

Modification Report
Promoting Competition in Operating Margins Provision
Modification Reference Number 0240
Version 4.0

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

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 Uniform Network Code* (UNC).*

In accordance with Uniform Network Code (UNC), National Grid NTS is currently able to procure Operating Margins* (OM) from Storage Facilities* and from its Liquefied Natural Gas (LNG) Importation Facilities* in a Storage Year*.

Special Condition C25 has been introduced into National Grid's Gas Transporter Licence in respect of the NTS, which requires National Grid NTS to use reasonable endeavours to promote competition in the provision of OM services by 1st April 2009.

This Modification Proposal, and associated Suggested Text, have been developed with the help of interested parties in the Transmission Workstream OM Contestability Sub-Group and have the support of the attendees of this sub-group.

As detailed in the Suggested Text, it is proposed that the present provisions for Operating Margins be revised to enable more flexibility in the provision of Operating Margins and also introduce the ability for National Grid NTS to procure OM services from other sources such as, NTS-connected supply and demand sources and Distribution Networks (DNs). To accommodate the above it is proposed that the definition of Operating Margins Gas Delivery Arrangements* be extended so that OM services can be provided by NTS-connected supply and demand sources and DNs.

The current UNC arrangements require that National Grid NTS specifies and procures its Operating Margins Requirements* on a Storage Year basis primarily from storage-based providers. As new providers may not be storage-based it is proposed that the Storage Year is changed to a more generic approach such that the Operating Margins Requirement will be reviewed when necessary for the new Operating Margins Year (OMY) which is a period of 12 months commencing on the date set out in the Operating Margins Statement. Where National Grid NTS has entered into Operating Margins Capacity Arrangements* or Operating Margins Gas Delivery Arrangements these arrangements can, subject to the agreements in place with these providers, be terminated or Storage Capacity* sold onto a third party and alternative arrangement(s) entered into within the OMY. Following a change in the

requirement for Operating Margins Capacity Arrangements, National Grid NTS may reassess the requirement of gas-in-storage and procure and dispose of gas accordingly.

The Closing Margins Adjustment Charge* applies only to gas sold that had been previously held in storage under Operating Margins Capacity Arrangements. Current arrangements take account of start of year and within year Storage Gas Transfers and/or sale of gas. It is proposed, for consistency with these existing arrangements, that Pre Year adjustments and/or sale of gas are also included within the Closing Margins Adjustment Charge calculation.

It is intended that the vast majority of the present Operating Margins provisions are retained; however, Section K has been reviewed in order to add clarity to the existing processes, in particular the role of the Relevant System Manager* and the provision of clearer guidelines regarding the disposal of any excess gas and purchase of gas to be held in storage by National Grid NTS. Again this process has been done with the support and over-sight of the Transmission Workstream Sub-Group and the suggested revised legal text has been reviewed by, and has the support of, this group.

Implementing this Modification Proposal will mean that the current contracting process will remain consistent with the Procurement Guidelines and continue to be operated in accordance with the System Management Principles Statement.

Currently Section K paragraph 2.3.2 restricts the use of OM in case of damage to or failure of any part of the NTS (other than Programmed Maintenance) to the Gas Flow Day*. It was agreed by the Sub-Group that such a restriction is not appropriate and could indeed pose significant operational difficulties should such an OM event occur close to the end of a Gas Flow Day. It is therefore proposed that Operating Margins can be used in these specific circumstances for up to 24 hours following the event. It should be noted that this would not alter the level of bookings required for Operating Margins. Whilst this change is not required to facilitate Operating Margins contestability, as described above the issue is considered by the Operating Margins sub group as a pragmatic change that should be included as part of this Modification Proposal.

During the development and drafting of the proposed revisions to Section K, National Grid NTS became aware of previous legal drafting errors relating to the prevailing text of Section K. Some cross reference errors have occurred as a result of the implementation of legal text for approved Network Code Modification Proposal 0311 – “Operational Use of Storage post Unbundling” and subsequently compounded by Network Code Modification 0710 – “Removal of Top-up Arrangements”. It is proposed that these drafting errors are corrected during this revision of Section K. The revisions required have been listed in section 16 below; these have then been incorporated into the proposed Section K rewrite envisaged by this Modification Proposal. The proposed corrections have been reviewed by the sub-group and agreed.

Paragraph K4.2.6 does not reflect the correct provisions in paragraph K4.2.4 and National Grid NTS propose that the correct references for paragraph K4.2.6 be inserted under the auspices of this Modification Proposal. The revisions are as stated within section 16 below.

National Grid NTS considers that the correct text for paragraph 4.2.4 (a) referring to Carry-Across Gas, would ensure that the costs and processes described in paragraphs K4.2.4 (h) and K4.2.7 are meaningful. National Grid NTS, supported by, attendees of the OM Sub Group, proposes reinstatement of incorrectly deleted text (additionally amended to reflect the removal of Balancing Margins and the role of Top Up Manager which were achieved through Modification Proposals 0311 and 0710) should be reinserted as part of this Modification Proposal.

National Grid NTS considers that both these amendments are justified on the basis that they would appropriately reflect the intent of implemented Modification Proposal 0311 and 0710 i.e. that no change to the methodology that National Grid NTS follows for the calculation of net and gross Weighted Average Cost of Gas (WACOG) be made as a result of either of the above modifications.

Suggested Text

List of cross reference errors, which are based on current UNC TPD Section K text, have been included below:

Paragraph K2.2.4: The Proposal seeks to change the prevailing incorrect TPD cross reference of paragraph 4 to paragraph 3.

Paragraph K3.2.4: The Proposal seeks to change the prevailing incorrect TPD cross reference of K3.2.7 to K3.3.6.

Paragraph K3.2.5: The Proposal seeks to change the prevailing incorrect TPD cross reference of K3.4.1 to K3.5.1.

Paragraph K3.3.1(a): The Proposal seeks to change the prevailing incorrect TPD cross reference of K3.1.2 to K3.1.4.

Paragraph K3.3.2(f)(i) & 3.3.2(f)(ii): The Proposal seeks to change the prevailing incorrect TPD cross reference of K3.3.7 to K3.3.6.

Paragraph K3.3.2(g): The Proposal seeks to change the prevailing incorrect TPD cross reference K 3.2.3 to K3.2.4.

Paragraph K3.4.1: The Proposal seeks to change the prevailing incorrect TPD cross reference of K4.5 to K4.4.

Paragraph K3.3.2(f)(ii): The Proposal seeks to change the prevailing incorrect reference of Residual Storage Gas to Residual Surplus Gas, as Residual Storage Gas is not a defined term.

Paragraph K4.2.4(a): Incorrect deletion of part of the text within paragraph K4.2.4(a) should be reinstated, “the quantity of relevant Carry-over Margins Gas multiplied by the Operating Margins WACOG and the quantity of relevant Carry-Across Gas (in respect of which the relevant Storage Facility is the deficit facility) multiplied by the Operating Margins WACOG in respect of the surplus Storage Facility, in each case as at the last Day of such Storage Year.”

Paragraph K4.2.6:

The changes required under the proposal are as follows:

UNC: K 4.2.6

"For the purposes of this paragraph 4 "**Net Margins WACOG**" is:

Operating Margins WACOG calculated in accordance with this paragraph 4.2 but on the basis that the amounts under paragraphs 4.2.4(**ed**) and (**ef**) are excluded from such calculation, and that in respect of amounts under paragraphs 4.2.4 (**a(b)and (c)**) an appropriate deduction shall be made to remove amounts reflected in the value of the gas or gas-in-storage acquired for Operating Margins Purposes attributable to Transportation Charges and injection charges at the rates applicable at the start of the relevant Storage Year."

Paragraph K4.4.2(a): The following amendments are required as Operating Margins is not a value to be multiplied by and WACOG is not defined:

Following each Storage Year the difference between:

(a) the aggregate (for each Operating Margins Facility for Operating Margins Purposes) of the quantities of gas:

~~(i)~~ subject to Residual Gas Transfers (as Residual Surplus Gas) under paragraph 3.4 multiplied by Operating Margins;~~and~~

~~(ii)~~ WACOG for the relevant Operating Margins Facility (as at the end of the Storage Year following which such transfers are made); and

Paragraph K 4.4.2(b): The Proposal seeks to change the prevailing incorrect reference of (ii) to 3.3.2 (f) (ii).

UNC TPD Section F

Paragraph F 4.5.2: The Proposal seeks to change the prevailing incorrect TPD cross reference of K5.2 to K4.3.

Suggested Text:

This is provided as a separate document due to Draft Modification Report template restrictions.

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;

In respect of Standard Special Condition A11 1(a), the efficient and economic operation of the pipeline, the Proposer believes this Proposal would enable Operating Margins gas to be utilised for up to 24 hours following damage to or failure of any part of the NTS instead of restricting OM use to the Gas Flow Day. This therefore removes the significant operational difficulties should such an OM event occur close to the end of a Gas Flow Day.

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 subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

In respect of Standard Special Condition A11 1(c), the efficient discharge of the licensee's obligations, the Proposer believes that this Proposal would enable National Grid NTS to meet its Special Condition C25 whereby it requires National Grid NTS to use reasonable endeavours to promote competition in the provision of OM services by 01 April 2009.

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;

In respect of Standard Special Condition A11 1(d), the securing of effective competition, the Proposer believes that this Proposal is facilitating further competition in the provision of Operating Margins services.

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.

Implementation 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;

Implementation 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

National Grid NTS believes that, in order to utilise the procurement flexibility introduced by this Proposal, if implemented, National Grid NTS would need to secure the approval from the HSE to a material change to the Transporters Safety Case to allow procurement of OM from providers other than Storage

Facilities and or LNG Importation Facilities.

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

a) Implications for operation of the System:

As this Proposal seeks to provide additional service provision opportunities rather than replace existing providers National Grid NTS believes that the operation of the system would not be adversely affected. Indeed, with enabling Operating Margins gas to be utilised for up to 24 hours following damage to or failure of any part of the NTS will remove any significant operational difficulties should an event occur towards to close of the Gas Flow Day.

b) Development and capital cost and operating cost implications:

No such implications have been identified.

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

Not applicable.

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

No such consequences have been identified.

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

No such consequences have been identified.

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

Not applicable.

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)

For a majority of Users there will be no impact, however in the event that a User chooses to take part in OM process there will be a tender process to participate in and delivery terms to be agreed.

Development and capital cost and operating cost implications

National Grid NTS believes there is no additional development, capital or operating cost implications.

Consequence for the level of contractual risk of Users

None identified.

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

Users may wish to contract with National Grid NTS to be able to provide the Operating Margins services.

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

This Modification Proposal has been raised to enable National Grid NTS to comply with Special Condition C25 of the Gas Transporter Licence, which requires National Grid NTS to use reasonable endeavours to promote competition in the provision of OM services by 01 April 2009.

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

Advantages

- Expanding the potential sources of Operating Margins provision could lead to a reduction in the cost of the service.
- By developing the UNC to allow procurement of Operating Margins from an increased range of potential providers it should be possible, through running of contestable procurement exercises, to establish the extent of competition in Operating Margins service provision.
- Moving from procuring Operating Margins on a Storage Year basis to an Operating Margins Year will allow National Grid NTS to better manage its overall Operating Margins holdings across storage based and non-storage based Operating Margins providers. Operating on an Operating Margins Year basis will not act as a barrier to any provider wishing to participate in the provision of Operating Margins.
- Increasing the range of potential Operating Margins service providers by extending the definition of Operating Margins Gas Delivery Arrangements could mean diversity of service provision and location and could lead to a reduction in Operating Margins costs.
- Enabling National Grid NTS to utilise Operating Margins Gas for up to 24 hours instead of restricting utilisation to the end Gas Flow Day in the case of damage to or failure of any part of the NTS has a benefit of removing the

arbitrary restriction which could impact the efficient operation of the system.

- The legal text changes to Section K add clarity to the Operating Margins processes described.

Disadvantages

- An additional level of complexity to the procurement process.

11 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:

Organisation		Position
Association of Electricity Producers	AEP	Supports
E.ON UK plc	E.ON	Supports
National Grid NTS	NGNTS	Supports
Scotia Gas Networks	SGN	Supports
Scottish and Southern Energy plc	SSE	Supports
Statoil (U.K.) Limited	STUK	Supports

All six representations supported implementation of this Proposal.

12 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.

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

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.

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

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

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

This Proposal could be implemented with immediate effect following direction

from Ofgem.

16 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.

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

At the Modification Panel meeting held on 22 January 2009, of the 9 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

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

Revised Legal Text was provided by the Proposer on 04 February 2009.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters