

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

Version 1.0

This Workstream Report is presented for the UNC Modification Panel's consideration. The Transmission Workstream considers that the Proposal is sufficiently developed and should now proceed to the Consultation Phase. [The Workstream also recommends that the Panel requests the preparation of legal text for this Modification Proposal.]

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.

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.

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.

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

Under prevailing Energy Balancing arrangements, the risk associated with the downgrading of company ratings is a risk borne by Users through the neutrality process. We believe that the procurement of Ratings services introduces efficiencies and improvements to the risk management role xoserve undertakes on behalf of System Users. Therefore we believe that this Proposal is 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.

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

As previously stated there will be no User Pays charges associated with development and implementation costs for this Proposal. The service costs for the procurement of the Ratings Services are approximately £40K per annum. As stated above we seek to recover the service procurement costs through existing Adjustment Neutrality Invoicing processes, therefore a separate User Pays Charge will not be required. Consequently we do not believe that an ACS 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;*

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;*

We believe that, if implemented, this Proposal will facilitate the recovery costs, associated with managing risks associated with downgrading of company ratings, through the neutrality process. The equitable apportionment of such costs, across the Users throughput, ensures that effective competition is maintained between relevant Shippers, in respect of cost recovery for these services. Implementation of this Modification Proposal would better facilitate this Relevant Objective

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.*

We believe that the procurement of Company Ratings services introduces significant improvements in; the accuracy of the monitoring of financial institutions credit positions on a daily basis; streamlining the process; and cutting down the man hours required to carryout the evaluation process in comparison to maintaining a manual process. The provision of these process and services have been introduced as a result of a consensus of EBCC members, who recognise that increased levels of risk associated with the frequency of ratings being downgraded represented a very real concern to the community. We believe that the introduction of the process and the funding of the services through neutrally provides transparency of the associated costs and improvements in the monitoring of Company Ratings. Therefore we believe that this Proposal, if implemented, demonstrates an economic and efficient improvement in the administration of the Code.

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:

It is proposed to pass through 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.

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

- The use of a third party ratings services reduces risk to Community.

Disadvantages

- Cost of Service – 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 Workstream Report)

No written representations have been received.

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 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 Workstream recommendation regarding implementation of this Modification Proposal

The Transmission Workstream considers that the Proposal is sufficiently developed and should now proceed to the Consultation Phase. [The Workstream also recommends that the Panel request the preparation of legal text for this Modification Proposal.]