Joint Office of Gas Transporters

Stage 04: Final Modification Report

What stage is this document in the process?

01 Proposal

02 Workgroup Report

03 Draft Modification Report

04 Final Modification Report

0350:

Combining the NTS entry capacity and exit capacity credit checks

This modification seeks to combine the NTS entry capacity and exit capacity credit checks, which will subsequently remove a User's ability to allow their NTS Entry Capacity to lapse.

The Panel recommended that this modification should be implemented.

High Impact:
Entry Shippers, National Grid NTS

Medium Impact:
Insert name(s) of impact

Low Impact:
Insert name(s) of impact

About this document:

This document is a Final Modification Report, presented to the Panel on 21 April 2011. The Authority will consider the Panel's Recommendation and decide whether or not this change should be made.

Any questions?

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1 Summary

Why Change?

The UNC credit arrangements for Quarterly NTS entry capacity allow a User at a single Entry Point to keep deferring their long term entry capacity commitments indefinitely without incurring any penalty.

Combining the entry and exit capacity credit calculations in to one process would reduce the risk from a User default and simplify the credit arrangements, while also requiring some Users to post additional security.

Solution

Combine NTS entry and exit capacity credit checks

It is proposed that the process currently described in TPD Section V3.3.4 be amended to include amounts related to the relevant User's 12 months of NTS entry capacity as well as 12 months of NTS exit capacity to form a combined entry and exit capacity credit check.

For the avoidance of doubt the sanctions currently described in Section V3.3.2(c) will apply if a User does not provide the required security to meet the new combined credit arrangements that includes both their entry and exit capacity commitments.

Entry Capacity Credit Check

In addition to the above we propose to remove UNC TPD Section B 2.2.15 and B 2.2.16 as the purpose of these two sections is replaced by the above changes.

Removal of these sections will mean that an entry User will no longer be able to defer their registered quarterly NTS entry capacity and the relevant User will continue to be treated as holding the relevant NTS entry capacity, and will subsequently be invoiced for that capacity in the timeframe commensurate with the capacity concerned. Any failure by the User to pay the subsequent invoices will be treated in the same way as any other transportation related debt.

Clarify Legal Text

We believe that it is important that a User understands when a breach of the UNC can lead to termination under Section V3.3.3 and where the system capacity sanctions described in Section V3.3.2 only applies. To add further clarity to the legal text implemented by Modification Proposal 0261 it is proposed that the changes contained in Consent to Modify C037 be considered in the development of the legal text for this proposal.

Impacts & Costs

Some shippers will be required to provide additional credit/security (currently estimated at around £14.75m) to cover their total capacity commitment. It is estimated that the annual costs could be in the range of £0 to £1m.

While it is anticipated that the removal of the 12 month entry credit check will deliver a small administrative benefit to National Grid, EDF Energy believe the savings are not significant.

Implementation

It is proposed that this proposal is implemented on the 1st of the month following the calendar month after the Authority's decision to implement the proposal. i.e. if the direction to implement was received on 15th January 2011, then 1 calendar month after is 15th February and the 1st of the month following this would be 1st March. Therefore the implementation date in this example would be 1st March 2011.

This would allow time for the necessary changes to be made to the National Grid Transmission credit administration processes.

Please note that Users will not be required to provide any credit/security to cover their next 12 months of exit capacity until 1st October 2011 (12 months prior to the start of the new exit reform arrangements).

The Case for Change

The Advantages of the proposed change are

- Discourages speculative Quarterly NTS Entry Capacity auction bidding because Users would face the prospect of being terminated if sufficient credit is not provided and capacity subsequently paid for, as opposed to allowing capacity rights to lapse without penalty. Thus reducing the risk of inefficient system investment and minimising the need to recover revenue from other Users bidding for capacity at the same ASEP.
- Provides an incentive for Users to provide the appropriate level of security to cover existing and future entry and exit capacity commitments since they face the prospect of termination otherwise.
- Minor reduction in UNC Parties administrative burden of monitoring two separate credit arrangements.

Implementation would therefore better facilitate Relevant Objectives (a), (c) and (d).

2 Why Change?

For some time the industry have been evaluating the current UNC credit arrangements for Quarterly NTS entry capacity and in particular the issue where a User at a single Entry Point would effectively be able to keep deferring their long term entry capacity commitments indefinitely without incurring any penalty. The following provides the background to this issue and the associated industry developments, which have led to this proposed solution.

Entry Capacity Credit Arrangements

Following Review Group 0221, Modification Proposals 0246/0246A/0246B "quarterly NTS Entry Capacity User Commitment" were raised in May 2009 to address the issues identified by Review Group 0221. The Authority rejected these proposals on 3rd June 2010 as they considered that these proposals imposed an excessive burden of costs on shippers and introduced additional administrative complexity.

In the Authority's decision letter for 0246/0246A/0246B "Quarterly NTS Entry Capacity User Commitment" they agreed that the removal of the ability for shippers to defer their security commitments for booked quarterly system entry capacity would represent a significant improvement on the current arrangements and better facilitate the relevant objective set out in National Grid's gas transporters licence condition A11.1 (a). The Authority also highlighted that it has already approved a similar proposal with regards to exit capacity (0261 – see below) and without fettering its discretion, would welcome a similar proposal with respect to entry capacity.

Exit Capacity Credit Arrangements

Modification Proposal 0261 'Annual NTS Exit (Flat) Capacity Credit Arrangements was raised in July 2009 and implemented on 1 January 2010. This proposal removed TPD Section B3.2.7 and associated paragraphs to remove the ability for the User's Annual NTS Exit (Flat) Capacity to lapse.

In the Authority's decision letter (8 December 2009) they stated "UNC 261 will impose greater discipline on users when booking exit capacity such that they are more likely to book capacity levels that are actually required. This should reduce the risk of associated revenue being socialised and collected from the shipper community".

Consent to Modify C037 Revision to the legal text associated with the implementation of UNC Modification 0261: Annual NTS Exit (Flat) Capacity Credit Arrangements

In considering the legal text inserted into UNC as part of the implementation of 0261 it was noted that although the text implemented the changes proposed by 0261 it could benefit from further clarity. Consent to Modify C037 was raised on 1 March 2010 to address this but the Panel recommended that it would be better addressed by a Modification Proposal, as the Panel felt that there should be consultation on the text changes. Following this recommendation the consent to modify was subsequently rejected by the Authority on 18th March 2010.

0332 Removal of a Users ability to allow Quarterly NTS Entry Capacity to lapse

The current NTS entry capacity security provisions are set out in Section B2.2.15 of the UNC TPD and mean that National Grid NTS looks at the aggregated amount of the User's current Relevant Code Indebtedness and the following twelve months liability for capacity charges associated with quarterly NTS entry capacity, as acquired in the auctions for Quarterly NTS Entry Capacity (QSEC).

If the above aggregated amount exceeds 85% of the User's Code Credit Limit, then National Grid NTS will notify the User. The User can subsequently either increase its Code Credit Limit by providing additional security or be in the position where the User's registered quarterly NTS entry capacity for each of the relevant calendar quarters will lapse and the User will cease to be treated as holding the registered quarterly NTS entry capacity.

An illustration of the current UNC Code Credit limits and Code Credit Checks is attached as Annex 1.

National Grid NTS raised Modification Proposal 0332 in September 2010, to amend the aforementioned aspects of the current UNC credit requirements for Quarterly NTS Entry Capacity (QSEC) to no longer allow a User to defer their registered quarterly NTS entry capacity, when they have not provided the security required.

This Modification Proposal was subsequently referred by the September 2010 Modification Panel for development via the Transmission Workstream.   During the October Transmission Workstream discussions on 0332, National Grid NTS was asked to provide some analysis on the option of combining the Entry Capacity and Exit Capacity credit checks. This analysis highlighted 4 Shippers (9% of the 44 active entry shippers) would be required to provide an extra £14.75m credit/security if the two credit processes were combined.

It was the consensus of the Workstream that there was merit in addressing the new risk identified and therefore that the Modification Proposal should be amended to combine the entry capacity and exit capacity credit checks. It was recognised that the initial driver for 0332 (removal of a Users ability to allow Quarterly NTS entry capacity to lapse) would still be met as 0261 had already amended the exit capacity credit process to remove a User's ability to allow their capacity to lapse.

3 Solution

Combine NTS entry and exit capacity credit checks

It is proposed that the provisions currently described in V3.3.4 be amended to include 12 months of NTS entry capacity as well as 12 months of NTS exit capacity to form a combined entry and exit capacity credit check.

For the avoidance of doubt the sanctions currently described in Section V3.3.2 (c) will apply if a User does not provide the required security to meet both their entry and exit capacity commitments.

The following text change has been provided only to illustrate the intent of the proposal and could be subject to change in the preparation of the suggested legal text:

3.3.4 For the purposes of paragraph 3.3.2 (c) (i) and (iii) and the application of Section B3.3.3 (f), a User's Value at Risk shall be treated as including the aggregate NTS Exit (Flat) Capacity Charges and NTS Entry Capacity Charges payable by the User for each Day in the following twelve (12) calendar months commencing from the first Day of the calendar month following the Day in respect of which the User's Value at Risk is to be determined.

Entry Capacity Credit Check

We propose to remove the arrangements described in UNC TPD Section B 2.2.15 & B 2.2.16 as they are no longer required due to the above changes.

Removal of these sections will mean that an entry User will no longer be able to defer their registered quarterly NTS entry capacity. The relevant User will continue to be treated as holding the relevant NTS entry capacity, and will subsequently be invoiced for that capacity in the timeframe commensurate with the capacity concerned. Any failure by the User to pay the subsequent invoices will be treated in the same way as any other transportation related debt

Clarify Legal Text

We believe that it is important that a User understands when a breach of the UNC can lead to termination under Section V3.3.3 and where the system capacity sanctions described in Section V3.3.2 only applies.

As highlighted in Consent to Modify C037, the UNC text as it currently stands does not clearly explain that;

- The Value at Risk (VAR) definition (which is determined on the basis of invoiced amounts) is treated under V3.3.4 as also including the following 12 months of exit capacity charges, including those yet to be invoiced. This is consistent with the intent of Modification Proposal 0261.
- Where VAR is determined outside of the terms specified in V3.3.4 only invoiced amounts are included. This means that termination can only apply under V3.3.3 where the VAR of the User exceeds 100% of the User's Code Credit Limit in respect of "invoiced" amounts, whereas the system capacity under

V3.3.4 applies the 100% rule to "non-invoiced" VAR. This is consistent with the intent of Modification Proposal 0261.

To add further clarity to the legal text implemented by Modification Proposal 0261 it is proposed that V3.2.1 (d) and V3.3.4 be amended and it is proposed that the changes contained in C037 (see below) be considered in the development of the legal text for this proposal.

Amend paragraph V3.2.1 (d) to read as follows:
"(d) <u>Subject to paragraph 3.3.4,</u> **"Value at Risk"** at any point in time….."

Amend paragraph V3.3.4 to read as follows:
"3.3.4 For the purposes of paragraph 3.3.2(c) (i) and (iii) and the application of Section B3.3.3 (f), a User's Value at Risk shall be treated as including the <u>amounts of the</u> aggregate NTS Exit (Flat) Capacity Charges payable by the User for each Day in the following twelve (12) calendar months commencing from the first Day of the calendar month following the Day in respect of which the User's Value at Risk is to be determined, <u>irrespective of whether such amounts have been invoiced under Section S</u>".

4 Relevant Objectives

The Workgroup considered that implementation impact the achievement of **Relevant Objectives A11.1 (c), (d) and (f)**

The benefits 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.	This Proposal may discourage speculative auction bidding as the bidder would be aware of the tighter credit arrangements and sanctions that could be applied, thus reducing the risk of inefficient system investment and providing an incentive for Users to honour their NTS Entry Capacity auction commitments. It will therefore give National Grid NTS and the shipper community greater assurance over the appropriateness of any associated system investments and/or allowed revenue returns as the bidder will be required, to avoid termination, to pay for entry capacity allocated regardless of whether or not they utilise it.
d) 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 would reduce the risk of speculative bidding and so potentially reduce the level of Entry Capacity Commodity charges, which can impact Shippers disproportionately depending on their portfolio. Reducing uncertainty about commodity charges can also facilitate competition by not deterring entry. If the consequence is termination rather than capacity lapsing, it would be possible for another user to purchase and use the available long term entry capacity, facilitating development at that entry point in the interests of competition. The need to provide additional credit to cover total Entry and Exit Capacity commitments also reduces the risk of subsequent charges that may result from a User default. By introducing appropriate

	credit requirements, and potentially improving cost allocations between Shippers, implementation would be expected to facilitate 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.	
f) Promotion of efficiency in the implementation and administration of the Code	Having one credit process rather than two increases efficiency in the implementation and administration of the Code.

EDF Energy agree that implementation of this proposal will improve the efficient discharge of National Grid's relevant objectives and have a beneficial impact on competition amongst Users. However, they believe that the main benefit of this proposal is to reduce the exposure of Shippers to any defaulting party that has not lodged sufficient credit. This therefore reduces the risks faced by Shippers, and so potentially reduces a barrier to entry. EDF Energy disagree that the reduction of uncertainty in the TO Commodity charge will have an impact on competition. They believe any benefits from reducing the potential level of this charge is potentially overstated.

British Gas Trading believe that the greatest beneficiary is most likely to be competition between shippers. However, any uncertainty around commodity charges may act as a barrier to market entry. British Gas Trading also believe that the single credit process would appear to better facilitate the efficient administration of the UNC.

5 Impacts and Costs

Costs

Indicative industry costs – User Pays
Classification of the Proposal as User Pays or not and justification for classification
No User Pays service is proposed and hence this does not fall within the User Pays remit.
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
N/A
Proposed charge(s) for application of Users Pays charges to Shippers
N/A
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve
N/A

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	• None
Operational Processes	• None
User Pays implications	• N/A

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• If a User is required to provide additional security there may be additional costs. These are estimated at between £0 to £1m.
Development, capital and operating costs	• See above
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	• None
Development, capital and operating costs	• None
Recovery of costs	• N/A
Price regulation	• N/A
Contractual risks	• N/A
Legislative, regulatory and contractual obligations and relationships	• N/A
Standards of service	• N/A

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None
UNC Committees	• None
General administration	• None

Impact on Code	
Code section	Potential impact
Section V	Amend V3
Section B	Amendments to B2.2.15 & B2.2.16

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	None
Storage Connection Agreement (TPD R1.3.1)	None
UK Link Manual (TPD U1.4)	None
Network Code Operations Reporting Manual (TPD V12)	None
Network Code Validation Rules (TPD V12)	None

Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification **0565 Transco Proposal for Revision of Network Code Standards of Service** at the following location: http://www.gasgovernance.com/networkcodearchive/551-575/

Impact on UNC Related Documents and Other Referenced Documents	
ECQ Methodology (TPD V12)	None
Measurement Error Notification Guidelines (TPD V12)	None
Energy Balancing Credit Rules (TPD X2.1)	None
Uniform Network Code Standards of Service (Various)	None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	None
Gas Transporter Licence	None

Other Impacts	
Item impacted	Potential impact
Security of Supply	None
Operation of the Total System	None
Industry fragmentation	None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	None

6 Implementation

It is proposed that the proposal is implemented on the 1st of the month, 1 calendar month after the decision. i.e. if the direction to implement was received on 15th January, then 1 calendar month after is 15th February and the 1st would be 1st March, the implementation date in this example would be 1st March.
This would allow time for changes to necessary credit and credit administration processes.

EDF Energy believe it is important to note that the shorter the notice period that is made available to lodge additional credit, the greater the costs of lodging such credit. Therefore any decision on implementation needs to balance the benefits of reducing the industry's exposure against the greater costs that will be imposed on some Shippers. EDF Energy agree that implementation should take place on the 1st of the next month after agreement as per the proposer's suggestion.

National Grid NTS provide clarification that Users will only be required to provide credit/security to cover 12 months of exit capacity from 01 October 2011 (12 months prior to the start of the new exit capacity arrangements). They hope that the Authority decision will be made well in advance of this date ensuring that Users can be informed by National Grid NTS of their revised credit requirement (including the affect of combining the entry and exit capacity checks), allowing Users time to put sufficient credit in place.

7 The Case for Change

In addition to that identified above, the Workgroup has identified the following:

Advantages

The Advantages of the proposed change are

- Discourages speculative Quarterly NTS Entry Capacity auction bidding, thus reducing the risk of inefficient system investment and minimising by the need to recover revenue from other Users bidding for capacity at the same ASEP.
- Provides an incentive for Users to provide sufficient security to cover their entry capacity and exit capacity commitments for the following 12 months.
- Reduces UNC Parties administrative burden of monitoring two separate credit arrangements.

Disadvantages

Single ASEP Users would no longer have the benefit of allowing Registered Quarterly NTS Entry Capacity to lapse in the event that security is not put in place

8 Legal Text

Transportation Principal Document

Section V – GENERAL

Amend paragraph 3.2.1(d) to read as follows:

"(d) Subject to paragraph 3.3.4*, **"Value at Risk"** at any point in time….."*

Amend paragraph 3.3.4 to read as follows:

"3.3.4 For the purposes of paragraph 3.3.2(b)(i) and (iii) and the application of Section B3.3.3(f), a Users (excluding DNO Users) Value at Risk shall be treated as including:

(I) the amounts of the aggregate NTS Exit (Flat) Capacity Charges;

(II) the amounts of the aggregate NTS Entry Capacity Charges

payable by the User for each Day in the following twelve (12) calendar months commencing from the first Day of the calendar month following the Day in respect of which the User's Value at Risk is to be determined, irrespective of whether such amounts have been invoiced under Section S"

Section B – SYSTEM USE AND CAPACITY

Delete paragraphs 2.2.15 and 2.2.16.

9 Consultation Responses

Representations were received from the following parties:

Respondent	
Company/Organisation Name	Support Implementation or not?
British Gas Trading	Supports
EDF Energy	Supports
E.ON UK	Supports
National Grid NTS	Supports
RWE npower	Neutral
Scottish Power Energy	Supports
Total E&P	Supports

Of the seven representations received six parties offered support for implementation and one party provided a neutral response.

Summary Comments

EDF Energy believe it is not clear whether this modification will have retrospective implications or whether it just covers credit requirements going forward, and this could have implications for Shippers gaining entry capacity entitlement without being in a position to put up the necessary credit. Such Users would now be classed as a "User in Default" and would have lost their capacity entitlement. EDF Energy would welcome the proposer's and Ofgem's views on this specific issue.

Scottish Power Energy agree that combining these separate processes will reduce the risk of User default and will discourage speculative auction bidding, whilst at the same time providing an appropriate incentive for Users to maintain adequate security and simplifying the overall credit arrangements. However they are mindful that this may result in additional security cover being required from across some of the shipper community and believe that prior to implementation of the proposal it would be prudent to provide advance notice of any such additional commitment to any shippers so impacted.

E.ON UK believe the benefits of implementation are somewhat over-played by National Grid NTS. They believe the risk facing the Shipper community as a whole would be unchanged by this proposal; however they acknowledge that this proposal may reduce the likelihood or incidence of National Grid NTS having to recover charges from the generality of Users, rather than the User who booked the capacity in the first place.

RWE npower believe the risk to the wider community of underwriting the balance of any costs following termination remains and is only mitigated to the extent that National Grid can sell the entry capacity. They believe the ability to sell the complete strip of capacity rights rather than just quarterly rights is another benefit of this proposal. They believe strengthening the credit arrangements may provide an incentive on Users to bid actual requirements in auctions, potentially increasing the efficiency of auctions. RWE npower also believe that the modification provides a partial solution to the underlying issues that arise as a consequence of: 1) the revenue driver mechanism and entry capacity incentive framework within the NGG transporter licence; and 2) the absence of cost-reflective liabilities on users triggering incremental entry capacity.

10 Panel Discussions

The Panel Chair summarised that the modification seeks to combine the entry and exit capacity credit processes. This would include removing the ability to allow exit capacity to lapse, in line with the entry capacity process.

Members believed that having one credit process rather than two would be expected to increase efficiency in the implementation and administration of the Code.

Members also recognised that, since a potential consequence would be termination rather than capacity lapsing, it would be possible for another user to purchase and use the available long term exit capacity, facilitating development at that exit point in the interests of competition.

Members also recognised that implementation could reduce the risk of speculative bidding and so provide more reliable investment signals to National Grid NTS, which would be consistent with facilitating efficient discharge of the licensee's obligations. The avoidance of speculative bidding could also avoid commodity charges that arise to cover uncollected revenue arising from incentive schemes, and some Members believed could adversely impact competition.

Members also noted that some Users would need to provide additional security to cover total Entry and Exit Capacity commitments. This reduces the risk of subsequent charges that may result from a User default. By introducing appropriate credit requirements, and potentially improving cost allocations between Shippers, implementation would therefore be expected to facilitate competition.

Panel Members voted unanimously in favour of implementing Modification 0350.

Therefore the Panel determined to recommend implementation of Modification 0350.

The benefits 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.	Positive
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators	Positive

(who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	
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	Positive

11 Recommendations

Panel Recommendation

Having considered the 0350 Modification Report, the Panel recommends:

- that proposed Modification 0350 should be made;

12 Appendix 1

Appendix 1 – Illustration of current UNC Code Credit limits and Code Credit Checks