

Modification Report
RG0252 Proposal 8: Unsecured Credit Limit allocated through payment history
Modification Reference Number 0305
Version 3.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

Where capitalised words and phrases are used within this Modification Proposal, those words and phrases shall usually have the meaning given within the Uniform Network Code (unless they are otherwise defined in this Modification Proposal). Key UNC defined terms used in this Modification Proposal are highlighted by an asterisk (*) when first used.

This Modification Proposal*, as with all Modification Proposals, should be read in conjunction with the prevailing Uniform Network Code* (UNC).

Executive Summary

This Modification Proposal seeks to amend the criteria for credit provided by payment history in UNC Transportation Principle Document (TPD) Section V paragraphs 3.1.5 and 3.1.6 to reflect the recommendations of Review Group* 0252 ‘Review of Network Operator Credit Arrangements’ (RG0252) .

It is proposed that credit provision based on a User’s payment history is only available as an option for new entrants (upto the 2 year anniversary date of the User acceding to the UNC). It is also proposed that the UNC adopt a revised approach to administration errors that may allow the credit provision to be maintained where a late payment has occurred.

Background

Review Group 0252 was established in July 2009 to undertake a review of the existing credit arrangements within UNC TPD Section V taking into account other credit related issues that have occurred since the publication of the Ofgem Best Practice Guidelines (BPG) document.

One of the topics discussed by the Review Group was Unsecured Credit Limit* risk and in particular the use of independent assessments and payment history in determining the Unsecured Credit Limit to be provided to small Users*. One concern raised by Review Group attendees was that good payment history under the UNC was not always a useful means of gauging if an applicant was fully credit worthy, as they may not be paying other creditors and this would not be visible to the gas transporters.

The current UNC payment history requirements are detailed in TPD Sections V paragraphs 3.1.5 and 3.1.6, briefly these arrangements allow for payment history to be built up over a 5 year period, however when a payment of greater than £250 is late then any accumulated history would be reset to zero.

The use of payment history as a credit tool to date has been a limited event as Users have opted for other credit tools, such as Letter of Credit* (LoC), Deposit Deed* and independent assessment.

It should be noted that an independent assessment also contains an element of payment history; however this is a more rounded approach that includes a wider payment history check taking into consideration payments to the Transporter(s)* and other parties, when determining the final score/amount of Unsecured Credit Limit to be provided.

RG0252 discussed several potential options for changing the way payment history is currently accrued and, given the aforementioned cross over with independent assessment, the initial preference was to remove payment history as a credit tool. However, following consideration of the views of some small Users about the potential impact on competition it was recognised that new entrants may have difficulty obtaining a full independent assessment until they have been trading for a period of time.

Consideration was also given to reducing the amount of payment history that can be accrued from 5 years to 2 years to limit the exposure to the community. However, the Review Group felt that a further step should also be applied, where a User should move to other credit tools once the initial period of two years expired. This view was provided on the basis that after 2 years the User would have built up sufficient credit history to enable them to undertake an independent assessment.

With the above discussions in mind the Review Group recommended that payment history be retained as a credit tool but that its use be limited to new entrants only with a time limit of a maximum of 2 years from the point they accede to the UNC. After such time the User would need to choose an alternative credit tool and, given that the Review Group have also proposed some enhancements to the independent assessment, this mechanism may be the tool of choice. The Review Group believed this approach would provide responsible credit and limit the exposure to the community of a credit default.

The Review Group also compared the gas payment history processes to the electricity regime (Connection Use of System Code (CUSC)) and it was proposed that the UNC adopt a similar approach to late payments to allow for administration errors. In the current gas regime, if a payment of greater than £250 is late then the accumulated payment history would be reset to zero. In the CUSC a softer landing is applied, where if a payment is received up to and including 2 days after the payment due date then the credit limit would not revert to zero in the first instance.

Nature of the Proposal

It is proposed that TPD Sections V3.1.5 and V3.1.6 should be amended to indicate that credit provision based on a User's payment history is only available as an option up to the 2 year anniversary date of the User acceding to the UNC. After such time the User would not be eligible to use this credit tool. All other credit tools available within TPD Section V, such as independent assessment, Deposit Deed, etc would continue to be available to the User.

It is also proposed to amend the aforementioned UNC Sections to allow for User administration errors referred to earlier in this Proposal:

- Amend 3.1.6 to allow for a payment that is received up to and including 2 days after the payment due date. The Unsecured Credit Limit would not increase for the following month and interest would be charged on the late payment.
- However, the Unsecured Credit Limit would not be reset to zero in the first instance but if payment was late more than once within a rolling 12 calendar month period then the credit limit would reset to zero. Interest would also be charged on the second late payment.

