

Modification Report
Introduction of a financial incentive performance regime for the resolution of
User Suppressed Reconciliation Values (USRVs)
Modification Reference Number 0637
Version 5.0

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

To reduce the number of unresolved suppressed NDM Reconciliation Values through the implementation of a financial incentive performance regime, as follows:

USRV Backlog

All items in the suppressed pot as at the implementation date will be assessed for the 95% standard with the first date for potential incentives being the 20th of the second month following implementation. At this time, the backlog will be analysed and any items which are over four months old will incur an incentive payment of £30. On the 20th of each subsequent month, a charge of £30 would apply to each item in the backlog over 4 months old at that date.

Ongoing performance incentive.

For all USRVs received from Transco between the 21st of a month and 20th of the following month, (period X), each User shall provide a full response to Transco for 50% of such queries by the 20th of month X + 1 and for 95% of such USRVs by the 20th of month X + 2.

No incentive would apply on the 50% performance.

For each User:

All USRVs from month X not responded to by month X+2 below the 95% standard would attract an incentive payment of £20. If performance was 95% or over, no incentives would be payable.

No further charge would apply in the third month.

All subsequent USRVs from month X not responded to by month X+4 will attract an incentive payment of £30.

All subsequent USRVs from month X not responded to by month X >4 and above will attract an incentive payment of £30 for each subsequent month until responded to.

Where the number of USRVs in a month increases by 50% or more compared to the average number for the previous six months and the increase is more than 20 USRVs, the standard will be increased by 1 month.

All sums received via incentive payments will be allocated to the RbD community as per the current RbD invoicing system (based upon market share for the relevant LDZ for the relevant period) after deducting an administration charge.

Liability framework.

The following incentive regime would apply per User:

A is the total USRVs sent to a User in month X.

B is the total USRVs responded to from month X to month X+2.

C is the total USRVs responded to from month X to month X+4.

D is the total USRVs responded to from month X to month X+>4.

E is the incentive payment of £20.

F is the incentive payment of £30.

Payment for month X+2 = $((0.95 * A) - B) * E$.

There is no further payment in month X+3.

Payment for month X+4 = $(A - C) * F$.

Payment for months X+5 onwards = $(A - D) * F$.

Incentive Cap

An overall monthly cap for total incentive payments of £100,000 will apply. Where this value is exceeded, a scaling methodology will be used.

In the event that the cap is exceeded, the amounts payable by Users in respect of that month will be reduced pro rata such that the aggregate of such reduced amounts is equal to the monthly cap.

Invoicing methodology

Incentive charges in accordance with the above framework would be calculated and issued to Users on a monthly basis. All such charges would be aggregated by LDZ and credits issued to Users having Smaller Supply Points on a quarterly basis.

To minimise RbD community exposure in the event of non-payment of incentives, all such charges would be allocated once relevant funds have been collected. Funds collected in a given quarter would be allocated to RbD Users within the first month of the following quarter.

To ensure that the costs of administering the regime are funded accordingly, prior to allocating credits, 2% of the charges collected will be deducted to cover the additional costs incurred by Transco of calculating, issuing and collecting charges and of allocating, issuing and paying the corresponding credits.

2. Transco's Opinion

Transco's opinion is that this Modification Proposal should be implemented.

A User Suppressed Reconciliation Value ('USRV') is the Network Code term for a Reconciliation validation charge 'filter' failure generated using Meter Readings supplied by a User. The USRV would then be submitted to the User and the User expected to provide a response to Transco in accordance with standards contained within the Network Code Reconciliation Suppression Guidelines.

USRVs are passed to the User for investigation, the current performance of a number of Users to investigate the validity of the underlying data and notify Transco either to process the reconciliation or undertake re-reconciliation is inconsistent and significantly below standard.

This has created a number of significant commercial issues for Users in particular and to a lesser extent Transco:

- There is now a considerable backlog of USRV items (currently in excess of 38,000 items) outstanding with Users, with the backlog increasing and where the reconciliation would result in a User debit, no incentive for Users to both clear such backlogs and implement measures to ensure the timely resolution of ongoing filter failures.
- There is no Reconciliation by Difference ('RbD') incentive for Users with only Larger Supply Point portfolios to resolve their USRVs. Filter failure suppressions submitted to such Users via the NDM reconciliation process remain subject to the documented standards in the guidelines. Failure by Larger Supply Point Users to resolve their USRVs could have a consequential and adverse impact on Users whose portfolio is reconciled using RbD.
- Although the USRV clearance obligations are documented within the Network Code Reconciliation Suppression Guidelines, they are not reinforced through the application of incentives or a similar regime. The number of unresolved filter failures for a particular period will remain suppressed and hence excluded from the next available reconciliation invoice.

Whilst Transco intends to further develop its mechanisms to monitor and report USRV resolution performance, Transco believes that the measures identified within this Modification Proposal, which have been discussed by the Suppressed Reconciliation sub-group of the Supply Point and Billing Workstream, would improve performance of Users in resolving USRVs.

Concerns have been expressed by some Users with respect to the risk of inappropriate User behaviour or 'gaming'. The suggestion is that with respect to a Larger Supply

Point a User may internally re-calculate the suppressed value and determine that it is preferable to pay the incentive charge rather than seek resolution of the suppression. Transco accepts that such behaviour is possible but believes that the likelihood would be mitigated by implementation of this Modification Proposal. As a consequence of its existing monitoring activities, Transco would seek to report any suspicious behaviour.

Transco believes that implementation of this Modification Proposal would reinforce the contractual obligations placed upon Users to investigate suppressed NDM Reconciliation Invoice Values. It would be consistent with the 'unbundled' NDM meter reading regime and provide increased certainty for Users charged through RbD.

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

Implementation of an incentive framework would facilitate improvement of User performance in resolving suppressed filter failures by:

- Reinforcing the contractual obligations placed upon Users to resolve USRVs.
- Increasing certainty for Users charged through RbD.
- Ensuring that appropriate and cost reflective charges are applied to Users in respect of their use of Transco's facilities.

The measures identified within this Modification Proposal are consistent with facilitating effective competition between relevant shippers and between relevant suppliers.

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

a) implications for the operation of the System:

No such implications have been identified.

b) development and capital cost and operating cost implications:

Costs would be incurred with respect to implementing and maintaining the performance regime as proposed.

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:

To ensure that the costs of administering the regime are funded appropriately, prior to allocating credits to RbD Users, 2% of the charges collected would be deducted to cover the additional costs incurred by Transco of calculating, issuing and collecting charges and of allocating, issuing and paying the corresponding credits.

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

No such consequences have been identified.

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

Implementation of this Modification Proposal would not increase the level of Transco's contractual risk.

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

No changes to Transco's systems have been identified. Transco is not aware of the impact on Users systems.

7. The implications of implementing the Modification Proposal for Users

Incentivises prompt and timely investigation of suppressed NDM Reconciliation Invoice Values by Users.

Transco acknowledges that on occasions, inter-User liaison may be necessary to facilitate the resolution of a reconciliation 'filter failure', particularly where a change of supplier has occurred during or subsequent to the reconciliation period. This in turn may give rise to delay in early resolution. Transco is also aware of the increased complexities faced by Users as a consequence of unbundling measures which could cause delay in resolution.

It is important to note, however, that the Reconciliation Suppression Guidelines incorporate performance thresholds ('dead bands') the purpose of which is to mitigate the impact of such difficulties. The thresholds are reflected as part of the performance regime identified within this Modification Proposal and have recently been reviewed and revised as necessary by the Suppression Guidelines sub-group.

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

No such consequences have been identified.

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

Advantages

Incentivises prompt and timely investigation of suppressed NDM Reconciliation Invoice Values by Users.
Provides increased certainty with respect to Users having Smaller Supply Points.

Disadvantages.

No disadvantages have been identified.

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

Nine representations have been received by Transco with respect to this Modification Proposal. Three respondents expressed support for implementation, Three were supportive in principle or qualify their support and three respondents were opposed.

A number of common themes were identified within the representations which are described as follows:

Necessity for proposal

Statoil (UK) ('STUK') believes that Transco should focus on those shippers who have a high number of outstanding USRVs instead of targeting all shippers. STUK states that it is unclear of the actions that Transco have taken in the past to resolve these USRVs and believes, therefore, that effort should be directed to those shippers who are the "worst offenders". STUK comments that the introduction of financial penalties at this stage appears to be extreme and believes that Transco should attempt to resolve the issue through other means before financial penalties are considered.

