ofgem

Modification proposal:	**Uniform Network Code (UNC) 0111: Management of Users Approaching and exceeding Upper Limits of Credit Limit**		
Decision:	**The Authority[1] has decided to reject this proposal**		
Target audience:	**The Joint Office, Parties to the UNC and other interested parties**		
Date of publication:	**26 January 2007**	Implementation Date:	**N/A**

Background to the modification proposal

In February 2003 Ofgem published a conclusion and proposal document[2] which set out the high level principles that should be applied to credit cover arrangements with respect to the use of the gas transportation system. In September 2004 a further consultation document[3] was published recommending that a number of workgroups identify best practices in comparable industries and to develop best practice guidelines for gas and electricity network operator credit cover arrangements.

In February 2005 Ofgem published the best practice guidelines[4] in which Ofgem stated that it expects network operators (gas and electricity) and their counter parties to take steps to bring their credit arrangements into line with the approach set out in this document. Consequently the development of appropriate credit cover arrangements for network operators has been subject to considerable debate by Ofgem and the industry.

The modification proposal

The modification proposal seeks to make a number changes to various elements of the credit arrangements provisions as set out in the Uniform Network Code (UNC).

Currently each system user has a credit limit assigned to it by the Transporter. When a user's indebtedness reaches 70% of that credit limit the Transporter will issue a notice which will alert the User to its level of indebtedness. A further notice is issued when the user reaches the 85% indebtedness which will also enable the Transporter to make cash calls. The modification proposes to remove the current two notice requirements and only issue a single notice where indebtedness reaches 80%.

The proposal also seeks to add a further measure to manage the scenario where the User's indebtedness exceeds 100% of their credit limit. The User will be issued a notice requiring that one business day after reaching this limit the User will be required to secure additional security within two Business Days to bring the indebtedness to below 100%. Where additional security is not obtained until after two business days, the

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] Arrangements for gas and electricity network operator credit cover: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/1836_14feb03.pdf
[3] Recommendations for best practice guidelines for gas and electricity network operator credit cover: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/8795_22604.pdf

[4] Best practice guidelines for gas and electricity network operator credit cover: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf

additional security provided must be enough to reduce the level of indebtedness to 80% of the User's credit limit and remain at that level for the following 12 months.

In addition the proposal also seeks to include provisions concerning remedies for instances where the User fails to provide additional security following a notice issued by the Transporter. The Transporter will be able to claim liquidated damages in line with the Late Payment of Commercial Debts (interest) Act 1998 based on the value of the additional security outstanding.

Finally the proposal seeks to introduce a period of one month's grace to allow the user to post additional security where a material change to the User's trade is detected as a consequence of an increase in the relevant Transporter's transportation charges.

UNC Panel[5] recommendation

The panel did not recommend implementing this proposal. Of the 9 voting members present, capable of casting 10 votes, 2 votes were cast in favour of implementing this modification.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 22 December 2006. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR[6]. The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC[7].

Reasons for the Authority's decision

Section V3 of the UNC establishes that each Transporter will, in accordance with the Code Credit Rules determine and assign to each User a Code Credit Limit (CCL). This CCL represents the maximum Relevant Code Indebtedness (RCI) that the Transporter will extend to the relevant User. The RCI is the total amount for which, at any point in time the User actually owes to the Transporter whether this amount has been billed or not. The CCL is the amount a User will need to secure.

This modification proposal introduces measures to mitigate the financial risk to Transporters of Users that are approaching or that have exceeded their CCL.

Currently when the User reaches RCI levels that represents 70% and 85% of the CCL the Transporter will issue a Notice to make the User aware of their RCI with a view that the User will undertake the necessary mitigating action to ensure that their RCI remains below 100% of the CCL. This proposal seeks to replace these two trigger points with a single Notice trigger point of 80%.

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[5] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[6] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com
[7] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://62.173.69.60/document_fetch.php?documentid=6547

In addition where a User breaches 100% of their agreed CCL the Transporter will issue a Notice that will require the User to secure additional security within two Business days that would bring the User's RCI below 100% of the CCL.

Considering these proposed measures it could be assumed that both actions would better facilitate the relevant objective of the code as they would promote administrative efficiencies and would allow the User to utilise 100% of its CCL thus affording the User maximum trading power.

However it is Ofgem's view that the current CCL methodology requires the User to over collateralise by having to secure credit that is equivalent to the CCL, i.e. the maximum possible level of indebtedness. Ofgem notes that in its consultation document it was suggested that the level of collateralisation which the User should secure was the value of billed but unpaid charges (assuming a monthly billing period), augmented by an amount equal to charges for a further 15 days' usage (based on the same daily rate implicit in billed charges), as this would provide a rough proxy for the time-weighted average of such charges arising within a billing cycle.

Ofgem is of the view that this level of collateralisation is the most reasonable level required to be secured by the User to provide an environment whereby the User is able to trade with a monopoly provider and provide the Transporter with a reasonable level of risk to mitigate against.

In the credit best practice guidelines Ofgem stated that the Transporter should assess a User's VAR everyday and where the User's aggregate VAR exceeds 100% of their credit limit then the Transporter should take the appropriate remedial action.

To the extent that the proposed trigger point is in line with our best practice guidelines and therefore would seem to better facilitate the relevant objectives this improvement is marginal when compared to the more fundamental issue of over collateralisation as discussed above.

Further as the concept of VAR has not been introduced, the two remaining measures as outlined in the proposal, which are both predicated on the concept of VAR, cannot take effect[8]. On this basis, the proposal can not be implemented.

Ofgem considers that this proposal could have benefited considerably from going through the development process where industry experts would have had the opportunity discuss the issues raised in this decision letter along with any other inconsistencies that may have been raised in the other credit related modifications proposals that had been presented to Ofgem.

Sarah Harrision
Managing Director, Corporate Affairs
Signed on behalf of the Authority and authorised for that purpose.

[8] See Ofgem decision for modification UNC 114