

CODE MODIFICATION PROPOSAL No son of 0233
Changes to Outstanding Energy Balancing Indebtedness Calculation
Version x.x

Date: 22/01/2010

Proposed Implementation Date: ASAP

Urgency: Non Urgent

1 The Modification Proposal

a) Nature and Purpose of this Proposal

National Grid NTS has raised this Proposal on behalf of the Energy Balancing Credit Committee.

Uniform Network Code (UNC) referenced Sections are to the Transportation Principal Document except where stated otherwise.

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. As an outcome of the EBCC review, Modification 0233V – *'Changes to Outstanding Energy Balancing Indebtedness Calculation'* was raised as one of three Proposals seeking to address some of those concerns highlighted during the review. Following Ofgem's rejection of Modification 0233V, members of the EBCC have considered the decision letter and have raised this Proposal with a view to addressing Ofgem's concerns relating to transparency, uncertainty of timing/data and providing Users with a right of appeal.

As a result of the last year's events associated to User failure, the EBCC has expressed concern that under prevailing arrangements there are instances where there is a lag time between the Energy Balancing Credit (EBC) manager becoming aware, that a User may be in financial difficulty, and that User being required to notify National Grid that it is approaching default, or has appointed an administrator.

For the purposes of effectively monitoring and managing a User Balancing Indebtedness the User is only required to communicate with National Grid, or take the appropriate action, where the User has either been Cash Called (UNC X2.6) or where National Grid has notified of Further Security Request (UNC X2.10).

We believe that the absence of User communication, during a period where it may be evident that the User's actual level of indebtedness is increasing, may represent a risk to the community resulting in unnecessary User default

costs. Experience has demonstrated that although National Grid NTS may attempt to engage with the User, the User has no obligations to respond until such time as it is Cash Called, based on its Anticipated Relevant Balancing Indebtedness (ARBI). This delay in communication may increase Users' exposure to avoidable financial loss.

The EBCC and National Grid consider that the changes proposed within this Modification will introduce enhancements in the effective management of Energy Balancing credit and controls, which may mitigate the concerns described above.

This Proposal combines two elements which are outlined as follows;

1. Users' Ability to Appeal against Cash Call Notices

The existing UNC Cash Call appeal provisions do not provide sufficient flexibility to allow a User to appeal to National Grid NTS in respect of Cash Call notices where the User has more up-to-date 'closed-out'¹ values. Under the prevailing provisions defined in paragraph X2.7.1 (c), a User cannot appeal on the grounds of its Outstanding Relevant Balancing Indebtedness when the appeal is related to the calculation of its ARBI in accordance with Section X2.5.2 (c).

As a consequence of prevailing code provisions, there is potential for a User to be exposed to unnecessary Cash Call notices under Section X2.6. Subsequently, further Security Requests may be issued to a User in accordance with Section X.2.10 if more than one such notice was issued within 28 days of the submission of a Cash Call, in accordance with Section X2.6.4. In turn, the impact of such actions could result in the User experiencing adverse cash flow issues and thus increasing the potential of it becoming a Defaulting User.

Implementation of this Proposal would allow a User to provide more up-to-date 'closed out' values to National Grid NTS which may contribute to that User's Daily Imbalance calculation. Together with the relevant cash-out prices these Daily Imbalances make up that User's Outstanding Relevant Balancing Indebtedness. The provision of more up-to-date values would therefore better anticipate both that User's cumulative energy balancing position at close-out and any consequent liability faced by other Users should that User be Terminated for any reason.

2. National Grid NTS ability to process adjustments to a User's Outstanding Balancing Indebtedness

On behalf of the EBC manager monitors all User Balancing Indebtedness on the Gemini System. There have been instances where the EBC manager has determined that the User's prevailing ARBI does

¹ (closed-out – a period within which specified data is complete and for the purposes of Energy Balancing cannot be revised)

not reflect the true extent of the User's Outstanding Relevant Balancing Indebtedness. In addition the EBC manager may also become aware of information in the public domain, which indicates an imminent and increased risk of a User defaulting and therefore has the potential to increase the risk of all Users' exposure to avoidable financial loss. Under prevailing arrangements the EBC manager may provide reports to the EBCC, which highlight concerns associated with the affected User's ARBI values not reflecting actual indebtedness values; and the risk that this represents to the Shipper User community. Under prevailing arrangements the EBCC does not have the jurisdiction to take any risk mitigating actions until such time as the User fails to respond to a Cash Call, based on the ARBI calculation.

Implementation of the Proposal would allow the affected User's ARBI values to be revised to account for any relevant up-to-date "closed-out" actual values (for the purposes of this Proposal "closed out" values are Daily Trade Nomination Quantities in accordance with UNC Section C5 and Daily Output Quantities "closed-out" in accordance with UNC Section E1.8.1 (b)) that are available at the time within the Transporters' UK Link system for the relevant Gas Days. Where such values are applied the National Grid NTS will provide supporting information to that User for validation purposes.

Nature of the Proposal

We propose that an alternative calculation of a User's ARBI values should be undertaken in the following circumstances;

The EBCC, through its own initiative or at the request of the affected User, any other Shipper User or National Grid NTS, may initiate the Test detailed below (A. the Test). National Grid NTS will apply the alternative calculation of ARBI, in respect of the affected User, where the following Test is satisfied;

A. The Test

- Application of the alternative calculation would give a materially different result from the prevailing ARBI calculation; and
- Application of the prevailing ARBI calculation instead of the alternative is likely to have a materially adverse effect on the interests of either:
 - (i) the affected User (where the balancing indebtedness is overestimated); or
 - (ii) all Users collectively (where the balancing indebtedness is underestimated).

Commencing as soon as reasonably practicable, after the EBCC's decision,

National Grid NTS will apply the alternative calculation. The alternative calculation shall be applicable for a period of 10 consecutive days. However the EBCC may decide (by [majority] [unanimously]) on a shorter period (in a case in A(i)) by consent with the affected User).

The application of the alternative calculation may be extended (beyond 10 days) by a further decision of the EBCC where the affected User's balancing indebtedness has again satisfied the Test A(i).

Where the alternative calculation is being applied, the EBCC may decide of its own initiative, or at the request of the affected User, or National Grid NTS, to discontinue applying the alternative calculation, if the EBCC considers that the Test A(i) is no longer satisfied.

Where the EBCC is requested to make a decision in respect of the Test A.(i), the EBCC will meet as soon as reasonably practicable to consider the matter.

The affected User will be provided with the opportunity to attend the EBCC meeting and provide information prior to any decision.

It is proposed that the alternative calculation will use actual Trade Nomination data and (where it is available) "closed-out" exit (UDQO) data for the 'unclosed period' (i.e. the period for which entry "closed-out" data is not available, at the time at which Relevant Balancing Charges are being calculated).

Following such action, it is proposed that the prevailing arrangements within the UNC Section X and the Energy Balancing Credit Rules, which relate to Cash Calling processes, should remain unchanged. This in effect will provide adequate opportunity for the affected User to appeal any resultant Cash Call notice that may be issued and allow for the EBCC to employ discretion where necessary should the User become a Defaulting User as a consequence of such action.

Purpose

The current provisions within Section X2.5.2(c) detail the formula by which a User's ARBI is calculated. National Grid NTS and the EBCC believe that such arrangements provide ARBI assessments which generally demonstrate an appropriate level of monitoring of Users' Outstanding Balancing Indebtedness. However, the prevailing arrangements prevent National Grid NTS from acting on a more up-to-date assessment of a User's Outstanding Relevant Balancing Indebtedness where;

- it has more up-to-date values available within its system; and
- it is aware that a User's business status may represent an imminent and increased risk of User default.

As a consequence of the prevailing provisions, the community may be exposed to unnecessary financial risk due to the potential 9 day time-lag in

actual “closed-out” values being reflected in a User’s Outstanding Relevant Balancing Indebtedness.

Following the circumstances described in the Nature of the Proposal section above, implementation of this Proposal would, allow National Grid NTS to use more up-to-date “closed-out” values (Daily Trade and Exit Allocations) that contribute to a User’s Daily Imbalance and together with the application of the relevant System Clearing prices these Daily Imbalances make up a User’s Outstanding Relevant Balancing Indebtedness. Use of more up-to-date ‘closed out’ values would therefore better anticipate each User’s cumulative energy balancing position at close-out and any consequent liability faced by other Users should that User be Terminated for any reason.

Closed-out Data

For the purposes of this Proposal the definition of “closed-out” values shall be data which is:

- (i) the relevant User’s Daily Imbalance associated with the relevant day(s) Trade Nomination Quantities as at 07:00 on D+1 (in accordance with UNC Section C5.1 and C5.2); and/or
- (ii) Output Quantities closed-out at D+5 (in accordance with UNC Section E1.8.1 (b))

Application of the Closed-Out Data

Under prevailing arrangements the purpose of the ARBI formula is to accrue a User’s Balancing Indebtedness for periods where the majority of a User’s balance position is not available as finalised closed-out values. The ARBI formula is applied on a 10-day-rolling-average of the User’s total energy imbalance.

Following the circumstances described in the ‘Nature of the Proposal’ this Proposal also seeks to apply the ARBI formula to evaluate a relevant User’s anticipated indebtedness for each Day where closed-out values may not be available. However where actual closed-out values are available for a Day, within the period applicable to the ARBI formula, National Grid NTS will replace the values derived within the ARBI calculation, with actual closed-out values. These closed-out values will replace the proportion of the value derived through the ARBI calculation that sought to estimate the closed-out value.

Application of the Alternative Calculation

In order to provide for the alternative calculation, a change in structure (but not effect) of the normal calculation is needed. Anticipated Balancing Indebtedness is a proxy for balancing indebtedness for the unclosed period, using prior Days for which data is available. However, there is no explicit correlation between Days in the unclosed period and the closed-out Days the data for which is used. This correlation needs to be created in order to

provide for the alternative calculation.

Currently, Anticipated Balancing Indebtedness is calculated based on average Daily Imbalances for the User by reference to a period (called the 'relevant period') of the same duration as the unclosed period but expiring at the start of the unclosed period (i.e. on the 'relevant Day' – the latest Day for which closed-out entry data is available). For each Day in the relevant period, an average of the User's Daily Imbalances over the preceding 10 Days (called the 'Imbalance Period') is used. For each Day in the relevant period adjusted SAP is applied to this average Daily Imbalance.

This will be changed (in structure not effect) to say that for each Day (i) in the unclosed period, Day (k) is the Day which precedes Day (i) by the duration of the unclosed period. For each Day (i), an average Daily Imbalance will be calculated based on the 10-day period which ends on Day (k). The adjusted SAP for Day k is then applied to this average Daily Imbalance. This gives the same result as the existing calculation.

The alternative calculation then works as follows. Instead of the average Daily Imbalance for each Day (i) in the unclosed period, a specific Daily Imbalance is calculated, using actual NBP trade (Trade Nomination) data for Day (i), and average entry and exit data (UDQIs and UDQOs) for the same 10-day period ending Day (k). However for Days (i) for which exit closed-out data is available, the actual data (UDQOs) are used instead of the 10-day average. The adjusted SAP for Day (i) rather than Day (k) is used.

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

Urgent status is not requested.

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.

Modification 0233 and its variations were discussed as part of several EBCC meetings throughout 2008 and 2009 and more recently, this Proposal was discussed at the November 2009 EBCC meeting.

It is recommended that this proposal is discussed at a Transmission Workstream and provided it is agreed that it is sufficiently clear, should then proceed to consultation.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

This Proposal seeks to implement changes to prevailing xoserve services, and therefore must be considered under the User Pays remit. xoserve has

advised that the changes required to support this Proposal are manual process changes.

In its role as Energy Balancing Credit manager (EBC), and for the purpose of better informing the EBCC, xoserve undertakes a series of ARBI monitoring processes, these processes, although not specified within the UNC Code provisions, are undertaken in accordance with its monitoring of debt management responsibilities. These monitoring processes are similar to those proposed within this Modification. Furthermore, xoserve has advised that the Proposal, if implemented, would have the benefit of reducing the level of unnecessary Cash Calling of Users and its ability to meaningfully communicate with a User that is at imminent risk of defaulting. xoserve believe that the anticipated cost savings associated with the streamlining of these administrative processes will offset the costs which may be incurred as a result of the implementation of this Proposal.

In conclusion, xoserve anticipates that any development, implementation or operational costs associated with the proposed changes can be absorbed into the prevailing Energy Balancing Indebtedness monitoring processes. As the anticipated costs for the implementation of this Proposal are not believed to be material and are outweighed by the process efficiency benefits.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

We consider that this Proposal should be funded on the basis of 100% Shipper Users, however as discussed above we believe that as a greater proportion of the manual processes necessary to facilitate this Proposal are already developed and utilised by the EBC manager, the costs associated with the implementation and operation of this change will be offset against savings associated with the improvements in administrative processes, xoserve has therefore confirmed that there will be no additional cost to be recovered as a result of this Modification Proposal.

c) Proposed charge(s) for application of Users Pays charges to Shippers

Not required

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

Not required

3 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

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;

The shortcomings of the prevailing Anticipated Relevant Balancing Indebtedness calculation allied with a lack of provisions to appeal against any subsequent Cash-Call may discriminate against Users that provide sufficient security against their actual energy balance. If implemented this Proposal will provide Users with a right of appeal, based on more up-to-date values, which may reduce a User's exposure to unnecessary Cash Calls and, in the extreme, Termination. By removing this potentially discriminatory aspect, implementation would be expected to better facilitate this relevant objective.

Conversely, the ability of National Grid NTS to use more up-to-date allocation values might be expected to bring forward Cash Call and other measures and so reduce the exposure of all Users' to the debts of a Defaulting User.

4 The implications of implementing this 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 this Modification Proposal, including:

a) The implications for operation of the System:

No such implications are anticipated.

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

For the purpose of ensuring the EBCC is informed of Energy Balancing Indebtedness issues, under prevailing arrangements the Energy Balancing Credit Manager utilises more 'up-to-date' values in its monitoring processes. These processes are similar to the revisions this Proposal is seeking to implement and therefore, xoserve has advised that it would not anticipate that such changes would affect operating costs.

Consideration of Automated Processes

During discussions, National Grid NTS and the EBCC recognised that an xoserve system change, through which the Closed-out values described in this Proposal could be automatically applied,

- for every day of the ARBI formula period; and
- to all Users' ARBI,

would provide the most favourable and non discriminatory approach to facilitate this change. However during the development of Modification Proposal 0233, National Grid NTS requested that its service provider carry

out analysis of estimated development costs and timescale required to deliver a fully automated system solution. Having received this information from the service provider, and following discussion with members of the EBCC, it was determined that the cost and timescales required to introduce a fully automated system were prohibitive and outweighed the benefits that this Modification Proposal sets out to achieve.

We believe that the “by exception” and manual changes that this Proposal is seeking to introduce provides the most efficient and economic solution to the concerns expressed by the EBCC in that it; introduces arrangements which may protect the community from exposure to the risk of avoidable costs resulting from User default, in the absence of generating excessive costs to the industry for the implementation of supporting operational changes.

We anticipate that the number of occasions that the proposed changes are applied will be minimal. However we are mindful that should the frequency of the revised ARBI calculation application increase to the point at which it is no longer economical or efficient to undertake this revised calculation as part of a manual process, we will consider raising a subsequent Proposal, which would seek to implement the fully automated solution.

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:

No Proposal is made for the recovery of the costs outlined above.

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 are identified.

6 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)

No such requirement has identified.

7 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

It is proposed that the changes required to support this Modification will be achieved through implementation of or revisions to manual processes, therefore no such implications are anticipated.

8 The implications for Users of implementing the Modification Proposal, including:

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

In order to support the proposed revisions to existing rules regarding a User's ability to challenge Cash Call notices, Users may need to revise existing processes and procedures in order to be able to provide more up-to-date values to National Grid NTS.

b) The development and capital cost and operating cost implications

We welcome the views of respondents.

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

It is anticipated that the community's contractual risk would be reduced by this implementation of Proposal, as it would enable potential User Default to be identified earlier than currently, or to be avoided by permitting National Grid NTS (subject to EBCC agreement) to act earlier to manage a User's outstanding energy balancing indebtedness position, which may ultimately avoid a User Default.

We welcome the views of respondents.

9 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)

No such implications are identified.

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

No such consequences are identified.

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

Advantages

- Reduces a User's risk of unnecessary Cash Calls and Termination.
- Reduces the exposure of other Users through Balancing Neutrality Charges in the event of a User Default

Disadvantages

- Non identified

12 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)

No representations yet received.

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

Non yet received

14 Any other matter the Proposer considers needs to be addressed

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

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

16 Comments on Suggested Text

Non yet received

17 Suggested Text

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document

Section(s) X2.5.1 Calculation of Outstanding Relevant Indebtedness

Proposer's Representative

Claire Thorneywork (National Grid NTS)

Proposer

National Grid NTS