

**Modification Report**  
**Acceptable Security Tools available to Users for Transportation Credit Arrangements**  
**Modification Reference Number 0146**

Version 5.0

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. One such recommendation was the range of security tools that should be available to a User to cover any exposure beyond its unsecured credit limit. It further recommended that it would be for each User to determine which, how many and in what percentage they are used.

This Proposal seeks to specify within the UNC the range of acceptable security tools available to Users these being any of the following tools (or combination of them):

- An approved Letter of Credit or equivalent bank guarantee from a bank with a long term debt rating of not less than A by Moody’s or Standard & Poor’s,
- Prepayment agreement (payment made before the delivery of the service).
  - paid monthly by the User upon notification from the Transporter of the amount required in advance of the invoice due date and applied against the relevant invoices.
- A performance bond (provided by an insurance company, not a bank),
- Independent security (a guarantee provided by a Qualifying Company),
- Deposit Deed Agreement (including cash deposit, advance payment or payment made after the delivery of the service but before contract settlement),
  - a deed held by the Transporter and called upon if the User defaults on a payment,
  - For the purposes of clarification both Prepayment Agreements and Deposit Deed Agreements may be used as security or for payment.
- Parent Company Guarantee (PCG)
  - PCGs from both England and Wales registered companies and non-England and Wales registered companies are acceptable though in the case of the latter, the country of residence of such company must have a sovereign credit rating of at least A awarded by Moody’s Investors Service (or equivalent rating by Standard and Poor’s Corporation) and the User shall, where requested to do so by the Transporter, provide at its own expense a legal opinion as to enforceability.

- Bi-lateral insurance
  - Such a policy must provide for settlement of a User's debt (i.e. for the benefit of the Transporter) in respect of transportation invoices,
  - the policy terms must be unconditional in all material matters in order to be rated at full value.

A security tool providing cash on demand will be rated at full value. A tool that has conditionality but is certain to provide cash in a timely manner will be rated up to full value. The value of an individual tool will be agreed between the relevant Transporter and the relevant User. In the event that the two parties cannot agree on this value, an expert appointed pursuant to the Dispute Resolution provisions (General Terms: Section A) of the UNC will determine such.

If this Proposal is not implemented, the 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.

**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 further achievement of this relevant objectives.

**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:**

No significant development, capital or operating cost implications have been identified although development of the bi-lateral insurance product may generate future cost to one or more industry players.

**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:**

The majority of the security tools identified are currently acceptable to all

Transporters. On this basis the only change to Transporters' level of contractual risk would be that associated with bi-lateral insurance products. Representations are invited to confirm whether risk is increased by any other proposed tool and if so, provide an indication of the consequential impact on 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.

**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)*

Existing operational arrangements and requirements are anticipated to apply in respect of each credit tool and therefore implementation is not anticipated to have any distinct implications for Users. Prospective use of the bi-lateral insurance product may have distinct operational requirements.

*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.

NG UKD suggested that further work may be required to develop the bi-lateral insurance product.

*Consequence for the level of contractual risk of Users*

With the scope of tools available formalised in the UNC (if implemented) User contractual risk will be reduced.

**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.
- Codifies current practice.
- Provides clarity as to which credit security tools are acceptable to Transporters.

**Disadvantages**

- 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)**

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

SSE provided the following concerns:

- The Moody's and S&P ratings appear to be confused i.e. A and BB- are S&P not Moody's as written. They expressed that the terminology needs to be clear and consistent and that clarification is required for the range of A bands.
- The legal text definitions for a Parent Company should specify that any PCG provided is done so under the jurisdiction of English Law.
- They questioned if Prepayment is an acceptable form of cover.
- They also questioned if deposit funds are held in a segregated account and if interest is payable and point out this also applies to Prepayment funds.

SGN expressed concern that the Proposal appears to allow double counting; i.e. permitting a User's credit limit to be extended beyond its Unsecured Credit Limit (UCL) where the User is relying on a Parent Guarantee to set the UCL.

RWE expressed concern surrounding the provision of Parent Company Guarantees as a form of security.

Some respondents acknowledged the concerns raised at the Distribution Workstream regarding the discriminatory impact on non England and Wales guarantee providers, particularly in respect of those registered in Scotland, and the resultant additional User costs of providing legal opinions.

**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)**

The proposer believes that in light of the limited works required to implement, this Modification Proposal could be implemented with immediate effect upon 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, 9 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel 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 B: SYSTEM USE AND CAPACITY**

*Amend paragraph 2.2.14 as follows:*

2.2.14 Following a notice...provide adequate surety or security (in accordance with Section V 3.4.5), all monthly...

*Amend paragraph 2.2.16 as follows:*

2.2.16 Following a notice under paragraph 2.2.15...provide adequate surety or security (in accordance with Section V3.4.5), the User's Registered...

## TPD SECTION V: GENERAL

*Amend heading under paragraph 3.4 to read as follows:*

“Security under Code”

*Amend paragraph 3.4.1 to read as follows:*

3.4.1 Any instrument of surety or security provided by a User pursuant to paragraph 3.4.6 (and whether...

*Amend paragraph 3.4.2 to read as follows:*

3.4.2 Where a User has provided surety or security pursuant to paragraph 3.4.6 the User (or the person giving the surety) may request the Transporter to release all or any of such security or agree to a reduction in any maximum amount of such surety.

*Amend paragraph 3.4.5 to read as follows:*

“For the purposes of Code:

“**Bi-lateral Insurance**” shall mean an policy of insurance (that is unconditional in order to attain 100% of its face value) for the benefit of the Transporter, provided by a Qualifying Company and in such form as is acceptable to the Transporter;

“**Deposit Deed**” shall mean an agreement that is Enforceable and in such form as provided to the User from time to time by the Transporter enabling the deposit of cash as surety or security or advance payments by a User;

“**Enforceable**” shall mean the Transporter (acting reasonably) is satisfied that the instrument of security is legally enforceable and in this respect, where security is provided by a company registered outside of England and Wales, the country of residence of such company must have a sovereign credit rating of at least A awarded by Moody’s Investors Services or such equivalent rating by Standard and Poor’s Corporation (where such ratings conflict, the lower of the two ratings will be used) and the User shall at its own expense provide such legal opinion as the Transporter may reasonably require;



**“Letter of Credit”** shall mean an unconditional irrevocable standby letter of credit in such form as provided to the User from time to time by the Transporter from such bank as the Transporter may approve, (provided that payment may be made at a United Kingdom branch of such issuing bank) with a long term debt rating of not less than A provided by Moody’s Investors Services or equivalent rating by Standard and Poor’s Corporation (where such ratings conflict, the lower of the two ratings will be used);

**“Guarantee”** shall mean an on demand irrevocable guarantee or performance bond provided by a Qualifying Company or a Parent Company that is Enforceable and in such form as provided to the User from time to time by the Transporter;

**“Prepayment Agreement”** shall mean an agreement between the Transporter and the User that is Enforceable and in such form as provided to the User from time to time by the Transporter with the purpose of enabling a User to make payments of amounts calculated on a monthly basis by the Transporter (using an accrual methodology set out therein) as representing the Transporter’s estimate of the amounts (other than in respect of Energy Balancing Charges) which will become due by the User to the Transporter in a charging month;

**“Parent Company”** shall mean:

- (i) in the case of a company registered in England and Wales a public or private company within the meaning of section 1(3) of the Companies Act 1985 with a long term debt rating of at least BB- provided by Standard and Poor’s Corporation or equivalent rating by Moody’s Investors Services (where such ratings conflict, the lower of the two will be used) that is either a shareholder of the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989); or
- (ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting

reasonably;

**“Qualifying Company”** shall mean:

(i) in the case of a company registered in England and Wales a public or private company within the meaning of section 1(3) of the Companies Act 1985 that has a long term debt rating of at least A by Moody’s Investors Services or equivalent rating by Standard and Poor’s Corporation (where such ratings conflict, the lower of the two will be used); or

(ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably.

*Delete paragraph 3.4.6 and replace with the following:*

“A User may extend its exposure beyond its Unsecured Credit Limit by providing surety or security in one or more of the forms set out below:

- (a) Bi-lateral Insurance; and/or
- (b) Letter of Credit; and/or
- (c) Guarantee; and/or
- (d) Deposit Deed; and/or
- (e) Prepayment Agreement;

provided that where an instrument of surety or security is conditional, the Transporter may agree with the User a value below 100% of its full face value. Where the value of the instrument of surety or security cannot be agreed between the User and the Transporter, the User may refer such dispute to Expert Determination in accordance with GT Section A, paragraph 2.”

*Delete paragraph 3.4.7.*

For and on behalf of the Relevant Gas Transporters:

**Tim Davis**  
**Chief Executive, Joint Office of Gas Transporters**