

The Joint Office, Transporters, Shippers and other
interested parties

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24 November 2005

Dear Colleague,

Uniform Network Code modification proposals 0027: 'Right of Set Off under Uniform Network Code'

Having considered the issues arising from this proposal Ofgem¹ has decided not to direct the implement the modification, as Ofgem does not believe that it will better facilitate the achievement of the relevant objectives of the Uniform Network Code (UNC), as set out in standard special condition A11² of relevant Gas Transporters Licences. This letter explains the background to the modification proposal and outlines the reasons for Ofgem's decision.

Background to the proposals

In February 2005 Ofgem published its conclusions³ on best practice guidelines for gas and electricity Network Operator (NWO) credit cover. The conclusions document indicated that appropriate changes would need to be brought forward by parties to industry codes in order to arrive at credit cover arrangements consistent with the best practice guidelines.

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 evidence demonstrates that the net position is usually that a User owes the Transporter more than the Transporter owes to the User.

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

² This Licence Condition can be viewed at: http://62.173.69.60/document_fetch.php?documentid=6547

³ This can be found on the Ofgem website at:
http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf?wtfrom=/ofgem/work/index.jsp§ion=/areasofwork/creditcover

Currently UNC section S3.3 does not permit set off.

The modification proposal

This proposal seeks to implement recommendations detailed within paragraph 3.49 of the conclusions document.

It is proposed that the UNC be modified to permit the offset of User credit amounts against User debit amounts (in respect of Transportation services). The right of set off would only be available where:

- The relevant Transporter was the same party in respect of both the credit and debit amounts; and
- The relevant User was the same party in respect of both the credit and debit amounts.

Where the Transporter elects to undertake such a set off, it is proposed that:

- The Transporter will issue a 'set off notice' to the User prior to the invoice due date of the earliest invoice within the set off 'group' of invoice items, except in instances where a User is in breach of section S3.1
- The 'set off notice' will specify the invoice items payable by the Transporter which are being set off against the specified invoice items payable by the User
- In the event that a User registers a valid invoice query (and consequently withholds the amount payable) in respect of an invoice within the set off 'group', the Transporter will undertake investigation as to whether the amount due to the User can be set off against an alternative amount due to the Transporter. If no such suitable invoice item is available, the Transporter will pay such amount to the User.

Respondents' views⁴

There were eleven responses to this modification proposal, of which four offered support, two offered qualified support, and five were opposed to its implementation.

Comments in support of the proposal included that it would realise tangible benefits of administrative efficiency. It was also stated that the proposal would result in reduction of overall User indebtedness and therefore reduction of User credit security utilisation. More generally, it was noted that the incorporation of terms within the UNC would result in implementation of consistent rules, ensuring that there is no inappropriate discrimination or barrier to entry. Two of the above respondents also stated that the proposal would facilitate the securing of effective competition between relevant Users.

Whilst noting that the proposal would promote Transporters' ability to operate their networks in an efficient and economic manner, two respondents offered qualified support, on the basis that this would be outweighed by the implementation costs for some Users.

⁴ This section is intended to summarise the principal themes of the respondents' views and is not intended to provide a comprehensive overview of the responses received. These can be found on the Gas Transporters information service (formally known as Nemysis) <https://gtis.gasgovernance.com>

A key concern of respondents who opposed implementation was the potential for significant implementation costs to be incurred. One respondent, who believed that a cost-benefit analysis should be carried out, indicated that it is currently difficult to form a view on whether the proposal better facilitates the relevant objectives. Although agreeing with the premise of the proposal, three of the above expressed preference for arrangements to also be elective for Users.

Panel Recommendation

At the modification panel meeting held on 20 October 2005, of the 9 voting members present, capable of casting 10 votes, 5 votes were cast in favour of implementing this modification proposal. Therefore, the panel recommend non-implementation of this proposal⁵.

Ofgem's view

Ofgem considers the relevant objectives pertinent to this proposal to be (a) the efficient and economic operation of the pipe-line system, and (d) the securing of effective competition between relevant shippers.

In respect of payment terms, Ofgem indicated in the conclusions document its belief that moves should be made toward any reasonable improvements in efficiency, including rights of set off under codes. In this respect, Ofgem notes that the proposal has the potential to reduce Transporter and User costs and therefore to facilitate the efficient and economic operation of the pipe-line system.

However, Ofgem shares the concern articulated by some respondents regarding the potential costs of implementation as a result of systems changes required by this proposal. Furthermore, whilst this proposal would incorporate provisions into the UNC, in principle providing visibility to Users, in practice, the elective nature of the proposal (on the part of Transporters) could result in differing arrangements across networks. This, in turn, would impede the ability of both new entrants and existing participants to familiarise themselves with market rules and efficiently arrange their businesses. It is not clear whether the potential benefits of these arrangements would outweigh the costs of implementation which are imposed on Users. Accordingly, Ofgem considers that this proposal may impact on the ability of some Users to act as efficient operators and consequently be detrimental to competition.

Ofgem considers that while the proposal may contribute to the efficient and economic operation of the pipe-line system, the detrimental effect on Users may outweigh this benefit. As a result Ofgem is unable to conclude that overall this proposal will better facilitate the relevant objectives. Ofgem also notes that the question of imposed costs on Users would be removed by allowing Users to elect whether to take advantage of these arrangements. Going forward, it remains open to parties to the UNC to bring forward further modification proposals.

⁵ A Panel recommendation requires a majority vote from voting members at a quorate meeting of the Modification Panel. Paragraph 9.5.5 of the Modification Rules currently provides that where there are an equal number of votes in favour and not in favour of implementation, the Modification Panel is deemed to have recommended non-implementation.

Ofgem's decision

For the reasons outlined above, Ofgem has decided not to direct the implementation of this modification, as Ofgem does not believe that it will better facilitate the achievement of the relevant objectives of the UNC, as set out in standard special condition A11 of relevant Gas Transporters Licences.

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 'Nick Simpson', with a horizontal line underneath.

Nick Simpson
Director, Modifications