

Modification proposal:	Uniform Network Code (UNC) 0233V: 'Changes to Outstanding Energy Balancing Indebtedness Calculation' (UNC 0233V)		
Decision:	The Authority ¹ has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	13 May 2009	Implementation Date:	Not applicable

Background to the modification proposal

Financial responsibilities

In light of the current financial crisis, the Energy Balancing Credit Committee (EBCC)² undertook a review of the Energy Balancing Credit Rules (EBCR)³ and the Uniform Network Code (the 'code') to identify potential amendments that could minimise the financial risk faced by Users as a result of a User Default⁴. This is one of three modification proposals (the 'proposal') that have been developed as a result of this review⁵.

Outstanding and Anticipated Balancing Indebtedness

In order to participate in the gas balancing market Users are required to provide Security to help ensure they have sufficient collateral in place to pay debts. Under the code there are a number of mechanisms designed to help ensure that a User's debt does not exceed the amount of Security provided. One such mechanism is the calculation of each User's daily⁶ level of indebtedness, which is called their Outstanding Relevant Balancing Indebtedness⁷ ('indebtedness').

Each User's indebtedness takes into consideration an estimation of their anticipated indebtedness, which is defined as their Anticipated Balancing Indebtedness (ABI). An ABI is calculated on a daily basis for each User based on a prescribed methodology outlined in the code. This methodology is based on the prevailing System Average Price (SAP) for that day and the sum of a User's throughput over the preceding 10 days⁸. The code does not permit NG NTS to deviate from this prescribed method for calculating ABI.

Cash Call Limit

A Cash Call Limit represents a threshold for a User's maximum level of indebtedness that is permitted under the code. It is determined as a percentage of the total amount of Security they have provided⁹, which is currently 85 per cent. When a User's level of indebtedness breaches its Cash Call Limit that User is requested to pay a prescribed

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This is a body of industry representatives with certain rights and responsibilities relating to the management of the gas community's energy balancing credit risk. Further information relating to the activities of the EBCC can be found on the Joint Office website at www.gasgovernance.com.

³ The EBCR sets out processes and procedures that provide a framework used to help Users manage their indebtedness and help manage the exposure of all Users to financial loss. A copy of the EBCR can be found on Joint Office website.

⁴ Where Users are in breach of their financial responsibilities they are defined as being in 'Default'. Users' financial responsibilities are outlined in Section F of the code and the circumstances that could result in a User Default are outlined in Sections X and V of the code.

⁵ For further background relating to the EBCC review and the other modifications raised as a result of the EBCC review please refer to our decisions on UNC modification proposals 0234 'To Correct Drafting Inconsistencies between Sections X and V of the UNC in Respect of User Default and Termination' and 0235 'Recovery of Debt and Smearing of Revenues via Energy Balancing Neutrality'. These can be found on the Joint Office website.

⁶ References to 'daily' refer to the 'Gas Flow Day' that relates to the deliveries, offtakes or flows of gas (or other operations). Further information relating to Gas Flow Days can be found in the code.

⁷ From this point forward this will be referred to as 'indebtedness'.

⁸ Each Users daily ABI is based on the average system price and the sum of each Users throughput over the previous 10 days. Further information relating to how ABIs are calculated can be found in Section X 2.5. of the code.

⁹ This is referred to as a Secured Credit Limit.

amount to NG NTS¹⁰. This request is made in the form of a Cash Call Notice¹¹. When a User receives two Cash Call Notices within a 28 day period they are issued with a Request to Provide Further Security (RPFS). Further Security is then required to be lodged with NG NTS in the eight Business Days following the day the RPFS was issued¹². If this does not occur then it could lead to NG NTS meeting with the EBCC to consider the termination of the User¹³.

Right of Appeal

Currently under the code, Users can appeal a Cash Call Notice if there is an error in the prescribed methodology used to calculate their ABI¹⁴. If the appeal is upheld the Cash Call Notice will either be deleted or reissued; if not, the original Cash Call Notice stands. However, Users cannot appeal a Cash Call Notice on the basis that the ABI does not accurately represent its current level of indebtedness. Additionally, the code prohibits NG NTS from recalculating User's indebtedness if it has information available to it, which better represents that User's indebtedness.

Users can appeal an RPFS up to five business days after the request was submitted if they consider the RPFS to be inappropriate. The code does not specify any other circumstance with which Users can raise an appeal against an RPFS. There is no right of appeal against Notice of Failure under the code.

The modification proposal

This proposal seeks to change, the code to enable Users and NG NTS, on direction from the EBCC, to re-calculate User's ABI by using data that is currently not permitted by the code ('closed out data'). The Proposer suggests that this data could include but is not limited to daily trade allocation data or exit allocation data. In circumstances where such data is available this proposal would enable:

- NG NTS, upon direction from EBCC, to recalculate a User's ABI using 'closed out data' which can be found in the public domain, or provided by Users, if the recalculation of that User's ABI would result in a better, reflection of the User's indebtedness. Also, if it would result in an increase of that User's level of indebtedness above their Cash Call Limit; and
- Users to appeal Cash Call Notices if they can provide 'closed out data' which can be verified by NG NTS as providing a more accurate representation of their ABI.

UNC Panel¹⁵ recommendation

At the Modification Panel meeting on 02 April 2009, the Panel recommended implementation of this Proposal. Of the nine Members present capable of casting a vote, all voted in favour of implementation.

The Authority's decision

The Authority has considered the issues raised by the proposal and the Final Modification Report (FMR) dated 03 April 2009. The Authority has considered and taken into account

¹⁰ This is referred to as a Cash Call amount and is calculated as the difference between the User's level of indebtedness and their Cash Call Limit added to an amount equal to 10 per cent of their User's Cash Call Limit.

¹¹ Further information relating to Cash Call Limits and Notices can be found in Section X of the code. From this point forward this is also referred to as a 'Cash Call'.

¹² If a User still fails to lodge the required level of further Security with NG NTS a Notice of Failure is issued that requests payment of the RPFS by the following business day. Further information relating to this can be found in the EBCR.

¹³ This is achieved by issuing a Termination Notice. These notices inform Users of the time and date they will cease to be a User of the gas balancing market. The circumstances in which they are issued are outlined in Section X and V of the code.

¹⁴ Users can also appeal a Cash Call Notice if: the sum of any number of Cash Calls issued to a single User in the same calendar month exceeds the lesser of £1,000,000 or 20 per cent of the User's Cash Call Limit; and if the User considers that the amount of the relevant Cash Call has been calculated erroneously. Further information can be found in Section X of the code.

¹⁵ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR¹⁶.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the code¹⁷.

Reasons for the Authority's decision

Five responses were received to the Joint Office consultation on this proposal and all responses supported implementation of this proposal. The majority of respondents agreed with the Proposer that the proposal would further relevant objectives (c) and (d) of the code. However, the Authority considers that this proposal would have an adverse affect on relevant objective (d) and is neutral in relation to the remaining relevant objectives. Our reasons for this are outlined below.

Relevant objective (c): so far as is consistent with sub paragraph (a) and (b), the efficient discharge of the licensee's obligations under this licence¹⁸

The Proposer and a number of respondents considered that this proposal potentially reduces discrimination against Users that provide sufficient Security to cover their indebtedness. These Users are currently unable to appeal Cash Call Notices that are based on an inaccurate representation of their indebtedness. The Proposer and respondents consider that by removing this potential for discrimination, implementation of this proposal would be expected to facilitate the achievement of this relevant objective.

We consider that in order to robustly assess this proposal against this objective, we require more information regarding its potential impact on the efficient discharge of the licensee's obligations. In the absence of this information we consider this proposal to be neutral against this objective when compared to the current baseline.

Relevant objective (d): so far as is consistent with subparagraphs (a) to (c) the 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;

Risk of exposure to defaulting User debt

The Authority notes that the Proposer and a number of respondents consider that this proposal could enable NG NTS to instigate measures to help reduce User exposure to a defaulting User's debt earlier than currently permitted under the code. Some respondents also supported the ability under the proposal to enable Users to notify NG NTS of data that could better reflect their level of indebtedness. The Proposer and respondents considered that these measures could help reduce User exposure to unnecessary costs, and therefore enhance competition.

Ofgem welcomes the Proposer's intention in this regard. Ofgem notes that this proposal could provide NG NTS with the flexibility to re-calculate a User's ABI to account for the activities of that User in areas of the energy balancing market not accounted for in the current calculation of ABI¹⁹. However, for reasons of reduced transparency and increased uncertainty on timing and the criteria used, we consider that this could have a detrimental impact on competition by impairing Users' ability to efficiently manage their

¹⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

¹⁷ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see:

http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

¹⁸ Standard Special Condition A6. Conduct of Transportation Business

¹⁹ For example this could include User trading behaviour that could be accounted for in ABI by using daily trade allocation data.

energy balancing positions. As such it could increase the risk of User default. These issues are discussed further below:

i. Transparency

As a general principle Ofgem consider that the information used by NG NTS to calculate User indebtedness should be clear and transparent. We are concerned that this proposal could reduce transparency regarding how and when User ABIs are calculated. The code currently outlines the prescribed methodology and data used to determine ABI and this provides Users with the opportunity to understand their ABI at any point in time. This opportunity could help Users manage their energy balance positions and help ensure they make efficient decisions to facilitate their competitiveness in the market.

The proposal would provide NG NTS with the ability to utilise any data in the public domain to re-calculate User ABI in order to issue Cash Call Notices. As such Users may not necessarily be aware of what data can be used to calculate their ABI at any given time. The Authority considers that this reduces the transparency and predictability with which ABIs are calculated. This could have a detrimental impact on the ability for Users to efficiently manage their level of indebtedness. Depending on the prevailing market conditions, in some instances this could increase the risk of User Default.

ii. Uncertainty - timing

Ofgem considers that this proposal could increase uncertainty with regards to the amount of Security that Users are required to provide at any given point in time. If implemented this proposal would provide NG NTS with a flexible tool with which to overwrite the current ABI calculation, when directed by the EBCC, with any data that can be found in the public domain. In doing so it reduces the current degree of certainty currently afforded to current and new market participants regarding the amount of Security they are required to provide at any given time.

This increased uncertainty could act as a disincentive for new Users to enter the market and could adversely impact the behaviour of existing Users. Under current arrangements the current indebtedness calculation can be used as a tool for new entrants to estimate how much Security they require to participate in the market (related to above). If the ABI can be recalculated using data that is not fully defined and on a potentially ad hoc basis, it removes a level of predictability and hence certainty currently surrounding User Security requirements.

iii. Uncertainty - Lack of criteria

Ofgem notes that this proposal does not stipulate specific criteria for the type of information NG NTS can use to recalculate ABI other than it must be publicly available. We are concerned that the proposal provides insufficient guidance and criteria which the EBCC could use as a basis for its decision on whether or not to direct NG NTS to recalculate a User's ABI and the information that NG NTS could or should use in this circumstance. This lack of guidance and criteria provides ambiguity for Users.

We consider that in order for this proposal to more clearly demonstrate that it will facilitate this objective, it may be appropriate for provision to be made in the code for a degree of criteria and guidance to increase certainty for Users. Although we note that this could be mitigated by an effective appeals mechanism.

Additional right of appeal

The Proposer and a number of respondents argue that this proposal better meets this objective as it provides Users with a right of appeal against unnecessary Cash Calls. Currently, there could be circumstances where a User's ABI does not present an accurate representation of their indebtedness. By allowing Users to appeal Cash Call Notices by

using data currently prohibited by the code this Proposal enables Users to seek to change their ABI to prove that they have sufficient Security to cover their indebtedness²⁰. In cases where this can be verified by NG NTS, Users may not have to pay Cash Call Notices and the Proposer and respondents consider that this could result in more Users remaining active in the market. Ofgem supports the intention of this proposal to provide Users with an additional right of appeal.

Further right of appeal

The Authority notes that, if the proposed modification was implemented, Users may want to challenge the 'closed-out-data' that NG NTS has used to recalculate their ABI on the grounds that NG NTS has rejected or failed to consider 'closed-out-data' the user believes is material or where they have concerns about the quality or completeness of the 'closed out data' NG NTS has used and the inferences that it has taken from this data. It is not clear from the legal text whether this situation is already accounted for by the appeals mechanism included with the modification proposal or other existing appeals mechanisms in the code. Were a similar proposal to be raised again we would welcome further consideration and clarity of the rights of a User to appeal in the circumstances noted above.

Summary

The Authority notes that this proposal could enable a more accurate current representation of a Users ABI and this could enable Users to appeal a Cash Call Notice and enable NG NTS to issue Cash Call Notices in circumstances where they otherwise would not be able to. In particular, we note that the proposal attempts to account for a Users activity in areas of the energy balancing market that are currently unaccounted for in the current prescribed methodology used to calculate ABI.

However, on balance Ofgem considers that the possible detrimental impacts of the proposal on transparency and uncertainty could have a greater negative impact on competition than the benefits outlined by the Proposer and respondents. Therefore, although we support the intent of the proposal, we do not consider that it better facilitates this objective compared to the current baseline.

We note that a review of credit²¹ has now commenced. Given the nature of this proposal and the degree of development that has already been undertaken, we consider that any successor to 233V could proceed separately and ahead of any further recommendations that may come from the review.

Ian Marlee
Director, Trading Arrangements
Signed on behalf of the Authority and authorised for that purpose.

²⁰ This applies when the 'closed out data' is provided to and verified by NG NTS to recalculate that Users ABI to show that their level of indebtedness has improved when compared with that outlined in their Cash Call Notice.

²¹ Review (252) of "Network operator credit".