

OFGEM DECISION LETTER No. 0598

"Revision of Notice Period in the Event of a Users Credit Rating being Downgraded"
Version 1.0

Shippers, Transco and Other Interested Parties

Our Ref: Net/Cod/Mod/0595/0596/0597/0598

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23 October 2002

Dear Colleague,

Decision on request for urgent status for Modification Proposals 0595 - 'Revision to the process for recovering unpaid capacity and commodity invoices', 0596 – 'Revision to the process for recovering unpaid energy balancing charges invoices', 0597 – 'All Accruals & Outstanding Debt to become Payable Immediately in the Event of User Insolvency', and 0598 – 'Revision of Notice Period in the Event of a Users Credit Rating being Downgraded'.

Ofgem has considered the requests from AEP Energy Services Ltd for Modification Proposals 595 and 596, and from Transco for Modification Proposals 597 and 598 to follow urgent procedures.

Ofgem does not consider that modification 595 merits urgent status, that the decision on urgency for modification 596 should be suspended, that modification 597 does not merit urgent status and that modification 598 does merit urgent status. Further details on Ofgem's decisions are set out below:

Modification 595, 'Revision to the process for recovering unpaid capacity and commodity invoices'

This modification proposal would require Transco to make an application to the Authority in situations where a User is in default and/or is terminated from Transco's network code and Transco does not have sufficient credit cover in place to cover any outstanding amounts owed in relation to System Capacity and/or System Commodity Charges. The Authority would provide a direction to Transco on the amount that Transco may recover from Users and how it may do so.

In proposing this modification, AEP Energy Services Ltd recognises that the issue of credit is the subject of an Ofgem consultation, but suggests that the risks to shippers and the industry given current market conditions require the change to be made immediately. AEP says that this change is necessary to bring the credit arrangements for the long-term capacity auctions into line with Ofgem's decision of 27 September 2002.

Ofgem is aware that this modification proposal contains issues of ongoing concern to shippers, which also require resolution ahead of the long-term capacity auctions in January 2003. Whilst this proposal reflects previously stated Ofgem policy and could potentially form a solution

(should it meet relevant objectives for implementation), Ofgem does not consider that urgent consideration is warranted, providing the modification is progressed in a timely manner.

Ofgem is of the opinion that there is sufficient time available for resolution of these issues ahead of January 2003 under normal procedures, which should enable fuller consideration of all relevant information. However, should this not progress adequately, it would remain open to any party to raise a further urgent modification proposal nearer to the time.

Modification 596, 'Revision to the process for recovering unpaid energy balancing charges invoices'

This modification proposal would require Transco to make an application to the Authority in situations where a User is in default and/or is terminated from Transco's network code and Transco does not have sufficient credit cover in place to cover any outstanding amounts owed in relation to Balancing Invoices. The Authority would provide a direction to Transco on the amount that Transco may recover from users and how it may do so.

As above, in proposing this modification, AEP Energy Services Ltd recognises that the issue of credit is the subject of an Ofgem consultation, but suggests that the risks to shippers and the industry given current market conditions require change to be made immediately.

Ofgem is aware that the issues raised in this proposal are also addressed in modification proposal 572 'the provision of letters of credit for energy balancing credit cover', which is due to reach Ofgem for determination shortly. Modification 572 would require all shippers to provide security to support their energy balancing activity, namely letters of credit from approved banks with an "Aa3" or higher credit rating, or cash.

At this time, Ofgem believes that proposal 572 is likely to supersede this proposal. In view of this, Ofgem considers that decision on urgency status of this modification proposal should be postponed for seven days, pending its receipt of the final modification report on proposal 572. This will enable a more informed view to be reached on whether this modification proposal 596 should follow the urgent procedures.

Modification 597, 'All Accruals & Outstanding Debt to become Payable Immediately in the Event of User Insolvency'

This modification proposal would provide that where a user is insolvent, in that a receiver, administrator, trustee-in-bankruptcy or other insolvency practitioner, either foreign or domestic has been appointed, but a Termination Notice has not been issued, Transco would have the right to submit invoices for accruals based upon services supplied up to the time of appointment, and all invoices issues, either prior to, or following the appointment, would become immediately due for payment.

Additionally, the proposal seeks to extend the provisions relating to termination and its consequence on entry capacity holdings by including a right to allow Transco to recall a user's holding in the event of insolvency.

In raising this modification proposal, Transco highlighted its aspiration to take prudent commercial actions to enable revenue recovery and mitigate its exposure. However, Ofgem is unsure at present how this proposal would assist mitigation of exposure, as Transco's position would appear to remain the same, despite changes to timing of events. Ofgem considers that

this proposal is not clear as to why it may make a material difference and also require urgent status and therefore does not agree that it merits urgency status.

Modification 598, 'Revision of Notice Period in the Event of a Users Credit Rating being Downgraded'

This modification proposal would extend the provisions of Modification 521 'Where a guarantor is downgraded to any speculative rating, removal of the notice period required for the revision of a User's Secured Credit Limit and Code Credit Limit', implemented on 15 March 2002, to give Transco the right to issue notice of an immediate revision to a user's credit security should there be any downward revision of a credit rating, either published or privately obtained, of the User, guarantor or any other security provider. Additionally, the proposal seeks to give Transco the right to review, and if appropriate, require the user to revise immediately, its level of credit security in the event it is necessary to make a demand on any existing instrument of security provided by the user.

Ofgem recognises that this proposal addresses an issue in need of resolution. Market experience to date has highlighted the ability of credit ratings to fall rapidly, to which market rules have proved unable to respond. A recognised potential outcome of these existing rules is significant commercial impact upon Transco, shippers and/or customers and therefore Ofgem considers that urgent consideration of this proposal is warranted.

The timetable for the modification proposal to follow urgent status is set out below:

Issued to Ofgem for decision on urgency	18 October 2002
Proposal agreed as urgent	23 October 2002
Proposal issued for consultation	23 October 2002
Close out of representations	30 October 2002
Final report to Ofgem	04 November 2002
Ofgem decision expected	06 November 2002

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,



p.p.
Nick Simpson
Director of Industry Code Development