This proposal is further illustrated by the following examples:

- Case 1 - User pays on time: User's Unsecured Credit Limit increases (providing all other invoices are paid on the due date in that month) as with the current UNC by 0.033%. The User will only be permitted to increase their Unsecured Credit level for a period of 2 years from the date they accede to the UNC and as a result the maximum level that can be afforded will be 0.8% of 2% of the relevant gas transporter's Regulatory Asset Value* (RAV).
- Case 2 - User misses payment due date on an invoice but pays up to (and inc.) 2 days late: User's Unsecured Credit level remains unchanged and does not increase and interest is charged on the late payment.
- Case 3 – User pays an invoice more than 2 days late: User's Unsecured Credit allowance reverts to zero and interest is charged on the late payment.
- Case 4 – User pays an invoice up to (and inc.) 2 days late on 2 separate occasions within a 12 calendar month rolling period: the Unsecured Credit Limit reverts to zero after the second instance and interest is charged on the late payments.

Suggested Text

TPD Section V

Amend paragraph 3.1.5 to read as follows:

“The Transporter may allocate an Unsecured Credit Limit to a User based upon the period of time elapsed that such User has paid all invoices by their due date for payment in accordance with Section S, such that after a calendar month and only until the second anniversary of the User's User Accession Date, a User may be allocated an Unsecured Credit Limit on the basis of 0.4% of the relevant Transporter's Maximum Unsecured Credit Limit over a 12 Month period and increasing on an evenly graduated basis each Month up to a maximum of 2 0.8% of the relevant Transporter's Maximum Credit Limit ~~after 5 Years~~.”

Amend paragraph 3.1.6 to read as follows:

“Where a User has been allocated an Unsecured Credit Limit pursuant to paragraph 3.1.5 above, and such User subsequently fails to make payment in

full of any invoice (other than in respect of Energy Balancing Charges) issued in accordance with Section S:

~~(a) with a total amount due of £250 or less, then such User's Unsecured Credit Limit shall be reduced by 50% from the date of such payment default; or~~

(a) on the Invoice Due Date for payment but payment is made in full within 2 Business Days of the Invoice Due Date ("a late payment"), the User shall pay interest on the Invoice Amount and:

(i) where a late payment is made on only one occasion in a 12 Month period the User's Unsecured Credit Limit shall not be increased in accordance with paragraph 3.1.5 above for that Month;

(ii) where a late payment is made on more than one occasion in a 12 Month period the User's Unsecured Credit Limit shall be reduced to zero from the date of the second late payment.

~~(b) with a total amount due of greater than £250, or where a User fails to make payment where payment is made more than 2 Business Days from the Invoice Due Date on any other occasion within 12 Months of a default as set out in (a) above, then such User's Unsecured Credit Limit shall be reduced to zero from the date of such payment default.~~

Subject to paragraph 3.1.5 and this paragraph 3.1.6, the User's payment history may continue to be used following the date of any payment default as set out above to increase the reduced value of the User's Unsecured Credit Limit in accordance with paragraph 3.1.5 above.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

Implementation would not affect xoserve systems or procedures and therefore would not be affected by User Pays governance arrangements.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

3 Extent to which implementation of the proposed modification would better

facilitate the relevant objectives

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (b): so far as is consistent with sub-paragraph (a), the 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;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (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;

By confining the potential exposure/costs that maybe incurred by gas transporters, shippers and ultimately consumers, as a result of a User credit default this Modification Proposal will reduce a possible barrier to entry and may subsequently increase competition. The Proposer believes that limiting payment history to new entrants and restricting its usage to the initial 2 years following accession to the UNC does not prevent such Users from entering the market place.

The Proposal retains all current credit tools for all new entrants during the first 2 years and in addition introduces some allowance for administration errors which takes into account the new User status. Once the User is established, i.e. 2 years post acceding to UNC, then the option of credit provision based on payment history would be removed as by this time a User will be able to use the additional credit tools described in UNC TPD Section V.

We believe that this Modification Proposal therefore strikes an appropriate balance between facilitating new entrants to the market and the risk that such new entrants impose on existing market players and as such furthers this relevant objective.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the 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;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

Implementation would not be expected to better facilitate this relevant objective.

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

There are no implications for operation of the System.

b) Development and capital cost and operating cost implications:

There would be a requirement to make minor changes to the Transporters credit monitoring arrangements.

c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

Not applicable.

d) Analysis of the consequences (if any) this proposal would have on price regulation:

Not applicable.

6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

Reduced contractual risk to gas transporters through limiting both the circumstances/duration that payment history can be used to determine a User's Unsecured Credit Limit and the value that is provided.

7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications

for the UK Link Systems and related computer systems of each Transporter and Users

No implications have been identified.

8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

No implications have been identified.

Development and capital cost and operating cost implications

No implications have been identified.

Consequence for the level of contractual risk of Users

Removing the existing payment history credit tool for Users that have acceded to the UNC for longer than 2 years will reduce the risk of “bad debt” pass through to Users from a credit default.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No implications have been identified.

10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No consequences have been identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Reduces risk from pass through of bad debt resulting from a credit default.
- Introduces a CUSC style ‘soft landing’ to allow for a User administration error.
- Continues to facilitate new entrants.

Disadvantages

- Removing a form of unsecured credit for a User after 2 years of acceding to UNC.

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Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Organisation	Response
British Gas Trading	Supports
Contract Natural Gas	Not in Support
E.ON UK	Supports
First:utility	Not in Support
National Grid Distribution	Supports
National Grid NTS	Supports
Northern Gas Networks	Supports
RWE npower	Not in Support
Scotia Gas Networks	Supports
ScottishPower	Supports
SSE	Supports
Wales & West Utilities	Supports

In summary, of the 12 responses received, 9 supported implementation and 3 opposed implementation of the Proposal.

British Gas Trading challenged whether the Legal Text should be strengthened to make clear the sanctions that will apply in the event that a User fails to put in place another payment method at the end of the 2 year payment history period.

Contract Natural Gas appreciated the concerns raised about the current arrangements for using payment history in determining the Unsecured Credit Limit and were supportive of the concept of a soft landing for administrative errors. However it does not support this Proposal as it stands, as it does not believe it will better facilitate securing effective competition between shippers and between suppliers in an appropriate manner for two reasons:

1. The ultimate responsibility for maintaining creditworthiness should rest with the shipper (or supplier). The ability to use payment history would reduce the credit backing needed by new entrants, who potentially have the weakest understanding of the risks in the industry, and would lead to credit facilities being directed preferentially to purchases in the wholesale

market. Consequently, Contract Natural Gas considers that the use of payment history increases the risk of default and the risk to be borne by transporters and then by other shippers. Consequently, it favours the Review Group's initial preference for removing the use of payment history in determining a shipper's Unsecured Credit Limit.

2. If payment history is to be a part of the arrangements, then it needs to be available to all shippers and not just those who have less than two years' experience in the market. A time limit is an arbitrary factor unrelated to a shipper's performance and in effect discriminates between new and established shippers.

E.ON UK considered this should ensure that undue barriers to entry are not created for new entrants, whilst incentivising use of appropriate credit tools by existing Users.

First:utility did not consider that the amendment of TPD Sections V 3.1.5 and 3.1.6 to withdraw the ability of a User to build up an Unsecured Credit Limit after two years will significantly reduce the risk of other Users and will increase the financial burden for smaller Users, perhaps even to the point of constraining growth. The requirements are stringent. If any payment is missed, the Unsecured Credit Limit of the User in question will be reduced by 50% from the date of this default. If the amount of the missed payment is over £250, or if a User misses any payment following a previous default of less than £250, the User's Unsecured Credit Limit is then set to zero.

First:utility considered that, after two years, a new entrant should be in a position to undertake an Independent Credit Assessment, it is often difficult and expensive for smaller Users to obtain Independent Credit Ratings and almost impossible for them to obtain Approved Credit Ratings. They are therefore required to post cash, which ties up working capital, which could otherwise be used operationally.

National Grid Distribution considered that this Proposal appears to remove the availability of a credit tool for exiting Users in the market for greater than two years. The Review Group identified that payment history is a component of an independent assessment, which provides a more rounded assessment of a User's liquidity than payment history in isolation. Hence this is a preferable form of measurement to determine a User's level of unsecured credit.

Northern Gas Networks expressed a view that good payment history with the Transporter does not necessarily mean that a User is creditworthy as it may not be paying other creditors. The introduction of the soft landing will also reduce unnecessary administration and potentially harsh penalties where a genuine error has occurred.

RWE npower considered the proposed approach to only allow new Users the ability to use payment history is discriminatory. The approach the CUSC offers is non-discriminatory with regard to payment history whilst also offering a "soft landing" which RWE npower strongly supports and believes should be introduced into the UNC. In line with the CUSC, RWE npower considered that the payment history allowance maximum should remain at 2% of the

Transporter's Maximum Credit Limit and not be reduced to 0.8% as suggested in the above Proposal.

RWE npower considered the current text "based upon period of time elapsed" does not sufficiently convey the objectives of this clause. If this clause is to reward consistent and timely payment, RWE npower would suggest the wording "the Transporter may allocate an unsecured credit limit based upon a criteria of consistent and timely payment by the User of all invoices by the due date and in accordance with Section S.", be inserted into TPD Section V3.1.5.

RWE npower would also suggest the wording of TPD Section V3.1.6a as follows, "on the Invoice Date for payment **and** where payment is made in full within 2 Business days" and that immediately following TPD V3.1.6 (a) (ii) insert the word "or".

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

The Review Group suggested that the Modification Proposal is implemented 3 calendar months after the Authority decision, to allow time for any User affected to arrange alternative credit tools.

17 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 19 August 2010, the eleven Panel Members present determined by PANEL MAJORITY to recommend implementation of the Proposal, with six Members voting in favour.

The Panel Chair noted that twelve responses had been received, of which nine supported and three opposed implementation. He suggested that clear and effective credit requirements within the UNC provide protection and reassurance for all parties, helping to prevent bad debt escalating to inappropriate levels. Requiring credit provision also provides an appropriate barrier to entry. Hence including appropriate credit arrangements within the UNC is consistent with facilitating effective competition between Shippers. Consequently reviewing and improving the arrangements where appropriate is also consistent with facilitating effective competition.

The Panel Chair summarised that Proposal 0305 seeks to remove the use of payment history in setting credit limits other than for new entrants. It also provides for a revised approach to administration errors that may allow credit provision to be maintained where a late payment has occurred. By removing the ability to rely on payment history, which may not represent a rounded view of credit worthiness, risk would be reduced thereby facilitating effective competition. However, retaining the option for new entrants is discriminatory and so may not be regarded as facilitating effective competition. In addition, it may not be economic for smaller Users in particular to access the alternatives provided for in the UNC, such that the removal of the payment history option may increase costs for smaller Users such that implementation would not be expected to facilitate competition.

The GdF Suez Panel member was concerned that this is a tool that is being used and it is proposed to withdraw it, and questioned how transition would be managed. The National Grid NTS Panel member advised that, to allow those using the tool to make alternative arrangements, the intent is for the proposal to be implemented three months after approval is received from Ofgem.

The EDF Energy Panel member suggested removing the tool was not clearly justified. A good payment record is desirable and is evidence that Users manage their accounts effectively. The Northern Gas Networks Panel member did not agree and suggested that transportation charge payment history does not provide a view of how a User is operating with respect to other creditors. Looking at a more rounded independent assessment would be expected to be a better indicator.

The British Gas Panel member noted there was a balance to be struck. Removal of a tool, which may be particularly relied on by smaller Users, had to be measured against the reduced risk of default and cost to the industry.

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity

Markets Authority in accordance with this report.

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Text

TPD Section V

Amend paragraph 3.1.5 to read as follows:

“The Transporter may allocate an Unsecured Credit Limit to a User based upon the period of time elapsed that such User has paid all invoices by their due date for payment in accordance with Section S, such that after a calendar month and only until the second anniversary of the User’s User Accession Date, a User may be allocated an Unsecured Credit Limit on the basis of 0.4% of the relevant Transporter’s Maximum Unsecured Credit Limit over a 12 Month period and increasing on an evenly graduated basis each Month up to a maximum of 0.8% of the relevant Transporter’s Maximum Credit Limit ~~after 5 Years.~~”

Amend paragraph 3.1.6 to read as follows:

“Where a User has been allocated an Unsecured Credit Limit pursuant to paragraph 3.1.5 above, and such User subsequently fails to make payment in full of any invoice (other than in respect of Energy Balancing Charges) issued in accordance with Section S:

- ~~(a) with a total amount due of £250 or less, then such User’s Unsecured Credit Limit shall be reduced by 50% from the date of such payment default; or~~
- (a) on the Invoice Due Date for payment but payment is made in full within 2 Business Days of the Invoice Due Date (“a late payment”), the User shall pay interest on the Invoice Amount and:
 - (i) where a late payment is made on only one occasion in a 12 Month period the User’s Unsecured Credit Limit shall not be increased in accordance with paragraph 3.1.5 above for that Month;
 - (ii) where a late payment is made on more than one occasion in a 12 Month period the User’s Unsecured Credit Limit shall be reduced to zero from the date of the second late payment.
- ~~(c) with a total amount due of greater than £250, or where a User fails to make payment where payment is made more than 2 Business Days from the Invoice Due Date on any other occasion within 12 Months of a default as set out in (a) above, then such User’s Unsecured Credit Limit shall be reduced to zero from the date of such payment default.~~

Subject to paragraph 3.1.5 and this paragraph 3.1.6, the User’s payment history may continue to be used following the date of any payment default as set out above to increase the reduced value of the User’s Unsecured Credit Limit in accordance with paragraph 3.1.5 above.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters