

**Modification Report**  
**Extension of Transco's rights to apply sanctions**  
**Modification Reference Number 0627**  
Version 2.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

## **1. The Modification Proposal**

To extend the circumstances when the provisions of Section V.3.3.2 of the Network Code could be applied to include instances where a User is in default by an amount greater than £10,000.

## **2. Transco's Opinion**

Transco's opinion is that this modification proposal should be implemented. The purpose of this Modification Proposal is to increase the remedies available for prompting payments from Users while removing the need to take Termination, Legal or Insolvency action as a first step. The ability to provide a measured response to non-payment which avoids precipitous action could reduce risk for all Users.

Currently where a User exceeds 85% of its Code Credit Limit, Transco is entitled to refuse to accept any or all of the following (these measures are collectively referred to as “sanctions”):

- Applications for system capacity or increases of system capacity:
- Applications to acquire capacity on the secondary market:
- Supply point nominations or confirmations.

The only current contractual remedy in the event of non payment is to terminate a User from the Network Code. By allowing Transco to impose sanctions in this situation in addition to when a User exceeds the 85% indebtedness trigger, Transco would have an escalation process to stimulate payment by restricting portfolio growth without the threat of termination. Transco is of the opinion that for Users in default, it is sensible to have a halfway-house remedy that encourages payment whilst minimising the risk of bad debt to Transco and the Shipping Community and avoiding any precipitous action.

The justification to support this change results from Transco not being in a commercial position to temporarily withdraw services as a lever to force payment. Restricting the rate at which the debt increases, while still allowing the shipper to trade, should be seen as a prudent commercial measure.

By allowing Transco to have the flexibility to apply a remedy for non-payment without termination, limited financial exposure would be incurred. Transco believes that termination should be an action of last resort, however, it is currently the only contractual remedy for non-payment of an overdue transportation debt in excess of £10,000.

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

The ability to provide a measured response to non-payment which avoids precipitous action could reduce risk for all parties and therefore better facilitate the relevant objectives by the efficient and economic operation of the pipeline System.

**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:**

Transco's costs would be treated as normal operating 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**

Sanctions may be applied to limit a Users portfolio growth where a User is in Default.

**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**

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**

- Provides Transco with the flexibility to apply a remedy for non payment of Transportation invoices without Termination.
- Minimise financial exposure and ultimately bad debts to Transco and the Shipping Community.

**Disadvantages**

- May increase the costs of Transco's administration processes for those Users in Default.

**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 seven Users:

TotalFinaElf Gas ("TGP"), Powergen , British Gas Trading ("BGT"), Scottish and Southern Energy ("SSE") Innogy, ExxonMobil International Ltd and EDF Energy ("EDFE").

Three representations support the implementation of this Modification Proposal with four representation against implementation.

**• Alternative Options**

The views expressed by those Users against implementation of this Modification Proposal were supportive of the overall concept to reduce exposure of non payment but considered that alternative approaches needed to be fully explored. SSE stated *"SSE welcomes moves to reduce exposure associated with non-payment of invoices but has concerns that these proposals do not address fundamental issues"*. BGT shared this view and stated *"Whilst we are supportive of Transco having appropriate measures to prompt payment from Users, we do not believe that this Modification Proposal would deliver any appreciable benefit in protecting the exposure of the industry as a whole to the problems of late payment and bad debt"* It further stated *"The preferred alternative would be to adopt an agreed industry procedure with recognised steps of escalation and mechanism to appeal sanctions"*.

Transco Response: Transco's view is that the proposed changes would deliver more effective cash collection processes and minimise the financial exposure to shippers. This view was shared by those Users that support implementation of this Modification Proposal. Powergen stated *"Powergen are in favour of the proposal as terminating a User, although rarely used, would ultimately be to the cost of other Users. This proposal would therefore minimise financial exposure to shippers and prevent other shippers from taking advantage of the current arrangements"*. EDFE offered qualified support and agreed with the principles contained in the proposal which provided Transco with additional tools for dealing with the late payment of Transportation invoices, although it did refer to the Ofgem Review of Credit Arrangements and the awaited outcome. In response to the views expressed about further development with the industry on alternative options and the outcome of the Ofgem Credit Consultation, Transco is working towards improving the existing credit provisions and given the Ofgem response on other Credit related Modification Proposals, each one should be assessed on its individual merit in terms of whether it facilitates the relevant objectives.

- **Credit Arrangements and Application of Sanctions**

Although both TGP and Innogy recognised the justification and sentiment of the proposal, they could not support its implementation. TGP stated *"the sanctions proposed are too severe for what may be an operational error or misunderstanding"* and Innogy stated *"in our view it weakens the credit management arrangements"*. The latter being the introduction of discretion for Transco in the application of the rules. Whilst ExxonMobil broadly supports the proposal, it did suggest that Transco allow a one or two day period to elapse after the default prior to effecting the remedies and also to consider cases of genuine payment processing mishaps.

BGT expressed the view that non payment has a number of elements that require different remedies and stated *"It is necessary to differentiate between those Users which 'won't pay' and those that are judged as 'can't pay'. For the latter we suspect that the proposed lesser sanctions would be appropriate or in the interest of Transco or the wider industry"*. In cases where Users will not pay BGT referred to the stretching of payment deadlines to extend credit and disputes and stated *"It is not necessarily the case that Transco are in the best position to apply their discretion on matters of this nature"*

Powergen stressed that it was important for Transco not to potentially restrict the time between non payment and Termination by following two different processes and stated *"Transco may apply the threat of sanctions for non payment and then find that the counter party can not pay,*

*rather than will not pay, requiring Transco to issue a notice of non payment to give them the right of termination".*

Transco Response: In response to the representation which refers to the sanctions being severe, particularly if there was an operational error or misunderstanding, Transco would like to clarify that the proposed modification is aimed to reduce the severity of the existing remedies available ie. Termination, for the non payment of invoices. In terms of the view expressed about the credit management arrangements being weakened, this is not the case as the introduction of discretion in the process is only being applied to these new provisions and is therefore in addition to Legal remedies available for the collection of cash. In response to the suggestion of a one or two day lapse after the default date, Transco does not consider this to be a requirement given that these provisions are discretionary.

Transco agrees with the view that there may be different reasons for non payment of invoices ie. "can't pay" and "won't pay" and it must treat each instance equitably in terms of the process whilst applying its discretion based on the historical information available at the time. Whilst the sanctions would restrict the Users normal operation in acquiring new supply points and capacity, these are meant to limit the exposure and deter the Users that "won't pay" from withholding payments whilst restricting the exposure for the "can't pay" User. Where there is an invoice dispute in accordance with section S4.2 of the Network Code, then these provisions will not apply. In response to the question raised about running two processes, Transco would like to confirm that these new provisions will not impact on the existing Termination process in that either one can be invoked and they are not contingent on each other.

- **Payment History**

SSE requested whether any quantitative analysis could be provided in respect of the frequency and extent of the default at present, including the number of occasions Transco has had to impose sanctions, their effectiveness and also justification as to the figure of greater than £10,000 for the sanctions to be applied. In terms of the latter SSE stated "*It is not clear how this figure has been arrived at. There is no justification or analysis to suggest that this is an appropriate level*". It suggested that in relation to larger players this level maybe too low and for smaller players too high and whether a percentage based option should be considered. SSE also questioned whether lowering of the current 85% threshold was considered to introduce early or additional warnings that a party is reaching its Code Credit Limit.

Transco Response: As there are currently no sanctions for the non payment of invoices, Transco does not have any figures to assess as charging debit interest and Termination are the only remedies available. However, in respect of the analysis for the number of invoices above £10,000 that were paid late, the following figures were presented at both the Supply Point Billing and NT & T workstreams.

	Oct 02	Nov 02	Dec 02	Jan 03	Feb 03	Mar 03	<b>Total</b>
No of Invoices Issued	831	894	572	1268	1047	830	5422
No of Invoices paid late	39	33	32	31	24	41	201

The total financial value for the 201 invoices paid late is £49.9m.

The figure of £10,000 was proposed as this is in line with the existing provisions for a User in Default as defined within Section V4.3 of the Network Code. Transco would like to confirm that this proposal was raised to provide additional remedies for non payment of invoices as this was identified as an area where process improvements could be made and did not consider that changes to the credit limit threshold and additional early warning were appropriate in these circumstances.

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

Implementation of this Modification Proposal is not required to enable Transco 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 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**

Development of Transco's internal processes and procedures is required.

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

A period of 1 month following a decision by Ofgem to implement is required to develop internal processes and procedures.

## **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

### Insert new paragraph at S 3.5.3

“Without prejudice to any other rights of Transco under the Code, including without limitation those under Section V4.3, where, in relation to any amount (or amounts in aggregate) of not less than £10,000 which has become due for payment by a User under the Code (excluding for the avoidance of doubt amounts which are the subject of an Invoice Query which by virtue of paragraph 4.2.2 have not become due for payment) and the relevant User has not paid the amount in full by the due date for payment;

Transco shall be entitled to reject or refuse to accept all or any of the following by the relevant User:

(i) an application for System Capacity or increased System Capacity at anySystem Point under Section B or Section G5; and

(ii) a System Capacity Trade under Section B5 in respect of which the User is Transferee User; and

(iii)a Supply Point Nomination or Supply Point Confirmation under Section G, other than a Supply Point Nomination or Supply Point Reconfirmation (unless made in the context of an application under paragraph (i) (above));

with effect from the day after the due date for payment until such time as the relevant User has paid the amount due for payment in full.”



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 **0627**, version **2.0** dated **16/09/2003**) 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.