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09 December 2005

Dear Colleague,

**Uniform Network Code modification proposal 0026: 'Application of Charges consistent with Late Payment of Commercial Debts (Interest) Act 1998'**

Ofgem<sup>1</sup> has considered the issues raised in the modification report in respect of this proposal and having regard to the principal objective and statutory duties of the Authority<sup>2</sup>, has decided to direct the implementation of the modification.

Ofgem considers that modification proposal 0026 would better facilitate the achievement of the relevant objectives of the Uniform Network Code (UNC), as set out under Standard Special Condition A11<sup>3</sup> of the relevant Gas Transporters' Licences as compared with the existing provisions of the UNC. Ofgem also considers that modification proposal 0026 would be consistent with its wider statutory duties.

This letter explains the background to the modification proposal and outlines the reasons for Ofgem's decision.

**Background to the proposals**

*Current arrangements*

UNC section S 3.1 details the invoice payment terms to which Users are obliged to adhere. UNC section S 3.5 makes provision for Transporters to charge interest where any amount

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<sup>1</sup> Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter

<sup>2</sup> Set out in Section 4AA of the Gas Act 1986, as amended.

<sup>3</sup> This Licence Condition can be viewed at: [http://62.173.69.60/document\\_fetch.php?documentid=6547](http://62.173.69.60/document_fetch.php?documentid=6547)

payable under an Invoice is not paid on or before the Invoice Due Date. The 'Applicable Interest Rate', at which interest will be applied if payment is not made in accordance with UNC sections S 3.1 and S 3.5, is detailed within section S 3.6. At present the 'Applicable Interest Rate' is the base rate of Barclays Bank plc plus three percentage points per annum.

### *The Best Practice Guidelines*

In February 2005 Ofgem published its conclusions on best practice guidelines for gas and electricity Network Operator (NWO) credit cover<sup>4</sup>. The document covered a wide range of issues (of which this modification proposal addresses only one) which in Ofgem's view strike an appropriate balance between providing protection against the risk of exposure in the event of default, and the costs of mitigating that risk. The conclusions document indicated that appropriate changes would need to be brought forward by parties to industry codes in order to arrive at credit cover arrangements consistent with the best practice guidelines.

Amongst other things, the conclusions document set out remedies that should apply in circumstances where a company fails to make payment on the applicable invoice due date. Such remedies include the application of interest and administration fees, which Ofgem indicated should not be extreme or excessive.

### **The modification proposal**

It is proposed that the 'Applicable Interest Rate' be amended to reflect the rate contained within the Late Payment of Commercial Debts (Interest) Act 1998, being at a rate equal to the Bank of England base interest rate plus eight percentage points per annum. This rate is calculated by adding 8 percentage points to the reference rate, which is the Bank of England base rate on 30 June and 31 December each year. This rate is applicable for the following six-month periods i.e. 1 July to 31 December and 1 January to 30 June respectively.

It is also proposed that the Transporter will charge a fee to cover the additional administration that late payment incurs. The Late Payment of Commercial Debts (Interest) Act 1998 permits a creditor to recover compensation as follows:

Size of the late paid debt	Value of Compensation that can be claimed
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

### **Respondents' views<sup>5</sup>**

There were eleven responses to this modification proposal, of which eight were in favour, one gave qualified support and two opposed its implementation.

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<sup>4</sup> This can be found on the Ofgem website at:

[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370\\_5805.pdf?wtfrom=/ofgem/work/index.jsp&section=/areasofwork/creditcover](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf?wtfrom=/ofgem/work/index.jsp&section=/areasofwork/creditcover)

<sup>5</sup> This section is intended to summarise the principal themes of the respondents' views and is not intended to provide a comprehensive overview of the responses received. These can be found on the Gas Transporters information service (formally known as Nemisys) <https://gtis.gasgovernance.com>

Comments by respondents in favour of the proposal included that the incorporation of a common set of rules, which apply to all Users, will reduce the effects of industry fragmentation, will ensure consistency across the network and ensure that there is no inappropriate barrier to entry. More specifically, it was stated that the proposed rates are reasonable and would act as a deterrent to late payment. It was also noted that Users have every opportunity to avoid payment of this rate.

In respect of relevant objectives, respondents indicated that the proposal would facilitate the securing of effective competition between relevant shippers and also that it would promote the Transporters' ability to operate the network in an efficient and economic manner.

Whilst agreeing that Users should be subject to appropriate incentives to make payment, the respondent who offered qualified support expressed concern that the proposed rate may be considered penal. The respondent also suggested that there is no evidence that this level of charge will reduce the number of late payments received from Users.

Of the respondents who opposed implementation, one expressed concerns with regard to the proposed legal text, including that it was unclear how administration charges would be applied in practice. Other comments included that there are already remedies in force for late payment, and that this proposal would cause an unfair financial burden on small Users, where delays may be caused by genuine administrative difficulties.

One of the above respondents subsequently raised concerns regarding post consultation changes to the legal text, however these were discussed by the modification panel of 20 October 2005, who determined that this was in keeping with ordinary process where improvements to legal text are identified and did not of themselves require re-consultation.

### **Panel Recommendation**

At the modification panel meeting held on 20 October 2005, of the 9 voting members present, capable of casting 10 votes, 9 votes were cast in favour of implementing this modification proposal. Therefore, by panel majority, the implementation of this proposal is recommended.

### **Ofgem's view**

Ofgem is of the opinion that all parties should make arrangements to meet their obligations in a timely manner. Where this does not occur in relation to payment terms, Ofgem believes that a number of remedies, including interest and administration charges, should be applied. As indicated above, such charges should not be extreme or excessive. In this regard, the application of charges consistent with prevailing legislation, namely the Late Payment of Commercial Debts (Interest) Act 1998, would appear reasonable.

Furthermore, Ofgem considers that such arrangements should be applied across relevant networks in a clear and consistent manner. This would both remove the potential for discrimination and make it easier for both new entrants and existing participants to familiarise themselves within the market rules and arrange their businesses accordingly, thereby better facilitating the achievement of competition between relevant shippers. Therefore, Ofgem would expect interest and administration fees to be charged in all instances.

Whilst noting comments regarding the potential impact on particular Users and on the level of charges, Ofgem agrees with the view that Users have the ability to avoid these by ensuring that bills are paid on time. Moreover, by prompting timely payment, such arrangements could reduce the amount of administrative action required by Transporters to pursue overdue amounts, thereby better facilitating the efficient and economic operation of the pipe-line system.

Under existing UNC provisions (section S 3.5) such charges will apply from the Invoice Due Date. Furthermore, sanctions, including the ability to suspend registration of (inward) transfers, will also apply from the day after the due date for payment, in circumstances where any amount (or amounts in aggregate) of £10,000 or more is unpaid. Whilst the timing of these arrangements is not in line with its conclusions, Ofgem recognises that this was not within the scope of this proposal.

Ofgem does note, however, that the legal text was revised to address a number of the concerns expressed on the practical application of this proposal. Should code signatories wish to clarify or address further points in this area, it is open to them to raise further modification proposals.

### **Ofgem's decision**

For the reasons outlined above, and having regard to its principal objective and statutory duties, Ofgem has decided to direct the implementation of this modification. Ofgem believes that this modification will better facilitate the achievement of the relevant objectives of the UNC, as set out in Standard Special Condition A11 of relevant Gas Transporters Licences; in particular (a) the efficient and economic operation of the pipe-line system, and (d) the securing of effective competition between relevant shippers.

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

**Nick Simpson**  
**Director, Modifications**