

Direct Dial: 0207-901-7433
9 November 2001

Transco, Shippers and Other Interested Parties

Your Ref:
Our Ref: NetiCod/Mod/475

Dear Colleague,

Modification Proposal 475: Termination of User in Receivership

Ofgem has considered the issues raised in modification proposal 475: Termination of User in Receivership. Ofgem has decided to direct Transco to implement the modification, because we believe that the proposal will better facilitate the relevant objectives of Transco's Network Code. The modification will be implemented with immediate effect.

In this letter, we explain the background to the modification proposal and give our reasons for making our decision.

Background to the proposal

Independent Energy's collapse in September 2000 raised a number of issues concerning the operation of credit cover as set out in the network code. When a shipper defaults on paying its balancing costs, the costs are smeared across the shipping community. The Energy Balancing Credit Committee (EBCC) represents shippers' interests relating to discontinuation and recovery action regarding energy balancing debt. Events following Independent Energy's failure have highlighted the need to amend current credit management procedures.

Currently shippers determine their own credit limit. In accordance with the Credit Risk Management Procedures, Transco is required to determine whether the shipper's credit rating is sufficiently high to meet the secured credit limit or whether further guarantees of security are required. If a shipper exceeds 85% of its secured credit limit Transco will issue a cash call notice. Shippers are required to pay the amount set out in the cash call notice by the next business day. If Transco does not receive these funds it issues a failure to pay a cash call notice, requesting payment within three business days. If a shipper fails to pay within this period Transco can, at its discretion, issue a termination notice. In the interim period Transco may withhold payments to the shipper of energy balancing invoice charges. These procedures have been largely unchanged since the introduction of the network code in 1996.

The experience of Independent Energy's collapse has raised the issue of how to recover debt when a shipper goes into receivership. A shipper's credit position is calculated seven business days after the gas day. Therefore, when the shipper enters receivership it could take up to nine calendar days before the scale of the debt can be identified. Three modification proposals were originally raised to address these concerns, namely, 441, Termination of User in Receivership, 446, Revision to Indebtedness Cash Call Trigger and 447, Provision Enforcement of a Minimum level of Energy Balancing Security. Ofgem rejected all three proposals due to concerns over their potential impact on Users.

Modification 441 was the predecessor to modification 475. Modification 441 proposed that Transco be given a mandatory obligation to send out a termination notice once a User has entered into receivership unless the Receiver provides the EBCC with a satisfactory written commitment that all post receivership debt will be paid. The termination notice would be issued one business day after Transco is notified of a receiver being appointed. The Receiver would then have only one day to determine whether the company is recoverable and whether it should provide commitment to finance the debt itself.

Ofgem were concerned about the limited time of one business day given to the receiver to decide whether they would be able to meet the ongoing debt. This situation could potentially lead to a premature termination. Furthermore, Ofgem believed that rather than Transco having a mandatory obligation to terminate, it was for the EBCC to have discretion regarding the decision as it affected energy balancing debt. Whilst Ofgem, therefore, supported the rationale for the modification, we did not believe that the original drafting would better facilitate the relevant objectives of Transco's network code.

The modification proposal

Modification 475 proposes that Transco, if directed to do so by the EBCC, will issue a termination notice to a User that has entered into receivership, unless a written commitment is provided that is satisfactory to the EBCC. The written commitment represents an assurance from the receiver that it will pay Transco all the energy balancing debt accrued from the date of appointment. The termination notice will not be issued in under two business days of Transco being notified that a receiver has been appointed.

Respondents' views

There were nine responses, all of which expressed support for the modification proposal. A number of respondents suggested that the modification would further the relevant objectives in encouraging competition as it would minimise the liability risk to shippers that currently exist under the regime when a User enters receivership. Whilst, there was support for Transco to have a mandatory right to terminate, it was also recognised that the EBCC should maintain discretion to determine when it is fair and appropriate to terminate a User in relation to energy balancing debt.

Whilst there is the desire to minimise the risk to the community it was recognised that the receiver may need a minimum of two days in order to be in a position to give the assurances that the EBCC seek. Hence, Transco should not issue a termination notice in under two business days of the appointment of the receiver. However, Transco will be in discussions with the EBCC during this period.

Respondents recognise the additional work being undertaken in the industry regarding Supplier of last Resort Arrangements. The view was expressed that this work should not prevent the implementation of this modification proposal.

Ofgem's view

Ofgem welcomes the community's commitment to reforming the current credit arrangements regarding energy balancing. Ofgem believes the legal drafting accurately reflects the aim of the modification proposal. The modification only relates to energy balancing debt and gives Transco a right to terminate a User in receivership, following direction from the EBCC. Hence, the decision on termination regarding energy balancing debt remains at the EBCC's discretion. Similarly, Transco maintain discretion on whether to terminate based on transportation debt.

The proposal refers to adequate assurances that represent the maximum that the EBCC would request from the receiver. Ofgem understand that lesser assurances may be acceptable to the EBCC. Ofgem agrees that Transco should not issue a termination notice in under two business days of the appointment of the receiver in order to safeguard against a situation of premature termination.

Of gem welcomes the EBCC's recognition of the work currently being undertaken on Supplier of last Resort (SolR) and, in particular, the role of termination of a User from the network code. It is important that the EBCC are aware of ongoing industry discussions relating to SolR and how it may impact on the work of the committee.

Of gem's decision

Of gem believes that this modification proposal will address the concerns of the EBCC in clarifying the procedure when a User enters receivership. It is important that the EBCC maintain discretion regarding a decision on termination regarding energy balancing debt and this is reflected in the legal text.

By adding clarity to the process, we believe that the modification will further Transco's relevant objective to run an efficient and economic pipeline system.

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,

Nick Simpson
Director, Industry Code Development