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30 July 2010.  
Your Reference:UNC Modification Proposals 0298 - 0311.

**Re: UNC Modification Proposals 0298 - 0311**  
**Suite of credit related Proposals raised following Review Group 0252**

Dear Bob

Thank you for your invitation seeking representations with respect to the above Modification Proposals. National Grid Gas (Distribution) ("NGD") recognises that the purpose of Review Group 0252 was to undertake a review of the prevailing transportation credit arrangements within the UNC that were by and large introduced to implement the 'best practice' (advocated by the Ofgem Best Practice Guidelines<sup>1</sup> published in 2005) and recommend any changes to those guidelines in the context of the current economic climate.

We understand that the overriding aim of these Proposals is to minimise the risk of unsecured bad debt which could potentially be 'passed through' to residual market participants and ultimately consumers. As such, we understand that any Proposals in respect of which the Authority directs implementation will be deemed to be best practice (superceding the relevant elements of the 2005 Best Practice Guidelines) and compliance with these revised terms will become the pre-requisite for a Transporter seeking approval from the Authority to 'pass through' any bad debts it incurs as a consequence of applying the UNC credit terms.

The 14 Proposals referenced above are a suite of measures seeking to achieve these aims and therefore NGD has provided responses to all the Modification Proposals within this representation.

In respect of Proposals 0298 to 0309 (inclusive) NGD believes that implementation would better facilitate the relevant objectives of securing effective competition between relevant shippers and the promotion of efficiency in the implementation of the network code. This is achieved by minimising the potential exposure to Users (and Transporters) associated with bad debt. More generally, implementation would refine the UNC credit terms to maintain consistency and ensure the availability of a suite of appropriate credit tools which effectively cover the risk.

**Proposal 0298: Amend and remove UNC TPD Section V3 text inconsistencies, errors and bi-lateral insurance clause**

NGD offers **qualified support** for this Proposal. We support the correction of typographical errors & inconsistencies, also the removal of bi-lateral insurance (on the basis that no party has identified such a product) and in addition clarification of the level of security required (where a User fails to provide additional security). However, we have concerns in respect of the Code Credit Limit requirements proposed as a consequence of a material change in a User's trading level.

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<sup>1</sup> Best practice guidelines for gas and electricity network operator credit cover – Conclusions document (58/05) - February 2005  
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To trigger these requirements, it is proposed to exchange the current quantitative test (a minimum percentage increase in the User's Value at Risk (VAR)) for an undefined "material increase" test. In our view this would appear to create the risk of inconsistent interpretation of this term between respective DNOs and Users. Our preference would be for a more specific test, or as a minimum greater definition and guidance in respect of what qualifies as 'material' in this context. In absence of this, we believe that there is an increased risk of disputes in respect of interpretation of this term.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0299: Alignment of portfolio sanctions across UNC TPD Sections V and S**

NGD offers **support** for this Proposal which seeks to align the timescales afforded to a User to rectify a breach of the Code Credit Limit between sections S and V of the UNC. We believe that implementation would reduce the risk of the accrual of bad debt by reducing the period within which a User must address a breach of its Code Credit Limit from five Business Days to one Business Day before the Transporter is entitled to take action to address the matter.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0300: Introduction of Fitch as an allowable Credit Rating Agency for the purposes of Code Credit Arrangements**

NGD offers **support** for this Proposal which seeks to add an additional Approved Credit Rating Agency (Fitch). In light of the usage of Fitch as a rating agency comparable with Standard and Poor's and Moody's in the context of the Transporters Licence and in the Connection and Use of System Code (CUSC) within the electricity industry, we believe that aligning the UNC with such authorities is a pragmatic step.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0301: Removal of the use of Specially Commissioned Ratings for the purposes of obtaining an Unsecured Code Credit Limit**

NGD offers **support** for this Proposal which seeks to remove Specially Commissioned Ratings as an acceptable unsecured credit tool. We agree with the proposer that the lack of ongoing monitoring of Specially Commissioned Ratings critically limits the reliance that can be placed upon such ratings over time. We therefore support the restriction of permissible forms of unsecured credit to those tools that provide an enduring and dynamic assessment of a User's ability to meet its Transportation liability.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0302: Definition of Regulatory Asset Value (RAV) when calculating Maximum Unsecured Credit**

NGD offers **support** for this Proposal which seeks to clarify the source of the information to enable the Transporter and the industry to identify the Regulatory Asset Value (RAV) of the Transporter on an ongoing basis. We believe this provides a greater level of clarity compared to the prevailing UNC terms. However we note that the values specified within the Gas Distribution Price Control Review (GDPCR) Final Proposals document (December 2007) detail non-adjusted 2005/2006 values and suggest that a consistent Transporter approach to adjusting such prices to determine the RAV for the respective years would be desirable.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0303: Obligation for Users to maintain a Code Credit Limit and at a reasonable level**

NGD offers **support** for this Proposal which seeks to oblige User to post a Code Credit Limit equal to the highest value '100% VAR' notice issued to a User within a two month period where more than two such notices are issued in that period.

Whilst the proposed terms would allow the User to reduce its Code Credit Limit to meet its actual VAR the day following the increase of the Code Credit Limit (to meet the 'peak VAR' value), we believe the costs associated with varying a Code Credit Limit to this frequency would provide an incentive not to breach the Code Credit Limit in the first instance.

To this extent we believe that the Proposal would achieve its objective of incentivising the right behaviours in terms of utilising other methods of reducing Code Credit Limit usage such as proactively increasing Code Credit Limits (by increasing the value of security posted) or payment of invoices prior to the Invoice Due Date.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0304: Introduction of a rating table for independent credit rating agencies for use with Independent Assessment**

NGD offers **qualified support** for this Proposal which seeks to clarify the level of unsecured credit that can be obtained via an independent credit rating agency.

Discussions within Review Group 0252 revealed that some parties were having difficulty applying the existing independent assessment terms, specifically the lack of supporting information in respect of the scoring mechanism. This Proposal seeks to align the UNC to the approach taken in the Distribution Connection and Use of System Agreement (DCUSA) by aligning this scoring mechanism to the ratings utilised by a number of recognised credit rating agencies. To this extent, incorporating greater definition into the UNC can only be an improvement to the prevailing terms.

However, the wording of the Proposal and the suggested legal text state that the Code Credit limit will be "*no higher than the lower of the value recommended by the assessment agency and the value calculated based on the table [which specifies the percentage of the RAV applicable to the respective ratings]*". NGD believes that this would not provide absolute clarity as to the actual level of unsecured credit to which a User is entitled. Therefore our support is qualified on the basis that greater certainty would be achieved if the legal text identified that a User obtains a level of unsecured credit which is *the lower of* the percentage of the Transporters RAV (as determined by the rating determined by the CRA) or the absolute financial value recommended by the credit rating agency.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

### **Proposal 0305: Unsecured Credit Limit allocated through payment history**

NGD offers **support** for this Proposal which seeks to restrict the ability for a User to utilise payment history as a form of Unsecured Credit to the first two years of it's accession to the UNC. In addition, revised 'soft landing' terms would apply where a User secured via this means does not pay an invoice by the Invoice Due Date.

Although this would appear to remove the availability of a credit tool for exiting Users in the market for greater than two years, the Review Group identified that payment history is a component of an independent assessment which provides a more rounded assessment of a User's liquidity than payment history in isolation. Hence this is a preferable form of measurement to determine a User's level unsecured credit.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with effect from two calendar months after the date of direction.

## **Proposal 0306: Administration of Shipper Credit Security Contact Details**

NGD offers **support** for this Proposal which seeks to oblige Users to notify Transporters of appropriate credit contacts within their respective organisations and to keep such details up to date. The provision of timely and accurate User contact information is essential to ensure that notices issued by Transporters pursuant to TPD Section V3 are addressed to the contacts best placed to take actions required within with the prescribed timescales.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

## **Proposal 0307: Alignment of Defaulting User Threshold with Insolvency Act (1986) Threshold**

NGD offers **support** for this Proposal which seeks to reduce the debt level at which a User Default is triggered from £10,000 to a value in line with the Insolvency Act (currently £750). Whilst adoption of the Insolvency Act trigger would appear to be a significant reduction compared to prevailing terms, this value refers to individual Transporters and therefore a User is able to effectively accrue up to £3,750 outstanding debt (subject to remaining less than £750 in debt per Transporter) before triggering the User Default terms. As the incorporation in Network Code of the existing £10,000 limit predates the sale by National Grid of a number of its Distribution Networks in 2005, it is clear that the existing terms effectively enabling £50,000 to be accrued before a User is considered in Default is an unintended consequence.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

## **Proposal 0308: Appropriate use of the terms Surety and Security in UNC TPD Section V**

NGD offers **qualified support** for this Proposal which seeks to reflect the correct uses of the terms Surety and Security in section V3.

We do not necessarily agree with the table setting out the meaning of Surety and Security, however looking at the suggested text in detail, we do not believe that there is a detrimental impact to the meaning of each clause. We would suggest that for clarity Surety and Security is added as a defined term for the purposes of Section V of the UNC, this would prevent any potential inconsistencies with the context of Surety and Security in the different Sections of the UNC.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

## **Proposal 0309: Timeframes for establishing and extending Guarantees and Letters of Credit**

NGD offers **support** for this Proposal which seeks to clarify the implications of a Letter of Credit and a Guarantee approaching its expiry date. The Proposal seeks to ensure that transition between two forms of credit or periods of validity of a Letter of Credit or Guarantee does not result in a period for which no security is in place. Accordingly, implementation would reduce risk to Transporters, and potentially Users, associated with bad debt.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

## **Proposal 0310: Removal of DNO Users from UNC TPD V3.3.4**

NGD offers **comments** in respect of this Proposal which seeks to remove the requirement for DNOs to provide credit to National Grid Transmission (NTS) for NTS Exit (Flat Capacity) from 2012.

NGD understands that discussion of this topic at a number of meetings of the UNC Transmission Workstream during 2009 identified that the financial risk associated with a defaulting DNO is low or non-existent due to the Energy Act 2004 provisions which would require the DNO's obligations to fall within scope of an energy administration order in such circumstances. This would require the new DNO to adopt the liabilities for NTS Exit (Flat) Capacity booked by the original DNO.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

**Proposal 0311 Removal of DNOs as Users from UNC TPD V3 and V4**

We would like to offer the following *comments* in respect of this Proposal.

We agree with the proposer that the classification of DNO's as Users under sections V3 & V4 is inappropriate.

Given that DNO's have licence obligations to maintain good credit ratings and that they have to have a network code to be a Gas Transporter, the concept of terminating a DNO from code is unworkable. If NTS believes that there is a genuine concern, (and for the avoidance of doubt, NGD does not), that their fellow UNC Transporters may find themselves in a position where they are unable to pay for services then they should propose contractual provisions and remedies that are implementable.

It is also a concern that these rules were introduced as a package with UNC Modification 195AV and, consequently, they were not specifically consulted on. Had the insertion of these provisions been the subject of a separate proposal, we feel it is very unlikely that it would have been implemented for the reasons given above.

In the event of the appropriate direction from the Authority, NGD would be able to implement this Proposal with immediate effect.

Please contact me on 01926 653541 (chris.warner@uk.ngrid.com) should you require any further information.

Yours sincerely,

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