Representation For. 0023

"Re-assessment of User Unsecured Credit Limits"
Version 1.0

Date of Communication:	20/09/2005
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Slant:	Against
Strictly Confidential:	No

Abstract

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6th September 2005

Mod 0023

Dear Julian,

Thank you for inviting us to respond to Mod Proposal 0023. Although there are similarities between Mod 0023, 0031 &0041 there are important differences both in the content of the proposals and in the drafting of the Draft Mod Reports. I will comment on the drafting Mod 0023first and later in this letter upon the aspects of the proposal itself.

In section 1 the Modification Proposal, the DMR has in the main lifted text directly from the original proposal. However, other albeit small parts of the original have been changed. This in itself is not necessarily wrong, but it is unclear when changes to the original are appropriate.

In the third paragraph starting "In accordance with the Code Credit Rules....." The wording seems to infer that the Code Credit Rules are superior to the UNC. I believe that the code credit rules are an ancillary document to the UNC. I would be concerned if this statement was meant to suggest that the rules within the UNC could be overridden by the Code Credit Rules.

There are a number of references to Transco rather than Transporter which do not seem appropriate. For instance in the 5th paragraph of section 1 (the Modification Proposal) it refers to a Users Unsecured Credit Limit being assessed by Transco, surely this should be carried out by the appropriate Transporter as detailed in the legal text.

As to the content of the proposal, there are two parts; the first part looks to set the maximum unsecured credit limit at 2% of the Transporters Regulatory Asset Value. The second part deals with the level of unsecured credit limit that is allowed by the Transporter according to the credit rating agencies Standards & Poor's and Moody's Investors Service.

We support the introduction of the maximum unsecured credit limit of 2% of the Transporters Regulatory Asset Value. In fact we incorporate this into our own Mod Proposal 31.

However, we do not support the selection of only part of the recommendations identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05. Considerable time and effort has been expended by Ofgem and many participants in the production of this document. For the Proposer then to select only certain aspects of the particular topic and to ignore other parts of the subject seems opportune. The range of credit ratings that this mod proposes reflects the status quo rather than embracing the developing environment.

We believe that there has been a misunderstanding as to the purpose of a Credit Rating. Whilst it is true that it is used as a general guide to the overall creditworthiness of a company, it has a more specific role, namely that of determining the likelihood of a company defaulting on a 5 year corporate debt. Transportation charges, (Commodity and Capacity invoices) are billed monthly and paid before the completion of the second month, the Reconciliation invoice is paid before the middle of the following month. However the Reconciliation invoice is effectively a redistribution of costs to the appropriate meter point owners rather than a revenue raising exercise by the transporter. Thus the maximum period that a transporter is exposed to is 2 months rather than 5 years.

JP Morgan the highly regarded bank has developed a method of assessing payment risk, known as CreditMetrics TM. This well established and relatively simple method facilitates an analysis of the risk of default on short term debt (90days).

	45 days	90 days
AAA	0.00%	0.00%
AA	0.00%	0.00%
A	0.00%	0.01%
BBB	0.04%	0.08%

BB 0.13% 0.28%
B 0.72% 1.46%
CCC 5.23% 9.99%

The above table clearly shows that the likelihood of a BB rated company defaulting on its short term debt is not materially different to that of an AAA rated company.

Whilst it is not a requirement for the proposer to explain why they are not including the full range of credit ratings as identified in the "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" doc, the fact that they only wish to "mirror the scope" of their current arrangements leads one to suspect that they are only interested in keeping costs down to a minimum.

Therefore we do not support this proposal. We see no justification for the omission of the BB band of credit ratings from the range of companies entitled to a level of unsecured credit. We urge the Regulator to reject this proposal in favour of Mod 0031 which includes the BB band of credit ratings as identified in the Best Practices Guidelines.

Yours sincerely,

Simon Howe.
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