

Modification Report
Application of Charges consistent with Late Payment of Commercial Debts
(interest) Act 1998
Modification Reference Number 0026
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 is one of a number of Proposals which seek to implement recommendations 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 elements of recommendations detailed within paragraphs 3.53 to 3.57 of the conclusion document.

UNC Section S3.1 details the invoice payment terms to which Users are obliged to adhere. UNC Section S3.5 makes provision for Transporters to charge interest where any amount payable under an Invoice is not paid on or before the Invoice Due Date. The "Applicable Interest Rate" at which interest will be applied if payment is not made in accordance with UNC Sections S3.1 and S3.5 is detailed within UNC Section S3.6. At present this "Applicable Interest Rate" is the base rate of Barclays Bank plc plus three percentage rates per annum.

Ofgem's document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05 paper identifies that a User be penalised if it fails to pay in accordance with the UNC. The application of interest for late payment is intended to be a deterrent and the Consultation concludes that the existing rate of interest as defined in UNC Section S3.6 is not at a sufficient level to be an effective deterrent to all Users. This is because it may be more economic for Users to incur an interest charge from the Transporter than to loan funds from a bank or other financial body and pay the invoice on its payment due date.

It is proposed that the 'Applicable Interest Rate' be amended to reflect the rate contained within the Application of the Late Payment of Commercial Debts (Interest) Act 1998 being at a rate equal to the Bank of England base interest rate plus eight percentage points per annum. Transco believes that this would act as an incentive to ensure that payments are made in accordance with prevailing contracts. This rate is calculated by adding 8 percentage points to the reference rate, which is the Bank of England base rate on 30 June and 31 December each year. This rate is applicable for the following six-month periods i.e. 1 July to 31 December and 1 January to 30 June respectively.

It is also proposed that the Transporter will charge a fee to cover the additional administration that late payment incurs. The Late Payment of Commercial Debts (Interest) act 1998 permits a creditor to recover compensation as follows:

Size of the late paid debt	Value of Compensation that can be claimed
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

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

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.

WWU also concluded that *“the proposal facilitates the relevant objective of securing effective competition between Relevant Shippers”*.

UKD also believes that *“incorporation of credit arrangements within the Uniform Network Code that oblige Transporters to implement consistent rules would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers”*.

TGP and TEP believe that the proposal *“promotes the Transporters ability to operate the network in an efficient and economic manner and so fulfills the relevant objectives of licence condition A11”*.

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

No such implications on security of supply or operation of the Total System have been identified. Incorporating credit rules within the UNC may help to reduce the impacts of industry fragmentation.

TGP and TEP concurred that a *“common set of rules, which apply to all Users, will reduce the effects of industry fragmentation and ensure consistency across the network”*.

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:

The proposer has suggested that any costs would be minimal.

WWU commented that “*costs of implementation are likely to be negligible*”.

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 such consequences are anticipated.

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.

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 either Transporters or Users.

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

The incentive for prompt payment may increase costs for some Users and would thereby potentially increase Users’ level of contractual risk.

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 are anticipated

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.

Disadvantages

- Potentially increases some Users’ costs through application of a penal interest rate.

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

Eleven representations (from the following) were received with respect to this Modification Proposal. Seven parties support implementation, two parties offered qualified support and two parties oppose implementation.

<u>Organisation</u>	<u>Abbreviation</u>	<u>Position</u>
Wales & West Utilities	WWU	Support
Transco UKD	UKD	Support
Transco UKT	UKT	Qualified Support
Scotia Gas Networks	SGN	Support
Northern Gas Networks	NGN	Support
British Gas Trading	BGT	Support
RWE npower	RWE	Oppose
Total Gas & Power	TGP	Support
Total E&P	TEP	Support
Regent	REG	Oppose
E.ON	EON	Qualified Support

WWU commented that the proposal is “*consistent with Ofgem’s conclusions... administration charges are reasonable and the interest charge is accepted as a being at a level which would act as a deterrent to Users from running up debts*”.

UKD identified that “*the current level of interest payable by Users...are at an insufficient level to provide an effective incentive for timely settlement. Transco concurs with the view expressed within Ofgem’s Conclusions Document which recommends application of an interest rate and administration charge consistent with the Late Payment of Commercial Debts (Interest) Act 1998*”.

UKT stated that the proposal “*reflects the recommendations of Ofgem’s ‘Best Practices Guidelines’...an interest rate at 8% above base is set at a sufficient level to incentivise Users not to delay payments*” and added that “*such measures introduce robust procedures and best practice...that may minimise the impact that User failure may have on the industry...*” by “*...providing greater confidence within the industry in respect of mitigation from exposure to credit risk*”.

SGN believes “*the rate proposed for late payment it appropriate and should act as a reasonable deterrent to late payment*”.

BGT highlighted that the “*intent of this rate escalator is to serve as an incentive to pay on time and not to use this industry settlement process as a form of credit ...this rate could be judged as a relatively attractive option for short-term credit*”. BGT suggested that “*it could be asserted that this rate is penal...we believe that*

Users have every opportunity to avoid payment of this rate and it cannot be considered as a penalty but providing a much stronger incentive than exists at present”.

RWE stated that “*there are aspects of the legal drafting which mean that we can not support the proposal”.*

Confirming the aspects, RWE commented “*...the title of the Act is incorrect in the proposed paragraph 3.6.5. It is quoted as the "Late Payment of Commercial Debts (Interest) Debts Act 1998." When it should be the "Late Payment of Commercial Debts (Interest) Act 1998”*”.

A further aspect was highlighted as “*current paragraph 3.6.4 states:*

The Applicable Interest Rate shall be the base rate for the time being of Barclays Bank PLC plus:
(a) except as provided in paragraph 0, three (3) percentage points per annum;
and
(b) for the purposes only of paragraphs 1.5.4(a) (ii), 4.2.5 and 4.3.2., or where otherwise expressly provided in the Code one (1) percentage point per annum.

The purposes of clause b is to allow bona fide invoice disputes or challenges ... So that if the dispute is not found to be valid then the User would currently pay interest on the unpaid monies at Base Rate +1%. If the invoice is paid and a subsequent dispute is found to be valid then the Transporter pays interest on the unpaid monies at Base Rate +1%. Thus neither side is vulnerable to overly high interest rates. The wording of the proposed clause 3.6.4 [has] no mention of exceptions for paragraphs 1.5.4(a) (ii), 4.2.5 and 4.3.2”. RWE suggested that this “*may have the perverse effect of encouraging Users, where they are very confident of their challenge, to pay the full amount and then dispute it so that they can earn high levels of interest”.*

Following consultation with the Proposer, it confirms that it did not intend for the provisions under TPD S3.6.4(b) to be removed and therefore recommends that the legal text reflects the following:

Paragraph 3.6.4 shall be deleted and replaced with the following:

3.6.4 The Applicable Interest Rate shall be:

- (a) except as provided in paragraph (b), the rate of interest set for the relevant period as the statutory interest rate for the purposes of the Late Payment of Commercial Debts (Interest) Act 1998; or
- (b) for the purposes only of paragraphs 1.5.4(a)(ii), 4.2.5 and 4.3.2, or where otherwise expressly provided in the Code, the base rate for the time being of Barclays Bank PLC plus one (1) percentage point per annum.

Add new paragraph 3.6.5 as follows:

If the Applicable Interest Rate (pursuant to paragraph 3.6.4(a)) is exercised then the creditor shall be entitled to recover compensation from the debtor to the value according to the provisions of the Late Payment of Commercial Debts (Interest) Act 1998.

Finally, RWE highlighted *“three issues...with the level of fixed charge that the creditor may recover...first ...the wording "the creditor shall be entitled"...This is discriminatory...second...it is unclear how a creditor, if that creditor were a User rather than a Transporter, would raise a fixed charge and interest invoice... third...it is not clear how the Transporter will treat the situation where several invoices are due but all or some are paid late. Would this be dealt with one compensation charge or multiple compensation charges?”*

Having discussed this issue with the Proposer, it has confirmed that it wishes to retain the discretionary element of the application of charges for late payment. In respect of the second question, the proposer confirmed that in respect of amounts payable to Users by Transco, it will issue the appropriate credit amounts (as currently occurs in respect late paid amounts due to a User). In respect of the third question, the proposer has confirmed that in respect of charges levied by Transco, it will levy one compensation charge per late paid invoice.

TGP and TEP stated that an *“8% shortfall charge is an appropriate incentive to ensure that Users pay outstanding bills”*.

REG believe that *“Transco already has other remedies...These include late interest charges of 3% over base...sanctions against shippers for late payment of invoices with value greater than £10,000-00...[and]...requires credit to be placed...which covers more than 100% of any invoice”*. REG stated that *“Delays may be caused by genuine administrative difficulties (eg staff being sick, on holidays etc)... these charges and higher interest...would cause an unfair financial burden”* and that *“as a small shipper, we received 175 invoices from transco in 2004/05. 55%... were below £1,000 and 35%...less than £100...applying £40-00 surcharge...will be very severe”*. In summary REG contend that *“The Act does not need to be applied if there are other remedies in place...Transco has sufficient powers to make shippers comply...additional remedies appear draconian and unnecessary”*.

EON commented that *“Users should be subject to appropriate incentives...however we are concerned that Base Rate plus 8% per annum may be considered penal”* and added that *“Late payments often tend to be administrative...There is no evidence that this level of charge will reduce the number of late payments”*.

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 were this Modification proposal to be implemented.

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

In light of the works required to implement, the Proposer suggests that a lead-time of one calendar month will be required for implementation of the Modification Proposal 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 20 October 2005, of the 9 Voting Members present, capable of casting 10 votes, 9 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

**UNIFORM NETWORK CODE - TRANSPORTATION PRINCIPAL
DOCUMENT**

Section S: INVOICING AND PAYMENT

Paragraph 3.6.4 shall be deleted and replaced with the following:

3.6.4 The Applicable Interest Rate shall be:

- (a) except as provided in paragraph (b), the rate of interest set for the relevant period as the statutory interest rate for the purposes of the Late Payment of Commercial Debts (Interest) Act 1998; or
- (b) for the purposes only of paragraphs 1.5.4(a)(ii), 4.2.5 and 4.3.2, or where otherwise expressly provided in the Code, the base rate for the time being of Barclays Bank PLC plus one (1) percentage point per annum.

Add new paragraph 3.6.5 as follows:

If the Applicable Interest Rate (pursuant to paragraph 3.6.4(a)) is exercised then the creditor shall be entitled to recover compensation from the debtor to the value according to the provisions of the Late Payment of Commercial Debts (Interest) Act 1998.

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 :