

**Draft Modification Report**  
**Suspension of the Neutrality and Compensation Value Audit**  
**Modification Reference Number 0467**

Version 2.0

This Draft Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

**1. The Modification Proposal**

Section V of the Network Code requires a Neutrality and Compensation Value Audit (NCVA) to be undertaken for each Gas Year or 'relevant period'. This is overseen by a sub-committee of the Network Code Committee. Following the completion of three satisfactory audits, covering the period March 1996 to March 1999, the NCVA sub-committee noted that any future audits would require a competitive tender prior to the award of a new contract. However, to cover the period March 1999 to September 1999 an extension to the contract was agreed with the then current auditor, on the understanding that this would close the review period at the end of the gas year. Subsequently a single source tender was awarded to the same auditor, for a further three months. This was to provide assurance about the operation of the processes following changes in the regime caused by the introduction of the New Gas Trading Arrangements (NGTA) and Modification Proposal 0204 - Amendment to Standards of Service.

In July 2000, following publication of the latest audit, the NCVA sub-committee considered it an appropriate opportunity to review the current status of the audit. In particular the sub-committee considered the cost of the audit to users, approximately £200,000, against the benefits and material value of the issues identified.

The NCVA sub-committee concluded that it considered it appropriate at this point to recommend the suspension of future audits. This recommendation was based on the proviso that measures were in place that may afford shipper confidence in Transco's compliance with audit provisions in the Network Code, for both neutrality and compensation areas. It was agreed that Transco should present an overview of its audit processes, and this was presented to the Network Code Committee. Following the presentation, the Committee agreed that there was little interest in pursuing a tender for a third party auditor and accepted that a Modification Proposal, to suspend the NCVA, should be raised.

**2. Transco's Opinion**

Transco is broadly neutral to this Modification Proposal, and therefore believes it is primarily a matter for Users to recommend whether or not it is appropriate to implement. However, based on views expressed by Users at the Network Code Committee, Transco presently supports implementation of this Modification Proposal and suspension of the Neutrality and Compensation Value Audits.

Following the last NCVA, analysis revealed that the cost of the audit exceeded the total value of the issues identified. It could be argued that the cost of the audit is immaterial - it is confidence that neutrality and compensation processes operate in accordance with

provisions in the Network Code that is the key purpose of the audit. However, Transco has provided examples to the Network Code Committee of the internal procedures and controls it has in place to ensure compliance. Transco is of the opinion that these continuing controls can be regarded as offering Users reassurance that the processes are operating as intended. In this context, the majority of errors identified as a consequence of the latest NCVA had been previously recognised through the Transco internal audit processes and controls and were being addressed.

The Network Code Committee has expressed the view that it is reasonably confident that Transco internal controls and processes are sufficiently thorough that suspending the NCVA merits consideration. Information in respect of controls and processes for compensation, incentives and neutrality is currently available to shippers via standards of service reports on SIS and via the Liabilities Sub-Committee reports.

In the light of the cost to Users of the NCVA, both in terms of the contract price and the commitment of time to the process, and the lack of material issues identified in audits to date, Transco believes there would be merit in suspending the audit requirement. The requirement could, however, be reinstated should User concerns emerge in future.

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

The Modification Proposal better meets the relevant objectives in that it would afford more economic operation. This would be achieved by reducing neutrality costs, since the cost of the Audit is recovered via the neutrality mechanism.

**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 such implications.

**b) development and capital cost and operating cost implications:**

Transco is not aware of any such implications.

**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 require no such recovery of costs.

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

Transco is unaware of any such consequences.

**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 is unaware of any such consequence.

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

Transco is unaware of any such implications.

**7. The implications of implementing the Modification Proposal for Users**

Transco is unaware of any such implications.

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

Transco is unaware of any such implications.

**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 such consequence.

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

Advantages:-

Reduced cost for Users

Disadvantages :-

No third party audit assurance that relevant processes are performed in accordance with Network Code processes.

**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 on this draft modification report.

**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**

No programme of works would be required.

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

If approved, the proposal could be implemented without delay as no system changes or other works are required.

**16. Recommendation concerning the implementation of the Modification Proposal**

Based on views of the Users expressed in the Network Code Committee Transco recommends the implementation of this Modification Proposal.

**17. Text**

**Section V:**

**Paragraph 12.1.1**

Amend to read:-

12.1.1 Transco will, subject to paragraphs 12.1.3 and 12.1.4, appoint .....

**Paragraph 12.1.3**

Add the following new paragraph:-

12.1.3 A Neutrality Auditor may not be appointed for a relevant period:-

- (a) where Transco proposes after consultation with the Network Code Committee or any relevant Sub-committee and where the Director (upon Transco's application) gives Condition 7(4) Approval that such Neutrality Auditor not be appointed; or
- (b) where:-
  - (i) pursuant to this paragraph 12.1.3 a Neutrality Auditor was not appointed for the immediately prior relevant period; and
  - (ii) Transco reasonably determines that such Neutrality Auditor should not be appointed after consultation with the Network Code Committee or any relevant Sub-committee, unless (upon the application of Transco or any User made within 10 Business Days after Transco notified to Users the decision of the Committee or Sub-committee) the Director in any case shall give Condition 7(4) Disapproval.

#### **Paragraph 12.1.4**

Add the following new paragraph:-

12.1.4. In the event that a Neutrality Auditor is appointed for a relevant period following relevant period(s) where (pursuant to paragraph 12.1.3) the Neutrality Auditor was not appointed, he may not review any prior relevant period unless expressly instructed by the Network Code Committee in accordance with paragraph 12.2.1.

#### **Paragraph 13.8.1**

Amend to read:-

13.8.1 Transco will, subject to paragraphs 13.8.3 and 13.8.4, appoint .....

#### **Paragraph 13.8.3**

Add the following new paragraph:-

13.8.3 A Compensation Value Auditor may not be appointed for a relevant period:-

- (a) where Transco proposes after consultation with the Network Code Committee or any relevant Sub-committee and where the Director (upon Transco's application) gives Condition 7(4) Approval that such Compensation Value Auditor not be appointed; or
- (c) where:-

(i) pursuant to this paragraph 13.8.3 a Compensation Value Auditor was not appointed for the immediately prior relevant period; and

(ii) Transco reasonably determines that such Compensation Value Auditor should not be appointed after consultation with the Network Code Committee or any relevant Sub-committee, unless (upon the application of Transco or any User made within 10 Business Days after Transco notified to Users the decision of the Committee or Sub-committee) the Director in any case shall give Condition 7(4) Disapproval.

#### **Paragraph 13.8.4**

Add the following new paragraph:-

13.8.4. In the event that a Compensation Value Auditor is appointed for a relevant period following relevant period(s) where (pursuant to paragraph 12.1.3) the Compensation Value Auditor was not appointed, he may not review any prior relevant period unless expressly instructed by the Network Code Committee in accordance with paragraph 13.9.1.

***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: