

Modification Report
Management of Users Approaching and Exceeding Code Credit Limit
Modification Reference Number 0145

Version 4.0

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 where a User’s Value at Risk (VAR) reaches 80% of the value of the Code Credit Limit (CCL), the Transporter issues a warning notice to the User (which would not be accompanied by calls for additional security or the disconnection of existing customers and/or inhibiting the registration of new customers). Whilst the conclusions document advocated that this notice is issued at 85%, National Grid Distribution believes that implementation efficiencies for Transporters can be achieved if this notice is issued at 80%. This level of Value at Risk is a key point in other aspects of the proposed credit arrangements and given that no sanctions are applied at this level (it merely being a notice) this would not appear to be a significant deviation from the conclusions document. It is proposed to remove the current notice requirements and availability of sanctions at 70% and 85% Relevant Code Indebtedness (as a percentage of the Code Credit Limit) respectively.

It is proposed that the current measures available to Transporters (pursuant to UNC TPD section V3.3.2) are only available where a User’s VAR exceeds 100% of its CCL. The measures being the entitlement for the Transporter to reject:

- an application for System Capacity or increased System Capacity,
- a System Capacity Trade, or
- a Supply Point Nomination or Confirmation (subject to the following proposed provisions).

It is further proposed that where a User’s VAR exceeds 100% of the value of the CCL in place, the User be required (by a notice issued to the User on the following Business Day) to provide additional security within two Business Days of the date of the notice sufficient to reduce the User’s VAR below 100% of the CCL. Where the additional security is provided after the two business days identified above, the value of this additional security would be required to be sufficient to reduce the User’s VAR to 80% of the CCL. For the following 12 month period, the value of the security in place will be deemed to be 80% of its normal value.

It is further proposed to incorporate within the UNC provisions concerning remedies for instances where a User fails to provide additional security (where a User’s VAR exceeds its CCL) following a notice issued by the Transporter. Where such additional

security is not forthcoming, the Transporter would claim liquidated damages in line with the Late Payment of Commercial Debts (Interest) Act 1998 based on the value of the additional security outstanding.

The above sanctions will be applied in accordance with the following timetable:

| Number of Business Days relative to expiry of notice | Action |
|--|--|
| -2 | Notice issued. Sanctions available to Transporter: ability to reject an application for System Capacity (or an increase in such) or a System Capacity Trade |
| 0 | Expiry of notice (2 business days following date of issue) |
| 1 | Liquidated damages trigger (in line with Late Payment of Commercial Debts (Interest) Act 1998). Transporter issues statement of position to User and confirms how default is to be remedied. |
| 3 | Formal User response required |
| 5 | Sanction available to Transporter to suspend registration of Supply Points (Supply Point Nomination and Confirmation) |

It is further proposed that where a User experiences a material change to its level of trade (detected via monitoring of a VAR) as a consequence of an increase in the relevant Transporter's transportation charges, a notice period of one month will be allowed for the User to post any additional security required. A 'material change' will be an increase in the User's VAR of 20% or greater from the previous day.

UNC Transportation Principal Document Section V3.3.3 currently entitles the Transporter to give Termination Notice where Relevant Code Indebtedness exceeds 100% of the User's CCL. It is further proposed to amend this provision to reflect that this entitlement alternatively applies where a User's VAR exceeds 100% of the User's CCL.

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

Standard Special Condition A11.1 (a): *the efficient and economic operation of the pipe-line system to which this licence relates;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (b): *so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line*

system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

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. This measure facilitates the securing of effective competition between relevant shippers.

Some Shippers believed that this Proposal would increase the likelihood of defaults and subject Users to greater financial risks leading to instability and uncontrollable financial risk which may deter new entrants and hence not further this relevant objective.

Standard Special Condition A11.1 (e): *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

Implementation would not be expected to better facilitate this relevant objective.

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:

The Proposer believes that significant changes would be required in respect of operational processes and procedures in the event of implementation of this Modification Proposal which will incur development costs in adjusting trigger levels for sanctions and creating processes and procedures to enable compliance with the provisions of this proposal. An equivalent increase in operating cost may transpire in the prospective operation of the new provisions that would be introduced.

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.

NG NTS consider any costs would fall into the category of Transmission Operator operating costs and would therefore treat these costs in the same way as their existing Transmission Operator operating costs.

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

Removal of measures which a Transporter is currently able to apply at the point a User exceeds 85% indebtedness under UNC section V3.3.2 will increase Transporters level of contractual risk.

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 secure pass through of any bad debt it incurs. In such cases, 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. Where a Transporter is able recover bad debt incurred this mitigates the Transporter's increased contractual risk associated with implementation of aspects of the Best Practice 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

No such consequence is anticipated.

NG NTS and SGN believe there will be an increase in the level of contractual risk of

each Transporter due to the reduction in the minimum level of credit required to be posted by a User and extended timescales before a Transporter is able to take action to reduce their bad debt exposure.

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

Administrative and operational implications (including impact upon manual processes and procedures)

Users may be required to amend operational processes to address the new triggers for notices and requests received from the Transporter to rectify its credit security position.

Development and capital cost and operating cost implications

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.

Consequence for the level of contractual risk of Users

Where a User's Value at Risk is between (in excess of) 85% and 100%, its level of contractual risk will reduce as the measures pursuant to Section 3.3.2 will not be available to Transporters. Where indebtedness exceeds 100%, Users would potentially be exposed to additional financial risk (associated with charges levied in accordance with the Late Payments of Commercial Debts (Interest) Act 1998). This risk can be avoided by rectification of the credit security position within the required timescale.

