

Modification Report
Availability of Unsecured Credit Based on User Payment Record or Independent
Assessment
Modification Reference Number 0113
 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.

In line with a recommendation of the above, the implementation of UNC Modification 0031 dictated that the unsecured credit limit for an individual User is set as a proportion of a Transporters maximum credit limit (being 2% of the Transporter’s Regulatory Asset Value). The proportion of this maximum credit limit afforded to a User is determined by the public credit rating of the User (subject to a minimum level) allocated by two credit rating agencies; Moody’s and Standard & Poors.

Pursuant to a further recommendation of the conclusions document, it is proposed that a User without a credit rating allocated by Moody’s or Standard & Poors or with public rating allocated by the aforementioned agencies that is below the current prescribed minimum (Standard & Poors BB- or Moodys equivalent) be able to obtain unsecured credit via two alternative means:

1. Payment Record¹:

A User that settles all of its Transportation invoices by the due date on an ongoing basis obtains an unsecured credit level of 0.4% per 12 month period (escalating on an evenly graduated basis each month) up to a maximum of 2% of the Transporter’s maximum credit limit (obtained after 60 months unblemished payment record). Any failure to pay a transportation invoice by the due date would return the User to 0% unsecured credit.

For illustrative purposes, the level of unsecured credit is thus accrued as follows

Time period from last late payment	Additional Credit allowance as % of Transporter’s maximum credit limit	Aggregate Credit allowance as % of Transporter’s maximum credit limit
1 month	0.033	0.033
2 months	0.033	0.067
3 months	0.033	0.1
4 months	0.033	0.133
5 months	0.033	0.167
6 months etc	0.033	0.2

¹ Ofgem Conclusions Document (58/05) paras 3.16 – 3.17

1 year	0.4	0.4
2 years	0.4	0.8
3 years	0.4	1.2
4 years	0.4	1.6
5 years	0.4	2.0

2. Independent Assessment²:

An assessment by one of a panel of three appointed agencies selected by the Transporter would allocate a rating allowing the User:

- for unrated Users from 3⅓% up to 20% of the Transporter's maximum credit limit,
- for Users with a Moody's or Standard & Poors rating below prescribed minimum from 3⅓% up to 13⅓% of the Transporter's maximum credit limit.

Where unsecured credit is afforded by the relevant Transporter on the basis of an independent assessment, an annual re-assessment will be required. It is proposed that liability for the cost of the initial assessment and annual re-assessment would be as follows:

- Relevant Transporter – 80%
- User – 20%

The cost of any additional interim reviews procured outside the above identified occurrences (i.e. initial assessment and annual re-assessment) will be borne by the User.

Where such assessments are obtained, unsecured credit will be allocated based upon a score between 0 and 10 in accordance with the following:

Standard & Poors Credit Rating (or Moody's equivalent)	Independent Assessment Score		Credit allowance as % of Transporter's maximum credit limit
	Unrated Users	Users with rating below prescribed minimum	
BBB+	10	~	20
BBB	9	~	19
BBB-	8	~	18
BB+	7	~	17
BB	6	~	16
BB-	5	~	15
<hr style="border-top: 1px dashed black;"/> <BB-	4	4	13⅓
	3	3	10
	2	2	6⅔
	1	1	3⅓
	0	0	0

Application

² Ofgem Conclusions Document (58/05) paras 3.21 – 3.24

In respect of the interaction between unsecured credit obtained by payment history or independent assessments, a User would only be able to obtain unsecured credit from one of the two alternatives at any one time.

It is anticipated that a User will only request an Independent Assessment from the Transporter where it reasonably believes that such an assessment will result in a credit scoring of at least 1 (representing 3⅓% of the Transporter's maximum credit limit). In the event of implementation, National Grid will monitor the number and outcome of requests it receives for Independent Assessments and may deem that further UNC Modification is necessary in this area to minimise cost in the provision of credit arrangements.

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

BGT and Corona argued that an increase in cost and risk would accrue to Users were the Proposal to be implemented, and hence implementation would not better facilitate 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

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:

Although no significant development, capital or operating cost implications have been identified NGN believed that there are material operating costs for Transporters in operating this proposed system which seeks to provide sixty (60) incremental credit step increases for a User based on an enduring unblemished payment record.

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.³

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

Independent Assessment

Transporters contractual risk would increase as more Users are likely to be able to obtain unsecured credit from the Transporter. Such Users will have either been allocated a rating by an approved credit rating agency (Moody's Investor Service or Standard & Poor's) which is below the prescribed minimum or will not have been assessed by an approved credit rating agency. Therefore it is possible that Users with a higher degree of risk (in respect of individual User failure) will be able to obtain unsecured credit.

Payment History

Transporters contractual risk would increase as more Users are likely to be able to obtain unsecured credit from the Transporter. Such Users will be able to accrue an escalating level of Unsecured Credit from the Transporter based on timely settlement of invoices. Where a User relies on such, it is unlikely to have obtained a credit rating from an approved credit rating agency or an independent assessment as such ratings would afford a higher level of unsecured credit. Therefore it is possible that Users with a higher degree of risk (in respect of individual User failure) will be able to obtain unsecured credit.

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.

³ Ofgem Conclusions Document (58/05) paras 4.1 – 4.7

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

Operational costs for a User which is able to accrue unsecured credit on the basis of its payment history would reduce as there is not direct cost to the User of obtaining credit via this means (assuming that its current method of security does have a direct cost). Where an independent Assessment is utilised, this may provide a more economic means of obtaining credit from the Transporter than those currently available to an individual User.

A User wishing to 'protect' its payment history (as this provides unsecured credit) may deem it prudent to implement additional or enhanced administrative measures to ensure invoice values are settled in a timely manner.

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.

A number of Users and SGN pointed out that implementation could increase the amount of unsecured credit across the industry, which would increase contractual risk for Users in general.

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

A User may deem it appropriate to reflect any operational cost efficiencies in the level of charges it levies to its suppliers which may subsequently be reflected in the level of charges a supplier levies to its customers.

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 this provides alternative and economic means of obtaining unsecured credit from Transporters.
- For Users this may free up capital which is currently tied up in the provision of credit arrangements.
- Reduces the amount of credit cover to be lodged by Users without a credit rating.

Disadvantages

- Is likely to increase the value of credit which is unsecured, increasing risk for all Users.
- 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	Not in Support
Corona Energy	Corona	Not in Support
E.ON UK	EON	Supports
National Grid Distribution	NG UKD	Supports
National Grid Transmission	NG NTS	Qualified Support
Northern Gas Networks	NGN	Not in Support
RWE Npower	RWE	Supports
Scotia Gas Networks	SGN	Supports
Statoil UK	STUK	Supports
Total Gas & Power	TGP	Supports
Wales & West Utilities	WWU	Not in Support

BGT and Corona expressed concern about the Independent Assessment proposal, which could result in cross-subsidising a process to the benefit of an individual User.

Corona and WWU suggested that payment history is not necessarily a measure of future ability to pay.

NG NTS noted that the reference to Moody’s Investment Services differs from the name used in the existing.

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.

In the absence of reference to specific implementation requirements within the Proposal, there appear to be two distinct options for implementation of unsecured credit obtained on the basis of payment history, those being:

- unsecured credit only accrues from the date of implementation, therefore the maximum level achievable is (at the earliest) 5 years following the date of implementation; or
- at implementation, the Transporter evaluate a User's previous payment history to assess such Users entitlement.

Representations were invited as to which of the above is an appropriate method of implementation of the payment history aspect of the Proposal. NG NTS observed that the second option would align the credit arrangements for gas network operators with those already implemented for electricity network operators.

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, 7 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 3.1.1 to read as follows:

“3.1.1 For the purposes of the Code:

(a)...

(b)...

(c) The Unsecured Credit Limit is that proportion of the Maximum Unsecured Credit Limit extended to a User by the Transporter as calculated in accordance with paragraph 3.1.6 or 3.1.7 as appropriate.

Add new paragraph 3.1.7 as follows:

3.1.7 Subject to paragraph 3.1.10, where a User does not have an Approved Credit Rating, or a User’s Approved Credit Rating is less than Ba3 awarded by Moody’s Investment Services or an equivalent rating by Standard and Poor’s Corporation, such User may obtain an Unsecured Credit Limit by:

(a) payment history in accordance with paragraph 3.1.8 below; or

(b) independent assessment in accordance with paragraph 3.1.9 below

provided that a User shall only be able to obtain an Unsecured Credit Limit by one of the above methods at any one time.

3.1.8 The Transporter may allocate an Unsecured Credit Limit to a User based upon the period of time elapsed that such User has paid all invoices by their due date for payment in accordance with Section S, such that after a calendar month, a User may be allocated an Unsecured Credit Limit on the basis of 0.4% of the relevant Transporter’s Maximum Unsecured Credit Limit over a 12 Month period and increasing on an evenly graduated basis each Month up to a maximum of 2% of the relevant Transporter’s Maximum Credit Limit after 5 Years.

3.1.9 Where a User has been allocated an Unsecured Credit Limit pursuant to 3.1.8 above, and such User subsequently fails to make payment of any invoice issued in accordance with Section S, then its Unsecured Credit Limit shall be deemed to be valued at zero from the date of such payment default.

3.1.10 Upon request from a User, the Transporter may appoint one of a panel of 3 independent agencies to allocate an Unsecured Credit Limit to the User where:

(a) such User is unable to obtain an Approved Credit Rating (up to a maximum of 20% of the relevant Transporter’s Maximum Unsecured Credit Limit); or

(b) such User has an Approved Credit Rating below Ba3 (awarded by Moody’s Investment Services or an equivalent rating by Standard and

Poor's Corporation) (up to a maximum of 13¹/₃% of the relevant Transporter's Maximum Unsecured Credit Limit).

a score of between 0 and 10 will be allocated to the User in accordance with the following table to calculate the User's Unsecured Credit Limit:

<u>Independent Assessment Score</u>	<u>% of Transporter's Maximum Unsecured Credit Limit</u>
10	20
9	19
8	18
7	17
6	16
5	15
4	13 ¹ / ₃
3	10
2	6 ² / ₃
1	3 ¹ / ₃
0	0

3.1.11 Any Unsecured Credit Limit allocated in accordance with paragraph 3.1.10 shall be reviewed annually. Where any costs are incurred by the Transporter in providing an Unsecured Credit Limit in accordance with paragraph 3.1.10, including any annual reviews, the User shall pay to the Transporter 20% of such costs incurred. Where any additional reassessments are required by the User or the Transporter, the User shall meet the full cost of such reassessment.

For and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters