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Direct Dial: 020-7901-7355

19 July 2006

The Joint Office, Transporters,
Shippers and other interested parties

Our Ref: NET/COD/MOD/0076

Dear Colleague,

Notice and Direction in relation to Uniform Network Code (UNC) modification proposal 0076: "Right of Set Off under Uniform Network Code".

The Gas and Electricity Markets Authority (the "Authority"¹) has considered the issues raised in the modification report² in respect of modification proposal 0076: "Right of Set Off under Uniform Network Code"

The UNC Modification Panel (the Panel) recommended to the Authority that modification proposal 0076 should be implemented.

Having considered the modification report and the Panel's recommendation, as well as having regard to the Relevant UNC Objectives³ and Ofgem's wider statutory duties⁴, the Authority has decided to direct a modification to the UNC in line with modification proposal 0076.

This letter explains the background to the modification proposal and sets out the Authority's reasons for its decision. This letter constitutes notice by the Authority under section 38A of the Gas Act 1986.

Background

In February 2005 Ofgem published "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover – Conclusions Document"⁵ following extensive industry consultation. This indicated that appropriate changes would need to be brought forward

¹ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² This report can be found on the Gas Transporters Information Service at : <https://gtis.gasgovernance.com>

³ The Relevant UNC Objectives are contained in Standard Special Condition A11 of the Gas Transporters Licence and can be viewed at: <http://62.173.69.60/document> fetch.php?documentid=6547

⁴ Ofgem's statutory duties are wider than the matters that the Panel must take into consideration and are explained in sections 4AA – 4B of the Gas Act 1986.

⁵ This can be found at http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf

by parties to industry codes in order to arrive at credit cover arrangements consistent with the best practice guidelines set out in the document. One of the changes seen as appropriate was that Network Operators should have rights of set off under the UNC (paragraph 3.49)

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 for a monthly billing cycle the net position is usually that the User is in debt to the Transporter.

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

The modification proposal

It is proposed that the UNC be modified to permit the Transporter to offset 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, and
- The relevant User is in breach of the relevant payment terms, or has agreed with the Transporter the set-off of the relevant amounts.

In respect of the set-off:

- The Transporter would issue a 'set-off notice' to the Users in instances where a User is in breach UNC section S3.1,
- The 'set-off notice' would specify the relevant invoice payable (or, if applicable the unpaid overdue invoice) by the User and the invoice payable by the Transporter which is being set off on or before the invoice due date.

The Proposer views

The proposer suggested that the measures identified within 0076 further the Relevant UNC Objective of facilitating the efficient and economic operation by the licensee of its pipe-line system by ensuring that robust procedures and best practice measures are in place to minimise the impact on the industry of User failure. The proposer also suggested that implementation of 0076 would represent a reasonable efficiency improvement in respect of the making of payments and that this was consistent with the Relevant UNC Objective of the promotion of efficiency in the implementation and administration of the Network Code and/or the Uniform Network Code.

Respondents' views

There were nine responses to the consultation in respect of modification proposal 0076 modification proposal, of which eight supported the modification with another respondent offering qualified support. A number of respondents commented that they believed the modification had the potential to reduce administrative costs. Other comments in favour

of the implementation of the modification included that the amendment had the potential to reduce User indebtedness, although one party commented that as the credits paid from Transporters to Users are relatively small compared to the amounts owed by Users, this benefit may be minimal. A common theme within the responses was that as (in general) the activation of the offset mechanism is elective for both Transporters and Users, there is no risk of costs being imposed on Users. This reason was key to a number of respondents offering their support to the amendment.

Some parties expressed a concern that as 0076 would enable Transporters to choose whether or not to utilise the set-off mechanism it may not be consistently implemented by transporters which could cause Users to incur additional costs as a result of having to deal with different arrangements on different networks. Other concerns raised included that the proposal did not identify how far in advance of the payment due date the off-set notice would be issued and therefore it was not clear how long a User had to rearrange any payment schedules. Another question raised was whether the Invoice Due Date is defined by the date of the credit or debit invoices, as the answer to this question could lead to late payment charges being triggered under the UNC Rules.

The respondents' views are summarised in the modification report which can be found on the Gas Transporters information website⁶ along with the full text of the responses made.

UNC Modification Panel's recommendation

The Panel recommended to the Authority that the modification proposal should be implemented.

Ofgem's view

Having considered the modification report and having had regard to the Relevant UNC Objectives and Ofgem's statutory duties, we have decided to direct that the modification be made.

This section sets out the reasons for the Authority's decision in the context of its assessment of the modification proposal against the relevant objectives, in particular objective (d) and (f) and the Authority's wider statutory duties.

We consider that allowing a right of set off in the circumstances outlined in the modification report constitutes recognition of commercial best practice and business efficiency in accordance with objective (f). Further, requiring agreement of the User (under normal circumstances) before activation of the code's set off provisions constitutes a further safeguard to ensure the use of these provisions only where they are beneficial to both parties.

Ofgem notes that the modification proposal retains the ability of Transporters to impose the effects of the set-off provisions in the event that a User is in breach of the relevant payment terms. We recognise that imposing these terms could have cost implications on parties, but consider that these costs can be avoided by adhering to the payment terms set out in the UNC. Incentivising timely payments in this way we consider further secures

⁶ <https://gtis.gasgovernance.com>

the efficient implementation and administration of the code arrangements facilitating objective (f).

Whilst the modification proposal is likely to better facilitate the achievement of Relevant UNC Objective (d) by improving efficiency and facilitating new entrants, we share the concerns raised during consultation which suggested that as the utilisation of the off-set mechanism required the agreement of the Transporter, the modification proposal could lead to differing arrangements across networks and between Users. Ofgem does not consider that this risk outweighs the benefits to competition and efficiency that the proposal delivers. Ofgem notes that the modification process provides a mechanism for parties to make such refinements to the arrangements as they think appropriate according to the Relevant UNC objectives.

The Authority's Direction

For the reasons set out above, the Authority directs National Grid Gas plc (NGG) to make the modification as set out in the modification report in accordance with Condition A11.15(b) of NGG's Transportation Licence.

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 'N. Simpson', written over a horizontal line.

Nick Simpson
Director, Modifications

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