Joint Office of Gas Transporters

Stage 04: Final Modification Report

0404:

Profiling payment of LDZ capacity transportation charges for Small Shipper Organisations.

There is a view that some smaller Shipper organisations are experiencing cash flow issues as a result of the mis-alignment between their income and the transportation charges levied by DNs. This modification proposes that Shippers meeting certain criteria are permitted to profile the payment of certain charges more in line with their income.

Panel did not recommend implementation

High Impact: Smaller Shippers

Medium Impact: Distribution Networks

Low Impact: -

At what stage is this document in the process?

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About this document:

This document is a Final Modification Report, presented to the Panel on 19 April 2012.

The Authority will consider the Panel's Recommendation and decide whether or not this change should be made.

Any questions?

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1 Summary

Is this a Self-Governance Modification?

The Modification Panel determined that this is not a self-governance modification.

Why Change?

Some Workgroup attendees hold a view that some smaller Shipper organisations are experiencing cash flow issues as a result of the mis-alignment between their income and the transportation charges levied by DNs. This modification proposes that Shippers meeting certain criteria are permitted to profile the payment of certain charges more in line with their income.

Solution

It is proposed that, subject to meeting specific criteria, smaller Shippers will be offered the option to profile their payment of LDZ transportation charges, such that a greater proportion is paid in the winter months and less will be paid in the summer months, although the charges levied will remain the same and all invoiced charges must be paid in full to the DN (including any relevant interest and administration charges) by the end of the relevant financial year.

Impacts and Costs

No Xoserve systems' impacts are anticipated to be necessary to support this modification. There would be no change to LDZ transportation invoices, however Shippers that met the criteria and elected to profile payments would not be required to pay the full amount of invoices during the summer months, but would be required to pay all outstanding amounts during the winter months and in any event pay in full within the relevant financial year. Transporters would be required to monitor the unpaid amounts to ensure that the correct amounts were repaid by the stipulated payment dates (detailed in this modification) and would not invoke the current arrangements available to the DN (detailed in UNC TPD Section S3.5.3 and V4.3) where the Shipper adhered in full to the rules specified in this modification.

Implementation

Some Workgroup attendees agree that this modification should be implemented in time to allow small Shippers the option to profile transportation payments for financial year 2012/13. See Section 6 for detail on dates.

The Case for Change

Implementation may facilitate competition by helping to ensure small Shipper's revenue and costs are more closely aligned, reducing the possibility of gas being shipped / supplied at a loss during the summer months and addressing a cashflow issue which can act as a barrier to market entry and a barrier to business development for smaller Shipper/Suppliers.

2 Why Change?

The present LDZ charging arrangements are primarily based on capacity bookings, which are largely fixed throughout the year. In the case of domestic Shippers, transportation charges are based on SOQs derived from the AQ, which is set for a year. By contrast, Shipper and Supplier revenue is driven by the amount of gas consumed, which is higher in winter than in summer.

The mismatch between the profiles of Shipper / Supplier revenue and transportation charges potentially makes the sale of gas a loss making activity during the summer months for certain Shipper / Suppliers. While this may not create particular difficulties for Shippers and Suppliers with large, diverse portfolios, or those with a low cost of capital, a significant cashflow issue may be created for some smaller Shipper / Supplier organisations. The issue may be particularly acute for smaller Shipper / Suppliers with a primarily domestic customer base or portfolios with a large number of pre-payment meters. The mismatch therefore may create an inappropriate barrier to market entry and business development and change is potentially needed to encourage greater competition within the domestic market.

Some Workgroup attendees were concerned that there is very little evidence to suggest there is a need for these arrangements.

3 Solution

It is proposed that Shippers which meet certain criteria be permitted to profile the payment of Distribution Network Capacity transportation invoices across a year, with the intention of paying in full all outstanding amounts by the end of March in each financial year.

The intention is for the facility to profile payments to be available to smaller Shippers only, and to be restricted to those who supply the SSP market. It is therefore proposed that only Shippers supplying less than 100,000 Smaller Supply Points nationally and where the individual Shipper's Code Credit Limit is less than £500,000, (also less than £500,000 where multiple Shipper licences are owned by the same organisation) would be eligible to take advantage of the option to profile payments. The following business rules would apply:-

1. Shippers meeting the following criteria would be permitted to participate in the summer / winter profiling payment process:-

   (a) Shippers with less than or equal to 100,000 Smaller Supply Points across all Distribution Networks, and

   (b) where Shippers meet the criteria in 1 (a), who also have an organisational Code Credit Limit (as defined in UNC TPD Section V 3.2.1 (a)) of less than £500,000 recorded with the Distribution Network they wish to profile Summer / Winter payments with; and

   (c) where Shippers meet the criteria in 1 (a) & (b) and the Shipper's maximum Value at Risk in the three months preceding May of the relevant year was less than the Shipper's Code Credit Limit.

