

URGENT Modification Report
Referral of Entry Capacity Disputes to the Energy Balancing Credit Committee
Modification Reference Number 0402

Version 2.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 OFGEM has agreed that this Modification Proposal should be treated as Urgent because it is of the opinion that there is an increased potential for manifest errors and entry capacity disputes to occur following the introduction of the within day capacity market on 1 June 2000.

Procedures Followed:

Transco agreed with OFGEM (and has followed) the following procedures for this Proposal:

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| Issued to Ofgem for decision on urgency | 23 May 2000 |
| Proposal agreed as Urgent | 24 May 2000 |
| Proposal issued for consultation | 25 May 2000 |
| Close out for Representations | 5 June 2000 |
| Final Report to Ofgem | 12 June 2000 |
| Ofgem decision expected | 19 June 2000 |

1. The Modification Proposal

It is proposed that all existing and future entry capacity disputes should be referred to the Energy Balancing Credit Committee. This committee shall have powers to resolve entry capacity disputes, similar to current powers in relation to energy balancing.

2. Transco's Opinion

Transco is of the opinion that the Energy Balancing Credit Committee (EBCC) is not an appropriate forum for determining the validity of previously accepted entry capacity bids. The duties of the EBCC are encapsulated in Credit Risk Management Energy's (CRME) obligations to minimise the financial risk of potential default by an individual shipper operating in the Energy Balancing regime. The EBCC members do not have the ability to determine the appropriateness of charges on any transportation invoice. It could present a conflict of interest if the members of the EBCC were expected to comment on the validity of bids and also pronounce on a 'fair value' in the case of a disputed charge when they themselves have previously competed in the auctions.

Transco believes that the existing Network Code provisions in section S provide a process for dealing with invoice disputes. Entry capacity disputes are captured by this process and

accordingly there exists an existing satisfactory process for the resolution of both entry capacity and capacity neutrality charge disputes.

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

Transco believes that this proposal is counter to the objective of operating an economic and efficient system. The primary release mechanism for entry capacity is through a series of pay as bid auctions. To be successful in the auctions, a User must indicate that he places a higher value on a unit of capacity than competing Users.

Any subsequent re-assessment of that value by a body such as the EBCC would need to take into account that a lower valuation or lower bid quantity could have impacted upon all competing Users who had held the same or lower valuations. A re-assessment of values and volumes for a single User may therefore detract from the efficiency of the allocation process to all other Users.

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

No impact upon operation of the system is envisaged.

b) development and capital cost and operating cost implications:

No capital or operating cost implications are anticipated.

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:

Not applicable.

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

Not applicable.

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 believes that it should remain responsible for managing its own credit exposure. The potential non-payment of entry capacity charges is managed as detailed in the industry agreed document 'RGTA NTS Entry Capacity Billing Principles' section 4, Credit

Implications. As these are Transco's primary charges, it is not appropriate to establish an industry process for dealing with the consequences of non-payment. Network Code sections S and V contain remedies to manage late or defaulted payment.

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

No implications are envisaged.

7. The implications of implementing the Modification Proposal for Users

If implemented Users will be able to challenge the terms of previously accepted bids for entry capacity. That will impact the User which brings forward a dispute and potentially all other Users, both successful and unsuccessful, that had previously competed for that capacity.

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

No implications are envisaged.

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

If implemented the terms by which a User purchases Entry Capacity from Transco may not be binding. However, the obligations of Transco to the purchaser of entry capacity would remain unchanged.

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

Advantages

A User can retrospectively alter the terms of a bid if it is deemed to be inappropriate.

Disadvantages

Retrospective changes to a previously accepted bid would detract from the efficiency of the allocation process.

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 Scottish and Southern Energy (SSE), BP Amoco (BPA), Shell Gas Direct (SGD), British Gas Trading (BGT), Total Gas Marketing (TGM) and Elf Gas & Power (EGP).

BP Amoco and SSE are in support of the proposal. SSE agrees that referring disputes to the EBCC will provide a “robust and recognised process”, which it argues is essential to have in place given the number of entry capacity transactions which will arise in the future.

SGD, BGT, TGM and EGP are not in support of the proposal believe that it would not be appropriate to widen the remit of the EBCC to deal with monies owed to Transco in respect of transportation revenue. BGT stresses that if the remit of the EBCC was to be extended to this area, this should not be done on the basis of an urgent Modification Proposal.

EGP agrees that the proposal “is based on an incorrect interpretation of the duties and powers of the EBCC” and it does not agree that the parallel drawn with the treatment of Energy Balancing charges is appropriate. Both EGP and BGT outline the background leading to the establishment of the EBCC and its current role. Both respondents are of the opinion that, unlike described in the proposal, the role of the EBCC is to provide guidance rather than specifically instructing Transco to take certain actions in order to resolve disputes. BGT argues that dispute resolution procedures are contained in Section T of the Network Code and Section S also contains specific provisions to allow Shippers to dispute transportation invoice charges.

SGD raise two concerns over the proposal. Firstly, it suggests that it may allow Shippers to use capacity services without being required to make any payments for these. The Shippers

making accidental bids would be neutral from the consequences of their actions despite the fact that these actions are likely to have an impact on other Shippers and the secondary market.

Secondly, SGD suggests that Transco may not be neutral from the effects of Shippers which do not pay for capacity services and therefore any solution should reflect the fact that Transco as well as Shippers would incur costs if Shippers did not make full payment for capacity services. Like SGD, both BGT and EGP note that Transco is not neutral to capacity charges in the same manner it is neutral to energy balancing charges. As capacity charges contribute to Transco's transportation revenue BGT and EGP argue that Transco would have more of a vested interest in pursuing the debt, and therefore industry exposure would be limited. BGT also notes that as Transco has no financial exposure to energy balancing debt it is not currently given a vote on the EBCC.

BGT also queries whether the proposal is suggesting that separate capacity credit limits would be established and argues that there would be significant issues relating to whether the EBCC would have access to information relating to Shipper's transportation credit limits, which must be consulted on in a wider context than through an urgent Modification Proposal.

SGD, BGT and EGP all agree that an important issue has been identified and propose that measures are required to protect the industry from manifest errors when bidding, although they do not believe that this proposal is an appropriate way to approach this.

SGD notes that Transco's current IT systems for operating the capacity regime do not contain any mechanisms for dealing with manifest errors and considers that this should be something discussed by the industry. SGD argues that, to deal with manifest errors, systems should be developed which are more consistent with the systems in place in other trading markets, which allow full reversal of trades before the service is utilised.

SGD stresses that such mechanism should be introduced promptly as the current arrangements may distort competition and "cannot be considered efficient or economic". EGP also expresses support for the introduction of a mechanism which would verify "out of market" bids.

BGT points to the provisions in place on the OCM for incorrectly entered bids and suggests that it could be appropriate to introduce measures such as these for capacity bids and offers. However, it considers that these measures should be fully discussed in the RGTA workgroup before being adopted. EGP also expresses support for greater transparency in the publication of information so performance can be monitored and expects Transco's procedures to be open to regular audit.

Transco's Response

Transco does not agree that the EBCC is an appropriate body for resolution of transportation charge disputes. It does believe that BGT is correct in its observation that Network Code section S provides a means for capturing invoice disputes, including entry capacity charges.

Transco notes with interest SGD's argument that IT systems should be developed that are consistent with the systems that are in place in other trading markets, which allow full reversal of trades before a service is utilised. EGP also raised the prospect of systems being developed which would verify 'out of market' bids. Both these proposals could, as suggested by BGT, be explored by the Capacity Workstream with a view to developing protection systems for use in future auctions.

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) or the statement furnished by Transco under Standard Condition 3(1) of the Licence

Implementation is not required as a consequence of 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.

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

There are no modifications required to the UK-Link Systems and therefore a programme of works will not be required as a result of implementing the Modification Proposal.

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

As Transco is not in support of this Modification Proposal no implementation timetable is provided.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not support 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 Director General in accordance with this report.

19. Text

As Transco is not in support of this Modification Proposal no legal text is provided.

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Director General of Gas Supply Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0402**, version **2.0** dated **14/06/2000**) be made as a modification to the Network Code.

Signed for and on Behalf of the Director General of Gas Supply.

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 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 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 Director does not so approve the Agreement then Clause 3 shall apply.

2. If the Director 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 Director 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 Director 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 Director 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.