# Draft Modification Report
# Provision Enforecement of a Minimum Level of Energy Balancing Security
# Modification Reference Number 0447

Version 1.0

This Draft 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

The proposal made was as follows:

"It is proposed that if a User is required to pay two Cash Call Notices (whether the Notice is revised, re-issued, or first issue) within any rolling 28 calendar day period, Transco will issue a “Request to Provide Security Notice” (which will form a new appendix to the Energy Balancing Credit Rules), as soon as reasonably practicable. This Notice will request the User to provide security in accordance with the Energy Balancing Credit Rules to fully support a Secured Credit Limit. This limit shall be equivalent to 120% of the peak indebtedness level during that 28 calendar day period within eight Business Days from the date of the Notice. Additionally, the “Request to Provide Security” Notice will specify that the additional security must not expire within 90 days of the date of the Notice.

Alternatively, the User may appeal against the “Request to Provide Security” Notice within five Business Days from the date of the Notice. In such an instance the User will be required to provide information and evidence demonstrating why the required Secured Credit Limit is not suitable for their energy balancing behaviour. Under 1.2.3 of the Network Code Supplement, Transco may consult the Energy Balancing Credit Committee in relation to any aspect of its functions under the Supplement and therefore may exercise this right when considering any such appeal. Any consultation will be carried out in accordance with 1.2.5 of the Supplement in relation to the protection of the User’s identity.

If the User fails to comply with the “Request to Provide Security” Notice, a “Failure to Provide Security” Notice (which will form a new appendix to the Energy Balancing Credit Rules), will be issued. This will notify the User that Transco shall be entitled to give a Termination Notice to the User if the User does not provide an increased level of security within a further fifteen Business Days from the date of that Notice.

Where Transco has issued a “Failure to Provide Security” Notice and until the required total value of security is provided in accordance with the Energy Balancing Credit Rules, Transco will not pay and (irrespective of the Invoice Due Date) shall be entitled to withhold payment pursuant to any Energy Balancing Invoice in respect of any amounts payable to the User in respect of Energy Balancing Charges.

Furthermore, in the event that under contingency arrangements the Flexibility Mechanism is in use, the User shall not be entitled, nor will Transco accept, any flexibility bid.

The relevant figures will be contained within the Notices that will form appendices to the Energy Balancing Credit Rules. This reflects the current process for Notices already governed by the Energy Balancing Credit Rules"

The proposer justified the Modification Proposal as follows:

The recent failure of Independent Energy has exposed the shipping community to some £1.5M of pre-receivership energy balancing debt. This has focused attention on the need to tighten-up current credit management procedures, which have (other than Modification 103 implemented on 1 October 1997) remained largely unchanged since the introduction of the Network Code in 1996. Of particular concern is the potential for Users to rapidly increase indebtedness through trading at the National Balancing Point (NBP) that results in large imbalance positions. Members of the Energy Balancing Credit Committee (EBCC) have concluded that enforcement of minimum levels of security that better reflect the current activities of particular Users are required.

Under the Network Code Supplement, Users are required to elect a Secured Credit Limit in relation to their energy balancing position. For those Users that have not been assigned an Investment Grade rating by a designated credit rating agency, a suitable form of security must be provided to support that limit, in compliance with the Energy Balancing Credit Rules. A “Cash Call Limit” is allocated for each User that is equivalent to 85% of the Secured Credit Limit. Outstanding Relevant Balancing Indebtedness, which represents the cumulative debt position, is then measured against this limit.

On behalf of all Users, Transco operates procedures to track each User’s ongoing energy debt position. Upon identification of an unsecured excess, appropriate action is taken in order to protect all Users from this exposure. This action is encapsulated within the Cash Call Notice process.

This process is carried out in accordance with the Network Code and the Energy Balancing Credit Rules and the latter are subject to the approval of the Energy Balancing Credit Committee. This committee is established by the Network Code as a committee of Users under the non-voting chairmanship of Transco. Ofgem also attends the committee meetings in a non-voting capacity.

