Grid NTS has reasonable grounds to believe that the effect of the review will be to reduce the User’s Secured Credit Limit;

provided that nothing in this Section X shall require National Grid NTS to undertake a review under paragraph 2.2.6(a)(ii) or 2.2.6(a)(iii).

© all rights reserved

(b) Where any published credit rating of a provider of security is revised downwards to the extent that the said credit rating following such revision is less than the minimum prescribed credit rating as set out in the Energy Balancing Credit Rules, a User's Secured Credit Limit may be immediately reviewed and revised by National Grid NTS in accordance with the Energy Balancing Credit Rules, on notice to the User.

(c) For the purposes of assisting National Grid NTS in its the credit rating assessment process as outlined in the Energy Balancing Credit Rules, National Grid NTS will procure from third parties the provision of services which provide regular updates of company published credit ratings ("Credit Rating Analytic Services")."

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters

© all rights reserved