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Dear Fran

### **Credit Cover Arrangements**

I refer to your Consultation Document entitled “Arrangements for Gas and Electricity Supply and Gas Shipping Credit Cover” published in March 2002 and I am pleased to provide the following comments on behalf of United Utilities as both electricity and gas network operator.

Our comments on the specific issues requested are as follows;

#### Aligning Credit Cover Requirements in Gas and Electricity Balancing Arrangements

Although United Utilities is not directly affected by this proposal we see merit in aligning requirements across the gas and electricity markets. We would point out that parental company guarantees did not provide effect credit cover in the recent Enron case and support the move to limit the type of credit cover to letters of credit or cash.

#### Only Letters of Credit and Cash should be accepted as Credit Cover

We welcome and support this proposal as it provides the most effective level of protection whilst maintaining the incentives framework on all parties. However, it does not provide the total solution and it will still be necessary to have a mechanism for recovery through the price control for debts occurred prior to a trade sale or SOLR appointment, for example. In addition, cash carries some risk as growing companies can trade beyond their credit cover, which is generally reviewed twice per year on 1 April and 1 October. There is also a delay between the review date, calculating and informing the Supplier of any top up we may require and actually receiving the cheque.

Approved Credit Ratings and Parental Guarantees offer little protection to a Distributor as evidenced by the failure of Enron. Enron USA had an Approved Credit Rating and provided a Parental Guarantee for Enron Direct Limited.

The most efficient mechanism for facilitating this option would be for the Distributor to hold the cash on deposit (paying an appropriate interest rate) as it avoids the expense of an escrow account. If a Supplier declines to place cash on deposit and requests an escrow account then we would ask that the Supplier meets the bank charges associated with setting up and running the escrow account. Letters of Credit by banks with Approved Credit Rating should be drafted in accordance with the Uniform Customs and Practice for Documentary Credits (1993 Revision) ICC Publication No 500.

The requirement to provide a cash deposit or Letter of Credit equal to 60 days DUoS should not be weakened. Indeed, we strongly believe this period should be increased to 90 days as we need this period to cover any debts that are already outstanding plus any new debts that will accrue, between realising a Supplier is beginning to fail and the appointment by Ofgem of a Supplier of Last Resort. Ninety days billing may easily have become outstanding by the end of this process.

#### Requirement that Credit Cover should be removed and bad debts addressed within the Price Control Framework.

We are uncomfortable with this as the sole means of dealing with this issue as it reduces incentives on all parties to manage the position efficiently. As the document acknowledges it will be necessary to introduce regulatory incentives into this area which would represent a significant expansion of regulation into an area which is normally governed by commercial contracts.

We consider this approach may lead to looser financial discipline by both Supplier and Distributor and the additional regulatory controls necessary would not be welcome. It is also anticipated that the general level of indebtedness would rise significantly.

If the dominant Supplier in a given distribution area were to fail, the impact on the distributors cash flow would be severe, and waiting until the next financial year to recover losses through the price control mechanism would not be a practical option.

Whatever credit cover arrangements are in place there is always likely to be a level of bad debt and a clear mechanism should be in place within the price control to allow for pass through of these costs.

In gas transportation recovery of any bad debt would be through increasing the Condition 4 charge. However, given the Transco price cap applied to IGT's any rise in this charge would need to be offset by a reduction in Condition 4C effectively resulting in the transporter bearing the cost. Whatever the outcome of this consultation this mechanism should be reviewed to ensure these costs do not fall on the transporter.

#### Combination of Measures

This would be our preferred option as it maintains the incentive framework whilst providing the back stop of guaranteed recovery necessary for low risk distribution businesses with compulsory obligations to offer DUoS services.

All Suppliers would be required to provide credit cover by means of Letters of Credit or cash. Any shortfall due to under provision or debts accrued before a trade sale or the appointment of a Supplier of Last Resort may be recovered through the price control mechanism, provided the Distributor could show it had employed reasonable measures to minimise its losses. A definition of the Distributor's obligations in this area would be helpful.

The procedure for dealing with Suppliers who decline to maintain the requisite level of credit cover must be clearly understood by all parties. In the past It has been necessary to give notice to suspend new registrations in order to persuade Suppliers to put the necessary cash deposits in place.

## Costs

The costs incurred by Distributors are administrative costs associated with managing of the credit cover issue and occasional legal fees incurred in vetting proposed contracts. From a Distribution perspective they are not significant compared to the greater issue of protecting DUoS income.

## Enforcement Rules

We strongly support work on identifying where clearer enforcement rules are required. More clearly defined enforcement rules would increase visibility and potentially reduce levels of indebtedness.

The following areas need to be considered;

- Clarification of the rules for Distribution Companies setting out in what circumstances we may restrict or prevent the registration of new customers when a Supplier has reached certain levels of indebtedness. Where a Supplier is persistently late in paying his DUoS invoices, we believe this should trigger a mechanism that would enable a Distributor to suspend further registrations if the suppliers performance did not improve. It is not consistent with the principal of facilitating competition in supply to allow some companies to gain advantage over others by delaying payment of DUoS bills.
- Provision of accurate and timely data essential to the billing process by Suppliers and their agents. Suppliers should be discouraged from delaying the DUoS billing process and disputing DUoS bills if they themselves are responsible for delays in providing essential information. In return, Distributors must provide accurate DUoS bills on time.

Understanding of the billing timetable by both parties.

- Creating an industry standard unpaid invoice follow up process linked into the Supplier of Last Resort process and the suspension of further registrations.
- Understanding and applying the dispute process with a view to keeping disputes to the minimum as this delays payment and increases debt.
- Placing a licence obligation on Suppliers to comply with the Use of System agreement.
- What mechanisms can be utilised by IGT's to prevent further registrations by defaulting suppliers on their networks.

## Bringing Transco's Code Credit Rules into the Network code

It would seem appropriate to bring these into line with equivalent arrangements in electricity.

## Timing of Invoicing Cycle and Payment Terms

We would welcome any debate on how to reduce the level of indebtedness. For example, if a mechanism for establishing weekly direct debits could be found with balances settled on a monthly basis, it may be possible to reduce the amount of cover.

There are two areas not covered by the consultation document which we believe need to be considered in this context.

#### Embedded Distributors and Generators

The evolution of embedded distributors and embedded generators suggests the need for service agreements between the distributor and embedded operators. It would appear desirable to include the credit cover implications of such new agreements within this Ofgem consultation.

It is suggested that Ofgem anticipate the development of service agreements between distributors and embedded operators and bind them to the final outcome of this consultation process.

#### Splitting the NHH Meter Operator Activity between MAM and MAP

Credit cover requirements for meter operation services are currently triggered by a link in NHH Meter Operation Service agreement requires that a Use of System agreement is in full force and effect. The Use of System agreement has a condition precedent that requires companies without Approved Credit Ratings.

Credit cover requirements in the context of metering competition and the proposed map/mam arrangements (particularly where compulsory obligations are retained on the distribution business) should be within the scope of these proposals.

I hope you find these comments helpful and if you wish to discuss any of the issues raised please do not hesitate to give me a ring.

Yours sincerely

**Mike Boxall**  
**Head of Electricity Regulation**