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value for all customers*

Direct Dial: 020-7901-7355

19 July 2006

The Joint Office, Transporters,
Shippers and other interested parties

Our Ref: NET/COD/MOD/0077

Dear Colleague,

Notice and Direction in relation to Uniform Network Code (UNC) modification proposal 0077: "Notice Period for Credit Limit Revision (as a consequence of Credit Rating downgrade) and remedies for non-compliance with a request for provision of additional security".

The Gas and Electricity Markets Authority (the "Authority"¹) has considered the issues raised in the modification report² and representations made in respect of modification proposal 0077: "Notice Period for Credit Limit Revision (as a consequence of Credit Rating downgrade) and remedies for non-compliance with a request for provision of additional security".

The UNC Modification Panel (the Panel) recommended to the Authority that modification proposal 0077 should be approved.

Having considered the modification report, representations and the Panel's recommendation, as well as having regard to the Relevant UNC Objectives³ and Ofgem's wider statutory duties,⁴ the Authority has decided to direct a modification to the UNC in line with modification proposal 0077.

This letter explains the background to the modification proposal, and sets out the Authority's reasons for its decision. This letter constitutes notice by the Authority under section 38A of the Gas Act 1986.

¹ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² This report can be found on the Gas Transporters Information Service at : <https://gtis.gasgovernance.com>.

³ The Relevant UNC Objectives are contained in Standard Special Condition A11 of the Gas Transporters Licence and can be viewed at: http://62.173.69.60/document_fetch.php?documentid=6547

⁴ Ofgem's statutory duties are wider than the matters that the Panel must take into consideration and are explained in sections 4AA – 4B of the Gas Act 1986.

Background

In February 2005 Ofgem published its conclusions on best practice guidelines for gas and electricity Network Operator credit cover.⁵ The document was the result of two years of detailed discussion and consultation with electricity and gas industry parties. The document covers a wide range of issues which in Ofgem's view strike an appropriate balance between providing protection against the risk of exposure in the event of default, and the costs of mitigating that risk.

Relevant aspects⁶ of Ofgem's conclusions in relation to this proposal are:

- In relation to each User, the deemed Value at Risk for Use of System (UoS) charges at any time should be the amount in money which is equal to the sum of:
 - (a) the aggregate value of all charges which at that time have been billed to such User (but not necessarily due) but remain unpaid; and
 - (b) a deemed amount equal to the aggregate value of all UoS charges that would be incurred in a fifteen day period at the same average daily rate implicit in billed charges under (a).
- Where the reassessment of a User's credit scoring or credit rating has led to a revision in its Unsecured Credit Limit (UCL) and consequently to the need for increased security to be posted, the applicable notice period for the provision of such additional security should be 2 business days;
- In the event that a User does not comply with a request to provide, or increase the level of, security, and is therefore in default, the following should apply:

Number of days after default	Action suggested
Day 0	Due date
Day +1	Interest and administration fee trigger
Day +1	Transporter to issue a formal notice of default as to statement of position and how default is to be remedied
Day +3	Formal response is required
Day +5	Ability to suspend registrations of (inwards) transfers

The notice of default should be issued to the notified contract manager of the User's staff
This notice of default and associated response should be copied to Ofgem

- In all instances interest and administration fees should be charged, in line with the above timetable. These should not be extreme or excessive.

Current UNC arrangements

Each Transporter determines and assigns each User a Code Credit Limit (CCL), which represents the maximum permitted Relevant Code Indebtedness. A CCL may comprise of an Unsecured Credit Limit (UCL) calculated on the basis of the User's Approved Credit Rating (ACR), as set out in the table below, and/or security or surety provided in

⁵ Click [here](#) for a link to the relevant Ofgem document (No. 58/05).

⁶ For full details, readers should refer to the conclusions document

accordance with V3.4. The Transporter will limit the UCL of any User and related company to a maximum of 2 per cent of its Regulatory Asset Value (RAV) (The 'Maximum UCL').

Approved Credit Rating		User's % of Maximum UCL
Standard & Poor's	Moody's Service Investors	
AAA/AA	Aaa/Aa	100
A	A	40
BBB+	Baa1	20
BBB	Baa2	19
BBB-	Baa3	18
BB+	Ba1	17
BB	Ba2	16
BB-	Ba3	15

Currently, where any published credit rating of a User or any person providing surety for the User is revised downwards, the User's CCL may be reduced on notice of no less than 30 days (or any lesser period agreed by the User). One exception is in circumstances where the rating is revised downwards to the extent that it is less than the minimum prescribed credit rating as set out in the relevant Transporter's Code Credit Rules (CCR), in which case the User's CCL may be immediately revised, on notice to the User.

Where a User's Relevant Code Indebtedness has exceeded 70%, and subsequently 85% of its CCL, and the User has been notified respectively, for so long as indebtedness continues to exceed 85%, the Transporter shall be entitled to reject or refuse to accept all or any of the following by the relevant User:

- Application for System Capacity or increased System Capacity at any system point
- In relation to the NTS, a System Capacity Trade in respect of which the User is the Transferee User;
- A Supply Point Nomination or Supply Point Confirmation other than a Supply Point Renomination or Supply Point Reconfirmation

Should Relevant Code Indebtedness exceed (and continue to exceed) 100% of the CCL the Transporter may issue a Termination Notice⁷. Where a termination notice is issued the Transporter may invoice the User for services provided, with all amounts being immediately due for payment.

The modification proposal

Notice period for Code Credit Limit Revision (as a consequence of Credit Rating downgrade)

It is proposed that where a User's (or User's security provider) published credit rating is downgraded, the notice period for reduction of the User's CCL would be 2 business days. The relevant Transporter would issue notice to the User the business day following the downgrade of the User's (or User's security provider) credit rating.

