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Our Ref: AHT/Mod 0112 response

Dear Julian

Representation in response to Modification Proposal 0112: “Aggregation of Credit Positions or Use of Group Ratings”

Thank you for the opportunity to respond to this Draft Modification Report (DMR).

National Grid NTS offers qualified support for this proposal and offers the following comments, in line with the section headings in the DMR.

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

National Grid NTS agrees 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.

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

National Grid NTS does not foresee any implications for security of supply or operation of the Total System. National Grid NTS believes that consistent credit arrangements could facilitate non-fragmentation of the industry.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

National Grid NTS does not foresee any implications for operation of the System.

b) development and capital cost and operating cost implications:

National Grid NTS understands that this Modification Proposal is unlikely to require significant expenditure for development, capital or operating costs.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate ways to recover the costs:

National Grid NTS considers that any such costs would fall into the category of TO operating costs and would therefore treat these costs in the same way as our existing TO operating costs.

d) analysis of the consequences (if any) this proposal would have on price regulation:

National Grid NTS notes and takes comfort from the Proposer's reiteration of the assurances made in Ofgem's Best Practice Guidelines¹ regarding the potential for bad debt recovery, resulting from the implementation of the Guidelines.

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

National Grid NTS agrees that implementation of the Modification Proposal would codify current practice, however we would like to register some concerns over the continued use of Parent Company Guarantees (PCG) as a method of obtaining an Unsecured Credit Limit.

As recent history has demonstrated, Parent Companies do not always provide a cast iron financial guarantee to fulfil a subsidiary's debts and therefore present a risk to Transporters (and the rest of the industry) of bad debt.

With these concerns in mind, National Grid welcomes the conditions of acceptance included in Ofgem's Best Practice Guidelines and reiterated in the Modification Proposal that:

- 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 & Poor's. If the rating agencies differ, the lower rating will apply.

These conditions should help to ensure that any PCG issued to provide Users with an Unsecured Credit Limit offers suitable financial protection to Transporters.

However, National Grid NTS notes that the legal text provided with Modification Proposal 0112 does not codify the above conditions of acceptance and appears to be reliant on the legal text provided for Modification Proposal 0109 "Acceptable Security Tools available to Users for Transportation Credit Arrangements" in order to implement Ofgem's Guidelines. National Grid NTS believes that the legal

¹ "Best practice guidelines for gas and electricity network operator credit cover, Conclusions document, February 2005, 58/05"

text for this Modification Proposal needs to be amended as detailed in section 19 of this response below to address this concern.

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

National Grid NTS notes that no UK Link system implications have been identified.

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

National Grid NTS agrees with the Proposer that the Modification Proposal should not impact on Users in terms of the administrative and operational costs they face.

However, National Grid NTS also agrees with the Proposer that Users could see an increased level of contractual risk should circumstances require Transporters to seek recovery of bad debt in accordance with Ofgem's Guidelines. If pass through of such debt is approved, Users could face an increase in Transportation Charges in subsequent years.

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

National Grid NTS agrees with the Proposer that Suppliers and subsequently Consumers could be impacted by an increase in costs as a result of bad debt pass through, dependent upon the commercial arrangements in place between the respective parties with regard to Transportation Charges.

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

National Grid agrees with the Proposer's interpretation of Ofgem's Best Practice Guidelines.

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

Advantages

National Grid agrees that alignment with Ofgem's Best Practice Guidelines could assist with the prevention of industry fragmentation and that codification of current practice should provide a greater level of clarity to all industry parties.

From a Transporter perspective, the Modification Proposal offers the advantage of clarity that the aggregated counterparty credit limits granted by a PCG cannot exceed the credit entitlement of the parent.

Disadvantages

As stated in point 5 above, National Grid NTS has concerns that the continued use of PCGs as a method of obtaining an Unsecured Credit Limit could present a risk to Transporters, however we take 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.*

National Grid NTS also recognises the Proposer’s stated disadvantage to Users that Users may be subject to a level of financial risk of bad debt incurred by the Transporter.

14. Programme for works required as a consequence of implementing the Modification Proposal

National Grid NTS understands that there would be very little impact on operational processes and procedures in the event that this Modification were implemented.

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

Given the limited impact outlined in section 14, National Grid NTS considers that this proposal could be implemented with immediate effect from the Authority’s direction being given.

19. Legal Text

As noted in section 5 above, National Grid NTS does not believe that the legal text provided with Modification Proposal 0112 fully reflects the intention of the Modification Proposal. Specifically, in the proposed amended paragraph 3.1.6(b), the legal text refers to “Qualifying Company” and “Parent Company”. These terms are not currently defined in Section V of the Transportation Principal Document (TPD) of the Uniform Network Code (UNC), although they have been added as new defined terms in the legal text provided with Modification Proposal 0109 “Acceptable Security Tools available to Users for Transportation Credit Arrangements”. In the event that Modification Proposal 0112 were implemented, but 0109 were not, National Grid NTS believes that the conditions for acceptance of PCGs would not be placed within the UNC and therefore the intent of Modification Proposal 0112 would not be fully reflected in the UNC.

National Grid NTS suggests that the legal text be amended to include definitions of “Qualifying Company” and “Parent Company” to ensure that if only Modification Proposal 0112 were implemented, the “conditions of acceptance” would be reflected in the UNC.

Yours sincerely

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