

Modification Report
Specially Commissioned Credit Ratings
Modification Reference Number 0107
Version 1.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 9.6.

1. The Modification Proposal

In respect of transportation credit arrangements, Ofgem published a number of recommendations in its conclusions document "*Best practice guidelines for gas and electricity network operator credit cover*" 58/05 in February 2005. One such recommendation was that a User should be able to utilise a Specially Commissioned Rating (obtained from either Moody's or Standard & Poors) to obtain unsecured credit from the Transporter.

Unsecured credit obtained via a public rating is already provided for within the Uniform Network Code (UNC) following the implementation of Modification 0031 '*Re-assessment of User Unsecured Credit Limits*'.

It is proposed to add provisions to the UNC which allow a User to utilise a Specially Commissioned Rating (Ofgem Conclusions Document (58/05) para 3.8) obtained from either Moody's or Standard & Poors credit rating agencies to obtain unsecured credit from the Transporter. The proposed provisions would further reflect that:

- In the event that both approved agencies are commissioned to provide a rating and such conflict, the rating that affords the lower level of unsecured credit would be utilised,
- The ratings must be monitored and re-assessed at least annually, and
- The User would bear the cost of any initial assessment and any periodic reviews (for the duration that the User utilises such rating to obtain unsecured credit from the Transporter).

It is proposed that a Specially Commissioned Credit Rating would be subject to all UNC provisions which relate to public ratings; for example the level of credit afforded in respect of each acceptable rating and those concerning consequences of a rating downgrade.

If this Proposal is not implemented, the UNC will not reflect the recommendations contained within the Ofgem conclusions document and Transporters will not be obliged to operate this aspect of their credit arrangements in a consistent manner.

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

The proposer believes that implementation of consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination and no inappropriate barrier to entry. It believes that this facilitates the securing of effective competition between relevant shippers.

NG NTS and SGN agreed that implementation of consistent credit processes should help ensure that there is no inappropriate discrimination and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between relevant shippers.

TGP believes the provision of another mechanism in which Users can procure unsecured credit will allow more Shippers to enter the market and hence encourage competition.

Corona believes that the Proposal is unbalanced in its treatment of the different forms of rating, and because of this discrimination and the increased risk of default, implementation of the Modification Proposal would not better facilitate the relevant objectives.

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 or operation of the Total System have been identified. Incorporating elements of credit rules within the UNC may help to reduce the impacts of any industry fragmentation.

NG NTS agrees that consistent credit arrangements could facilitate non-fragmentation of the industry.

TGP believes that providing a uniform set of rules regarding specially commissioned credit ratings will help to prevent industry fragmentation.

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:

No development and capital cost and operating cost implications have been identified.

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 on price regulation have been identified.

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

Though implementation may increase the value of unsecured credit afforded by Transporters, the level of risk (i.e. likelihood of failure) is equivalent to that currently permitted by the UNC for Users which have an Approved Credit Rating provided by Moody's or Standard & Pools.

Corona disagrees believing that the degree of transporter risk is greater in light of the irregular assessments of the Specially Commissioned Ratings, when compared to equivalent Approved Ratings.

NG NTS agrees that the level of credit risk consequent to the proposed Modification will be equivalent to that currently permitted by the UNC for Users which have an Approved Credit Rating provided by Moody's or Standard & Poor's and therefore there should be no change to the contractual risk of Transporters.

TGP believe if more Users are afforded unsecured credit as a result of the Modification, then the amount of unsecured debt will increase, resulting in an increase in contractual risk. TGP anticipate any such increase will be modest, as relatively few Users will not have a credit rating.

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 implications have been identified.

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

Users would bear the costs of the initial assessment and any periodic reviews required where the specially commissioned rating is used to obtain unsecured credit from the Transporter.

BGT believes that an increase in the use of unsecured credit across the industry brings with it an element of increased risk for the remainder of the shipping community.

NG NTS supports the proposal that Users should bear the costs of the initial assessment and any periodic reviews where required. In terms of the level of contractual risk faced by Users, NG NTS has a concern that the proposal may increase the value of unsecured credit at risk.

Although implementation of this Modification may increase the value of unsecured credit, which could be a concern SGN understands this level of risk is equivalent to that currently permitted by the UNC for Users which have an Approved Credit Rating provided by Moody's or Standard and Poor's. SGN agrees with the Proposer that Users should bear the costs of the initial assessment and any periodic reviews where required.

TGP agrees it is appropriate that the relevant User bears the costs for providing a specially commissioned credit rating. As a result of this, the costs of this Modification for other Users will be minimal.

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

TGP believe the Transporters will now be obliged to provide unsecured credit to a User if a specially commissioned credit rating is produced. Previously, the Transporter would have determined the User's unsecured credit, individually. This Modification will therefore impact the contractual relationships between applicable Users and all Transporters, though this impact will be modest.

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

Advantages

- Provides the User with an additional means of obtaining unsecured credit from a Transporter
- Allows previously excluded Users access to Unsecured Credit
- Alignment with Best Practice Guidelines

NG NTS agrees with the Proposer that the Modification represents an advantage to Users in terms of offering an additional means of obtaining unsecured credit from a Transporter.

Disadvantages

- Potentially increases the value of credit which is unsecured
- Greater risks associated with unsecured credit obtained in this manner
- Discriminates against Users with Approved Credit Rating
- Increases the risk of bad debt if the amount of unsecured credit increases.

Whilst recognising the stated advantage above, NG NTS equally recognise the concern raised by the Proposer that the Modification could potentially increase the value of credit which is unsecured and, by implication, the increased risk of bad debt occurring. National Grid NTS shares this concern but, as a Transporter, takes comfort from the reassurances provided by Ofgem in its Best Practice Guidelines document which states:

- 4.3 *“Companies demonstrating compliance with or able to satisfactorily to explain departure from the guidelines will be able to recover all bad debt losses arising in respect of charges not due for payment at the date of the relevant counterparty's insolvency, net of any dividends or recoveries;*

4.4 *Such companies will also be able to recover a proportion of bad debt losses arising in respect of charges overdue for payment at the date of the relevant counterparty's insolvency, net of any dividends or recoveries (which would be offset proportionately against all outstanding balances), depending on the age of the outstanding receivable. Ofgem has noted comments from a number of respondents regarding the opportunity to recover 100 per cent of bad debt whilst employing reasonable procedures. Ofgem has concluded that the amount recoverable would be equal to the value of outstanding balances subject to bona fide dispute (plus or minus the value of any reconciliation adjustments subsequently made) together with a proportion of the value of all undisputed balances (up to a maximum of 100 per cent) that varies inversely with the age of the balance, as set out below. The overall recoverable amount would be reduced for any other recoveries."*

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

Representations were received from the following parties:

Organisation	Abbreviation	Position
British Gas Trading	BGT	Qualified Support
Corona Energy	Corona	Not in Support
National Grid Distribution	NG UKD	Supports
National Grid Transmission	NG NTS	Supports
RWE Npower	RWE	Supports
Scotia Gas Networks	SGN	Supports
Total Gas & Power	TGP	Supports

Corona believes that this Modification Proposal, although sound in principle, is unbalanced in its treatment of the different forms of Rating. They believe that due to the fact that Specially Commissioned Ratings are, by their very nature, a snapshot of a User's financial viability and not continually reviewed they generate greater risks than those obtained through the Approved route. For this reason Corona cannot support the implementation of this proposal as drafted in its present form. In summary, Corona believes that due to the fact that Specially Commissioned Ratings are not continually reviewed by the Commissioning body then there is justification to assert that there is increased financial risk associated with those parties operating under them. This may be rectified by, for example, altering the amount of Unsecured Credit Limit which maybe awarded to a User which has obtained such a Rating.

The SME would comment that Proposal seeks to implement the best practice as identified within Ofgem's Conclusions document which advocates that the equivalent level of unsecured credit is afforded for the respective ratings applicable to both public and specially commissioned ratings. Recognising that the Conclusions Document cannot prejudice subsequent decisions made by Ofgem, it is nevertheless apparent that all aspects of the Best Practice document were concluded following extensive representation by industry participants and sought to balance risk against benefit.

BGT supports the main principles behind this Modification Proposal. However they expressed residual concerns about the extent to which legal drafting achieves what is set out in the Draft Modification Report, as well as the omission of explicit reference to further simple, but necessary, safeguards. BGT believes it necessary for parties to be obliged to reveal the results of any credit rating assessments obtained within a specific time period for example all ratings obtained in the last 12 months. BGT believes that with appropriate safeguards to prevent undue risk being passed to the other Shippers, the use of specially commissioned credit ratings could be a pragmatic option for managing transportation debt risk, while targeting the relatively modest initial and periodic assessment costs only at the relevant party. Combined with ongoing, rigorous and vigilant credit and debt management processes by Transporters, the use of such credit ratings could increase the choice of credit tools available to UNC parties, and help to facilitate new market entry and lower costs. BGT would be happy to lend its support to this Proposal on the basis that these points are amended. BGT believes that were this to be the case, the relevant objective of facilitating the securing of effective competition between relevant suppliers is achieved.

NG NTS notes that the reference to paragraph 3.2.5 in the Legal Text that starts “*A User’s Code Credit Limit...*” should be a reference to paragraph 3.2.4 in line with version 2.11 of Section V of the UNC, dated 4 September 2006. In addition, there is a typographical error in the last sentence of the proposed amended paragraph 3.1.1, such that the proposed text that currently reads “*User has a reasonable belief that it’s Approved...*” should read “*User has a reasonable belief that its Approved...*”.

Recognising the above detailed issues with the legal text as contained within the Draft Modification Report, a number of changes have been made to the legal drafting contained within section 19 of this Modification Report:

- The second paragraph to be amended is alternatively identified as V3.2.4 (this was erroneously identified as V3.2.5 within the legal drafting detailed in the Draft Modification Report).
- Removal of an apostrophe as follows: in the last sentence of the proposed amended paragraph 3.1.1, the text within the Draft Modification Report reads “*User has a reasonable belief that it’s Approved...*” has been amended to reflect “*User has a reasonable belief that its Approved...*”.
- Addition of the following sentence at the end of the proposed amended paragraph V3.1.1: “*Where the User commissions more than one Specially Commissioned Rating, it shall notify the Transporter of each such rating and the Transporter shall use the lowest as the Approved Credit Rating*”. Requiring the User to provide all ratings commissioned within a defined period (for example 12 months as suggested by BGT) is outside the scope of the Proposal and therefore has not been incorporated.

NG UKD recognises Ofgem’s preference for key credit cover arrangements to be set out in commercial codes in the interests of transparency¹ and accordingly raised this Proposal. Whilst acknowledging that allowance of such ratings may increase the volume of unsecured credit, NG UKD believes that the degree of risk (i.e. the likelihood of individual User failure) would not be

¹ Ofgem document ‘*Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover*’ 58/05 – Summary

greater given that the minimum acceptable ratings and level of credit entitlement in respect of each rating is proposed to be equivalent to that afforded to Users with an Approved Credit Rating.

RWE agrees with the Modification Proposal to add provisions to the UNC that would allow a User to utilise a Specially Commissioned Credit Rating, obtained from either Moody's or Standard & Poor's credit rating agencies to obtain unsecured credit from the Transporter. By obtaining this unsecured credit from the Transporter, it would help to ensure that there is no inapt discrimination against a User and no inappropriate barrier to entry for a prospective User. RWE believes that by adding the above provisions into the UNC, it offers previously disqualified Users additional means of obtaining unsecured credit from a Transporter.

TGP commented that at present it is up to each individual Transporter how a User without a public credit rating, and who wishes to have one commissioned, is handled with regard to costs and the level of unsecured credit that is subsequently provided. It is appropriate that this inconsistency is removed by incorporating a clear set of guidelines within the UNC. The procedures detailed within the Modification Proposal seemed proportionate to TGP, which supports its implementation.

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

The Proposer believes that minimal changes would be required in respect of operational processes and procedures in the event that this Modification Proposal were implemented. Specific comments are invited from other parties in respect of implementation requirements.

NG NTS and TGP agreed that there would be very little impact on operational processes and procedures in the event that this Modification Proposal were implemented.

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

The Proposer believes that in light of the limited works required to implement, this Modification Proposal could be implemented with immediate effect upon direction being received from the Authority.

NG NTS and TGP agreed that this Proposal could be implemented with immediate effect upon the Authority's direction being given.

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

18. Transporter's Proposal

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

19. Text

TPD SECTION V: GENERAL

Amend paragraph 3.1.1 to read as follows:

“3.1.1 For the purposes of the Code:

- (a) the “**Regulatory Asset Value**” is...
- (b) an “**Approved Credit Rating**” is a published and monitored long term issuer rating, or a Specially Commissioned Rating of not less than Ba3 by Moody’s Investor’s Service or equivalent rating by Standard and Poor’s.
- (c) the... in accordance with the table set out in paragraph V3.1.6”
- (d) a “**Specially Commissioned Rating**” is a rating commissioned and paid for by a User with either Moody’s Investor’s Service or Standard and Poor’s and which shall be monitored on a daily basis and reassessed on an annual basis.

The Transporter will determine...(The “Maximum Unsecured Credit Limit). The User shall notify the Transporter within 1 Business Day if the User’s Approved Credit Rating changes or if the User has a reasonable belief that its Approved Credit Rating is likely to change. Where the User commissions more than one Specially Commissioned Rating, it shall notify the Transporter of each such rating and the Transporter shall use the lowest as the Approved Credit Rating.

Amend paragraph 3.2.4 to read as follows:

“A User’s Code Credit Limit...

- (a)...
- (b)...
- (c) where any published or Specially Commissioned Rating of the User ...
- (d)...
- (e) at...Limit.

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 :