

Julian Majdanski
Joint Office of Gas Transporters
51 Homer Road
Solihull
B91 3QJ

Phil Lawton
Distribution Regulation Manager
Phil.lawton@uk.ngrid.com
Direct tel +44 (0)1926 656448
Direct fax +44 (0)1926 656602

www.nationalgrid.com

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Your Reference 0144, 0144AV, 0145, 0146, 0147, 0148

Re: Modification Proposals

0144/0144AV: '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'

Dear Julian,

Thank you for your invitation seeking representations with respect to the above Modification Proposals. As proposer, National Grid Gas (Distribution) ("NGD") supports implementation of proposals 0144, 0145, 0146, 0147 and 0148. NGD understands the aims of Modification Proposal 0144AV but we do not believe that the provisions of this proposal are in line with the Ofgem Best Practice Guidelines¹ and therefore oppose implementation of this proposal.

All of the Proposals seek to introduce into the Uniform Network Code (UNC) credit arrangements deemed to be best practice by Ofgem. It is worthy of note that the best practice identified is applicable to credit arrangements for both gas and electricity network operators and was concluded with a full awareness of the prevailing billing and invoicing arrangements within each industry.

The above Proposals are a suite of measures seeking to align to the aforementioned best practice. Therefore NGD has provided responses to all six Modification Proposals within this representation.

0144/0144AV

NGD recognises that the existing credit rules (in taking account of peak trading values) may require an unnecessarily high value of credit security to be in place for a User. This is especially apparent for Users with a high proportion of domestic customers where there is a significant reduction in the volume of gas transported in summer months. The provisions advocated by Modification Proposal 0144 link the minimum level of security required to the User's financial exposure to the Transporter at that point in time and therefore allow the User the option of tailoring its security level accordingly within the year.

This exposure (the 'primary amount') is one component of the 'Value at Risk' (VAR) which determines the minimum credit level. The other element is an additional 15 days proxy and the daily rate of this proxy is determined by reference to the daily rate implicit in the billed charges represented by the primary amount.

Whilst in general, implementation of the above Proposal would reduce the overall level of security required to be posted by Users (and therefore arguably increases risk of unsecured losses occurring), we note the ability (as identified in all of the Draft Modification Reports) for a Transporter to secure pass through of any bad debt it

¹ Best practice guidelines for gas and electricity network operator credit cover – Conclusions document (58/05) - February 2005

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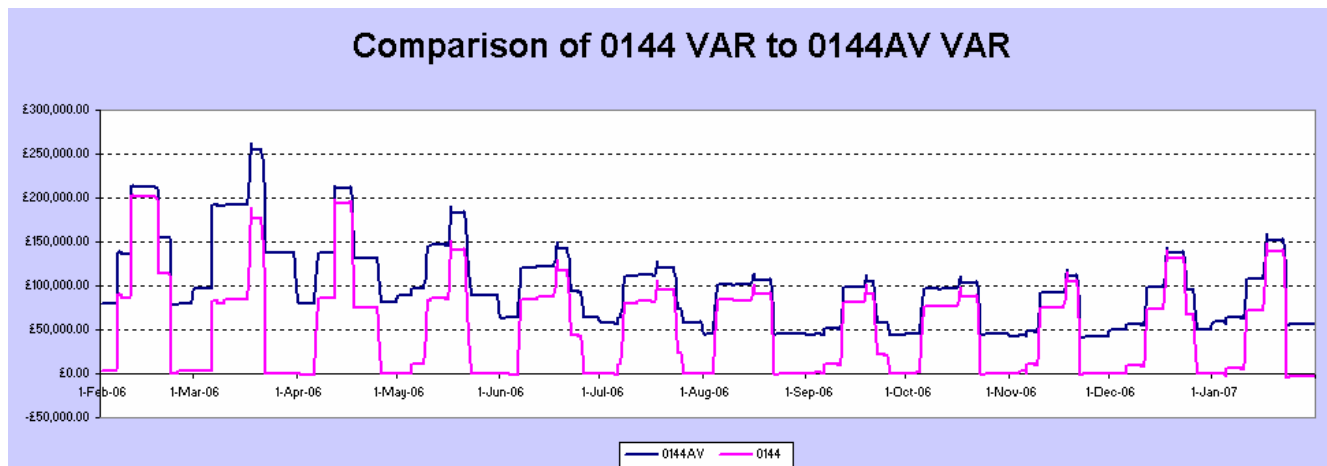
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incurs where it is able to demonstrate compliance with best practice. The above Proposal seeks to implement this best practice.

Ofgem clarified the operation of this pass through within its Best Practice Guidelines whereby under normal circumstances, at the subsequent price control review the Transporter would 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.

Wales and West Utilities (WWU) subsequently raised Modification Proposal 0144AV, the sole difference from 0144 being the calculation of the additional proxy. This alternative proxy is an additional 20 days and the daily rate is determined by reference to the aggregate amount of Transportation Charges invoiced to the User in the previous calendar month. We have undertaken analysis (see appendix A) involving application of this methodology to a random User's accrued charges over a recent twelve month period which demonstrates that compared to 0144, this version of the VAR principle would require Users to maintain a higher level of credit security where the value of outstanding charges is low. Similarly, in peak trading periods a User would be required to provide a higher level of credit security than the methodology advocated by 0144. This difference was particularly apparent for winter into summer months where the peak value trend is downwards.



Whilst we understand the philosophy of 0144AV, NGD does not believe that the alternative reflects the best practice advocated by the Ofgem conclusions document, specifically section 3.30(b) which states that the proxy amount is “a deemed amount equal to the aggregate value of all Use of System charges that would be incurred in a fifteen day period at the same average daily rate implicit in billed charges under (the primary amount)”.

0145

NGD supports incorporation of terms into the UNC that would allow a User to utilise the full extent of its credit cover in absence of the application of sanctions by the Transporter. We believe it is appropriate that sanctions are only applied where a User's VAR exceeds the full value of the credit security in place. Where such a breach occurs, NGD supports the implementation of effective and proportionate measures to ensure that a User takes prompt action to address the value of its security in place for the protection of the industry as a whole. We believe that the measures proposed strike this balance.

0146

Inclusion of Security Tools within the UNC would ensure that all Transporters are obliged to allow the use of a consistent range of credit tools by Users. As the majority of the tools defined are already acceptable to NGD, this would appear to be a reasonable proposal that for NGD has no specific implementation requirements. Further work may be required to develop the bi-lateral insurance product and we would anticipate that this would be triggered where a User provided an indication that it wished to use such a product.

We note that a degree of discussion within the UNC Distribution Workstream has focussed on the right of the Transporter to request a legal opinion where a Parent Company Guarantee (PCG) (from a company registered

outside of England and Wales) is utilised as credit security. NGD maintains a firm belief that this right is appropriate in order to allow the Transporter to maintain a level of confidence that the security tool presented is enforceable within the prevailing jurisdiction. Such enforceability would directly mitigate the risk of high value pass through to the User community.

0147

This proposal seeks to implement a number of enhancements to the terms incorporated within the UNC following the implementation of Modification 0113.

- **Missed Payments**

NGD recognises that there may be instances where, for whatever reason, payments of a small value remain outstanding beyond the due date. Due to the potential disproportionate implications to unsecured credit accrued under the Modification 0113 provisions, this proposal seeks to mitigate this adverse impact where the amount outstanding is below £250. NGD believes that the proposal advocates a proportionate response to missed payments of relatively small amounts whilst noting that further breach of payment terms (of any amount) within twelve months would reduce the allowance to 0. This latter aspect should ensure that adequate diligence is applied by Users to the making of timely payments.

- **Independent Assessments – Ad hoc re-assessments**

NGD supports the principle advocated by this proposal that (aside from the initial assessment and the annual re-assessment) the initiator pays for an adhoc re-assessment. Under prevailing arrangements the User is liable for such costs, regardless of the identity of the initiator.

- **Independent Assessments – Agencies**

This aspect of the proposal seeks to address an essentially procedural point in respect of appointment of the independent credit rating agency. NGD believe the changes proposed would ensure the User has entitlement to select the rating agency (from a panel of three provided by the Transporter).

0148

The use of PCGs and the rules regarding their application as detailed within the Proposal are already acceptable to, and operated by, NGD. The proposed provisions would formalise requirements for a parents' aggregate security provision to not exceed its ability to bear risk. This would appear to be a reasonable proposal that for NGD has no specific implementation requirements.

If you require any further information in respect of this representation please contact Chris Warner on 07778 150668 or email chris.warner@uk.ngrid.com.

Please contact Chris Warner on 01926 653541 (chris.warner@uk.ngrid.com) should you require any further information with respect to the above.

Yours sincerely

Phil Lawton
Distribution Regulation Manager