

TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0595
"Revision to the process for recovering unpaid capacity and commodity invoices "
Version 2.0

Date: 23/10/2002

Proposed Implementation Date:

Urgency: Non-Urgent

Justification

In Ofgem's letter of 27 September 2002, which accompanied the modifications to Transco's GT licence, Ofgem indicated that Transco is able to apply to Ofgem for an Income Adjusting Event should it be unable to recover a shortfall in transportation charges or capacity charges as a result of a shipper termination. In this letter, Ofgem indicated that as part of this process it would consider whether the credit arrangements Transco had established were reasonable and commercial in nature, having regard to other credit arrangements adopted for long-term supply contracts in the gas and electricity sectors. Until this has been demonstrated, it would be Transco, and not its customers, that carry the risk of shipper default with respect to entry capacity.

The current drafting of the Network Code, as modified as part of the implementation of modification 500 relating to long-term auctions, allows Transco to recover unpaid amounts from invoices that have remained unpaid for 2 months from users through, for example, capacity neutrality adjustments.

AEP do not believe that the current Network Code rules are consistent with the position in relation to credit outlined by Ofgem as part of the overall NTS TO price control and NTS SO incentive arrangements. AEP do not believe that Transco should be able to automatically recover unpaid amounts from Users. AEP is also concerned that the current mechanism used to determine how unpaid invoices are recovered is arbitrary and inappropriate. Amounts are recovered in proportion to the neutrality driver, which uses a shippers proportion of capacity held at all ASEPs relative to the total capacity in circulation. As there is a defined lag between failure to pay and recovery through neutrality, this may lead to perverse behaviour in the capacity market to avoid neutrality charges. The current rules may also lead to inequitable recovery from certain shippers based on short term capacity positions.

AEP believe that Transco should first have to demonstrate that it has acted reasonably and commercially in managing credit exposure. Where it is able to do so, it should be allowed to recover all amounts that are owed to it. However, Transco should develop and consult on a robust and reasonable methodology to determine how these costs will be recovered from users.

This proposal merits urgent status as given current market conditions and Code credit arrangements there is a significant risk to shippers that one or more Users may default and be terminated from Code. Under the current Code Rules, any bad debts will be automatically recovered from shippers in an inappropriate and arbitrary manner. Experience from the collapse of Enron suggests that the unpaid amounts to be recovered could be very large. In the absence of a modification to the current rules, this could be expected to have a significant

commercial impact on shippers and customers. Given the possibility of default by one or more parties in the coming weeks, this modification proposal merits urgent status.

Although the issue of credit is the subject of an Ofgem consultation, the risks to shippers and the industry given current market conditions require change to be made immediately. There has been a long delay in the publication of conclusions by Ofgem (this consultation was initiated in March). If Ofgem's conclusions are not consistent with this proposal, a further rule change can be raised to bring the rules in line with Ofgem's conclusions. This proposal will protect shippers and customers in the intervening period.

Nature of Proposal

Where a User is in default and/or is terminated from the Network Code and Transco does not have sufficient credit cover in place to cover any outstanding amounts owed in relation to System Capacity and/or System Commodity Charges, Transco must make an application to the Authority. The Authority will provide a direction to Transco on the amount that Transco may recover from Users. The Authority will also direct how Transco may recover any amounts from users.

Transco will not be able to recover any unpaid amounts associated with Capacity and Commodity invoices without a direction from the Authority.

Purpose of Proposal

This modification would, if implemented, better facilitate the relevant objectives of the efficient and economic operation of the pipeline system and competition between shippers and suppliers. The proposal will provide a strong incentive on Transco to act economically and efficiently in setting up appropriate capacity arrangements and managing credit risk appropriately. It will also ensure that any recovery from shippers of unpaid amounts is fair and equitable. This will promote competition,

Consequence of not making this change

Current credit arrangements and recovery mechanisms will remain in place. This will increase shippers' assessments of the risks of participating in the gas market. Shippers will seek to pass these additional risks through to customers through higher charges. The current arrangements may also act as a barrier to new entry for small players.

Area of Network Code Concerned

Section B

Proposer's Representative

Stephen Charles Smith (AEP Energy Services Ltd)

Proposer

Stephen Charles Smith (AEP Energy Services Ltd)

Signature

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