

Modification Report
Management of Users Approaching and exceeding Upper Limits of Credit Limit
Modification Reference Number 0111
Version 2.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

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.

Pursuant to recommendations contained within the conclusions document it is proposed that where a User’s indebtedness reaches 80% of the value of the credit limit in place, the Transporters issue a warning notice to the User which would not be accompanied by calls for additional security or the disconnection of existing customers and/or inhibiting the registration of new customers)¹. Whilst the conclusions document advocated that this notice is issued at 85%, National Grid Distribution believes that implementation efficiencies for Transporters can be achieved if this notice is issued at 80%. This level of indebtedness is a key point in other aspects of the proposed credit arrangements and given that no sanctions are applied at this level (it merely being a notice) this would not appear to be a significant deviation from the conclusions document. It is proposed to remove the current notice requirements at 70% and 85% credit limit usage.

It is proposed that the current measures available for Transporters (pursuant to UNC TPD section V3.3.2) are only available where indebtedness exceeds 100% of its credit limit. The measures being the entitlement for the Transporter to reject:

- *an application for System Capacity or increased System Capacity,*
- *a System Capacity Trade, or*
- *a Supply Point Nomination or Confirmation (subject to the following proposed provisions).*

It is further proposed that where a User’s indebtedness exceeds 100% of the value of the credit limit in place, the User be required (by a notice issued to the User on the following Business Day) to provide additional security within two Business Days of the date of the notice sufficient to reduce the indebtedness level below 100%. Where the additional security is provided after the two business days identified above, the value of this additional security would be required to be sufficient to reduce the User’s indebtedness to 80% of the credit limit. For the following 12 month period, the value of the security in place will be deemed to be 80% of its normal value.².

It is further proposed to incorporate within the UNC provisions concerning remedies for instances where a User fails to provide additional security (where VAR exceeds the value of the credit limit) following a notice issued by the Transporter. Where such additional security is not forthcoming the Transporter would claim liquidated damages

¹ Ofgem Conclusions Document (58/05) para 3.46

² Ofgem Conclusions Document (58/05) paras 3.50 – 3.53

in line with the Late Payment of Commercial Debts (Interest) Act 1998 based on the value of the additional security outstanding².

The above sanctions will be applied in accordance with the following timetable:

Number of Business Days after expiry of notice	Action
0	Expiry of notice (2 business days following date of issue)
1	Liquidated damages trigger (in line with Late Payment of Commercial Debts (Interest) Act 1998). Transporter issues statement of position to User and confirms how default is to be remedied.
3	Formal User response required
5	Sanction available to Transporter to suspend registration of Supply Points (Supply Point Nomination and Confirmation)

It is further proposed that where a User experiences a material change to its level of trade (detected via monthly assessment of the Value at Risk) as a consequence of an increase in the relevant Transporter's transportation charges, a notice period of one month will be allowed for the User to post any additional security required³. A 'material change' will be a change of +20% or greater from the previous month.

If this Proposal is not implemented, 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

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. This would therefore facilitate the securing of effective competition between relevant shippers.

Corona argued that implementation would increase risk and the likelihood of default, which would deter entrants and not further competition.

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 industry fragmentation.

² Ofgem Conclusions Document (58/05) paras 3.50 – 3.53

³ Ofgem Conclusions Document (58/05) para 3.47

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 significant development, capital or 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:

Where a Transporter secures pass through of any bad debt it incurs, Ofgem clarified in its Best Practice Guidelines that at the subsequent price control review the Transporter will be permitted to raise up to the full value of the bad debt from regulated charges including an allowance for the cost of funding the loss pending recovery.⁴

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

Removal of measures which a Transporter is currently able to apply at the point a User exceeds 85% indebtedness under UNC section V3.3.2 will increase Transporters level of contractual risk.

This Proposal seeks to implement one aspect of the arrangements identified in Ofgem's Best Practice Guidelines. Where a Transporter is able to demonstrate that it has implemented credit control, billing and collection procedures in line with the Guidelines, it may be in a position to recover bad debt incurred (see section 4d above) which mitigates the Transporter's increased contractual risk associated with implementation of aspects of the Guidelines.

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 UK Link systems implications have been identified.

⁴ Ofgem Conclusions document (58/05) paras 4.1 – 4.7

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

Where a User's indebtedness is between (in excess of) 85% and 100%, its level of contractual risk will reduce as the measures pursuant to Section 3.3.2 will not be available to Transporters. Where indebtedness exceeds 100%, Users would potentially be exposed to additional financial risk (associated with charges levied in accordance with the Late Payments of Commercial Debts (Interest) Act 1998). This risk can be avoided by rectification of the credit security position within the required timescale. Users may be required to amend operational processes to address the new triggers for notices and requests received from the Transporter to rectify its credit security position.

Where a Transporter obtains approval to pass through bad debt, this is likely to be subsequently reflected in increased Transportation Charges which would be payable by Users in a subsequent period.

Some respondents argued that implementation of this Modification Proposal would increase the level of contractual risk faced by Users that are solvent and abide by the credit rules.

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

Dependent on the contractual arrangements in place between the respective parties, bad debt costs which are reflected in subsequent Transportation Charges may be borne in part or in full by Suppliers and subsequently consumers.

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

Where a Transporter secures pass through of any bad debt it incurs and demonstrates that a delay in recovery would have a material adverse effect on its financial position, Ofgem clarified in its Best Practice Guidelines that it may consider early licence modifications such that amounts can be recovered prior to the next price control period.

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

Advantages

- Alignment with Best Practice Guidelines.
- For Users with indebtedness between (in excess of) 85% and 100% exposure to the measures available to Transporters pursuant to Section V3.3.2 will be removed.
- Users would be able to utilise the full extent of their credit security without sanction.
- Reduces the amount of credit cover to be lodged by Shippers.
- Provided Transporters with the ability to recover costs incurred due to Shippers breaching credit limits.

Disadvantages

- For Transporters no practical measures will be available to mitigate exposure where a User’s indebtedness exceeds 85% (and does not exceed 100%).
- For Users, if a Transporter can demonstrate compliance with Best Practice Guidelines (of which this is one element), Users may be subject to a level of financial risk of bad debt incurred by the Transporter.
- May not provide adequate time for Shippers to provide additional credit before sanctions invoked.

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	Not in Support
Corona Energy	Corona	Not in Support
E.ON UK	EON	Qualified Support
National Grid Distribution	NG UKD	Supports
National Grid Transmission	NG NTS	Qualified Support
Northern Gas Networks	NGN	Not in Support
RWE Npower	RWE	Not in Support
Scotia Gas Networks	SGN	Supports
Statoil UK	STUK	Not in Support
Total Gas & Power	TGP	Qualified Support
Wales & West Utilities	WWU	Not in Support

Shippers suggested that it would be inappropriate for the Transporter to wait until a party has exceeded 100% of its credit limit before it is able to take steps to limit that party’s ability to incur further debt.

NG NTS noted that the draft legal text contains a reference in the proposed new paragraph 3.2.11 to “Value at Risk” which is not currently a defined term.

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

Significant changes would be required in respect of operational processes and procedures in the event of implementation of this Modification Proposal.

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

In light of the work required, this Modification Proposal could be implemented with effect from 3 months following the appropriate direction being received from the Authority.

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 21 December 2006, of the 9 Voting Members present, capable of casting 10 votes, 2 votes were cast in favour of implementing this Modification Proposal. Therefore, the Panel did not recommend implementation of this Proposal.

18. Transporter's Proposal

This Modification Report contains the Transporter's proposal not to modify the Code and the Transporter now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

TPD SECTION B: SYSTEM USE AND CAPACITY

Amend paragraph 2.2.13 as follows:

2.2.13 In the event...exceeds **100%** of the User's Code Credit Limit...

Amend paragraph 2.2.15 as follows:

2.2.15 Where at 17:00 hours...exceeds **100%** of its Code Credit Limit

TPD SECTION V: GENERAL

Amend paragraph 3.2.10 as follows:

3.2.10 Where the Transporter...not exceeding 100% of the User's Code Credit Limit. Subject to paragraph 3.2.11 below, where a User has not provided...payable by the User...

Add new paragraph 3.2.11 as follows:

3.2.11 Notwithstanding paragraph 3.2.10, where at any time as a direct consequence of an increase in the relevant Transporter's Transportation Charges, a User's Value at Risk is increased by over 20% from the previous calendar month, a User will have one calendar month from the date of notice given by the relevant Transporter to provide additional surety or security and after the expiry of such date, paragraphs 3.2.10 (a) and (b) shall apply.

Delete paragraph 3.3.1 and replace with the following:

3.3.1 Where:

- (a) a User's Relevant Code Indebtedness exceeds 80% of its Code Credit Limit and the Transporter has given notice to the User to that effect; and
- (b) at any time following any notice given pursuant to (a) above the User's Relevant Code Indebtedness exceeds 100% of its Code Credit Limit, the Transporter will notify the User of such event, giving such User 2 Business Days from the date of such notice to provide additional surety or security for the amount specified by the Transporter in the notice in order to reduce its Relevant Code Indebtedness to below 100% of its Code Credit Limit.

Delete paragraph 3.3.2 and replace with the following:

3.3.2 Without prejudice to paragraph V3.3.3, where a User fails to provide such additional security as required in paragraph 3.3.1 (b) by the date specified in the notice pursuant to 3.3.1(b):

- (a) the amount of such surety or security required shall be increased to that amount required to reduce the User's Relevant Code Indebtedness to below 80% of its Code Credit Limit and any surety or security subsequently provided shall be deemed to be valued at 80% of its face value for the following 12 calendar months; and
- (b) with effect from the next Business Day after the date specified in such notice, the User shall pay to the Transporter that amount set out in the table in paragraph 3.2.10(a), based upon the amount of additional surety or security demanded by the Transporter and the daily charge set out in paragraph 3.2.10(b); and

- (c) subject to paragraph 3.3.1, where and for so long as the User's Relevant Code Indebtedness exceeds 100% of the User's Code Credit Limit, the Transporter shall be entitled to reject or refuse to accept all or any of the following by the relevant User:
- (i) an application for System Capacity or increased System Capacity at any System Point under Sections B or G5; and/or
 - (ii) in relation to the NTS, a System Capacity Trade under Section B5 in respect of which the User is Transferee User;

until such time as the User's Relevant Balancing Indebtedness is reduced to less than 100% of its Code Credit Limit.

- (d) where from the fifth Business Day after the date specified in the notice, the User's Relevant Code Indebtedness exceeds 100% of the User's Code Credit Limit, the Transporter shall be entitled to reject or refuse to accept a Supply Point Nomination or Supply Point Confirmation under Section G, other than a Supply Point Renomination or Supply Point Reconfirmation until such time as the User's Relevant Balancing Indebtedness is reduced to less than 100% of its Code Credit Limit.

For and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters