

0569S:

Removal of the minimum security requirement from the Energy Balancing Credit Rules

- 01 Modification
- 02 Workgroup Report
- 03 Draft Modification Report
- 04 Final Modification Report

The current £10,000 minimum security requirement for balancing credit is an arbitrary figure and acts as a barrier to entry for smaller Users with new, innovative business models, thus hampering competition. This modification proposes that balancing credit requirements be determined for each User on the basis of the formula currently contained within Section 2.1 of the Energy Balancing Credit Rules and based on each User's individual throughput and that the arbitrary minimum security requirement be removed from the Energy Balancing Credit Rules.



The Workgroup recommends that this self-governance modification should now proceed to Consultation.



High Impact: None



Medium Impact: None



Low Impact: Shippers, Transporters and Transporters Agent

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About this document:		
This report will be presented to the Panel on 21 January 2016		
The Panel will consider whether the modification should proceed to Consultation or be returned to the Workgroup for further assessment.		 07776 137403
The Workgroup recommends the following timetable:		Transporter: National Grid NTS
Amended modification considered by Workgroup	07 January 2016	 fergus.healy@nationalgrid.com
Workgroup Report presented to UNC Modification Panel	21 January 2016	
Draft Modification Report issued for consultation	21 January 2016	 01926 655031
Consultation Close-out for representations	11 February 2016	Systems Provider: Xoserve
Final Modification Report available for Panel	12 February 2016	 commercial.enquiries@xoserve.com
UNC Modification Panel decision	18 February 2016	

1 Summary

Is this a Self-Governance Modification?

The Proposer believed this was not a Self-Governance Modification as the proposed removal of the minimum balancing credit requirement from the Energy Balancing Credit Rules (EBCR) represents a material change to that document.

However, at its meeting on 17 December 2015, the Panel determined that the criteria for Self-Governance are met, as this modification is not expected to have a material impact on transportation and competition.

Why Change?

The Energy Balancing Credit Rules state in Section 2.1:

“All Users are required to maintain a minimum level of security at all times, which is currently set at £10,000, in order to provide sufficient protection for the gas community from User failures”.

While the Proposer fully appreciates that this requirement is driven by the desire to avoid outstanding costs being recovered from other Users in the case of default, it feels that there is a strong need to carefully balance this risk with the overarching objective to encourage competition and avoid creating barriers to entry.

It is the Proposer's view that a more level playing field could be created by enforcing the already existing requirement within the Energy Balancing Credit Rules that the minimum security requirement for New Users be based on 3 days non-deliverability at 12 months average System Average Price (SAP) to represent 85% of the Secured Credit limit based upon an estimate of projected annual throughput. This is both reasonable and equitable. All that needs to be removed is the arbitrary minimum security requirement, which ignores the result of the above calculation if that result is less than £10,000.

Solution

Amend the Energy Balancing Credit Rules, Section 2.1c "Cash Call Limit Calculations", to remove the £10,000 minimum level of security:

“All Users are required to maintain a minimum level of security at all times, ~~which is currently set at £10,000,~~ in order to provide sufficient protection for the gas community from User failures. For the avoidance of doubt any monies held in a Users Cash Call Account shall be excluded from the calculation of peak indebtedness over the last 12 months.”

Relevant Objectives

Implementation of this modification would facilitate relevant objective d) i) and ii) securing of effective competition between shippers and suppliers.

Implementation

No implementation timescales are proposed, however the Proposer requested implementation as soon as possible following a decision by Panel.

The change proposed is a simple one without any attendant costs attached in relation to implementation and this proposal has already been the subject of discussion at several EBCC meetings with Xoserve conducting analysis in relation to this.

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No.

2 Why Change?

The current minimum security requirement for balancing credit is an arbitrary figure and acts as a barrier to entry for smaller Users with new, innovative business models, thus hampering competition. This modification proposes that balancing credit requirements be determined for each User on the basis of the formula currently contained within the Energy Balancing Credit Rules and each User's individual throughput and that the minimum security requirement be removed from the Energy Balancing Credit Rules.

It is the Proposer's view that a more level playing field could be created by enforcing the already existing requirement within the Energy Balancing Credit Rules that the minimum security requirement for New Users be based on 3 days non-deliverability at 12 months average System Average Price (SAP) to represent 85% of the Secured Credit limit based upon an estimate of projected annual throughput. This is both reasonable and equitable. All that needs to be removed is the arbitrary minimum security requirement, which ignores the result of the above calculation if that result is less than £10,000.

By way of example, a User with a supply portfolio of 1,000 domestic properties could expect an annual throughput of 12,500,000 kWh (based on the recently adopted Ofgem average domestic gas usage of 12,500 kWh). The formula for New User Cash Call Limit determination within the Energy Balancing Credit Rules results in the following Secured Credit Limit:

$$\begin{aligned} & 12,500,000 \text{ kWh} / 365 \\ & \quad \times 3 \\ & \times 12 \text{ month average SAP (1.52p for 12 months to November 30, 2015)} \\ & = \pounds 1,561.64 \\ & +15\% \text{ to find Secured Credit Limit} \\ & = \pounds 1,795.89 \text{ (Rounded = } \pounds 2,000) \end{aligned}$$

1,000 domestic properties could, in the Proposer's view, be a perfectly feasible first year target for a small User with an initial local focus that aspired to gradual growth to begin with. The calculation above demonstrates that, for small supply businesses of this type who wish to ship for themselves rather than incur the cost of paying a third party User to perform this function on their behalf, the current minimum security limit acts as a significant barrier to entry.