⁷ The issue of a Termination Notice has the effect that the User shall cease to be a User for the purposes of the UNC

The revised CCL would become effective from the third business day following the downgrade of the relevant User's credit rating.

Remedies for non-compliance with a request for provision of additional security

Where the above reassessment of a User's CCL subsequently requires the posting of additional security, it is proposed that this request is incorporated into the above notice issued by the Transporter to the User. Therefore the deadline for provision of additional security is 2 Business Days following issue.

Where a User fails to provide the additional security (to return the User to a maximum 100% CCL utilisation), with effect from the day following expiry of the notice period, a daily charge equivalent to that percentage interest rate as is set out from time to time in the Late Payments of Commercial Debts (Interest) Act 1998 be charged in respect of the credit 'shortfall'.

Additionally, it is proposed that where a User fails to provide the additional security by the required deadline, an administration fee may be levied according to the size of the credit shortfall, as follows:

Amount of credit shortfall	Value of Compensation that can be claimed
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

Overall, it is proposed that the above defined measures be applied according to the following timetable:

Relevant Day	Action
Day -3	User's (or User's security provider) credit rating downgraded. Transporter notified by relevant approved credit rating agency
Day -2	Transporter issues notice to User of new CCL (effective from day 0). If relevant, notice also issued of requirement for Users to provide additional security (required by day 0)
Day 0	Effective date for new CCL and deadline for provision of additional security (if required)
Day +1	Where additional security not provided: Interest and administration fee trigger. Transporter to issue a formal notice of credit shortfall and how position is to be remedied
Day +3	Where additional security not provided: Formal User response is required

Respondents' views

A number of respondents considered that the modification proposal would ensure that the code better facilitated the Relevant UNC Objectives when compared to the current baseline by providing clarity in the market, ensuring there was no undue discrimination, and helping to promote a level playing field for market participants. Some respondents noted that although the implementation of the proposal might increase costs for some

Users, this needed to be balanced against the protection which the modification would provide for Transporters and the Shipping Community at large.

Although their comments were not particularly referenced to the Relevant UNC Objectives, several respondents also suggested that 0077 was, in their view, consistent with Ofgem's credit cover guidelines even though it represented a tightening of the arrangements when compared to the existing UNC.

The differences between modification proposal 0025 'Notice Period for Code Credit Limit Downgrade and Remedies for Non-Compliance' (which was rejected by Ofgem on 3 February 2005) and 0077 were highlighted by a number of respondents. In general it was noted that 0077 sought to address the aspects of modification proposal which Ofgem had made negative comment on in its decision letter for 0025. One respondent considered that the proposed introduction of interest charges and administration fees for delays in the provision of security, could be considered a less onerous penalty than placing such Users into default. Three respondents also noted that 0077 provides a longer timescale for when additional security needs to be posted than was suggested under 0025.

One respondent, although supportive of the basic principle of the modification proposal was concerned about the impact 0077 would have were the credit rating of the entity providing surety for the User is revised downwards. The respondent considered it would be appropriate for the User's credit rating to be revised downward in the event that its parent company was subject to a reduction in its credit rating. However the respondent stressed that it may not be equitable to reduce the credit rating of a User who is reliant upon an unrelated third party for the provision of their security. The respondent also commented that such a User may find it difficult to provide any additional collateral required at two day's notice (other than cash) as it takes about a week to arrange a letter of credit.

One party commented that the table indicating the timescales for actions to be taken when a party is defaulting on payment has not been included in the legal text.

UNC Modification Panel's recommendation

The UNC Modification Panel (the Panel) recommended to the Authority that modification proposal 0077 should be approved.

Ofgem's view

Having considered the modification report, and having had regard to the Relevant UNC Objectives as well as Ofgem's statutory duties, we have decided to approve modification proposal 0077.

Modification proposal 0077 reduces the notice period under which a party should provide additional collateral in the event that a revision in its credit scoring or credit rating results in a revision of its unsecured credit limit and consequently for increased security to be posted. This reduction from 30 days to 3 days, although a significant shortening of the

timeframe provided under the UNC, will ensure that where additional collateral is required it is provided in a timely fashion. This will help protect both Transporters and Users from the risks of bad debt associated with Shipper default and in turn serve to promote the efficient and economic operation of the pipeline system and help secure effective competition between shippers and/or suppliers.

In the event that a User fails to provide appropriate additional collateral by the due date, Ofgem agrees that the payment of administration fees and interest rates as set out under the Late Payments of Commercial Debts Act will help to ensure that appropriate credit arrangements are put in place.

As part of a consultation response it was suggested that the table indicating the timescales along with action should be taken when a party is defaulting on payment has not been included in the legal text. Ofgem notes that should parties feel that modification proposals could be raised which would clarify or otherwise improve the arrangements introduced by 0077, they are free to do so.

We note the concern of one respondent regarding the downgrading of an independent credit provider. However Ofgem consider that whether credit support is provided by a Parent Company Guarantee or independently is a matter for the parties concerned.

Ofgem consider this modification proposal is likely to better facilitate the achievement of relevant UNC objective (d) by incentivising provision of additional collateral in a timely fashion and helping to protect Transporters and Users from the risk of bad debt.

The Authority's Direction

For the reasons set out above, the Authority directs National Grid Gas plc (NGG) to make the modification as set out in the modification report in accordance with Condition A11.15(b) of NGG's Transportation Licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. N. Simpson', written over a horizontal line.

Nick Simpson
Director, Industry Codes and Licensing

Signed on behalf of the Authority and authorised for that purpose by the Authority