

CODE MODIFICATION PROPOSAL No. 0148
Aggregation of Credit Positions or Use of Group Ratings
Version 1.0

Date: 04/05/2007

Proposed Implementation Date: 01/09/2007

Urgency: Non Urgent

1 The Modification Proposal

a) Nature and Purpose of this 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 Users may aggregate their credit positions or use group ratings (for example Parent Company Guarantees (PCGs)) provided that the arrangements are robust and unconditional. The conditions for the acceptance of such are:

- The credit support provider must offer a guarantee which is legally enforceable in England and Wales. Guarantors based outside England and Wales may be required to provide legal opinion of enforceability,
- The guarantor entity will be subject to the same credit scoring process as the buyer, and must also be willing to provide information to facilitate the completion of this process,
- The country of residence of the guarantor must have a sovereign credit rating of at least A awarded by Moody’s Investors Service (or equivalent rating by Standard & Poor’s). If the rating agencies differ, the lower rating will apply, and
- The minimum acceptable rating is Ba3 awarded by Moody’s Investors Services (or equivalent rating by Standard & Poor’s). If the rating agencies differ, the lower rating will apply.

The PCG may be used in one of two ways:

- the unsecured credit limit assigned to the User would be based on the credit strength of the parent guarantor. Thus for example, a BB rated User guaranteed by an A rated parent would obtain an unsecured limit equal to 40 per cent of the relevant Transporter’s maximum credit limit. Where more than one User obtains credit from a single PCG, the aggregate counterparty credit limits (obtained via that PCG) shall not exceed the credit entitlement of the parent.

- As a guarantee for an amount in addition to an Unsecured Credit Limit assigned to the User based on its stand alone credit rating. In such a case, the additional amount secured by the parent must not exceed the parent company's ability to bear risk and must take into account the extent to which other Users are secured by the parent under the UNC.

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.

b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)

N/A

c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.

This Modification Proposal has been developed within the Uniform Network Code (UNC) Distribution Workstream. General consensus on its objectives was forthcoming. 'Proceed to consultation' is therefore requested.

2 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

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.

3 The implications of implementing this 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 this Modification Proposal, including:

a) The implications for operation of the System:

No implications for operation of the system have been identified.

b) The development and capital cost and operating cost implications:

No significant development, capital or operating cost implications have been identified.

- c) **Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:**

No cost recovery mechanism is proposed.

- d) **The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

Based on the assumption that implementation would codify current practice no change to Transporters' level of contractual risk is anticipated. Representations are invited to confirm whether this assumption is correct, and if not, 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 extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)**

Implementation is not required for such.

- 6 **The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users**

No UK Link systems implications have been identified.

- 7 **The implications for Users of implementing the Modification Proposal, including:**

- a) **The administrative and operational implications (including impact upon manual processes and procedures)**

Existing operational arrangements and requirements are anticipated to apply in respect of the arrangements which are the subject of this Proposal and therefore implementation is not anticipated to have any distinct implications for Users.

- b) **The 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.

c) **The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

With the scope of the use of group ratings formalised in the UNC (if implemented) User contractual risk will be reduced.

8 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, 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 the Transporters

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 not otherwise identified in paragraphs 2 to 9 above

Advantages

- Alignment with Best Practice Guidelines.
- Codifies current practice.

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 as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)

No representations have been invited at this stage.

12 Detail of all other representations received and considered by the Proposer

No such representations have been received.

13 Any other matter the Proposer considers needs to be addressed

No such additional matters (related with this proposal) have been identified.

14 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal

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.

15 Comments on Suggested Text

None.

16 Suggested Text

TPD SECTION V: GENERAL

Amend paragraph 3.1.6 to read as follows:

- “ (a) Where a User has an Approved...
- (b) Subject to paragraph 3.1.6 (c), where a Qualifying Company or Parent Company provides security to a User in the form of a Guarantee pursuant to paragraph 3.4.5 (the “Security Provider”), then the Approved Credit Rating of such Security Provider may be used in place of the User’s to calculate such User’s Unsecured Credit Limit in accordance with the table set out in paragraph 3.1.6.
- (c) Where a Security Provider provides security for more than one User, the aggregate Unsecured Credit Limits of such Users shall not exceed maximum credit entitlement of the Security Provider calculated in accordance with the table set out in paragraph 3.1.6.
- (d) A User may utilise an Approved Credit Rating from a Security Provider in accordance with paragraph 3.1.6 (b) in combination with a Guarantee from such Security Provider, provided that in the opinion of the Transporter, such Security Provider’s ability to bear risk is not exceeded.

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document

Section(s) V

Proposer's Representative

Phil Lucas (National Grid)

Proposer

Chris Warner (National Grid)