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Mod 0031

Dear Julian,

Thank you for inviting us to respond to Mod Proposal 0031. 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 of Mod 0031 first, and later in this letter upon the aspects of the proposal itself.

In section 1 the Modification Proposal, the DMR in the main has 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 section 2 "Extent to which implementation of the proposed modification would better facilitate the relevant objectives" there is a paragraph which records the fact that some but not all transporters "expressed a view that increasing the availability of unsecured credit could increase costs in the event of default, thereby increasing costs for other Users, and hence does not facilitate the securing of effective competition between Relevant Shippers since this would deter entry". It is interesting to note that this paragraph is not included in the Draft Mod Report for Proposal 0041 although this Mod 0041 proposes to include the same bands of credit ratings. This discrimination towards a Mod Proposal, which seeks to implement the full range of credit ratings as described in the Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05 sections 3.4 to 3.9, should be explained. Transporters made it very clear in the Distribution Workstream meeting that they were opposed to this proposal, which is their entitlement. However, it is unfortunate that the same Subject Matter Expert prepared the DMR for both 0031 and 0041 and that the Joint Office did not ensure an even handed treated of both proposals.

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.

The arguments surrounding the introduction of the maximum unsecured credit limit of 2% of the Transporters Regulatory Asset Value are identified in the Best Practice Guidelines. We support the conclusion and hence include this in our proposal.

We believe that not to support the selection of all the recommendations identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05 sections 3.4 to 3.9 is discriminatory. Considerable time and effort has been expended by Ofgem and many participants in the production of this document. This was where the various pros and cons of the proposals were debated and a balanced position which reflected an equitable outcome was established.

Notwithstanding the last comment 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.

Transporters have suggested in the Distribution Workstream meetings and it is noted in the Draft Mod Report that they might incur additional costs in monitoring a BB or below rated company. It seems unlikely that they would not have been monitoring any such companies previously. There was also the suggestion that there would be a one off development cost in establishing a process. Users requested that Transporters provide evidence of the potential costs but to date we have not had sight of these so we are not able to comment further. Nevertheless we would expect the Regulator to subject these costs to care scrutiny. We find it ironic the some transporters may argue against a proposal on the grounds of very marginal cost increases when Shippers have recently incurred much larger costs as a result of the DN sale.

Concern has been expressed in many quarters about the fact that nearly all domestic customers are supplied by just six suppliers. This proposal if implemented could reduce the cost of entry to new smaller participants, who by the fact that they would not be incumbent energy suppliers may be in a position to introduce innovation and change to the benefit of their customers. It is claimed by some Transporters that additional credit cover may be required for some Users, but it is not clear on what basis they make this claim.

There is a suggestion that this proposal might introduce inconsistencies between the UNC and various Code Credit Rules. This seems to suggest that the Code Credit Rules are superior to the UNC. If there are inconsistencies between the two, then the Code Credit Rules should be changed to reflect the higher authority of the UNC. Users are signatories to the UNC and not the Code Credit Rules, which are created (and varied from time to time) by the Transporters and issued to the Users.

We not only support this proposal, but commend it to the Regulator as representing an unbiased amendment to the UNC reproducing the recommendations of the document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05 sections 3.4 to 3.9

Yours sincerely,

Simon Howe.
Gas Network Codes Manager