

URGENT Modification Report
Tender for Enron's MSEC holdings
Modification Reference Number 0509
Version 3.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because sufficient time is needed to allow shippers to formulate bidding strategies and an additional MSEC auction to be conducted prior to start of the monthly capacity period in question.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Issued to Ofgem for decision on urgency	11 December 2001
Proposal agreed as urgent	12 December 2001
Proposal issued for consultation	12 December 2001
Close out for representations	13 December 2001
Final report to Ofgem	14 December 2001
Ofgem decision expected	17 December 2001

1. The Modification Proposal

This Modification Proposal specifically seeks to enable the sale via an auction process of the recalled MSEC purchased by Enron for the period January 2002 to March 2002. However, it is intended that the Modification, if implemented, should facilitate a similar process in the event of a shipper termination giving rise to MSEC capacity no longer held by Users.

It is proposed that the auction will be on a similar basis to that defined in the Network Code, Section B2.3.

The process would therefore ensure that the intent of Modification Proposal 0481 remains intact and that any capacity no longer held by Users following any shipper termination is made available to interested parties .

Implementation of this Modification Proposal would ensure the revenue generated from the sale of the recalled capacity for January to March 2002 would be treated as formula revenue, as in the original MSEC process.

Practical Implementation of Tender of January to March 2002 MSEC

If this Modification proposal is implemented, it is envisaged that an invitation to tender would be issued by Transco, which would ask Users to bid for the associated MSEC.

The tender evaluation would follow the process established in the Network Code for the sale of MSEC. Users will be asked to submit their bids in accordance with Section B2.3.4 and B2.3.5 of the Network Code, although this would be in a paper based format rather than through the RGTA system.

Once the invitation to tender has closed Transco will allocate the available MSEC in accordance with Section B2.3.7, B2.3.8 and B2.3.9 of the Network Code via an offline process. To ensure successful implementation, the allocated capacity would then need to be datafixed into the RGTA system after completion of the process.

The secured MSEC holdings will have the same rights and obligations as if it had been secured during the original auction process.

Once the allocation process has been completed Transco would make the information available in accordance with B2.3.10.

For the available January to March 2002 capacity the tender process is intended to open on 19th December 09:00 and the last time by which bids would be accepted would be 19th December 17:00.

2. Transco's Opinion

Transco opposes implementation of this proposal. Whilst Transco recognises the widespread view that the principles of Modification Proposal 0481 should persist it believes there are unacceptable risks associated with a proposal to address, in the short term, an approach whereby capacity no longer held by Users is made available via an additional MSEC auction.

Transco believes that the intent of Modification Proposal 0481 could be maintained through the release of Daily System Entry Capacity, which can be made available using proven business processes that are already utilised by a wide range of Users. These processes could be used to

make capacity no longer held by Users available without increasing operational and administrative risks for both Transco and Users.

To complete a tender process for MSEC no longer held by Users will require such an auction to be run offline. Following such a tender it would then be necessary to data-fix essential information into the RGTA IT system. This system contains data relating to all Entry Capacity held by Users. It is also used to manage the Daily Auctions for Firm and Interruptible capacity and is the primary source of data for the invoicing of charges and credits associated with System Entry Capacity.

Whilst Transco would take every care to implement data fixes to ensure that there are no unanticipated impacts resulting from errors in data input or subsequent processing of data-fixed information, such an approach may significantly increase the risks of errors associated with the operation of the regime. Any data fixing activity that takes place will increase the risks associated with the maintenance of data integrity that were designed before many recent regime changes (most noticeably Modification Proposal 0481) and which already require sophisticated manual intervention to ensure contractual compliance. This risk should be considered in the light of the timescale within which this auction process would be completed.

Transco notes that the Network Code does envisage User terminations and that it defines how capacity no longer held by Users should be treated. Transco believes that these processes remain the most appropriate method of dealing with this issue given the high risks to both Transco and the community associated with developing new business processes to support a monthly release of such MSEC.

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

Transco believes that this modification proposal does not better facilitate the relevant objectives, specifically condition 7 (1) (a) the efficient and economic operation by the licensee of its pipeline system.

This proposal, if implemented would generate significant risk to the data held within the RGTA system. If this data was corrupted the effect could be to expose the Shippers to inaccurate information regarding their Entry Capacity holdings which could create further uncertainty in respect of gas flows onto the system and the appropriateness of capacity invoiced sums.

Datafixing may also increase risks associated with the processing of the Daily auctions for Firm and Interruptible Capacity, as the aggregate capacity holdings are used to determine the levels of capacity made available on a daily basis.

Transco therefore believes, that the increased risks arising from the necessary data-fixing may be damaging to competition between shippers.

**4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:**

If implemented successfully then there would be no impact on the operation of the system. If the processes around the data fix did not work as expected and generated outcomes inconsistent with the intent of the Network Code then Users might have problems identifying their capacity levels, which could in turn effect their ability to flow gas.

Data or processing problems might also impact Transco's ability to manage the daily auctions, which in turn could affect Shippers ability to deliver gas to the system.

b) development and capital cost and operating cost implications:

If this Modification Proposal is implemented it would generate some modest operational costs to enable the offline auction to be completed and the subsequent data fixing into the RGTA system. Such costs might escalate should problems then arise requiring extensive manual and offline processes to correct erroneous data, subsequent processing or invoicing.

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 would anticipate that such costs would be met from revenues allowed for such purposes.

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 believes that implementation of this proposal might substantially increase the level of Transco contractual risk. Systems have already had to be adapted, or manual workarounds implemented to manage other changes implemented at very short notice. This includes such changes as Modification Proposal 0481, which introduced fundamental changes to the capacity regime that are not supported by Transco IT systems and which hence require extensive manual off-line control processes to ensure Network Code compliance. This proposal would further increase Transco's contractual risk to an unacceptable level.

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

This process would require extensive data fixing on the RGTA system.

7. The implications of implementing the Modification Proposal for Users

This Modification Proposal would enable Users to apply for capacity no longer held by Users via an MSEC auction process.

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 implications.

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

Advantages

Users can apply for additional Entry Capacity to the extent specified in Modification 0481

Disadvantages

There will be operational costs generated in making the capacity available through this process, generated in managing an offline auction process and the preparation and testing of the data-fixes.

There will be risks associated with data fixing into the RGTA system, which could result in inaccurate invoicing and problems with the operation of the Daily Firm and Interruptible Capacity auctions.

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

Summary of Representations :

Representations have been received from eleven parties, one of which have requested their comments to be treated as confidential. The non-confidential responses were received from :-

AGIP (UK) Ltd	(AGIP)
Amerada Hess Gas Ltd	(AH)
BG Gas Services Ltd	(BG)
British Gas Trading	(BGT)
Innogy plc	(I)
Powergen	(PG)
Scottish & Southern Energy	(SSE)
Scottish Power	(SP)
Shell Gas Direct Ltd	(SGD)
Total Final Elf Gas & Power Ltd	(TFE)

Summary

Two respondents (SP,SGD) express support for the modification proposal.

Four respondents (AGIP,BGT,I,Anon.) express either conditional support or support to the principles only.

Five respondents (AH,BG,TFE,SSE,PG) do not support the modification proposal.

General

Of those respondents supporting the proposal, it is argued that the release of the “recalled” capacity through an MSEC auction process maintains the principles of Network Code Modification 0481. BGT draws attention to the fact that offering capacity through the daily auctions limits the period to book capacity to only seven days ahead, and adds revenues from DSEC sales to Transco’s incentive revenue.

Those respondents expressing support to the principles of the modification proposal only, argue that there are number of practical implications and further considerations that should be taken into account. For example, two respondents would not support the modification if the volumes to be released are not material. AGIP expresses preference for a delay in the auction until January which would offer capacity for the months February and March only, and within-day firm auctions being utilised for the remainder of December 2001 and January 2002. A number of respondents recognise the significant operational difficulties in introducing an additional monthly auction at short notice. BGT state that if the operational difficulties are too great, then the use of the Unsold Long Term Firm (ULTF) may be the only alternative. SGD recognises that conducting an unexpected auction involves some new difficulties for all involved, but argue that all risks and responsibilities are allocated between parties appropriately.

Of those respondents not expressing support for the proposal, four parties (AH,TFE,BG,SSE) suggest a preference for the “recalled” MSEC capacity to be offered through the existing Day-Ahead firm capacity auction or the Unsold Long Term Firm (ULTF) auction as provided by Network Code. In particular, SSE argues that the proposal does not better facilitate the relevant

objectives and that as Ofgem and Transco are aware of the volumes and terminals involved, they believe that it should not be too complicated to channel any revenues into the buy back fund, rather than hastily introduce another process that would create further risks for Transco and shippers.

Three respondents (SSE,TFE,Anon.) argue that the modification proposal introduces additional complexity to the capacity allocation process and may detract from industry discussion in other RGTA areas. SSE state that the resources and effort from industry parties would be better spent focusing on the development of the entry capacity regime for April 2002 (and beyond), in addition to any further changes that are required pending the release of Ofgem's SO final proposals.

SSE also considers it inappropriate that the 24 hour urgent consultation timetable has been put forward to introduce a process that would endure permanently in the Network Code and argue that sufficient time must be afforded to consider the modification proposal. SSE suggests that further thought needs to be given to introducing future, more robust arrangements in the event of a shipper default and that this issue is already being addressed in Capacity Workstream meetings. SGD put forward a similar argument and argues that a longer term debate is needed on whether mitigating credit risks through the mechanism of re-distributing capacity is appropriate and that Shippers should face the specific costs of their own credit worthiness.

SSE strongly opposes the implementation of the proposal as anything other than a transitional measure to the end of March 2002.

BG argues that the release of the "recalled" capacity through the MSEC auction could force buy-backs and that it also introduces the risk of creating distortions in the value of already released capacity through holding a mid period auction.

PG suggests that the "recalled" capacity should be treated as Use-it or lose-it (UIOLI) capacity on the bases that it is the most cost-effective solution, all the capacity is released to the market, and that it gives consistency to the principle that the quantity of day-ahead interruptible made available reflects the amount of MSEC holdings which is "lost" under UIOLI.

Quantities of MSEC

Five respondents (BG,SSE,PG,I,Anon) comment that their ability to respond on the issue has been made more difficult by the lack of knowledge of the volumes, prices or terminals involved. They argue that the introduction of an additional MSEC auction is only justified if the levels of entry capacity are material.

Other Comments

Two respondents (SP,BGT) suggest that changes to the auction rules are considered for this additional MSEC auction. BGT suggest that the number of auction rounds is reduced from five to two. SP assume that the capacity will be made available under the same conditions as the original MSEC release, including the same reserve price. It further suggests that the capacity

could be offered to the next highest bidder in the auction round in which the capacity was allocated, at the price bid, but recognises the complexity for this unique situation of termination.

SSE expresses agreement with Transco that it is unreasonable to introduce the additional risks on Transco and the market generally that could arise as a result of any data fixing or paper based system that would be required to facilitate the release of recalled MSEC.

SSE urges that if the proposal is implemented the decision must be made on Friday 14 December, as to do otherwise would give shippers at best only one business day to put together a bidding strategy.

SSE also comments that the recalled MSEC creates complexities in terms of the cash flows within the entry capacity regime, arising from both a differential between the price originally paid by Enron and the new purchaser and the possibility of some or all of the recalled MSEC not being sold.

Transco response

Transco shares the view of a number of respondents concerning the risk to data integrity associated with data fixing within the RGTA system and that the timescales may make this risk unacceptable. Transco acknowledges the advantages of releasing the capacity through the day ahead auctions, which provide a proven method to release capacity to the market.

Transco recognises the view that the principles associated with the implementation of Modification 0481 should be maintained. However Transco notes that the Network Code currently provides for the release of such capacity no longer held by Users without the need for a Network Code Change. Transco also notes that the timescales involved in firstly considering, and then if appropriate, implementing the proposal has, and might continue to cause conflict with the other priorities currently facing the community associated with the development of the RGTA proposals.

Transco acknowledges the respondents concerns about Transco not releasing the associated volumes and the Terminals affected, however the Network Code is explicit about commercial confidentiality issued and which has prevented Transco from releasing such information.

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

A specific programme of work involving a small team of Transco employees within System Operation, Information Services Department and Billing would be necessary to ensure implementation

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

(The following timetable subject to an Ofgem decision.)

Issue of Auction invitation	17th December 2001
Bid window opens	19th December 2001 08:00
Bid window closes	19th December 2001 17:00
Transco conducts auction allocation	19th December 2001 evening

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend that this proposal is implemented.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This revised Modification Report contains Transco's proposal not to modify the Network Code but has been prepared following direction from the Gas & Electricity Markets Authority.

19. Text

Section B: SYSTEM USE AND CAPACITY

Amend paragraph 2.1.8 to read as follows:

"pursuant to paragraph 5.4 (a transferee election') and paragraph 2.1.9 shall apply."

Add new paragraph 2.1.9 to read as follows:

- "2.1.9 In respect of the System Entry Capacity which has ceased to be treated as held by a User pursuant to paragraph 2.1.8 for any calendar month ("**Re-available Monthly Capacity**"):
- (a) Transco shall promptly notify users of the amount of the Re-available Monthly Capacity and thereafter invite applications for the Re-available Monthly Capacity in respect of each Aggregate System Entry Point and each relevant calendar month;
 - (b) the invitation will specify the date on which applications pursuant to such invitation may be made and the amount of Re-available Monthly Capacity for each Aggregate System Entry Point and for each relevant calendar month; and
 - (c) Users may apply for Re-available Monthly Capacity on the invitation date by submitting an application ("**re-available capacity bid**") for Re-available Monthly Capacity for which purposes paragraphs 2.3.4, 2.3.5, 2.3.6, 2.3.7(a), 2.3.8, 2.3.9 and 2.3.10 shall apply as if any reference therein to:
 - (i) a monthly capacity bid was a reference to a re-available capacity bid;
 - (ii) Monthly System Entry Capacity (other than the second reference thereto in paragraph 2.3.9) was a reference to Re-available Monthly Capacity; and
 - (iii) each calendar month in the Gas Year was a reference to each calendar month in respect of which Re-available Monthly Capacity is available."

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0509**, version **3.0** dated **17/12/2001**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **3.0**.

Signature:

Process Manager - Network Code
Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriateprovided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.