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.
- For a User with a Code Credit Limit ‘usage’ of in excess of 85% Relevant Code Indebtedness, exposure to the measures available to Transporters pursuant to Section V3.3.2 will be removed until, under the proposed arrangements the User’s Value at Risk exceeds 100%.
- Users would be able to utilize the full extent of its credit security without sanction.

Disadvantages

- For Transporters no practical measures will be available to mitigate exposure where a User’s Value at Risk exceeds 85% (and does not exceed 100%).
- 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)**

| Organisation | | Position |
|------------------------------|--------|-------------------|
| British Gas Trading | BGT | Not in Support |
| Corona Energy | Corona | Not in Support |
| E.ON UK | EON | Not in Support |
| National Grid Distribution | NG UKD | Support |
| National Grid Transmission | NG NTS | Qualified Support |
| Northern Gas Networks | NGN | Not in Support |
| RWE npower | RWE | Not in Support |
| Scotia Gas Networks | SGN | Support |
| Scottish and Southern Energy | SSE | Not in Support |
| Wales & West Utilities | WWU | Not in Support |

Some Shippers expressed concern with potential credit defaulters exposing the balance of the shipping community to significantly increased risk, in excess of any benefit that might accrue through lower credit costs across the industry.

Some Shippers also expressed concern with restricting the ability of a Transporter to take preventative action where it is evident that credit limits have been, or are imminently to be, breached.

Some Shippers expressed a concern that it is unclear in the Modification Proposal what happens to a user if, having had their VAR reduced, a further default occurs.

WWU pointed out that the suggested legal text refers to 'Value at Risk', which is not currently a defined term within the UNC and hence this Proposal is dependent on either Modification Proposal 0144 or 0144AV being implemented.

12 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

No such requirement has been identified.

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

No such requirement has been identified.

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

No programme for works has been identified.

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

In light of the work required, the Proposer believes that this Modification Proposal could be implemented with effect from three 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 19 July 2007, of the 9 Voting Members present, capable of casting 9 votes, 3 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel did not recommend 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 3.2.10 as follows:

3.2.10 Where the Transporter... such that when applied it will result in the ~~Relevant Code-Indebtedness~~ Value at Risk of the User not exceeding 100% of the User's Code Credit Limit. Subject to paragraph 3.2.11 below, where a User has not provided such additional surety or security by such second Business Day then with effect from the next Business Day ~~next~~ following such second Business Day the following shall payable by the User:

(a) ... ;

(b)

Add new paragraph 3.2.11 as follows:

3.2.11 Notwithstanding paragraph 3.2.10, where at any time as a direct consequence of an increase in the relevant Transporter's Transportation Charges, a User's Value at Risk is increased by over 20% from the previous day, a User will have one calendar month from the date of notice given by the relevant Transporter to provide additional surety or security and after the expiry of such date, paragraphs 3.2.10 (a) and (b) shall apply.

Delete title of paragraph 3.3 and replace with the following:

"Requirements as to Value at Risk"

Delete paragraph 3.3.1 and replace with the following:

3.3.1 Where:

- (a) a User's Value at Risk exceeds 80% of its Code Credit Limit and the Transporter has given notice to the User to that effect; and
- (b) at any time following any notice given pursuant to (a) above, the User's Value at Risk exceeds 100% of its Code Credit Limit, the Transporter will notify the User of such event, giving such User 2 Business Days from the date of such notice to provide additional surety or security for the amount specified by the Transporter in the notice in order to reduce its Value at

Risk to below 100% of its Code Credit Limit.

Delete paragraph 3.3.2 and replace with the following:

- 3.3.2 Without prejudice to paragraph V3.3.3, where a User fails to provide such additional security as required in paragraph 3.3.1 (b) by the date specified in the notice pursuant to 3.3.1(b):
- (a) the amount of such surety or security required shall be increased to that amount required to reduce the User's Value at Risk to below 80% of its Code Credit Limit and any surety or security provided by such User shall be deemed to be valued at 80% of its face value for the following 12 calendar months; and
 - (b) with effect from the next Business Day after the date specified in such notice, the User shall pay to the Transporter that amount set out in the table in paragraph 3.2.10(a), based upon the amount of additional surety or security demanded by the Transporter and the daily charge set out in paragraph 3.2.10(b); and
 - (c) subject to paragraph 3.3.1, where and for so long as the User's Value at Risk exceeds 100% of the User's Code Credit Limit, the Transporter shall be entitled to reject or refuse to accept all or any of the following by the relevant User:
 - (i) an application for System Capacity or increased System Capacity at any System Point under Sections B or G5; and/or
 - (ii) in relation to the NTS, a System Capacity Trade under Section B5 in respect of which the User is Transferee User;

until such time as the User's Value at Risk is reduced to less than 100% of its Code Credit Limit.

- (d) where from the fifth Business Day after the date specified in the notice, the User's Value at Risk exceeds 100% of the User's Code Credit Limit, the Transporter shall be entitled to reject or refuse to accept a Supply Point Nomination or Supply Point Confirmation under Section G, other than a Supply Point Renomination or Supply Point Reconfirmation until such time as the User's Value at Risk is reduced to less than 100% of its Code Credit Limit.

Delete paragraph 3.3.3 and replace with the following:

- 3.3.3 Subject to paragraph 3.3.1, where and for so long as the Value at Risk of the User for the time being exceeds 100% of the User's Code Credit Limit, the Transporter may give Termination Notice (in accordance with paragraph 4.3) to the User.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters