

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: E.ON
Representative: Richard Fairholme
Date of Representation: 16 May 2011

Do you support or oppose implementation?

Not in Support

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

Whilst the proposed solution may, in the view of the proposer, address their own difficulties, there is a real risk of undermining the overall robustness of the current transportation credit arrangements affecting all other Shippers, as a result. The current requirement for an Approved Credit Rating of a Parent Company ensures that potentially significant credit risk is only carried by those equipped to do so. Allowing a lower standard of Parent Company Guarantee as an acceptable form of security may undermine the robustness of the arrangements and increase the risk of money not being recovered from the defaulting Shipper. Furthermore, as Ofgem has previously stated, *"it is likely that the parent and subsidiary will be in the same or related industries and may face financial difficulties at the same time. This has been borne out in recent events."* (Source: Ofgem, Modification Proposal 0572 'The provision of Letters of Credit for energy balancing credit cover', 29 April 2003). Whilst the proposal may lower the operating costs for affected Shippers, in our view, it carries the risk of potentially increasing, to the detriment of the wider Shipper community, the costs of default; which could far outweigh the administrative savings for some Shippers that this proposal may facilitate, if implemented.

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

By removing the need for a Parent Company to have an approved credit rating with a long term debt rating of at least BB-, there would be a reduced barrier to Shippers (large or small, existing or new) creating "shell" parent companies which could then carry all the transportation credit risk of that Shipper (at much lower cost than posting cash as security). If the Shipper were then to get into financial difficulties, such a "shell" company could be wound up, with the financial liabilities then passed onto the remainder of the Shipper community. Implementation of this proposal may increase the risk that transportation credit debts are not recovered from the defaulting party in the event of Shipper failure, with the costs then smeared across the wider Shipper community.

It is also worth noting that under Energy Balancing Credit Rules, the credit arrangements have evolved in completely the opposite direction to that proposed by this Proposal, with Parent Company Guarantees (PCG) of *any* rating being deemed unacceptable for energy balancing credit purposes. The possibility of using a PCG as an acceptable form of security was removed by Network Code Modification Proposal 0572.

Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

We do not believe this proposal would better facilitate any of the relevant objectives. By potentially increasing the risk that the costs of a Shipper default cannot be recovered from the defaulting party, competition between Shippers is likely to be adversely affected due to the increased risk of the remaining Shippers having to pick up these costs.

Impacts and Costs:

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

We do not believe the case for enhanced competition between Shippers can be made until the impact on the wider Shipper community has been properly quantified. The proposal contains no evidence on this point.

Implementation:

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

We do not support implementation.

Legal Text:

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

The text appears to reflect the intent of the proposal.

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.