Direct Dial: 0171-932-7433

25 May 2001

Transco, Shippers and Other Interested Parties

Your Ref:
Our Ref: Net/Cod/Mod/441

Dear Colleague,

Modification Proposal 0441: Termination of User in Receivership

Ofgem has considered the issues raised in modification proposal 0441: 'Termination of User in Receivership'. Ofgem has decided not to direct Transco to implement this modification, because we do not believe that the proposal will better facilitate the relevant objectives of Transco's network code.

In this letter, we explain the background to the modification proposal and give our reasons for making our decision.

Background to the proposal

Independent Energy's collapse in September 2000 raised a number of issues concerning the operation of credit cover set out in the network code. When a shipper defaults on paying its balancing costs, the costs are smeared across the shipping community and Transco is not liable for the payment of outstanding energy balancing debt. The Energy Balancing Credit Committee (EBCC) represents the shippers' interests and has limited powers relating to discontinuation and recovery action regarding energy balancing debt. Current credit practises attempt to mitigate this risk. However, the events following Independent Energy's failure have highlighted the need to address current credit management procedures.

Currently shippers determine their own credit limit. In accordance with the Credit Risk Management Procedures, Transco is required to determine whether the shipper's credit rating is sufficiently high to meet the secured credit limit or whether further guarantees of security are required. If a shipper exceeds 85% of its secured credit limit Transco will issue a cash call notice. Shippers are required to pay the amount set out in the cash call notice within the next day. If Transco does not receive these funds it issues a failure to pay a cash call notice, if a shipper is unable to pay within three days Transco can, at its discretion, issue a termination notice. In the interim period Transco may withhold payments to the shipper of energy balancing invoice charges. These procedures have been largely unchanged since the introduction of the network code in 1996. It should be noted that the recent increase in gas prices has resulted in a significant increase in cash call and failure to pay cash call notices.

The experience of Independent Energy's collapse has raised the issue of how to recover debt when a shipper goes into receivership. A shipper's credit position is calculated seven business days after the gas day. Therefore, when the shipper goes into receivership it could take up to nine calendar days before the scale of the debt can be identified. In this instance it was found that the Receiver was unwilling to finance the energy balancing debt which continued to accrue during the period the company remained in receivership. As a result, debt was incurred by all shippers whilst the party appointing the Receiver gained increasing

benefit. In the event the Receiver managed to sell Independent Energy's business as an ongoing concern to a supplier willing to accept the post receivership debt.

Shippers need to ensure that the credit management requirements are sufficiently robust so as to reduce their financial risk. Three modification proposals, 441, Termination of User in receivership, 446, Revision to Indebtedness Cash Call Trigger and 447, Provision Enforcement of a Minimum Level of Energy Balancing Security, were raised to address their concerns.

The modification proposal

The modification proposes that Transco be given a mandatory obligation to send out a termination notice once a User has entered into receivership unless the Receiver provides the EBCC with a satisfactory written commitment that all post receivership debt will be paid. Transco's network code stipulates that the termination will come into effect one day after the notice has been issued to limit the build up of debt. This being the case the Receiver has one day to determine whether the company is recoverable and whether it should provide commitment to finance the debt itself before its licence is revoked.

Respondents' views

Eleven representations were made with regard to this proposal, ten of which supported the modification.

One respondent did not support this modification. The respondent felt that it should be left to Transco's discretion whether a termination notice is issued and hence this would enable them to invite views from other stakeholders.

The general view held by those shippers that supported the modification was that the proposal would prevent escalating debt and so reduce the financial risk on other shippers in the industry.

Transco was concerned that one business day may be insufficient for a Receiver to decide whether they will be able to meet ongoing debt and sought views on this issue. Two respondents expressed the view that no additional time was needed for the Receiver to give a satisfactory assurance to the EBCC as to whether the debt could be managed. One respondent felt that the Notice should take immediate effect. Two respondents felt that two business days was more appropriate. Furthermore one respondent felt that this matter should be considered by the EBCC in a general overview of the Receiver's overall commitment.

With regard to the role of the EBCC, three respondents, whilst supportive of the modification, expressed concern that Transco would be able to serve a termination notice prior to discussions with the EBCC. They felt that this decision should be made by the EBCC. One respondent stated that the criteria for agreeing not to issue a terminal notice should be clear and that the EBCC should produce a guidance note to this effect.

Ofgem's view

Ofgem shares the concern raised by respondents that one business day may be insufficient for a Receiver to decide whether they will be able to meet ongoing debt. Indeed, Transco may experience difficulties contacting the Receiver within a day. This could lead to a

premature termination. Ofgem agrees that the EBCC, as representatives of the shipping community, should determine whether or not to take this risk of postponing the issue of a termination notice. Furthermore the modification does not make it clear whether a provision is made for Transco to serve a termination notice after the EBCC decide to defer serving one.

Ofgem believes that a mandatory obligation should not be placed on Transco to serve a termination notice. Transco should instead be advised by the EBCC as to whether to serve a notice or defer one. It should also be at the EBCC's discretion whether terminating within one day would be appropriate.

Ofgem's decision

Whilst Ofgem notes that termination notices may be required to ensure that the shipping community is protected from the escalating debts of a shipper in receivership we believe that the decision to terminate should be determined by representatives of the shipping community, i.e. the EBCC, rather than a mandatory requirement on Transco. In some instances it may be in the interests of the shipping community to delay a termination notice if it provides the Receiver with sufficient time to confirm that it can provide a commitment to cover post receivership debts. Therefore although Ofgem supports the rationale of this modification we do not believe the modification in its present form will better facilitate the relevant objectives of Transco's Network Code in some instances.

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,

Nick Simpson
Director, Industry Code Development