The Energy Balancing Credit Committee has identified an issue arising from the present Energy Balancing Credit Rules. If a User is regularly required to pay Cash Call Notices, this is an indication that its Secured Credit Limit is insufficient for its energy balancing behaviour. In such an event, Transco does not have the right to insist on a minimum Secured Credit Limit nor a minimum supporting security.

There is therefore a need for a Network Code Modification which allows Transco to implement a more appropriate Secured Credit Limit and obtain relevant security in support of that limit.

## 2. Transco's Opinion

Transco's position on this Modification Proposal is essentially neutral as it is not exposed to the financial risks involved and acts in the interests of the community as a whole under the Energy Balancing Credit Rules.

Transco considers that this Modification Proposal could be of benefit to Users as a whole and may reduce the risk of energy balancing debt exposure over the community. However, it is also aware of the effect that this Modification Proposal may have on some small shippers in particular in that increased costs of securities may have the adverse effect of making them more financially vulnerable and, as a consequence, more likely to enter into receivership.

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

A User entering receivership with a cash shortfall arising from energy imbalances might create a debt burden on all other Users via the balancing neutrality mechanism. This potential debt burden can be viewed as a form of subsidy. If it is considered that such subsidies are symptoms of inefficient or uneconomic operation of Transco's pipeline system, to the extent that this Modification Proposal would be expected to reduce this burden, implementation could be considered as enhancing efficient and economic operation.

Transco also notes the argument that such subsidies might hinder the development of competition and a history of debt burdens absorbed by the User community might be considered as a barrier to entry of new Users.

## 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. It is anticipated that enforcing the minimum credit limit will reduce the necessity of making further cash calls on the User. However there is the possibility of increased financial risk to that User in that increasing securities to the minimum credit limit may cause a User to enter receivership. This would have operational implications on Transco if it were obliged to serve a termination notice.

### b) development and capital cost and operating cost implications:

Transco is not aware of any development or capital costs arising 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:**

Transco does not believe that it would be appropriate to have any special cost recovery measures in place should the implementation of the Modification Proposal lead to increased costs for Transco.

**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 unaware of any such implications.

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

The Modification Proposal is intended to reduce the credit risk on Users through balancing neutrality and therefore be of benefit to Users as a whole. Implementation of this Modification Proposal could also have implications for some smaller shippers in particular in that it could be argued that increasing securities to meet the minimum credit limit may have the effect of making the shipper financially vulnerable and more likely to enter receivership.

**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 unaware of any such implications.

**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**

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.

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

Advantages

Transco's Credit Risk Management processes may more effectively manage the risk of exposure to Users.

The managing and monitoring of a User's credit limit to energy balancing indebtedness may reduce the risk of the User moving into a position of receivership.

Disadvantages

It could be argued that increasing a User's security to a minimum credit limit may increase its financial vulnerability which may ultimately result in it entering receivership.

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

Representation are now invited.

**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 such requirement.

**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 License**

Transco is unaware of any such requirement.

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

Transco is unaw
are of any such consequence

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

The Modification Proposal has a target implementation date of 1 February 2001. To allow the normal processes of consultation and preparation of the Final Modification Report to take place, the earliest possible date for implementation would be 16 February 2001.

**16. Recommendation concerning the implementation of the Modification Proposal**

Transco is supportive of the objective of this Modification Proposal and feels that its implementation could facilitate better credit management of energy balancing. This may be to the general benefit of all Users.

**17. Text**

*Add new paragraph 2.6.4 to read as follows (and renumber existing paragraphs 2.6.4 and 2.6.5 as paragraphs 2.6.5 and 2.6.6 respectively)*:

"Paragraph 2.10 shall apply where within 28 days of the submission of a Cash Call to a User Transco submits a further Cash Call (including a revised Cash Call pursuant to paragraph 2.7.3) to the same User.".

*Amend renumbered paragraph 2.6.5 to read as follows*:

"….where a Cash Call or Further Security Request is submitted….".

*Amend renumbered paragraph 2.6.6 to read as follows*:

"Paragraph 2.6.5….".

*Add new paragraph 2.10 to read as follows*:

2.10 **Further Security Request**

2.10.1 Where this paragraph 2.10 applies Transco will as soon as reasonably practicable on or after the [date] on which the further Cash Call (referred to in paragraph 2.6.4) is submitted submit to the User a Further Security Request.

2.10.2 For the purposes of this Supplement a "**Further Security Request**" is a notice, in a form set out in the Energy Balancing Credit Rules, requiring the User to provide a further, additional [or revised] Guarantee or Security in such amount and for such period as determined in accordance with the Energy Balancing Credit Rules.

2.10.3 Where:

(i) a Further Security Request (the "**relevant**" Further Security Request) has been submitted to a User;

(ii) the User considers it [inappropriate] that is should be required to provide a further, additional [or revised] Guarantee or Security,

the User may, not later than 12:00 hours on the 5th Business Day following the Day on which the Further Security Request was submitted, so notify Transco, specifying in as much detail as possible the User's reasons for so considering.

2.10.4 Where a User gives a notification under paragraph 2.10.3:

(i) the relevant Further Security Request (and the obligation to provide further, additional [or revised] Guarantee or Security) will be suspended, subject to paragraph 2.10.5;

(ii) Transco will review the details provided by the User and will review the calculations made of the User's Outstanding Relevant Code Indebtedness;

(iii) if requested by Transco the User shall provide by telephone or facsimile any further details or explanation of its view.

2.10.5 Following its review under paragraph 2.10.4, Transco will as soon as reasonably practicable (and wherever possible within 24 hours after the User's notification under paragraph 2.10.3):

(i) where it is reasonably satisfied that it is [inappropriate] that the User provide further, additional [or revised] Guarantee or Security in accordance with the Further Security Request, withdraw the Further Security Request or revise the further, additional [or revised] Guarantee or Security requested accordingly and submit the revised Further Security Request to the User;

(ii) otherwise, notify the User that the Further Security Request remains valid (and is no longer suspended),

and such revised Further Security Request or notification shall be substantially in the form set out in the Energy Balancing Credit Rules, and if given on a Day which is not a Business Day or after [17:00] hours on a Business Day shall be treated as having been given on the next following Business Day.

2.10.6 A User may not give a further notification under paragraph 2.10.3 to Transco in respect of a relevant Further Security Request (whether or not revised under paragraph 2.10.5).

2.10.7 Where Transco has submitted a Further Security Request to a User, the User shall, subject to paragraph 2.10.4, provide further, additional [or revised] Guarantee or Security in such amount and for such period as determined in accordance with the Energy Balancing Credit Rules.

2.10.8 Where Transco has submitted a revised Further Security Request or notified a User that a Further Security Request remains valid pursuant to paragraph 2.10.5 until the further. additional [or revised] Guarantee or Security is provided in accordance with the Further Security Request Transco shall be entitled to withhold payment pursuant to any Energy Balancing Invoice in respect of any amounts payable to the User in respect of Energy Balancing Charges.

2.10.9 Where a User has not provided the further, additional [or revised] Guarantee or Security in accordance with the Further Security Request by 12:00 hours on the 15th Business Day following:

(i) the date the Further Security Request was submitted;

(ii) where the User has given a notification under paragraph 2.10.4, the date the revised Further Security Request was submitted or the date the User was notified that the Further Security Request remains valid pursuant to paragraph 2.10.5,

and irrespective of the User's Outstanding Relevant Code Indebtedness as at any Day after the submission of the Further Security Request, Transco shall be entitled to, and as soon as reasonably practicable thereafter will, give Termination Notice to the User (for the purposes of Section V4.3.3) to the effect that the User shall cease to be a User with effect from the Day following the date of the Termination Notice and Transco shall send a copy of any notice given under this paragraph 2.10.9 to the Director.".

***Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report***

Signed for and on behalf of Transco.

Signature:

**Tim Davis**
**Manager, Network Code Development**
Date: