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Our Ref: AHT/Mods 0144_0148 response

Dear Julian

Representation in response to Modification Proposals 0144 to 0148:

- **0144/0144A: Quantification of Value at Risk (VAR) to determine a User's minimum Code Credit Limit Requirement**
- **0145: Management of Users Approaching and Exceeding Code Credit Limit**
- **0146: Acceptable Security Tools available to Users for Transportation Credit Arrangements**
- **0147: Administration of Unsecured Credit Afforded on the basis of Payment History and Independent Assessment**
- **0148: Aggregation of Credit Positions or Use of Group Ratings**

Thank you for the opportunity to respond to the Draft Modification Reports (DMR) for the abovenamed Modification Proposals. National Grid Transmission is submitting a joint response for these proposals and offers comments as follows, in line with the section headings in the DMR.

Summary of Support

National Grid Transmission offers support for the Modification Proposals as follows:

- 0144: Qualified Support with preference for alternate 0144A
- 0145: Qualified Support
- 0146: Support
- 0147: Support
- 0148: Support

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

We agree 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 Proposals on security of supply, operation of the Total System and industry fragmentation

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

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

a) implications for operation of the System:

We do not foresee any implications for operation of the System.

b) development and capital cost and operating cost implications:

We understand that there will be minor costs associated with making changes to our operational processes and procedures and systems as a result of these Modification Proposals, but they are not expected to be significant.

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

National Grid Transmission notes that the Proposers do not present any cost recovery mechanisms, however, we consider 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:

We note and take comfort from the assurances made in Ofgem's Best Practice Guidelines¹ (BPG), specifically paragraphs 4.1 to 4.7, regarding the potential for bad debt recovery in the subsequent price control review, 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

Modification Proposals 0146, 0147 & 0148

National Grid Transmission considers that these Modification Proposals will not impact on the level of Transporters' contractual risk and therefore we support their implementation.

Modification Proposals 0144, 0144AV & 0145

In contrast, we believe that these Modification Proposals will increase the level of contractual risk of each Transporter, as they will reduce the minimum level of credit required to be posted by a User and extend the timescales before which Transporters are able to take sanctions to reduce their bad debt exposure.

However, we take comfort in the reassurances provided by Ofgem in its BPG and therefore offer qualified support for these proposals. The BPG 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;

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

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.*

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

a) Administrative & Operational implications

We consider that for the majority of these Modification Proposals, there will be some administrative or operational impact on Users; with the most pronounced effect resulting from Modification Proposals 0144, where Users may wish or be required to adjust their level of credit cover to reflect Value at Risk within year, and 0145, to accommodate the different levels at which Transporters may send notices for a User exceeding its credit limit.

b) Development, Capital & Operating Cost implications

Where there are changes required to administrative or operational processes as identified above, these may incur a minor development cost for establishing the new process and an ongoing operating cost, for example closer monitoring of the Value at Risk under Modification Proposals 0144 and 0144A to ensure that the level of credit cover in place is sufficient at all times.

We agree with the Proposer that, if these Modification Proposals were implemented, Users could face increased operating costs if a Transporter succeeded in passing through costs resulting from bad debt incurred as a result of other Users going out of business, in line with Ofgem's BPG.

In addition, Modification Proposals 0144 and 0144AV could represent both an increase and a reduction in the costs to Users. Users may see a reduction in costs as a result of the effective reduction in the minimum level of credit cover to be provided under the proposal. However, this potential benefit could be offset by the increase in costs of varying their credit cover mid-year.

Level of Contractual Risk

We believe that Modification Proposals 0144, 0144AV and 0145 all have the potential to increase the level of Users' contractual risk, as we believe these proposals increase the risk of bad debt to Transporters. If Transporters operate their credit procedures in line with Ofgem's BPG, there is an increased risk to Users of Transporters passing the debt through to Users in their Transportation Charges in subsequent years.

We also agree with the Proposers that, under Modification Proposals 0144 and 0144AV, if Users choose to retain a level of credit that is very close to their Value at Risk, this could leave them more at risk to the sanctions available to Transporters should their credit limit be breached, albeit inadvertently.

National Grid Transmission agrees that it is possible that the level of contractual risk could reduce slightly under Modification Proposals 0146 and 0148 as a result of the existing arrangements for provision of security tools being codified in the UNC, thereby making the existing credit processes less open to interpretation and challenge.

We also agree that under Modification Proposal 0147, the level of contractual risk will reduce for those Users who underpay an invoice by £250 or less, as they would no longer have their unsecured credit limit immediately reduced to zero as a result of missing the payment.

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

National Grid Transmission recognises that for Modification Proposals 0144, 0144AV and 0147, there is a possibility that a User may reflect any operational cost efficiencies it achieves in obtaining unsecured credit in the level of charges it levies to its Suppliers, which could possibly be reflected in the level of charges a Supplier levies to its customers.

We agree with the Proposers 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 Proposals

We agree with the Proposers' interpretation of Ofgem's BPG for all of these Modification Proposals.

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

Advantages

National Grid Transmission agrees that, for all of these Modification Proposals, alignment with Ofgem's Best Practice Guidelines and codification of existing credit practices could assist with the prevention of industry fragmentation.

For Modification Proposal 0144 and 0144AV, we agree that Users could see a benefit in the reduction in the minimum level of credit security required to be in place. We also agree that alternate proposal 0144AV may provide a more stable environment than original Modification Proposal 0144 and we consider that it should provide less of an increase in the level of Transporters' contractual risk than 0144.

Modification Proposal 0145 offers a benefit to Users whose Value at Risk currently exceeds 85% of their Code Credit Limit. At present, were this to occur, the Transporter could apply certain sanctions to prevent the User from increasing their Value at Risk until such time as the Credit Limit were increased, in future, were this proposal to be implemented, the User could "use" up to 100% of its Code Credit Limit before facing such sanctions.

Modification Proposal 0147 represents an advantage to Users by giving them an error of margin when paying invoices, in that any unsecured credit limit achieved through payment history will not be reduced to zero immediately upon underpayment of an invoice (within the stated tolerance).

Disadvantages

We consider that Modification Proposals 0144, 0144AV and 0145 carry the disadvantage of increasing the level of contractual risk of each Transporter, as they will reduce the minimum level of credit required to be posted by a User and extend the timescales before which Transporters are able to take sanctions to reduce their bad debt exposure. These proposals will also increase the administrative burden on Transporters with regard to closer and more frequent monitoring of levels of Value at Risk and credit limits.

For Users, this could also be a disadvantage where any increase in risk results in bad debt being incurred and that debt is able to be passed through to Users via an increase in Transportation Charges in subsequent years.

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

National Grid Transmission agrees with the assessment made by the Proposers of the appropriate implementation timetable; namely that Modification Proposals 0144, 0144AV and 0145 should be implemented with effect from 3 months following the appropriate direction being received from the Authority; and that Modification Proposals 0146, 0147 and 0148 could be implemented immediately following receipt of the direction.

19. Legal Text

National Grid Transmission notes that the Modification Panel determined that no legal text was required to be produced for any of these Modification Proposals, but that the Proposers have provided **suggested** text for each of them. We also note that the suggested legal text for Modification Proposals 0144 (and 0144AV) and 0145 is linked, such that the concept of Value at Risk which appears in 0145 does not currently exist in the UNC, but is defined in the suggested legal text for 0144. A similar situation exists for Modification Proposal 0148 which uses terms defined in the suggested legal text for Modification Proposal 0146, but which do not currently exist in the UNC.

We consider that this issue should not prove to be a problem should the Authority determine that any of the Modification Proposals be implemented, as the relevant Transporter will be directed to provide the actual legal text for inclusion in the UNC, which can be drafted in such a way as to incorporate all defined terms relevant to each proposal that is implemented.

Yours sincerely

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