

TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0596

"Revision to the process for recovering unpaid energy balancing charges invoices"

Version 1.0

Date: 18/10/2002

Proposed Implementation Date: 31/10/2002

Urgency: Urgent

Justification

The current Network Code rules allow Transco to recover unpaid amounts from energy balancing invoices that have remained unpaid for 3 months from users through an "Additional Monthly Adjustment Neutrality Cost".

In the event of the failure of a shipper, these costs (that are then recovered from shippers) can be significant, depending on the size and portfolio of the shipper. In the case of the collapse of Enron, approximately £9m of debts were recovered from shipper in a single month.

Transco is acting as shippers' agent when managing credit exposure associated with energy balancing. Following Ofgem's consultation on credit and lessons learned from the collapse of Enron, Powergen has raised a modification that proposes that Transco should be required to hold cash or letters of credit as security against energy balancing liabilities. Transco has indicated that it does not support this modification, as it believes that any changes to the current arrangements should be made when Ofgem publishes its conclusions.

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.

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.

AEP does not believe that the current mechanism for recovering costs is appropriate. The current methodology is arbitrary and inequitable. The proportion of unpaid amounts recovered from shippers is based on a shipper's proportion of total system throughput in an essentially arbitrary month (determined by the invoicing cycle). AEP do not believe that this is an appropriate methodology to recover unpaid amounts that could be significant.

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.

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 Balancing Invoices, 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 Balancing 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 credit 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 F

Proposer's Representative

Stephen Charles Smith (AEP Energy Services Ltd)

Proposer

Stephen Charles Smith (AEP Energy Services Ltd)

Signature

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