

# Initial Modification Report No.11

## Changes to the Small Adjustment

### and

## Phase 2 Reduction of Imbalance Tolerances

1<sup>st</sup> February 2021

Please find below Initial Modification Report No.11 to the NI Network Gas Transmission Code raised by the Transporter, as required under sections 2 and 3 of the Code Modification Rules.

#### **A Description of the nature and purpose of the modification**

This proposal is being made to implement a change to the balancing regime and correct an administrative error.

In 2019, the Transporter carried out a Tolerance Review as part of its Interim Measures programme of compliance with the Balancing Regulation EU 312/2014. The Balancing Regulation has been transposed into UK law as a result of Brexit. The relevant legislation is now Schedule 2 of the Gas (Security of Supply and Network Codes) (Amendment) (EU Exit) Regulations 2019.

The Tolerance Review identified, amongst other things, the need to review the multipliers (known as the 'small adjustment') which are applied to the Daily Gas Price when calculating marginal prices. This review of the small adjustment has now been completed and the Transporter is proposing a reduction in the multipliers which would have the effect of making them less penal than they are currently.

The Tolerance Review also identified the need for a reduction in Shippers' Imbalance Tolerances and a phased approach to this reduction was commenced in April 2020 through the implementation of Modification No.8 (*Phased Reduction of Imbalance Tolerances, Alignment of Tolerance Load Bands with DM/NDM Categories & Update to Exit Reallocation Rules*). Phase 2 is due to commence in April 2021 and will reduce tolerance levels further, strengthening the incentive on Shippers to balance their daily inputs and outputs to the NI Network.

The proposed phase 2 reductions were previously consulted on as part of Proposed Modification No.8. Due to an administrative error the incorrect phase 2 tolerance percentages were included in the final approved text of the Transition Section. Therefore, this modification is to make the changes as originally intended and to delete the Transition Section.

Whilst making the small adjustment less penal could in theory weaken the incentive on Shippers to balance, the Transporter considers that making this change at the same time as implementing the phase 2 tolerance reductions will mitigate this risk, since the tightening tolerances will mean Shippers have to continue to focus on maintaining/improving their balancing performance, as they have been doing successfully to date under phase 1.

Further detail is provided in section G below.

**B How the modification better facilitates the relevant objective**

The Relevant Objective, (condition 2.4 of the Transporter Licences) will be better facilitated by the NI Network Gas Transmission Code as a result of the proposed changes. They will support compliance with Balancing Regulation EU 312/2014 (as transposed) and by continuing to incentivise Shippers to balance their portfolios, they should improve the reliable and efficient operation of the NI Gas Transmission Network.

**C The clauses of the NI Network Gas Transmission Code that require amendment**

On implementation, this Proposed Modification would amend text in sections 8.2.1 and 8.3 and remove the Transition Section.

**D Impact on the networks of the Designated Pipeline Operators, Adjacent Transporters and/or relevant agreements in respect of the NI Network:**

The Transporter has considered the impacts the modification may have and concluded as follows:

***Operation of the networks of the Designated Pipeline Operators (DPOs)***

There has been a reduction in residual balancing actions and the quantities of balancing gas needed under phase 1 of the tolerance reductions. Reduced residual balancing is generally helpful, although the operational materiality of the improvements seen to date has been small.

It is not possible to say whether implementing the reduction in multipliers at the same time as the phase 2 tolerance reductions will yield further reductions in the requirement for residual balancing, but the Transporter considers that any further changes are likely to be further improvements in balancing performance and so would be generally positive for the operation of the networks.

***Adjacent Transporters & Relevant NI Agreements***

There has not been a material impact under phase 1 of the tolerance reductions on the Adjacent Transporters or on any relevant NI Agreements, and similarly, the Transporters would expect any impact of the proposed changes to be broadly positive in these respects.

Nonetheless, the Transporter intends to closely monitor the impact of the proposed amendments to the small adjustment charges on all relevant Agreements and on the operation of the networks.

**E The date proposed for implementation**

The Transporter proposes that this Modification should take effect from 1<sup>st</sup> April 2021.

**F How to Respond**

Please send responses no later than 1<sup>st</sup> March 2021 by email to:

**shippercommunications@gmo-ni.com**

## **G Further Information and Analysis of the Proposed Changes**

### **1. Reducing the Small Adjustment Multipliers**

The Balancing Regulation sets out the rules which Transporters should apply in relation to balancing of gas networks. The balancing arrangements are designed to incentivise Shippers to balance their own portfolios and minimise the need for residual balancing by the Transporter. Imbalance tolerances are not allowed (except where Interim Measures were adopted) and Shippers must pay the costs of residual balancing in proportion to their throughput. Shippers' individual imbalances are financially cleared (i.e. effectively bought or sold) each day by the Transporter through a cash-out mechanism. The incentive for Shippers to balance is created by making the financial clearing price unattractive. Penal rates (also known as 'marginal' cash-out prices) are created by adjusting the daily average gas price by a multiplier known as the 'small adjustment', which differs depending on whether the imbalance is positive or negative.

In Northern Ireland, the gas market has a relatively small number of participants and as such, where any individual Shipper does not balance their portfolio themselves on a day, the physical impacts and hence costs of residual balancing could be quite significant. Also, Northern Ireland Shippers generally have tended to be relatively small and have not always benefitted from contractual flexibility or other access to adjacent markets to be able to respond with agility to changing demand on a day.

Historically, Northern Ireland has therefore used comparatively high value multipliers and relatively generous tolerances within its balancing regime, to ensure that imbalance positions which fall outside of a Shippers' tolerance have been strongly disincentivised.

The current values of the multipliers in Northern Ireland were set in 2010 and are:

- for a Positive Imbalance: 0.7
- for a Negative Imbalance: 1.5

The Balancing Regulation states that *"the value of the small adjustment shall not exceed ten percent of the weighted average price unless the transmission system operator concerned can justify otherwise to the national regulatory authority and have it approved"*.

Adopting Interim Measures allowed Northern Ireland to move towards compliance with the Balancing Regulation gradually over a period of time. Hence the relatively high value multipliers of the small adjustment have been retained to date. However, with the phased reduction of tolerances underway, the Transporter considers there is now an opportunity to achieve compliance with the Balancing Regulation on the value of the small adjustment.

The Transporter therefore proposes that the small adjustment should now move to the ten percent level. The proposed multipliers are:

- for a Positive Imbalance: 0.9
- for a Negative Imbalance: 1.1

These values represent significant reductions to the current multipliers.

The Transporter considers that implementing this change at the same time as the phase 2 tolerance reductions will go towards mitigating any risk of weakening the incentive on Shippers to balance that such changes to the multipliers might otherwise entail.

At the same time, it will provide a safety net for Shippers who might otherwise face increased financial exposure as a result of the implementation of phase 2 tolerance reductions.

The Transporter intends to continue its monitoring of Shipper balancing performance and will review and amend the imbalance arrangements, including the small adjustment multipliers, as necessary if a need to further strengthen incentives is identified or in the event of any unforeseen consequences.

## 2. Phase 2 Tolerance Reductions – Correction of Values

The Tolerance Review Report proposed reductions in phases as shown in the table below:

Category	Consumers	Previous Tolerance	Phase 1	Phase 2
1	Power Generation	3%	3%	2%
2	Downstream consumers whose loads are greater than or equal to 1,465,416,000kWh/annum and who are not Power Generation Customers	3%	3%	2%
3	Downstream consumers whose loads are greater than or equal to 733,000* kWh/annum but less than 1,465,416,000 kWh/annum	10%	5%	3%
4	Downstream consumers whose loads are less than 733,000* kWh/annum	20%	10%	5%

\* Modification No.8 also amended the boundary between category 3 and 4 to align with the Distribution Networks' Daily Metering threshold of 2,196,000 kWh/annum

The final approved text of Modification No. 8 (*Phased Reduction of Imbalance Tolerances, Alignment of Tolerance Load Bands with DM/NDM Categories & Update to Exit Reallocation Rules*) inadvertently contained the tolerances at the same values for categories 3 and 4 as those for phase 1, as a result of an administrative error. This Proposed Modification therefore corrects those values to those shown in the table above for phase 2, in line with the findings of the Tolerance Review Report.

As part of the implementation of these changes, the Transporter undertook to monitor and assess the impact of phase 1 before the date for implementation of phase 2.

The Transporter has completed that assessment and has found that there has been, year on year:

- a 44% reduction in number of balancing actions taken;
- a 57% reduction in the quantity of residual balancing gas required;
- a reduction of 18% in Distribution Shippers' absolute imbalances.

Whilst it is not possible to attribute these changes entirely to the phase 1 tolerance reductions, particularly given the unusual circumstances of the past year, the improvements in balancing performance overall are encouraging and suggest that Shippers are responding to the increased incentives as would be expected.

Hence the Transporter considers there is no reason why the phase 2 changes should not be implemented at the start of April 2021 as planned.

## H Proposed Legal Text

***With effect from the Implementation Date of this Proposed Modification:***

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*Modify section 8.2.1 to read as follows:*

### **Imbalance Tolerance Percentage**

8.2.1 Within 10 Business Days of providing a Downstream Load Statement in respect of an Exit Point in accordance with section 22.8, a Shipper shall be informed by the Transporter of its weighted average tolerance, expressed as a percentage, using the information contained in the Downstream Load Statement as set out below (a Shipper's "**Imbalance Tolerance Percentage**" or "**ITP**"):

$$\text{ITP (as \%)} = \frac{100}{\text{TC}_{\text{vm}}} \times (a + b + c + d)$$

where:

$$a = \sum C_{\text{vm}} \times C_f \text{ for Un1}$$

$$b = \sum C_{\text{vm}} \times C_f \text{ for Un2;}$$

$$c = \sum C_{\text{vm}} \times C_f \text{ for Un3;}$$

$$d = \sum C_{\text{vm}} \times C_f \text{ for Un4;}$$

$\sum C_{\text{vm}}$  = the maximum quantity in kWh/d which may reasonably be required to supply all of the Shippers' demand in the relevant downstream load category listed in column (2) in the table below (a "**Downstream Load Category**") at all Exit Points on a Gas Flow Day D as set out in the relevant Downstream Load Statement;

$\text{TC}_{\text{vm}}$  = aggregate of each  $\sum C_{\text{vm}}$  of each Downstream Load Category;

Un = the number identifying the Downstream Load Category listed in column (1) of the table below; and

$C_f$  = Downstream Load Category weighting factor listed in column (3) of the table below.

#### Imbalance Tolerance Table

(1)	(2)	(3)
Number identifying Downstream Load Category	Downstream Load Category	Downstream Load Category weighting ( $C_f$ )

(Un)

1	Power generation consumers	<del>32</del> %
2	Downstream consumers whose loads are greater than or equal to 1,465,416,000 kWh/annum and are not power generation consumers	<del>32</del> %
3	Downstream consumers whose loads are greater than or equal to 2,196,000 kWh/annum but less than 1,465,416,000 kWh/annum (generally classified in a DNO's distribution network code as daily metered consumers)	<del>53</del> %
4	Downstream consumers whose loads are less than 2,196,000 kWh/annum (generally classified in a DNO's distribution network code as non-daily metered consumers)	<del>105</del> %

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*Modify Section 8.3 to read as follows:*

### **8.3 Imbalance Charges**

8.3.1 Imbalance Charges shall be calculated, subject to section 8.1.1, in accordance with this section 8.3.

8.3.2 On any Gas Flow Day D on which a Shipper has a Positive Imbalance, an Imbalance Charge shall be payable to it equal to the sum of:

(a)  $QWT \times \text{Daily Gas Price}$ ; plus

(b)  $MIQ \times P_{\text{smps}}$ ,

where  $P_{\text{smps}}$  is the lower of:

(i) the Daily Gas Price multiplied by ~~0.709~~; or

(ii) the System Marginal Sell Price on the relevant Gas Flow Day D (as defined in the GB Uniform Network Code).

8.3.3 On any Gas Flow Day D on which a Shipper has a Negative Imbalance, it shall pay an Imbalance Charge equal to the sum of:

(a)  $QWT \times \text{Daily Gas Price}$ ; plus

(b)  $MIQ \times P_{\text{smpb}}$

where  $P_{\text{smpb}}$  is the higher of:

- (i) the Daily Gas Price multiplied by ~~4.51.1~~; or
- (ii) the System Marginal Buy Price on the relevant Gas Flow Day D (as defined in the GB Uniform Network Code).

8.3.4 If a Shipper has a Negative Imbalance and/or Positive Imbalance which exceeds its ITQ either, on 4 or more consecutive Days, or on any 6 Days in any Month, its ITP shall be reduced by one half, until such time as the Shipper has avoided a Negative Imbalance and/or Positive Imbalance for 5 consecutive Days when its ITP shall be reinstated at the original level.

8.3.5 Where a Shipper is eligible to pay a Modified Imbalance Charge in accordance with section 6.10.2(b), the Modified Imbalance Charge shall be determined in accordance with the formula set out in section 8.2.1 save that the  $C_i$  value shall be equal to 100% for the purposes of determining the Modified Imbalance Charge.

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Remove the Transition section as shown below:

~~T. TRANSITION ARRANGEMENTS FOR THE SECOND PHASE REDUCTION OF THE IMBALANCE TOLERANCE PERCENTAGE~~

~~T1 Introduction~~

~~T1.1 This section T provides for the implementation of the second phase reduction in the Imbalance Tolerance Percentage.~~

~~T2 Definitions~~

~~T2.1 In this section T1, "Transition Date" means 1<sup>st</sup> April 2021.~~

~~T3 Second Phase Reduction in Imbalance Tolerance Percentage~~

~~T3.1 With effect from the Transition Date, the imbalance tolerance table in section 8.2.1 shall be modified as shown below:~~

Imbalance Tolerance Table

~~(1) (2) (3)~~

~~Number identifying Downstream Load Category Downstream Load Category weighting (C<sub>i</sub>)  
(U<sub>n</sub>)~~

~~1 Power generation consumers 2%~~

~~2 Downstream consumers whose loads are greater than or equal to 2%  
1,465,416,000 kWh/annum and are not  
power generation consumers~~

~~3 Downstream consumers whose loads are greater than or equal to 2,196,000 kWh/annum  
but less than 1,465,416,000 kWh/annum  
(generally classified in a DNO's distribution  
network code as daily metered consumers) 5%~~

~~4 Downstream consumers whose loads are less than 2,196,000 kWh/annum  
(generally classified in a DNO's distribution  
network code as non-daily metered consumers) 10%~~

~~T3.2 For the avoidance of doubt, with effect from the Transition Date and thereafter on an enduring basis, a Shipper's ITP shall be determined using the imbalance tolerance table in section 8.2.1 as modified by section T3.1 of this Transition Section.~~