CONCLUSIONS REPORT TO THE AUTHORITY

Modification Proposals to the Gas Transmission Transportation Charging Methodology

NTS GCM 15R:

User Commitment & Entry Capacity Cancellation Fees

DRAFT 22nd December 2009

[This version has not been submitted to the Authority for consideration]

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Executive Summary

This document is issued by National Grid Gas plc ("National Grid") in its role as holder of the Gas Transporter Licence in respect of the NTS (the "Licence").

This document sets out a proposal for amending the Gas Transmission Transportation Charging Methodology (the "Charging Methodology") in respect of the introduction of an NTS Entry Capacity Cancellation Fee as proposed by UNC Modification Proposals 0246, 0246A (or equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B[1]).

This proposal, GCM15, would ensure that revenue recovered from Users in regard to entry capacity cancellation fees would appropriately offset other NTS transportation charges.

GCM15: National Grid proposes through this document that:

- Cancellation fees (or equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B) in regard to non-incremental obligated entry capacity that would have resulted in TO revenue would be treated as TO entry revenue; this would result in reduced TO Entry Commodity Charges
- Cancellation fees (or equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B) in regard to incremental and non-obligated entry capacity that would have resulted in SO revenue would be treated as SO revenue; this would result in reduced SO Commodity Charges (Entry & Exit)

Implementation

It is proposed that these arrangements are implemented with effect from 1st April 2010 subject to the implementation of UNC proposal 246, 246A or 246B.

[1] This is a change to this charging Proposal (NTS GCM 15) in light of representations received (see section 6).

1 Introduction

1.1 This document is issued by National Grid Gas plc (“National Grid”) in its role as holder of the Gas Transporter Licence in respect of the NTS (the “Licence”).

1.2 This document sets out a final proposal for amending the Gas Transmission Transportation Charging Methodology (the “Charging Methodology”) in respect of the introduction of an NTS Entry Capacity Cancellation Fee (or equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B).

1.3 This proposal, GCM15, would ensure that revenue recovered from Users in regard to entry capacity cancellation fees would appropriately offset other NTS transportation charges.

2 Background

2.1 The 0221 UNC Review Group 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

2.2 One of the issues identified by the Review Group is that 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.

2.3 This could lead to a situation where, following User default or deferral of capacity commitment, the revenue associated with the User’s capacity commitment will be recovered through increases to general NTS Transportation Charges, i.e. non User specific NTS Entry Commodity Charges.

2.4 UNC Modification Proposal 0246 has been raised to seek to address this issue.

2.5 As part of the 0246 UNC Proposal, Users will be required to put in place and subsequently keep in place sufficient security to underpin their existing and anticipated capacity holdings.

2.6 It is proposed that the following actions be classed as “events of User default”:

- the required level of security exceeds the value of the security in place; or
- the User’s supplied security tool (Letter of Credit or Deposit deed) has less than the minimum number of days validity remaining; or
- the credit rating of the financial institution providing the Letter of Credit has gone below the minimum credit rating specified in UNC TPD Section V.

2.7 If an “event of default” occurs, and is not rectified within the next 10 Business Days, then the User’s relevant entry capacity holdings, as defined by UNC Modification Proposal 0246, will be cancelled and the User will be charged a cancellation fee.

3 Discussion and Issues

Licence

3.1 The intention of putting credit in place was that this credit could be used to offset charges to other users in the event of a User default occurring. The relevant charges that would increase would be the TO Entry Commodity charge, which applies only at entry, and the SO Commodity charge which applies to both entry and exit.

3.2 A Modification to the NTS Charging Methodology is required to incorporate the UNC defined cancellation fees such that they can be treated appropriately in accordance with the NTS Licence. The UNC will define the charges and the proposal laid out in this proposal GCM15 will map the charges on to the relevant price control terms. This would allow the mapping of the charges to TO and SO collected revenue, as required, and allow the consequential recalculation of other existing charges taking into account revenues resulting from the cancellation fees.

3.3 The capacity cancellation fees would need to be determined in accordance with the NTS Charging Methodology, in compliance with the following NTS Licence conditions, in order for them to offset other NTS charges;

- Standard Special Condition C8B 2(a); Definition of TORCOMt ~ TO revenue other than that collected through capacity charges
- Standard Special Condition C8C 2(a); Definition of RCOMt ~ SO revenue other than that collected through capacity and other Licence defined charges

3.4 Cancellation fees in regard to non-incremental obligated entry capacity that would have resulted in TO revenue would be treated as TO entry revenue; this would result in reduced TO Entry Commodity Charges

3.5 Cancellation fees in regard to incremental and non-obligated entry capacity that would have resulted in SO revenue would be treated as SO revenue; this would result in reduced SO Commodity Charges (Entry & Exit)

Commodity Charge Impact

3.6 Shippers can calculate the approximate impact on their net entry commodity charges of the revenue received from any capacity cancellation fees.

3.7 Every £1m of entry revenue arising from cancellation fees, received in relation to capacity that would have been treated as TO revenue, will result in a 0.0001 p/kWh reduction in the TO Entry Commodity charge over a 12 month period.

3.8 Every £2m of entry revenue arising from cancellation fees received in relation to incremental capacity that would have resulted in SO revenue will result in a 0.0001 p/kWh reduction in the SO Commodity charge, applied at both entry and exit, over a 12 month period.

3.9 The cancellation fee will be treated as income in the year in which it is invoiced.

3.10 If the collection of a cancellation fee could not be reflected in TO Entry Commodity charges within the relevant formula year, due to the timing of the invoice, the TO over-recovery mechanisms may be triggered subject to the level of potential over-recovery. This would involve the TO buy-back offset mechanism, the TO entry commodity charge rebate, or the TO entry commodity charge credit being used to return any TO over recovery. The entry commodity rebate or credit would be paid following the end of the formula year. For any TO over recovery below a £1m threshold, the value would flow through the Licence defined TOK term to the following formula year. The impact would be only on the TO Entry Commodity charge in the following formula year due to the separate treatment of entry and exit over or under recovery of TO allowed revenue within the Charging Methodology.

4 Terms of the Original Proposal

4.1 National Grid proposed that:

- Cancellation fees in regard to non-incremental obligated entry capacity that would have resulted in TO revenue would be treated as TO entry revenue; this would result in reduced TO Entry Commodity Charges
- Cancellation fees in regard to incremental and non-obligated entry capacity, which would have resulted in SO revenue, would be treated as SO revenue; this would result in reduced SO Commodity Charges (Entry & Exit)

Implementation

It was proposed that these arrangements were implemented with effect from 1st September 2009.

5 Representations Made

5.1 National Grid NTS received 8 responses to its consultation on NTS GCM 15; 5 were in support, 1 offered qualified support and 2 were against. None of the responses were marked as confidential, and copies of the responses have been posted on the Gas Charging section of the National Grid information website.[2]

Support for the Proposal

Respondent	Abbr.	View
RWE npower & RWE Supply and Trading GmbH	RWE	Support
EDF Energy plc.	EDF	Conditional Support
British Gas Trading Ltd (Centrica)	BGT	Qualified Support & Comments
The Association of Electricity Producers	AEP	Support
E.ON UK plc	EON	Do Not Support
Scottish and Southern Energy plc	SSE	Support
Scottish Power plc	SP	Support
ExxonMobil Gas Marketing Europe	EMGME	Do Not Support

Summary of Responses by Consultation Question

Respondents Views

AEP "agree that if mod 246 is implemented then this change to the charging methodology allows any cancellation fees to be directed to the appropriate revenue stream be that TO or SO."

SSE comments "This proposal would ensure that revenue recovered from Users from entry capacity cancellation fees would offset other appropriate transportation charges."

SP "believe that cancellation fees in regard to baseline entry capacity that would have resulted in TO revenue should be treated as TO entry revenue and those in relation to non-obligated entry capacity that would have resulted in SO revenue should be treated as SO revenue. This will result in reduced TO and SO charges respectively."

RWE comments "Given the entry capacity regime, it is necessary to distinguish between TO and SO revenues and we agree that cancellation fees in respect of baseline entry capacity should be treated as TO entry revenue and reduce TO Entry Commodity Charges and that cancellation fees in respect of incremental and non-obligated entry capacity should be treated as SO revenue (in the case of incremental entry capacity for 5 years) and result in reduced SO Commodity Charges (Entry & Exit)."

[2] GCM15 consultation responses can be found at ;

http://www.nationalgrid.com/uk/Gas/Charges/consultations/

EMGME "does not support the implementation of the UNC Mod 0246 that this charging proposal is designed to facilitate. In view of the fact that we do not support Mod 0246, we do not support GCM 15. "

EDF "support implementation of this proposal provided that either modification proposal 0246 or 0246A is implemented." EDF "recognises that the intent of this proposal is to ensure that any cancellation fees recovered are treated as either TO or SO revenue and so decrease the relevant charges."

BGT "agrees in principle with the proposal raised in GCM15, namely that money received in regard to baseline entry capacity should be treated as TO revenue and money received in regard to incremental and non-obligated entry capacity should be treated as SO revenue."

EON "does not support this proposal.", however, they "have sympathy with this proposal to the extent that it ensures monies recovered from a defaulting Shipper properly flow into the "appropriate" pot for TO or SO purposes; although we note that this is primarily for accounting purposes under National Grid's licence and doesn't affect the total sum of charges we face as Shippers."

National Grid's View

5.2 National Grid welcomes support for the proposal. National Grid notes that both of the responses that did not support the GCM15 charging proposal indicated that this was based on non support of the UNC proposal and one of these responses indicated support for the intent of the proposal

Implementation

Respondents Views

BGT comments that "GCM15 relates specifically to Network Code Modification 0246. At the time this consultation was raised there was only the original modification 0246 to be considered. Since that time alternatives to the original modification proposal have been raised and these do not all include a fee and those that do use different terminology. As there are now alternatives to modification 246 the term "Cancellation fees" could be misleading in future, therefore we consider that the proposal raised in GCM15 should not be implemented in the proposed timescale. Instead it would be appropriate to wait until Network Code Modification 246 and its alternatives have completed due process, including Impact Assessment. At that point National Grid should review and re-consult on a proposal which is in line with the approved Network Code Modification."

RWE comments that "As Ofgem has already confirmed that there will be a Regulatory Impact Assessment on UNC0246. National Grid should, if practicable, align the proposed implementation schedule for GCM 15 with the RIA timetable and any subsequent Ofgem decision."

SP "believe that an impact assessment needs to be undertaken in relation to this proposal and the interaction with modification 0246, its alternates and/or any other possible alternative proposals to deal with the circumstances. This will in all likelihood require further consultation on the associated charging mechanism(s)."

AEP comments that “Ofgem has also stated that it will undertake an impact assessment on the modification proposals, although it is unclear as to whether this will include the charging methodology changes too. In this regard we encourage NG to carefully consider the timescales in which it progresses to issue a conclusions report to avoid initiating the 28 day veto period. Consistent with this we would not welcome this change progressing and becoming a redundant element of the charging methodology since this is inefficient and potentially confusing. “

National Grid’s View

5.3 National Grid is mindful of the interaction with the UNC Modification Proposals and will issue this consultation conclusions document following the Ofgem decision on the UNC proposals.

Summary of Responses by Relevant Objectives

Reflect the Cost Incurred by the Licensee

Respondents’ Views

EON is concerned “that the term ‘Entry Capacity Cancellation Fee’ may be misleading and could suggest that payment of a fee would enable a Shipper to relinquish some or all of their capacity holdings at no further cost, or be a “cheaper” alternative to putting in place the required credit security. In our view, such outcomes are not intended from the related UNC Modification Proposals. It is also not clear from this charging proposal what happens if the defaulting Shipper does not pay the cancellation fee. For example, if a Shipper is subsequently terminated, is this fee then chargeable to all Shippers on top of the charges for the capacity which has been cancelled; i.e. ‘capacity cancelled’ + ‘capacity cancellation fee’? If this is the proposal, then we do not consider that it ‘reflects the costs incurred by the licensee in its transportation business ’ as this would be tantamount to double charging Shippers for the same capacity and would not be cost-reflective.”

EDF notes that “The Licence requires NGG to develop a charging methodology so that transportation prices “reflect the costs incurred by the licensee in its transportation business”. However it is not clear how the cancellation fee is cost reflective. In particular we would note that NGG is charging for something which it may not have undertaken any investment for and so no costs were incurred.”

National Grid’s View

5.4 National Grid believes that the proposed revision to the methodology would better meet its Licence conditions in regard to taking into account developments in the transportation business and facilitating effective competition as detailed in section 8 below. It is proposed that the amount of credit put in place is defined within the UNC and that this is the amount that would be invoiced for. As this proposal (NTS GCM 15) is defining the treatment, but not the level, of the charge, the obligation to be cost reflective is not applicable.

Properly Take Account of Developments in the Transportation Business

Respondents’ Views

AEP “agree that in the event that mod 246 is implemented that this is consistent with the charging methodology objectives by taking account of developments in the transportation business.”

RWE comments that "GCM 15 will ensure that any revenue recovered via the capacity cancellation fee is correctly treated within the price control framework."

<u>National Grid's View</u>

5.5 National Grid believes that the proposed revision to the methodology would better meet its Licence conditions as detailed in section 8 below.

Facilitate effective competition between gas shippers and between gas suppliers

<u>Respondents' Views</u>

EDF notes "NGG's Licence also requires NGG to develop a charging methodology that facilitates effective competition between gas Shippers. EDF Energy would note that this proposal should facilitate competition by reducing Users' exposure to a User who defaults on entry capacity secured through the QSEC auction. However we would note that credit is only required to cover 10% of the value of the bookings. Therefore Shippers continue to be exposed to 90% of the default. We therefore believe that this is marginal."

<u>National Grid's View</u>

5.6 National Grid believes that the proposed revision to the methodology would better meet its Licence conditions as detailed in section 8 below.

Other issues raised during the Consultation

Alternative UNC Proposal 246B

<u>Respondents' Views</u>

EON "do not consider that it is appropriate for National Grid NTS to only propose a charging solution which supports its own proposal (Mod 246) and thereby, somewhat unfairly fails to deal with an alternative proposal; namely Modification Proposal 246B. We believe it would have been more pragmatic for National Grid NTS to review and re-issue this consultation paper, taking into account the alternative proposals raised under the UNC. Although we understand that this charging proposal may 'fall away' if Modification Proposal 246 is not implemented, it feels wasteful of Shipper's time to be responding to a further consultation on the same issue when this could have been avoided by withdrawing this proposal and a re-consultation, covering all three UNC Modification Proposals. Without such a revision, we do not consider that this proposal 'properly take[s] account of developments in the transportation business'."

SSE notes "If as a result of implementation of mod proposal 246 or 0246A then it will be necessary to include the 'cancellation fee' in the Gas Transmission Transportation Charging Methodology. However, if mod proposal 246B were implemented we would expect a revised charging consultation."

AEP comments that "since this consultation was issued two alternates to mod 246 have been raised and whilst the comments above will apply if mod 246A is implemented, they will not if 246B is implemented. Since mod 246B does not use the term cancellation fee and a different methodology change will be required."

National Grid's View

5.7 National Grid raised charging consultation GCM15 on 16th April 2009 in relation to UNC Modification Proposal 0246 which was also raised on 16th April 2009 and issued for consultation on 27th April 2009. Alternative UNC Modification Proposals 0246A and 0246B were raised on 23rd April 2009 after GCM15 had been issued.

5.8 UNC Modification Proposal 0246A used the same 'cancellation fee' terminology as 0246 and hence GCM15 would apply equally to this alternative as it would to the original. This was noted at the 7th May 2009 gas TCMF meeting.

5.9 UNC Modification Proposal 0246B did not use the term 'cancellation fee' and appeared not to introduce a new NTS charge but simply referred to National Grid drawing down on credit in the event of a default. This was also noted at the 7th May 2009 Gas TCMF meeting. Further discussions with the Proposer have indicated that UNC 0246B will involve a mechanism, to draw down on credit, that replicates the cancellation fee albeit by another name. National Grid has concluded that a further charging methodology consultation is not required as the principles underlying the charge introduced by 246 and 246A are identical to those underlying 246B and the principles were supported by the majority of respondents.

6 Changes to the Original Proposal in the light of Representations Made

6.1 National Grid believes that a change to the proposal is required in light of responses and questions raised throughout the GCM15 consultation process.

6.2 Further discussions with the Proposer have indicated that UNC 0246B will involve a mechanism, to draw down on credit, that replicates the cancellation fee albeit by another name. National Grid has concluded that a further charging methodology consultation is not required as the principles underlying the charge introduced by 246 and 246A are identical to those underlying 246B and the principles were supported by the majority of respondents. For this reason the final proposal has been amended to take into account "equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B" along with the cancellation fees defined in other proposals.

6.3 In addition, the impact assessment timeline for the 246 suite of UNC modification proposals did not allow for a 1st September 2009 implementation date, as originally proposed.

6.4 The final modified proposal is detailed in Section 7.

7 Final Proposal

7.1 National Grid proposes that:

- Cancellation fees (or equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B) in regard to non-incremental obligated entry capacity that would have resulted in TO revenue would be treated as TO entry revenue; this would result in reduced TO Entry Commodity Charges
- Cancellation fees (or equivalent credit drawdown charges proposed under UNC Modification Proposal 0246B) in regard to incremental and non-obligated entry capacity, which would have resulted in SO revenue, would be treated as SO revenue; this would result in reduced SO Commodity Charges (Entry & Exit)

<u>Implementation</u>

It is proposed that these arrangements are implemented with effect from 1st April 2010 subject to the implementation of UNC proposal 246, 246A or 246B.

8 Justification

Assessment against Licence Objectives

8.1 The Licence requires that proposed changes to the Charging Methodology shall achieve the relevant methodology objectives.

8.2 Where transportation prices are not established through an auction, prices calculated in accordance with the methodology should:

- 1) Reflect the costs incurred by the licensee in its transportation business;
- 2) So far as is consistent with (1) properly take account of developments in the transportation business;
- 3) So far as is consistent with (1) and (2) facilitate effective competition between gas shippers and between gas suppliers.

8.3 National Grid believes that GCM15 would satisfy the relevant objectives as, it would properly take account of developments in the transportation business should the relevant UNC proposal be directed for implementation.

8.4 GCM15 should facilitate the UNC modification which should reduce cross subsidies between Users at different ASEPs (since defaulting Users will contribute to the TO or SO revenue streams and thereby reduce the impact on non defaulting Users) and between entry and exit Users (since defaulting Users will contribute to the SO revenue in regard to incremental and non-obligated entry capacity and will reduce the SO charges applicable to both entry and exit) and hence should facilitate effective competition between gas shippers and between gas suppliers.

8.5 It is proposed that the amount of credit put in place is defined within the UNC and that this is the amount that would be invoiced for. As this proposal (NTS GCM 15) is defining the treatment, but not the level, of the charge, the obligation to be cost reflective is not applicable.

Assessment against EU Gas Regulations

8.6 EC Regulation 1775/2005 on conditions for access to the natural gas transmission networks (binding from 1 July 2006) are summarised below. The principles for network access tariffs or the methodologies used to calculate them shall:

- Be transparent
- Take into account the need for system integrity and its improvement
- Reflect actual costs incurred for an efficient and structurally comparable network operator
- Be applied in a non-discriminatory manner
- Facilitate efficient gas trade and competition
- Avoid cross-subsidies between network users
- Provide incentives for investment and maintaining or creating interoperability for transmission networks
- Not restrict market liquidity
- Not distort trade across borders of different transmission systems.

8.7 National Grid believes that GCM15 is consistent with the principles listed above, specifically the amended methodology should;

- Be applied in a non-discriminatory manner
- Avoid cross-subsidies between network users