

1 November 2006



Julian Majdanski  
Modification Panel Secretary  
Joint Office of Gas Transporters  
Ground Floor Red  
51 Homer Road  
Solihull  
West Midlands B91 3QJ

Dear Julian,

**Re: Draft Modification Reports 0109, 0111, 0112, 0113, 0114**

Corona Energy ("Corona") wishes to submit the following in response to the above draft modification reports.

**Introduction**

By way of introduction Corona wishes to emphasise key observations made in our response to Ofgem's Consultation Document "*Recommendations for best practice guidelines for gas and electricity network operator cover.*" Our response detailed the principles we believe should be adhered to when considering any modification to the credit rules, and are reproduced as follows:

*"A number of issues must be taken into account when considering whether changes to the existing credit arrangements will further facilitate competition by lowering barriers to entry but without simultaneously undermining confidence in the efficient operation of the gas and electricity markets." We believe it is important to distinguish between the two aspects of this statement.*

- I. Providing/increasing unsecured credit to smaller/unrated companies will lower barriers to entry.*
- II. The greatest potential to undermine confidence in the gas and electricity markets will occur due to the failure of a large shipper/supplier, of which there have been a number of such failures in the last few years (Independent Energy, Enron, and TXU Europe). Failure of small shippers/suppliers has limited financial or operational impact.*

*In addition, our assessment of the recommendations of the Workgroups and Ofgem have taken into consideration the following:*

- any changes to the credit arrangements should ultimately be for the benefit of the customer, either through a more competitive market, or a more secure and stable environment, or both;*



- *as a regulated industry, the Network Operators (“NWO”) do not have the option to refuse to trade with a counterparty.”*

In light of this, Corona’s evaluations as to the merits of the various Modification Proposals are based on the fulfilment, or otherwise, of the basic principles which we believe are fundamental to the operation of the credit arrangements and by extension the competitiveness of the UK gas markets.

In summary, Corona’s assessment of the individual Modification Proposals will, in addition to testing them against the Relevant Objectives, consider the following impacts:

- Reduced barriers to entry for “smaller” companies
- Increased potential for failure for “larger” companies
- Produce benefits to customers
  - i. more competitive markets; and/or
  - ii. more secure and stable environment

Hereafter, the measures detailed above will be termed the “Corona Objectives”.

### **Draft Modification Report 0109**

Corona fully supports the implementation of this Modification Proposal. In reality the range of tools is currently acceptable to Transporters. The proposal inserts into UNC an ongoing obligation to allow the employment of these tools to all Users. Codification ensures that these arrangements will continue to be in place across all networks, reducing User uncertainty and costs.

### **Better Facilitating of the Relevant Objectives and Corona Objectives**

Corona accords with the view expressed in the Draft Report that the Proposal would facilitate the securing of effective competition between Shippers. This will, in turn, provide benefits to customers.

Corona believes that the Proposal would reduce barriers to entry for smaller companies by requiring Transporters to adopt a consistent approach to credit requirements.

### **Draft Modification Report 0111**

Corona does not support the implementation of this Proposal.

There are obvious cross-overs with Modification Proposal 0114 in relation to the assessment of Value at Risk and subsequent mitigating actions/remedies. Corona does not support the implementation of Modification Proposal 0114 and believes that a combined implementation of the two proposals would not further the Relevant Objectives or the Corona Objectives.



This Modification Proposal 0111 provides Transporters with no mechanism by which they can ensure Users remain within their credit limits, as security can only be requested once the exposure has exceeded the value of the security provided. We do not believe this is an appropriate commercial arrangement for a regulated business, and hence cannot be considered best practice.

The current process whereby Users are notified when the exposure exceeds 70% of their security, and are required to lodge additional security once exceeding 85%, seems to have operated well in the past. Our only revision to this process would be to amend the thresholds to 80% and 95% respectively. At 95%, the remaining 5% unutilised security is equivalent to approximately 2 days exposure, so the User should have lodged additional security at the point they have reached 100% exposure.

### **Better Facilitating of the Relevant Objectives and Corona Objectives**

Corona does not believe that this Proposal would better facilitate the Relevant Objectives. We believe that the Proposal would increase the likelihood of defaults and subject Users to greater financial risks.

Corona believes that it would lead to instability which is not conducive to fostering a competitive environment.

Finally, uncontrollable financial risk is not attractive to new investors and as a result this Proposal would, to some degree, deter new entrants from participating in the market.

### **Draft Modification Report 0114**

As previously stated, Corona does not support the implementation of this Modification Proposal.

Firstly, there appears to be an inconsistency in the wording of the modification. In the second paragraph it states "...that Transporters adopt a 'Value at Risk' (VAR) mechanism to determine the minimum value of credit limit required to be in place .." while in the third paragraph it states "...this VAR figure determines the maximum value of the security a User may have to provide....". The accompanying legal text suggests that the VAR figure is used to determine minimum levels of credit and we believe that this is the correct interpretation. For clarity's sake we recommend that the Proposer clearly outlines the intention of the Proposal in the text of the Final Modification Report.

Secondly, the calculation of VAR is, in our opinion, inappropriate as the minimum credit period granted by virtue of the payment due dates of CAP and CAZ invoices are 20 days into the month following the month of supply. Furthermore, the proposed calculation only takes into consideration the actual charges in the previous month, not the peak charges in the previous 12 months. We therefore believe VAR at any one point in time should be calculated as:



- The peak value of all Transportation charges invoiced to the User within one of the previous 12 calendar month, plus
- a value equivalent to 20 days of the average daily charge in respect of the same peak value month.

### **Better Facilitating of the Relevant Objectives and Corona Objectives**

Corona does not believe that this Proposal would better facilitate the Relevant Objectives. We believe that the Proposal undervalues the amount of credit which should be lodged to support a gas shipping activity. For this reason we are of the view that Users will be insufficiently covered and incidences of default are likely to increase.

Corona believes that it would lead to instability which is not conducive to fostering a competitive environment.

Finally, uncontrollable financial risk is not attractive to new investors and as a result this Proposal would, to some degree, deter new entrants from participating in the market.

### **Draft Modification Report 0112**

Corona fully supports the implementation of this Modification Proposal. It will allow companies to spread guarantees across Users without imposing any additional risks on the community.

### **Better Facilitating of the Relevant Objectives and Corona Objectives**

Corona accords with the view expressed in the Draft Report that the Proposal would facilitate the securing of effective competition between Shippers. This will, in turn, provide benefits to customers.

### **Draft Modification Report 0113**

Corona does not support the implementation of this Modification Proposal.

In relation to the payment history element of the Proposal, Corona is firmly of the view that payment history is not necessarily a measure of future ability to pay. In the gas industry this is particularly important due to the very seasonal nature of the business, with working capital requirements peaking in the winter months. On-time payments in the summer months provide only limited assurance that winter payments will be made. If the period over which payment history is assessed is too backward looking it cannot be considered that this would produce a reasonable assessment of the company's current creditworthiness. This rings true even if the retrospective assessment incorporates winter periods.

The proposal effectively assesses payment history over a period up to 5 years which for reasons stated above we consider to be inappropriate.



In terms of the Independent Assessment element of the Proposal we are aware that Modification Proposal 0107 sets out similar arrangements. Corona stated that it did not support the implementation of this Proposal and for completeness recites the key elements of that response below:

*“Corona’s concern lies not with the ability of the User to obtain a Specially Commissioned Rating, but the process by which it is reviewed. Publicly provided ratings are subject to continual review by those parties which have awarded the rating and as a consequence may change on a frequent or short term basis. In our view the Specially Commissioned Rating is afforded greater stature on the basis that it is not continually verified and only reviewed on an annual basis. To this effect, Corona does not understand the reference to daily monitoring, as provided for in the legal text, as this is not carried out by the Ratings Agency, but we imagine by the User and/or the Transporter. We would suggest, therefore, that the Specially Commissioned Rating swings the balance firmly in favour of those Users operating under them and it could be argued discriminates against those Users which operate under the more traditional publicly provided ratings. This is specifically highlighted in Section V paragraph 3.2.4 (c) which can only apply to Approved Credit Ratings on, in most instances, a more than annual basis:*

*“3.2.4 A User’s Code Credit Limit may from time to time be reviewed and revised.....*

*3.2.4 (c) where any published credit rating of the User or any person providing surety for the User is revised downwards”*

*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 maybe rectified by, for example, altering the amount of Unsecured Credit Limit which maybe awarded to a User which has obtained such a Rating. Corona does not have any specific proposals in this regard, however, we suggest it may be worth considering two potential ways forward:*

- a) applying a fixed percentage reduction to the Maximum Unsecured Credit Limit reflecting the level of risk associated with the less frequent independent Ratings review e.g. A User awarded a Specially Commissioned Rating of ‘A’ can only obtain 50% of the 40% Maximum Unsecured Credit Limit (as provided for in the table presented in paragraph 3.1.6 of Section V). In this example the User’s Unsecured Credit Limit would be 20% of the Maximum Unsecured Credit Limit, or*
- b) the Specially Commissioned Rating has a lower status than that provided in the more traditional manner. By way of example and with reference to the table stated above, a User with a Specially Commissioned Rating of ‘A’ for the purposes of obtaining an Unsecured Credit Limit would be treated as equivalent to a BBB+ rating in the table.*

*Corona believes that this Modification Proposal although sound in principle is unbalanced in its treatment of the different forms of Rating. We 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."*

### **Better Facilitating of the Relevant Objectives**

Corona believes that due to the reasons stated above concerning discrimination and increased risk of default the Modification Proposal would not better facilitate the Relevant Objectives.

The Proposal will not lead to greater stability and will not harness competition between Users.

We trust you find our comments useful and if you have any questions then do not hesitate to get in touch.

Yours sincerely

Gary Russell  
Finance Director