

Draft Modification Report
Modification Reference Number 0353
Liability mechanism for incorrect EUC apportionment (97/8, 98/9)

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 states that: “Transco update the Annual Quantity and other specified data each 1st October for non-daily metered sites. For gas years 1997/8 and 1998/9,

Transco have made gross errors in the calculation and provision of this data to shippers. This has had the effect of Transco making excessive capacity charges for those impacted NDM supply points (around 40,000 per annum), which have subsequently been rebated. More seriously, shippers faced an undue increase in SOQ and deemed demand, which directly translated into increased purchase of deliverability assets, gas and increased commercial exposure.

This modification proposal places a transparent, market related liability on Transco to reflect some of the costs to the industry, both realised and carried through exposure to Transco’s errors in calculating EUCs. This liability is proposed to be a bottom line hit to Transco and would not be recoverable through Neutrality or "k" factor. This Modification proposal only applies for Registered Users whose capacity for any affected sites is overstated by a net positive amount.”

2. Transco's opinion:

This Modification seeks to recover liability payments from Transco for errors affecting the EUC’s of some larger Non Daily Metered, Industrial and Commercial supply points. Whilst the problem was first identified following the AQ98 Review, it also occurred during the earlier AQ97 Review. Having identified the issue, Transco took immediate steps to alleviate the effects on Shippers including:

- * Agreeing Capacity Withholds
- * Agreeing a resolution process
- * Reporting of affected meter points for reconciliation purposes

As Transco was unable to automatically amend the affected meter points, due to data quality system risks, the resolution process allowed for those Shippers that appealed sites to be reimbursed for the associated administration costs.

In addition to issues associated with the resolution process, Shippers expressed concern that inflated SOQ’s gave rise to further 1 in 20 peak day exposure. During discussions with the EUC sub group, it was acknowledged that Shippers would employ a variety of strategies with regard to this risk, from purchasing additional storage to deferring any action. Depending on a Shipper’s risk management policy

and commercial circumstances, potential additional costs could vary significantly, with some Shippers incurring no costs at all.

Although sympathetic to Shipper concerns, Transco maintains that whilst the EUC misallocations may have increased risk, it does not follow that this translates directly into additional costs to Shippers. The methodology envisaged by the Modification Proposal seeks to reimburse affected Shippers for actions they may not have taken and costs they may not have incurred. Throughout this process Transco has consistently asked Shippers to provide evidence of additional costs: to date none has been submitted.

The Proposal indicates that a retrospective amendment to Sections H and V of the Network Code may be required. Transco remains of the opinion that retrospective amendments to Network Code, in general, do not further the terms of the relevant objectives. In this case, the Proposal seeks to recover costs from Transco and does nothing to improve the commercial and contractual framework, as the errors have already been identified and addressed.

Section V. 8.1. of Network Code provides that, “No Party shall be liable to any other Party for loss arising from any breach of the Code.” This includes, loss of profit, increased costs and any indirect or consequential loss. This is a standard feature of contracts and protects all parties against claims for consequential losses.

Retrospective amendment to such terms would raise substantially the level of risk for all Parties and therefore increase costs for the industry. Where appropriate, Transco has agreed liability mechanisms for specific processes and these are recognised and understood by all parties on a prospective basis.

Throughout discussions with Shippers, Transco has suggested that this Proposed Modification to the Network Code is unnecessary and inappropriate. Whilst acknowledging the difficulties of providing evidence of costs incurred, Transco believes that payment of liabilities without adequate proof of loss is difficult to reconcile with standard commercial practice. On this basis Transco reiterates its offer of 11 May 1999, that it is prepared to enter into confidential discussions with any Shipper that is prepared to furnish hard evidence of additional costs incurred.

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

This Proposal does not better facilitate the relevant objectives, in that a Modification which seeks retrospectively to recover costs due to past errors, which have been recognised and addressed, does not improve the contractual framework, under Licence Condition 7(1).

Instead the Modification is primarily a vehicle for certain Shippers to claim liability payments from Transco for unquantified loss.

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

a) **implications for the operation of the System:**

There are no implications for operation of Transco systems.

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

There are no capital and operating cost implications for Transco.

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:**

The Modification Proposal states that any liability payment should not be recovered by Transco. However Transco would expect that any liabilities contemplated would be considered within the discussions surrounding the regime introduced by Modification 204.

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

This Proposal will have no consequences on price regulation.

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:**

The Proposal carries a significant level of contractual risk to Transco in that it retrospectively seeks to vary the terms of Network Code with regard to limitation of liability. Any decision which allowed for liability payment without hard evidence of loss would fundamentally alter the contractual balance. The precedent could leave Transco exposed to future claims.

The Network Code contemplates a level of risk accepted at the time by all parties and includes specific liabilities where agreed. Application of retrospective liabilities undermines the contract and will discourage development of the Code and future commercial initiatives.

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

There are no known development implications for computer systems of Transco or Users.

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

Only those Users affected by misallocated EUC's will be eligible for liability payments as set out in the Proposal.

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

There are no implications for these parties.

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:**

Other than those affecting the Network Code as detailed in Section 5 of this report, there are no legislative, regulatory or contractual consequences of implementing this Proposal.

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

Advantages: Shippers affected by misallocated EUC's arising from the AQ '97 and AQ '98 reviews will receive liability payments..

Disadvantages: Retrospective amendment to Network Code increases level of risk to all Users and Transco, without improving the regime.

The Proposal does not require proof of loss and therefore allows for payment which may be substantially more than any actual loss incurred.

The principle of liability payment with no requirement to prove loss could set a precedent for future claims, undermining the contractual framework.

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

Representations are requested for this Modification Proposal.

Transco Response:

12. **The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation:**

The Proposal does not affect 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 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:**

Transco is not aware of any changes of methodology established under Standard Condition 3(5).

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

No programme of works will be required.

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

Transco does not support the Proposal and therefore no timetable is provided.

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

Transco recommends rejection of the Modification Proposal

17. **Text :**

Transco does not support the Modification and accordingly no text is provided. The Proposer has suggested unspecified amendments to Sections H and V of the Network Code.

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: