

Draft Modification Report
Termination of User in Receivership
Modification Reference Number 0475
Version 2.0

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:

"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, and believes that the results of any such review should be central when decisions are taken regarding the issue of a Notice of Termination.

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. To help clarify this, Transco would welcome representations on this issue.

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 allowing the receiver a further business day to provide a written commitment would reduce the probability that implementation of this Modification Proposal would lead to an increase in the number of Notices of Termination.

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, if the receiver had more time than the two business days specified in this Modification Proposal, there would be more opportunity 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)

Transco invites representations.

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 4(5) or the statement furnished by Transco under Standard Condition 4(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 to Modification Proposal 0441, which was very similar, 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 Proposals 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. Text

Section V: GENERAL

Amend paragraph 4.3.3 to read as follows:

"4.3.3. Upon the occurrence of a User Default (**save for a User Default arising by reason of the circumstances set out in paragraph 4.3.1.(e).(ii).**), 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. **Where a User Default occurs by reason of the circumstances set out in paragraph 4.3.1.(e).(ii). Transco shall, unless the receiver as soon as reasonably practicable after being appointed provides adequate assurances to Transco in compliance with the principles established in the Code Credit Rules, Energy Balancing Credit Management Supplement or Energy Balancing Credit Rules as appropriate, issue a Termination Notice and such notice shall specify a maximum of no more than 2 business days from the giving of the notice whereby the User shall cease to be a User from the date specified in the notice.**"

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:

Tim Davis
Manager, Network Code

Date: