

Modification Report
Revisions to the Management of Cash Call Accounts (Breach of Security Limit)
Modification Reference Number 0666
Version 2.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

It is proposed that Section X of the Network Code is modified as follows:

Where a User's indebtedness exceeds 85% of their credit limit, Transco would be allowed to withhold payment of any Energy Balancing Invoice credit item until the User's indebtedness fell below the 85% threshold. In such circumstances, Transco would not pay late-payment interest on the withheld credit value.

2. Transco's Opinion

Transco view is that this proposal mitigates some of the risks associated with User failure by placing tighter controls on the management of Cash Call Accounts. Following a review of the Network Code and the Energy Balancing Credit Rules ("EBCR"), it was identified that by revising the rules governing the management of Cash Call Accounts, the level of risk faced by Users could be reduced thus limiting the risk of financial loss to the shipper community from the operation of the Energy Balancing regime. The principle of the proposal has been discussed with the Energy Balancing Credit Committee, and in accordance with its recommendation, Transco has raised this proposal.

If the existing provisions for the management of Users' Cash Call Accounts were maintained and a User became insolvent when its indebtedness had exceeded 85% of its credit limit, remaining Users may be faced with higher smearing charges than would be the case if Transco had retained the funds and used these against outstanding credit exposures.

3. Extent to which the proposed modification would better facilitate the relevant objectives

Tighter management of Cash Call Accounts for Users exceeding 85% of their credit limits would reduce the risk for all Users and therefore could be expected to facilitate a more secure and competitive environment in which to operate.

4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:

Transco is not aware of any impact to the operation of the system.

b) development and capital cost and operating cost implications:

Transco is not aware of any development or capital costs from the implementation of the Modification Proposal.

c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:

Implementation would not cause Transco to incur any additional costs.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Transco is unaware of any such consequence.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

Transco does not believe that implementing this Modification Proposal would have any consequence on the level of contractual risk to Transco under the Network Code.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

Transco is not aware of any implications for computer systems.

7. The implications of implementing the Modification Proposal for Users

Transco is not aware of any implications on Users by implementation of this Modification Proposal.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

No such implications have been identified.

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

No such implications have been identified.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

- The tighter management of Cash Call Accounts will protect all Users from any potential financial risk on the shipper community where a User exceeds 85% of its credit limit.

Disadvantages

- A User exceeding 85% its credit limit would not be able to request monies from its Cash Call Account or receive any credit interest payments until such time as indebtedness was reduced below 85%.

11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Six representations were received for this Modification Proposal. Four were supportive and two were opposed to its implementation.

Edf Energy Plc, Entergy-Koch Trading Europe Ltd, Powergen UK Plc & British Gas Trading offer their support for the Modification Proposal and believe that introduction of the measures identified in this Modification Proposal will reduce the exposure faced by shippers where a User exceeds 85% of its credit limit and thus reduce risk. Edf states that "allowing Transco to withhold payment of an Energy Balancing Invoice credit item, if a User was to exceed 85% of their credit limit, will reduce the levels of risk for all Users, decreasing the chances of the community receiving financial penalties. The tightening of the Credit Rules will facilitate a more secure environment in which to operate and a more competitive environment for all Users". Edf "believes that the EBCC, with its expert knowledge, would have discussed any serious issues in the development of the modification". Entergy-Koch asserts that "the proposal introduces a better-balanced approach to indebtedness where a shipper has an increased incentive to manage its credit position and hence reduce the risks that may otherwise pass to other system Users".

Transco's response: Transco agrees with the views expressed by these respondents.

Powergen states that "Transco should have the capability to off-set any credit notes within their cash call calculations such that all shippers can gain from improved utilisation of credit". It believes that "clarification is perhaps needed, however, to determine whether in Transco's calculation of a User's indebtedness, they are taking into account potential credit notes owed to a User. If the payment of a credit note would move a User beyond the 85% limit, it should not be paid until such time that additional security is supplied to reduce the credit utilisation below 85%. It also needs to be made clear in regards to interest, that it should go to the benefit of Shippers and not Transco's bottom line".

Transco's response: Transco does have the right to off-set the credit notes within their cash call calculations under X2.5.2 (d) (ii). and the calculation of indebtedness is based on the net invoice position. Users also have the right to appeal the position under the Cash Call Appeals X2.5.2 (c) if they believe that the position has not been reported correctly. In the

circumstances outlined in the Proposal Transco proposes that monies due to the User are paid into its Cash Call Account. Interest is applied to the monies in the Cash Call Account at 0.5% below the Bank of England base rate applied monthly. Monies held in this account are treated as security and used to offset that User's debts in line with Network Code section X2.8.8. Transco would not be the beneficiary of such monies.

British Gas has commented that the Modification Proposal specifically refers to "Energy Balancing Invoice credit item", and it has assumed that this principle extends to all Energy Balancing credit items including Gas Reconciliation Energy (GRE) amounts in Reconciliation Invoices.

Transco's response: The term "Energy Balancing Invoice" as defined in X1.1.6 means an Invoice Document in respect of any Energy Balancing Charges or interest thereon and as such includes (GRE).

British Gas makes "the observation that in some circumstances the credit amount due to the shipper may be far greater than the amount of the identified risk from breach of credit cover limit. Therefore there is potential for some mechanism to relate the maximum withholding of credit due to the assessed level of risk to the community and set this as a limitation of the withhold". However it recognises "that in this case the 'remedy' to enable payment of the energy credit amount is within the gift of the affected shipper".

Transco's response: As discussed above, the assessment of a User's indebtedness is based on the net invoice position. Therefore, as the User is already in excess of 85% the potential level of financial loss will increase with the value of the credit item due to be paid back. Indebtedness can quickly escalate by 100% leaving the company exposed to potential loss. Transco does not believe that materiality should be factored into the administration of this process and that it should simply be required to apply a rule that requires it not to credit a User that has indebtedness in excess of the 85% trigger.

British Gas believes that there is a "need for timely and accurate communication at such time between concerned parties. The facilitation of a commonly agreed position is key to prompt resolution."

Transco concurs with this view.

Scottish and Southern Energy supports the principle behind the Modification Proposal but believes that the "focus should be on the Cash Call process rather than the billing process, and identifying ways of improving the Cash Call process to minimise the likelihood that Users exceed their credit limit".

Transco's response: Transco believes that this Proposal represents an improvement to the Cash Call process which it sees as being inextricably linked with the billing process. It also believes that further improvements to the processes can be developed through the Energy Balancing Credit Committee but that the ultimate aim of this Proposal is to limit the financial exposure to a User failure.

SSE expresses the view that it is not entirely clear how the proposal is intended to work and that it may not provide the correct incentive. It believes that it is not clear what credit the Proposal is referencing and "assumes it is individual credit items within an overall invoice". It also believes that it is not clear what happens about the two month mismatch in timing between invoicing and any Cash Call.

Transco's response: Transco can confirm that the Modification Proposal refers to individual credit items within an overall invoice and can clarify that there are no issues concerning timing as an assessment of a User's indebtedness is designed to represent the User's position on any one day.

SSE also believes that the proposal does not specify what would happen where there is an error in determining that a party had exceeded their credit limit or where there is a dispute. It does not believe that it is reasonable "particularly in the case of an error that Transco should be allowed firstly to withhold payment of any credit and then avoid paying interest". It believes that "interest should not be withheld where an error or dispute has been upheld". Total Gas & Power Limited also point out that "an 85% breach may occur due to an operational error, misunderstanding or a conscious decision to withhold payment due to a dispute, and as such does not mitigate the non-release of energy balancing credit invoice items.

Transco's response: In instances where a User believes that there has been an error or where there is a dispute concerning whether it has exceeded its Cash Call limit the existing rules for appealing a Cash Call under Network Code reference X2.7 would be applied. There is no right of withhold in respect of Energy Balancing invoices where it is deemed that an error or dispute is outstanding, it is appropriate therefore that such items should form part of the Users total exposure when calculating whether an 85% breach has occurred.

Total "considers that there is a need for additional warnings that a User is approaching the 85% limit" and notes that a similar arrangement of notification exists within the Electricity credit model. It does not advocate the replication of these arrangements, however it is "of the opinion that there is a need to develop an agreed industry procedure, formulating a set of unambiguous rules, reducing any discretion that Transco may have with respect to such issues. This would therefore create a transparent process that the industry can monitor, allowing shippers to undertake corrective actions where necessary in order to remedy breaches in their credit limit".

Transco's response: Transco welcomes suggestions regarding notification requirements and additional warnings and believes that the fora to discuss such ideas are the Energy Balancing Credit Committee and the Credit Sub-group.

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

Transco is unaware of any change in legislative, regulatory obligations or contractual relationship of Transco, and each User or Non-Network Code Party as a consequence of implementing this Modification Proposal.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

This proposal is not required to facilitate any such change.

14. Programme of works required as a consequence of implementing the Modification Proposal

The program of works required to implement this modification proposal includes changes to the Energy Balancing Credit Rules which requires approval by EBCC members and is subject to a 2 month minimum notice period unless agreed otherwise.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

This modification proposal can be implemented with immediate effect following determination by Ofgem subject to the completion of the work as detailed in 14.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this proposal is implemented.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

SECTION X: NETWORK CODE SUPPLEMENT

Amend paragraph 2.9.2 to read as follows:

...Energy Balancing Charges, (and no interest shall accrue and be payable on any such amounts from the Invoice Due Date until the day on which the payment is made) and Transco shall instead pay the relevant amounts into the User's Cash Call Account.

Signed for and on behalf of Transco.

Signature:

Terry Grove
Service Delivery Manager
Support Services

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0666**, version **2.0** dated **25/02/2004**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **2.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.