Joint Office of Gas Transporters

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: **National Grid NTS**

Representative: Beverley Viney

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.

We note that the proposer states that they "believe that implementation of recent changes to the credit arrangements within the UNC have had unintended consequences ...", we disagree with this statement as the recent credit changes where well developed and discussed fully within Review Group 0252. Views of small shippers were sought as part of RG0252 and we believe that the Modification Proposals raised were developed in line with 'Best Practice guidelines for gas and electricity network operator credit cover' (BPG). The implementation of Modification Proposal 0306 has led to an increase in the use of an Independent Assessment as a means of providing unsecured credit to small parties, which was an intention of the proposal. Unsecured Credit via the use of Independent Assessment was always intended to be based on the User's assessment and not that of a Parent Company of the User. The current criteria of at least BB- for a parent company guarantee is based on the BPG and National Grid Transmission believe that there is a risk associated with Parent Company Guarantees even for parties with an Investment Grade Rating and allowing the parents Independent Assessment to be so used to set the level of unsecured credit does not take in to account the ability of a parent to financially support their trading levels as well as that of their child's. We also believe this proposal does not quantify the risk the transporters and ultimately the shipper community would be taking in allowing the use of Parent Company Guarantees (PCG)s in this manner. For these reasons National Grid does not support the proposal.

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

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The Best Practise Guidelines explain the reasoning for setting an individuals credit limit and it states that "where a counter party benefits from a suitable PCG, the unsecured credit limit assigned to that counterparty should be based on the credit strength of the guarantor". The BPG methodology used for allocating a credit limit does not advocate an unsecured credit limit being based on a rating below a BB-.

Although the guidelines include a view that Ofgem feel an "unrated company does not necessarily pose a high risk of default", we do not believe that the guidelines support unrated companies being suitable guarantors.

We have previously stated in our response to Modification Proposal 0246 that Parent Company Guarantees may not offer the same protection in the event of insolvency of the Guarantor, as there is a risk that the Guarantor (particularly if the guarantor is part of the same group of companies as the defaulting User) will not be able to fulfil its obligation in the event that the relevant User does not meet its obligations and this statement also applies to 0360.

Some of the disadvantages of using Parent Company Guarantees as part of an Independent Assessment are listed below;

- The Independent Assessments do not take in to account the ability of a parent to financially support their trading levels and those of their child / children

- The Independent Assessments are not based on the financial ability of a company to act as a guarantor

Ofgem have previously stated in the BPG "that a balance therefore needs to be struck, to ensure that network operators are able to properly manage the financial risk that network Users may impose, while maintaining credit cover and payment terms which do not unduly restrict access to and use of those networks". We believe having BB- as the starting point for Parent Company Guarantees forms a key component in achieving this balance.

As analysis has not been provided by the proposer as part of the proposal to indicate the likely levels of unsecured credit to be provided it is difficult to assess whether the aforementioned balance would be compromised or not by implementing this proposal.

It is our view that the risk to the industry may be limited because the amount of unsecured credit provided to the User via the Parent Company Guarantee is currently subject to the lesser of an Independent Assessment Score in line with the table contained in UNC TPD V 3.1.7 and the Unsecured Credit Limit credit value recommended by the Independent Agency. However, if this lesser rule was removed as proposed by Modification Proposal 0375 this could mean that small parties may gain access to up to £39M of unsecured credit from National Grid, based on a parent company guarantee and we consider this to be inappropriate and unjustified.

Therefore the risk of adopting modification 0360 maybe significant and we do not believe it is responsible for Users to be allowed to overtrade, particularly in the context of the recent troubles in the Banking sector and it should be noted that the Best Practise Guidelines advocates "responsible credit".

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Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

We disagree that this will allow more equitable credit arrangements as our current understanding is that Modification Proposal 0360 will increase the risk to all Transporters and, via pass through arrangements, other Shipper Users. This proposal would therefore mean that Users (small and large) using other credit tools would be unfairly impacted and we believe this is not good for competition.

Impacts and Costs:

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

Whilst we agree that this modification may reduce credit costs for some Users, it will increase the risk to the transporters and ultimately there is a risk any bad debt will be passed through to the wider shipper community.

Implementation:

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

Legal Text:

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

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.

We are also concerned that if Modification Proposal 0375 were to be implemented along with this modification then the impact of this modification would be greatly increased, and with this in mind we would hope that the Authority would consider Modification Proposals 0360 and 0375 in tandem.

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