2. For the months May, June, July and August each year a qualifying Shipper may pay a minimum of 50% of the LDZ Capacity invoice for the Smaller Supply Point element of the invoice for that month. (ZCA & CCA charge types).

3. Qualifying Shippers would re-pay outstanding amounts owing to the relevant DN (resulting from the adoption of business rule 2) from the May, June, July and August LDZ Capacity invoices over the months of October, November, December, January, February and March of the same financial year (adhering to the timeline detailed below)

4. The payment of outstanding amounts by the Qualifying Shipper would be in line with the following schedule:

   (i) The total outstanding amount from the May, June, July and August LDZ Capacity Invoice (resulting from the adoption of business rule 2 by the Qualifying Shipper) would be paid on the basis of one sixth of the total outstanding amount (as of 31st August) to be paid by the end of October, November, December, January, February and March of the same financial year.

(ii) Were a qualifying Shipper to opt to pay more than one sixth of the total outstanding amount (as of 31st August) in any one month October to March they would be permitted to do so.

5. For the avoidance of doubt, interest on any outstanding amounts would continue to be applied by the Transporter in line with existing provisions detailed in UNC TPD Section S 3.6.

6. All payments made by the qualifying Shipper in relation to the outstanding amount would be offset against the earliest occurring outstanding amount for the purposes of interest calculation and VAT payment purposes. Shippers would be required to clarify their VAT payments in relation to the outstanding amounts.

7. For the avoidance of doubt obligations set out in UNC TPD Section V3 "Code Credit Limits" or UNC TPD Section V4 "Discontinuing Users and Termination" would not be altered by this Modification Proposal.

8. For the avoidance of doubt provisions detailed in UNC TPD Section S3.5.3 relating to unpaid amounts would not be altered by this Modification Proposal. However, where Shippers adhere in full to the repayment timescales associated with summer invoice deferment the DN would not invoke these options for the non payment of these amounts only.

4 Relevant Objectives

Impact of the modification on the **Relevant Objectives:**	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	No
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	No
c) Efficient discharge of the licensee's obligations.	No
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	Yes (d i and ii)
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards… are satisfied as respects the availability of gas to their domestic customers.	No
f) Promotion of efficiency in the implementation and administration of the Code	Negative
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators	No

Some Workgroup attendees consider relevant objective d (i) and (ii) (Securing of effective competition between relevant Shippers and relevant Suppliers) may be better facilitated by the implementation of this modification. By allowing qualifying small Shipper organisations to more closely align their Distribution Network transportation costs to their income, this would improve their cash flow situation. Improving cash flow for small Shippers would remove a deterrent to expand their businesses, encouraging organisations to take on increased numbers of small supply points and offering more innovative tariff structures. However, some Workgroup attendees consider that this modification could create a perverse incentive by encouraging smaller shippers to remain within the qualification levels and therefore adversely affect competition.

Some workgroup attendees were concerned that there is a lack of analysis and evidence to back up the statement that this arrangement is wanted or needed by Shippers in order to test that the relevant objective is met.

Workgroup attendees understand that the current arrangements may make supply to small supply points in the summer a loss making activity for all organisations in this sector. However, this modification aims to introduce measures, which may prevent this being a deterrent to new market entrants and to supply point acquisition in this area of the market.

British Gas do not believe this modification will secure effective competition and highlight there has been no impact analysis to demonstrate this and that the modification could create an incentive for smaller shippers not to grow beyond the 100k, £500k credit limit level which could in turn distort competition.

MEUC can foresee difficulties arising at times of proposed transfers depending on the time of year, with this becoming a barrier to competition.

Northern Gas Networks argue that the modification would discriminate against shippers who do not qualify and therefore will not secure effective competition.

Northern Gas Networks and Wales & West Utilities highlight that this modification would have a negative impact on relevant objective f) due to the administration involved in operating this process and thus would not promote efficiency.

5 Impacts and Costs

Consideration of Wider Industry Impacts

None identified.

Costs

Indicative industry costs – User Pays
Classification of the modification as User Pays or not and justification for classification
Not user pays. It is not envisaged there would be any Transporter central systems' changes.
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
Not applicable
Proposed charge(s) for application of Users Pays charges to Shippers
Not applicable
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve
Not applicable

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	• None
Operational Processes	• There would be an increased cost associated with the monitoring and administration of transportation invoices and credit arrangements.
User Pays implications	• None

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• There would be an increased cost associated with the monitoring and administration of transportation invoices.

