

Transco, Shippers and other
interested parties

Your Ref:
Our Ref: Net/Cod/Mod/737
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21 March 2005

Dear Colleague,

Modification proposal 737, 'Failure to Pay Cash Call Notice (reduced timescales)'

Ofgem¹ has carefully considered the issues raised in Modification proposal 737, 'Failure to Pay Cash Call Notice (reduced timescales)' and has decided to direct Transco to implement this modification, as we believe that it will better facilitate the achievement of the relevant objectives of Transco's network code. Ofgem considers that this decision is also consistent with its wider statutory duties.

In this letter we explain the background to the modification proposal and outline the reasons for making our decision.

Background to the proposal

Transco's energy balancing credit regime is embodied in the network code supplement (section X) and the Energy Balancing Credit Rules (EBCR). Section X provides the Credit Risk Manager – Energy (CRM-E) and the Energy Balancing Credit Committee (EBCC) (whose members are elected to represent the interests of the shipping community operating on Transco's network) with a number of powers, duties and rights in order to manage the community's energy balancing credit risk. Transco, who is financially 'neutral' to energy balancing activity, was appointed by the shipping community to act as the CRM-E on its behalf, applying the EBCR in accordance with the instructions of the EBCC.

Each user is responsible for the financial implications of balancing its daily gas flows across Transco's network. All users also assume a share of credit risk associated with other users' energy balancing activity, as in the event of a shipper failure unpaid charges are apportioned between all users.

Each user is allocated a cash call limit, which is a value not exceeding 85% of posted security. Transco monitors each user's outstanding relevant balancing indebtedness on a daily basis.

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

Where indebtedness (which includes amounts due under energy balancing invoices) exceeds a user's cash call limit Transco will issue a cash call notice. Unless successfully appealed, users are currently required to pay amounts set out in cash call notices within the next day. Where payment is not received Transco will issue a failure to pay cash call notice, advising that it may issue a termination notice to the user if payment of the full amount is not made by the third business day of such notice. If payment is not subsequently received, Transco may issue a termination notice to the user, effective from the following business day.

The proposal

The intention of this modification proposal is to reduce the number of days for the expiration of a failure to pay cash call notice under X2.9.1 to allow only one business day for compliance. It is also proposed that the wording in X2.9.1 should be amended to reflect that Transco will refer to the EBCC in such circumstances, to determine whether a termination notice should be issued.

Transco raised this modification proposal following discussions at the EBCC where members agreed that three business days is an excessive period and that one business day would be appropriate for compliance.

Respondents' views

Seven representations were received in relation to modification proposal 737. Of these, six respondents offered support for the implementation of the proposal, while one respondent was supportive of the proposal in principle. Respondents generally agreed that the modification proposal represents a reduction in the potential exposure of the industry in the event of the failure of a user.

Two respondents raised concerns that the reduction in the timetable may have in terms of restricting users' ability to make payments, particularly with respect to the BACS payment route (3 business day payment facility), though one highlighted the opportunity that has already been provided to pay or dispute invoices by this stage. The other respondent felt that it may be more appropriate to amend the timescale from three to two days.

Transco's view

Transco supports the implementation of modification proposal 737. Transco is of the view that this proposal protects the shipping community against potential losses in the event of a user default. Transco considers that the current three days presents an unnecessary risk to the shipping community, and that two days of that exposure could be avoided. Transco also considers that the proposal will still allow sufficient time for payments to be made via the BACS route, and provided an illustrative timetable within the FMR. Transco also notes that all shippers have the ability to make a same-day payment via CHAPs, albeit at a marginally higher cost.

On 20 January 2005² the Authority granted its conditional consent to the potential sale of four of Transco's Distribution Networks. One such condition to the Authority's consent requires satisfactory industry code arrangements and to this end Ofgem has recently launched its

² National Grid Transco – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks *Decision document February 2005 21/05*

consultation³ on, amongst other things, the Uniform Network Code (UNC) as developed by Transco. Transco has confirmed that, in its view, this modification proposal furthers the relevant objectives of both its prevailing network code and the UNC, and that the proposed changes to text would not need to be altered.

Ofgem's view

The reduction in the time required for the expiration of a failure to pay cash call notice and an emergency EBCC meeting being convened will expedite the process for a potential termination notice to be issued. Therefore, Ofgem considers that the implementation of this proposal could reduce financial risk to the shipping community.

Whilst, Ofgem would be concerned if this modification proposal were to result in shippers who are able to pay being prematurely or unnecessarily terminated from the network code, Ofgem does not consider that this will be the case. Termination may prevent further exposure but does not of itself do anything to reduce outstanding debt and, as recognized by one respondent, every opportunity should be given for a shipper to continue operating. Ofgem therefore welcomes the amendment to paragraph 2.9.1 of Section X, which allows that Transco *may* rather than *will* issue a termination notice and allows the EBCC to take full account of all relevant circumstances before instructions are given.

Ofgem considers that implementation of this proposal will facilitate competition by shippers, both in terms of allowing greater transparency and control of the risks associated with energy balancing, and in turn may generate efficiencies, for instance in allowing for lower costs of capital.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to direct Transco to implement this modification as Ofgem considers that it would better facilitate the achievement of the relevant objectives of Transco's network code, as outlined under amended standard condition 9 of its GT licence, and is consistent with statutory duties of the Authority. In particular, Ofgem considers that this proposal will facilitate competition between shippers. Without prejudice to the outcome of the abovementioned consultation, Ofgem also considers that implementation of this proposal would further the relevant objectives of the proposed UNC.

If you have any further questions regarding this letter please do not hesitate to contact me on the above number.

Yours sincerely,



Nick Simpson
Director, Modifications

³ Ofgem open letter: Gas distribution network sales – consultation on network code arrangements; 4 March 2005.