

**Modification Report**  
**Notice Period for Credit Limit Downgrade and Remedies for Non-compliance**  
**Modification Reference Number 0025**

Version 2.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 9.6.

**1. The Modification Proposal**

This is one of a number of Proposals which seek to implement recommendations identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05. This concluded the high-level principles that should be applied and further work required in respect of credit cover arrangements for transportation.

This Proposal seeks to implement recommendations detailed within paragraphs 3.50 to 3.54 of the conclusion document.

Uniform Network Code (UNC) Section S3.1 details the invoice payment terms to which Users are obliged to adhere. UNC Section V3.2.4 makes provision for Transporters to review in accordance with the Code Credit Rules a User's Code Credit Limit. This can only take place if a User's (or User's security provider) published credit rating is downgraded.

Currently, the credit limit reduction can only take effect after a notice period of thirty-days or a lesser period agreed by the User (unless the downgrade is of the User's published credit rating to a level below the minimum prescribed by the Transporter/s in which case the credit limit can be immediately revised). It is proposed that where such a credit rating is reduced, this be reflected by the Transporter with a minimum notice period of two Business Days or a lesser period agreed by the User

It is further proposed that where a User does not comply with any request to provide additional security, the following would apply. The User will be in default (all monies will effectively become overdue and payable):

<b>Number of Days After Default</b>	<b>Action Suggested</b>
Day 0	Due Date
Day +1	Administration and daily fee trigger
Day +1	Transporter to issue formal notice of default as to statement of position and how default is to be remedied.
Day +3	Formal User response is required
Day +5	Ability to suspend registration of Supply Points

It is proposed that in all instances, administration and daily fees should be charged in accordance with the above timetable in line with the amounts detailed as follows:

<b>Size of Credit ‘shortfall’</b>	<b>Administration fee that can be claimed</b>
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

It is proposed that a daily fee be charged in respect of the credit ‘shortfall’ at a rate equal to the Bank of England base interest rate plus eight percentage points per annum. This rate is calculated by adding 8 percentage points to the reference rate, which is the Bank of England base rate on 30 June and 31 December each year. This rate is applicable for the following six-month periods i.e. 1 July to 31 December and 1 January to 30 June respectively. Transco believes that this would act as an incentive to ensure appropriate credit arrangements are in place.

It is further proposed to utilise any other legal remedy available. It is anticipated that this would prompt a User to take the required action.

## **2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives**

Implementing consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

WWU commented believes that *“the proposal facilitates the relevant objective of securing effective competition between Relevant Shippers”*.

UKD stated that *“incorporation of credit arrangements within the Uniform Network Code ..would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers”*.

UKT *“consider that this Proposal, if implemented, may facilitate greater competition between Users as a result of providing greater confidence within the industry in respect of risk mitigation from exposure to Shipper default”*.

TGP and TEP concluded *“we...believe that modification 0025 promotes the Transporters ability to operate the network in an efficient and economic manner and so fulfills the relevant objectives of licence condition A11”*.

## **3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation**

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

TGP and TEP concurred that “*a common set of rules, which apply to all Users, will reduce the effects of industry fragmentation and ensure consistency across the network*”.

**4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including**

**a) implications for operation of the System:**

No implications for operation of the system have been identified.

**b) development and capital cost and operating cost implications:**

The proposer has suggested that any costs would be minimal.

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

No cost recovery mechanism is proposed.

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

No such consequences are anticipated.

**5. 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**

No such consequence is anticipated.

**6. 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 systems impacts are anticipated by either Transporters or Users.

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

The Proposal may increase costs for some Users. It may not be practical for Users to put in place the required security within the minimum timescale proposed.

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

No such implications have been identified.

**9. 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 such consequences are anticipated.

**10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal**

**Advantages**

- Increased alignment of the UNC with best practice as identified in Ofgem's conclusions document.
- Ensures credit cover continues to be sought on a non-discriminatory basis
- Significant reduction in time available to take required steps following reduction of a Users Credit Limit (reduced Transporter risk).

