

**Modification Report**  
**Right of Set Off under Uniform Network Code**  
**Modification Reference Number 0027**  
Version 3.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 9.6.

**1. The Modification Proposal**

This is one of a number of Proposals which seek to implement recommendations identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05. This concluded the high-level principles that should be applied and further work required in respect of credit cover arrangements for transportation.

This Proposal seeks to implement recommendations detailed within paragraph 3.49 of the conclusion document.

Under the UNC, Transporters may issue either credit or debit invoices to Users, payable by the Transporter or the User within terms specified in the UNC.

Historical evidence demonstrates that the net position is usually that a User owes the Transporter more than the Transporter owes to the User.

It would be beneficial to Transporters and Users in terms of administration burden if (in respect of Transportation services) a Transporter had the ability to offset amounts it was due to pay to the User against any invoice value that the User is due to pay the Transporter.

This right of set off would only be available where:

- the relevant Transporter was the same party in respect of both the credit and debit amounts, and
- the relevant User was the same party in respect of both the credit and debit amounts.

Currently UNC Section S3.3 does not permit offsets and therefore Transco proposes that the UNC be modified to permit the off set of User credit amounts against User debit amounts (in respect of Transportation services) as recommended within Ofgem's Consultation.

Where the Transporter elects to undertake such a set off, it is proposed that:

- the Transporter will issue a 'set off notice' to the User prior to the invoice due date of the earliest invoice within the set off 'group' of invoice items, except in instances where a User is in breach of Section S3.1.
- the 'set off notice' will specify the invoice items payable by the transporters which are being set off against the specified invoice items payable by the User.

- in the event that a User registers a valid invoice query (and consequently withholds the amount payable) in respect of an invoice within the set off 'group', the Transporter will undertake investigation as to whether the amount due to the User can be set off against an alternative amount due to the Transporter. If no such suitable invoice item is available, the Transporter will pay such amount to the User.

**2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives**

Implementing consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

WWU commented that *“at this stage it is difficult to form a view on whether the proposal better facilitates the relevant objectives and as a result, recommends that the proposal is rejected”*.

UKD concurred that *“incorporation of payment terms within the Uniform Network Code...would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers”*.

Explaining its support for the proposal, UKT believes that it *“may promote competition among Users by simplifying and improving arrangements for payment of Transportation charges and by keeping banking charges to a minimum”*.

TGP and TEP concluded that *“while modification 0027 promotes the Transporters ability to operate the network in an efficient and economic manner and so fulfills the relevant objectives of licence condition A11, the costs to some Users may outweigh this...we can only give our qualified support”*.

**3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation**

No such implications on security of supply or operation of the Total System or industry fragmentation have been identified.

**4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including**

**a) implications for operation of the System:**

No implications for operation of the system have been identified.

**b) development and capital cost and operating cost implications:**

The proposer has suggested that any costs would be minimal and outweighed by subsequent operational cost saving.

WWU suggests “*this proposal would cause shippers to incur significant systems development costs...costs of development have not been provided by shippers and WWU refutes the statement in the report that the costs of implementation would be minimal...there are likely to be costs to both Users and transporters of implementing this change, although at this stage no formal assessment of the necessary system changes has been initiated*”.

UKD commented that it “*estimates that if a right of set off were...in place...from January 2005 to August 2005, Transco would have had the ability to reduce the quantity of invoices issued by 39%. In addition ...realised a...saving of approximately £6,500 in...banking charges*”.

**c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:**

No cost recovery mechanism is proposed.

**d) analysis of the consequences (if any) this proposal would have on price regulation:**

No such consequences are anticipated.

**5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal**

No such consequence is anticipated.

**6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users**

No systems impacts are anticipated by either Transporters or Users.

Users have identified that significant systems changes would be needed and that a minimum three month lead time (preferably six to nine) should be allowed if the right of set of is not elective for Users.

**7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk**

Administratively, implementation of the Modification Proposal has the potential to reduce Shippers’ costs if there are no systems implications. Provided it is elective for Users to choose to use this facility, costs would be expected to be reduced.

If use of the proposed facility is mandatory for Users, Users would anticipate increased costs.

