Stage 02: Work Group Report

What stage is this document in the process?

01 Proposal

02 Work Group Report

03 Draft Modification Report

04 Final Modification Report

0350:

Combining the NTS entry capacity and exit capacity credit checks

This modification seeks to combine the NTS entry capacity and exit capacity credit checks, which will subsequently remove a Users ability to allow their NTS Entry Capacity to lapse.

The Proposer recommends proceeding directly to Consultation

High Impact:
Entry Shippers, National Grid NTS

Medium Impact:

Low Impact:

Contents

About this document:

The purpose of this report is make a recommendation to the Panel, to be held on 16 June 2011, on whether 0350 Modification is sufficiently developed to proceed to the Consultation Phase and to submit any further recommendations in respect of the definition and development of this Modification.

Any questions?

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1 Summary

Why Change?

For sometime the industry have been evaluating the current UNC credit arrangements for Quarterly NTS entry capacity and in particular the issue where a User at a single Entry Point would effectively be able to keep deferring their long term entry capacity commitments indefinitely without incurring any penalty.

A summary of the industry developments undertaken to date, to address this issue are as follows:

- **Modification Proposals 0246/0246A/0246B 'quarterly NTS Entry Capacity User Commitment'** were raised in May 2009 to address the issues identified by Review Group 0221. The Authority rejected these proposals on 3rd June 2010 but highlighted that it has already approved a similar proposal with regards to exit capacity (0261) and without fettering its discretion, would welcome a similar proposal with respect to entry capacity to remove the ability for the User's quarterly NTS Entry Capacity to lapse.
- **Modification Proposal 0261 'Annual NTS Exit (Flat) Capacity Credit Arrangements**' was raised July 2009 and implemented on 1 January 2010. This proposal removed TPD Section B3.2.7 and associated paragraphs to remove the ability for the User's Annual NTS Exit (Flat) Capacity to lapse. Consent to Modify C037 was subsequently raised on 1 March 2010 to clarify aspects of the 0261 text but the Panel recommended that it would be better addressed by a Modification Proposal, as the Panel felt that there should be consultation on the text changes.

- **Modification Proposal 0332 'Removal of a Users ability to allow Quarterly NTS Entry Capcity to lapse'** was raised in September 2010, to amend the current UNC credit requirements for Quarterly NTS Entry Capacity (QSEC) to no longer allow a User to defer their registered quarterly NTS entry capacity, when they have not provided the security required. During developmental discussions at the Transmission Workstream National Grid NTS was asked by a User to provide some analysis on the option of combining the entry capacity and exit capacity credit checks. This analysis highlighted that four Shippers would be required to provide an extra £14.75m credit/security if the two credit processes were combined. It was the consensus of the Workstream attendees that there was merit in combining the two credit calculations in to one process as it would reduce the risk from a User default and simplify the credit arrangements. National Grid Transmission has therefore raised this new Modification Proposal to combine the entry capcity and exit capcity credit checks. It was recognised that the initial driver for 0332 would still be met as 0261 had already amended the exit capacity credit process to remove a Users ability to allow their capacity to lapse.

Solution

<u>Combine NTS entry and exit capacity credit checks</u>

It is proposed that the process currently described in TPD Section V3.3.4 be amended to include amounts related to the relevant User's 12 months of NTS entry capacity as well as 12 months of NTS exit capacity to form a combined entry and exit capacity credit check.

For the avoidance of doubt the sanctions currently described in Section V3.3.2(c) will apply if a User does not provide the required security to meet the new combined credit arrangements that includes both their entry and exit capacity commitments.

Entry Capacity Credit Check

In addition to the above we propose to remove UNC TPD Section B 2.2.15 and B 2.2.16 as the purpose of these two sections is replaced by the above changes.