**Disadvantages**

- Significant reduction in time available to take required steps following reduction of a Users Credit Limit (increased Shipper risk).
- Potentially increases some Users' costs through application of penal interest rate.

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

Eleven representations (from the following) were received with respect to this Modification Proposal. Seven parties support implementation, two parties offered qualified support and two parties oppose implementation.

<u>Organisation</u>	<u>Abbreviation</u>	<u>Position</u>
Wales & West Utilities	WWU	Support
Transco UKD	UKD	Support
Transco UKT	UKT	Qualified Support
Scotia Gas Networks	SGN	Qualified Support
Northern Gas Networks	NGN	Support
British Gas Trading	BGT	Support
RWE npower	RWE	Oppose
Total Gas & Power	TGP	Support
Total E&P	TEP	Support
Regent	REG	Oppose
E.ON	EON	Support

WWU highlighted that “*credit ratings are a reasonable basis for ascertaining default risk, but they cannot be relied upon to fully reflect the “financial state” of an entity in a timely manner. It is important that the UNC recognises this, and this modification proposal introduces a pragmatic process to permit the transporter to react to downgrades in a consistent and prompt manner*”. It believes that “*the administration charges are reasonable and that the trigger payment is at an appropriate level...the proposal is even-handed, straightforward to administer and cost-effective. It recognises the need to permit transporters to react swiftly to changing circumstances*”.

UKD commented that “*Timely revision of credit security...is vital in terms of minimising financial risk to Transporters and potentially Users.... as identified within the Ofgem Conclusions Document, Transco believes two Business Days is sufficient for Users to lodge additional security*”. It added that it “*further agrees with the recommendation identified within Ofgem’s Conclusions Document in respect of the levy of charges to Users and the ability to restrict portfolio growth in the event that the Credit Security arrangements are not in place within the required timescale*”.

In respect of the legal text as detailed within the Draft Modification Report UKD “*suggests the following amendments which cover two specific points:*

- 1. the ‘deadline’ for User provision of additional security or surety following the downgrade of a User’s published credit rating should be the close of business on the second Business Day (1700hrs) following the issue of the notice (reflected in amended text within additional section V3.2.9), and*
- 2. as detailed within the Modification Proposal, inclusion of the right for a Transporter to suspend User registration of Supply Points where that User has failed to provide additional security or surety where requested by the Transporter, this right being available from the commencement of the fifth Business Day following the ‘deadline’ for the provision of the additional security or surety (reflected within the additional Section V3.2.10).*

*The full legal text proposed is detailed below:*

#### **TPD SECTION V: GENERAL**

*Amend paragraph 3.2.4 to read as follows:*

A User’s Code Credit Limit may from time to time...on notice of not less than 30 Days in the case of (a), (b), (d) and (e) or 2 Business Days in the case of (c) below (or in any such case, such lesser period agreed by the User) to the User:

*Add new paragraph 3.2.9 to read as follows:*

Where a User’s Code Credit Limit has been revised downwards in accordance with paragraph 3.2.4 (c) above, such User must where notified by the Transporter provide additional surety or security for such amount as shall be notified by the Transporter and in a form acceptable to the Transporter no later than 17:00 hours on the second Business Day after the date of the notice given pursuant to paragraph 3.2.4. Where a

User has not provided such additional surety or security by such date, the User shall pay to the Transporter:

(a) such amount as set out in the table below based upon the amount of additional surety or security demanded by the Transporter; and

Amount of additional security required	Amount
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

(b) a daily charge equivalent to that percentage rate as is set out from time to time in the Late Payments of Commercial Debts (Interest) Act 1998 multiplied by the amount of additional security demanded by the Transporter.

*Add new paragraph 3.2.10 to read as follows:*

Where a User has not provided such additional surety or security as set out in paragraph 3.2.9, with effect from 06:00 hours on the seventh Business Day following the date of the notice given pursuant to paragraph 3.2.4, the Transporter shall be entitled to reject or refuse to accept a Supply Point Nomination or Supply Point Confirmation by the relevant User under Section G, other than a Supply Point Renomination or Supply Point Reconfirmation (unless made in the context of an application for System Capacity or increased System Capacity at any System Point under Section B or G5) until such time as the relevant User has provided such additional surety or security.

UKT recognised that “*down grading notice is currently carried out over a 30-day notice period*” and added “*we agree that the down grading notice could be achieved within a 2-day period*”. UKT believes that “*such measures introduce robust procedures and best practice measures that may minimise the impact that User failure may have on the industry*”.

SGN confirmed that it was “*generally supportive of the timetable and proposed interest rates but disagree with the amendment to 3.2.4 which keeps notice at 30 days under (d). We believe that (d) should be reduced to 2 days along with (c)*”.

Without prejudice to any view expressed by the Authority, the SME would comment that the proposal seeks to implement recommendations detailed within sections 3.39 and 3.40 and as such this proposal only advocates change in respect of the revision of a Code Credit Limit in the event of the reduction of a published credit rating. To incorporate impacts on the Code Credit Limit due to other circumstances would appear to be outside the scope of the Proposal.

BGT commented that the “*current provisions within Code Credit Rules ...do not reflect ... the credit position of a User may change within a short time. This proposal would bring these measures to bear over a period of just five days which*

*is both more realistic and serves as a greater incentive for a User to address their credit position more expeditiously”.*

RWE confirmed that it *“can not support this proposal because we believe that the legal text is seriously flawed”*. Reflecting discussion in the Distribution Workstream, RWE confirmed that it was *“generally understood why a Transporter might wish to protect themselves, and by implication the other Users, if another User suffers a downgrading of its Credit Rating...reduction of 30 to 2 days...was accepted in the main as the appropriate”*.

Reflecting its specific concern, RWE stated *“proposed legal text V. 3.2.4 ... refers to "or 2 Business Days in the case of (c)". The text of c is "where any published credit rating of the User or any person providing surety for the User is revised downwards;"”*. RWE suggested that *“The consequence of the legal text is that a perfectly sound User, whose credit rating is unaffected, will be faced with having to find additional security at 2 days notice because the credit rating of another person or company is downgraded. I do not believe that this was the intention of the Proposal, but it would be the result if the Mod is approved”*.

The SME would comment that the obligation to provide additional security (within new section TPD V3.2.9) is on the User relevant to the Code Credit Limit in question and is not incumbent on any third party who provides surety or security on that Users behalf. The wording of TPD V3.2.4(c) (which is not subject to change if this proposal were implemented) merely acknowledges that the User may fulfill its surety or security requirements via a third party. These terms will not impose any obligations on any User whose Code Credit Limit has not been impacted by the published Credit Limit downgrade.

RWE also noted that *“The second new paragraph in the proposal 3.2.9 states “... User must where notified by the Transporter provide additional surety or security no later than 0559 on the second Business Day after the date of the notice ....”. The implication...in effect means that the Users has only 1 Business Day after the notice day to arrange the required additional surety or security. We believe that the time should have been 2359 on the second Business day”*.

The SME notes the definition of “Business Day” (UNC General Terms Section C2.2.1(b)) being ‘(except for the purposes of TPD Sections G and M) a Day other than a Saturday or a Sunday or a Day which begins at 06:00 hours on a bank holiday in England and Wales’. Accordingly, the close of a Business Day according to the definition is 05:59 and therefore the proposed deadline is the end of the second Business day following the date of this issue of the notice. This allows the relevant User a minimum of two business days and a maximum of two days, twenty-three hours and 59 minutes notice (assuming the notice is issued at 06:00 on the notice issue date). The SME notes that the proposer has suggested amendment of the legal text to reflect the deadline as the ‘close of business’ (‘17:00 hours on the second Business Day after the date of the notice’).

In respect of the financial penalties proposed, RWE commented that *“although this has been identified in the Best Practice Guidelines...we are not aware of, and Transco did not provide, any evidence that the extra incentive was required.”* It

added that *“the "Late Payment of Commercial Debt Act" is an act that was introduced to penalise large companies, who as a result of their size were late in paying invoices to small companies... This Modification is contrary to this principle as it is concerned with payment of security not invoices”*. RWE summarised *“We believe that these provisions are too onerous and could fatally contribute to financial problems that the User might be facing”*.

TGP and TEP confirmed that they *“agree that setting a limit of 2 business days to provide additional cover ensures sufficient protection to the industry and minimises the potential of bad debt... 8% shortfall charge is an appropriate incentive... Users will be aware of potential credit problems prior to the downgrade and... have sufficient notice of the need to source additional credit cover”*.

TGP and TEP expressed concern that *“the table indicating the timescales for actions to be taken when a party is defaulting on payment has not been included within the legal text. We understand... that this is an oversight, but we would be more comfortable with this proposal if this timetable is included with the UNC”*.

The SME notes that the proposer has provided suggested additional text within its representation in respect of the aforementioned actions to be taken.

REG believe that *“requestes [that] require the shipper to increase their security... within two days notice will add an unfair financial burden... which could result (in some circumstances) to smaller shippers defaulting. This in turn could lead to a reduction in the competitive environment, which is contra to one of Ofgem's key principals”*. It added *“the increase in the security is required when the exposure to Transco is least, so to add on a limit to request the funds within two days is unduly erroneous... By adding on the non-payment remedies after the second day of notification (late payment charges per day and interest of 8% above base) seems unduly harsh”*.

REG commented *“all businesses... are exposed to... commercial risk.... shippers provide credit terms to... cistomers without the necessity of securities and harsh penalties.... by implementing these proposals , Transco will be totally protected from any risk exposure”*.

Confirming its support, EON stated *“We consider this to be a pragmatic move to reduce the time available to take steps following reduction of a Users Credit Limit, thereby reducing Transporter risk”*.

**12. 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.

**13. 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.

**14. Programme for works required as a consequence of implementing the Modification Proposal**

Changes would be required in respect of operational processes and procedures were this Modification proposal to be implemented.

**15. Proposed implementation timetable (including timetable for any necessary information systems changes)**

In light of the works required to implement, the Proposer suggests that a lead-time of one calendar month will be required for implementation of the Modification Proposal if so directed.

**16. 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.

**17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel**

At the Modification Panel meeting held on 20 October 2005, of the 9 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

**18. Transporter's Proposal**

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

**TPD SECTION V: GENERAL**

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*Add new paragraph 3.2.9 to read as follows:*

Where a User's Code Credit Limit has been revised downwards in accordance with paragraph 3.2.4 (c) above, such User must where notified by the Transporter provide additional surety or security no later than 17:00 hours on the second Business Day after the date of the notice given pursuant to paragraph 3.2.4. Where a User has not provided additional surety or security by such date, the User shall pay to the Transporter:

(a) such amount as set out in the table below based upon the amount of additional surety or security demanded by the Transporter; and

Amount of additional security required	Amount
Up to £999.99	£40
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(b) a daily charge equivalent to that percentage rate as is set out from time to time in the Late Payments of Commercial Debts (Interest) Act 1998 multiplied by the amount of additional security demanded by the Transporter.

*Add new paragraph 3.2.10 to read as follows:*

Where a User has not provided such additional surety or security as set out in paragraph 3.2.9, with effect from 06:00 hours on the seventh Business Day following the date of the notice given pursuant to paragraph 3.2.4, the Transporter shall be entitled to reject or refuse to accept a Supply Point Nomination or Supply Point Confirmation by the relevant User under Section G, other than a Supply Point Renomination or Supply Point Reconfirmation (unless made in the context of an application for System Capacity or increased System Capacity at any System Point under Section B or G5) until such time as the relevant User has provided such additional surety or security.



Subject Matter Expert sign off:

*I confirm that I have prepared this modification report in accordance with the Modification Rules.*

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

**Tim Davis**  
**Chief Executive Joint Office of Gas Transporters**

Signature:

Date :