Final

Working Group 2 Report on Potential Solutions to the Financial Effect of Misallocations at 0600 hours to 0600 hours sub terminals

Situation at Affected Terminals

National Transmission System will run a 5:5 gas day from 1 October 2015.

The majority of beach sub terminals will continue to run 6:6 ("**Affected Terminals**").

There is no arrangement between National Grid, or the Affected Terminals, and Shippers to handle mismatches (e.g. line pack flexibility or operational balancing type arrangements) available for 1 October 2015.

Shippers at Affected Terminals will only have day ahead and within day information about their intended and actual flows on a 6:6 basis and will accordingly have to schedule and nominate to National Grid and make "Claims" to the Claims Validation Agent based on 6:6 numbers.

National Grid will give the Claims Validation Agent a 5:5 aggregate metered Daily Quantity for each Affected Terminal and the Claims Validation Agent will need to allocate that number between shippers based on 6:6 Claim numbers.

If the CVSL arrangements are not changed (the "**Do Nothing**" option): (1) if the Daily Quantity is less than the aggregate of all shippers' Claims, all shippers' Claim numbers will be reduced pro rata; and (2) if the Daily Quantity is greater than the aggregate of all shippers' Claim numbers, the excess gas will be lost to the NTS as unallocated gas. Depending on the overall NTS imbalance, such excess gas may be sold by National Grid and the proceeds returned to all shippers via the balancing neutrality system rather than just to shippers at the Affected Terminals.

If "**Option A"** is voted through by the CVSL members: (1) if the Daily Quantity is less than the aggregate of all shippers' Claims the allocated quantities of the shippers entering gas into the NTS will be reduced to reflect the difference in two days' 5-6 volumes; and (2) if the Daily Quantity is greater than the aggregate of all shippers' Claims, the allocated quantities of the shippers entering gas into the NTS will be increased to reflect the difference in two days' 5-6 volumes and a volume of unallocated gas may be identified.

Shippers entering gas into the NTS will likely incur imbalance charges (SMBP, SMSP and Scheduling Charges) on a daily basis as a result of the difference between the 5:5 Daily Quantity

and the shippers' 6:6 Claim numbers. With Option A meaning they would be allocated long positions, they may also incur NTS Entry Capacity Overrun Charges and will no longer know how much NTS Entry Capacity to book to avoid these as they will not be able to foresee what they will be allocated. We have called all imbalance charges arising from the gas day differences "**synthetic**" imbalance charges.

Monies raised from synthetic imbalance charges will be returned to all shippers via the balancing neutrality charge system.

EU Regulations – Key Sections

Key sections of Regulation (EC) No 715/2009 of the European Parliament dated 13 July 2009 **("2009 Regulation")** and Commission Regulation (EU) No 312/2014 of 26 March 2014 establishing a Network Code on Gas Balancing of Transmission Networks **("BAL Code")** are set out in the attached Schedule (together the "**Regulations**").

The relevant basic principles that the Regulations are seeking to achieve are :

- **Non-discriminatory** rules for access conditions to natural gas transmission systems.
- Balancing Rules to reflect **genuine system needs** taking into account the resources available to the transmission system operator.
- Imbalance charges shall be **cost-reflective** whilst providing **appropriate financial incentives on network users to balance their input and off-take of gas**.
- Imbalance charges to **avoid cross-subsidisation** between network users and shall not hamper the entry of new market entrants.
- **Shippers to have primary responsibility to balance their balancing portfolios** in order to minimise the need for transmission system operators to undertake balancing actions.

Legal Status of the Regulations

- Directly effective UK law.
- The BAL Code forms part of the 2009 Regulation.
- Principle of EU statutory interpretation that wording that is both clear and in keeping with the purpose of the legislation must be given its plain meaning. If wording not in keeping with the purpose of the legislation, a more purposive approach to the wording should be taken.

Effect of Regulations given the situation at Affected Terminals

- Under the existing UNC framework, Shippers at Affected Terminals will pay unearned, immitigable synthetic imbalance charges arising from the difference between the aggregate flow of gas through the Affected Terminal in the period 0500 hours to 0500 hours and 0600 hours and 0600 hours on a likely daily basis. Such imbalance charges will **not be related to genuine system needs** (Art 21 of 2009 Regulation) nor to shippers' intended flows**.**
- Shippers will therefore not be able to comply in full with the **responsibility to balance their balancing portfolios** (Art 4.1 BAL Code).
- Such imbalance charges will not therefore fully **financially incentivise shippers to balance** (Art 21.3 of 2009 Regulation and Art 4.2 BAL Code) nor **be cost reflective** (Art 19.3 of BAL Code).
- Shippers at non Affected Terminals will not bear these synthetic imbalance charges resulting in shippers at Affected Terminals being **discriminated against** (Art 1(a) of 2009 Regulation).
- The monies raised by the synthetic imbalance charges will, under the current version of the Uniform Network Code, be returned to all shippers entering and exiting gas to and from the NTS through the balancing neutrality charge regime, not just to shippers at the Affected Terminals. There will therefore be **cross subsidisation** by the shippers at the Affected Terminals (Art 21.3 of 2009 Regulation).
- Note: Shippers' NTS daily imbalances are currently calculated in accordance with Article 21 of the BAL Code and SMBP and SMSP are calculated in accordance with Article 22 of the BAL Code. There appears to be nothing in the Regulations stipulating how the other imbalance charges the shippers will incur - Scheduling Charges and NTS Entry Capacity Overrun Charges - must be calculated.

Possible Solutions

In the absence of changes to upstream metering to adopt a 0500 to 0500 gas day, operational balancing arrangements between the Affected Terminals and National Grid or National Grid offering line pack flexibility services, the Working Group considers that the only way to comply with the principles and intentions of the Regulations is for the synthetic imbalances not to attract imbalance charges at the Affected Terminals.

This would mean that the distorting effect of the synthetic imbalance charges would be removed and the charges that are levied for differences between shippers scheduled and actual flows on an 0600 hours to 0600 hours basis will (i) provide incentives to balance and (ii) be cost reflective whilst avoiding (i) discrimination of shippers at Affected Terminals and (ii) cross subsidisation by them of other shippers.

By this we mean:

(1) not levying Scheduling Charges for differences arising between a shipper's scheduled quantity and that portion of its allocated quantity arising from the Affected Terminal difference between the 0500 hours flows and 0600 hours flows only;

(2) National Grid in its Residual Balancer role, buying long positions arising from synthetic imbalances at zero cost rather than SMSP and selling short positions at zero cost rather than SMBP (Note: these buys and sells will not affect the mass balance as the correct quantity of gas will be physically in the NTS; these are just notional imbalances arising from timing differences); and

(3) no Capacity Overrun Charges being levied on NTS Entry Capacity overruns caused by synthetic overruns. (Note: The question of how, if Option A, is adopted shippers will ever accurately be able to book NTS Entry capacity at Affected Terminals is a separate issue not addressed by this paper.)

We think this can either be done by upfront waivers of the imbalance charges (the "**ex ante**" solution) or by the imbalance charges being levied and then subsequently reimbursed to shippers (the "**ex post**" solution), depending on which solution is technically easiest for National Grid to implement.

The synthetic portion of a shipper's daily imbalance should be able to be calculated by reversing the impact of the 5:5/6:6 adjustment to shipper's Claim numbers. [NOTE ***Practicalities of how/who should do this to be discussed further tomorrow***].

The Working Group recognises that Uniform Network Code Modifications will be needed to achieve these solutions.

Interpretation of the Regulations in respect of ex ante and ex post solutions

Ex ante

There appears to be nothing in the Regulations preventing the waiver of Scheduling Charges and Overrun charges arising from synthetic imbalances.

If Articles 21 and 22 of the BAL Code are read prescriptively they could be interpreted as not allowing sufficient flexibility to allow a portion of a daily imbalance to be bought or sold by National Grid at a zero price. However, if it is deemed that applying Articles 21 and 22 of the BAL Code literally means that the overarching purposes of the Regulations cannot be met given the practical realities at the Affected Terminals, then they could deemed not to be a bar to an ex ante solution.

Ex post

Article 30 of the BAL Code in respect of balancing neutrality cash flows appears to provide a mechanism by means of which cash generated as a result of synthetic imbalances can be returned to shippers at Affected Terminals.

Art 30 Balancing neutrality cash flows

"30.1 The neutrality charge for balancing shall be paid by or **to the network user concerned".** *(i.e. No obligation to return to all network users)*

30.2 **The national regulatory authority shall set or approve** (*OFGEM discretion)* and publish the methodology for the calculation of the neutrality charges for balancing, including their apportionment amongst network users and credit risk management rules.

30.3 The neutrality charge for balancing shall be **proportionate to the extent the network user makes use of the relevant entry** or exit **points concerned** or the transmission network (*so could be returned only to the shippers at the relevant Affected Terminal*).

30.4 The neutrality charge for balancing shall be identified separately when invoiced to network users and the invoice shall be accompanied by sufficient supporting information defined in the methodology referred to in paragraph 2."

Schedule

Regulation (EC) No 715/2009 of the European Parliament dated 13 July 2009 ("2009 Regulation")

Art 1 (a)

This Regulation aims at: (a) setting **non-discriminatory** rules for access conditions to natural gas transmission systems **taking into account the special characteristics of national and regional markets with a view to ensuring the proper functioning of the internal market in gas**;

Art 21.1

Balancing Rules shall reflect **genuine system needs** taking into account the resources available to the transmission system operator.

Art 21.3

Imbalance charges shall be cost-reflective to the extent possible, whilst providing **appropriate incentives on network users to balance their input and off-take of gas**. They shall **avoid cross-subsidisation** between network users and shall not hamper the entry of new market entrants.

Commission Regulation (EU) No 312/2014 of 26 March 2014 establishing a Network Code on Gas Balancing of Transmission Networks ("BAL Code")

Recital 4 – reiterates the 2009 Regulation

Regulation (EC) No 715/2009 sets non-discriminatory rules for access conditions to the natural gas transmission networks with a view to ensuring the proper functioning of the internal market in gas. **Market-based balancing rules financially incentivise network users to balance their balancing portfolios via cost-reflective imbalance charges**.

Recital 6 – Information

In order to enable network users to balance their balancing portfolios, this Regulation also sets out minimum requirements for information provision to implement a market-based balancing regime. The information flows provided under this Regulation therefore aim to support the daily balancing regime and seek to be a set of information **to support the network user in managing its risks and opportunities in a cost efficient way.**

Art 4 General Principles

Art 4.1

The network users shall be responsible to balance their balancing portfolios in order to minimise the need for transmission system operators to undertake balancing actions set out under this Regulation.

Art 4.2

Balancing rules established in accordance with this Regulation shall reflect genuine system needs, taking into account the resources available to transmission system operators and **shall provide incentives for network users to balance their balancing portfolios efficiently.**

Art 19 Daily Imbalance Charges

Art 19.3

The daily imbalance charge **shall be cost reflective** and shall take account of the prices associated with transmission system operator's balancing actions, if any, and of the small adjustment referred to in Article 22(6).

Art 20 Imbalance charge calculation

Art 20.3

The daily imbalance charge calculation methodology shall define:

(a) the calculation of the daily imbalance quantity referred to in Article 21;

(b) the derivation of the applicable price referred to in Article 22; and

(c) any other necessary parameter.

Art 21 Daily imbalance quantity calculation

Art 21.1 – Note : 'input' is not defined

The transmission system operator shall calculate a daily imbalance quantity for each network user's balancing portfolio for each gas day in accordance with the following formula:

daily imbalance quantity = inputs – off-takes

Art 21.2

The daily imbalance quantity calculation shall be adapted accordingly where:

(a) a linepack flexibility service is offered…

Art 21.6

The daily imbalance quantity shall be based on the final daily imbalance quantity.

Art 22 - Applicable Price

22.1 For the purpose of daily imbalance charge calculation as provided in Article 23 the applicable price shall be determined as follows :

(a) marginal sell price where the daily imbalance is positive (i.e. the network user's inputs for that gas day exceed its off–takes for that gas day); or
(b) marginal buy price where the daily imbalance quantity is negative (i.e. the network user's off-takes for that gas day exceed its inputs for that gas day).

22.2 (a) a marginal sell price is the lower of: (i) the lowest price of any sales of title products in which the transmission system operator is involved in respect of the gas day; or (ii) the weighted average price of gas in respect of that gas day minus a small adjustment.

(b) a marginal buy price is the higher of: (i) the highest price of any purchases of title products in which the transmission system operator is involved in respect of the gas day ; or (ii) the weighted average price of gas in respect of that gas day plus a small adjustment

Art 29 Neutrality principles

Art 29.2

The transmission system operator shall pass to network users:

(a) any costs and revenues arising from daily imbalance charges and within day charges;

(b) any costs and revenues arising from the balancing actions undertaken pursuant to Article 9, unless the national regulatory authority considers those costs and revenues as incurred inefficiently in accordance with the applicable national rules. This consideration shall be based upon an assessment which:

(i) shall demonstrate to what extent the transmission system operator could have reasonably mitigated the costs incurred when undertaking the balancing action; and

(ii) shall be made with regard to the information, the time and the tools available to the transmission system operator at the moment it decided to undertake the balancing action;

(c) any other costs and revenues related to the balancing activities undertaken by the transmission system operator, unless the national regulatory authority considers these costs and revenues as incurred inefficiently in accordance with the applicable national rules.

Art 30 Balancing neutrality cash flows

30.1 The neutrality charge for balancing shall be paid by or to the network user concerned.

30.2 **The national regulatory authority shall set or approve** and publish the methodology for the calculation of the neutrality charges for balancing, including their **apportionment amongst network users** and credit risk management rules.

30.3 The neutrality charge for balancing shall be **proportionate to the extent the network user makes use of the relevant entry or exit points concerned** or the transmission network.

30.4 The neutrality charge for balancing shall be identified separately when invoiced to network users and the invoice shall be accompanied by sufficient supporting information defined in the methodology referred to in paragraph 2.