



Transco, Shippers and other
interested parties

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18 August 2003

Dear Colleague,

Modification proposal 642, 'Withholding of energy charge where LDZ reconciliation has been disputed'

Ofgem has carefully considered the issues raised in modification proposal 642 'Withholding of energy charge where LDZ reconciliation has been disputed' and has decided not to direct Transco to implement the modification, as we do not believe that it will better facilitate the achievement of the relevant objectives of Transco's Network Code. In this letter we explain the background to the modification proposal and outline the reasons for making our decision.

Background to the proposal

An LDZ Reconciliation, retrospectively correcting the apportionment of energy costs across the community, was included in the August Reconciliation Invoice. This involves a significant sum being charged to all RbD Shippers, and is due for payment on 8th September 2003. The application of this charge has been disputed by at least one shipper, but under the current rules shippers are not permitted to withhold payment of the energy element of any energy balancing or reconciliation charge or invoice while the dispute is being resolved.

Ofgem granted urgent status to this modification on 18th August 2003, after considering the criteria¹ it generally applies to such requests. In this instance, it appeared that implementation or otherwise of the modification could have a significant commercial impact upon Transco and shippers, and was also linked to an imminent date related event, insofar as the reconciliation invoice is due for payment on 8th September 2003.

The modification proposal

The modification proposal aims to amend various clauses within the Network Code, allowing shippers to withhold the energy element of a reconciliation charge where a valid dispute has been raised and not resolved. It is proposed that in the event of a correction of a misallocation of energy, caused by an LDZ reconciliation, the Network Code requirement for a shipper to pay the energy element of the charge in full even when a valid dispute is raised, will be dis-applied.

¹ See www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2752_Urgency%20Criteria.pdf

It is intended that this Modification Proposal is implemented for a fixed term of six months only, alleviating the current concern regarding a potentially significant charge becoming payable by all shippers subject to RbD. It is further intended that the full impacts of this proposal will be reviewed and if appropriate developed into a permanent change to the Network Code.

Respondents' views

Transco received five shipper representations in response to this modification proposal, all of which supported implementation.

A common theme amongst respondents was that more time should be allowed for users to validate reconciliation charges before they are due for payment, especially given the period of time they may cover. One respondent suggested that there would be merit in limiting the degree of retrospection for reconciliations and invoicing, for example to a period of 2 - 3 years. If the transporter fails to make necessary adjustments within this time, it foregoes its right to raise reconciliation invoices.

One respondent raised concern at the impact implementation of the proposal may have upon neutrality arrangements, in particular being concerned that any withheld sums should not result in further costs being smeared across the community. Another respondent, the proposer, suggested that in certain circumstances the change is not allocated against neutrality and that in these circumstances only, users should be able to withhold payment when raising a valid dispute.

Four of the respondents referred to the benefits of giving this area further consideration via the establishment of a review group.

Transco's view

Transco does not support implementation of this modification proposal.

Transco states its belief that the current energy balancing settlement arrangements are both efficient and promote competition between Users. It further believes that the implementation of this proposal could provide a perverse incentive to dispute invoice items, reducing timely cash flows into gas balancing neutrality arrangements. Transco further suggests that this cash flow shortfall would either have to be funded by Transco in its settlement agency role, or the User community could expect to see higher Neutrality Adjustment Financing Charges. Transco states that the principle of 'pay now query later' has been established within the energy balancing rules both in order to protect it and the wider community against a User default, and to minimise Neutrality Adjustment Financing Charges.

On the cessation of invoices after a set period, Transco refers to its Network Code obligations to allocate correct charges to the community and where it identifies an error, its duty to adjust the charges accordingly. It further states that whilst this particular proposal relates to a debit to Users, reconciliations may also result in credit being due to some or all Users.

Ofgem's view

Ofgem agrees that the procedures around energy reconciliations may benefit from a review, especially where there is a significant readjustment or long term retrospection involved, given the impact this may have on Users forecasts and immediate cash flows. Ofgem notes that this particular reconciliation has been discussed in several industry meetings, dating back to February 2003 and is disappointed that it was still considered necessary for a shipper to resort to an urgent modification

proposal at this stage in proceedings. Ofgem therefore welcomes the subsequent proposal 643, which will establish a review group to look specifically at the Network Code rule on withholding of energy payments under dispute and to consider circumstances where this may be appropriate. It is hoped that this review will encompass the amount of information made available to Users up to and including the issuance of a reconciliation invoice, as well as the appropriateness or otherwise of withholding payments during disputes.

Ofgem notes the view of Transco, and another respondent, that implementation of this proposal could create a perverse incentive for Users to dispute invoices. Whilst this effect could, to an extent, be mitigated by appropriate grounds for dispute being specified within Network Code, as currently applies to non-energy invoices, this does not form part of this proposal and would require further development.

Whilst significant and unforeseen energy reconciliations can reduce certainty for both the GT and Users, it is correct that energy balancing revenues be adjusted in light of better information about the actual off-take of gas. Ofgem also agrees with Transco, that such reconciliations may result in a credit to users, rather than a debit as in this case. It would be unreasonable to deprive any party of monies they were due by introducing an inappropriate point of cessation. For example, the Limitations Act 1980 refers to a period of six years as the time limit for actions founded on a simple contract.

The proposer acknowledges that this is a complex area and that this proposal does not in itself provide a permanent resolution to this issue. Ofgem are also mindful not to set a precedent of making urgent modifications to existing energy balancing settlement arrangements simply in order to withhold or delay payment of a particular invoice. In Ofgem's view, if the current rules are considered inappropriate, they should appropriately be given the full consideration afforded by the review group established under modification proposal 643.

Ofgem's decision

For the reasons outlined above, Ofgem has decided not to consent to this modification, as we do not believe that it better facilitates the achievement of the relevant objectives as outlined under Amended Standard Condition 9 of Transco's GT 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,



Jon Dixon
Head of Gas Network Codes