Removal of these sections will mean that an entry User will no longer be able to defer their registered quarterly NTS entry capacity and the relevant User will continue to be treated as holding the relevant NTS entry capacity, and will subsequently be invoiced for that capacity in the timeframe commensurate with the capacity concerned. Any failure by the User to pay the subsequent invoices will be treated in the same way as any other transportation related debt.

Clarify Legal Text

We believe that it is important that a User understands when a breach of the UNC can lead to termination under Section V3.3.3 and where the system capacity sanctions described in Section V3.3.2 only applies. To add further clarity to the legal text implemented by Modification Proposal 0261 it is proposed that the changes contained in Consent to Modify C037 be considered in the development of the legal text for this proposal.

Impacts & Costs

Combining the entry and exit capacity credit checks will reduce the potential impact on the shipper community from a User default:

- By removing the User's ability to defer its Registered Annual Entry Capacity, implementation should reduce speculative bids and ensure that any request for Capacity that results in investment in the NTS is efficient and economic. Investment signals used by National Grid NTS to trigger system development would therefore be reinforced. For those Users participating in the QSEC auctions, the requirement to pay will be regardless of whether or not they are in a position to utilise the capacity they have booked, should the User have insufficient credit in place then ultimately the termination provisions within UNC TPD Section V will apply.
- Shippers will be required to provide credit/security to cover the total value of the next 12 months of entry and exit capacity, where as under the current arrangements the shippers could use a lower level of credit/security to cover their next 12 months of entry and exit commitment under two separate credit processes.

There will be an impact on some shippers as they will be required to provide additional credit/security (currently estimated at around £14.75m) to cover their total capacity commitment. The cost of doing so will depend on the security tools available to them but based on some previous analysis performed by National Grid Transmission for 0246, it is estimated that the costs could be in the range of £0 to £1m.

It is anticipated that the removal of the 12 month entry credit check will deliver a small administrative benefit to National Grid.

Implementation

It is proposed that this proposal is implemented on the 1st of the month following the calendar month after the Authority's decision to implement the proposal. i.e. if the direction to implement was received on 15th January 2011, then 1 calendar month after is 15th February and the 1st of the month following this would be 1st March. Therefore the implementation date in this example would be 1st March 2011.

This would allow time for the necessary changes to be made to the National Grid Transmission credit administration processes.

Please note that Users will not be required to provide any credit/security to cover their next 12 months of exit capacity until 1st October 2011 (12 months prior to the start of the new exit reform arrangements).

The Case for Change

The Advantages of the proposed change are

- Discourages speculative Quarterly NTS Entry Capacity auction bidding, thus reducing the risk of inefficient system investment and minimising the need to recover revenue from other Users bidding for capacity at the same ASEP.
- Provides an incentive for Users to provide the appropriate level of security to cover existing and future entry and exit capacity commitments.
- Reduces UNC Parties administrative burden of monitoring two separate credit arrangements.

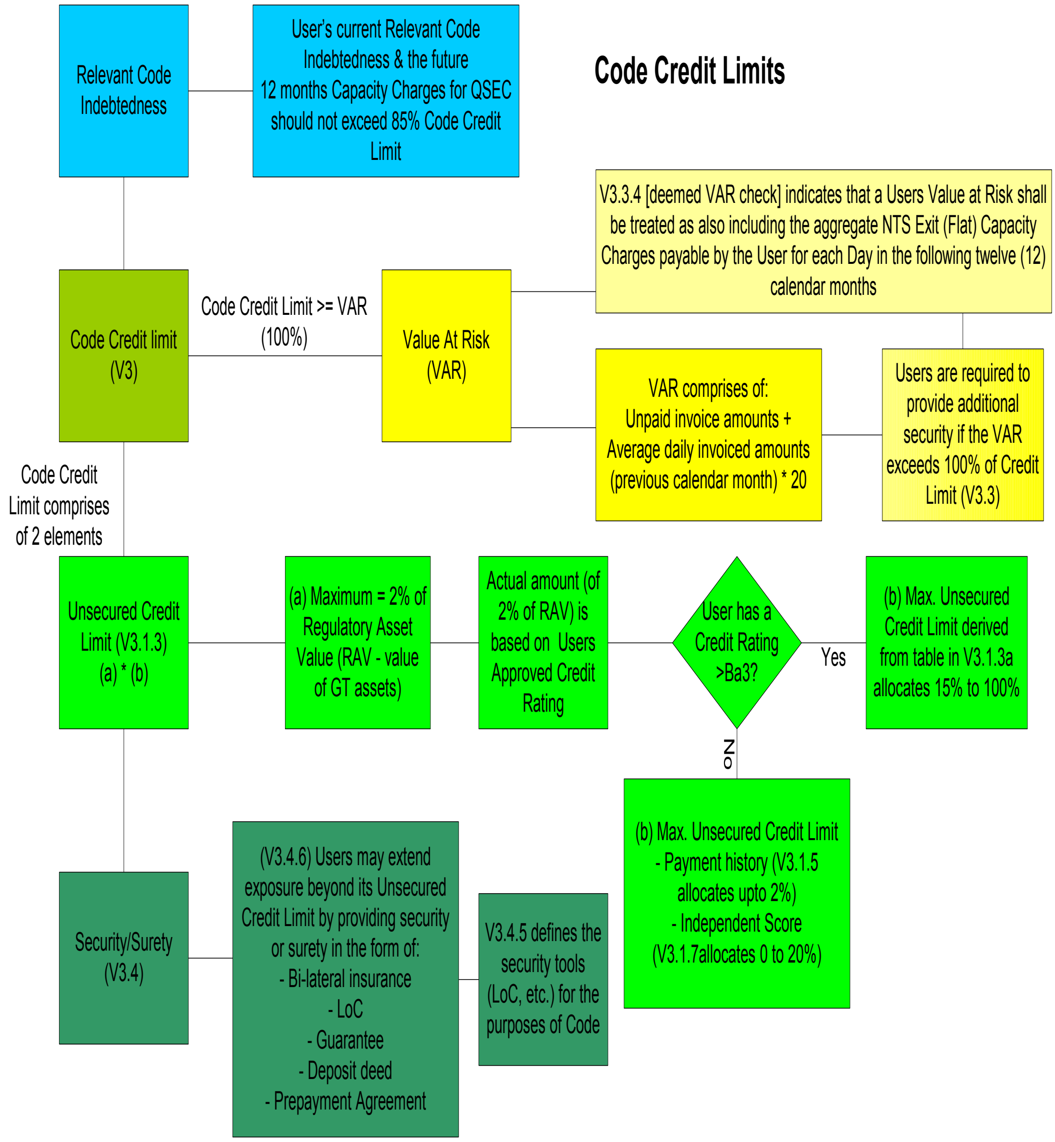
National Grid NTS considers this Proposal would, if implemented, better facilitate the Relevant Objectives as set out in its Gas Transporters Licence A11.1 (a), (c) and (d).

Recommendations

The Proposer invited the Panel to:

- DETERMINE that Modification Proposal 0350 progressed to Consultation

Appendix 1 – Illustration of current UNC Code Credit limits and Code Credit Checks



2 Why Change?

For some time the industry have been evaluating the current UNC credit arrangements for Quarterly NTS entry capacity and in particular the issue where a User at a single Entry Point would effectively be able to keep deferring their long term entry capacity commitments indefinitely without incurring any penalty. The following provides the background to this issue and the associated industry developments, which have led to this proposed solution.

Entry Capacity Credit Arrangements

Following Review Group 0221, Modification Proposals 0246/0246A/0246B "quarterly NTS Entry Capacity User Commitment" were raised in May 2009 to address the issues identified by Review Group 0221. The Authority rejected these proposals on 3rd June 2010 as they considered that these proposals imposed an excessive burden of costs on shippers and introduced additional administrative complexity.

In the Authority's decision letter for 0246/0246A/0246B "Quarterly NTS Entry Capacity User Commitment" they agreed that the removal of the ability for shippers to defer their security commitments for booked quarterly system entry capacity would represent a significant improvement on the current arrangements and better facilitate the relevant objective set out in National Grid's gas transporters licence condition A11.1 (a). The Authority also highlighted that it has already approved a similar proposal with regards to exit capacity (0261 – see below) and without fettering its discretion, would welcome a similar proposal with respect to entry capacity.

Exit Capacity Credit Arrangements

Modification Proposal 0261 'Annual NTS Exit (Flat) Capacity Credit Arrangements was raised in July 2009 and implemented on 1 January 2010. This proposal removed TPD Section B3.2.7 and associated paragraphs to remove the ability for the User's Annual NTS Exit (Flat) Capacity to lapse.

In the Authority's decision letter (8 December 2009) they stated "UNC 261 will impose greater discipline on users when booking exit capacity such that they are more likely to book capacity levels that are actually required. This should reduce the risk of associated revenue being socialised and collected from the shipper community".

Consent to Modify C037 Revision to the legal text associated with the implementation of UNC Modification 0261: Annual NTS Exit (Flat) Capacity Credit Arrangements

In considering the legal text inserted into UNC as part of the implementation of 0261 it was noted that although the text implemented the changes proposed by 0261 it could benefit from further clarity. Consent to Modify C037 was raised on 1 March 2010 to address this but the Panel recommended that it would be better addressed by a Modification Proposal, as the Panel felt that there should be consultation on the text changes. Following this recommendation the consent to modify was subsequently rejected by the Authority on 18th March 2010.

0332 Removal of a Users ability to allow Quarterly NTS Entry Capacity to lapse

The current NTS entry capacity security provisions are set out in Section B2.2.15 of the UNC TPD and mean that National Grid NTS looks at the aggregated amount of the User's current Relevant Code Indebtedness and the following twelve months liability for capacity charges associated with quarterly NTS entry capacity, as acquired in the auctions for Quarterly NTS Entry Capacity (QSEC).

If the above aggregated amount exceeds 85% of the User's Code Credit Limit, then National Grid NTS will notify the User. The User can subsequently either increase its Code Credit Limit by providing additional security or be in the position where the User's registered quarterly NTS entry capacity for each of the relevant calendar quarters will lapse and the User will cease to be treated as holding the registered quarterly NTS entry capacity.

An illustration of the current UNC Code Credit limits and Code Credit Checks is attached as Annex 1.

National Grid NTS raised Modification Proposal 0332 in September 2010, to amend the aforementioned aspects of the current UNC credit requirements for Quarterly NTS Entry Capacity (QSEC) to no longer allow a User to defer their registered quarterly NTS entry capacity, when they have not provided the security required.

This Modification Proposal was subsequently referred by the September 2010 Modification Panel for development via the Transmission Workstream. During the October Transmission Workstream discussions on 0332, National Grid NTS was asked to provide some analysis on the option of combining the Entry Capacity and Exit Capacity credit checks. This analysis highlighted 4 Shippers (9% of the 44 active entry shippers) would be required to provide an extra £14.75m credit/security if the two credit processes were combined.

It was the consensus of the Workstream that there was merit in addressing the new risk identified and therefore that the Modification Proposal should be amended to combine the entry capacity and exit capacity credit checks. It was recognised that the initial driver for 0332 (removal of a Users ability to allow Quarterly NTS entry capacity to lapse) would still be met as 0261 had already amended the exit capacity credit process to remove a User's ability to allow their capacity to lapse.

3 Solution

<u>Combine NTS entry and exit capacity credit checks</u>

It is proposed that the provisions currently described in V3.3.4 be amended to include 12 months of NTS entry capacity as well as 12 months of NTS exit capacity to form a combined entry and exit capacity credit check.

For the avoidance of doubt the sanctions currently described in Section V3.3.2 (c) will apply if a User does not provide the required security to meet both their entry and exit capacity commitments.

The following text change has been provided only to illustrate the intent of the proposal and could be subject to change in the preparation of the suggested legal text:

3.3.4 For the purposes of paragraph 3.3.2 (c) (i) and (iii) and the application of Section B3.3.3 (f), a User's Value at Risk shall be treated as including the aggregate NTS Exit (Flat) Capacity Charges and <u>NTS Entry Capacity Charges</u> payable by the User for each Day in the following twelve (12) calendar months commencing from the first Day of the calendar month following the Day in respect of which the User's Value at Risk is to be determined.

<u>Entry Capacity Credit Check</u>

We propose to remove the arrangements described in UNC TPD Section B 2.2.15 & B 2.2.16 as they are no longer required due to the above changes.

Removal of these sections will mean that an entry User will no longer be able to defer their registered quarterly NTS entry capacity. The relevant User will continue to be treated as holding the relevant NTS entry capacity, and will subsequently be invoiced for that capacity in the timeframe commensurate with the capacity concerned. Any failure by the User to pay the subsequent invoices will be treated in the same way as any other transportation related debt

<u>Clarify Legal Text</u>

We believe that it is important that a User understands when a breach of the UNC can lead to termination under Section V3.3.3 and where the system capacity sanctions described in Section V3.3.2 only applies.

As highlighted in Consent to Modify C037, the UNC text as it currently stands does not clearly explain that;

- The Value at Risk (VAR) definition (which is determined on the basis of invoiced amounts) is treated under V3.3.4 as also including the following 12 months of exit capacity charges, including those yet to be invoiced. This is consistent with the intent of Modification Proposal 0261.
- Where VAR is determined outside of the terms specified in V3.3.4 only invoiced amounts are included. This means that termination can only apply under V3.3.3 where the VAR of the User exceeds 100% of the User's Code Credit Limit in respect of "invoiced" amounts, whereas the system capacity under V3.3.4 applies the 100% rule to "non-invoiced" VAR. This is consistent with the intent of Modification Proposal 0261.

To add further clarity to the legal text implemented by Modification Proposal 0261 it is proposed that V3.2.1 (d) and V3.3.4 be amended and it is proposed that the changes contained in C037 (see below) be considered in the development of the legal text for this proposal.

Amend paragraph V3.2.1 (d) to read as follows:
"(d) Subject to paragraph 3.3.4, **"Value at Risk"** at any point in time….."

Amend paragraph V3.3.4 to read as follows:
"3.3.4 For the purposes of paragraph 3.3.2(c) (i) and (iii) and the application of Section B3.3.3 (f), a User's Value at Risk shall be treated as including the amounts of the aggregate NTS Exit (Flat) Capacity Charges payable by the User for each Day in the following twelve (12) calendar months commencing from the first Day of the calendar month following the Day in respect of which the User's Value at Risk is to be determined, irrespective of whether such amounts have been invoiced under Section S".

4 Relevant Objectives

The Proposer believes that 0350 will better facilitate the achievement of **Relevant Objectives A11.1 (a), (c) and (d)**

Proposer's view of the benefits of 0350 against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	This Proposal may discourage speculative auction bidding as the bidder would be aware of the tighter credit arrangements and sanctions that could be applied, thus reducing the risk of inefficient system investment and provides an incentive for Users to honour their NTS Entry Capacity auction commitments. It will therefore give National Grid NTS and the shipper community greater assurance over the appropriateness of any associated system investments and/or allowed revenue returns as the bidder will be required to pay for entry capacity allocated regardless as to whether they can utilise it. It is anticipated that the removal of the 12 month entry credit check will deliver a small administrative benefit to National Grid.
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	
c) Efficient discharge of the licensee's obligations.	By providing an incentive on Users to book Quarterly NTS Entry Capacity only when required it is expected to reduce the risk of "speculative" NTS Entry Capacity auction bidding and therefore the associated subsequent investment in unwarranted physical NTS Entry Capacity.

d) 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.	So far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition. Implementation would reduce the risk of increased Entry Capacity Commodity charges to the shipper community, from a User signalling and being allocated Enduring Annual NTS Entry Capacity that is subsequently allow to lapse, by that User not providing sufficient security. The need to provide sufficient credit to cover the total Entry and Exit Capacity commitment also reduces the above risk of subsequent charges that may result from a User default.
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards… are satisfied as respects the availability of gas to their domestic customers.	
f) Promotion of efficiency in the implementation and administration of the Code	

5 Impact and Costs

Costs

Include here any proposal for the apportionment of implementation costs amongst parties.

Indicative industry costs – User Pays
Classification of the Proposal as User Pays or not and justification for classification
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
Proposed charge(s) for application of Users Pays charges to Shippers
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	• None
Operational Processes	• None
User Pays implications	• N/A

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• If a User is required to provide additional security there may be additional costs. These are estimated at between £0 to £1m.
Development, capital and operating costs	• See above
Contractual risks	•
Legislative, regulatory and contractual obligations and relationships	•

Impact on Transporters

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	•
Development, capital and operating costs	•
Recovery of costs	• N/A
Price regulation	• N/A
Contractual risks	•
Legislative, regulatory and contractual obligations and relationships	•
Standards of service	• N/A

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None
UNC Committees	• None
General administration	• None

Impact on Code	
Code section	Potential impact
Section V	Amend V3
Section B	Amendments to B2.2.15 & B2.2.16

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	None
Storage Connection Agreement (TPD R1.3.1)	None
UK Link Manual (TPD U1.4)	None
Network Code Operations Reporting Manual (TPD V12)	None
Network Code Validation Rules (TPD V12)	None
ECQ Methodology (TPD V12)	None

Impact on UNC Related Documents and Other Referenced Documents	
Measurement Error Notification Guidelines (TPD V12)	None
Energy Balancing Credit Rules (TPD X2.1)	None
Uniform Network Code Standards of Service (Various)	None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	None
Gas Transporter Licence	None
Transportation Pricing Methodology Statement	None

Other Impacts	
Item impacted	Potential impact
Security of Supply	None
Operation of the Total System	None
Industry fragmentation	None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	None

6 Implementation

It is proposed that the proposal is implemented on the 1st of the month, 1 calendar month after the decision. i.e. if the direction to implement was received on 15th January, then 1 calendar month after is 15th February and the 1st would be 1st March, the implementation date in this example would be 1st March.

This would allow time for changes to necessary credit and credit administration processes.

7 The Case for Change

In addition to that identified elsewhere, the Proposer has identified the following:

Advantages

The Advantages of the proposed change are

- Discourages speculative Quarterly NTS Entry Capacity auction bidding, thus reducing the risk of inefficient system investment and minimising by the need to recover revenue from other Users bidding for capacity at the same ASEP.
- Provides an incentive for Users to provide sufficient security to cover their entry capacity and exit capacity commitments for the following 12 months.
- Reduces UNC Parties administrative burden of monitoring two separate credit arrangements.

Disadvantages

- Single ASEP Users would no longer have the benefit of allowing Registered Quarterly NTS Entry Capacity to lapse in the event that security is not put in place.

8 Recommendation

The Work Group invites the Panel to:

- AGREE that Modification Proposal 0350 be submitted for consultation; and
- AGREE that Code Administrators should issue 0350 Draft Modification Report for consultation with a close-out of dd month 2011 and submit results to the Panel to consider at its meeting on[Panel meeting date].

Consultation Ends

17:00 on xx Month 2011

Recommendation

Modification Group recommends

Insert text here