

OFGEM DECISION LETTER No. 0528

"Expand Definition of Restricted User to include other Licenced Parties"
Version 1.0

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Transco, Shippers and interested parties

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Dear Colleagues,

Modification proposal 0528 - 'Expand definition of Restricted User to include other Licensed Parties'

Ofgem has considered the issues raised in the Modification Proposal 0528 'Expand definition of Restricted User to include other Licensed Parties'. Ofgem has decided to direct Transco to implement the modification because we believe that this proposal will better facilitate the relevant objectives of Transco's Network Code.

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

Background

Section V.2.5.1 of the Network Code defines a 'Restricted User' under the Network Code. A person or body may only be admitted as a Restricted User of the Network Code if they have been designated by the Gas and Electricity Markets Authority (the Authority) or receive an Order from the Secretary of State declaring them as a Recognised Clearing House (RCH) for the purposes of the Financial Services Act 1986 (the Act).

Restricted User status can only be granted for the purposes of making trade nominations to Transco. If a person or body is not a signatory to the Network Code it cannot make trade nominations to Transco. Currently EnMO is designated as a Restricted User by the Authority for the purposes of providing the On-the-Day-Commodity-Market. Ofgem understands that the London Clearing House is currently the only RCH for the purposes of the Act.

Under the Act a body or person can be declared by an Order from the Secretary of State to be a Recognised Investment Exchange (RIE). An RIE is obliged to ensure that satisfactory arrangements are made for securing timely discharge of the rights and liabilities of the parties to transactions effected on its exchange. The Financial Services Authority (FSA) accepts that an RIE may satisfy this requirement either by making its own arrangements for clearing transactions or by appointing a RCH to

do so. Where an exchange conducts its own clearing arrangements it will be subject to FSA supervision equivalent in that respect to FSA supervision of RCHs.

The modification proposal

It is proposed that the Network Code be amended to change the current definition of a Restricted User to include any person or body that is declared by order of the Secretary of State to be a RIE for the purposes of the Act.

Respondent's views

Six responses were received to the proposal. Of the six, four supported the proposal and two did not.

The respondents who supported the proposal believed that it would promote the development of clearing services for Over-the-Counter gas trading by allowing new entry into the provision of this service. Respondents believed wider provision of such a service would promote liquidity, improve price transparency and reduce discriminatory trading, thereby improving competition in shipping and supply activities. Some of these benefits could be expected as a result of the greater security and anonymity provided by centrally cleared trades.

Two respondents did not support the proposal because they did not believe that the proposer of the modification had provided sufficient reasons why the proposal better facilitated the achievement of the relevant objectives of the Network Code in Condition 9 of Transco's gas transporters licence. The two respondents believed that the modification proposal had sufficient implications to warrant further discussions within a workstream.

Transco's views

Transco stated that it had no reason to object to the proposal as RIE and RCHs could be viewed as materially equivalent organisations. It understood that there is considerable overlap between the recognition requirements to meet and maintain the status of RIE or RCH with the FSA.

Transco noted that the shortened timetable for consultation on the modification proposal had been agreed by the Network Code modification panel, including shipper representatives.

Ofgem's view

Ofgem believes that expanding the definition of restricted user under the Network Code to include RIEs can be expected to facilitate the development of clearing services for OTC gas trades. The offering of such services can be expected to improve liquidity and price transparency in the traded markets, and may allow more efficient management of credit risks. These developments can be expected to better facilitate the securing of effective competition between shippers, which will ultimately benefit customers.

RIEs are regulated under the Act by the FSA, and the regulatory requirements are similar to those for a RCH. Therefore, it can be expected that any clearing services offered by RIE will be subject to appropriate FSA supervision.

Ofgem has also noted that the change to the proposed modification would more closely align the provisions of the Network Code regarding allowing clearing houses to be a party to the agreement with the provisions of the Balancing and Settlement Code in electricity.

Ofgem understands that the Network Code modification panel, including shipper representatives, voted unanimously to send the proposed modification for consultation and also voted unanimously for it to have a reduced consultation period.

Ofgem's decision

Ofgem has decided to direct Transco to implement the above modification proposal because we believe that it better facilitates the achievement of the relevant objectives of the Network Code under Condition 9 of Transco's gas transporters licence. In particular, we believe that the proposal will better secure effective competition between shippers.

Ofgem expects Transco to implement the modification immediately.

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

Nick Simpson
Director, Industry Codes