

CODE MODIFICATION PROPOSAL No xxxx

<Title>
Version x.x

Date: 25/02/2009

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 Shipper Users.

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

1. There is currently an inappropriate length of time between a User committing to buy long term NTS Entry Capacity and the User financially underpinning this commitment.
2. Incremental capacity auction allocations lead to release of additional allowed revenue to National Grid NTS. 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 NTS has raised this Modification Proposal to address these perceived shortcomings. For the avoidance of doubt, this proposal aims to introduce long term NTS Entry Capacity security arrangements that will run in parallel with those currently existing 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 NG

NTS 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 NTS 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.

These provisions define the requirement for NG NTS to be provided with security for near term entry capacity, i.e. the next 12 months capacity charges that form part of the transportation invoicing arrangements and it is proposed that the provision in the UNC within Section B2.2.15 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 default rules described in section V will now apply where the User has not provided the security required under Section B2.2.15. It is anticipated that this change will enhance current incentives for Users to submit the required security as per UNC TPD Section B2.2.15.

The following relates to the main aspect of the proposal:

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). The level of security will be the amount determined by the entry capacity risk assessment i.e., the User's User Security Value (USV). Full details of the entry capacity risk assessment and the USV are explained later in the proposal. The User shall provide this security via either a Deposit Deed* or Letter of Credit*.

Prior to the commencement of the auction allocation process NG NTS will determine whether a User's revised USV (reflecting their existing holding and any new capacity bids made) exceeds the actual security provided. If the User USV exceeds the security provided then NG 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.

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

Entry Capacity Risk Assessment

All Users with QSEC NTS entry capacity holdings will be required to provide appropriate security known as the User Security Value based on a risk assessment of the Allocated Capacity Values (ACV). Each User's User Security Value (USV) required will be calculated as follows:

$$USV = \sum nACV_n \text{ multiplied by } (UCR + UPR_n)$$

Where:

n = individual ASEP

ACV = that Users allocated QSEC NTS Entry Capacity bids at the ASEP for all Years Y2 to Y16 inclusive multiplied by [0.2].

In order to ensure that their auction bid values are allocated the User will be required to derive the ACV for each ASEP prior to each QSEC auction, by estimating the (max) value of their successful capacity bids across all auction periods and adding this to the value of their existing capacity holding for Gas Years Y2 to Y16 (inclusive).

UCR is the User Credit Risk. Where a User has an Approved Credit Rating from Standard and Poor's, or Moddy's Investors Service, the User's UCR will be determined via the table below.

Where a User currently uses an Independent Assessment Score or Parent Company Guarantee (PCG) as security for their Transportation Invoicing, then the associated rating/score will be used in determining a Users UCR via the table below.

Standard and Poor's	Moody's Investors Service	Independent Assessment Score	User Credit Risk (UCR)
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%

UPR is the User Project Risk (UPR). Where a User's NTS entry capacity utilisation is, in NG NTS's opinion, dependent on (UK based) investment in order to achieve an increase in flow rate into the system at an existing or a new ASEP then a User Project Risk assessment will be applied.

Where a UPR is applied Users will initially be allocated a UPR of 50%.

The UPR will be reduced from the initial 50% where the User can demonstrate that certain project activities have been completed or are not applicable. The project activities indicated are such activities that National Grid NTS believes are necessary to ensure that the Entry Capacity allocated is capable of being utilised. The activities and the amounts allocated to these activities are shown in the table below.

Project Activity	UPR reduction (%)
Full project approval and project finances are in place	10%
Regulatory consents are in place, for example Third Party Access.	5%
Feasibility study and land (lease or ownership) are in place	5%
UK planning permission (onshore and offshore (if applicable) in place	10%
Construction contracts are signed (include appropriate timescales)	10%
Construction completed	10%

When seeking to reduce the UPR below its initial 50% or for any subsequent reduction, the User must provide the required evidence to support the position of their project; as such information is not in possession, or control, of National Grid. The evidence provided must be sufficient to enable National Grid NTS to be reasonably satisfied that the project has progressed to the stage proposed by the User.

Where following a Users submission of information to support a request to change the position of a project, NG NTS is not reasonably satisfied that the project has progressed sufficiently, then the project will remain at the current stage of assessment and the level of security will remain unchanged.

Where NG NTS is of the reasonable opinion that the status of a project may have changed since the User last demonstrated the position (i.e. a planning appeal has over-turned existing planning permission) then position of the project will be amended. If the revised USV exceeds the security currently provided, then the User will be notified and required, within 10 working days of the notice to provide the additional security.

In the event that there are a number of Users directly associated with the project the UPR will be applied across all Users at that ASEP.

Where there is a dispute between the User and National Grid NTS as to whether a UPR should be applied or the extent of the project activities completed then the NG NTS view shall stand but the User may appeal to the Authority. To the extent that such an appeal is successful then the Authority may direct NG NTS as to the appropriate level of the UPR.

Long Term Entry Capacity Default 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 [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 section V.

If an “event of default” occurs, a notice will be issued to the User by National Grid NTS informing the User of the event of default and requiring the User 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 reject any further applications for QSEC and AMSEC capacity by the User.

In the event that the User has not met the conditions of the notice, then the Users QSEC capacity holding across all ASEPs in Years Y2 to Y16 will be cancelled and the User charged a cancellation fee equivalent to the Users security held for the purposes of underwriting the Users holding of QSEC.

It is proposed that the provisions of UNC TPD Section B5.4 will continue to apply in relation to the cancelled 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 cancelled NTS Entry Capacity will be offered in subsequent capacity auctions and treated as unsold capacity.

It is proposed that any revenues accumulating from the cancellation charge and any new Allocated Capacity Values from the resale or B5.4 process will be combined and compared to the expected revenue. If there is an excess or shortfall in expected revenue from the assessment, then this will be shared across the shipper community.

- 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 NTS 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 (7% 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 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 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 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 NTS 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 NTS 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 NTS 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 NTS 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)