

TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0629
"Minimum Level of Security for Energy Balancing"
Version 1.0

Date: 14/05/2003

Proposed Implementation Date:

Urgency: Non-Urgent

Justification

Recent financial failures, such as Independent Energy and Enron, have resulted in the shipping community being exposed to pre-insolvency debt via the energy balancing neutrality smearing mechanism. These failures have focused Users' attention on the need to maximise the protection afforded by the provisions contained in the Network Code Supplement (Section X) and the Energy Balancing Credit Rules ("EBCRs"). Of particular concern is the potential for a User to increase its trading activity at the National Balancing Point, resulting in a significant imbalance and a rapid increase in its credit exposure. Following recent discussions at the Energy Balancing Credit Committee ("EBCC"), members were of the opinion that it would be appropriate to impose minimum levels of security that better reflect Users' prevailing balancing activities.

In accordance with Section X, where a User elects to maintain a Secured Credit Limit in relation to their energy balancing position, they must do so in accordance with the EBCRs. At present, Users may secure their credit limit in a number of ways, ranging from Approved Credit Ratings, Parent Company Guarantees, Letters of Credit to the lodgment of cash via a Deposit Agreement or prepayment. However, Modification 0572 ("The provision of Letters of Credit for Energy Balancing Credit cover") is to be implemented on 1 August 2003 and all Users that elect to secure a credit limit would have to provide either cash or a Letter of Credit. It should be noted that despite the stringent rules regarding types of suitable security, there is currently no absolute obligation on a User to secure a credit limit.

Once a User has secured a credit limit, its "Cash-Call Limit" would be allocated and set at a level equivalent to 85% of the Secured Credit Limit. "Outstanding relevant balancing indebtedness", which represents the cumulative debt position, is then measured against this limit. Where a User has not secured a credit limit, any energy balancing debt incurred by the User results in an immediate "Cash-Call".

The EBCC has identified that if a User is regularly required to pay Cash-Call Notices, this is an indication that its Secured Credit Limit is insufficient for its energy balancing activities. In such cases, Transco does not currently have the right to insist on a minimum Secured Credit Limit thereby leaving the community exposed to potential levels of bad debt, that could, otherwise be avoided. Implementation of this proposal would place an obligation on the User.

To secure a credit limit at an appropriate level using an approved instrument of security, thus closing the loophole that currently exists within the current provisions.

Nature of Proposal

It is proposed that where a User is served with two Cash-Call Notices (irrespective of whether this is the first notice, a revision to, or a re-issue of a previous notice) within any rolling 28 calendar day period, ("the measurement period"), Transco would issue a "Notice to Provide Increased Security", as soon as reasonably practicable after the second cash-call notice. The notice would advise the User that in accordance with the Energy Balancing Credit Rules it is required to fully secure a credit limit agreed between Transco and the User, which in any event would be no less than the User's reported peak indebtedness during the measurement period. The User would be required to provide the requested increased security within seven Business Days from the date of the notice.

Additionally, the "Notice to Provide Increased Security" would specify that the additional security must not expire within 90 days of the date of the Notice, although a lesser period could be agreed between the User and Transco where both parties are in agreement.

The User would have a right of appeal against the "Notice to Provide Increased Security" within five Business Days of the notice being served. The User would be required to provide evidence to demonstrate why the required Secured Credit Limit does not reflect their typical energy balancing activities. Where an appeal is lodged, under Section X1.2.3, Transco may convene the Energy Balancing Credit Committee to consider any such appeal. Any consultation would be carried out in accordance with Section X1.2.5 in relation to the protection of the User's identity.

If the User fails to comply with the "Notice to Provide Increased Security", a "Failure to Provide Increased Security Notice" would be issued on the eighth Business Day. In the event that the User does not provide the required security cover within a further seven Business Days from the date of the Failure Notice, the User would be classified "In Default", and Transco would be entitled to call upon any security already lodged or serve a Termination Notice.

Where Transco has issued a "Notice to Provide Increased Security", and until such request has been satisfied, Transco would be entitled to withhold payment pursuant to any Energy Balancing Invoice in respect of any amounts payable to the User in respect of Energy Balancing Charges (irrespective of the Invoice Due Date) and the User would not be entitled to late payment interest in accordance with Section S3.5. In addition, Transco would be entitled to disregard any request made by the User under Section X2.8.6 to release any monies held in the User's cash-call account.

Both notices would be included in template form as appendices to the Energy Balancing Credit Rules.

Purpose of Proposal

The purpose of this proposal is to provide Transco with suitable recourse in the event that a User has repeated cash-calls resulting from the provision of insufficient security for Energy Balancing. The ability to react promptly in order to prevent rapid increases in levels of indebtedness would reduce credit risk exposure and, therefore, could be expected to facilitate a more competitive environment for Users.

Consequence of not making this change

Whilst there remains no requirement for a minimum level of security to be provided, there remains the potential for the community to be exposed to financial loss in the event of a User's failure that could otherwise been avoided. A User could continue to receive frequent Cash-Calls and Failure to Pay Cash-Call Notices, making payment at the last opportunity in order to avoid termination provisions being invoked.

Area of Network Code Concerned

S3.5, X 2

Proposer's Representative

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Proposer

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Signature

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