

CODE MODIFICATION PROPOSAL No xxxx
<Enduring Annual NTS Exit (Flat) Capacity User Commitment>
Version x.x

Date: 01/04/2009

Proposed Implementation Date:

Urgency: Non Urgent

1 The Modification Proposal

a) Nature and Purpose of this 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).*

Background

Review Group 0221 “Review of Entry Capacity and the Appropriate Allocation of Financial Risk” was established in September 2008 to assess whether or not the current credit arrangements, in place for securing long term NTS Entry Capacity, were sufficiently robust and provide the correct balance of risk between various Shipper Users.

Following conclusion of this Review Group National Grid NTS* has also reviewed the credit arrangements within the NTS Exit Capacity* arrangements and considers that one of the main issues identified in relation to the NTS Entry Capacity arrangements is also apparent in the new Exit Capacity* regime i.e. there is an inappropriate length of time between a User* committing to buy Enduring Annual NTS Exit (Flat) Capacity and the User financially underpinning this commitment.

National Grid NTS has raised this Modification Proposal to address the above issue in relation to Shipper Users and has taken into account some of the discussions within Review Group 0221 and some of the principles in Modification Proposal 0246 “Quarterly NTS Entry Capacity User Commitment”.

Modification Proposal

Modification Proposal 0246 contains principles regarding the formulation of security requirements in respect of the booking of NTS Entry Capacity which adopt a different approach to those currently within Section V3. These provisions will not apply to DNO Users because they do not book entry capacity.

If these principles were to be applied for the booking of long term NTS Exit Capacity then the question arises should DNO Users be subject to the same security requirements in respect of such booking.

It is proposed that Distribution Network Operators (DNOs) should be excluded and that, given the characteristics of DNOs, the proposal shall only apply to Shippers.

DNOs have several licence obligations related to determining the level and utilisation of NTS Exit Capacity and these activities are appropriately funded by the Authority. As a result of such arrangements National Grid NTS concludes that the Shipper Community would not be at risk to any DNO default, since the DNO cannot, due to its pipeline system security standard, choose to cancel its capacity. If the DNO became unable to pay its debts then its obligations would as a protected energy company, fall within the scope of an energy administration order and so subject to rescue or transfer prescribed by the Energy Act 2004.

National Grid NTS also believe that including the DNOs would ultimately result in unnecessary costs being levied on Shippers/customers through increased charges.

It is therefore proposed that Shipper Users will be required to put in place and subsequently keep in place sufficient security to underpin Enduring Annual NTS Exit (Flat) Capacity.

National Grid NTS will be notifying each Shipper User by 01 May 2009 of their Initial Enduring Annual NTS Exit (Flat) Capacity for each NTS Exit Point*. It is proposed that each Shipper User will be required to provide sufficient security to underpin its total amount of Enduring Annual NTS Exit (Flat) Capacity by the last Business Day* in July. The level of security required will be the amount determined by the Exit Capacity Risk Assessment* i.e. the User's User Security Value (USV)*. Full details of the Exit Capacity Risk Assessment and the USV are explained later in this proposal.

The Shipper User shall provide this security via either a Deposit Deed* or Letter of Credit*. Deposit Deeds and Letter of Credits are a firm commitment to pay and cannot be amended or cancelled without agreement of all parties involved, fully covering against insolvency. Other security tools are not being considered as they do not offer the same protection for the rest of the User community in the event of insolvency of the defaulting User.

Shipper Users may apply for new or additional Enduring Annual NTS Exit (Flat) Capacity at an NTS Exit Point through making applications within the Annual Application Window* in July of each Gas Year*. Each Shipper User will be required to provide sufficient security by the last Business Day in July to cover its application(s). Shipper Users can also apply for Enduring Annual NTS Exit (Flat) Capacity outside of the Annual Application Window (any time between 01 October and 30 June) in each

Gas Year. Each Shipper User will be required to provide sufficient security prior to accepting National Grid NTS's offer for Enduring Annual NTS Exit (Flat) Capacity otherwise the offer (even if accepted by the User) will be deemed invalid. The level of security required is detailed below.

A Shipper User may reduce the amount of Enduring Annual NTS Exit (Flat) Capacity which it holds at an NTS Exit Point by giving notice of the reduction to National Grid NTS. A notice of reduction may be requested during 1 July to 15 July. Shippers Users will be able to take into consideration their requests for reductions when providing sufficient security by the last Business Day in July. Should the reduction request be rejected by National Grid NTS by 30 September in the Gas Year then the Shipper User shall be required to ensure that sufficient security is put in place within 10 Business Days to cover its full Enduring Annual NTS Exit (Flat) Capacity holding.

Note: If a Shipper User applied to reduce its Initial Enduring Annual NTS Exit (Flat) Capacity holdings in July 2011, then this could only be effective from October 2012 at the earliest.

A Shipper User as an Assignor User* will be able to assign all of its Enduring Annual NTS Exit (Flat) Capacity to another Assignee* User at the same NTS Exit Point. Assignments* will be rejected by National Grid NTS where the Assignee User does not have at least sufficient security in place to cover both its existing Exit Capacity holding and the total value of the Capacity being assigned.

The security provisions proposed in this proposal are in addition to those currently within UNC TPD Section V.

Exit Capacity Risk Assessment

As detailed above, all Shipper Users will be required to provide appropriate security to support their Enduring Annual NTS Exit (Flat) Capacity holdings. This security will be known as the User Security Value and will be based on a risk assessment of the Allocated Capacity Values (ACV). Each User's required User Security Value (USV) will be calculated as follows:

$$USV = ACV + VAT$$

Where:

ACV = that Shipper User's Enduring Annual NTS Exit (Flat) Capacity allocated at all NTS Exit Points for Gas Years Y2 to Y6 inclusive multiplied by indicative prices (updated on 1 May each year) multiplied by [0.1].

In order to ensure that its Enduring Annual NTS Exit (Flat) Capacity applications are accepted the Shipper User will be required, prior to the end of Annual Application Window to derive its post application ACV, by estimating the value of its capacity applications and reductions and add or subtract this from the value of its existing capacity holding for Gas Years

Y2 to Y6 (inclusive) and take into consideration any changes made to indicative prices.

National Grid considers that Gas Years Y2 to Y6 of the Enduring Annual NTS Exit (Flat) Capacity should be used to derive the ACV, as this is reflective of the enduring NTS Exit Capacity arrangements (Enduring Annual NTS Exit (Flat) Capacity applications cover capacity, where the first gas flow day is in this period) and is consistent with the proposed Quarterly NTS Entry Capacity User Commitment*.

Long Term NTS Exit Capacity Default Process

It is also proposed that the following actions be classed as “events of User default”:

1. the amount determined by the User’s USV exceeds the value of the security in place; or
2. the User’s supplied security tool (LoC or Deposit deed) has less than 30 days validity remaining; or
3. the credit rating of the financial institution providing the LoC has gone below the minimum credit rating specified in UNC TPD Section V.
4. User is terminated under UNC TPD Section V.

If an “event of User default” occurs, a “default process” will be triggered whereby a notice will be issued to the Shipper User by National Grid NTS. The Shipper User will be informed of the “event of default” and required to provide the necessary security to cover at least the User’s USV within the next 10 Business Days.

In addition, National Grid NTS will aim to lessen the impact of the event of default by rejecting any further applications for Enduring NTS Exit (Flat) Capacity by the User, until the necessary security is put in place.

These initial stages in the process are not required for Users defaulting due to Termination under Section V.

In the event that the Shipper User has not met the conditions of the notice after 10 Business Days, or in the event that the User has been terminated under UNC TPD Section V, then the Shipper User will cease to hold Enduring Annual NTS Exit (Flat) Capacity at any NTS Exit Points. The Shipper User will also be charged a cancellation fee equivalent to the User’s security held for the purposes of underwriting the User’s holding of Enduring Annual NTS Exit (Flat) Capacity for Years Y+2 to Y+6 inclusive as proposed in this proposal. As a further appropriate sanction, National Grid NTS will also reject any further applications made to acquire NTS Exit Capacity or increase via a System Capacity Trade* until after the next Annual Application Window.

Where a Shipper User fails to provide or maintain the security required by this proposal and the User's prevailing Enduring NTS Exit (Flat) Exit Capacity has been subject to a Transfer, then UNC TPD Section B5.4.1 will apply i.e. the Transferee User* may elect to be registered as holding the Enduring Annual NTS Exit (Flat) Capacity. Any remaining Enduring Annual NTS Exit (Flat) Capacity that has not been subject to a trade will revert to National Grid NTS and will be released in the event that a User applies for Enduring Annual NTS Exit (Flat) Capacity.

It is proposed that any revenues accumulating from the cancellation fee invoice will be compared to the expected revenue from NTS Exit Capacity arrangements. It is anticipated that National Grid NTS will need to consult on the Charging Methodology to define the cancellation fee and consequential recalculation of the existing charges which will be considered as part of the actual revenue assessment.

- b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)**

- c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.**

2 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

National Grid NTS considers this Proposal would, if implemented, better facilitate the following Relevant Objectives as set out in its Gas Transporters Licence:

- In respect of Standard Special Condition A11 1(a), efficient and economic this proposal seeks to mitigate community risk from User default resulting in initial under-recovery of NTS allowed revenue and subsequent redistribution of this allowed revenue to remaining Users through increases in general transportation charges. Given the licence obligations and activities applicable to DNO Users it is felt that the above risk does not materialise in relation to these Users. As such National Grid NTS feels that it is unnecessary and indeed at odds with the relevant objective (inefficient and uneconomic) to include these Users within this proposal. As such National Grid NTS considers that it is appropriate and due discrimination to exclude these Users from this proposal.

- In respect of Standard Special Condition A11 1(d), the securing of effective competition, this proposal, whilst extending the credit arrangements, aims to reduce the Shipper community's exposure to a User failing to pay for their Exit Capacity holdings, without introducing a prohibitive cost to Users who may wish to take part in the Exit Capacity regime. National Grid NTS believe that this proposal ensures that costs and shipper default risks are allocated appropriately across all Users.

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

This proposal seeks to strike an appropriate balance between capturing an efficient level of User commitment and mitigating the shipper community's risk from a User's failure to pay NTS Exit Capacity charges.

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

a) The implications for operation of the System:

This Proposal seeks to ensure that any investment in the NTS is efficient and economic by requesting an appropriate level of User Commitment, which we believe should not unduly discourage Users from applying for NTS Exit Capacity.

b) The development and capital cost and operating cost implications:

The aggregate level of security to be provided by Users as a result of the introduction of this proposal is expected to be in the region of £36.8m (10% of all Allocated Capacity Values (ACV) in years Y2 to Y6), which would equate to an estimated Letter of Credit cost across all Users of around £0.9m per year. This estimate is based on an average 2.5% LoC cost.

As the new Exit Capacity regime only applies to Enduring Annual Capacity being utilised from gas flow day 1 October 2012 onwards, then there is a soft landing, which means that the level of security and costs will be lower in 2009 (only years Y4 to Y6 are in scope) and 2010 (only years Y3 to Y6 are in scope).

However, Users with poor credit ratings may choose to use a deposit deed as a cheaper option, as the amount deposited is currently subject to bi-annual interest payments equal to Bank of England base rate.

This Proposal seeks to provide an incentive for Shipper Users to honour Long Term Exit Capacity commitments and ensure that any investment in the NTS is efficient and economic. This would be reflected in the Transporter's development and capital costs.

c) Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:

National Grid NTS believes that any changes to the UKLINK system resulting from this proposal should be funded via a "User pays" approach. A ROM has been requested. National Grid NTS proposes that development and implementation costs should be funded 100% by Shipper Users in proportion to TBC

- d) The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

No such consequences have been identified.

- 5 The extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)**

Not applicable.

- 6 The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users**

A full assessment has not yet been conducted but National Grid NTS believes there will be system impacts as a result of having to carry out the entry capacity default process.

- 7 The implications for Users of implementing the Modification Proposal, including:**

- a) The administrative and operational implications (including impact upon manual processes and procedures)**

For those Shipper Users applying for Enduring Annual NTS Exit (Flat) Capacity, the User will probably need to adjust its administrative arrangements to reflect the User Commitment arrangements proposed in this proposal so that it is able to assess its credit requirements and ensure a Deposit Deed or Letter of Credit is in place at all times to match its Capacity holdings.

- b) The development and capital cost and operating cost implications**

National Grid NTS recognises that there will be cost implications in extending the security arrangements as highlighted in 4b.

- c) The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

By reinforcing the obligations on Shipper Users to pay capacity charges, the current risk to other Users would be reduced.

- 8 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, any Non-Code Party)**

User commitment developed for UNC TPD Section B will be considered as part of the development of NTS Exit ARCA's.

9 Consequences on the legislative and regulatory obligations and contractual relationships of the Transporters

No such consequences have been identified.

10 Analysis of any advantages or disadvantages of implementation of the Modification Proposal not otherwise identified in paragraphs 2 to 9 above

Advantages

National Grid NTS believes that by introducing appropriate User Commitment for long term exit capacity:

- Shipper Users will continue to signal sufficiently far in advance to allow National Grid NTS to make appropriate investment decisions.
- The proposal lessens the risk of, and shipper community exposure to, an event of a Shipper User failing to pay its NTS Exit Capacity charges.
- Provides an incentive for Shipper Users to honour existing and future Enduring Annual NTS Exit (Flat) Capacity commitments.

Disadvantages

National Grid NTS recognises that there are some disadvantages in relation to this proposal, namely that

- Shipper Users may feel that their capital is tied up in the provision of the additional User Commitment which prevents other use of these funds. The provision of Letters of Credit or Deposit Deed will also come at a cost to the User. National Grid NTS would welcome views from respondents as to the actual extent of the annual costs in this area.
- Projects could be delayed or cancelled as a result of the new User Commitment required.

11 Summary of representations received as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)

12 Detail of all other representations received and considered by the Proposer

13 Any other matter the Proposer considers needs to be addressed

14 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal

15 Comments on Suggested Text

16 Suggested Text

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document

Section(s)

Proposer's Representative

Ritchard Hewitt (National Grid NTS)

Proposer

National Grid NTS