

Representation

Draft Modification Report

0360 - Removal of Credit Rating Restrictions from Definition of Parent Company

Consultation close out date: 19 May 2011
Respond to: enquiries@gasgovernance.co.uk
Organisation: First Utility
Representative: Chris Hill
Date of Representation: 18 May 2011

Do you support or oppose implementation?

Support

Please summarise (in one paragraph) the key reason(s) for your support/opposition.

This Modification, if implemented, should assist in furthering competition and provide a level playing field for all Users regardless of their size by giving smaller Users an alternative option for unsecured credit provision which is currently only provided to larger Users. As the amount of unsecured credit that a Transporter might extend to a more financially secure parent could be more sufficient for that User's needs, this would avoid or ameliorate the potential situation where a smaller User might have to post considerable amounts of cash to make up the difference between its required Transportation Unsecured Credit amount and the amount that the Transporters will extend to it based on its Independent Assessment score. This cash could then be used to grow the business rather than being tied up as security.

Are there any new or additional issues that you believe should be recorded in the Modification Report?

Previously, Users without an approved credit rating were able to build a level of unsecured credit over time based on their payment history. However, as this will no longer be the case from July 1st 2011 if a User has been active in the market for more than 2 years, it may be that some smaller Users affected by this change would like to provide a Parent Company Guarantee as an alternative to posting cash to make up some or all of the difference between the Independent Assessment amount and their Unsecured Credit amount if that User has a parent which is more financially sound than the User itself. This Modification seeks to provide them with the ability to do this.

The UNC currently defines a parent company as a company with an approved credit rating of BB- or better as rated by Standard and Poor's (or an equivalent rating provided by Moody's or Fitch). This means that a parent company which does not meet the criteria is barred from providing a Parent Company Guarantee to its subsidiary. This Modification would change that definition to allow a User's parent company to provide a Parent Company Guarantee to its subsidiary irrespective of whether or not it has a BB- or better approved credit rating.

Although we are aware that some larger Users have expressed concerns in relation to their perceived increased risk should this Modification be implemented by Ofgem, we would like to make the point that the financial risk that smaller Users pose to both larger Users and the market as a whole is negligible. By contrast, the risk that default by a large User would pose to the market is immense and we note Ofgem's view in the Best Practice Guidelines for Network Operator Credit Cover,

"As has been stated before, a rated entity could well be more likely to fail than a well run and collateralised smaller company that is unrated. For this reason Ofgem has sought to balance the likelihood and potential cost to consumers of the failure of unrated companies with the need for each unrated company to provide security".

In the last ten years there have been three defaults which have had a major impact on the UK energy market, two of large and established energy companies and one of an investment bank. All three of these entities had approved credit ratings significantly better than BB- at the time of their demise.

If, however unlikely it might be, a default on this scale occurred today, the consequences to smaller Users could be significant. Despite this, larger Users who have a parent with an approved credit rating of BB- or better are allowed to cover their some or all of their unsecured credit amounts for Transportation by means of a simple Parent Company Guarantee rather than cash. It therefore seems counter intuitive that smaller Users whose potential default would have a much smaller impact on the market are currently denied this option, particularly as the parent would be assessed in line with the Independent Assessment table contained in UNC TPD V 3.1.7 should this Modification be implemented. This would ensure that any Parent Company Guarantee would be set at an appropriate level as determined by an Independent Rating Agency.

We agree that the implementation of this Modification by Ofgem would slightly increase the risk to Users, including First Utility, as other smaller Users may choose to avail themselves of this option. However, we feel that the benefit that implementation would provide to competition outweighs this relatively small increase in overall risk to the market.

Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

We believe that implementation of this Modification would better facilitate the relevant objective of the securing of effective competition between relevant shippers and suppliers as it will remove a barrier to competition.

Impacts and Costs:

What analysis, development and ongoing costs would you face if this modification were implemented?

The implementation of this Modification by Ofgem would lead to a reduction in the costs of eligible smaller suppliers as they would be required to post less cash to meet their Transportation unsecured credit requirements due to the ability of their parent to provide a Parent Company Guarantee on their behalf.

Implementation:

What lead-time would you wish to see prior to this modification being implemented, and why?

This Modification could be implemented as soon as a decision is given by Ofgem. We would request that Ofgem provide a decision before July 1st 2011 if possible.

Legal Text:

Are you satisfied that the legal text will deliver the intent of the modification?

Yes, we believe that the legal text will deliver the intent of the Modification if implemented.

Is there anything further you wish to be taken into account?

Please provide any additional comments, supporting analysis, or other information that that you believe should be taken into account or you wish to emphasise.

No.