

Modification Report
Termination of User in Receivership
Modification Reference Number 0475

Version 3.0

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 proposal made was as follows :

"The discretionary powers afforded to Transco relating to the Notice of Termination should be replaced with a mandatory obligation to issue such a notice following the notification of a User entering into receivership. However, this will not remove Transco's entitlement to consult with the Energy Balancing Credit Committee in relation to any aspect of its functions under the Supplement.

We propose that a Termination Notice is issued two business days after Transco is notified of a receiver being appointed, unless, a written commitment, in a form satisfactory to the EBCC, is provided to Transco, by the receiver, that all Energy Balancing Debt accrued from the date of appointment of the receiver will be paid. In such an event, normal enforcement steps will be pursued as provided for in the Supplement."

The proposer justified the Modification Proposal as follows :

"Following Ofgem's rejection of modification proposal 0441, the EBCC has met with Ofgem. This proposal has been raised to address the specific concerns identified in Ofgem's rejection letter. The proposal contains two amendments to the original text of mod 441.

The current arrangements in the Network Code Supplement, Energy Balancing Credit Management, stipulate the measures which can be taken following a Users failure to pay a Cash Call.

On failing to pay a Cash Call Transco is entitled to give Termination Notice which will have the effect of removing the User's ability to operate under the Network Code.

Section V 4.3 of the Network Code considers the issue of termination and identifies events or circumstances where upon the User can be categorised as being in default. Paragraph

4.3.3 states that in such circumstances where a User is in default, Transco may give Termination Notice. In other words, consistent with the Supplement the issuing of a Termination Notice is not mandatory and is at the discretion of Transco. The issue of Receivership is cited in Section V4.3.1 of the Network Code and is included as one of the events or circumstances contributing to the classification of a User as a defaulting User and, henceforward, empowering Transco with the option to give Notice of Termination.

In the case of the Energy Balancing Debt, Transco is financially neutral to the payment or otherwise of outstanding invoices. For this reason the Energy Balancing Credit Committee was established to provide the impacted parties, the Shipping community, with limited powers to control debt escalation.

The Powers and Duties of the Committee are outlined in Section 2.2 of the Energy Balancing Credit Rules, most pertinent of which relate to the discontinuation, or otherwise, of recovery action regarding Energy Balancing Debt. These powers are consistent with the Enforcement and Recovery Steps provided for in Section 3.4 of the Supplement.

The community through the EBCC was required to "test" the robustness of the Code during a recent incident involving a Shipper in receivership. Whilst in receivership, it was apparent that the relevant administrative receiver was unwilling to finance the Energy Balancing Debt which continued to accrue during the period the company remained in receivership.

If a Receiver wishes to sell a business as a going concern, it is normal practice that he makes provisions for contractual supplies. At present, debt is incurred by the Community, whilst the party appointing the Receiver gains increasing benefit.

We believe that it is in the interest of the industry to protect the Users from exponential and uncontrollable accrual of Energy Balancing Debt and suggest that the Network Code should be modified to halt such debt escalation."

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.

Transco recognises that this Modification Proposal may assist in obtaining from the receiver the necessary commitment that the ongoing debt arising from the User's Supply Point portfolio would be covered. This may be achieved by the receiver finding another User who is able to take on the Supply Point portfolio as a going concern. Transco agrees that the Energy Balancing Credit Committee (EBCC) would be the appropriate body to

review the submissions made by the receiver which would seek to give the required commitment, in accordance with the Energy Balancing Credit Rules. In response to the representations Transco agrees that even where these assurances are not received the EBCC should be consulted. The legal drafting clarifies Transco's obligations to consult with the EBCC.

The Modification proposes a period of two days in which the receiver may make arrangement with an alternative User. Transco concurs that in general two days is a sufficient period in which the receiver may make such arrangements. However, it is Transco's view that a degree of flexibility in allowing the duration of a reasonable period is appropriate to ensure that premature terminations are avoided. Furthermore, Transco notes that the Modification Proposal did not specify a maximum period between the service of a Termination Notice and the date on which that Termination becomes effective. Transco asked for representations on this issue and has concluded from these that whilst a period of two business days would normally be appropriate, some flexibility would be beneficial here as well. The legal drafting reflects this.

Transco also believes there would be advantages if there were greater clarity regarding the adequacy of present arrangements for retaining gas supplies to a Terminated User's Supply Points and believes this matter should be considered concurrently with this Modification Proposal. If, for example, a Termination Notice becomes effective as a result of implementing this Modification Proposal, but physical supplies continue, the industry would continue to bear the associated costs. Transco is therefore working with Ofgem and the community with a view to supporting the introduction of more robust and timely arrangements under which the Supplier of Last Resort (SOLR) may be appointed.

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

The proposer has suggested that 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. Such subsidies might also hinder the development of competition since a history of debt burdens absorbed by the Users community might be considered to be a barrier to entry. Implementation of this Modification Proposal could, therefore, be seen as securing effective competition between relevant shippers.

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

Transco's operation of the system would be affected if there were an increased likelihood of serving a Notice of Termination on the User. Under present arrangements, it is possible such a termination might lead to isolation of certain individual Supply Points. Transco believes

that any increase in likelihood is linked to the period that the receiver is given to provide adequate assurances. For this reason Transco has suggested that the receiver is given a reasonable period to provide assurances and agrees with the proposer that this would usually be two business days.

b) development and capital cost and operating cost implications:

Transco is not aware of any development or capital costs arising from implementation of this Modification Proposal. If implementation of this Modification Proposal increased the likelihood of serving a Notice of Termination, there would be operating costs implications. However, by hastening the arrangements for transfer to another User or service of a Notice of Termination, backed up by suitable SOLR arrangements, this Modification Proposal would restrict the amount of transportation charge debt exposure.

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 believe that it would be appropriate to have any special cost recovery measures in place should the implementation of the Modification Proposal lead to increased costs for Transco.

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

As Transco's discretion would be reduced if this Modification Proposal were implemented the level of contractual risk to Transco could also be expected to reduce.

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

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

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

When a User enters receivership there is potentially an effect on a number of parties, including suppliers, producers and consumers. Implementation of this Modification Proposal, linked with appropriate SOLR provisions, should limit the period of uncertainty for these parties and with it any ongoing debt exposure. Implementation therefore could be considered to be of benefit to Non-Network Code Parties.

However, in the absence of robust SOLR arrangements, consumers are responsible for establishing alternative arrangements for their gas supply and might incur additional costs in doing so. If implementation of this Modification Proposal increased the likelihood of Termination then implementation could be viewed as increasing the financial risk to these consumers.

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 obligation or contractual relationship of Transco, Users 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 it would:

- Increase the leverage which Transco has on the receiver to provide a commitment to cover ongoing debts
- Reduce the exposure of Users as a whole to costs arising through balancing neutrality as a result of non-recovery of energy balancing debt
- Strengthen the role of the EBCC in assessing whether satisfactory ongoing debt commitments have been made.

Disadvantages of implementing this Modification Proposal are that it would:

- Increase the likelihood of serving a Notice of Termination. However, the present wording of the legal draft would give the receiver a reasonable period to provide assurances. Consequently, there would be an opportunity for the receiver to transfer the Supply Point portfolio to another User and so avoid the need for such a notice to be served.
- If a Notice of Termination were served, create a situation in which, in the absence of an appointed SOLR, unsecured debts might continue to accrue for an indefinite period.

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 the following parties :

Exxon Mobil Gas Marketing

British Gas Trading (BGT)

Innogy

Shell Gas Direct Limited (SGD)

Scottish and Southern Energy (SSE)

Alliance Gas Limited (AGL)

TXU Europe Energy Trading Limited (TXU)

Powergen

All respondents express support for the Modification Proposal and, in light of the rejection of Modification Proposal 0441, many urge for a decision regarding implementation to be made as soon as possible.

Facilitating the Relevant Objectives

SGD believed that this Modification Proposal would better facilitate the relevant objectives as in the event of receivership costs would be "targeted at those companies/receivers who seek to obtain the benefits of the continuing business". SSE believed that this Modification Proposal would also better facilitate the relevant objectives as it "would minimise the liabilities faced by all shippers under the current energy credit management regime". AGL also stated that the credit risk illustrated by the events involving Independent Energy "could potentially be viewed as a barrier to entry and believed that this Modification Proposal in reducing this risk would "act to encourage competition between relevant Shippers".

Transco's Response:

Transco agrees with the statements made by these Users that implementation of the Modification Proposal would further the relevant objectives in encouraging competition.

Retention of Transco's Discretion

AGL believed that it was "appropriate for Transco to have a mandatory obligation to serve a termination notice in order to incentivise the receiver to enter into negotiations with the EBCC at the earliest opportunity". They, however, make this statement in the context that "the notice can be revoked in the context of the operational meeting of the EBCC, provided further security is provided in the 2 business days following notification but before termination." SGD made a related point that a default position of automatically serving a notice would ensure that "no organisation.....is put in the invidious position of needing to positively pursue that a company is put out of business." TXU pointed out that "the modification also gives Transco the opportunity to discuss the issue with the EBCC prior to the issue of the termination notice". BGT expressed the view that this Modification Proposal differs from the rejected Modification Proposal 0441 in that it clarifies "that the EBCC retain involvement in the process. If Transco have any doubt that termination is appropriate, they may seek the EBCC sanction to defer this action." SGD also take up this point in stating that "As now, Transco and ultimately the Energy Balancing Credit

Committee (EBCC) will retain the ability to operate discretion in determining when it is fair and appropriate to terminate a User"

Transco's Response:

Transco concurs that whilst this Modification Proposal has a mandatory element, providing the receiver makes a submission within a reasonable period, Transco would still retain its existing powers of discretion. Prior to the issue of any 'Termination Notice' Transco would consult the EBCC. The proposed legal text reflects this.

Period for Receiver to Make Arrangements

SSE comments on the fact that Transco might on occasions require an element of flexibility in allowing the receiver to make alternative arrangement and so be able to make assurance required to prevent the service of a Notice of Termination. It states that "We have no objection to this, provided that the EBCC remains mindful of the circumstances which led to the appointment of the receiver and is satisfied that the undertakings provided by the receiver would minimise the likelihood of further debt." It, however, supports the view that allowing two days for such assurances "should be the standard".

Transco's Response

Transco notes that there is no objection to its opinion put forward in the Draft Modification Report that a degree of flexibility is appropriate in allowing the receiver a reasonable period to provide assurances. Transco also notes that this opinion is supported in the representation from SSE.

Period from Notice

AGL agrees that there should be a period of two business days between the issue of the Termination Notice and the effective time for the notice. However it states that "we would stipulate that this is conditional upon Transco consulting with the EBCC during the two day period." Exxon Mobil takes the view that "the period between the issue of the Termination notice and the time at which the Notice becomes effective should be minimised to no more than 24 hours, so as reduce the risk of significant gas volumes being sold by the party in receivership which benefits the secured creditors at the cost of the shipping community". SSE takes the view that "In the event that a Termination Notice is issued, we suggest that this should be with immediate effect, as if the receiver is not prepared to make arrangements to underwrite ongoing debt, the community should not be exposed to any additional costs." It can be seen therefore that, within the representations, the suggested period of notice varies from immediate to two business days.

Transco's Response

Transco recognises the range of views within the representations and takes the view that some flexibility is appropriate but that a period of two business days would often elapse. It confirms that during this period it would expect to be in discussions with the EBCC.

Supplier of Last Resort Arrangements

SSE agrees with the view that more robust procedures are required to ensure retention "of supplies to supply points where the user has been terminated." However, it states that it does not see "that the implementation of this proposal should be delayed whilst new Supplier of Last Resort arrangements are being developed." Innogy makes the same point in stating that "the ongoing development of the SOLR regime should not influence the implementation of this modification proposal."

Transco's Response :

Transco supports the views expressed in these representations that whilst the SOLR arrangements should be more robust this need not prevent the implementation of this Modification Proposal.

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

Transco is unaware of any such requirement.

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

Transco is unaware of any works required to implement this Modification Proposal. The main changes would be in the operational controls within the credit control function of Transco. Such changes would need to be discussed and agreed with the EBCC. Transco believes that the routine meetings of EBCC are sufficient to ensure that credit control procedures take into account the implementation of this Modification Proposal.

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

If the decision were taken to implement this Modification Proposal, Transco recommends that an implementation date should only be agreed when the EBCC had satisfactorily concluded its discussions on changes required to the Energy Balancing Credit Rules and/or the Network Code Supplement. This would allow all relevant changes to take effect simultaneously.

16. Recommendation concerning the implementation of the Modification Proposal

In view of the general support expressed by Users, Transco does not oppose implementation of this Modification Proposal. However, Transco would support GEMA if it desired to take a consistent view across the gas and electricity markets. Transco would also support the view that this Modification Proposal, together with Modification Proposal 0474, should be considered as part of a wider package of potential changes. In particular Transco believes that responsibility for costs should be clarified in the event that a Termination Notice became effective but physical supplies were maintained. Transco believes that appropriate arrangements can be agreed by the industry and would be willing to facilitate discussions to develop proposals.

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

Section V: GENERAL

"Amend Section V, paragraph 4.3.3 to read as follows:

- "4.3.3. (a) Upon the occurrence of a User Default, and at any time after such occurrence at which the User Default is continuing Transco may give notice ("Termination Notice") to the Defaulting User to the effect that the User shall cease to be a User with effect from the date (which may be any date on or after the date on which the notice is given) specified in the notice.
- (b) Without prejudice to Transco's right to give a Termination Notice, as set out in paragraph V4.3.3(a), where the condition in paragraph 4.3.3(c) is satisfied, paragraph 4 of the Supplement shall apply.
- (c) The condition referred to in paragraph V4.3.3(b) is that:
- (i) a User Default occurs by reason of the circumstances set out in paragraph V4.3.1.(e).(ii) ; and
- (ii) the receiver fails to provide adequate assurances to Transco in compliance with the principles established in the Energy Balancing Credit Management Supplement and Energy Balancing Credit Rules (such assurances not to exceed a legal and binding commitment by the receiver to pay to Transco all Energy Balancing Debt accruing from (and including) the date of appointment of the receiver), as soon as reasonably practicable after being appointed (but for the avoidance of doubt not within two Business Days of its appointment);

"Amend the Supplement, new paragraph 4:

4. Appointment of Receiver

- 4.1 Subject to paragraph 4.2, where Section V4.3.3(b) applies, Transco shall, as soon as reasonably practicable, give Termination Notice (for the purposes of Section V4.3.3) to the User to the effect that the User shall cease to be a User with effect from the Day following the date set out in the Termination Notice.
- 4.2 4.2.1 Before Transco shall take the action envisaged by paragraph 4.1, Transco shall convene a meeting of the Energy Balancing Credit Committee as soon as reasonably practicable following the receiver's failure to provide those assurances referred to in Section V4.3.3(b) and shall consult with the Energy Balancing Credit Committee to determine whether Transco should be obliged to issue the Termination Notice, pursuant to paragraph 4.1, or whether Transco should defer taking such step.
- 4.2.2 Subject to paragraph 1.3, Transco shall be entitled to take such action as the Energy Balancing Credit Committee recommends pursuant to the meeting referred to in paragraph 4.2.1 as soon as reasonably practicable.

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 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 **0475**, version **3.0** dated **26/10/2001**) 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 **3.0**.

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.