

Modification proposal:	<b>Uniform Network Code (UNC) 568: Security Requirements and Invoice Payment Settlement Cycle for the Trading System Clearer (UNC568)</b>		
Decision:	The Authority <sup>1</sup> directs this modification be made <sup>2</sup>		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	22 April 2016	Implementation date:	To be confirmed by the code administrator

## Background

Under Standard Special Condition A11<sup>3</sup> (as modified by Special Condition 8B<sup>4</sup>) of its gas transporter licence National Grid Gas, in its role as owner and operator of the gas National Transmission System, (NGG(NTS)) appoints an independent market operator to provide an electronic trading system. The Uniform Network Code (UNC) sets out requirements for this trading system. This market is known as the On-the-day Commodity Market (OCM), and is the primary trading venue used for system balancing. The current Trading System Operator is ICE Endex, as appointed by NGG(NTS) and designated by Ofgem.

The OCM is a central counterparty cleared market, which decreases the systemic risk associated with trading on the OCM. All participants on the OCM are required to provide collateral to cover the positions they take on the OCM. Under UNC Section D, ICE Endex, as the Trading System Operator, must act as the Trading System Clearer (TSC) or appoint another person as the TSC.

Alongside these arrangements, the UNC requires Users to provide security to cover indebtedness for Energy Balancing Charges. This security is put in place to protect other Users should a User default on these charges. This includes situations where the TSC may be indebted to NGG(NTS), and so the TSC (as a User under code) is currently required to provide security. The TSC would be indebted to NGG(NTS) where NGG(NTS) has sold gas to a shipper. As the central counterparty, in this situation the TSC would be owed money by the shipper, and would owe money to NGG(NTS). The TSC has their own collateral arrangements in place to cover this exposure to the shipper, and currently must also provide security under the UNC to cover NGG(NTS)'s exposure to the TSC.

Until 24 February, the role of TSC was carried out by APX Commodities Limited (APX UK). Under this model, buyers and sellers provided collateral to APX UK. Where APX UK was indebted to NGG(NTS) as a result of market participant buying gas from NGG(NTS), APX UK were able to use their clients collateral funds from this transaction to meet their security obligations under the UNC.

From 24 February, ICE Endex has made changes to the OCM clearing arrangements. They have taken on the role of TSC, and will discharge these obligations through an agreement with their affiliate ICE Clear Europe Limited (ICE Clear) to provide clearing and settlement services.

<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> <https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

<sup>4</sup> <https://epr.ofgem.gov.uk//Content/Documents/National%20Grid%20Gas%20Plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>

As a result of these changes ICE Endex will not be able to comply with the requirements in the UNC to provide security. This is because it will be relying on ICE Clear to discharge its clearing obligations; and so ICE Endex will not hold any collateral related to the clearing of OCM transactions. In addition, ICE Clear is subject to financial regulation as a clearing house and central counterparty. This means it is unable to use collateral it receives from members as security under the UNC. As a result, ICE Endex (and ICE Clear) will be unable to fulfil security requirements in the manner they are currently fulfilled by APX UK.

In advance of this change, the Energy Balancing Credit Committee (EBCC) agreed to temporarily suspend the requirement for ICE Endex to provide security. This was subject to:

- confirmation of the appropriateness of certain agreements and procedures,
- the establishment of a temporary limit that would trigger an emergency EBCC meeting and,
- ICE Endex undertaking to raise a modification to propose changes to security arrangements and settlement cycle for the Trading System Operator.

This modification was raised to meet this third requirement.

### **The modification proposal**

ICE Endex raised the modification in November 2015. The modification aims to make changes to the UNC, to address potential issues with the Trading System Operator and TSC's ability to comply with the UNC security arrangements.

The modification would introduce an additional provision to the energy balancing credit arrangements. This would allow NGG(NTS) to waive parts of the Energy Balancing Credit Rules from applying to the TSC to implement a decision by the EBCC. This could allow the requirement for the TSC to provide security to be waived.

This proposed change does not limit the ability of NGG(NTS) or Xoserve<sup>5</sup> to issue a Cash Call to ICE Endex to reduce the exposure of NGG(NTS) to a level deemed appropriate by the EBCC. In this case, ICE would meet this requirement through a provision in their clearing arrangements that would allow them to transfer money from the clearing accounts of Users that bought gas from NGG(NTS) to NGG(NTS)'s clearing account.

The current UNC settlement cycle means that Energy Balancing Invoices are raised monthly, 23 days after the month end, and then are due for payment 12 days after the invoice is received. As a result, the indebtedness which a User is required to provide security against includes both any uninvoiced charges and any invoiced charges. At some points in the invoice cycle, this can be greater than two months' worth of charges.

As a consequence of the proposed change to the energy balancing credit arrangements, ICE Endex may be exempt from the requirement to provide security. As a result, NGG(NTS)'s exposure to ICE Endex may include more than two months' worth of energy balancing charges at certain points in the invoice cycle.

The second part of the modification proposes that a different invoice due date may be agreed between TSC and NGG(NTS), following consultation with the EBCC. This would allow the TSC to operate on a shorter settlement cycle – ie, daily invoicing and settlement of energy balancing charges. Such a change, if agreed, would have the effect of reducing NGG(NTS)'s exposure to ICE Endex – which ICE Endex argues mitigates the impact of the potential waiver of security requirements.

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<sup>5</sup> Xoserve deliver transportation transactional services on behalf of the major gas transportation companies. Amongst other areas, they administer the UNC credit arrangements.

In addition, the change in settlement cycle would facilitate ICE Endex and ICE Clear moving to a shorter settlement cycle for the OCM. They argue this would reduce the OCM collateral requirements for those trading on the OCM, and so reduce the cost of trading.

In the Final Modification Report (FMR), ICE Endex argues that the modification furthers relevant objective (g) by allowing the TSC to discharge its obligations under European financial regulations in a manner which is compliant with the UNC and UK financial regulation.

ICE Endex also argues that the modification indirectly supports relevant objective (d) by reducing the cost of trading on the OCM – provided that a reduction in the settlement cycle is agreed and implemented. ICE Endex argues that this reduction in the cost of trading would increase participation and liquidity on the OCM, and so have a beneficial impact on competition between relevant shippers trading on the OCM.

### **UNC Panel<sup>6</sup> recommendation**

At the UNC Panel meeting on 17 March 2016, a majority of the UNC Panel considered that UNC568 would better facilitate the UNC objectives and the Panel therefore recommended its approval. Panel Members considered relevant objectives (d), and (g), and agreed that implementation would have positive impacts. Panel Members agreed that UNC568 enabled compliance with EU financial regulations following ICE Endex's organisational changes. One Member noted that relevant objective (g) specifically referred to Regulation 715/2009 in the NTS Licence, so any reference to European financial regulation in the case of this objective was tenuous.

### **Our decision**

We have considered the issues raised by the modification proposal and the FMR dated 17 March 2016. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR.<sup>7</sup> We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;<sup>8</sup> and
- directing that the modification be made is consistent with our principal objective and statutory duties.<sup>9</sup>

### **Reasons for our decision**

We consider this modification proposal will better facilitate UNC objective (f) and has a neutral impact on the other relevant objectives. We also set out our views on relevant objectives (d) and (g), which were considered by the proposer and panel.

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<sup>6</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>7</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.co.uk](http://www.gasgovernance.co.uk)

<sup>8</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

<sup>9</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986 as amended.

***(f) so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code***

In our view, the modification enables NGG(NTS) to adapt the UNC credit requirements to reflect the specific circumstances of the TSC. The modification also ensures a temporary arrangement agreed by the EBCC can be formalised under the UNC. The change facilitates the balancing and clearing which are necessary under the UNC. In this way, we consider that the modification better facilitates relevant objective (f).

***(d) so far as is consistent with sub-paragraphs (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 proposer, panel and respondents all agreed that the modification would indirectly support relevant objective (d). This is primarily because the modification could allow ICE Endex to agree a shorter settlement cycle with NGG(NTS). In turn, they consider this would allow them to reduce their settlement cycle for OCM traders. They argue this would reduce the cost of trading on the OCM, and so have the potential to increase participation and liquidity on the OCM. In turn, they argue this would better secure effective competition between relevant shippers.

We agree that the reduction in settlement cycle, if agreed, may act to increase trading volumes and hence liquidity on the OCM. This may lead to increased competition, and so could indirectly better facilitate relevant objective (d). However, as the modification itself only creates the potential for this change to be made, we would expect any impact on competition to be marginal.

***(g) compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators***

The proposer, panel and respondents agreed that the modification would indirectly support relevant objective (g). This is because it supports ICE Endex's compliance with European financial regulation.

In our view, assessing whether the proposed modification enables compliance with the specified financial regulations falls outside of the scope of relevant objective (g).

**Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC568: 'Security Requirements and Invoice Payment Settlement Cycle for the Trading System Clearer' be made.

**Emma Kelso**

**Partner, Wholesale Markets**

Signed on behalf of the Authority and authorised for that purpose