Impact on Users	
Development, capital and operating costs	• None
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	• None
Development, capital and operating costs	• Additional operating costs would be incurred by the Distribution Networks in monitoring the profiled payments by participating Shippers.
Recovery of costs	• None
Price regulation	• None
Contractual risks	• Increased contractual risk associated with the potential for increased bad debt. A maximum exposure of approx. £1.5m per annum was identified by the DNOs.
Legislative, regulatory and contractual obligations and relationships	• None
Standards of service	• None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None
UNC Committees	• None
General administration	• None

Impact on Code	
Code section	Potential impact
Legal text to be provided.	• UNC TPD Section S

Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification **0565 Transco Proposal for Revision of Network Code Standards of Service** at the following location: www.gasgovernance.co.uk/sites/default/files/0565.zip

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	• None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	• None
Storage Connection Agreement (TPD R1.3.1)	• None
UK Link Manual (TPD U1.4)	• None
Network Code Operations Reporting Manual (TPD V12)	• None
Network Code Validation Rules (TPD V12)	• None
ECQ Methodology (TPD V12)	• None
Measurement Error Notification Guidelines (TPD V12)	• None
Energy Balancing Credit Rules (TPD X2.1)	• None
Uniform Network Code Standards of Service (Various)	• None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	• None
Gas Transporter Licence	• None

Other Impacts	
Item impacted	Potential impact
Security of Supply	• None
Operation of the Total System	• None
Industry fragmentation	• None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	• None

6 Implementation

To facilitate the option of profiling the payment of LDZ Transportation charges in financial year 2012/13 this modification proposal would require the following implementation timescale:

1. Fixed Implementation Dates of 1^{st} May 2012 or 1^{st} June 2012.
2. A Proposed Authority Decision Date by 30^{th} April 2012 to allow an implementation date of 1^{st} May 2012 or a decision date by 31^{st} May 2012 to provide for an implementation date of 1^{st} June 2012.
3. A backstop lead time of 1 month.

The first invoice available for summer/winter profiling would be the May 2012 LDZ Capacity invoice which will have an invoice due date of circa 20^{th} June 2012. To allow the DNs to put in place procedures to monitor and track payments and also to discuss with qualifying Shippers their intentions regarding deferment of transportation charges, the preferred implementation date would be 1^{st} May 2012. An implementation date of 1^{st} June 2012 would still facilitate the option of deferring payment; however this would not be ideal for DNs for the reasons stated.

7 The Case for Change

Nothing in addition to that identified above.

8 Legal Text

The Modification Panel had determined that formal legal text was not required for inclusion in the draft Modification Report. However, Scotia Gas Networks has provided legal text, published alongside this report at www.gasgovernance.co.uk/0404.

National Grid Distribution were concerned about the use of the term 'profiling notice' within the Legal Text and believed this adds a level of uncertainty as the relevant process is not defined. They also note a typing error in section 3.9.3 --- *Profiling Payment in respect of a LDZ Capacity Invoice,* ***~~is~~it*** *shall submit.*

Northern Gas Networks were concerned that the legal text does not appear clear in respect of the qualifying criteria and profiling process. These aspects are further described in the Legal Text section of their response.

Wales & West Utilities disagree that the legal text delivers the intent of the modification; they are concerned that elements of the legal text are confusing and ambiguous which may lead to differing interpretations and, as such, introduces new issues.

9 Consultation Responses

Representations were received from the following parties:

Respondent	
Company/Organisation Name	**Support Implementation or not?**
British Gas	Not in Support
MEUC	Not in Support
National Grid Distribution	Not in Support
Northern Gas Networks	Not in Support
RWE npower	Not in Support
Scotia Gas Networks	Comments
SSE	Not in Support
Wales & West Utilities	Not in Support

Of the 8 representations received 1 provided comments and 7 were not in support.

Summary Comments

British Gas raise a numbers of concerns surrounding the lack of impact analysis, the potential take-up, the risk of unknown potential cost exposure and the socialisation of costs. They consider the modification will increase the operating cost to Smaller Shippers, through higher interest and credit cover costs, increasing the possibility of default and bankruptcy.

British Gas is concerned that this modification could operate as an incentive for smaller Shippers not to grow past the 100k supply point level and £500k credit limit, which could distort competition as small Shippers could make a conscious choice not to grow further. In addition, the modification could disadvantage small Shippers who do not meet the eligibility criteria.

MEUC considers the solution on cash flow is in the hands of the small supplier as with all other suppliers', they can introduce a fixed element to their charges thereby recovering all transportation charges on a monthly basis with only the commodity varying. This in some ways may help their customers by making their bills more predictable.

National Grid is concerned that the modification effectively obligates the Gas Transporters to be 'lenders of last resort'; a late payment rate as provided for in UNC TPD Section S 3.6 being payable by the relevant User who utilises the provision. All qualifying Users could therefore take advantage of this provision as a potential source of revenue if it was deemed to be a cheaper form of credit than that which could be obtained from the market. This raises the issue of potential discrimination as only those Users which met the qualifying criteria would be entitled to partake in the proposed credit arrangements (there is also the question of whether Users who do meet the qualifying criteria of 100,000 customers and code credit limit of £500,000 but have a different demand profile i.e. higher gas usage in summer than winter, could also be disadvantaged).

National Grid Distribution consider the modification could create a risk of bad debt arising in the event that a User who has deferred payments during the summer months gets into difficulties prior to payment of the full year's Transportation Charges. The community and ultimately all consumers would bear this risk.

Northern Gas Networks also have concerns about the qualifying criteria, which would lead Transporters to treat small suppliers opting to use the process with what could be viewed as more favourable terms. They detail concerns about the excessive impact and costs on DNs and explain why they consider implementation of this modification could lead to an increase in bad debt and therefore shippers' value at risk could increase, requiring greater credit security.

Northern Gas Networks is concerned that making the changes suggested in this modification will make a material change to the overall cash-flow of relevant shippers. In the current environment where many residential properties use direct debt to pay utility bills, the Distribution charges element is broadly aligned to this method with the gas usage charges being the material swing in costs.

RWE npower does not agree that the Transporter/Shipper community is best placed to bear any financial risk that may be associated with specific Shippers. The credit market is the appropriate place to secure this to afford protection to all parties and consumers.

Scotia Gas Networks advises that this modification proposes criterion be set to allow a sub-set of Shipper organisations to participate in the process of profiling of charges. This business rule reflects the original proposal initiated by Modification 0383 to restrict the profiling of payments to smaller Shipper organisations, concentrating on the Smaller Supply Point market. This modification proposes that an upper limit of 100,000 Smaller Supply Points be set to restrict availability of the process to small Shipper organisations only. This reflects the original Utilita modification's intent and also introduces a further business rule to restrict participation to group organisations with a Code Credit Limit of less than £500,000. It was considered that it may be appropriate to restrict the profiling process to organisations which absolutely required the facility and not permit the whole industry the option to participate.

SSE is concerned that this modification places increased financial risks on shippers in the event of a default and effectively puts a requirement on transporters to be credit providers.

Wales & West Utilities were concerned that there was no evidence provided during Workgroup discussions from those potentially affected shippers. Given this, they suggested that this modification is not required. In addition, it is complex for DNOs and Shippers to implement and there is also an increased risk of bad debt as part payments in summer may mask inability to pay; insolvency risk re part payments being viewed as a shipper asset if comprehensive allocation to part paid invoices is not achievable.

10 Panel Discussions

The Panel Chair summarised that, being largely capacity based, DN transportation charges are payable in roughly equal monthly amounts. This is not aligned with income received by Shippers when their income is consumption based and gas is predominately consumed in the winter months. It has been suggested that this can create cashflow issues for Shippers, and that supplying domestic customers can be loss making in the summer months. To address this, Modification 0404 seeks to allow, subject to a size threshold, Shippers to defer payment of part of their transportation charges during the summer months, with consequently higher payments in the winter period.

Members recognised that, by more closely aligning income and costs for those Shippers that meet the qualifying criteria, implementation could be expected to provide a cashflow benefit and remove the disincentive to acquire customers in the summer months. Implementation could therefore be consistent with facilitating the securing of effective competition. However, Members also noted that restricting availability of the option to a subset of Shippers could be regarded as unduly discriminatory, and could also create a disincentive to business growth once a qualifying threshold is approached. Members noted that no evidence had been presented during the assessment process, nor in response to the consultation, to indicate that the benefits would outweigh the potential disadvantages to competition.

Members noted that deferring payments would increase the amount due and consequently increase the risk faced by other Shippers in the event of default. While recognising that the ability to defer payments may prevent a Shipper defaulting, conversely it could merely delay default and increase the cost of default. Implementation may, therefore, be detrimental to the securing of effective competition since market risk would be increased.

Members noted that the Transporters would need to make offline arrangements to monitor the payments received and due, and that this would potentially be complex and would increase costs. No evidence had been presented during the assessment process, nor in response to the consultation, to indicate that the benefits of implementation would be sufficient to outweigh the potential costs. As such, implementation could be considered to be detrimental to promotion of efficiency in the implementation and administration of the Code.

Members then voted, and with one vote cast in favour of implementation and eight against, did not determine to recommend that Modification 0404 be implemented.

11 Recommendation

Panel Recommendation

Having considered the 0404 Modification Report, the Panel recommends:

- that proposed Modification 0404 should not be made.