

UNC Modification Proposal 0521: Revision of User Admission Criteria to include Transporter verification of its ability to transact with the Applicant User

Additional Information for UNC Modification Panel

Following a review of the representations received in respect of this Proposal, **National Grid NTS** believes that the following background information would be useful to Modification Panel members when considering the Draft Final Modification Report at the Panel meeting on 23rd January 2015.

The Proposed Solution

Having considered all options, the proposed solution was the only practical solution to mitigate the identified risk. In the case referred to in the Proposal, Xoserve has sought the views of its current bank and three others in respect of the acceptability of other forms of payment, including utilisation of a third party letter of credit (on behalf of the Applicant User). However, these banks have declined to process (or expressed significant reservations about processing) such as principally, the Letter of Credit is for the benefit of the Applicant User.

Ultimately, any form of payment for services provided by a Transporter must be transacted through a financial institution which the Transporter employs to manage the funds it receives and the payments it makes in compliance with the existing provisions of UNC TPD S3.2. The core issue is the refusal of such institutions to deal with the Applicant User both in terms of receipt of, and payments to, it and this includes both direct and indirect payments via a third party.

Scope of Application

The Proposal applies equally to all Applicant Users. The EBCC recognises that there is potential issue with existing Users that subsequently are unable to transact with the Transporter however, this requires further consideration as to whether any UNC change is required. Further, the EBCC also recognises that there is a separate issue where the Transporter may be unable to determine certain credit tools put in place by an existing User prior to that User being unable to transact with the Transporter. This also requires further consideration as to whether any UNC change is required and therefore no specific changes related to either of these issues were incorporated in this Proposal.

The existing UNC terms for Transportation Credit Management and User Termination (UNC TPD Section V) and Energy Balancing Credit Management (UNC TPD Section X) are in place to mitigate the bad debt risk associated with existing Users. In these circumstances, if an existing User becomes unable to transact with the Transporter, the UNC provides for determination of credit tools to cover any bad debt and ultimately User Termination. In this respect, the outcome of an existing User's inability to transact with the Transporter is the same as is proposed for Applicant Users and therefore we do not believe the Proposal is discriminatory.

We believe that it is inefficient to allow an Applicant User that is unable to transact with the Transporter to become a User and then promptly apply the User Termination provisions following non-payments of invoices.

Management of Multiple Account Banks

The costs incurred by Xoserve, and indeed other Transporters, in the management of credit risk arrangements and invoice payments are funded under respective price control allowances and such costs are therefore socialised amongst Users via the relevant Energy Balancing and Transportation charges. For example, the ongoing transactional

costs for Energy Balancing are recovered via the finance adjustment to Energy Balancing neutrality.

Recognising that the refusal of a single financial institution to transact with the Applicant User should not, in itself, prevent the admission of that Applicant User, we have proposed that the *Transporter* should be obliged to seek the views of an alternative 'major and reputable' financial institution. Whilst the potential utilisation of an additional bank to manage certain transactions on behalf of the Transporter will result in increased transactional costs, we saw this as a reasonable cost for the Transporter to accrue (on behalf of Users) to appropriately maximise the opportunity for Applicant Users to enter the market.

However, we are concerned that the approach proposed in the Novatek Gas and Power GmbH representation which would enable the *Applicant User* to specify a financial institution that will transact with the Applicant could lead to disproportionately higher costs for the Transporter (and ultimately Users) in terms of the number of Account Banks that Transporters may be required to utilise and verification that such institutions (multiple Applicant Users could identify different institutions) are 'major and reputable' both initially, and on an ongoing basis. The ability of the *Transporter* to identify the alternative financial institution which is approached affords the Transporter the opportunity to constrain the additional costs to the industry by limiting the numbers of different financial institutions utilised to manage its transactions.

Further, it must be recognised that the implications of this Proposal apply not only to Xoserve (in terms of the management of Energy Balancing credit and payment arrangements on behalf of National Grid NTS), but also to each individual Transporter under the UNC (in terms of Transportation credit and payment arrangements). Invoices for Transportation services are issued centrally by Xoserve (on behalf of all Transporters) however, Users payments for specific invoices are required to be transacted via the specified Account Bank for each Transporter (i.e. each Transporter manages its revenue recovery function directly).

On this basis, it is therefore appropriate to seek to limit the overall cost to the industry of the management of multiple Account Banks by enabling each Transporter respectively to identify the alternative financial institution that is approached. Annex A identifies the potential 'set up' and 'ongoing' cost drivers for management of additional Account Banks by a Transporter.

We are currently in the process of seeking further definition of the potential *level* of costs associated with management of additional Account Banks from an Energy Balancing perspective and will provide this to Ofgem.

Whilst there are existing industry arrangements (the 'User Pays' mechanism) that would potentially enable the targeting of any additional incremental User Accession costs incurred to a specific Applicant User, there is no such mechanism to target any ongoing additional administration costs incurred by the Transporter for the management of a separate Account Bank specifically to administer the payments to/from one User. Whilst this is of limited concern where additional costs are appropriately minimised as envisaged by this Proposal, this could be of greater concern should such costs escalate, as we anticipate they potentially would, under the approach proposed by Novatek Gas and Power GmbH in its representation.

Annex A

Potential 'set up' and 'ongoing' cost drivers for management of additional Account Banks by a Transporter.

Set Up

- Liaison with treasury function to identify suitable organisation;
- Development of bank mandate ratified by board resolution;
- Development of a delegated authority framework;
- Setup online banking (with User Acceptance Testing)
- Setup of trading limits with relevant bank including overdraft facility and within day / daylight exposure limits (with User Acceptance Testing)
- Set up of general ledger accounts for new bank accounts (for Energy Balancing there may be at least 3 accounts for one User, effectively the equivalent of the neutrality account, cash call account and deposit deed account should the user decide to put in place cash as security)
- Potential changes to Gemini / UK Link to enable Account Bank account to be set at a shipper level rather than at network level as is currently the case.
- Establish costs of service via treasury function i.e. transactional processing costs overdraft costs
- Establish impact on financial statements of incorporation of combined banking charges to include User Acceptance Testing if necessary
- Establish any impacts on scope of audit for invoicing processes
- Establish framework to assess suitability of Banks and amend relevant Credit Rules pursuant to relevant governance process
- Establish appropriate segregation of duties around set up and ongoing operation of account to prevent fraud
- Review & sign off of proposed control framework by Risk & Financial Controls function

For National Grid, our Treasury function has advised that the 'setup' process for a new bank account will take approximately 3 months to ensure that National Grid is compliant with relevant Financial Services Authority and internal obligations.

Ongoing

- Monthly reconciliation of account
- Quarterly validation of costs and recovery
- Annual review of delegation of authorities framework to ensure appropriate operating limits
- Ongoing monitoring of Bank via Credit Rating Agency to ensure it meets acceptable criteria
- Annual review of control framework as part of Audit requirements