

Modification Report
Aggregation of Credit Positions or Use of Group Ratings
Modification Reference Number 0112
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 Users may aggregate their credit positions or use group ratings (for example Parent Company Guarantees (PCGs)) providing that the arrangements are robust and unconditional¹. The conditions for the acceptance of such are:

- The credit support provider must offer a guarantee which is legally enforceable in England and Wales. Guarantors based outside England and Wales may be required to provide legal opinion of enforceability,
- The guarantor entity will be subject to the same credit scoring process as the buyer, and must also be willing to provide information to facilitate the completion of this process; and
- The country of residence of the guarantor must have a sovereign credit rating of at least BB- awarded by Moody’s or Standard & Poors. If the rating agencies differ, the lower rating will apply.

Where a counterparty benefits from a suitable PCG, the unsecured credit limit assigned to that counterparty would be based on the credit strength of the guarantor. Thus for example, a BB counterparty guaranteed by an A rated parent would obtain an unsecured limit equal to 40 per cent of the relevant NWO’s maximum credit limit. Where more than one counterparty obtains credit from a single PCG, the aggregate counterparty credit limits (obtained via that PCG) shall not exceed the credit entitlement of the parent.

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.

¹ Ofgem Conclusions Document (58/05) paras 3.9 – 3.10

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. It is believed that this measure facilitates the securing of effective competition between relevant shippers.

RWE suggested that implementation of the Modification Proposal as it stands would not facilitate the securing of effective 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 any 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 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.²

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

Based on the assumption that implementation would codify current practice no change to Transporters' level of contractual risk is anticipated. Representations

² Ofgem Conclusions Document 58/05: sections 4.1 – 4.7

are invited to confirm whether this assumption is correct, and if not, indication of the consequential impact on 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.

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

Existing operational arrangements and requirements are anticipated to apply in respect of the arrangements which are the subject of this Proposal and therefore implementation is not anticipated to have any distinct implications for Users.

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 the subsequent price control period.

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.

- Codifies current practice.
- Provides clarity on acceptable forms of security

Disadvantages

- 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.

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

NG NTS argued that the legal text does not reflect the intention of the Modification Proposal, and suggested that it should include definitions of “Qualifying Company” and “Parent Company”.

RWE suggested there was a lack of appropriate safeguards in place to manage potential risk. RWE argued issues needed to be resolved regarding enforceability of Guarantors domiciled outside England and Wales, and that the information required to support the credit process is not detailed within the legal text. Further RWE regarded the legal text as unacceptable - Section V paragraph 3.4.5 is about bank deposits thereby alienating letters of credit etc. (paragraph 3.4.6).

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

Minimal 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 limited works required to implement this Modification Proposal could be implemented with immediate effect upon 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, 10 votes were cast in favour of implementing this Modification Proposal. Therefore, the Panel recommended implementation of this Proposal.

18. Transporter's Proposal

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

19. Text

TPD SECTION V: GENERAL

Amend paragraph 3.1.6 to read as follows:

“(a) Where a User has an Approved...

(b) Where a Qualifying Company or Parent Company provides security to a User pursuant to paragraph 3.4.5 (the “**Security Provider**”), then the Approved Credit Rating of such Security Provider may be used in place of the User’s to calculate such User’s Unsecured Credit Limit in accordance with the table set out in paragraph 3.1.6, provided that where such Security Provider provides security for more than one User, the aggregate Unsecured Credit Limits of such Users shall not exceed maximum credit entitlement of the Security Provider calculated in accordance with the table set out in paragraph 3.1.6.

For and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters