

Modification Report
Removal of Energy Balancing Incentives from the Network Code
Modification Reference Number 0519

Version 4.0

This 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

If implemented, this Modification Proposal would remove existing provisions that relate to Transco's energy balancing incentive from the Network Code. Transco's energy balancing incentive would instead be defined in its Gas Transporters (GT) Licence.

It would be necessary to coordinate implementation of this Modification Proposal with relevant amendments to Transco's GT Licence to help ensure that no conflict arises between the provisions of the Network Code and Transco's GT Licence.

2. Transco's Opinion

Transco believes this Modification Proposal is required to facilitate a revised governance structure for Transco's NTS SO incentives, as proposed by Ofgem, by enabling the migration of Transco's energy balancing incentive from the Network Code into its GT Licence. Ofgem's proposals would result in the definition of all of Transco's incentives being contained within Transco's GT Licence.

Transco believes that failure to implement this Modification Proposal might lead to inconsistency and conflict between the provisions of the Network Code and the proposed Transco GT Licence conditions.

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

It is proposed that implementation of this Modification Proposal is aligned with, and subject to, modification of Transco's GT Licence. This would facilitate adherence to Standard Condition 9(1)(b) of Transco's GT Licence, i.e. the efficient discharge of Transco's obligations under its licence.

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 implications for the operation of the System.

b) development and capital cost and operating cost implications:

Transco is not aware of any development, capital or operating cost implications that would arise from the implementation of this Modification Proposal.

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:

Not applicable.

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

This Modification Proposal does not propose any changes to the calculation of Transco's allowed revenue or the way in which it is recovered.

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 effect of this Modification Proposal would be to marginally reduce Transco's contractual risk under the Network Code through the removal of the energy balancing incentive scheme. However, it is envisaged that this effect would be offset by the inclusion of Transco's energy balancing incentive scheme in its GT Licence.

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

Transco's computer systems would be unaffected if this Modification Proposal is implemented. Transco is unaware of any impact upon Users' systems.

7. The implications of implementing the Modification Proposal for Users

Users would not have the ability to propose amendments to the energy balancing incentive via the Network Code Modification Rules. However, this effect is largely offset as Shippers are given opportunity to submit representations when Transco's GT Licence provisions are reviewed.

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

The obligations faced by Transco in relation to its energy balancing incentive would cease to be defined by the Network Code.

The regulatory obligations which would arise from potential amendments to Transco's GT Licence are not the subject of this Modification Proposal.

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

The advantages of implementing this Modification Proposal are:

facilitating implementation of Ofgem's proposed governance structure;
preventing conflict of terms between the Network Code and Transco's GT Licence in respect of Transco's NTS SO incentive schemes;
facilitating an appropriate governance structure and a stable regulatory regime within which Transco may respond to its incentives.

The stated advantages are consistent with Ofgem's view that "...those aspects of the new incentive arrangements that have the potential to materially affect Transco's financial position should be included in its licence ... this is necessary to provide Transco with a sufficient degree of certainty in order to allow it to respond to its incentives.". (paragraph 11.6: Transco's NTS SO incentives 2002-07, Final Proposals).

The disadvantage of this Modification Proposal is that the Network Code may be considered to be more flexible than Transco's GT Licence in respect of the ease with which it may be amended in response to regime changes. However, Ofgem has adopted the view that this disadvantage is offset by the need to balance "... the flexibility offered by the Code against the need for stability and certainty." in determining the appropriate governance structure for Transco's incentives. (paragraph 11.5: Transco's NTS SO incentives 2002-7, Final Proposals).

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

The following Shippers submitted representations in respect of the re-consultation for this Modification Proposal:

Shipper	Shipper Reference
British Gas Trading	BGT
TXU Europe Energy	TXU
Shell Gas Direct Ltd	SGD

The table below provides a summary of the representations made by Shippers:

**Shipper
Ref:**

Comments

BGT

- If Ofgem directs amendment of Transco's GT Licence, then the incentive structure within the Network Code becomes redundant.
- In the event that Ofgem does not direct amendment of the licence, there must remain the provision for an incentive regime within the Network Code.

TXU

- Holding the incentives in the licence may provide greater stability for Transco.
- The benefit of increased stability for Transco is outweighed by a loss of flexibility for Shippers to develop a highly complex regime.
- Implementation of this modification is, to a degree, inevitable.
- If this modification is implemented, a small 'expert' group might be of service in evaluating the interactions of the Network Code and licensing regimes.

SGD

- The incentives should remain within the Network Code.
- This proposal does not further the relevant objectives.
- Assuming implementation, SGD would welcome an explanation from Ofgem in light of SGD's various representations

Transco supports the view that this proposal should be implemented if Ofgem directs implementation of the relevant GT Licence conditions.

Transco believes its maximum allowed revenue is appropriately defined within its GT Licence and there are no proposals for this governance structure to be amended. Under Ofgem's proposals for Transco's NTS SO incentives 2002-2007, Transco's NTS SO incentive performance will form part of the calculation of its allowed revenue. Transco believes for the purpose of clarity, certainty and consistency, it is appropriate for the full definition of its NTS SO allowed revenue to be contained within a single document, i.e. its GT Licence.

Transco recognises that the Network Code modification process provides Shippers with a formal route through which they can propose amendments to the Network Code. However, if this Modification Proposal is implemented, Shippers would still be at liberty to make representations to Ofgem. It should also be noted that Ofgem's proposals envisage the parameters of the energy balancing incentive scheme being set for two years initially and that wide consultation can be expected when proposals for subsequent years are developed.

Transco recognises there may be proposals for further development of the energy balancing regime. However, Transco does not believe that migrating its NTS SO incentives into its GT Licence would prevent such development. If this Modification Proposal is implemented, the provisions that define Transco's and Shippers' obligations in relation to the operation of the energy balancing regime would subsist in the Network Code.

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

Not Applicable.

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

Implementation of this Modification Proposal is not required in relation to any proposed change in the methodology established under Standard Condition 4(A) of Transco's GT Licence.

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

A program of works would not be required as a consequence of implementing this Modification Proposal.

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

It is proposed that the implementation of this Modification Proposal is aligned with the proposed amendments to Transco's GT Licence.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that implementation of this Modification Proposal is aligned with, and subject to, modification of Transco's GT Licence.

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 Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Rename Section D as 'OPERATIONAL BALANCING AND TRADING ARRANGEMENTS'.

Delete paragraph 3.

TRANSITION DOCUMENT PART II

Delete text at paragraph 8.2.1 and insert new text and new paragraph 8.2.2 to read as follows:

"8.2.1 In respect of the application of Section D3 as amended in the period from 1 October 2001 up to (and including) the Day preceding the date of implementation of the Modification to the Code giving effect to this paragraph ("**relevant period**") (and by which modification Section D3 ceased to apply):

- (a) a reference to a Gas Year shall be treated as a reference to the relevant period;
- (b) amounts payable in respect of the relevant period by way of User Daily Incentive Amounts, User Annual Incentive Interest Amounts and User Annual Incentive Adjustment Amounts (under the Price Incentive Arrangement and the Linepack Incentive Arrangement collectively) shall continue to be invoiced and payable in accordance with Section S notwithstanding that such amounts are invoiced and payable after the relevant period;
- (c) amounts payable under paragraph (b) shall be calculated in accordance with Section D3 as it applied immediately prior to the end of the relevant period; and
- (d) between 1 April 2002 and the date of implementation of the Modification to the Code giving effect to this paragraph, the Maximum Incentive Amount limits, Incentive Performance Measure, Annual Maximum Incentive Amounts and other relevant parameters of the Energy Balancing Incentive shall be set and applied in accordance with the limits prescribed in special condition 28B paragraph 14(9) of the Transco Licence.

8.2.2 For the purposes of paragraph 8.2.1 terms used therein shall have the meaning attributed thereto in Section D3 as it applied immediately prior to the date of implementation of the Modification to the Code giving effect to this paragraph."

Signed for and on behalf of Transco.

Signature:

Tim Davis
Head of Regulation NT&T

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 **0519**, version **4.0** dated **17/09/2002**) 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 **4.0**.

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.