

CODE MODIFICATION PROPOSAL No xxxx

<Title>
Version x.x

Date: 09/02/2009

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 UNC parties.

Following Review Group 221 discussions, National Grid Gas believes there are two key shortcomings that have been identified:

1. There is currently no requirement to lodge security to reflect the level of financial commitment made, as a result of bids being allocated in a long term entry capacity auction.
2. Incremental Capacity auction allocations lead to release of additional allowed revenue to National Grid. If the User subsequently does not use this capacity then the additional revenue is recovered from all other Users through increased Transportation charges.

Modification Proposal

National Grid Gas has raised this Modification Proposal to address these perceived shortcomings. For the avoidance of doubt, this proposal aims to introduce long term Entry Capacity security arrangements that will run in parallel with those for transportation charges.

The following aspect of the proposal relates to the current arrangements:

Current security provisions set out in B2.2.15 of the UNC mean that NGG looks at the sum

of the User's current Relevant Code Indebtedness* and the following 12 months liability for capacity charges associated with Quarterly NTS Entry Capacity*, as acquired in Quarterly System Entry Capacity* (QSEC) auctions. If this aggregated amount exceeds 85% of the User's Code Credit Limit, then National Grid Gas will notify the User. The User can either increase its Code Credit Limit by providing additional security or allow the future 12 months QSEC to lapse. The UNC obligations surrounding the annual auction of Monthly NTS Entry Capacity* also involve a review of the User's credit position in relation to the value of bids submitted under the UNC provisions in Section B 2.2.13.

These provisions define the requirement for NGG to be provided with security for short term capacity, i.e. the next 12 months capacity charges that form part of the transportation invoicing arrangements and it is proposed that these provisions in the UNC within Section B 2.2.13 and 2.2.15 remain in place. However, we propose to amend Section B 2.2.16 to remove the current ability for the User's Registered Quarterly Firm NTS Entry Capacity to lapse and the long term entry capacity default rules described in this proposal will now apply to this short term capacity. It is anticipated that this change will enhance current incentives for Users to submit the required security as per UNC TPD Section B2.2.13 & B2.2.15.

The following relates to the main aspect of the proposal:

It is further proposed that all Users with entry capacity holdings will be required to provide appropriate security based on a risk assessment of the Allocated Capacity Values (ACV). The ACV will be calculated for each User separately as follows:

ACV = the sum of all Allocated Entry Capacity bids at all ASEPs for all Years Y2 [Y1 if inc. AMSEC] to Y16 inclusive multiplied by [0.2].

Each User's User Security Value (USV) required will be calculated as follows:

$$USV = ACV \text{ multiplied by } (\text{sum of } UCR + UPR)$$

Where:

UCR is the User Credit Rating calculated using the methodology contained with the the Entry Capacity Risk Assessment Methodology (ECRAM) statement.

UPR is the User Project Risk again calculated using the methodology contained with the Entry Capacity Risk Assessment Methodology (ECRAM) statement and using the values detailed in the table below.

Standard and Poor's	Moody's Investors Service	Independent Assessment Score	User Credit Rating (UCR) risk
AAA/AA	Aaa/Aa		25%
A	A		40%
BBB+	Baa1	10	45%
BBB	Baa2	9	45.25%
BBB-	Baa3	8	45.5%
BB+	Ba1	7	45.75%
BB	Ba2	6	46%
BB-	Ba3	5	46.25%
		4	46.625%
		3	47.5%
		2	48.33%
		1	49.125%
No credit rating	No credit rating	0	50%

The ECRAM will be published by National Grid Gas in a supplementary guidance document, and may be amended by National Grid Gas at any time.

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

The ECRAM will comprise examples of the following elements:

How to calculate the ACV – The User will be required to estimate the value of their successful capacity bids across all auction periods and ASEPs in that auction and add this to the value of their existing capacity holdings for Gas Years [2 to 16].

How the User Credit Rating (UCR) is calculated. User's will pay between 25% and 50% of the ACV depending on the quality of their credit rating, as specified by Standard and Poor's or Moody's.

How the User Project Risk (UPR) is calculated. Where a User's entry capacity utilisation is dependant on User (UK based) investment to develop an entry facility and or associated pipeline, then a project risk assessment will be undertaken. Users will pay between 0% and 50% of the ACV, depending on the progress of their project. The User must provide the required evidence to support the position of their project to National Grid.

Where there is a dispute between the User and National Grid as to the progress of a project the User may appeal to the Authority. Whilst such appeal is on-going the National Grid assessment of the User's UPR will be applied.

It is also proposed that Users will be required to provide security prior to participating in any auction process for Quarterly NTS Entry Capacity* (QSEC) [or Annual Monthly NTS Entry Capacity* (AMSEC)]. The level of security will be the amount determined by the entry capacity risk assessment i.e., the User's USV. The User shall provide this security via either a Deposit Deed* or Letter of Credit*.

During the auction allocation process National Grid NTS will determine whether a User's potential allocations of entry capacity at all ASEPs and over all auction Years combined with the User's existing entry Capacity holdings at all ASEPs for Gas Years [1] 2 to 16 inclusive would exceed the User's secured maximum USV. If the User exceeds the security

provided then prior to allocating NTS Entry Capacity National Grid NTS will reject all of that User's auction bids at all ASEPs and across all Years in that auction.

The User can provide additional security at any point prior to the start of the allocation process.

It is also proposed that the following actions be classed as "events of User default" which will trigger the following "default process":

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 [28 days] validity remaining.

If an "event of default" occurs, a notice will be issued to the User by National Grid NTS, requiring the User to at least equal the amount of security provided to the User's USV within 10 Business Days.

Where the security provided does not at least equal the User's USV after 10 business days following the above notice, the User will be obliged to pay the User's ACV [an invoice may need to be raised. National Grid NTS are currently investigating this point and further detail will be provided once this point has been clarified] Pending payment NG NTS will call on the security provided by the User. In addition National Grid NTS will reject any further applications for QSEC [or AMSEC] capacity by the User.

If the User does not pay the amount specified or where the breach is not capable of remedy then the User's NTS Entry Capacity allocated in the QSEC [and AMSEC] auctions will be recalled.

It is proposed that the provisions of UNC TPD Section B5.4 will continue to apply in relation to the recalled capacity but will be amended to reflect that they will be followed in the event of a long term entry capacity "default". Following application of Section B5.4 any remaining "recalled" NTS Entry Capacity will be offered in the next available suitable auction including an adhoc auction or the next scheduled suitable Entry Capacity auction covering the period of the recalled capacity. This will be at National Grid NTS's discretion.

It is proposed that any revenues accumulating from the first offering of the recalled capacity in an Entry Capacity Auction will be compared to the original value paid by the defaulting User for the recalled capacity. If there is a shortfall between the resale revenue and the original revenue then the security provided by the Defaulting User will be used to offset the shortfall. Any excess security remaining after this assessment will be returned to the defaulting User. Any remaining debt after this assessment will be treated as a Transportation debt remaining accrued by the User.

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), the efficient and economic operation of the pipeline, this Proposal provides an incentive for Users to honour existing and future entry capacity auction commitments. This in turn will give National Grid and the shipper community greater assurance over the appropriateness of any associated system developments and or allowed revenue returns.
- 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 Entry Capacity holdings, without introducing a prohibitive cost to Users who may wish to take part in the Entry Capacity auctions. We 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 a balance between capturing an efficient level of User commitment and mitigating the shipper community's risk from User failure to pay capacity charges. During the development of this proposal National Grid NTS has sought to reflect the views of the attendees of the 0221 Review Group. These views included the ability to mitigate the shipper community's risk to a single User's default, whilst at the same time not creating an undue barrier to entry or adversely impacting on the amount of capacity purchased through long term auctions and the long term investment singles that these auctions seek to provide.

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 prevent Users from bidding for unsold baseline and triggering non-obligated or incremental capacity.

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

The levels of security to be provided by Users as a result of the introduction of this proposal is expected to be in the region of £100m-£180m (7-13% of all Allocated Capacity Values (ACV)), which would equate to an estimated Letter of Credit cost (based on 2.5% of face value) across all Users of around £2.5m-£4.5m per year.

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 shall 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 Users in proportion to:

Total implementation and development costs * (User's ACV divided by the sum of all User's ACV)

The ACVs to be used in the above calculation shall be the ACVs applicable on the date of the implementation date of this proposal.

These sums will be invoiced over the remainder of the Gas Year following implementation of this Proposal.

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] National Grid NTS believes There will be system impacts as a result of having to compare auction bid values and the security provided prior to allocation of the QSEC [& AMSEC] capacity. There will also be invoicing implications which need to be considered.

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 Users participating in the QSEC [and AMSEC] auctions, the User will probably need to adjust their administrative arrangements to reflect the User Commitment arrangements so that they are able to assess their credit requirements and ensure a Deposit Deed or Letter of Credit is in place to match their current capacity holdings and any capacity auction strategy.

b) The development and capital cost and operating cost implications

National Grid NTS appreciates that there will be cost implications in extending the security arrangements. As a result of the 0221 Review Group discussions we consider that the costs incurred from implementing this proposal are offset by the benefits accrued from mitigating the risk of a User's failure to pay Entry capacity charges.

We also believe the operating costs associated with this proposal will be reasonable when compared to the Shipper community bearing the full cost of a project or major User failure

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

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)

The credit risk assessment process consists of a User Project Risk element. The outcome of this assessment will require these parties to provide evidence to support the development of their projects when requested to do so by National Grid indeed it is anticipated that Users will actively seek to provide this information.

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 Gas believes that by introducing appropriate User Commitment for long term entry capacity:

- The Shippers will continue to signal sufficiently far in advance to allow National Grid Gas to make appropriate investment decisions.
- The proposal lessens the risk of, and shipper community exposure to, an event of a Shipper failing to pay its entry capacity charges.

Disadvantages

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

- 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 will also come at a cost to the User.
- Implementation risk: Projects could be delayed or cancelled as a result of the new User Commitment required and other Users may seek to relinquish their capacity holding.

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

Name (Organisation)

Proposer

Name (Organisation)