The Proposer believes that it is the current policy intent of both the Government and the Regulator to encourage participation in the energy market at a small scale, local level. It seems to the Proposer that energy suppliers that commence operations on this basis are better positioned to engage with consumers and restore trust in suppliers than the large, vertically integrated market participants which operate at a national level. These suppliers aim to base their business models on the provision of high quality customer service, connection with local communities and getting the basics right before attempting to expand to a national presence.

The Proposer wished to reiterate that, while it understand the intent behind the setting of the minimum level of security at its current level, namely to insulate the rest of the market from any risk of default, it

feels that the existing basis for setting the minimum level of security for new Users serves this purpose as it is based on estimation of annual throughput, 3 days of non-deliverability (a very rare occurrence outside of extreme market conditions, where all participants could expect to be affected by these) and a 12 month average reference price for SAP.

However, the benefit of this proportionate and measured approach to minimum security calculation is outweighed by the effect on competition that the arbitrary current minimum required security level of £10,000 creates. It is self-evident that the wider market will be as equally unaffected by the default of a company with £10,000 posted in security as it will be by the default of a company with £2,000 posted in security. On the other hand, the £8,000 differential between these two figures which the new User is required to post will, if it is a supply business of the type already described, have a detrimental and wholly unnecessary effect on its cash flow position and uselessly tie up cash which it could make use of for other purposes without achieving any increased risk benefits for other Users.

The Proposer believes that significant benefit will accrue to both consumers and competition by removing the minimum security level but continuing to enforce the rule basing required minimum security levels on estimates of throughput coupled with actual, publicly available data in relation to 3 days non-deliverability at 12 months average SAP. This could then be reviewed for each User when required by the EBCC, thus creating a proportionate requirement for balancing security while avoiding undermining competition and new market entry.

3 Solution

Amend the Energy Balancing Credit Rules, section 2.1c "Cash Call Limit Calculations", to remove the £10,000 minimum level of security

All Users are required to maintain a minimum level of security at all times, ~~which is currently set at £10,000~~, in order to provide sufficient protection for the gas community from User failures. For the avoidance of doubt any monies held in a Users Cash Call Account shall be excluded from the calculation of peak indebtedness over the last 12 months.

User Pays	
Classification of the modification as User Pays, or not, and the justification for such classification.	No User Pays service would be created or amended by implementation of this modification and it is not, therefore, classified as a User Pays Modification.
Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.	N/A
Proposed charge(s) for application of User Pays charges to Shippers.	N/A
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	N/A

4 Relevant Objectives

Impact of the modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

Relevant Objective d) Securing of effective competition: (i) between relevant shippers; and (ii) between relevant suppliers;

Implementation of this modification will create a level playing field for smaller entrants in that they are not constrained by having to post levels of credit that are not reflective of the risk that they pose to the wider market. Instead, by virtue of basing balancing credit requirements for each Shipper on the basis of the formula contained in the Energy Balancing Credit Rules, this barrier to entry and competition will be removed while the market will continue to be adequately protected against any default risk, which furthers relevant objective d.

Workgroup Assessment

Workgroup participants heard that the Energy Balancing Credit Committee (EBCC) had been in discussion with the Proposer in an effort to reach a mutually agreeable position. A proposal had been made by the EBCC to amend the 'days' multiplier (in the formula in the New Users section of the EBCR Section 2.1c and as shown in Why Change? above) to 9 (from 3) and to remove the £10,000 minimum security, however the Proposer felt this was still a barrier to entry for new users.

The Workgroup considered the materiality associated with this proposal:

32 Users currently provided security at the minimum of £10,000, of which:

- 7 are in the Voluntary Discontinuance process (and could therefore still incur credit exposure)
- 20 currently have no activity and would provide no security under this proposal (and could therefore still incur credit exposure)
- 2 existing users would secure a combined £9,000 (ie £11k less than at present)
- 2 new users would secure a combined £6,000 (ie £14k less than at present)

In total, this proposal would remove around £300,000 of security (around 0.1% of the total security in place).

The Workgroup observed that, following this change, a new User could post zero balancing credit to participate in the market. It was noted that exposure is limited to 12 days, at which time the Credit Manager would be able to intervene. The Proposer argued that £10,000 of security offered little real protection for the industry in extreme cases.

5 Implementation

The Proposer does not believe that any costs would result from implementation of this modification beyond minor administrative costs relating to the change to the Energy Balancing Credit Rules.

No implementation timescales are proposed, however the Proposer would request implementation as soon as possible following a decision by Panel.

6 Impacts

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No.

7 Legal Text

No change is required to the text of the Uniform Network Code.

Suggested Change to Energy Balancing Credit Rules

It is proposed that the following text be removed from the Energy Balancing Credit Rules (which is a UNC Related Document):

~~“All Users are required to maintain a minimum level of security at all times, which is currently set at £10,000, in order to provide sufficient protection for the gas community from User failures. For the avoidance of doubt any monies held in a Users Cash Call Account shall be excluded from the calculation of peak indebtedness over the last 12 months.”~~

And replaced by the following text:

“All Users are required to maintain security at all times, in order to provide sufficient protection for the gas community from User failures. For the avoidance of doubt any monies held in a Users Cash Call Account shall be excluded from the calculation of peak indebtedness over the last 12 months.”

8 Recommendation

The Workgroup invites the Panel to:

- AGREE that this modification should be submitted for Consultation.