

To whom it may concern

Malcolm Arthur
Gas Codes Development Manager

malcolm.arthur@uk.ngrid.com
Direct tel +44 (0)1926 654909
Mobile +44 (0) 7789 942691

www.nationalgrid.com

11 January 2011

Dear Colleagues

Inter-day Linepack Product consultation paper – ‘Open Letter’

This ‘Open Letter’ seeks your views regarding your anticipated usage of an Inter-day Linepack service, as currently proposed within the UNC Modification Proposal 0337 (MP0337) ‘Introduction of an Inter-day Linepack Product’ <http://www.gasgovernance.co.uk/0337>.

This ‘Open Letter’ provides the opportunity for the views of all parties including those unable to attend the UNC Transmission Workstream/Review Group meetings to be captured prior to the final preparation of MP0337 for submission to the UNC Panel and subsequent decision by the Authority.

National Grid Gas (NGG) would additionally welcome industry feedback on areas where Users believe that the proposed Inter-day Linepack service may be improved, such that it better facilitate the needs of Users.

Responses to this ‘Open Letter’ are requested by 5pm on 1st February 2011. Please note that we intend to publish all responses unless they are clearly marked as confidential.

Summary

In response to its Gas Transporter’s Licence Condition C27, and in consultation with Shippers through the Uniform Network Code (UNC) governance processes, NGG has developed UNC Modification Proposal 0337 – “Introduction of an Inter-day Linepack Product”. Prior to finalising the details of this Proposal NGG is seeking your responses to the questions outlined within this document and summarised in **Appendix A** of this document. Responses to this Open Letter may contribute to the appropriate determination of progress, and any further development, of MP0337.

Background

Special Licence Condition C27 has placed a licence obligation on NGG NTS to use ‘Reasonable Endeavours to:

“Develop, in consultation with the Shippers and interested parties (including the Health and Safety Executive) a gas Linepack Product by the 1 April 2011 and shall report to the Authority on the conclusions of such development and consultation by 1 May 2011”

NGG NTS has sought to achieve these prescribed timescales through the formal UNC governance process. Indeed since May 2010 NGG, in consultation with the industry, has made significant progress in the development of a potentially viable Inter-day Linepack Product, which may facilitate the availability of such a service to Users.

By September 2010 development of an Inter-day Linepack Product had progressed to such an extent that NGG considered it appropriate to raise UNC Development Modification Proposal 0337– Introduction of an Inter-day Linepack Product. The UNC Workgroup report is due to be finalised and presented to the Transmission Workgroup on the 3rd March 2011, followed by the report’s submission to the March 2011 UNC Panel meeting, for recommendation, and subsequent formal consultation.

NGG is aware that concerns have been expressed regarding the viability of, and Industry appetite for, the proposed introduction of the Inter-day Linepack service as described in MP0337. During the development of MP0337 it has been suggested by a number of attendees at the meetings that it was unclear whether the Inter-day Linepack service would provide a tool that presented any notable benefit to the industry, and therefore there may be a risk that take up of the service would be limited and as such the cost of providing such a service would outweigh any potential benefit to the industry.

As a result of the above concerns, and the licence condition timescale to submit a report to Ofgem by 1st May 2011, NGG has issued this ‘Open Letter’ seeking industry views regarding the viability of the introduction of an Inter-day Linepack Product as proposed in MP0337.

The Proposal

MP0337 seeks to make available an Inter-day Linepack Product (ILP). This new service will facilitate the carry-over of a quantity of a User’s daily imbalance to the following Gas Day. This will be achieved by the User placing a bid onto an Inter-day Linepack Bulletin Board on the Gemini system. The Bulletin Board will be operated and managed by NGG NTS, who will undertake a new role as the proposed ‘Inter-day Linepack Manager’. The product will be released as a discretionary quantity on a daily basis.

The Inter-day Linepack Product is split into two services:

- a ‘Park’ service where Users may wish to carry over a quantity of an over-delivered imbalance: or
- a ‘Loan’ service; where a User may wish to borrow a quantity of under-delivered imbalance.

The Inter-day Linepack Manager may release one or both ‘Park’ and ‘Loan’ services on a Gas Day.

Accepted Inter-day Linepack bids will be transacted through the registration of a matched pair of NBP Trade Nominations on the relevant Gas Day; and a further matched (but opposite) pair of NBP Trade Nominations for the following Gas Day, the latter pair of NBP trade nomination will reverse-out the inter-day Linepack quantity for the following Gas Day, thereby achieving a “carry-over” of the imbalance quantity between the two relevant Gas Days. Both pairs of NBP trade nominations (for the Gas Day and the following Gas Day) will be registered on the Day the bid is accepted.

This service is seeking to introduce greater transparency associated with the value of providing the opportunity to “carry over” an imbalance quantity from one Gas Day to the next, where Linepack has the capability to accommodate such transactions. For the avoidance of doubt this service is not seeking to trade gas between Users and the new Inter-day Linepack Manager (ILM).

It is proposed that, subject to the User Pays cost recovery mechanism described below, all primary receipts from the sale of the ILP service will be returned to Shipper Users through the UNC Balancing Neutrality process.

Principle Factors when assessing the viability of the Inter-day Linepack Service

During the development of this new service it has become clear that there are 3 factors which determine the viability of the product:

- **Inter-day Linepack Release Quantity:** During development of the proposal NGG has sought to describe the factors which affect the amount of any future product release. The proposal also introduces a Methodology Statement which will set out the factors that influence the release of the new product. The first draft of this methodology will be released shortly; and
- **Revenue opportunity** - Again during development of MP0337 NGG has suggested a possible value calculation for an Inter-day Linepack Product. This value is based on either the price spread between End of Day (EoD) SAP on the Day and following Day, or the within day SAP at 14:00 hours on the Day and Forward price for D1 (Day Ahead price); and
- **Cost allocation** - The extent and proposed apportionment of any associated User Pays costs Associated with the development on ongoing cost recovery.

In this ‘Open Letter’, within MP0337 and in the various presentations given to UNC Review Group 0221 meetings and Transmission Workstream meetings (these presentations are available on the Joint Office website), NGG has provided its views and proposed values associated with the factors described above. We have set out our current thinking regarding the range of Inter-day Linepack quantities likely to be available, our views associated with predicted price spread associated with the determination of Inter-day Linepack Bids, and Users Pays system development and ongoing cost recovery options. We hope that this information will assist the industry in providing responses to the questions raised in this ‘Open Letter’.

Inter-day Linepack Release Quantity

During discussions in Review Group - 0221 meetings and the development of MP0337 NGG provided analysis supporting its views regarding the determination of Linepack quantities it could make available for release as an Inter-day Linepack Product. NGG determined that where existing within day operational Linepack requirements were not compromised, nor the likelihood of a requirement for it to take a Market Balancing Action increased, it could make available, on a discretionary basis, between **0 GWh to 110GWh** on any given Gas Day.

The factors which influence the above release quantities will be set out in a new Inter-day Linepack Service Methodology Statement. The first draft of this document will be released shortly. This Statement will provide a further insight into NGG’s methodology for determination of Inter-day Linepack quantities to be released. This methodology will play a similar role in relation to the new role of the ILM as the System Management Principles Statement (SMPS) currently does for the Residual Balancer role.

Question One: Having read and understood the nature of the proposal, do you consider that the proposed service will provide your company with an additional, commercially viable, tool to better manage your commercial risks?

Revenue Opportunity

During Workstream and Review Group discussions NGG has suggested that the Inter-day Linepack Product may be attractive to Users for the following two reasons;

- Price Arbitrage - benefit from the on the Day EoD SAP to EoD Day+1 SAP differential.
- Risk mitigation - avoidance of EoD System Marginal Prices (SMPs).

Question Two: Are you likely to utilise the Inter-day Linepack service and if so what would determine how much you would seek to purchase?

It would be particularly useful if you could provide examples to support your view.

Value of the Product

During industry discussions NGG has put forward its view that bids for the Inter-day Linepack Service are likely to be based on a price spread between the within day SAP price and the 'Day Ahead' market price. For example based on the average price spread between the within day SAP at 14:00 hours on the Day and the 'Day Ahead' market price, for each day within the period October 2009 to October 2010, the 'Parked' Interday Linepack Product indicative price spread would be within the region of 0.30 pence/therm.

Question Three: Do you consider that the potential pricing range of the Inter-day Linepack Product represents a commercial opportunity to your company?

MP0337 proposes that for each Product ('Park' and 'Loan') bid prices will be stacked and accepted in descending price order. It also proposes to put in place a zero reserve price.

Question Four: Do you believe that a zero reserve price is appropriate for this Product?

User Pays options

During the initial development of MP0337 NGG asked its service provider xoserve to provide a Rough Order of Magnitude (ROM) cost estimate for delivery of this new service. In November this cost estimate was delivered and estimated the implementation costs to be in the region of £1million. During the period of developing the ROM the business rules for 0337 were refined and a potential alternative delivery option was identified. As a result xoserve were requested to investigate this alternative delivery option and it has now provided a revised ROM cost estimate based on this option.

Revised estimated ROM costs are within the region of:

- The development and implementation costs at least **£213k**, but probably not more than **£288k**; and
- Ongoing Application Support will cost at least **£6k**, but probably not more than **£22k** per annum.

We believe that implementation of the proposed new service will provide a benefit to Shipper Users as it seeks to facilitate additional utilisation of NTS system Linepack as an additional

balancing tool for Users; and it seeks to reduce the potential for cross-subsidy between end of day Linepack utilisation and system balancing costs. For the reasons stated above NGG considers that the implementation costs for the MP0337 should be recovered from Shipper Users. Based on the estimated product value and release quantities described above NGG has estimated that the indicative duration for recovery of the estimated costs detailed above will be within 1 year. This assumption is based on;

- an average SAP to Day Ahead SAP price spread for the period October-09 to October-10
- excludes days where the spread above 1p/th
- an absolute spread used to reflect likelihood of both park or loan: and
- the bid efficiency factor makes a conservative adjustment to the full price spread to account for the fact that Users may not bid the full price spread

Indicative Cost Recovery Period

Daily Release Volume (GWh)	22
Daily Release Volume (therms)	750671
Average day to day spread (pence per therm) (extremes prices excluded, days where spread above 1ppt)	0.32
Efficiency assumption of 70% of average spread as bid	0.7
Days in Year	365
Average projected daily revenue (£)	£1,681.50
£288k Implementation Costs	171 days

N.B Conversions in line with the prevailing 10 year statement i.e. 1mcm = 11gwh.

Based on the indicative cost recovery estimates, detailed above, and the requirement to additionally recover ongoing application support costs on an annual basis, NGG considers that, for the purposes of proposing the User Pays cost recovery options, it is appropriate to adopt a recovery period of 1 year for the fixed implementation costs.

Based on the assumptions stated above, the table below describes the User Pays options proposed for development and ongoing application support cost recovery:

User Pays Cost Recovery Options	
1. Initial Development and Implementation and Costs	
Option A	Costs will be recovered as a 'one off' charge to all Shipper Users, based on their proportion of all Shipper Users' throughput.
	<ul style="list-style-type: none"> ○ A charge will be made to recover these costs based on the Shipper User's proportion of all Shipper Users' aggregate throughput for the 365 days preceding the commencement of the Inter-day Linepack service. <p>NB. All Inter-day Linepack Auction revenue will be apportioned to the Shipper Users based on their proportion of all Shipper Users' throughput.</p>
Option B	Costs recovered from Linepack auction revenue
	<ul style="list-style-type: none"> ○ These costs will be recovered from users of the service. ○ The Inter-day Linepack auction revenues will fund all development and implementation costs and will be recovered from the commencement day of the service to the point at which all such costs are recovered or for one year (whichever occurs sooner).

	<ul style="list-style-type: none"> ○ Once costs are recovered all future Inter-day Linepack Auction revenues will be apportioned to the Shipper Users based on their proportion of all Shipper Users' throughput. ○ In the event that after 1 year the relevant costs have not been met, any outstanding costs will be recovered from all Shippers Users assigned to the UNC at that time based on their proportion of all Users' aggregate throughput over the relevant 1 year period.
2. Ongoing Operational Costs	
Option A	Ongoing annual operational costs will be recovered through a fixed transaction charge (p/kWh)
	<ul style="list-style-type: none"> ○ The on-going operational costs will be recovered through the application of a transaction charge which will be added to each kWh of product purchased during the relevant year and billed monthly. ○ Any over recovery of the annual operating charges will be credited back to those who have bought the service that year as a 'one-off' invoice adjustment at end of year. ○ Any under-recovery will be recovered via balancing neutrality in the month following the anniversary of the charge being set.
Option B	Ongoing annual operational costs recovered through the Inter-day Linepack Auction revenue
	<ul style="list-style-type: none"> ○ Costs will be recovered from Linepack auction revenues. ○ Any over or under recovery will be smeared back to Balancing Neutrality Users based on their proportion of throughput over the relevant year following the anniversary of the charge being set.

Question Five: Do you consider that the indicative recovery period estimated by NGG Transmission is appropriate? If not, do you consider that the recovery period is likely to be over a greater or shorter timeframe?

Question Six: From the table detailed above for each of 1) the initial Implementation cost; and 2) ongoing OpEx cost, which options would you wish to see taken forward as the User Pays cost recovery arrangements for MP0377?

Question Seven: Are there any other User Pays Cost recovery options you would like to be considered? – Please detail why you believe this alternative option would better meet the relevant objectives.

Impact on other products

Question Eight: Do you envisage any other products being positively or negatively impacted by the introduction of the Inter-day Linepack Service?

NGG Inter-day Linepack release incentive

Question Nine: Do you have any views regarding the development and implementation of an Inter-day Linepack Product Quantity Release incentive placed on NGG? What interactions would such an incentive mechanism have on other existing Incentives?

Any other Issues

Question Ten: Do you have any other issue or views you wish to express regarding the proposed introduction of the Inter-day Linepack Product?

Question Eleven: Do you have any views you wish to express regarding areas that you consider may improve the Inter-day Linepack Product as proposed in MP0337, such that it would better facilitate the needs of Users?

Question Twelve: In order to enter into the LinePack transactions envisaged by MP0337 NGG believes that Users will need to consider whether they are FSA authorised to do so, or if not, whether they are outside the scope of the FMSA authorisation requirement at all times by taking advantage of an exclusion from such authorisation. Respondents are therefore requested to indicate whether they have considered this matter and if possible indicate whether they are FSA authorised or subject to the appropriate exclusion.

Next Steps

It is our intention to seek to incorporate relevant feedback to this Open Letter into MP0337 Workstream Report. To this end, your views on the Inter-day Linepack Product should reach us no later than 5pm on Tuesday 1st February 2011.

Should you have any questions regarding the content of this letter, please don't hesitate to contact me at malcolm.arthur@uk.ngrid.com or on the numbers detailed above.

Appendix A - Summary of Questions

Q1.	Having read and understood the nature of the proposal, do you consider that the proposed service will provide your company with an additional, commercially viable, tool to better manage your commercial risks?
Q2.	Are you likely to utilise the Inter-day Linepack service and if so what would determine how much you would seek to purchase? It would be particularly useful if you could provide examples to support your view.
Q3.	Do you consider that the potential pricing range of the Inter-day Linepack Product represents a commercial opportunity to your company?
Q4.	Do you believe that a zero reserve price is appropriate for this Product?
Q5.	Do you consider that the indicative recovery period estimated by NGG Transmission is appropriate? If not, do you consider that the recovery period is likely to be over a greater or shorter timeframe?
Q6.	For each of 1) the initial Implementation cost; and 2) ongoing OpEx cost, which options would you wish to see taken forward as the User Pays cost recovery arrangements for MP0377?
Q7.	Are there any other User Pays Cost recovery options you would like to be considered?
Q8.	Do you envisage any other products being positively or negatively impacted by the introduction of the Inter-day Linepack Service?
Q9.	Do you have any views regarding the development and implementation of an Inter-day Linepack Product Quantity Release incentive placed on NGG? What interactions would such an incentive mechanism have on other existing Incentives?
Q10.	Do you have any other issue or views you wish to express regarding the proposed introduction of the Inter-day Linepack Product?
Q11.	Do you have any views you wish to express regarding areas that you consider may improve the Inter-day Linepack Product as proposed in MP0337, such that it would better facilitate the needs of Users?
Q12.	In order to enter into the Line Pack transactions envisaged by MP0337 NGG believes that Users will need to consider whether they are FSA authorised to do so, or if not, whether they are outside the scope of the FMSA authorisation requirement at all times by taking advantage of an exclusion from such authorisation. Respondents are therefore requested to indicate whether they have considered this matter and if possible indicate whether they are FSA authorised or subject to the appropriate exclusion.