WWU contend that *“this proposal would cause shippers to incur significant systems development costs...costs of development have not been provided by shippers and WWU refutes the statement in the report that the costs of implementation would be minimal...there are likely to be costs to both Users and transporters of implementing this change, although at this stage no formal assessment of the necessary system changes has been initiated...For this reason, we believe a formal cost-benefit analysis should be preformed informing the industry, and the Authority of the merits of implementation”*.

TGP and TEP acknowledged that *“if Users have the ability to set-off...this reduces the amount of transactions...so reducing administrative and banking costs...we therefore agree with the proposer s assertion that this modification will reduce some User s costs”*. They added that *“some Users system may not be able to cope...without considerable adjustment hence incurring expense to the consumer...we note that at the distribution workstream the proposer has denied requests for setoff to be optional, so obviating the problem of system development costs”*.

**8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party**

No such implications have been identified.

**9. Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal**

No such consequences are anticipated.

**10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal**

**Advantages**

- Increased alignment of the UNC with best practice as identified in Ofgem’s conclusions document.
- Potentially reduces industry administration costs.

**Disadvantages**

- Would create significant system problems and costs for some Users if non-elective for Users.

**11. Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)**

Eleven representations (from the following) were received with respect to this Modification Proposal. Three parties support implementation, three parties offered qualified support and five parties oppose implementation.

<u>Organisation</u>	<u>Abbreviation</u>	<u>Position</u>
Wales & West Utilities	WWU	Oppose
Transco UKD	UKD	Support
Transco UKT	UKT	Qualified Support
Scotia Gas Networks	SGN	Support
Northern Gas Networks	NGN	Support
British Gas Trading	BGT	Oppose
RWE npower	RWE	Oppose
Total Gas & Power	TGP	Qualified Support
Total E&P	TEP	Qualified Support
E.ON	EON	Oppose
EdF Energy	EDF	Oppose

UKD believe that *“there is a tangible administrative efficiency...for both Transporters and Users...consequential benefits would also be a reduction in a Users overall indebtedness and therefore a reduction of credit...utilization...[which] ...would further minimise exposure to the Transporter issue of 70% and 85%... notices and the...associated sanctions”*.

SGN acknowledges that the proposal *“seeks to extend provisions to allow offset of invoices to Transportation invoices, as was practice prior to DN sale”*.

Though BGT expressed *“support [for] the principles and structure proposed within...0027”* it confirmed that it *“strongly object[s] to the inability of Users to initiate netting off”*.

RWE reflected that *“set-off would appear to be a pragmatic...[but] ...there is now the potential for major impact on Shipper invoicing and Settlement systems...the level of impact depends on whether the proposed facility is elective...this Modification gives the Transporter the elective right to do this but does not give the User right to decline”* and observed that *“If this proposal was truly elective, requiring both Shipper's and Transporter's agreement...RWE npower would support”*.

RWE identified that the proposal would advocates a *“process which would benefit Transporters ...It is not clear exactly what benefits would accrue to the Users”*.

RWE suggested that *“the legal text needs to be reconsidered...it does not identify how far in advance of the payment due date this [Set Off] notice would be issued, ... We would suggest that a period of not less than 5 business days”* and additionally proposed that *“it should be made clear that only those credits which are due to the User with a due date on or after the main invoice due date can be included in an offsetting arrangement. Any credit due to a User with a due date*

*before the due date of another invoice should not have its payment delayed so that it can be included in an off setting arrangement”.*

Having consulted the proposer, it believes that the legal text as drafted is fit for purpose. The proposer observed that where a credit with a due date before an invoice due date is set-off the User will benefit by their indebtedness being reduced at the credits due date, this reduces the risk to the Transporter. If the credit were returned the Users indebtedness would increase.

TGP and TEP commented that they had *“yet to see evidence of widespread industry support for this particular aspect of the guidelines and so we disagree that alignment with Ofgem’s view is necessarily an advantage... agreeing with the regulator opinion should not be seen as an advantage”.*

EON confirmed *“We do not support this proposal as we favour modification proposal 034, as a preferable lower cost option”.*

EDF acknowledged that it was *“more efficient to offset payments and credits”* but maintained *“serious concerns about the way in which this will work....at present these are not netted off and our payment and accounting systems have been developed to reflect this”.* EDF identified that *“significant change to payment processes is likely to add...extra cost...there is a lack of detail as to how the setting off mechanism would work...a late instruction to offset such payments against credits would cause obvious problems”.*

EDF expressed a preference *“for it to be elective in the first instance to ensure that EDF Energy can adjust it's processes accordingly without adding undue costs to the Settlement process”.*

**12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation**

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

**13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence**

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

**14. Programme for works required as a consequence of implementing the Modification Proposal**

Changes would be required in respect of operational processes and procedures in the event that this Modification Proposal is implemented.

**15. Proposed implementation timetable (including timetable for any necessary information systems changes)**

The Proposer suggests that a lead-time of one calendar month will be required for implementation of the Modification Proposal if so directed.

User attendees at the Workstream suggested that a lead time of six to nine months would be appropriate, but an absolute minimum three months notice should be given if set off is not elective for Users.

**16. Implications of implementing this Modification Proposal upon existing Code Standards of Service**

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

**17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel**

At the Modification Panel meeting held on 20 October 2005, of the 9 Voting Members present, capable of casting 10 votes, 5 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend non-implementation of this Proposal.

**18. Transporter's Proposal**

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

## 19. Text

### **TPD SECTION S: INVOICING AND PAYMENT**

*Amend paragraph 3.3.1 to read as follows:*

Without prejudice to paragraphs 3.8 and 4.2.2, amounts payable....

*Add new paragraph 3.8 to read as follows:*

#### **3.8 Set off notice**

3.8.1 Where a Transporter submits a notice ("**Set off Notice**") to a User in respect of a relevant Invoice Document the provisions of this paragraph 3.8 shall apply.

3.8.2 For the purposes of this paragraph 3.8 a "**relevant**" Invoice Document is an Invoice Document which:

- (a) has been submitted to the User;
- (b) comprises Invoice Amounts (including Invoice Amounts under any other relevant Invoice Document specified in the Set off Notice) which are payable both by and to a User; and
- (c) such Invoice Amounts are in respect of Transportation Charges.

3.8.3 A Set off Notice shall specify:

- (a) the identity of the User;
- (b) in respect of each relevant Invoice Document:
  - (i) the unique number by which the Invoice Document is identified;
  - (ii) the date the Invoice Document was submitted to the User;
  - (iii) the Invoice Type;
  - (iv) the Invoice Due Date;
  - (v) in respect of each Invoice Item, the Invoice Amount;
- (c) by reference to each of the Invoice Amounts payable both by and to a User under each relevant Invoice Document, the net amount payable by or to the User (the "**net invoice amount**"); and
- (d) the Invoice Document (the "**specified**" Invoice Document) in respect of which the net invoice amount is to be treated as payable (which in the case of a Set off Notice in respect of a single Invoice Document shall be such Invoice Document).



3.8.4 Following the submission of a Set off Notice:

- (a) payment of the net invoice amount by the Transporter or (as the case may be) the User on or before the Invoice Due Date of the specified Invoice Document shall be treated for the purposes of this Section S as payment in full of all Invoice Amounts payable by or to the User under each relevant Invoice Document specified in the Set off Notice;
- (b) paragraphs 3.2, 3.4 and 3.7 shall apply in respect of each relevant Invoice Document;
- (c) the Transporter or (as the case may be) the User will remain liable for the payment of interest in accordance with paragraph 3.5 in respect of the late payment of any Invoice Amount under a relevant Invoice Document where payment was not made by the Invoice Due Date; and
- (d) in the event the net invoice amount is not paid on or before the Invoice Due Date of the specified Invoice Document paragraph 3.5 shall apply in respect of each Invoice Document specified in the Set off Notice.

3.8.5 Where a User has notified the Transporter of an Invoice Query (in accordance with paragraph 4.2) in respect of an Invoice Item under a relevant Invoice Document:

- (a) prior to the submission of a Set off Notice, the Transporter shall take account of the Invoice Amount which is the subject of the Invoice Query when determining the net invoice amount payable;
- (b) following the submission of a Set off Notice, the Transporter will:
  - (i) make payment of any such amount for which it is liable pursuant to this Section S in respect of the Invoice Query; or
  - (ii) submit a revised Set off Notice to take account of the Invoice Amount which is subject of the Invoice Query (and the first Set off Notice shall cease to have effect).

Subject Matter Expert sign off:

*I confirm that I have prepared this modification report in accordance with the Modification Rules.*

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

**Tim Davis**  
**Chief Executive Joint Office of Gas Transporters**

Signature:

Date :