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Network Code Development

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Dear Colleague,

Modification Proposal 309 - Close Out of Reconciled Gas

As mentioned in the letter accompanying the Modification Proposal 309 pack faxed to you on 21 December, I enclose a copy of the latest draft of the Close Out Energy Business Rules. This document will continue to evolve as more information becomes available, however I hope you find it a useful reference at this stage.

Yours sincerely



Paul Rogers
Network Code Development

Modification Proposal 309 Close Out of Reconciled Gas

Definition and Energy Business Rules

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Executive Summary

The purpose of this document is to set out the background and circumstances in which Close Out of Reconciled Energy will be achieved within the context of the broader Full and Final Agreement which incorporates Transportation and Benefit share. In addition the Business Rules set out the framework for the energy modification and associated legal text which will eventually appear within the Transition Document of Network Code, when Full and Final Agreements are signed.

It is important to note that the Modification is being raised to put into effect the energy aspect of Close Out and will only be activated by the signing of the Full and Final Agreements.

The Business Rules detail the terms of the Aggregate Reconciliation, what is included in the process, calculation and application of pricing as well as Neutrality and settlement terms. Whilst every effort has been made to maintain clarity in the presentation of information, it is appreciated that Close Out, by its very nature is a complex process. If anyone requires further information or wishes to discuss aspects of this paper, please contact Paul Rogers on 0121 632 2393 or a member of the Close Out team on 0121 711 9764.

1. Introduction

1.1 Background -

Following the successful introduction of Network Code on 1 March 1996 it was recognised that as with any new and unique undertaking, issues would arise which the industry would need to resolve.

As these issues surfaced and could be identified they were allocated to what became known as the Invoice Quality Review project. As the project developed, Transco raised its status to one of the top issues affecting the industry and accordingly directed considerable resources to solve the problems arising.

Having successfully resolved many of these early problems, the industry recognised that in order to move forward, the outstanding invoice data quality issues from this period should be addressed in a more pragmatic and efficient manner. This gave rise to the IQR Close Out project, which has developed throughout 1998 to the point where it has now been constituted as a formal Network Code Review Group 263R.

1.2 Development

Transco has embarked on close out from the perspective of consensus and co-operation, recognising that there is mutual advantage for all parties to agree their reconciled energy and transportation positions. To demonstrate its commitment to the process and in an effort to maximise participation, Transco is prepared to distribute some of the potential savings from this process with Users, in the form of a benefit share. Whilst Users would and could not be forced to participate, benefit share payments will not be paid to the community if individual shippers fail to agree their reconciled energy positions. The final amount of benefit share will be dependent on participation in the transportation element of Full and Final. Benefit Share will only be paid when Users sign the transportation Full and Final agreement. If a User agrees reconciled energy but not transportation, Benefit Share will not be paid to that User, as no benefit will have been realised.

The mechanism for developing close out will centre on the requirement for a modification to give effect to the energy aspect only. This is because Users must all agree their individual reconciled energy position, in order to settle the overall amount and allow clearance of gas through neutrality.

In developing the modification and agreeing close out methodology principles, shippers have agreed to set up Network Code Review Group 263R. The review groups purpose is to consider the appropriateness of Close Out and develop a Modification and Business Rules with a view to achieving Full and Final settlement for the industry on 24 February 1999.

To achieve this the Review Group have used a multi track approach to develop the Modification in parallel with discussions on methodologies, benefit share and transportation. This concurrent activity has enabled the most efficient use of resources and time to achieve the target completion date. For a Modification to be ready for the early part of February 1999 to give effect to Full and Final, it must be raised by 17 December 1998 and implemented via the urgent route.

It is recognised that the Review Group will not propose the Modification until satisfied it achieves the requirements and that there is confidence in the progress of other issues.

As the Modification Proposal deals with the framework and principles and will only come into effect when all Full and Final agreements for energy have been signed, it is anticipated that it will be relatively uncontroversial.

1.3 Pre-requisites for the Modification process

The Review Group:

- * Must declare support for the content of the Modification Proposal.
- * There should be confidence that it will be received positively by other Users.
- * Ofgas must indicate that Urgent status will be granted.
- * Agreement on all outstanding issues should not be seen as a pre-requisite to issuing the modification, as protection is still afforded by the consultation process, Ofgas sign off and the Full and Final agreements themselves.
- * Modification proposals which have a financial or energy impact on the Close Out period may not prejudice the terms of any Close Out modification once it is implemented.

1.4 Advantages of Close Out

Close Out will enable the industry to deal with outstanding issues arising from the early part of Network Code and set them aside to allow resources to be concentrated on developing the regime for the future.

For both Transco and Shippers, there will be major cost saving and resource advantages as well as mitigating the risk of balance sheet uncertainty. All parties should have confidence that outputs from the process reflect what would have been achieved through line by line query handling.

The non discriminatory and consensual approach used by Close Out will ensure a more even handed basis for the Full and Final agreements, thus eliminating the risk of some shippers bearing the cost of agreements with other parties.

In recognition of the potential benefits, Transco will offer a financial benefit share to all Users. As the advantages will only be realised on the basis of maximum participation (Full participation in the case of energy), within agreed timescales, the level of payment will reflect these factors.

1.5 Close out project timescales

The key target completion dates are:

2 Dec - Transco issues draft Modification Proposal to Review Group

15 Dec- Transco issues revised draft to Review Group

15 Dec - Transco presents first cut legal text to Review Group

DRAFT REVIEW GROUP 263R

17 Dec - Industry meeting

18 Dec - Modification Proposal issued to Ofgas

12 Jan - Review legal text

18 Jan - Legal text issued

25 Jan - Close out for Representations

5 Feb - Ofgas decision

24 Feb - Full and Final date

2. **Basic Principles**

2.1 **Aim**

Close out is a mechanism by which Users and Transco have an opportunity to settle Users reconciled gas positions by resolving all remaining IQR, Non IQR, Reconciliation and any other issues for the period, gas day 1 March 1996 - gas day 31 January 1998 inclusive.

Close Out will incorporate all outstanding entry and exit issues within the relevant period to minimise exposure for all participants.

In recognition of the potential benefits for the industry, Close Out has been developed during 1998 and is now sufficiently advanced to commence the review process to facilitate and put into effect anticipated Full and Final agreements.

The aim is therefore to have a suitable modification available by 5 February 1999, which satisfies the industry's requirements and will give effect to the Full and Final agreements.

2.2 **Key Features**

No re-opening - On completion of the Close Out (when Full and Finals have been signed) there will be no re-course for any party to re-open the Close Out period, for any reason. This will include queries arising after 1 February 1998 which are attributable to the prior period.

The implementation of the Code Modification is conditional on the signing of the Full and Final agreement.

Neutrality - Transco will remain neutral with regard to Energy

Non Discrimination - Transco will not discriminate with regard to Full and Final

agreements between shippers. This will apply to both Energy and Transportation.

Aggregate Reconciliation - meter points included in Close Out as appropriate will be aggregated in order to determine the reconciliation quantity.

Settlement Period - The settlement period for close out will be gas day 1 March 1996 - gas day 31 January 1998.

Reconciled Energy - All shippers must settle their reconciled energy positions in order to keep neutrality whole.

Transportation - Whilst transportation is not compulsory, having agreed reconciled energy and with the additional incentive of benefit share, it is anticipated that most shippers will wish agree this aspect of Full and Final.

Participation - The key players in Close Out are; Transco, System Users and Ofgas.

Tolerance - The Review group has agreed to proceed on the basis of no tolerances for reconciled energy, due to the risk consequential neutrality smears to other Users.

3 Pre-requisites for Full and Final

Prior to Full and Final, all parties must be satisfied with the status of reconciled gas, plan methodologies and outstanding queries related to Close Out.

The level and allocation methodology of benefit share must be agreed

The modification must be in place, to come into effect once Full and Finals are signed.

As a minimum all shippers must be prepared to sign the Full and Final for reconciled energy.

4 Reconciliation Arrangements

4.1 Aggregate Reconciliation

All Close out issues will be expressed in terms of an aggregate reconciliation which differs from current reconciliation due to its composite nature. Whilst individual plan and reconciliation categories may need to be treated separately in recognition of their structure, there will be no individual meter point reconciliation.

The aggregate reconciliation will always reference gas day 31 January 1998, to ensure all relevant reconciliation energy is included within Close out.

4.2 IQR Plans, Non IQR Plans and Other Issues

All Close Out issues will be dealt with as specified in the agreed methodologies. In order to ensure that there are no gaps in the reconciled energy position, all issues affecting Close Out will be included in the process. It is anticipated that there will be no exclusions.

4.3 Reconciliation

Through various initiatives including the special read exercise, Transco has endeavoured to reduce the level of uninvoiced reconciliation relating to the Close out period. The remainder, which includes unread meters and suppressed reconciliations will be calculated using agreed methodologies.

In order to ensure that reconciliations relate only to the Close out period, any meter reads which result in consumption being calculated across gas day 31 January 1998, will be dealt with by variance functionality.

4.3.1 Variance Functionality

Variance functionality splits allocations and reconciliations at a specific point by means of the Demand Estimation Algorithms. This would allow for the identification of volumes and values up to the Close Out date.

Functionality has been developed to build upon the variance which already exists for the end of gas day 31 January 1998. Once activated this functionality would prevent reconciliations relating to the Close out period from being added to invoices whilst enabling the correct calculation of consumption relating to the period post Close out.

4.3.2 Close out of system reconciliation

At a time to be agreed with the Review Group, Transco will draw a line under system reconciliation for the purposes of determining the final reconciled energy position.

At this point, future reconciliation invoices will no longer include items with respect to the Close Out period. This is to allow Transco to calculate the remaining uninvoiced reconciliation position, to enable final confirmation of Full and Final amounts.

Without this functionality, every subsequent reconciliation invoice would change the Close Out position, making it impossible to settle on an agreed sum. Once switched on, line in the sand would remain in place indefinitely, to prevent Users being invoiced for the Close Out period, after Full and Final agreement.

4.3.3 Reconciliation Period

Reconciliation will be calculated on a flat profile basis for each User, with the total energy then multiplied by the Close Out system Average Price. This is consistent with the principle of Transportation calculations, whilst not requiring the same complexity. In effect the reconciliation period will be the time for which the User received energy allocations during the Close Out period.

4.3.4 Post Close out reconciliations

In the event that any post Close Out reconciliations which are reliant on reads within the Close out period are disputed, they will be investigated provided they are valid disputes under the terms of NWC section S 4. Any subsequent adjustment will amend the reconciliation energy for that portion relating to post Close Out, but there will be no change to the amount attributable to the Close Out period.

Any apportionment will be carried out under the terms of NWC section E 6.

4.3.5 Reconciliation categories

Close Out will include the following categories of unprocessed or uninvoiced reconciliation:

- Manual DM
- System DM
- NDM I&C - Datalogged
- NDM I&C - Metered
- NDM Competitive Domestic

All remaining suppressed items for the period will also be incorporated within the final total.

5. Determination of reconciliation clearing charges

5.1 Calculation of charges

Reconciled energy will be calculated in accordance with the agreed methodologies, using the appropriate SAP rate as detailed in section 5.2. Once validated the resulting charges will be construed as accurate for the purposes of Close Out and applied in a non discriminatory manner to all Users.

5.2 Close Out System Average Price

Close Out System Average Price will be calculated using a simple average of the 30 day rolling average SAPs prevailing on the last day of each month within the Close Out period. These will be applied on the basis of the monthly periods for which a User had energy allocations during Close Out. For example; Shipper A received energy

allocations from the start of Network Code, Shipper B didn't receive allocations until January 1997.

Shipper A will have have an average SAP based on 23 months of month end SAP, covering the period 1/3/96 - 31/1/98.

Shipper B will have an average SAP based on 13 months of month end SAP, covering the period 1/1/97 - 31/1/98.

The average SAP therefore applies to the period that the User was active during Close Out. This has the advantage that Users are not directly exposed to the effects of prices which they would not normally have experienced. This is consistent with reconciliation principles and reasonably simple and transparent to all parties.

6. Close Out Invoicing

6.1 Charge Types

Principle Invoices will be expressed in terms of a Reconciliation Clearing charge (GRE) issued to all relevant Users. This will be either a credit or debit to Users, depending on the individual level of over or under deeming as determined through Close Out.

Additional invoices issued under this process will be those for Reconciliation Neutrality, Energy Interest and Interest smear.

Reconciliation invoices will continue to be issued on the normal monthly cycle for on going items but will not be used for Close Out purposes.

6.2 Payment of charges

Within [] working days of all Full and Final agreements being signed, Transco will issue invoices to all Users for reconciled energy through the Ad Hoc system..

Invoices will be settled within 12 calendar days following the date of issue.

Users may not withhold any amounts due in respect of current disputes or matters relating to the Close Out period, which arise following signature of the Full and Final agreement.

With the exception of those already issued energy related charges in respect of the Close out period which remain outstanding, Close Out reconciled energy invoices will be treated separately from other Network Code invoices, for the purposes of netting off. The Offset of Close Out GRE, Close Out Reconciliation Neutrality, energy interest and energy interest neutrality will be acceptable where applicable.

Other than for a query arising as a result of a difference between the Full and Final

agreed amount and the invoiced total, Users may not raise an invoice dispute.

6.3 Credit Risk

Following the Energy Balancing Credit Committee meeting on 4 December 1998, it was agreed that the existing terms of the Network Code (including the Network Code Supplement) would apply for Close Out. This will minimise the credit risk for all Users to counter party default.

All affected Users should be in a position to assess any liability, following the release of provisional Close Out charges in December 1998 and again when charges are finally confirmed during early February 1999.

7. Neutrality

7.1 Treatment of neutrality

Underlining the principles of Close Out, Transco will remain neutral with regard to reconciled energy.

All reconciliation neutrality charges in respect of Close Out will be invoiced together with the associated reconciliation clearing, energy interest and interest smearing charges to allow offsetting where appropriate. They will not form part of the regular monthly Energy Balancing Invoice and with the exception of energy charges relating to the Close Out period, cannot be offset against any other Network Code invoices.

7.2 Basis of apportionment

The Review Group has agreed on a provisional basis that neutrality will be apportioned on the according to January 1998 User Daily Quantity Outputs (UDQO's).

This is in line with existing Network Code provisions as set out following the introduction of Reconciliation by Difference.

Apportionment on the basis of January 1998 UDQO's currently applies to all reconciliations taking place across the period 1 March 1996 - 31 January 1998. This method was introduced following RbD on 1 February 1998 to accommodate the aggregate nature of reconciliations for supply points with an AQ of < 73,200 Kwh.

As the majority of large reconciliations during 1997 and 1998 including Pre-Migration Reconciliation had been on the basis of January 1998 UDQO's it was felt that any departure from this methodology could penalise those Users who had incurred large neutrality charges over the Close Out period.

7.3 Neutrality cap

To avoid undue exposure to all Users and ensure that the effects of Close Out are not extended over a number of months, no caps or collars will be applied. This is in line with Close Out principles by preventing discrimination in treatment of debt and avoiding additional neutrality charges associated with supporting a shortfall in the neutrality account.

7.4 Neutrality Financing

The Close Out process is expected to clear all outstanding Reconciliation Neutrality debt and therefore any consequent overdraft on the Neutrality Bank Account. In addition all cashflows associated with Close Out Neutrality are expected to occur on a single, common date. Therefore, it is expected that no Reconciliation Neutrality Financing charges will occur after Close Out.

7.5 Neutrality Rationalisation

It is recognised by the Review Group that due to the nature of the process the total settlement figure is unlikely to achieve a zero balance through neutrality.

8. Transportation

References to transportation will not be included in the modification as this will be subject to bi-lateral agreements between shippers and Transco.

9. Benefit Share

Signing of the Full and Final agreement for transportation will trigger the payment of Benefit Share. However this can only take place after all relevant Users as defined in the methodology document have signed the Full and Final for Energy. Details of Benefit share rules and qualifying criteria will be specified in a separate paper.

10. Interest

Interest will be paid to an individual User in the circumstances where, after all debits and credits have been offset, that User is left in a net credit position. Interest will be payable on the net credit only and is then recovered through neutrality.

11. Exclusions

11.1 Theft of Gas (To be confirmed)

Due to Licence requirements, Theft of Gas cases will continue to be pursued for periods relating to Close Out. This will apply to both current and yet to be identified instances. The exact treatment of this issue will be clarified during the consultation period.

11.2 Siteworks

As siteworks terms and procedures do not form part of the Network Code, any outstanding invoice issues arising from the Transco Miscellaneous Billing System are not dealt with by Close Out