Transco's response is that this Modification Proposal has been raised following detailed and extended discussion within the Suppressed Reconciliation sub-group of the Supply Point & Billing Workstream. The sub-group considered but dismissed other options to address performance. These included, for example, invoking sanctions, cancelling a USRV after twelve months or auto-releasing invoices after a pre-determined period of time.

The sub-group identified that despite previous actions undertaken by Transco, USRV resolution performance had not improved. Such actions included:

- Regular updates provided at the Billing Operations Forum and Invoice & Adjustment Workstream using shipper level anonymous data.

- USRV data (highlighting those shippers performing poorly) sent to shipping community approximately seven times per year since early 2002.
- Poorly performing shippers individually contacted by Transco's Account Management department and position discussed.
- Shippers have been encouraged to make use of the Filter Failure team within Transco (Billing) in an advisory capacity.
- Individually tailored training has been provided to shippers' operational staff.

STUK notes that the current proposals are biased towards suppliers with larger portfolios, as the percentage target of 95% requires smaller suppliers which receive two or three USRVs a month, to effectively perform at 100%. STUK comments that experience has shown that suppliers who operate in the large I&C sector tend to receive lower numbers of USRVs, however, the USRVs that they receive are due to major problems, which may take some time to resolve.

Transco does not concur with the views of the respondent. While it may be argued that smaller numbers potentially compromise the % target, given that small numbers are involved, Users having Larger Supply Points should be more able to promptly field USRVs. It is important to the integrity of RbD that suppressions are resolved promptly; hence Transco believes that all shippers should be incentivised, regardless of portfolio size. In this context it should be noted that Larger Supply Points can account for significant energy.

Midlands notes its preference for a 'name and shame' policy with respect to shippers exceeding 60% non resolution of USRVs in addition to a financial incentive.

Transco acknowledges Midland's aspiration but comments that there are significant legal and contractual impediments to revealing User identities. Any publication of performance information would, therefore, of necessity need to be anonymous and undertaken in a similar manner to Transco's exercises highlighting poor performance which are referred to above.

Implementation timescales.

Two respondents refer to the timing of implementation. Innogy notes its strong disagreement with Transco's proposal to introduce the incentives with effect from 1st October 2003, and claims that there is no logical reason or explanation within the proposal to explain why this date has been proposed in "flagrant disregard" of the views of the Suppressed Reconciliation sub-group. Innogy states that the Modification Proposal was developed by the User Suppressed Reconciliation Values Forum at which NPower was represented. Innogy points out that as part of the discussions surrounding the introduction of a financial incentive regime, the sub-group always worked on the assumption that such a regime should be introduced from 1st January 2004. Innogy comments that this was in order to give Users ample time to attempt to resolve any backlog they may face prior to the introduction of the incentives regime.

Transco's response is that it was not aware of any specific implementation dates being proposed within sub-group discussion, although Transco did state at the March 2003 sub-group meeting that a Modification Proposal could be implemented within six months. Transco believes implementation in October 2003 would provide sufficient and reasonable notice such that the existing backlog could be cleared. Transco would not, however, oppose a January 2004 implementation date should this be the prevailing industry preference.

BP Gas Marketing ('BP') questions the wisdom of introducing the Modification Proposal during the implementation of metering competition, i.e. the Review of Gas Metering Arrangements (RGMA). BP expresses that view that the separation of Transco's metering assets from its core transportation business and the significant associated data migration, as well as the potential for reduced data integrity, may lead to a greater level of risk to shippers that would need to be evaluated.

Transco does not consider that RGMA should be viewed as an impediment to timely implementation of this Modification Proposal. As described below, metering problems constitute a small minority of suppressions requiring adjustment. Transco also believes that improving the contractual regime during periods of change is important and should not be overlooked.

Identification of 'filter failures'.

Innogy comments that it is also apparent that there is currently no date shown as to when the filter failure was first raised by Transco. Innogy observes that if this situation persists at implementation it will be difficult to apply the proposed incentives in a robust manner. Innogy points out that Users will themselves be able to track the date when they received the original filter failure. However, without any confirmation of this date from Transco in the filter failure record, disputes will almost certainly arise. London Electricity indicates that it can only support the Modification Proposal if the age of all filter failures is made readily available to its respective suppliers.

Transco's response is that while a specific 'date stamp' is not visible to the shipper, age monitoring is facilitated by the relevant enquiry facility which enables a search to be made by month. All USRVs also feature a sequential reference number.

Innogy comments that it has found that future filter failures can invariably be spotted while processing current ones. However, as it can only validate filter failures that Transco have specifically identified and sent, this causes frustration and is inefficient. Innogy suggests that consideration should therefore be given, prior to implementation, as to ways Users can be allowed to resolve all expected filter failures by apportioning over the entire period of failure, without having to wait for Transco to identify and send these as separate cases.

Transco's response is that invoice adjustment is not possible until a filter failure exists. Transco seeks to issue the filter failure to shippers as quickly as possible

after calculation. Transco encourages shippers to address USRVs on a meter point by meter point basis to ease processing.

Resolution of 'filter failures'.

STUK believes that under the existing proposal shippers would be exposed to charges for outstanding USRVs where they are awaiting resolution of queries from either TMAM or the GT. STUK comments that both TMAM and the GT are unwilling to offer comparable levels of liability payments and service levels through the recently negotiated standards of service package.

Transco's response is that its current standard for resolution of queries is twenty days (established under the Bosworth agreement). The 95% target for shipper performance was intended to give sufficient leeway for a small proportion of very difficult to resolve items. Analysis has shown that in 2002 only 1% of suppressed items required adjustments due to meter asset problems. The remainder were either released without adjustment or needed a correction to meter reads. It may therefore be concluded that queries raised with Transco would be unlikely to have a significant effect on shipper performance.

TotalFinaElf ('TFE') states that it is very concerned that significant improvements need to be made to the way filter failures are processed before such incentives can be introduced. TFE believes there are problems with the current processes that unless resolved would expose it to charges even when TFE believed it had fully met the required standards. TFE further notes that improvements need to be made to the Conquest system to ensure that the correct status is recorded and that this is updated in a timely fashion when the appropriate action has been taken. TFE states that secondly, there should be a corresponding incentive on Transco to ensure that the Conquest system accurately reflects the correct status and that, where actions are required by Transco, these are carried out within the appropriate timeframe. TFE expresses a view that without the above it believes that the Modification Proposal is unsupportable because TFE would be exposed to penalties even where it had done everything possible to meet the desired objectives. Innogy expresses the view that the Modification Proposal fails to take sufficient account of the role Transco plays in enabling Users to resolve filter failures in a timely and consistent manner. Innogy comments that having had first hand experience across all of its supply businesses of trying to resolve filter failures, it is conscious of the fact that its ability to do so is dependant on the actions of Transco's representatives and of the performance of Transco's Conquest query management system. Innogy states that in many cases Users will need to raise an accompanying meter asset query on Conquest in order to satisfactorily resolve a filter failure. Innogy notes that if the performance of this system is inadequate which in its experience is not uncommon this could frustrate a User's ability to mitigate its exposure to financial penalties.

Transco's response to TFE and Innogy's comments above is that the suppression liability 'clock' ceases immediately upon receipt of a USRV response by Transco. This is not conditional on Transco's ability to progress the response

through to its invoicing systems. In the event that a USRV response subsequently fails the filter a new suppressed item will be raised and the 'clock' reset. Shippers are therefore not significantly exposed in this respect through the performance of Transco's systems. Transco has experienced some issues with its internal interfaces, however, enhancements made to Transco's Conquest system in May 2003 have resulted in shippers reporting significantly improved performance.

TFE notes that it employs substantial resource to respond to filter failures generated using Meter Readings supplied by a User. TFE claims it has also carried out analysis to better understand the status of any backlog it has in USRVs. TFE comments that on the assumption that, for the purposes of the Modification Proposal, monitoring would be carried on Conquest code AASH (awaiting shipper action) it believes that there are numerous problems that complicate the situation. TFE states that of a representative sample of filter failures assigned to itself for action, it found that only 24% were "truly outstanding" in terms of requiring shipper action. TFE establishes that the remaining 75% fell under a number of categories that in its opinion meant that it had carried out its action and was waiting for either the "failure" to be removed or for action to be taken by Transco to allow resolution of the 'failure'.

