

Draft Modification Report
Introduction of an Additional Discretionary Release Mechanism for NTS Entry Capacity

Introduction of Additional Pay-as-Bid Auctions for NTS Entry Capacity

Modification Reference Number 0216 and 0216A

Version 2.0

This Draft Modification Report is made pursuant to Rule 9.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

0216

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). Key UNC defined terms used in this Modification Proposal are highlighted by an asterisk (*) when first used. This Modification Proposal*, as with all Modification Proposals, should be read in conjunction with the prevailing UNC.

Under the current Uniform Network Code* (UNC) arrangements National Grid NTS must make Unsold NTS Entry Capacity* available to Users* subject to a market test. National Grid NTS may also, at its own discretion, make additional Quarterly NTS Entry Capacity* and additional Daily NTS Entry Capacity* (i.e. in addition to Unsold NTS Entry Capacity*) available at an Aggregate System Entry Point*.

National Grid NTS does not propose to change the above arrangements, however these arrangements whilst providing National Grid NTS with a degree of flexibility in releasing NTS Entry capacity to the market also limit when and how that capacity may be released.

National Grid NTS proposes that the UNC be amended to enable National Grid NTS to introduce an additional capacity release mechanism, primarily to release additional NTS Entry Capacity outside of and in addition to the existing Quarterly and Daily auction mechanisms that are currently in place, although under certain circumstances National Grid NTS can envisage that there may also be an associated release of Unsold NTS Entry Capacity.

It is further proposed that any such release of NTS Entry Capacity shall:

- be at the sole discretion of National Grid NTS.
- be subject to the application of a Reserve Price*. For clarification this will be the prevailing AMSEC auction Reserve Price (for each ASEP/s at which the NTS Entry Capacity is released) as specified in the Statement of Gas Transmission Charges.
- be applied solely within that Capacity Year*
- be subject to the provisions of UNC Section V3

For the avoidance of doubt Users will pay Capacity Charges for the capacity allocated through this process i.e. quantity of NTS Entry Capacity allocated

multiplied by the bid price tendered multiplied by the relevant period for which capacity has been allocated.

For the avoidance of doubt, any NTS Entry Capacity allocated through this process shall be considered in respect of overruns.

- Allocated capacity shall be included in the User's aggregate Available NTS Entry Capacity* to determine the Overrun Quantity*.
- Bid prices (in respect of satisfied bids) shall be considered determination of System Entry Overrun Charge* rates at the ASEP where the allocation is made.

Please note that implementation of this Proposal may require National Grid NTS to amend the following:

- 'The Statement of Gas Transmission Charges' and
- 'The Statement of the Gas Transmission Transportation Charging Methodology'

For clarity, if amendments to the above statements are required National Grid NTS will not release NTS Entry Capacity other than through those auction mechanisms that currently allow such a release, until such amendments have been completed.

National Grid NTS will no later than 2 (two) Business Days prior to the first day for which applications for capacity have been made, inform each User of those of its capacity bids that have been accepted, the amount of NTS Entry Capacity which it is registered as holding for the ASEP and the relevant period (for clarification the relevant period will be the period for which the capacity has been allocated).

And no later than one Business Day prior to the first day for which applications for capacity have been made, National Grid NTS will provide information to all Users in accordance with UNC Section B paragraph 2.14.2 other than sub paragraphs (b) and (h).

While not forming part of the proposal, National Grid anticipates that any such release would:

- be subject to a market test mechanism (for clarification National Grid NTS anticipates that this would be a pay as bid auction), with a separate set of Terms and Conditions (in the same way as options tenders are). These Terms and Conditions would:
 - be made available by National Grid NTS a minimum of seven (7) days prior to any release of NTS Entry Capacity. For clarification the Terms and Conditions would be made available as part of the invitation process.
 - be accepted by Users. For clarification the Terms and Conditions will contain the business rules applicable to that release of NTS Entry Capacity. Users will be required to accept the Terms and Conditions prior to participating in the capacity release mechanism.

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Under the current Uniform Network Code (UNC) arrangements, National Grid NTS (NGG NTS) must make Unsold NTS Entry Capacity available to Users subject to a market test. National Grid NTS may also, at its own discretion, make additional Quarterly NTS Entry Capacity and additional Daily NTS Entry Capacity (i.e. in addition to Unsold NTS Entry Capacity) available at an Aggregate System Entry Point. For clarity, E.ON UK does not propose to change the above arrangements.

E.ON UK proposes that the UNC be amended to enable National Grid NTS to introduce one or more additional pay-as-bid auction(s) within the same Capacity Year, to release additional NTS Entry Capacity (including the associated release of Unsold NTS Entry Capacity) outside of, and in addition to, the existing Quarterly and Daily auction mechanisms that are currently in place.

However, E.ON UK proposes that National Grid NTS shall only be entitled to exercise this new discretionary right to effectively break from the current UNC structure of NTS Entry Capacity auctions:

- Until the end of the Capacity Year ending 30 September 2009; at which point the right shall cease to exist under the UNC. The purpose of this is to seek to minimise any unforeseen consequences arising from the new process, whilst allowing time for full industry review of the process, post-winter 2008/9.
- To make available NTS Entry Capacity in strips of no less than one (1) month and no greater than one (1) year.
- By giving a minimum of 28 days notice to Users of a proposed additional pay-as-bid auction to release additional (or associated Unsold) NTS Entry Capacity.
- By running each new pay-as-bid auction with a minimum of two (2) rounds, which should facilitate true price discovery for the new NTS Entry Capacity.

It should be noted that this Proposal does not oblige NGG NTS to release additional NTS Entry Capacity to the market. However, this Proposal does introduce flexibility for NGG NTS to introduce one or more additional pay-as-bid auctions to release more Entry Capacity than would otherwise be the case, but in more transparent and predictable circumstances than proposed under Mod 216. This Proposal places reasonable limits on the complete and sole discretion proposed by NGG NTS (in Mod 216) to potentially release NTS Entry Capacity (both additional and Unsold) at any time and under any circumstance in the same Capacity Year.

If Mod 216 were to be implemented, we do not believe that the current UNC rules provide a satisfactory limit on when and how NG NTS may call a new auction to release additional and associated Unsold NTS Entry Capacity. As a result, if implemented, the Proposer believes that Mod 216 could seriously undermine the existing auction structure and pricing, introducing unacceptable levels of uncertainty for all Users of the NTS; particularly new entrants.

As also specified in Mod 216, it is further proposed that any such release of NTS Entry Capacity shall:

- Be subject to the application of a Reserve Price. For clarification this will be the prevailing AMSEC auction Reserve Price (for each ASEP/s at which the

NTS Entry Capacity is released) as specified in the Statement of Gas Transmission Charges.

- Be applied solely within that Capacity Year.
- Be subject to the provisions of UNC Section V3.

For the avoidance of doubt Users will pay Capacity Charges for the Capacity allocated through this process; i.e. quantity of NTS Entry Capacity allocated multiplied by the bid price tendered multiplied by the relevant period for which capacity has been allocated.

For the avoidance of doubt, any NTS Entry Capacity allocated through this process shall be considered in respect of Overruns. Allocated capacity shall be included in the User's aggregate Available NTS Entry Capacity to determine the Overrun Quantity. Bid prices (in respect of satisfied bids) shall be considered for determination of System Entry Overrun Charge rates at the ASEP where the allocation is made.

National Grid NTS will no later than 2 (two) Business Days prior to the first day for which applications for capacity have been made, inform each User of those of its capacity bids that have been accepted, the amount of NTS Entry Capacity which it is registered as holding for the ASEP and the relevant period (for clarification the relevant period will be the period for which the capacity has been allocated).

And no later than 1 (one) Business Day prior to the first day for which applications for capacity have been made, National Grid NTS will provide information to all Users in accordance with UNC Section B paragraph 2.14.2 other than sub paragraphs (b) and (h).

The Terms and Conditions applicable to the new pay-as-bid auction(s) will:

- Be made available to Users by National Grid NTS a minimum of 28 days prior to release of the NTS Entry Capacity. The Terms and Conditions will form part of the auction invitation process.
- Be accepted by Users. For clarification the Terms and Conditions will contain the business rules applicable to that release of NTS Entry Capacity. Users will be required to accept the Terms and Conditions prior to participating in the capacity release mechanism.

2 **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;

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The Proposal would provide additional flexibility in the NTS Entry Capacity release arrangements to allow National Grid NTS to release additional NTS Entry Capacity. This should result in the release of additional capacity to the market and the avoidance of gas being stranded offshore, and thereby better facilitate the achievement of this objective.

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In respect of Standard Special Condition A11 paragraph 1(a), the Proposal would provide additional flexibility in the NTS Entry Capacity release arrangements to allow National Grid NTS to release additional NTS Entry Capacity via a pay-as-bid auction. This should result in the release of more capacity to the market (particularly for Winter 08/09) than would otherwise be the case, reducing the risk of gas being stranded offshore and better facilitating the achievement of this objective.

Standard Special Condition A11.1 (b): so far as is consistent with subparagraph (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;*

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

Standard Special Condition A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

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

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (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;*

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The Proposal would promote the securing of effective competition between relevant Shippers by use of a market test mechanism for the allocation of additional NTS Entry Capacity.

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In respect of Standard Special Condition A11 paragraph 1(d), the Proposal would promote effective competition between relevant Shippers by ensuring certainty for Shippers that capacity bought in previous capacity auctions in the same Capacity Year would not be undermined by release of additional and perhaps unexpected NTS Entry Capacity through an unspecified release mechanism, called at National Grid's discretion (as proposed in Mod 216).

In respect of Standard Special Condition A11 paragraph 1(d), the Proposal would further promote effective competition between relevant Shippers by ensuring that both new and existing Users are aware of the structure of NTS Entry Capacity Auctions and are able to plan and manage risk on this basis. In addition, by time-limiting this Proposal, any unforeseen consequences on the market are minimised.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (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;

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

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

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

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

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National Grid NTS believes that this Proposal, if implemented, may enhance security of supply by allowing Users the opportunity to obtain additional NTS entry Capacity than would otherwise be the case.

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E.ON UK believes that this Proposal, if implemented, may enhance security of supply by allowing Users the opportunity to obtain more NTS Entry Capacity than would otherwise be the case; particularly for the forthcoming winter

period.

E.ON UK also believes that this Proposal, by limiting how and when National Grid NTS can run a new pay-as-bid auction outside of the current UNC auction structure, will not have an adverse effect on industry or system fragmentation.

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

a) Implications for operation of the System:

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National Grid NTS does not believe this Proposal, if implemented, would adversely affect the physical operation of the System. By optimizing the release of NTS Entry Capacity*, implementation of this Proposal would provide Users with a greater opportunity to ensure gas supplies can be delivered at the earliest opportunity.

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E.ON UK does not believe this Proposal, if implemented, would adversely affect the physical operation of the System. By optimizing the release of NTS Entry Capacity, implementation of this Proposal would provide Users with a greater opportunity to ensure gas supplies can be delivered to market.

b) Development and capital cost and operating cost implications:

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National Grid NTS believes this Proposal, if implemented may have cost implications with regards to system implementation and operating costs.

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E.ON UK understands that this Proposal, if implemented may have some cost implications with regards to system implementation and operating costs.

It should be noted, however, that if implemented, this Proposal is likely to make use of the existing MSEC auction as a template and thus use existing functionality. As a result, we do not envisage that the costs would be substantial. In addition, as the Proposal is time limited the additional development costs could be minimised or avoided by a temporary solution using existing systems.

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

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National Grid NTS believes that these costs are internal to National Grid NTS and will be recovered through the existing charging regime.

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Based on NGG NTS's statement in Mod 216, E.ON UK believes that these costs are internal to National Grid NTS and will be recovered through the

existing charging regime.

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

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No such consequences on price regulation have been identified by either party.

5 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

0216 and 0216A

National Grid NTS and E.ON UK believe that neither Proposal will have a material impact on the level of contractual risk of each Transporter.

6 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

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National Grid NTS envisages that this Proposal, if implemented, will have an impact on the both the Gemini and UK Link systems. We would request that any such impact be assessed by xoserve.

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E.ON UK envisages that this Proposal, if implemented, could have an impact on both the Gemini and UK Link systems.

7 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)

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National Grid NTS is not aware of any such implications but would welcome responses from Users in this area.

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E.ON UK believes that implementation of this Proposal would retain much-needed certainty for Users about when and how to bid for NTS Entry Capacity.

Development and capital cost and operating cost implications

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National Grid NTS and E.ON UK are not aware of any such implications but

would welcome responses from Users in this area.

Consequence for the level of contractual risk of Users

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National Grid NTS and E.ON UK are not aware of any such implications but would welcome responses from Users in this area.

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

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National Grid NTS is not aware of any implications, but would welcome responses from Users in this area.

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This Proposal places reasonable limits on the discretion of National Grid NTS and by doing so, introduces certainty for all Users of the NTS about how and when additional NTS Entry Capacity may be released, outside of the established auction structure.

A 28 day notice period for a new pay-as-bid auction limits the gap between the spot market and the sale of capacity, thereby allowing Users to efficiently and economically manage their own risks.

9 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

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No such consequences have been identified by either party.

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

Advantages

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National Grid NTS considers that this Proposal will:

- facilitate additional flexibility in making additional NTS Entry Capacity available to the market
- allow Users the opportunity to secure additional NTS Entry Capacity, therefore allowing gas flows onto the system that may otherwise be prevented.

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E.ON UK considers that this Proposal:

- avoids undermining both the existing auction structure and NTS Entry Capacity Baselines. If National Grid NTS were to have unrestricted discretion as to when and how to run a new pay-as-bid auction, this could introduce previously unexpected amounts of NTS Entry Capacity to the market, which could undermine the value of capacity bought or sold in other auctions and would also undermine the importance of existing (or future) Baselines.
- ensures clarity and non-discrimination by ensuring that Users are aware that under this Proposal, additional or associated unsold capacity can only be released via a pay-as-bid auction and not by any other 'release mechanism'.
- by placing reasonable limits on National Grid NTS' discretion, this Proposal creates certainty and transparency for the market about the structure of NTS Entry Capacity auctions. This is particularly important for new entrants.
- limits the potential for adverse impact on exchange rates in the 'enduring' Trade and Transfer process by restricting the sale of capacity to strips of NTS Entry Capacity greater than one month.
- limits any unforeseen impacts on the market by placing time restrictions on National Grid's ability to exercise its new discretionary right to call a new auction. This should allow sufficient industry time before September 2009 to evaluate the success (or otherwise) of this new auction process and to plan for the future.
- A minimum two-round auction facilitates better price discovery in the market than a single round auction.

Disadvantages

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None identified.

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- If NGG NTS exercises its discretionary rights conferred under this Modification Proposal, it has been indicated by NGG NTS that releasing more capacity in this way would have an adverse impact on some Trade and Transfer exchange rates.

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

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The Proposer has met with National Grid NTS to discuss the viability of this alternative Proposal before raising it formally.

Written Representations are now sought in respect of this Draft Report.

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

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Implementation of either Proposal is not required to enable each Transporter to facilitate compliance with safety or other legislation.

13 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

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Implementation of either Proposal 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.

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

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No programme of works would be required as a consequence of implementing

either Modification Proposal.

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

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

16 Implications of implementing this Modification Proposal upon existing Code Standards of Service

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No implications of implementing either Modification Proposal upon existing Code Standards of Service have been identified.

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

18 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.

19 Text

Representations are now sought in respect of this Draft Report and prior to the Transporters finalising the Report.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters