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Shippers, Transco and Other Interested Parties

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19 February 2004

Dear Colleague,

Modification proposal 0633 'Cessation of Invoicing for Terminated and Discontinued Users'

Ofgem has carefully considered the issues raised in modification proposal 0633 'Cessation of Invoicing for Terminated and Discontinued Users'. Ofgem has decided not to direct Transco to implement the modification, as we do not believe that it will better facilitate the achievement of the relevant objectives of Transco's network code.

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

Background to the proposal

Currently a shipper may exit from network code either as a result of it requesting voluntary discontinuance (section V.4.2), or as a result of a network code termination being effected by Transco (section V.4.3). In all situations Transco is expected to issue invoices for services consumed and collect monies due either from the shipper or insolvency practitioner, irrespective of whether termination has occurred.

In order to achieve voluntary discontinuance network code obligations include that the shipper does not have supply points registered to it, and that payment is made in full. In order to allow for invoice adjustments a shipper's payment position will not be final, and it is therefore unable to discontinue, until 18 months has elapsed from the date of the final invoice issued. The implication of this is that if, for example, Transco issues an adjustment to previous charging 17 months after the last invoice, another 18 months must elapse before the revised position can be deemed final.

Transco has indicated that it is difficult to quantify the average time to achieve voluntary discontinuance, as the period to meet the above requirements will vary dependent upon the

make and nature of the shipper's business. However, the maximum statutory period that could elapse before voluntary discontinuance is achieved is 6 years (Limitation Act 1980).

In respect of terminations, Transco can continue to levy (and amend) claims for up to 6 years, or in the case of an insolvent creditor until the insolvency practitioner declares the final dividend (Insolvency Act 1984). Transco has indicated that less than 1% of all insolvency cases have claims agreed within 18 months, with the average usually at around 2 years. Once declared, any dividend received is smeared back among the community.

Where amounts are unrecovered (whether billed or unbilled), in either situation, these are passed through the recovery mechanisms to shippers.

In comparison, electricity arrangements provide that after 14 months of the last supply point ceasing to be registered to the party they are entitled to resign from the code. There is a further 6 month period where 'post final disputes' can be raised and in these circumstances the party that has left may still receive a bill. If the party was not in administration/liquidation then it would be paid in the normal course of events, otherwise it would be submitted as a claim.

The modification proposal

The proposal is intended to facilitate the orderly exit of participants from the market, by enabling certainty to be achieved as to when Transco invoicing will cease. The proposal is intended to apply only in cases of a shipper being terminated from network code or requesting voluntary discontinuance, i.e. where the shipper is exiting the market and does not have any supply points registered, does not hold any capacity of any type and does not hold any open trading positions. It is not intended to impact in any way on the invoicing relationship between Transco and shippers in the ordinary course of business.

The proposal seeks to link the date of the invoicing position becoming final to the cessation of activity by the shipper and the change in network code user status, but with a minimum three month notice period. Given that shippers operate differently under the network code according to the nature of their business, there are two parts to this proposal:

(1) In the case of a shipper who has operated in the Non Daily Metered (NDM) market as well as the Daily Metered (DM) market, it is proposed that the invoicing position becomes final 18 months from the end of the month in which the last NDM supply point left the portfolio, the last capacity holding expired or the last trade was completed whichever is the later.

(2) In the case of a shipper who has operated exclusively in the DM market and/or as a trader, it is proposed that the invoicing position becomes final 6 months from the end of the month in which the last DM supply point left the portfolio, the last capacity holding expired or the last trade was completed whichever is the later.

This reflects the different treatment of reconciliation in the two markets.

Once a shipper has been terminated or requested voluntary discontinuance, Transco and the shipper will review the circumstances applicable to the shipper's portfolio(s) in the light of (1) and (2) above and the required minimum three month notice period proposed and confirm the invoice position completion date (IPCD). It is further proposed that as the IPCD will be known

in advance neither Transco nor the shipper should be able to raise any new disputes or queries in the final month leading to the IPCD to ensure Transco has time to process adjustments due.

The proposer believes that these periods should give Transco sufficient time to review invoices issued for accuracy and completeness and allow the terminating/discontinuing shipper enough time to complete validation and disputes of invoices levied. This would also allow sufficient time for adjustments to be issued. The proposal is intended to operate both ways, namely that as well as stopping invoices being issued, it would also prevent queries being raised by the shipper.

The proposer indicates that in view of the extensive periods factored in for review of the invoicing position and its validation, it believes that the vast majority of issues will be identified and resolved by both Transco and the shipper. Where adjustments become evident after closure, it is proposed that they would flow through the normal mechanisms for transportation and energy for unrecovered amounts. In this respect it should be noted that adjustments can be both debit and credit.

Respondents' views

There were six responses to this modification proposal of which one, the proposer, supports implementation, and five are opposed.

Those respondents who oppose implementation of this modification proposal raised the following:

Two respondents commented that the proposal attempts to restrict the statutory period of six years available to Transco to recover any charges from an insolvent user, to mitigate financial exposure on behalf of the community. A frequently highlighted concern was that the proposal would increase the risk for shippers who could be required to fund a share of any shortfall where Transco is unable to fully recover charges. It was highlighted that reconciliations occur well after the proposed 18 month period, and suggested that the risk and uncertainty of such exposure to the community is not in the interest of competition.

Three respondents suggested that a distinction needs to be drawn between network code terminations and voluntary market exit. In regard to terminations, it was stated that as only 1% of insolvencies are closed out within the proposed 18 month period it is difficult to see how this can be considered appropriate. In contrast, support was offered, in principle, for the introduction of measures to facilitate an orderly exit from the market for voluntary discontinuances.

One respondent highlighted the need for a review of current contractual arrangements, to improve the process for shippers voluntarily exiting the market, to lessen the administrative burden and accelerate the process. A further respondent indicated a preference for ensuring that any charges which may be due are collected and applied in a timelier manner for all shippers, indicating that this would also provide greater clarity for the rest of the community. Alternate proposals for enabling market exit, including varied timings of absolute close out of billing positions, and the issue of a bond to cover payments after exit were also advocated.

The respondent who supported implementation noted that whilst it is correct that either Transco

or the shipping community could ultimately bear some increased costs, Transco has not made explicit the likely amount of such charges. The respondent suggests that after 18 months both the probability of such charges occurring, and the amount to be redistributed if such an event did arise, would be small.

Transco's view

Transco does not support this modification proposal. Transco states that if this proposal were implemented, the shipping community and Transco would be disadvantaged. In the event of shipper insolvency, under the Insolvency Act 1984 Transco could continue to levy charges until the final dividend is declared. However, under this proposal Transco would be forced to close out much sooner, and any charges would be borne by Transco or the shipping community, and ultimately by consumers.

Only 1% of insolvencies are closed out within an 18 month period, and therefore Transco believes that it should continue to levy charges beyond this time as this would increase recoverable funds by way of increased dividends. The statutory period in which to lodge a claim against an insolvent user (subject to a final dividend declaration) is six years and Transco questions why it would support a contractual change to restrict this given its role to mitigate financial exposure on behalf of the community.

Transco is of the opinion that a distinction should be drawn between orderly exit from the market and insolvency. It considers that any measures that could be introduced to facilitate an orderly exit from the market (voluntary discontinuance) should be discussed as a topic at the Supply Point and Billing Workstream. Whilst Transco does not support any like consideration in instances of insolvency, it does support some of the views of the proposer and some shipper representatives at the Workstream in that there may be scope for development of the principles within the proposal in relation to voluntary discontinuance of a solvent user.

Ofgem's view

Although this proposal relates generally to the cessation of invoicing for shippers exiting the network code, Ofgem considers that termination and voluntary discontinuance from the network code involve distinct issues, which should be addressed separately.

Network Code Terminations

Where a shipper exits the market following the issue of a termination notice its conduct will no longer be regulated by the terms of the network code. In such a case, Transco is less likely to be able to effectively manage the risk of exposure to remaining shippers. Ofgem recognises that Transco's ability to manage such risk is limited to pursuing claims for up to 6 years, or in the case of an insolvent creditor, until the insolvency practitioner declares the final dividend.

As detailed in Ofgem's conclusions and proposals document; 'Arrangements for gas and electricity network operator credit cover' March 2002 (the credit cover document), one of the principles underlying the arrangements for credit cover is that credit arrangements should provide as secure and stable business environment as is reasonable. It was also highlighted that credit arrangements should be designed to moderate the impact of financial failure and should not increase the risk that it will occur.

In line with the above, network code credit arrangements should serve to protect signatories from the impact of terminations. However, by restricting Transco's ability to issue invoices for services consumed and collect monies due, this proposal would place it at a disadvantage in comparison to other creditors, and increase the risk to itself and remaining shippers of exposure to unrecovered amounts. Therefore, whilst the proposal might restrict the financial exposure of a terminated shipper, it would not moderate the impact on remaining network code signatories, and in the event of a significant exposure could potentially cause a 'domino effect' leading to supply disruption.

For the reasons outlined above, Ofgem does not consider that the proposal would better facilitate the achievement of the relevant objectives as outlined under Amended Standard Condition 9 of Transco's GT licence.

Voluntary discontinuance:

Ofgem recognises that current arrangements for voluntary discontinuance do not facilitate or incentivise shippers to exit the market in an orderly manner, due to the prolonged and uncertain time period to bring it into effect. Ofgem therefore has sympathy for the desire to improve the existing arrangements. Ofgem is therefore disappointed that, aside from setting out the existing network code requirements, review at the Supply Point and Billing Workstream has not progressed this issue.

Whilst recognising the risk of exposure to the community (as discussed above), Ofgem believes that, in addition to ensuring the clarity of arrangements, more could be done to facilitate network code voluntary discontinuances. Ofgem therefore believes that consideration could be given as to whether it would be possible to strike a balance between the needs of a voluntary discontinuing shipper, and the protection of remaining shippers. For example, analysis could be undertaken to determine whether there is an average point (or points depending on the portfolio type) after which claims are of marginal value, and thereby represent a minimal risk of exposure.

Ofgem's decision

For the reasons outlined above, Ofgem has decided not to consent to this modification, as we do not believe that it better facilitates the achievement of the relevant objectives as outlined under Amended Standard Condition 9 of Transco's GT licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'N. Simpson', written over a horizontal line.

Nick Simpson
Director of Industry Code Development