

25 June 2007



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 0144/0144AV, 0145, 0146, 0147, 0148**

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 has 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 evaluations as to the merits of the various Modification Proposals are based on the fulfillment, 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 0144 and 0144AV – Quantification of Value At Risk to determine a User’s minimum Code Credit Limit Requirement**

Corona does not support implementation of Modification 0144 nor Modification 0144AV; however, it wishes to state a slight preference for Modification 0144AV.

Our concerns with the Proposals are the same as those detailed in our previous response to Modification 0114. Modification 0144 does not properly account for the payment dates of the Capacity and Commodity invoices, being a minimum of 20 days into the month following the month of gas flows. Secondly, it only considers the value of unpaid invoices and not the value of the invoices themselves likely to be experienced over a peak supply period. The combination of these conservative valuations will mean that there is significant potential for under securitisation. Similarly, although Modification 0144AV takes a more reasonable approach by adopting the 20 day principle, we would argue the simple addition of the unpaid invoice amount is likely to raise securitisation issues for the industry.

Corona believes that the approach proposed in our previous response is more pragmatic and more in line with the objective of providing credit arrangements which are secure and stable. The approach we proposed is as follows:

- 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 above seasonally adjusted



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

Corona does not believe that the Proposals would better facilitate the Relevant Objectives. We believe that the Proposals undervalue 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 the Proposals would, to some degree, deter new entrants from participating in the market

## **Draft Modification Report 0145 – Management of Users Approaching and Exceeding Code Credit Limits**

Corona does not support the implementation of this Proposal.

There are obvious cross-overs with Modification Proposal 0144 in relation to the assessment of Value at Risk and subsequent mitigating actions/remedies. Corona does not support the implementation of Modification Proposals 0144/144A and is clear that a combined implementation of the two proposals would not further the Relevant Objectives or the Corona Objectives.

This Modification Proposal 0145 provides Transporters with no mechanism by which they can ensure Users remain within their credit limits (this assumes that the Minimum Credit Limit is set at the level of VAR however that is calculated), 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 monopoly, 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 0146 – Acceptable Security Tools available to Users for Transportation Credit Arrangements**

Corona fully supports the implementation of this Modification Proposal. In reality the majority of the tools detailed are 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 would 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 0147 – Administration of Unsecured Credit Afforded on the basis of Payment History and Independent Assessment**

Corona supports the implementation of this Proposal despite the fact that we were unsupportive of the implementation of Modification 0113. Corona sees this Proposal as a sensible tweak to Modification 0113 as it recognises that a very low level of debt should not be considered to be a risk to the industry. We support the cap being set at £250.

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

Corona believes that the Proposal reduces unnecessary barriers for small entrants without placing any additional risks on other players. For this reason it will facilitate the securing of effective competition between shippers.

### **Draft Modification Report 0148 – Aggregation of Credit Positions or Use of Group Ratings**

Corona fully supports the implementation of this Proposal as 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 believes that the Proposal would facilitate the securing of effective competition between Shippers. This will in turn provide benefits to customers.

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

Yours sincerely

James Crosland