

**Modification Report**  
**Clarification of Gas Supply Emergency Claims Review Criteria**  
**Modification Reference Number 0636**  
Version 1.0

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**

The original Proposal was as follows:

"It is proposed that in the event of a National Gas Supply Emergency (NGSE), claims by Users for financial loss (existing paragraph Q4.2.5) would be subject to the following principles:

- Allowed costs should be based on an appellant's total costs and not the cost of an individual source;
- Intra-group transfers should be deemed to be made at market price;
- "Windfall gains" should be netted off wherever possible;
- Reasonable administrative/legal costs of making a claim should be allowed, but subsequent costs of pursuing a claim should not be;
- The above costs should be limited to 5% of the net claim; and
- Net income from the value of electricity sold less cost of gas shall be taken into account in the case of a power station "directed on" under PGCA rules."

Discussion within the NT&T Workstream has clarified and amended the original Proposal. This has led to the:

1. Withdrawal of the final bullet relating to PGCA rules;
2. Changes to the definition of "intra-group transfers" and "market price"; and
3. Recognition of treatment of "windfall gains"

### **Intra-Group Transfers**

The Workstream suggested that definition of intra-group should reflect the definition of a "33 1/3% Affiliate" as defined in accordance with the Network Code W2.9.7: "An "**Affiliate**" of a specified percentage in relation to a body corporate is:

- i. another body corporate which holds not less than the specified percentage of the voting rights of the first body corporate; or
- ii. a subsidiary of the first body corporate of such a body corporate as is referred to in paragraph (i);

and for these purposes "voting rights", "holding" voting rights and "subsidiary" are to be construed in accordance with Section 736A of the Companies Act 1985."

Thus any transfer by a User to or from a 33  $\frac{1}{3}$ % affiliate would be deemed to be made at market price.

### **Market Price**

The Workstream suggested that there should be a three stage determination of market price:

1. If the market had not been suspended at the commencement of the Day, the SAP calculated from all the OCM trades that had taken place would set the market price for intra-group transfers;
2. If the market had been suspended at the commencement of the Day or Transco reasonably believed that this SAP was not market reflective it would propose a price to Ofgem for approval; and
3. If Ofgem did not approve Transco's proposed market price an expert would be appointed generally in accordance with Section T2 of the Network Code and that expert would determine the applicable market price.

### **Windfall Gains**

The Workstream suggested that this issue would be solved by the satisfactory treatment of allowed costs based on an appellant's total costs. The principle accepted was that claims should be submitted on the basis of the net cost derived from all sources of gas delivered or procured by the User on that Day. This relied upon the assumption that the User would derive a benefit if its average purchase price of gas were lower than the cash-out price for that Day but would face a cost if its average purchase price were higher than the cash-out price.

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

Transco considers that the existing lack of clarity underlying the present claims process where discretion exists could be detrimental to the provision of support available from Users in the event of a NGSE. However, some discretionary element in the claims process is to an extent unavoidable to allow the claims reviewer to handle a wide span of consequences that might result from a Network Gas Supply Emergency.

The Workstream development process carefully considered market price determination issue and the principles were incorporated within the legal text that accompanied the Draft Modification Report. It is noted, however, that whilst there had been development of alternative methodologies within the NT&T Workstream, there was no clear consensus within the representations that a satisfactory process had been developed for determining the market price.

It is therefore appropriate to consider whether the approach advocated in the Draft Modification Report, or an alternative approach, would be considered preferable to the current position whereby the current Network Code leaves such discretion with the claims reviewer.

Transco, particularly in the light of the conflicting responses to this consultation, has considerable doubts as to whether a greater level of detail in respect to the determination of market price within the Network Code would be helpful. Transco therefore does not recommend implementation of this Proposal.

Transco also notes that issues such as the applicability of a single legal cost cap and the derivation of appellants' total costs were, according to some representations, still unresolved. Transco therefore concludes that this Modification Proposal should not be implemented. This need not prevent any further discussion at the Commercial Implications Working Group of the Gas Industries Emergency Committee which might take into account changes in the Fuel Security Code. Additionally, should Users believe there might be scope for improvements to the Network Code in this area, it might be helpful to raise this issue as a topic in the NT&T Workstream which might provide a vehicle for the development of a new Proposal.

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

Providing clearer criteria for evaluation of claims could increase the confidence with which Users would make gas available to the System in the event of a NGSE. This is consistent with the securing of effective competition between relevant Shippers, since such Shippers could have more confidence that they would be appropriately remunerated for incremental gas flows delivered to the System in an emergency. This might be expected to optimise availability of gas under an emergency, thereby increasing the ability to operate the System in an economic and efficient manner under such circumstances. However, Transco believes that some discretion would be inevitable and that attempts to define rules too closely in advance of the emergency might lead to undesirable settlements.

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

#### **a) implications for the operation of the System:**

Transco has not identified any implications for operation of the System.

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

Transco has not identified any development; capital cost; or operating cost implications.

#### **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 propose to recover any costs arising from the implementation of this Modification Proposal.

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

Transco is not aware of any consequences that implementation of this Modification Proposal would have 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**

Transco is not aware of any change in its level of contractual risk.

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

Transco is not aware of any development or other implications for computer systems arising from the implementation of this Modification Proposal.

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

Transco considers that Users might face a lower level of financial risk as a consequence of cooperation with the NEC.

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

The implications of a NGSE would extend to all parts of the gas chain including Non-Network Code Parties. It would therefore be expected that any benefits arising from maximising commercial opportunities through the establishment of clear claims criteria would apply to various gas industry participants.

**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 not aware of any such consequences.

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

Transco has identified the following advantages that would arise from implementation

- Greater clarity for the settlement of claims where Users or their affiliates take gas from a variety of sources and/or have financial interests in various links of the gas chain; and
- Avoidance of excessive legal and associated costs flowing through to balancing neutrality. This clarity and constraint on legal costs could assist Users in risk management.

Transco has identified the following disadvantage that could arise from implementation:

- A single percentage cap applying to the legal cost element of all claims might be considered as arbitrary; and

- The proposed rules would add complexity to the claims review process.

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

Five responses were received to the consultation:

British Gas Trading (BGT)	For
Centrica Storage Ltd (CSL)	For
Edf Energy plc (EDF)	Against
Powergen UK plc (PG)	Qualified Support
Total Gas & Power Limited (Total)	For

All respondents in favour of the Proposal suggested further discussion or enhancements to the Proposal. Particular aspects raised were as follows:

### Assessment of Appellant's Total Costs

BGT expressed the belief that "there may be difficulties in assessing the appellant's total costs" and suggested that "it may be beneficial to further discuss how such difficulties might be addressed". CSL believed that assessment of loss should not only consider gas delivered to the System but also costs involved with "ceasing injection at storage facilities or bringing sites to readiness for delivery at Transco's request." EDF commented that "The first bullet point alludes to the fact that a User can claim for 'Total Costs' but the legal text only refers to 'aggregate quantity of gas delivered to the system on the relevant day' which limits the over all inclusion of costs. For example, there is no reference, either in the bullet points or the legal text to claims relating to losses on the electricity side emanating from say imbalance costs." EDF did, however, recognise its agreement to the removal of the original sixth bullet point that sought to address "where power stations have been ordered to run by the Secretary of State under the PGCA rules." EDF referred to alignment with the Fuel Security Code and claims for costs "emanating from the involvement where the Secretary of State has intervened. Scenarios of concern included that where a CCGT was at or near its emissions limit for a pollutant and goes over-limit as a result of an instruction to operate, or where the generator is, following an instruction to operate issued under the FSC, taken to or near its limit and cannot operate profitably at another, later time after the national emergency has passed." PG were critical of the method of evaluating "windfall gains" and commented that "Rather than bringing clarity to the Gas Supply Emergency Claims Review Criteria, this clause actually introduces more complexity. It is impractical to take account of an appellant's aggregate net costs in relation to the aggregate quantity of gas delivered to the System on the relevant Day. The costs would be much more reflective if they were based on the actions taken by a User for bringing additional gas to the market, in the event of a NGSE."

### Transco's Response

Transco concludes from these responses that there is a lack of consensus on which costs should be included within the definition of appellant's total costs - even on the part of respondents that otherwise supported this Modification Proposal. Transco does not believe that the scope of this

Proposal should be widened to cover certain storage operation costs or related costs within the electricity industry as representations have not been sought on the related issues. The Workstream discussion that led to the removal of the sixth bullet would indicate that an extension that allowed the claims reviewer to consider electrical power generation issues should only be considered after detailed discussion with all the relevant parties.

### **Determination of Market Price for Intra-Group Transfers**

CSL agreed that implementation of this Modification Proposal would "provide the advantage of clarity for the settlement of claims where Users or their affiliates take gas from a variety of sources and/or have financial interests in various links of the gas chain." On the issue of market price, PG concurred with "Stage 1 as suggested by the workstream. For Stage 2, however, it is more appropriate that, where the market has been suspended at the commencement of the Day, the SAP should be set at yesterday's SAP, as a more accurate, objective reflection of the market price." EDF whilst agreeing with "the first determination of market price, where the SAP becomes the default price if the OCM has not been suspended" did "not feel comfortable in Transco being solely responsible for determining whether the SAP was market reflective or not where the market has been suspended" and believed that "where the market has been suspended Transco should 'always' appeal to Ofgem for a decision on the relevant market price for such a day."

### **Transco's Response**

Whilst there had been discussion within the Workstream about Transco taking a role in respect of determining the market price, Transco had not recommended this within the Draft Modification Report but had suggested that the claims reviewer assume this role. Transco would also wish to note at this point that Ofgem already has a role in making a final determination of the claim and this might be considered inconsistent with Ofgem's direct involvement in a previous stage of the claims review process. In respect of determining the appropriate SAP, Transco remains of the view that the SAP prior to suspension of its use of the OCM would often be a market reflective price and the claims reviewer would not have been obliged to apply that price in its assessment of any claim. Transco, whilst not now recommending implementation, would still conclude that the legal text submitted with the Draft Modification Report indicates an appropriate and robust process for determining market price.

### **Legal Cost Cap**

Total were of the opinion that the 5% limit on legal costs did not "accurately reflect the expense of making a small claim. The actual legal costs incurred when making a claim for £20,000 will be similar to the costs incurred when making a claim of £200,000. The 5% rule would allow only £1,000 for the former, and £10,000 for the latter claim, a considerable difference." Total acknowledged the status and purpose of DTI instructions but suggested that "those shippers who make small claims, possibly small producers, would unfairly be penalised if the 5% rule were applied." In order to remedy such an occurrence, Total recommended that "a sliding scale band should be imposed. More precisely, shippers would be able to claim, for example, legal costs up to 10% of their claim for amounts up to £250,000, and 5% on amounts thereafter." Total believed that "such a method would allow legal costs to be recovered which materially reflect the costs to shippers of making a claim, regardless of its actual monetary value." In contrast, EDF agreed with "the 5% cap on the total amount payable with no additional costs being allowed following

submission of such a claim. However, we would need some guarantees that extra administrative costs could not be pushed back onto Users where the final cost of a claim became higher than the originally envisaged by that User or the relevant 'Claims reviewer'. This point needs to be fully addressed. "

### **Transco's Response**

With the exception of this response, Transco is not aware of any concerns being expressed with the principle of a 5% cap and would note that this element has been incorporated in a number of documents discussed at CIWG and at Network Code Workstreams. Transco did not dissent from this principle when these discussions took place and does not feel it to be appropriate to introduce a change of this nature at this stage of the consultation. Transco believes that the 5% cap should be sufficient safeguard in limiting the exposure of the User community to administrative costs without developing any further guarantees.

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

Transco is not aware 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 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence**

Transco is not aware of any such requirement.

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

Transco is not aware of any requirement for a programme of works.

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

Whilst Transco is not recommending implementation it sees no reason why there should be any delay to implementation of this Proposal if a direction to implement were made.

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

Transco does not recommend implementation of this Modification 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 agreement from the Gas & Electricity Markets Authority in accordance with this report.



## **19. Text**

Signed for and on behalf of Transco.

Signature:

**Mike Calviou**  
**Commercial Frameworks Manager**  
**NT & T**

Date: