Draft Modification Report
Termination of Use in Receivership
Modification Reference Number 0441

Version 1.0

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.

We propose that a Termination Notice is issued one business day after Transco is notified of a receiver being appointed, unless, a written commitment, in a form satisfactory to the Energy Balancing Credit Committee (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 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. "

The proposer justified the Modification Proposal as follows;

"On failing to pay a Cash Call Transco is entitled to give Termination Notice which will have the effect of removing the Users 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."

Discussions in the Energy Workstream on 20/12/2000 generally endorsed the views of the proposer and emphasised that the proposal had been developed with care by the EBCC.

2. Transco's Opinion

Transco is essentially neutral in this matter 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 correct body to review the submissions made by the receiver which would seek to give the required commitment and this review of the receiver's commitment would be crucial in deciding whether a Notice of Termination was required or not.

Transco does not, however, believe that the receiver would always be able to make arrangements with another User by the following business day and is concerned that this might lead to premature termination of the User. Transco would therefore prefer the receiver to be given at least one further business day in which to make these arrangements. Furthermore, the Modification Proposal does not specify a maximum period between the service of a Termination Notice and the date on which that Termination becomes effective. Transco would welcome User's views on these two related points.

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 non-domestic Supply Points and believes this matter should be considered concurrently with this Modification Proposal.

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

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.

Transco also notes the argument that such subsidies might hinder the development of competition and a history of debt burdens absorbed by the User community might be considered as a barrier to entry of new Users.

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. On the other hand, by hastening the arrangements for transfer to another User or service of a Notice of Termination, 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 would also be reduced.

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, Storage 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 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.

I&C consumers, however, in the absence of shipper of last resort arrangements, have the responsibility following a Termination of their Supplier of establishing a gas supply contract with a different Supplier and might incur additional costs in doing so. If implementation of this Modification Proposal increased the likelihood of Termination then implementation could therefore be viewed as increasing the financial risk to 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

The Advantages of implementing this Modification Proposal are that it would:

- Increase the leverage which Transco has on the receiver to provide a commitment to coverongoing 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.

Disadvantage

- Increase the likelihood of serving a Notice of Termination. However, if the receiver had more time than the one Business Day 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.

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 invited.

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) of the statement; furnished by Transco under Standard Condition 3(1) of the License

Transco is unaware of any such requirement

14. Program 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)

Whilst the initial proposed implementation date (01/01/2001) has passed it is assumed that the proposer would request implementation as quickly as the consultation timetable allows. To allow the normal processes of consultation and preparation of the Final Modification Report to take place, the earliest possible date for implementation would be 16 February 2001.

16. Recommendation concerning the implementation of the Modification Proposal

Transco makes no recommendation on the implementation of the Modification Proposal at this stage in the belief that it is essential firstly for Users to give this proposal due consideration.

Transco further anticipates that Ofgem would wish to take a consistent view across the gas and electricity industries and may believe that this Modification Proposal should be considered as part of a package of changes including Modification Proposals 0446 and 0447.

17. Text

Section V: GENERAL

Amend paragraph 4.3.3 to read as follows:

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 is able to immediately provide adequate assurances to Transco in compliance with the principles established in the Code Credit Rules or Energy Balancing Credit Rules as appropriate, issue a Termination Notice and such notice shall specify a maximum of no more than [ ] 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 Development
Date: