Final Modification Report
Modification Reference Number 0274

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:

On a day when a negative SMP sell price is set, and a User has incurred incremental input UGF and associated imbalance charges in excess of £5,000 arising from the failure to enter a zero nomination at one or more System Entry Points, then Transco shall on the User's request revise such input allocations as if zero nominations had been made at the relevant System Entry Point(s), for the purposes of removing input UGF and recalculating associated imbalance charges.

The Proposal is made on the basis that when negative SMP sell prices were set, the level of penalty arising from input UGF was excessive and out of proportion to any damage or loss caused or costs incurred.

The Modifications Panel agreed that further development of this Proposal was not required, provided that Transco advise the community if any User other than the Proposer incurred UGF according to the above criteria and, if so, the magnitude of the re-smear. Transco can confirm that no other Users were affected and therefore in the interests of User confidentiality cannot disclose the level of materiality.

2. Transco's opinion:

Transco does not support this Proposal. Whilst input UGF provided a weak incentive for Users to nominate accurately, the potential for exposure through UGF charges was a risk that all Users knew of and could easily mitigate by inserting zeros, in accordance with the Network Code. This process was recognised to be inconvenient for Users and has since been resolved by Modification 0232.

Transco remains of the view that modifications which require retrospective changes should be discouraged to avoid setting precedents which undermine the robustness of current Network Code rules. This Proposal would also negate the good risk management of Users not exposed to UGF, particularly since smearing credits received as a result of the UGF charge would be debited and returned through neutrality to the non-nominating User.

However, Transco accepts that a negative SMP sell price does exacerbate input UGF charges to a level of materiality which may be disproportionate to the impact on the System. Transco has calculated the effect of removing the relevant UGF and adding the gas to the User's User Daily Quantity Input, thus amending the User's imbalance position for the days in question only. Were this Proposal to be implemented, Transco can confirm that the combined effects of overdelivery attracting the SMP sell price and the time value of money would result in the User not being fully refunded for the applicable UGF charges.

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

Condition 7(1), Relevant Objective (c)

The Proposal would make an exception to the rules in place at the time regarding input UGF. Provision of retrospective relief according to the suggested criteria would eliminate input UGF charges in some cases but not in others. Users would therefore not be treated equitably which could be to the detriment of effective competition.

4. The implications for Transco of implementing the Modification Proposal, including:

a) implications for the operation of the System:

The operation of the System would be unaffected.

b) development and capital cost and operating cost implications:

Transco would incur a small amount of additional operating cost to recalculate imbalance charges and adjust neutrality apportionment.

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:

Costs would be negligible for Transco and would be included in normal operating expenditure.

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

Transco is not aware of any consequences on price regulation.

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:

Implementation would set a precedent for amending other rules retrospectively, increasing the level of contractual risk to Transco.

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

There are no development implications for Transco or for Users.

7. The implications of implementing the Modification Proposal for Users:

On days when a negative SMP sell price was set and a User incurred input UGF and associated imbalance charges in excess of £5,000, all other Users would be required to pay back their credits received in consequence of that UGF to neutrality. The sum of these payments would then be returned to the original non-nominating User. With its input UGF charge removed, this User would then benefit from reduced imbalance charges.

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

Transco is not aware of any impact on these parties.

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:

Contractual relationships between Transco and System Users could be undermined. Transco is not aware of any legislative or regulatory obligations, nor of any consequences for Non-Network Code Parties.

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

Advantages:	- The User who incurred input UGF charges according to the above criteria would be compensated and thus pay reduced imbalance charges.
Disadvantages:	- All other Users would provide this compensation. - Retrospective change undermines the rules governing other aspects of the gas balancing regime.

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

Representations have been received from **Total Gas Marketing (TGM)** and **British Gas Trading (BGT)** who do not support the Proposal, and from **Enron** who support the Proposal. Two other parties provided a response in confidence. Both opposed the Proposal.

BGT view the retrospective aspect of the Proposal as unacceptable and **TGM** are reluctant to support the principle of retrospective changes to the Code unless an exceptional and significant community wide issue requires resolution. **BGT** emphasise that all Users were aware of the risk and could have mitigated the risk by inserting zeros. **BGT** note that many Shippers took steps and incurred costs to ensure that their systems and staff could deal with this issue - a point borne out by the fact that only one Shipper was affected. **BGT** suggest it would be inappropriate to divert charges to the Shippers who were prudent in their actions at the time.

Enron make the following comments in support of the Proposal:

The Modification Proposal

The principle of input UGFs and subterminal nominations was originally aimed at Shippers who had some knowledge of where gas was likely to be delivered by virtue of their purchase contracts. It did not anticipate the different requirements of spot gas trading at the beach. Had internal procedures been strictly followed, Enron would still only have nominated zero flow at the subterminals in question, which would have provided no additional information to Transco to allow it to balance the System more efficiently.

In approving Modification 0064, Ofgas recognised that input UGF charges can create circumstances when "the penalties imposed on these Shippers outweigh the costs to the System of their failure to nominate correctly", and that this view was supported by "almost all of those who responded to the Modification Proposal."

Modification 0069 was similarly supported and Enron trust that such support does not depend solely on whether the respondents themselves incurred UGF charges on each occasion.

Comments on Transco's opinion

The difference in penalty levels between entering a value and not entering a value merely encourages Shippers to enter a zero, therefore the incentive provided by UGF to nominate accurately is so weak as to be effectively non-existent.

Modifications which require retrospective changes should be discouraged, but not prohibited in all circumstances. This Proposal is not without precedent and Ofgas issued guidance under Modification Proposal 0192 on when retrospectivity has been and would be accepted for consideration.

There are a number of "unexploded mines" in the Code, one of which is the broader commercial consequences of extreme negative SMPs. When a Shipper uncovers one, it may give rise to a Modification that will protect others in future. Without a retrospective element, the first party to "detonate the mine" will be left as the only party bearing the cost.

Transco's suggestion that approval of the Proposal would negate the good risk management of Users not exposed to UGF is perhaps more concerned with tight administration controls rather than management of any market risk. Tight administration controls should protect those Shippers from incurring UGF costs, however, it is questionable whether this should also entitle them to significant windfall gains. This Proposal does not expose these Users to any additional costs, rather, they would retain the value of having held their consequent balancing neutrality revenue as an interest free loan.

Relevant Objectives

Enron agree with Transco's comment in section 3 of this report. However, restricting the application of the Proposal to days of negative SMP sell prices was intended to rework historical charges only where there was a material effect, rather than swamp Transco with a significant administrative burden to reapportion trivial sums of money.

In the early days of the Code, Modifications 0064 and 0075 treated UGF charges in a discriminatory fashion. This Proposal would help create a more level playing field during this time when some parties were not exposed to UGF by virtue of operating under legacy agreements.

Conclusion

It is not always possible to identify the shortcomings of the Code before a party suffers a significant and inappropriate commercial loss as a result. The right of appeal for retrospective changes as a means of protection against unintended results that operate against the development of the market should be retained.

Stringent controls are necessary to prevent the retrospective Modification route being used indiscriminately and as a means of avoiding proper prevention of problems. Ofgas' letter of comfort on Modification Proposal 0192 provides useful guidance in this regard and Enron believe that this Proposal meets these guidelines to merit a retrospective change.

Transco's Response:

Enron indicate that tight adminstration controls have a greater role in protecting Shippers from incurring UGF costs than management of any market risk and, had internal procedures been strictly followed, Enron would have nominated zero flow at the subterminals in question. Transco believes that whether Shippers incur costs through administrative problems or commercial decisions, the responsibility remains with that Shipper.

Enron state that when a Shipper uncovers an "unexploded mine" in the Code, it may give rise to a Modification which will protect others in future. With regard to input UGF, Modification 0232 has provided such protection. Implementation of this Proposal could only reduce Shippers' SMP risk through an increased likelihood of imbalance charges being reduced retrospectively.

Ofgas' guidance on retrospectivity issued under Modification Proposal 0192 was referred to. This letter stated that Ofgas has been willing to allow retrospective modifications, on a case by case basis, where a clear case of inappropriate cost allocation has been demonstrated. It is Transco's view that in this instance, costs have not been allocated inappropriately because those costs have been incurred by a User which are attributable to that User's action (or inaction), no error has occurred beyond that User's control and charges have been levied in accordance with agreed rules in place at the time.

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

Implementation is not required to facilitate compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:

Implementation is not required having regard to any change in the methodology established under the above clause.

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

No programme of works is required.

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

Transco does not support implementation, therefore no timetable is provided.

16. Recommendation concerning the implementation of the Modification Proposal:

Transco recommends rejection of the Proposal.

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 not to modify the Network Code and Transco now seeks direction from the Director General in accordance with this report.

19. Text;

Transco does not support implementation, therefore no text is provided.

Signed for and on behalf of Transco.

Signature:

Tim Davis
Tim Davis
Manager, Network Code

Date: 22/1/99

Director General of Gas Supply Response:

ANNEX

Restrictive Trade Practices Act - Suspense Clause

For the purposes of the Restrictive Trade Practices Act 1976, this document forms part of the Agreement relating to the Network Code which has been exempted from the Act pursuant to the provisions of the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996. Additional information inserted into the document since the previous version constitutes a variation of the Agreement and as such, this document must contain the following suspense clause.

1. Suspense Clause

1.1 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect:

(i) if a copy of the Agreement is not provided to the Director General of Gas Supply (the "Director") 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 Director 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 paragraph 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996.

provided that if the Director does not so approve the Agreement then Clause 1.2 shall apply.

1.2 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect until the day following the date on which particulars of this Agreement and of any such arrangement have been furnished to the Office of Fair Trading under Section 24 of the Act (or on such later date as may be provided for in relation to any such provision) and the parties hereto agree to furnish such particulars within three months of the date of this Agreement.