

**Modification Report**  
**Right of set off under Uniform Network Code**  
**Modification Reference Number 0076**  
Version 2.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 9.6.

## **1. The Modification Proposal**

This Proposal seeks to implement a recommendation identified within Ofgem's conclusion document "***Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover***" 58/05. This concluded the high-level principles that should be applied and further work required in respect of credit cover arrangements for transportation arrangements.

This Proposal seeks to implement recommendations detailed within paragraph 3.49 of the conclusion document.

Under the UNC, Transporters may issue either credit or debit invoices to Users, payable by the Transporter or the User within terms specified in the UNC. Historical data indicates that when considering monies owed between User and Transporter for the normal monthly billing cycle, the User will usually be in debt when the net position is calculated.

It would be beneficial to Transporters if (in respect of Transportation services only) a Transporter had the ability to offset amounts it was due to pay to the User against any invoice value that the User is due to pay the Transporter when a User is in breach of payment terms (UNC Section S3.1) or has agreed with the Transporter the set-off.

This right of set off would therefore only be available where:

- a) the relevant Transporter was the same party in respect of both the credit and debit amounts, and
- b) the relevant User was the same party in respect of both the credit and debit amounts, and
- c) the relevant User is in breach of the relevant payment terms, or has agreed with the Transporter the set-off of the relevant amounts.

In respect of the set off:

- the Transporter would issue a 'set off notice' to the User in instances where a User is in breach of Section S3.1
- the 'set off notice' would specify the relevant invoice payable (or, if applicable the unpaid overdue invoice) by the User and the invoice payable by the Transporter which is being set off on or before the invoice due date.

**2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives**

National Grid believes that implementation of this Proposal would represent a reasonable efficiency improvement in respect of the making of payments and is thus consistent with the relevant objective of the promotion of efficiency in the implementation and administration of the Network Code and/or the Uniform Network Code. While implementing set-off could impose costs on Users, the Proposal envisages set-off only being applied with the consent of the User involved such that the benefits would be expected to outweigh the costs.

Implementing consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

Corona, EDF, SGN and SSE also agreed implementation would promote efficiency.

**3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation**

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

**4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including**

**a) implications for operation of the System:**

No implications for operation of the system have been identified.

**b) development and capital cost and operating cost implications:**

No quantified estimates of Transporters development or capital costs have been provided.

National Grid Distribution “*estimates that if a right of set off were...in place...from January 2005 to August 2005, [National Grid] would have had the ability to reduce the quantity of invoices issued by 39%. In addition ...realised a...saving of approximately £6,500 in...banking charges*”.

**c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:**

No cost recovery mechanism is proposed.

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

No consequences on price regulation have been identified.

**5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal**

No such consequence is anticipated.

The SME believes that the level of contractual risk for Transporters is diminished where it is able to set off and utilise credits due to Users to reduce the level of outstanding debt though RWE commented *"In our experience the credits due from Transporters are relatively small compared to the amount owing by Users. Therefore we don't believe that this point is valid"*.

Corona believes that the proposal will *"have a minimal, but positive impact on overall contractual risk through the reduction of outstanding debt levels."*

**6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users**

No systems impacts are anticipated by Transporters.

User systems may need to be amended if they elect to allow set-off.

**7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk**

Implementation of the Modification Proposal has the potential to reduce or increase Users' administrative and operational costs. However, since the Proposal allows Users to elect whether or not to allow set-off, net benefits are anticipated.

Corona believes that *"the proposal will reduce administrative costs"*

RWE were *"unclear in how this modification proposal will benefit Users"*.

WWU believes that the proposal *"has the potential to increase the administrative costs for some market participants"*.

The SME believes there is potential for a reduction in a Users contractual risk in that where set off is utilised, a Users level of indebtedness is reduced which minimizes the risk of exposure to sanctions which Transporters are able to impose at the levels prescribed by UNC (currently 85%).

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

No such implications have been identified.

**9. Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal**

No such consequences have been identified

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

**Advantages**

- Increased alignment of the UNC with best practice as identified in Ofgem's conclusions document.
- Potentially reduces industry administration costs.

**Disadvantages**

- Potentially increases complexity, especially if each of the relevant Transporters act differently

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

<u>Organisation</u>	<u>Abbreviation</u>	<u>Position</u>
Corona Energy	Corona	For
EDF Energy	EDF	For
National Grid UKD	NG UKD	For
National Grid NTS	NG NTS	For
RWE Npower Plc	RWE	For
Scotia Gas Networks	SGN	For
Scottish and Southern Energy	SSE	For
Total Gas & Power	TGP	For
Wales & West Utilities	WWU	Qualified Support

The only concern Corona has with the proposal is *"the element of choice afforded to the Transporters in electing to effectively implement the proposal, or not. The legal text states that "the Transporter may submit a Set-off notice" irrespective of the desire of the relevant shipper to operate under this mechanism."*

Corona added *"In the event that a Transporter is unwilling to offer set-off and it is evident that this is generating unwarranted costs for the shipping community, Corona suggests that the proposal is revisited and a firm obligation to offer set off is enshrined in Code. At the current time, however, we do not wish to delay*

*the implementation of the proposal and trust that the voluntary arrangements succeed in meeting the overall objective of reducing administrative costs across the industry."*

*EDF is concerned "that this modification proposal has afforded the element of choice to the transporters as to whether the proposal would be adopted by all. EDF Energy considers that the benefits of this proposal will only be realised if all transporters adopt this proposal on the same date. With this in mind, EDF Energy would like assurance from all the relevant transporters that this modification proposal will be implemented by all."*

*RWE commented that "The modification proposal does not identify how far in advance of the payment due date this notice would be issued, thus it is not clear how a long a User has in order to re-arrange any payment schedules. We would suggest that a period of not less than 5 business days before the due date would give Users time to adjust any payment runs. However this issue can be addressed if the legal text reflected that once both parties have agreed to set off credits and debits it would cover all appropriate credits due from the Transporter until such time a User withdraws its agreement".*

*The following clarification has been provided by the proposer "The Transporter will to issue a set-off notice to the User. From National Grid's perspective in most circumstances the set-off notice will be issued two days prior to the Invoice Payment Due Date, however it must be recognized that if a User has failed to comply with their payment obligations as contained within the UNC it may not always be possible to provide two days written notice. National Grid believes that a suggestion of not less than 5 business days is not feasible given that the trigger for set-off is outside of the control of the Transporter and resides with the User".*

*WWU offered "qualified support for the implementation of this modification so long as the requirement to enter into set off arrangements is bi-lateral" but sought clarification as to "whether the Invoice Due Date is defined by the date of the credit or debit invoices. This could lead to late payment charges being triggered under UNC rules."*

*The following clarification has been provided by the proposer "The intention of the modification proposal is that if a User has elected to allow the Network Operator to set-off in all instances then the invoice with the earliest payment due date would be the trigger to undertake the physical set-off. Hence once invoice will be cleared on its payment due date, be that a credit or a debit, and the other invoice would be cleared before its payment due date. If a User has not elected to allow the Network Operator to set-off in all instances then the trigger for the Network Operator moving to a mandatory set-off would be the non-payment of a debit invoice by a User, in this instance the debit invoice would be overdue whilst the credit would not be overdue. Due to the fact that the debit invoice was not paid on its payment due date by the User late paid interest, compensation fees and sanctions as outlined within the UNC may be applicable".*

SGN commented that the “*right of set off would normally only be applied where the Transporter and User have agreed this in writing. We understand the... User would have a 5 day cooling off period*”. The SME would seek to clarify that the User’s written consent to set off is effective until such consent is withdrawn (in writing) and such withdrawal will become effective from the fifth business days following the date of receipt by the Transporter of the User’s withdrawal of consent.

TGP agreed that the “*ability for Transporters to impose set-off on Shippers who have debts outstanding seems an appropriate safeguard to protect the wider industry from incurring unrecoverable debts*”.

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

Implementation is not required to enable each Transporter to facilitate compliance 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 paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence**

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

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

Changes would be required in respect of operational processes and procedures in the event that this Modification Proposal is implemented.

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

Changes would be required in respect of operational processes and procedures. A lead-time of at least one month would be required for implementation of the Modification if so directed.

**16. Implications of implementing this Modification Proposal upon existing Code Standards of Service**

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

**17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel**

At the Modification Panel meeting held on 15 June 2006, of the 9 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

**18. Transporter's Proposal**

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

## 19. Text

### TPD SECTION S: INVOICING AND PAYMENT

*Amend paragraph 3.3.1 to read as follows:*

Without prejudice to paragraphs 3.8 and 4.2.2, amounts payable....

*Add new paragraph 3.8 to read as follows:*

#### 3.8 Set off notice

3.8.1 A Transporter may submit a notice ("**Set off Notice**") to a User in respect of a relevant Invoice Document where either:

(a) such User has failed to make payment in full in respect of such Invoice Document by the Invoice Due Date in accordance with paragraph 3.1; or

(b) such User has agreed in writing that a Transporter may apply set off in accordance with this paragraph 3.8 and such User has not withdrawn such agreement by notice in writing at least 5 Business Days prior to any Set Off Notice;

in such case, the provisions of this paragraph 3.8 shall apply.

3.8.2 For the purposes of this paragraph 3.8 a "**relevant**" Invoice Document is an Invoice Document which:

(a) has been submitted to the User;

(b) comprises Invoice Amounts (including Invoice Amounts under any other relevant Invoice Document specified in the Set off Notice) which are payable both by and to a User; and

(c) such Invoice Amounts are in respect of Transportation Charges.

3.8.3 A Set off Notice shall specify:

(a) the identity of the User;

(b) in respect of each relevant Invoice Document:

(i) the unique number by which the Invoice Document is identified;

(ii) the date the Invoice Document was submitted to the User;

(iii) the Invoice Type;

(iv) the Invoice Due Date;

(v) in respect of each Invoice Item, the Invoice Amount;

(c) by reference to each of the Invoice Amounts payable both by and to a User under each relevant Invoice Document, the net amount payable by or to the User (the "**net invoice amount**"); and

(d) the Invoice Document (the "**specified**" Invoice Document) in respect of which the net invoice amount is to be treated as payable (which in the case of a Set



off Notice in respect of a single Invoice Document shall be such Invoice Document).

3.8.4 Following the submission of a Set off Notice:

- (a) payment of the net invoice amount by the Transporter or (as the case may be) the User on or before the Invoice Due Date of the specified Invoice Document shall be treated for the purposes of this Section S as payment in full of all Invoice Amounts payable by or to the User under each relevant Invoice Document specified in the Set off Notice;
- (b) paragraphs 3.2, 3.4 and 3.7 shall apply in respect of each relevant Invoice Document;
- (c) the Transporter or (as the case may be) the User will remain liable for the payment of interest in accordance with paragraph 3.5 in respect of the late payment of any Invoice Amount under a relevant Invoice Document where payment was not made by the Invoice Due Date; and
- (d) in the event the net invoice amount is not paid on or before the Invoice Due Date of the specified Invoice Document paragraph 3.5 shall apply in respect of each Invoice Document specified in the Set off Notice.

3.8.5 Where a User has notified the Transporter of an Invoice Query (in accordance with paragraph 4.2) in respect of an Invoice Item under a relevant Invoice Document:

- (a) prior to the submission of a Set off Notice, the Transporter shall take account of the Invoice Amount which is the subject of the Invoice Query when determining the net invoice amount payable;
- (b) following the submission of a Set off Notice, the Transporter may:
  - (i) make payment of any such amount for which it is liable pursuant to this Section S in respect of the Invoice Query; or
  - (ii) submit a revised Set off Notice to take account of the Invoice Amount which is subject of the Invoice Query (and the first Set off Notice shall cease to have effect).

Subject Matter Expert sign off:

*I confirm that I have prepared this modification report in accordance with the Modification Rules.*

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

**Tim Davis**  
**Chief Executive, Joint Office of Gas Transporters**

Signature:

Date :