Transco acknowledges that responses to suppressions are only processed through charge calculation routines at certain times in the monthly reconciliation invoicing cycle. However, this is a planned activity to ensure the integrity of the reconciliation invoice. The shipper's obligation will cease with a response to the suppressed item. Clearance of the item is not dependant on it being included on an invoice. As described earlier, if the response to the suppression is in turn itself suppressed, this will create a new suppression, and its predecessor will be closed. Hence Transco's internal invoicing processes will have no impact on a shipper's ability to meet its Network Code obligations.

Innogy comments that as the persons employed by Transco to deal with Users responses to filter failures are, it understands, not dedicated to this task and have other responsibilities to fulfil, Transco's speed of response in validating and reporting back on filter failures can be inconsistent. Innogy states that Transco's response is, in its experience, dependant on at what time during the month the filter failures are submitted and which individual actions the enquiry. In order to address these concerns, prior to implementation Innogy expects Transco to issue guidelines on the standards of service Users can expect in relation to Conquest performance along with Transco's expected response time to filter failures. Innogy states that these could then form the basis of any redress Users may wish to claim, should they be financially disadvantaged through the incentive scheme as a result of failings by Transco.

Transco's response is that it is important to understand that Transco provides an advisory facility to help shippers to deal with their suppressions. Transco has no obligation to validate filter failures as suggested by the respondent. Responsibility for ensuring correct provision of data such as Meter Readings and revised volumes lies with the shipper. In the interests of supporting and helping its customers Transco provides a supplementary service. As described

earlier, performance of Transco's Conquest system has substantially improved since its initial 'teething' problems. Transco reacts quickly to any deterioration in performance, for example by viewing any system failure of over four hours duration as being 'critical'.

Innogy notes concerns with regard to the extent to which Transco's training guide for resolving filter failures is still appropriate. Innogy states its experience suggests that the majority of specialised codes used in filter failure resolution are often ambiguous, and that Transco seems happy to use one code to cover virtually all instance of filter failure. To this extent Innogy believes that as a precondition to introducing an incentive regime Transco should be required to update its training manual to reflect current circumstances.

Transco's training material is regularly reviewed to reflect current processes and will continue to be subject to such to maintain accuracy. Transco understands that some shippers have also developed their own training material. Transco is in the process of reviewing its filter failure codes in response to feedback from shippers.

User behaviour/monitoring.

STUK notes that the Draft Modification Report relates concerns with respect to shipper behaviour. STUK repeats its comments made during Workstream meetings that due to the standard transportation pass through clause in large I&C contracts there is no benefit for I&C shippers to avoid resolving USRVs. STUK notes that in fact, the timely resolution of USRVs is in the best interest of both the shipper and the consumer as this allows accurate invoicing which is perceived as good customer service.

Transco acknowledges this viewpoint but stresses that this does not appear to be reflected by the quantity of unresolved USRVs.

Midlands Sales comments that it feels there is a need for policing to ensure that 'gaming' does not occur. Midlands observes that there is the possibility of shippers using filter failures to enhance their working capital position by resolving the low value USRVs and the positive adjustments and keeping the large debits outstanding. Midlands suggests that this could be used on the three month rolling basis keeping a low but steady amount of USRVs outstanding.

Transco acknowledges the risk of gaming occurring but given that the risk currently exists, believes that the likelihood is reduced by implementation of this Modification Proposal. Transco has informed the shipping community that it will monitor resolved USRVs on three monthly basis to check for patterns of inappropriate behaviour. Through previous monitoring Transco has not so far identified any evidence of inappropriate prioritisation of responses. SSE indicates its support for Transco's intention to further develop its mechanism to monitor and report on USRV resolution performance.

Midlands states the current reporting mechanism only shows the percentage of USRVs cleared from the total amount. For the new regime to be effective, Midlands believes Transco needs to monitor the values of the USRVs outstanding.

Transco's response is that volumes of outstanding USRVs are already published but it believes that to measure outstanding values would be of little benefit as the suppressed value is no indication of final invoiced values. The suppressed values are frequently significantly incorrect with positive values regularly being adjusted to become negative and vice versa. However, Transco has already agreed to monitor released values for evidence of inappropriate behaviour.

STUK states its concerns that through the incentives regime, some suppliers may be encouraged to reduce their levels of USRVs by releasing inaccurate items onto the invoice and querying charges at a later date. This would have the effect of distorting RBD and lead to a larger number of adjustment invoices being raised.

Transco accepts the possibility of such a scenario arising. To address this, Transco regularly reviews released suppressions to identify such occurrences. On occasions Transco seeks to discuss anomalous responses with shippers and offers training where this is requested or appropriate.

Application of incentive.

BP expresses concern with regard to the potential 'back-dating' of liabilities envisaged in the proposal. BP comments that charges could arise from reads that fail due to out-of-date asset information held on the GT's system. BP believes that these failures could be caused by the actions of previous shippers and therefore the proposed regime could unfairly penalise the incumbent shipper. BP also points out that the ability to back-date charges is not generally recognised in the Network Code regime.

Transco stresses that this Modification Proposal is not retrospective; charges are not being applied for past behaviour. All charges would be prospective and only be applied once a 'backlog' USRV has been outstanding for a pre-determined period after implementation. Transco stresses that shippers have had and will continue to have ample opportunity to eliminate their backlog well before possible implementation of this Modification Proposal.

General

BP Gas Marketing advocates a USRV read replacement process and states that at previous Supply Point & Billing Workstreams it has suggested a process only for USRVs. BP advises of its intention to raise a Modification Proposal "Replacement Reads for USRVs" to reduce the risk arising from the potential introduction of such a punitive liability regime. BP establishes that this would seek to reduce the risk of charges being levied and RbD reconciliation being

delayed. BP states that the read replacement process would offer shippers/suppliers an opportunity to submit a replacement read for any read that has tripped the reconciliation filter. This replacement read would be received by Transco prior to the next cyclical read, and be loaded onto the Sites and Meters system without corrupting read history. This would facilitate data integrity and also reduce the exposure of shippers to potential financial liability.

Whilst out of scope for the purposes of this Modification Proposal, Transco believes such a mechanism would require careful consideration to ensure the integrity of the Meter Reading/NDM reconciliation regime is not compromised. Transco, however acknowledges that risk may be partially mitigated by such a facility although from a process perspective shippers would still need to receive a USRV, identify that it related to a poor read, obtain a better read and submit the same as a replacement. Where the incorrect read is not the latest read on Transco's system, current functionality already permits a correction to be processed by effectively linking two reconciliation periods. Transco looks forward to discussing the implications of BP's suggestion within the Supply Point & Billing Workstream.

Innogy states that whilst it accepts Transco should be allowed to recover the cost of implementing an incentive scheme which will ultimately be to the benefit of Users, the 2% value proposed in the Modification Proposal represents an arbitrary figure. Innogy notes that it may therefore bear little resemblance to the actual cost of providing this service and this fact needs to be recognised in the Modification Proposal. Innogy expresses the view that Transco should be required to review this fee annually and publish evidence supporting the appropriate fee to be charged.

Transco's response is that it determined the 2% value based on the cost of relevant administration, this being the calculation, preparation and issue of incentive charge invoices, and subsequent to this, calculation of allocation to RbD Shippers and preparation and issue of credit invoices. This amounts to £20,000 - £25,000 per annum. This is then compared with the overall maximum USRV capped value of £1.2m per annum. Under the assumption that USRV performance should improve, Transco would receive reduced income and so bears a degree of risk that its costs may not be recovered with no risk of all incentive revenue being absorbed by Transco costs if aggregate incentive charges are small. Transco would not oppose a limited review of the extent to which it should recover its costs at the appropriate time.

Innogy comments that the Modification Proposal does not address what happens if the formula relating to the 95% standard produces a negative number, which is conceivable in relation to the backlog and on-going filter failures.

Transco's response is that Section 8.3.3 of the legal drafting states the caveat that '.....for each USRV Month the User will pay to Transco the amount (provided such amount is positive) calculated as:.....'. No monies will therefore be payable in the event of a negative value being calculated.

SSE believes that in certain circumstances, for example where it is established that a filter failure is a direct result of data inaccuracy, there should be an appropriate appeals or adjustment mechanism to ensure such instances are not included in the performance assessment for incentive purposes.

Transco's response is that although filter failures are mainly a consequence of data inaccuracy, this Modification Proposal is consistent with a liberalised metering/meter reading regime when shippers are the primary provider of critical data. It is, therefore, shippers responsibility to ensure that such data is accurate and delivered on time. Transco does not believe an appeals or adjustment mechanism is appropriate in these circumstances.

Scottish Power notes that the original proposal made by Transco did not include a cap on the level of liability to be applied. Scottish Power notes that this was only included due to the concern of other shippers. Scottish Power believes that the inclusion of a cap is unnecessary.

Transco acknowledges the views of the the above respondent but believes that the inclusion of a cap provides certainty as the the maximum exposure faced by the shipping community whilst ensuring that the incentive level is effective.

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 Modification Proposal is not required to facilitate any such change.

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

Transco would be required to:

- Establish appropriate administration arrangements to monitor performance and calculate/allocate relevant incentives.
- Further develop the existing performance monitoring regime.

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

Transco proposes that this Modification Proposal be implemented with effect 21 February 2005.

16. Recommendation concerning the implementation of the Modification Proposal

Transco believes that this Modification Proposal should be 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 as new paragraphs to Section E8:-

"8.3 User Suppressed Reconciliation Values"

8.3.1 For the purposes of this paragraph 8.3 the "USRV Month" shall be the period of one month commencing on the 21st day of the month.

8.3.2 The User shall use all reasonable endeavours to ensure that no less than 50% of User Suppressed Reconciliation Values that are Suppressed in a USRV Month are not Suppressed in the immediately following USRV Month.

8.3.3 With effect from the third USRV Month after the User Suppressed Reconciliation Date and subject to paragraphs 8.3.4 and 8.3.5, in respect of each LDZ for each USRV Month the User will pay to Transco the amount (provided such amount is positive) calculated as:

$$\underline{(((0.95 * A) - B) * £20) + ((A - C) * £30)}$$

_____ where following Individual NDM Reconciliation in USRV Month 'p'

_____ A is the number of User Suppressed Reconciliation Values for the User that are Suppressed in USRV Month 'p';

_____ B is the number of User Suppressed Reconciliation Values for the User that are Suppressed in USRV Month 'p' which are not Suppressed in USRV Month 'p + 2';

_____ C is the number of User Suppressed Reconciliation Values for the User that are Suppressed in any USRV Month 'p' and which are not Suppressed in USRV Month 'p + 4' or any USRV Month after 'p + 4'.

8.3.4 In the event that the number of User Suppressed Reconciliation Values for a User in a USRV Month:-

_____ (i) is greater than 150% of the average for such User in the six previous USRV Months; and

_____ (ii) is no less than 20 User Suppressed Reconciliation Values greater than the average set out in (i) above

paragraph 8.3.3 shall not apply and, subject to paragraph 8.3.5, in respect of each LDZ and for such USRV Month the User will pay to Transco the amount (provided such amount is positive) calculated as:

$$\underline{(((0.95 * A) - B) * £20) + ((A - C) * £30)}$$

where following Individual NDM Reconciliation in USRV Month 'p'

A is the number of User Suppressed Reconciliation Values for the User that are Suppressed in USRV Month 'p';

B is the number of User Suppressed Reconciliation Values for the User that are Suppressed in USRV Month 'p' which are not Suppressed in USRV Month 'p + 3';

C is the number of User Suppressed Reconciliation Values for the User that are Suppressed in any USRV Month 'p' and which are not Suppressed in USRV Month 'p + 5' or any USRV Month after 'p + 5'.

8.3.5 The amount due from all Users under paragraphs 8.3.3 and 8.3.4 shall not exceed £100,000 and in the event that the aggregate of amounts due from all Users in an LDZ for a USRV Month exceeds such amount, the amounts due shall be reduced pro rata.

8.3.6 Transco shall retain 2% of all amounts received pursuant to paragraph 8.3.3 and 8.3.4 above (as such amounts may be adjusted pursuant to paragraph 8.3.5) and shall credit the remainder to Users:-

(i) after each period of three (3) calendar months and after Transco has received all payment due under paragraphs 8.3.3 and 8.3.4 from all Users for the relevant LDZ;

(ii) pro rata according to the aggregate of the User SP LDZ Aggregate AQ in such three month period.

8.3.7 Amounts payable by the User under paragraph 8 will be invoiced and payable in accordance with Section S. "

Insert in paragraph 1 of Section W:-

""User Suppressed Reconciliation Date": shall be 21st February 2005"

Signed for and on behalf of Transco.

Signature:

Peter Rayson
Commercial Manager - Customer

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 **0637**, version **5.0** dated **29/10/2004**) 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 **5.0**.

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.