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6th September 2005

Mod 0032

Dear Julian,

Thank you for inviting us to respond to Mod Proposal 0032. As the proposer of this Mod we support this as we believe the recommendations as identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05 represent a pragmatic and equitable solution to a perennial problem.

The Value at Risk (VAR) mechanism is a widely established process to determine the predicted level of business activity and to determine the basis for the calculation of the Code Credit Limit. This is currently based on peak usage and for new users it is set at 63 days of peak usage. The Best Practice Guidelines suggests that the VAR for Use of System (UoS) charges should be the sum of all the charges billed plus 15 days worth of the same daily average implied in the billed charges. UoS charges are billed on a monthly basis in arrears. The majority of months have 31 days so it seems reasonable to use this as part of the equation. Thus 31 +15 make the 46 days proposed.

Due to the nature of the demand patterns through the year generally in the summer months Shippers enjoy lower levels of consumption than in the winter. Thus the amount of credit cover required through the year will vary and reflect the amount of gas consumed by Shippers customers. This is especially true for Shippers with large domestic portfolios, which have to provide credit cover far in excess of their needs for nearly half the year. Based on an analysis of our own annual cycle of Transportation invoices we have 5 months of where the monthly total is less than 50% of our highest monthly cost. In fact we experienced one month which was about one third of the winter maximum. This is clearly an inefficient and unnecessary cost to shippers, when they have to provide a level of credit cover which is not required for half the year. Nor would it be an efficient or cost effective process for Shippers and Transporters to vary the amount of credit cover on a monthly basis to reflect the expected risk. Clearly an alternative solution needs to be developed.

Transporters have expressed concerns that if the proposal was implemented they would be faced with additional work monitoring the level of a Shipper's exposure over the peak winter months. However, we believe that over the last few winters Transco performed this function anyway. The new DNOs have not yet been through a winter cycle, so the argument of additional work is not valid. What may be true is that the available credit might not be sufficient to cover a Users requirement in the peak winter months until the Capacity invoice has been paid. This is normally due around the 20th of the month. Under the present regime if this were to happen than the Transporter would, at the 80% level of utilization issue a Cash Call. Upon receipt of such a notice Shippers have 2 options:
a) Pay the invoice early, on the day the cash call is due. This will immediately bring the Shipper well within its credit limit.
b) Pay the cash call and recover the money once the invoice has been paid.

There is a third option, which would require the Shipper to proactively manage its position that is to provide additional cover in the appropriate form (eg Letter of credit) over the winter months

We believe that there is nothing in the Code rules that prevents any Shipper from providing more security than the minimum. The prudent Shipper will then be able to provide a base level of cover for the year, which can be supplemented to accommodate the extra seasonal requirements. The only reason why Shippers have not done this in the past is that they have been grossly over covered for the low usage summer months.

Therefore this last option provides an efficient and cost effective solution. Shippers need only provide the level of security that is needed to reflect their seasonal commitments. There will be savings in the reduced cost of obtaining security. Transporters will have a level of cover, which will not require regular intervention in the form of Cash Calls. Transporters and Shippers could discuss the appropriate level of top up cover to reach a mutually acceptable.

Yours sincerely,

Simon Howe.
Gas Network Codes Manager