

Dear Julian

**Re: Modification Proposals 0023, 0024, 0025, 0026, 0027, 0031, 0032, 0034, 0041**

Wales and West Utilities (WWU) wishes to provide a single response to the above credit related modification proposals.

In accordance with our response to the initial Ofgem consultation regarding “The Best Practice Guidelines for Gas and Electricity Network Operator Cover”, WWU supports the principle of developing a consistent approach to credit arrangements across the networks.

Our response will consider the proposals individually, except in those cases where the proposals are similar in nature.

### **Proposals 23, 31 and 41 – Reassessment of User Unsecured Credit Limits**

The three modifications all propose the adoption of a maximum credit limit based on 2 per cent of the NWO’s RAV. WWU notes that this is consistent with Ofgem’s conclusions document and supports the introduction of this approach. The proposals set out alternative approaches for the determination of unsecured credit allowances in accordance with an individual company’s Investment rating.

Of the three proposals, WWU believes that Mod proposal 0041 is the most appropriate and should be implemented.

In our opinion, Mod proposal 0041 delivers a range of allowances which best reflect the risks of default and provides a non-discriminatory platform for acquiring unsecured credit. The report correctly identifies that the Basel 2 method is a useful benchmark, but needs to be considered in relation to the industry in which we are operating. The significant step change in risk of default attributable to companies with ratings below BBB- must be taken into account. It is our belief that more considered and robust means should be developed to determine appropriate levels of unsecured credit for those companies which fall into this category.

The allocation of unsecured credit across the companies ensures that the level of pass through risk for the NWO’s is consistent across the NWO’s and at a level which is reasonable given the risk profile of the rated companies.

Mod proposals 23 and 31 are at the two extremes of the spectrum, whereas Mod proposal 41 strikes the correct balance, between total industry risks/costs and consistent, non-discriminatory terms of access.

WWU believes that there may be additional costs in relation to monitoring Users credit positions and developing a process for assessing limits for the lower bands, BB+ to BB-, however we are of the view that they are unlikely to be significant.

In conclusion, WWU believes that Mod proposal 0041 best facilitates the relevant objective of securing effective competition between Relevant Shippers.

WWU notes that the table in the legal drafting is rather ambiguous. Firstly, the final category infers that any rated company can obtain an unsecured credit rating. In order to ensure consistency with the Ofgem conclusions document, we suggest that the final category group should be amended to include: BB+, BB and BB-. Secondly, the fourth category refers to BBB/Unrated. We are unclear as to the inclusion of “unrated” as this refers to companies which have not acquired a Standard and Poor’s rating which, in accordance with this proposal, would not obtain an unsecured credit limit. We suggest that this reference should be removed.

#### **Proposal 0024 - Independent security provision by an entity with an Investment Grade Rating of 'A' or above**

WWU supports the implementation of this proposal. It is consistent with the Ofgem conclusions document and ensures that the risk of default is set at acceptable levels. Furthermore, the proposal facilitates the relevant objective of securing effective competition between Relevant Shippers as it is non-discriminatory and does not create any barriers to entry. WWU believes that the costs of implementation for Transporters are likely to be negligible.

#### **Proposal 0025 - Notice Period for Credit Limit Downgrade and Remedies for Non-compliance**

WWU supports the implementation of this proposal. Recent experience has shown that companies’ 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.

WWU believes that the administration charges are reasonable and that the trigger payment is at an appropriate level to incentivise shippers to ensure sufficient credit arrangements are in place.

In conclusion, WWU believes that the proposal is even-handed, straightforward to administer and cost-effective. It recognises the need to permit transporters to react swiftly to changing circumstances, ensuring that

the risks of default are better aligned with the costs to shippers of managing their credit arrangements. Furthermore, the proposal facilitates the relevant objective of securing effective competition between Relevant Shippers.

### **Proposal 26 - Application of Charges consistent with Late Payment of Commercial Debts (interest) Act 1998**

WWU supports the implementation of this proposal. It is consistent with Ofgem's conclusions which state that "the application of charges consistent with the Late Payment of Commercial Debts (interest) would appear reasonable."

The administration charges are reasonable and the interest charge is accepted as being at a level which would act as a deterrent to Users from running up debts. WWU believes that the costs of implementation are likely to be negligible.

Finally, the proposal facilitates the relevant objective of securing effective competition between Relevant Shippers.

### **Proposal 27 - Right of Set Off under Uniform Network Code**

WWU does not support the implementation of this proposal. The proposal permits the transporter to elect to undertake a set-off following the submission of a set-off notice. It would appear that Users are unable to object to this notice and will be required to accept the revised amounts in their systems.

The implementation of this proposal would cause shippers to incur significant systems development costs and potentially, be required to accept credits/debits based on alternative methodologies i.e. set-off, or non set-off.

The costs of development have not been provided by shippers and WWU refutes the statement in the report that the costs of implementation would be minimal. We believe that there are likely to be costs to both Users and transporters of implementing this change, although at this stage no formal assessment of the necessary system changes has been initiated.

For this reason, we believe a formal cost-benefit analysis should be performed informing the industry, and the Authority of the merits of implementation.

WWU believes that at this stage it is difficult to form a view on whether the proposal better facilitates the relevant objectives and as a result, recommends that the proposal is rejected.

### **Proposal 32 - Adjustment to the number of days in the V A R calculation to bring the Code Credit Rules into line with the Best Practice Guidelines, Conclusions document Feb 2005**

WWU does not support the implementation of this proposal. Although we welcome a review of the current value at risk mechanism, we believe that the

proposal is too simplistic and is not consistent with the seasonal nature of the gas market. The fifteen day augmented charge may well be suitable during off-peak periods, but is insufficient during the winter months.

A forty-six day application is likely to generate additional operating costs for transporters, due to increased cash-calling activity, and constant readjustments of credit limits. WWU believes that a period of 55 days would be more consistent with the seasonal variations and would permit the normal billing and query cycle to be accommodated.

WWU believes that the costs of implementation are likely to outweigh the benefits and therefore, will not better facilitate the relevant objectives.

### **Proposal 34 - Netting off of Payments and Credits relating to Transportation Charges Modification Reference Number 0034**

WWU conditionally supports the implementation of this proposal. As indicated in the report, WWU does not net off invoices at present and the implementation of this proposal would generate development costs. These costs may not be incurred by other transporters which currently do not strictly operate in accordance with the requirements of the UNC.

WWU, however, will consider the application of this methodology, if the issue of withdrawals is addressed. The proposal does not comment on “withholds of payments” which may lead to under/overpayments if this methodology is adopted. Given our experience we recommend that the ability to withhold is removed from the UNC as it appears to be of limited use to shippers, but will cause WWU to incur additional systems costs if it is required to implement this proposal. Our records show that the withhold facility has been used only once during the term of our ownership and we are lead to believe that it has used less than a dozen times over the last six months across **all** networks.

WWU believes that the modification proposal is incomplete because it does not consider the impact of withholds. For this reason we believe that it would be inappropriate to implement this proposal and further development work needs to be done to examine its impacts and potential mitigating actions.

WWU is grateful to be given the opportunity to comment on these modification proposals. If you have any questions relating to any of the points raised in this response, then please do not hesitate to get in touch with either myself or Sue Davies on 02920 588097.

Regards

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Wales & West Utilities Ltd