Draft Modification Report
Revision to Indebtedness Cash Call Trigger
Modification Reference Number 0446

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 when aggregated over a rolling seven day period the User has an energy balancing debt, the following additional calculations shall be carried out in order to update the Users anticipated credit position.

For each Gas Day within the measurement period set the energy balancing deficit or surplus (in kWh) to the value n days previously. Where n is the number of calendar days equivalent to the previous seven Business Days.

Apply to these deficits and surpluses the System Average Price for that Gas Day to derive an equivalent debit/credits for each Gas Day

Aggregate these debits and credits for the measurement period and derive a net debit

Add this net debit to the Outstanding Relevant Balancing Indebtedness prevailing immediately prior to the commencement of the measurement period.

For the purpose of Cash Call this revised debt shall be the Outstanding Relevant Balance Indebtedness."

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 remained largely unchanged (other than Modification 103 implemented on 1 October 1997) 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 result in large imbalance positions. Members of the Energy Balancing Credit Committee (EBCC) have concluded that a better measure of indebtedness is required.

Prior to the due date of a Balancing Invoice, Users can build up levels of indebtedness if, day after day, they have a consistent deficit on their daily energy balance. The number of days which the Network Code allows for finalising energy allocation at entry plus the period for preparation and payment, would, in the extreme, allow Users to accrue up over two months of imbalance debt. If on the

due date, the User were unable to pay the invoice, the Users as a whole are required to fund this deficit in expected payments, which in the absence of additional controls could be substantial.

2. Transco's Opinion

Transco is essentially neutral in this matter 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 has, however, some sympathy with this Modification Proposal as it would give a more up to date energy balancing debt position for each User. This would allow Transco's Credit Risk team to take actions that limit the exposure of Users as a whole, based on the best information available at that time.

Transco also concurs that, where a User enters receivership, this Modification Proposal should limit the unrecoverable energy balancing debt to a lower level than would be the case at present.

Transco notes the argument that this Modification Proposal would not result in an increase in the number of Users entering receivership but would, in the extreme, only hasten the process. Transco believes that Representations on this point would be particularly helpful.

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 unaware of any implications for the operation of the System.

b) development and capital cost and operating cost implications:

Providing the implementation of this Modification Proposal does not increase the likelihood of Users entering receivership, the only implications that Transco has indentified are in the area of credit risk management and the computer applications that support Transco in that role. Transco believes that development, capital and operating costs arising from changes to its operations and the systems which support them would be minor.

If, however, the likelihood of Users entering receivership was increased by the implementation of this Modification Proposal there would be operating cost implications in transferring Supply Points to alternative Suppliers.

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 believes it is appropriate to fund any changes to its computer applications, arising from this Modification Proposal using existing revenue.

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 has identified the development implications for its computer systems and has concluded the minor changes needed to its credit risk support systems could be accommodated to meet the earliest implementation date that has been identified from the standard modification timetable (16 February 2001).

Users might wish to modify any existing systems that they have which mirror those used by Transco in credit risk management but it is expected that these systems changes would also be minor.

7. The implications of implementing the Modification Proposal for Users

This Modification Proposal is intended to reduce the credit risk on Users through balancing neutrality and is therefore considered by the proposer to be of benefit to Users as a whole.

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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

Providing implementation of this Modification Proposal would not increase the likelihood of Users entering receivership, but only hasten the process, it is believed that implementation could be in the interests of the Non-Network Code parties. This would be due to the shorter period of uncertainty for Non-Network Code parties that have a contractual relationship with the User concerned and the credit exposure that they might face during that period.

If implementation of this Modification Proposal did lead to an increase in the likelihood of Users entering receivership, I&C consumers would potentially incur additional costs arising from the change of Supplier.

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, Users or Non-Network Code Parties 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 would be managing the risk to Users based on more up to date information. Having up to date debt information is generally recognised as good practice for credit risk management processes.

In the event that a User that was Cash-Called ultimately entered receivership, this Modification Proposal could reduce the existing exposure of Users through balancing neutrality as a result of non-recovery of energy balancing debt.

Disadvantages

Implementation of this Modification Proposal might lead to an increase in the number of Cash-Call notices if Users continued to incur existing levels of energy balancing debt. This would have implications for cash flow.

It can be argued that increasing a User's exposure to Cash-Calls would increase its financial vulnerability which might 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)

Representations 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

The only works of which Transco is aware concerns the changes required in the computer applications used in its credit risk management process and similar applications which Users might have. Transco can complete these works to meet the implementation timetable identified below.

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 objectives of this Modification Proposal and feels that its implementation could facilitate better credit management of energy

balancing. Transco would welcome views as to whether of not this would be to the general benefit of all Users.

17. Text

NETWORK CODE SUPPLEMENT: ENERGY BALANCING CREDIT MANAGEMENT

Amend paragraph 2.5.2 to read as follows:

"….

(c) "[**Anticipated**] **Balancing Indebtedness**" for each User is an amount calculated, in respect of all days in the relevant period (each such day (*'i'*)), in accordance with the following formula:

$$ABI = \sum_{i=d-n}^{d-1} SAP_i * DI_{i-n}$$

where:

[A]BI is the [Anticipated] Balancing Indebtedness;

SAPi is the System Average Price for the Day falling *'i'* days prior to day *'d'*; and

DIi-n is the User's Daily Imbalance for the Day falling *'n'* days prior to day ‘*i'* [(being a positive or (as the case may be) negative amount in accordance with Section E5.1.2)],

n is the number of days in the relevant period,

and the "**relevant period**" is the period from (and including) the 7th Business Day preceding the relevant Day until (and including) the Day preceding the relevant Day (‘d-1’);

(d) "**Outstanding Relevant Balancing Indebtedness**" for each User means (subject to paragraph (f)) the sum of:

(i) the net aggregate….

(ii) the Net Invoice Amounts….

(iii) the Net Invoice Amounts….

(iv) the User's [Anticipated] Balancing Indebtedness,

less….;

Amend paragraph 2.5.3 to read as follows:

"The Relevant Balancing Charges and a User's [Anticipated] Balancing Indebtedness will be calculated….".

Amend paragraph 2.5.4 to read as follows:

"….

(i) ….the calculation of Relevant Balancing Charges and a User's [Anticipated] Balancing Indebtedness will disregard

Signed for and on behalf of Transco.
Signature:

Tim Davis
Manager, Network Code Development
Date: