

Modification Report
Withholding of Energy Charge where LDZ Reconciliation has been disputed
Modification Reference Number 0642

Version 1.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

The Proposer states that :-

"In the event of a correction of a misallocation of energy caused by an LDZ reconciliation, Users be allowed to withhold the Energy element of such charge where a valid dispute has been raised and not resolved. In these circumstances only, this proposal would dis-apply the Network Code requirement (Section 3.1 of Network Code Supplement) for a User to be required to pay the energy element of the charge in full even when a valid dispute is raised.

It is intended that this Modification Proposal is implemented for a fixed term of six months only which would alleviate the current concern regarding a significant charge becoming payable by all Users subject to RbD which we believe is erroneous. It would also provide sufficient time for the full impacts of this proposal to be developed into a permanent change to Network Code. It is our intent to raise a Modification Proposal to develop this permanent amendment"

2. Transco's Opinion

Transco does not support implementation of this Modification Proposal.

The principles by which the Energy Balancing rules are governed in respect of 'pay now query later' have been established to protect the Community against User default and minimise Neutrality Adjustment Financing Charges. These rules apply to the energy component of the regular monthly charges, including reconciliation components. The energy element of LDZ Reconciliations is no different, in its effect, to the regular charges. All forms of energy reconciliation including the energy component of LDZ Reconciliations, effectively adjust energy balancing revenues in light of better information about actual offtake of gas.

The existing provisions within the Network Code provide for Energy Balancing charges to be queried after payment. Thereafter, following resolution of any valid query disputing erroneous charges, a relevant adjustment (if appropriate) is made together with any interest due. The arrangements provide that, from 1st October 2003, Transco will have a financial incentive, in respect of its energy settlement agency role, to promptly resolve any such queries.

Transco does not see merit in changing the energy balancing settlement arrangements which it believes are both efficient in promoting competition between Users. Should this Proposal be implemented it would provide a perverse incentive to dispute invoice items, thereby reducing timely cashflows into gas balancing neutrality arrangements. Either this cashflow shortfall would have to be funded by Transco in its settlement agency role or the User community would expect to see higher charges arising from

Neutrality Adjustment Financing Charges. Thus the perverse incentive would be expected to act to the detriment of competition between Users and therefore could not be considered to further the relevant objectives.

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

Transco believes that implementation of the Proposal would create a perverse incentive to dispute charges which would be expected to act to the detriment of competition between Users.

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 impact to the operation of the system.

b) development and capital cost and operating cost implications:

Transco would incur development and operating costs associated with the additional invoicing processes and procedures that would be necessary.

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 not seek direct cost recovery however the incremental costs will contribute to operating costs and therefore would be shared with Users via their impact on the SO internal cost incentive scheme.

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

No such consequences have been identified.

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's level of contractual risk might be increased by the increase in disputed charges.

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

Transco systems would require significant development. Implementation of this Proposal would require a new invoice and associated revisions to existing invoicing functionality. Given the timescales envisaged in this Proposal this would likely involve extensive manual ad-hoc intervention.

Transco would anticipate that Users would need to amend their systems to accommodate this Proposal. This would be essential given that Transco would anticipate transmitting the new invoice electronically.

7. The implications of implementing the Modification Proposal for Users

Users would be able to withhold the Energy element of Reconciliation invoices under certain circumstances. Users would also have to amend their IT systems, business processes and procedures.

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

No such implications have been identified.

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 obligations or contractual relationship of Transco, and each User 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

Advantages:

The Proposer has identified that the advantages of this Modification Proposal would be the ability to withhold payments for charges in respect of the energy component of LDZ Reconciliations.

Disadvantages:

Implementation could create perverse incentives for Users to dispute invoices and could set a precedent for specific energy withholds.

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

Representations have been received from five Users:

Shell Gas Direct ("SGD"), Powergen, British Gas Trading ("BGT"), Scottish & Southern Energy Supply Ltd ("SSE"), and EDF Energy ("EDFE")

All five representations support the implementation of this Modification Proposal.

• Invoice Validation

In support of the Modification Proposal a common theme in the representations was that more time should be allowed by Users to validate these Reconciliation charges before the payment due date. SSE stated *"Given the period of time that this reconciliation is expected to cover and the potential magnitude of adjustments, it seems reasonable that Users should be given sufficient time to verify data and where appropriate raise disputes and have them resolved before being expected to pay"*. EDFE stated *"It is important that Shippers have the necessary time to raise a query and withhold payment for a limited period of time without being liable for termination for withholding monies"*.

Transco's Response: When Transco first identified that an error in measurement due to incorrect application of fixed gas composition parameters in the density correction of energy, it discussed this with both Users and Ofgem (Technical Directorate) well in advance of the proposed Invoice production date and provided presentations at various industry groups (see schedule below), explaining how the Density corrections had occurred, initial and revised estimated energy values, and the timetable for issuing the invoiced charges. At each stage in the process Users were updated on the progress and given the opportunity to raise any issues prior to the invoice being produced. Transco has already provided responses to those Users requesting further clarification of the charges.

5 th February 2003	Meeting with Ofgem Technical Directorate where the
8th February 2003	proposed reconciliation was presented
	Billing Operational Forum - Initial
	estimates for the reconciliation
24th February 2003	were presented to the community
	Topic raised for discussion at the
	Shrinkage Forum
10th April 2003	Billing Ops Forum - Further update on the
	progress with the reconciliation
10th June 2003	Billing Ops Forum - Further update on the
	progress with the reconciliation

Transco accepts that Users can raise an invoice dispute following payment of the charges in respect of the proper calculation of the invoice and the existing provisions within the Network Code already provide for this.

Whilst in some cases the charges could be seen as significant, in terms of charge validation of these charges, Transco considers these are no more complex than other charges derived from the proportion of market share.

The process adopted to date (and would be adopted in the event of a similar debit) has demonstrated to an acceptable commercial standard that the charge is valid. Users should not have an option to not pay when the charge has been demonstrated as valid where contractually such invoices are settled quickly.

- **Neutrality**

As the Modification Proposal does not make reference to the treatment of Neutrality in these specific circumstances further clarification would be required from the Proposer in the event that the proposal is implemented. SGD raised this concern in its representation and commented that the effect on Neutrality needs to be considered. SGD stated "*Otherwise, this modification would expose shippers without an RbD portfolio to a risk and cost not of their making*". Another view expressed by SGD was the importance to ensure that this Modification Proposal does not set a precedent and stated "*such that disputed balancing invoices could result in Transco recovering costs of unpaid costs from the community and potentially creating inefficient incentives to dispute invoices*". In support of Modification Proposal, BGT made reference in its representation to the Neutrality impacts in that Energy charges flow into Neutrality, and to

withhold such a charge would impact upon other Users. BGT stated *"However, in certain circumstances the charge is not allocated against neutrality. We are of the opinion that in these circumstances only it is inappropriate that the User is unable to withhold payment at the time of raising a valid dispute, as is the case with other charges raised by Transco for transportation"*.

Both BGT and SGD stated that they believe that these credits, which would flow through the Energy Neutrality Account to the Shrinkage Provider, should be viewed differently to other neutrality charges since the payment, or otherwise, should not affect shippers. SGD stated *" However, on the understanding that the intent is that Transco only would be exposed to the costs of unpaid invoices, this modification may be an approach to ensure that these disputes are resolved quickly"*. BGT stated *" In the particular circumstances that apply to this issue we believe that as the disputed sum is receivable by Transco and not subject to neutrality, no other parties would be prejudiced by the withholding of payment"*

Transco Response: Transco agrees with the views expressed by SGD that disputing balancing invoices potentially results in an inefficient incentive regime as it would act as an incentive to Users to dispute balancing invoices. Transco also agrees that shippers would be exposed to further risk and costs, although all Users would be exposed to this, not just shippers without an RbD portfolio. Transco's view is that the proposed change in respect of the treatment of Energy Balancing charges through Neutrality should not include provisions to exclude charges in certain circumstances as this challenges the fundamental principles of Energy Balancing. The Shrinkage Provider is a party to the Network Code and as such should not be treated differently as a result of any adjustments to LDZ Daily Quantity Inputs in the circumstances where the Shrinkage Provider is due monies owed.

In response to BGT's statement about no other parties being prejudiced by the withholding of payments, this is incorrect as the mechanisms for LDZ reconciliation disputes are identical to all other LDZ reconciliation invoices and charges are allocated against neutrality together with any corresponding reductions in energy to the NTS. The concepts of the allocation of energy and charges have been established to protect all Users and it therefore would be prejudiced if withholding of these charges was allowed.

- **Cessation of Invoice Charges**

EDFE raised the question as to whether there would be any merit in having the ability to draw a line under raising invoices and prohibit reconciliations within a time frame of between 2 and 3 years. It further stated *" If the Transporter fails to notice there has been an error within this time they forego their right to raise reconciliation invoices"*

Transco Response: Transco has Network Code obligations to allocate correct charges to the community and where it identifies any error, it has a duty to adjust the charges accordingly. Whilst the current charge being referred to within this Modification Proposal is mainly a debit to Users and a credit to Transco as the Shrinkage Provider, consideration would have to be given to other adjustments which could result in credits to all or some Users. To differentiate between Users due credits as opposed to Users being charged debits could be seen as not treating all parties equitably which would be contrary to the requirements of its Licence.

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

Implementation of this Modification Proposal is not required in order to comply 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 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Implementation of this Modification Proposal is not required to facilitate any such change.

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

Changes to processes, procedures and systems would be required to facilitate implementation of this proposal.

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

In view of Transco's recommendation, no implementation timetable is proposed.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend implementation of this Modification Proposal.

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 not to modify the Network Code and Transco now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Signed for and on behalf of Transco.

Signature:

Terry Grove
Service Delivery Manager

Support Services

Date: