

Modification proposal:	Uniform Network Code (UNC): Reduction of lapse periods in respect of failure notices issued in respect of energy balancing credit (UNC143)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	04 October 2007	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

Section X of the UNC details the powers and obligations through which National Grid NTS (NTS) and the Energy Balancing Credit Committee (EBCC) may limit Users' liability for energy balancing debt.

Following the termination of two Users during the winter of 2005/06 the EBCC carried out a review of events with a view to identifying areas where controls could be tightened in order to reduce future exposure to financial loss. This review resulted in a modification proposal, UNC102 'Removal of failure notices in respect of Energy Balancing Credit', that sought to mitigate the exposure of the market to bad debt for balancing charges by allowing a User to be terminated from the UNC more quickly where it had not paid its liabilities. This acceleration of timescales would have been delivered by removing steps to notify the User that it had failed to comply with the code and that a termination notice might be issued to it if this infraction was not corrected within defined timescales.

We rejected the proposal³, noting that *'we do not consider that a User should be exposed to [termination from the code] without being notified that this step is being considered. Such an approach may deny it the right to put its case if the infraction is disputed [...] UNC102 would introduce the risk that a prudent operator(s) could be expelled from the code⁴.*

Our decision went on to highlight that *'taken in isolation, we are sympathetic to [the acceleration of the timetable before termination may be considered], and a proposal that seeks to deliver this whilst providing appropriate safeguards to Users may present a more persuasive case for approval'.*

The modification proposal

UNC143 seeks to build on the principal concept enshrined in UNC102 – reducing the time lag before a termination notice may be issued to a bad debtor in order to prevent the further escalation of its debts – but uses a different method to achieve this aim.

UNC102 sought to accelerate the timetable by completely removing notifications to the User that it had failed to make payment on time and that a termination notice might be issued if it has not corrected this situation within a further defined period. UNC143 retains these notifications to the User, but instead heavily curtails the defined period

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 This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Our decision letter is available on our website [here](#).

⁴ This quote, and the one in the following paragraph, is extracted from page 3 of our UNC102 decision.

within which the User may correct the default (from seven business days to one for Failure to Supply Further Security Notices, and from five business days to one business day for failure to pay Energy Balancing Invoices).

Put simply, both UNC102 and UNC143 would accelerate the timetable before a termination notice may be issued against a bad debtor but only the latter would ensure that the affected User was aware that this step was being considered.

UNC Panel⁵ recommendation

The Modification Panel unanimously recommended implementation of this proposal at its meeting held on 21 June 2007.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 21 June 2007. 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 FMR⁶. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁷; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁸.

Reasons for the Authority's decision

We note that all of the respondents to the consultation on this proposal supported its implementation.

We consider that UNC143 will better facilitate the applicable code objectives and furthermore that a direction to implement it would be consistent with our wider statutory duties. We consider that the most relevant code objectives are (a) (efficient and economic pipeline operation), (d) (competition) and (f) (efficiency in the implementation and administration of the code).

We note, and agree with, the comments of one respondent in relation to the need for the code to be clear on whether the issuance of a termination notice is mandatory or discretionary.

Applicable objective (a) – the efficient and economic operation of the pipe-line system to which the Gas Transporter's licence relates

An argument has been made that UNC143 would either reduce the extent by which a User would be out-of-balance on the days following the issue of a Failure to Pay Cash Call

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://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

⁸ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Notice, or would reduce the period over which a User that is unable to balance its portfolio is able to continue to participate in the market. It is contended that these outcomes would reduce the extent and/or duration of NTS actions as the residual system balancer and hence facilitate the efficient and economic operation of the pipeline system (objective a).

Insofar as expelling a User who is not in balance from the code removes the requirement for the system operator to solve the consequences of its imbalances then we agree there may be a reduction in the extent and/or duration of NTS actions as the residual system balancer. The extent of this reduction may be hard to quantify as it is somewhat dependent on whether the User remained in imbalance and the overall direction in which the system is imbalance. But in principle, the removal of the need for NTS to take balancing actions in relation to a failing User should facilitate the efficient and economic operation of the pipeline system.

Applicable Objective (d) – the securing of effective competition

It has been contended that the proposal would limit the risk of financial loss to shippers resulting from the operation of the energy balancing mechanism, mitigating the socialisation of avoidable financial loss. It was argued that reducing this risk of financial loss would help to facilitate effective competition between Shippers.

We agree that allowing a more rapid consideration of termination steps against a non-paying User will help to prevent the escalation of bad debt for energy balancing charges. Because these debts may be socialised amongst other Shippers if not recovered from the debtor, this proposal would mitigate the exposure of Shippers to the financial consequences of failures by other participants whose actions they have no control over. The reduction in potential exposure to bad debts should also alleviate some of the risk that these debts may cause knock-on failures among other Shippers. The overall reduction in risk should aid Shipper confidence in participating in the market and will therefore help to secure effective competition.

Applicable Objective (f) – promotion of efficiency in the implementation and administration of the network code and/or uniform network code

It is argued that the implementation of these proposals would help to ensure that robust procedures and best practice measures are in place to minimise the impact on the industry of User failure, therefore promoting efficiency in the implementation and administration of the code.

We agree that the proposal will help to minimise the impact on the industry of User failure. It will additionally sharpen incentives for the prompt payment of invoices. Such outcomes should promote the efficient implementation and administration of the code.

National Grid Distribution (NGD), commenting on the suggested legal text provided as part of the proposal, highlighted that there was some inconsistency in terms that could lead to confusion in whether a termination notice will be issued or not where an Energy Balancing Invoice had not been paid in full on the Invoice Due Date. In notifications to the affected User (code clause X3.2.1), they would be told that they 'will' be given a Termination Notice if they have not made payment of the outstanding amount by the following Business Day. The use of 'will' suggests a guaranteed outcome, but subsequent paragraphs back away from suggesting this step is guaranteed, instead suggesting that it is an optional outcome (code clause X3.2.2 suggests that NTS 'may' give a Termination

Notice, whilst X3.2.5 states that NTS will consult with the EBCC 'to determine whether National Grid NTS should be obliged to issue the Termination Notice [...] or whether National Grid NTS should defer taking such step). NGD noted that UNC102 had sought to remove this inconsistency in terms⁹.

We agree that inconsistency in terminology is undesirable, particularly in such a material area of the code. Unfortunately the inconsistency highlighted by NGD remains in the final legal text. We consider that UNC143 is "neutral" to this inconsistency in terminology because it neither introduces nor corrects it. It may however be appropriate for this disparity to be removed in the future. This is particularly important because the flexibility given by X3.2.2 and 3.2.5 are important in establishing that EBCC has some discretion in deciding whether Termination Notices should be issued. This discretion forms an important safeguard to the industry in ensuring that the response to late payments can be proportionate, and that the risk of precipitous actions is reduced. The references to 'will' in other provisions may impede understanding of this.

More generally, we wish to reiterate the concern that we expressed in our decision letter for UNC102 that, unlike in the electricity balancing market, there is no code requirement to consult with the Authority before a signatory is issued with a termination notice. Whilst we consider that the EBCC has established a decent track record of acting responsibly and independently, it must be noted that there is an inherent risk of conflicts of interest in a framework whereby decisions that may precipitate the market exit of one participant can be taken by a committee comprising employees of rival market participants without any reference to a neutral arbiter. However, we also consider may itself increase the incentives on signatories to ensure prompt payment.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC143: '*Reduction of lapse periods in respect of Failure Notices issued in respect of Energy Balancing Credit*' be made.



Mark Feather

Associate Director, Industry Codes and Licensing

Signed on behalf of the Authority and authorised for that purpose.

⁹ By replacing the 'will' in X3.2.1 with 'may'.