

Draft Modification Report
Minimum Level of Security for Energy Balancing
Modification Reference Number 0629

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

It is proposed that where a User is served with two Cash-Call Notices (irrespective of whether this is the first notice, a revision to, or a re-issue of a previous notice) within any rolling 28 calendar day period, ("the measurement period"), Transco would issue a "Notice to Provide Increased Security", as soon as reasonably practicable after the second cash-call notice. The notice would advise the User that in accordance with the Energy Balancing Credit Rules it is required to fully secure a credit limit agreed between Transco and the User, which in any event would be no less than the User's reported peak indebtedness during the measurement period. The User would be required to provide the requested increased security within seven Business Days from the date of the notice.

Additionally, the "Notice to Provide Increased Security" would specify that the additional security must not expire within 90 days of the date of the Notice, although a lesser period could be agreed between the User and Transco where both parties are in agreement.

The User would have a right of appeal against the "Notice to Provide Increased Security" within five Business Days of the notice being served. The User would be required to provide evidence to demonstrate why the required Secured Credit Limit does not reflect their typical energy balancing activities. Where an appeal is lodged, under Section X1.2.3, Transco may convene the Energy Balancing Credit Committee to consider any such appeal. Any consultation would be carried out in accordance with Section X1.2.5 in relation to the protection of the User's identity.

If the User fails to comply with the "Notice to Provide Increased Security", a "Failure to Provide Increased Security Notice" would be issued on the eighth Business Day. In the event that the User does not provide the required security cover within a further seven Business Days from the date of the Failure Notice, the User would be classified "In Default", and Transco would be entitled to call upon any security already lodged or serve a Termination Notice.

Where Transco has issued a "Notice to Provide Increased Security", and until such request has been satisfied, Transco would 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 (irrespective of the Invoice Due Date) and the User would not be entitled to late payment interest in accordance with Section S3.5. In addition, Transco would be entitled to disregard any request made by the User under Section X2.8.6 to release any monies held in the User's cash-call account.

Both notices would be included in template form as appendices to the Energy Balancing Credit Rules.

2. Transco's Opinion

In respect of energy balancing, Transco is essentially neutral as it is not exposed to the financial risks involved and acts in the interests of the Users as a whole under the Energy Balancing Credit Rules.

Each User has an obligation to balance its gas inputs and outputs on a daily basis and Transco does recognise that on any given day circumstances may arise which result in imbalances for some Users. However, where there is a continued period of imbalance resulting in a cash shortfall, Transco considers it is prudent to have measures in place to protect the community and following support from EBCC, has raised the proposal on its behalf.

In consideration of Ofgem's decision not to implement Modification Proposal 0447 "Provision Enforcement of a Minimum Level of Energy Balancing security", Transco has taken account of the concerns raised and redrafted this new proposal accordingly. The cash call limit being proposed equates to 100% of peak indebtedness reflecting the User's current credit limit requirements. Transco does not consider that any User categories are disadvantaged by this proposal, as the level of security is being matched against the level of trading and as part of the pre implementation work for Modification 0572 "The provision of Letters of Credit for energy balancing cover", Transco has negotiated preferential interest rates with the bank for those Users who wish to utilise the option of Cash on Deposit.

Transco considers that this Modification Proposal should be of benefit to Users as a whole as it could reduce any potential risk of energy balancing debt exposure to the community.

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

A User entering insolvency 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.

**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

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. However, implementation of this Modification Proposal could have implications on those Users that continually fail to balance daily. By increasing security cover to meet the minimum credit limit requirement a User may be financially vulnerable, although these risks must be assessed against any

default. In the absence of this, the community is at present effectively financing such Users trading patterns.

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 of implementing this Modification Proposal are that:

- Transco's Credit Risk Management processes would be enhanced and there would be more effective management of risk of exposure to all Users.
- Acts as an additional incentive for Users to balance daily.
- Focus on CVA data ie. timeliness and accuracy.

A disadvantage of implementing this Modification Proposal is that:

- Increasing a User's security to a minimum credit limit could result in some additional cost for some Users although it is anticipated that these would be relatively small .

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 sought.

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

The program of works required to implement this modification proposal includes changes to the Energy Balancing Credit Rules including a new proforma for the notice which requires approval by EBCC members.

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

This modification proposal can be implemented with immediate effect following determination by Ofgem subject to the completion of the work as detailed in 14.

16. Recommendation concerning the implementation of the Modification Proposal

In view of the support expressed by EBCC members, Transco recommends implementation of this Modification Proposal.

17. Text

Supplement

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 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 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 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 Security in accordance with the Further Security Request, withdraw the Further Security Request or revise the further, additional or revised 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 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 Security is provided in accordance with the Further Security Request a User may not make a request pursuant to paragraph 2.8.6 and Transco shall:

- (i) be entitled to disregard a request purportedly so made pursuant to paragraph 2.8.6; and
- (ii) 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 Security in accordance with the Further Security Request by 12:00 hours on the 8th Business Day following:

- (i) the date the Further Security Request was submitted; or
- (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.

Transco shall submit to the User a Failure to Supply Further Security Notice in a form set out in the Energy Balancing Credit Rules.

2.10.10 Where the User has not provided the further, additional or revised Security in accordance with the Further Security Request by 12:00 hours on the 7th Business Day following the date the Failure to Supply Further Security Notice was submitted 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 may, 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."

2.10.11 It shall not be a condition to Transco's giving Termination Notice under paragraph 2.10.10 that Transco shall first have made any call upon or taken any steps to enforce or realise any Security.

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:

Debbie Dowling
Finance Manager

Support Services

Date: