Modification Report
Amendments to Provisions for the Calculation of Relevant Balancing Indebtedness of a Trading System Operator
Modification Reference Number 0685

Version 2.0

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

Due to the unique position of the Trading System Operator (TSO), actual data is available in respect of its trading activities at the close of the day and is available to Transco's Credit Risk Management department the following day. It is proposed therefore that the Network Code Supplement should be amended to take account of this data and remove the necessity to calculate the TSO's Outstanding Relevant Balancing Indebtedness on the basis of the Anticipated Balancing Indebtedness (an accrual formula that takes account of the previous 10 days activity adjusted to account for standard deviation) and replace this with actual data for the whole of the Imbalance Period.

2. Transco's Opinion

It is Transco's opinion that this Modification Proposal should be implemented.

Background to this Modification Proposal:

Transco, in its role as Energy Credit Risk Manager, has an obligation to monitor each User's Relevant Balancing Charges and the amount of the User's Outstanding Relevant Balancing Indebtedness, as soon as is reasonably practicable, after the day on which the User's initial Entry Allocation Statements are available.

Following the failure of a User in September 2000, Transco in conjunction with the Energy Balancing Credit Committee (EBCC) initiated a review of the provisions within the Network Code Supplement. As a result of this review it was identified that when assessing a User's total exposure on any one day, no account was taken of the previous 9 days' allocations. This was due to the provisions of E2.1.2 which specify that Users should submit such allocations to Transco not later than the 7th Business Day after the Gas Flow Day, and data is transferred from AT Link to Transco's exposure monitoring system overnight following the close of day, adding a further 2 days' delay.

To close this gap Modification 0474 'Revision of Indebtedness Cash Call Trigger' introduced the concept of an accrual for the unmeasured period 'Anticipated Balancing Indebtedness' (ABI). ABI is calculated based upon a formula that takes account of the previous 10 days' activity adjusted to account for standard deviation.

Further discussions at the EBCC resulted in recognition from EBCC members, that in not having direct control of its trading positions, the Trading System Operator (TSO) is in a unique situation for which the Energy Balancing Credit Rules do not make provision. This resulted in the EBCC requesting Transco to raise Modification Proposal 0609 'Changes to Energy Balancing Credit Arrangements for the Trading System Operator' with the intention of addressing a situation where through the occurrence of events beyond its control the TSO could be required to put in place security of theoretically unlimited value at short notice. Implementation of Modification 0609 on 1st March 2004 introduces an additional trigger whereby once the TSO's Outstanding Relevant Balancing Indebtedness exceeds 60% (rather than the Cash Call trigger of 85% for all other Users) Transco will have an obligation to convene an emergency Operational Meeting of the Energy Balancing Credit Committee (EBCC) to review the TSO's exposure.

Current Position:

Whilst the introduction of Modification Proposal 0609 'Changes to Energy Balancing Credit Arrangements for the Trading System Operator' provides advance notification to the TSO that it may breach its credit limit, using the ABI accrual methodology to calculate the TSO's indebtedness may be inappropriate, on the basis that it is difficult to demonstrate a trend, as one day may not be indicative of another, as seen in the case of other Users. The introduction of Modification Proposal 0609 is likely to cause a significant increase in the number of emergency Operational Meetings of the EBCC as there is no provision for the TSO to appeal its exposure at that point. If the actual data, which is available to Transco's Credit Risk Management department, were to be used to calculate the TSO's Outstanding Relevant Balancing Indebtedness rather than using an accrual methodology, there would be less possibility that meetings may be called unnecessarily, prior to any Cash Call being issued.

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

Transco believes that avoiding unnecessary administrative procedures and adding transparency to the process better facilitates its GT Licence "code relevant objective" of the securing of effective competition between relevant shippers and between relevant suppliers.

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 such implications.

b) development and capital cost and operating cost implications:

Transco is not aware of any such costs.

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:

Implementation of this Modification Proposal would not cause Transco to incur any additional costs.

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

Transco does not believe that implementing this Modification Proposal would have any consequence on the level of contractual risk to Transco under the Network Code.

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

Minor amendments will be required to Transco's offline monitoring systems. Transco is not aware of any implications for Users' systems.

7. The implications of implementing the Modification Proposal for Users

Transco is not aware of any implications, associated with this Modification Proposal, for the majority of Users. The TSO and the members of the EBCC are less likely to be called unnecessarily to Emergency Operational Meetings of the EBCC.

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

No such implications have been identified.

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

Advantages:

- The removal of the forecasting aspects of the indebtedness calculation when calculating the TSO indebtedness, would reduce the likelihood of the TSO breaching its limits and

consequently reduce the likelihood of unnecessarily convening an Emengency Operational Meeting of the EBCC.

Disadvantages:

- Transco is not aware of any disadvantages associated with this Modification Proposal.

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

Five representations were received for this Modification Proposal all of which were supportive.

British Gas Trading believes that it would "*allow Transco to assess the indebtedness of a Trading System Operator on the basis of the most up to date and current information rather than having to rely upon accurate anticipated position calculated over a 10 day period*". EnMo also believes "*that using the actual data rather than the average figures of the last 10 days will produce a more accurate reflection of the TSO's Outstanding Relevant Balancing Indebtedness.*" RWE "*sees the use of actual data to improve the measurement of indebtedness as the principal benefit of this Modification....*" Transco concurs with these views.

RWE Innogy states that the accrual methodology is "*a simple surrogate for actual data*" and therefore it "*believes that it is appropriate to replace the accruals methodology with actual data from trading activities where this is available*" and that "*the distortions created by applying unrepresentative trends through the accruals formula could understate rather than overstate the actual position.*" It also states that "*the additional flexibility afforded a Trading System Operator still requires active monitoring of breaches of the 60% trigger.*" EDF Energy supports the Proposal "*because the Trading System Operator's exposure should be based on available actual meter readings and not forecast readings. This ensures that the Trading System Operator has lodged credit cover for their actual position and there is less risk on other market participants.*" Transco concurs with these views.

Powergen and EnMO both believe that this Modifciation Proposal would reduce the risk of Emergency Operational Meetings of the EBCC being called unnecessarily, prior to any Cash Call being delivered.

Powergen states that "*to optimise costs, it may not be unreasonable for an organisation to have an indebtedness of above 60%, if not above 70%, prior to paying the monthly bill.*" Transco would respond that Modification Proposal 0609 'Changes to Energy Balancing Credit Arrangements for the Trading System Operator' considered the appropriate triggers and it is not the intention of this Proposal to revisit this issue. Powergen suggests that Transco should consider how quickly the debt is rising and the normal operating band of the organisation in its assessment. Transco concurs with this view and this is information that would be provided to the EBCC at any emergency Operational Meetings in line with the outcome of Modification 0609.

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

Implementation is not required to facilitate such compliance.

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

This Proposal is not required to facilitate any such change.

14. Programme of works required as a consequence of implementing the ModificationProposal

The programme of works required to implement this Modification Proposal includes changes to the Energy Balancing Credit Rules which requires approval by EBCC members and is subject to a 2 month minimum notice period unless agreed otherwise.

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

This Modification Proposal can be implemented with immediate effect following determination by Ofgem subject to the completion of the work as detailed above.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends 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 to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

SECTION X NETWORK CODE SUPPLEMENT

Amend paragraph 2.5.2 (c) to read as follows:

"**Anticipated Balancing Indebtedness"** for each User (other than the Trading System Operator) is an amount…

Amend paragraph 2.5.2(d) to read as follows:

> "**Outstanding Relevant Balancing Indebtedness**" for each User (other than the Trading System Operator) means …"

Amend paragraph 2.5.2 (g) to read as follows:

"Subject to paragraph 2.5.7 in determining…"

Add new paragraph 2.5.2(i) to read as follows:

"2.5.2 (i) "**Outstanding Relevant Balancing Indebtedness**" for the Trading System Operator means the sum of:

(i) the net aggregate amount (payable by or to the User) of the Relevant Balancing Charges for each Day of the Uninvoiced Period;

(ii) the Net Invoice Amounts in respect of all Energy Balancing Charges under each Energy Balancing Invoice which has been submitted for which the Invoice Due Date is on or after the Calculation Day; and

(iii) the Net Invoice Amounts in respect of all Energy Balancing Charges under each Energy Balancing Invoice which has been submitted for which the Invoice Due Date is before the Calculation Day and which have not been paid by the User;

less

(iv) the amount (excluding any interest earned thereon) of any Cash Call which has been paid by the Trading System Operator and not for the time being applied in or towards payment of any Invoice Amount under paragraph 2.8."

Amend paragraph 2.5.4 (a) to read as follows:

"Subject to paragraphs 2.5.6, 2.7.6 <u>and 2.5.7,</u> the calculation…

Amend paragraph 2.5.6 to read as follows:

<u>Subject to paragraph 2.5.7,</u> where:…

Add new paragraph 2.5.7

Paragraphs 2.5.2 (b), 2.5.2(c), 2.5.2 (d), 2.5.2 (g), 2.5.3, 2.5.4(a) and 2.5.6 shall not apply to the Trading System Operator.

Signed for and on behalf of Transco.

Signature:

Steve Coomber
Finance Manager

Support Services

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 **0685**, version **2.0** dated **24/05/2004**) 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 **2.0**.

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 appropriate

   provided 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.