

Stage 02: Workgroup Report

0360:

Removal of Credit Rating Restrictions from Definition of Parent Company

What stage is this document in the process?



This modification seeks to amend the definition of "Parent Company" to remove the requirement to hold a long term debt rating of at least BB-. This would allow additional parties to be supported by parent company guarantees, creating a more equitable competitive environment.

Other changes to Section V may be required to meet this aim and these proposed changes are laid out below.



The Workgroup invites the Panel to agreed that Modification 0360 be submitted for consultation.



High Impact:
Some small Shippers



Medium Impact:



Low Impact:
Transporters and other Shippers

0360

Workgroup Report

24 March 2011

Version 1

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About this document:

The purpose of this report is make a recommendation to the Panel, to be held on 21 April 2011, on whether Modification 0360 is sufficiently developed to proceed to the Consultation Phase and to submit any further recommendations in respect of the definition and assessment of this modification.

This report is seeking a shortened assessment period in light of the deferred implementation of Modification 0305.

A shortened assessment period is sought because a change in credit rules is due to be introduced on 1 July following the deferred implementation of Modification 0305. This is likely to have a significant adverse impact on a number of smaller shippers. A decision on implementation prior to 1 July is therefore sought to rectify the introduction of what the proposer believes is an unintended consequence of the recent modifications to the credit arrangements.



3 Any questions?

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1 Summary

Is this a Self-Governance Modification

This modification impacts credit requirements and is seeking a shortened assessment period. It does not meet the self-governance criteria since implementation would have a material impact on a number of Shippers.

Why Change?

Implementation of recent changes to the credit arrangements within the UNC have highlighted consequences which will adversely impact some smaller parties. In particular, the removal of some credit tools means that some parties may seek to rely on parent company guarantees. By defining a parent company as one with a long term debt rating of at least BB- provided by Standard and Poor's or an equivalent rating, smaller companies are excluded from this avenue. This exclusion imposes higher costs on some parties than others, and change is needed to create equitable competitive conditions.

Solution

It is proposed that the credit rating requirement be removed from the definition of parent company. By this means, parent company guarantees could be provided irrespective of the credit rating, with the credit impact being dependent on the rating of the parent company rather than being arbitrarily removed at a specific (high) level.

Impacts & Costs

Implementation would enable more Shippers to benefit from parent company guarantees in preference to more expensive forms of credit, including the posting of cash which could severely damage a Shipper's ability to compete in the market. However, the precise impact is dependent on each Shipper's commercial position, which is subject to commercial confidentiality. The proposer has shared with Ofgem the potential impacts in its own circumstances and would urge others to do likewise.

Implementation

Implementation should be as soon as reasonably practicable after direction from the Authority.

The preference for implementation of this modification is prior to 1st July 2011.

The Case for Change

Some members consider by creating more equitable competitive conditions and removing a barrier to entry, implementation would facilitate the relevant objective of securing effective competition.

Recommendations

The Workgroup invites the Panel to:

- AGREE that Modification 0360 be submitted for consultation; and
- AGREE that the Code Administrators should issue 0360 Draft Modification Report for consultation and submit results to the Panel to consider at its meeting on 19 May 2011.

2 Why Change?

The implementation of UNC Modification 0305: "Unsecured Credit Limit Allocated Through Payment History", which is due to come into effect at 06:00 on February 7th, 2011, will withdraw the current ability to accrue Unsecured Credit based on payment history for those Users who have been signatories to the UNC for a period greater than 2 years.

With the loss of this facility, First Utility approached Graydons (one of the Independent Credit Rating Agencies listed in the table contained in UNC TPD Section V 3.1.7 as a result of the implementation of UNC Modification 0304: "Introduction of a Rating Table for Independent Credit Rating Agencies for Use with Independent Assessment") and requested that a Level 3 report be provided for both First Utility and its parent, Impello plc.

Based on the results of these assessments, First Utility contacted the Gas Transporters to request that Impello plc provide security on behalf of its 100% subsidiary First Utility in the form of a Parent Company Guarantee (PCG).

The Gas Transporters declined to accept this on the grounds that Impello plc does not have an Approved Credit Rating of at least BB- and so does not meet the UNC definition of a Parent Company (see below). This means that it cannot provide a Parent Company Guarantee under the UNC as it currently stands.

A Parent Company is currently defined in UNC TPD Section V 3.4.5 as follows:

"Parent Company" shall mean:

- (i) In the case of a company registered in England and Wales a public or private company within the meaning of Section 1(3) of the Companies Act 1985 with a long term debt rating of at least BB- provided by Standard and Poor's Corporation or equivalent rating by Moody's Investors Services (where such ratings conflict, the lower of the ratings will be used) that is either a shareholder or the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by Section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989); or*
- (ii) In the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably.*

3 Solution

This Urgent Modification proposes that the above definition of a Parent Company in UNC TPD Section V 3.4.5 be amended to read:

"Parent Company" shall mean:

- (i) In the case of a company registered in England and Wales a public or private company within the meaning of Section 1(3) of the Companies Act 1985 that is either a shareholder or the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by Section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989); or*
- (ii) In the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably.*

It is also proposed that UNC TPD Section V 3.1.3(b) be amended to read:

"Subject to paragraph 3.1.3(c), where a Qualifying Company or Parent Company provides surety in respect of a User in the form of a Guarantee (the "Surety Provider"), then the Approved Credit Rating or Independent Credit Rating of such Surety 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 3.1.3(a) in the case of a Qualifying Company or paragraph 3.1.7(b) in the case of a Parent Company".

In addition, it is proposed that UNC TPD Section V 3.1.7 be amended to read:

"Upon request from a User or Parent Company, the User or Parent Company may select any one of the specified agencies for the Transporter to use to allocate an Unsecured Credit Limit to the User as follows:

- (a) Where such User or Parent Company is unable to obtain an Approved Credit Rating (up to a maximum of 20% of the relevant Transporter's Maximum Unsecured Credit Limit); or*
- (b) Where such User or Parent Company has an Approved Credit Rating less than that in 3.1.3(a) (up to a maximum of 13 1/3% of the relevant Transporter's Maximum Unsecured Credit Limit).*

A score of between 0 and 10 will be allocated to the User or Parent Company in accordance with the following table to calculate the User's Unsecured Credit Limit:

[table]

The Transporter will set the User's Unsecured Credit Limit no higher than the lower of the credit value recommended within the User's Independent Assessment and the value calculated by applying the User's Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit or, where a Parent Company has so requested, no higher than the lower of the credit value recommended within the

Parent Company's Independent Assessment and the value calculated by applying the Parent Company's Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit where the Parent Company has agreed to provide surety in the form of a Guarantee".

This amended definition, along with the associated changes to TPD Section V above, would then allow smaller Users whose parent company does not meet the credit requirements in the current definition to provide a Parent Company Guarantee based on an assessment of that Parent Company by one of the three Independent Credit Rating Agencies listed in the table in UNC TPD Section V 3.1.7.

This would then provide smaller Users with an alternative to more expensive forms of credit such as posting cash which could severely damage a smaller User's ability to compete in the market. Implementation would therefore result in more equitable competitive conditions.

4 Relevant Objectives

Implementation will better facilitate the achievement of **Relevant Objective d.**

| Proposer's view of the benefits against the Code Relevant Objectives | |
|--|--|
| Description of Relevant Objective | Identified impact |
| a) Efficient and economic operation of the pipe-line system. | |
| b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters. | |
| c) Efficient discharge of the licensee's obligations. | |
| d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers. | <p>Will allow more equitable credit arrangements for smaller Users, thus removing a barrier to entry and helping to secure effective competition between relevant shippers and suppliers.</p> <p>Implementation of this modification could increase exposure to failure and increase risk for market participants.</p> |
| e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers. | |
| f) Promotion of efficiency in the implementation and administration of the Code | |

5 Impacts and Costs

The ability of smaller Users to provide Parent Company Guarantees as an alternative to more expensive forms of credit will remove a potential barrier to competition.

Costs

| Indicative industry costs – User Pays | |
|--|--|
| Classification of the proposal as User Pays or not and justification for classification | |
| This is not a User Pays modification as there is no systems impact and no User Pays Service is proposed nor amended. | |
| Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification | |
| NA | |
| Proposed charge(s) for application of Users Pays charges to Shippers | |
| NA | |
| Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve | |
| NA | |

Impacts

| Impact on Transporters' Systems and Process | |
|---|--|
| Transporters' System/Process | Potential impact |
| UK Link | <ul style="list-style-type: none"> • None |
| Operational Processes | <ul style="list-style-type: none"> • None |
| User Pays implications | <ul style="list-style-type: none"> • None |

| Impact on Users | |
|--|--|
| Area of Users' business | Potential impact |
| Administrative and operational | <ul style="list-style-type: none"> • Cost of providing credit potentially reduced |
| Development, capital and operating costs | <ul style="list-style-type: none"> • None |
| Contractual risks | <ul style="list-style-type: none"> • Potential for higher exposure to defaulting User |

Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification **0565 Transco Proposal for Revision of Network Code Standards of Service** at the following location:
<http://www.gasgovernance.com/networkcodearchive/551-575/>

| Impact on Users | |
|---|--|
| Legislative, regulatory and contractual obligations and relationships | <ul style="list-style-type: none"> None |

| Impact on Transporters | |
|---|--|
| Area of Transporters' business | Potential impact |
| System operation | <ul style="list-style-type: none"> None |
| Development, capital and operating costs | <ul style="list-style-type: none"> None |
| Recovery of costs | <ul style="list-style-type: none"> None |
| Price regulation | <ul style="list-style-type: none"> None |
| Contractual risks | <ul style="list-style-type: none"> None |
| Legislative, regulatory and contractual obligations and relationships | <ul style="list-style-type: none"> None |
| Standards of service | <ul style="list-style-type: none"> None |

| Impact on Code Administration | |
|-------------------------------|--|
| Area of Code Administration | Potential impact |
| Modification Rules | <ul style="list-style-type: none"> None |
| UNC Committees | <ul style="list-style-type: none"> None |
| General administration | <ul style="list-style-type: none"> None |

| Impact on Code | |
|-----------------|----------------------|
| Code section | Potential impact |
| Section V 3.4.5 | Changes as described |
| | |

| Impact on UNC Related Documents and Other Referenced Documents | |
|--|------------------|
| Related Document | Potential impact |
| Network Entry Agreement (TPD I1.3) | None |
| Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4) | None |
| Storage Connection Agreement (TPD R1.3.1) | None |
| UK Link Manual (TPD U1.4) | None |

| Impact on UNC Related Documents and Other Referenced Documents | |
|--|------|
| Network Code Operations Reporting Manual (TPD V12) | None |
| Network Code Validation Rules (TPD V12) | None |
| ECQ Methodology (TPD V12) | None |
| Measurement Error Notification Guidelines (TPD V12) | None |
| Energy Balancing Credit Rules (TPD X2.1) | None |
| Uniform Network Code Standards of Service (Various) | None |

| Impact on Core Industry Documents and other documents | |
|---|------------------|
| Document | Potential impact |
| Safety Case or other document under Gas Safety (Management) Regulations | None |
| Gas Transporter Licence | None |

| Other Impacts | |
|--|------------------|
| Item impacted | Potential impact |
| Security of Supply | None |
| Operation of the Total System | None |
| Industry fragmentation | None |
| Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties | None |

6 Implementation

Implementation should be as soon as reasonably practicable after direction from the Authority.

The preference for implementation of this modification is prior to 1st July 2011.

7 The Case for Change

In addition to that identified the above, the Workgroup has identified the following:

Advantages

- No additional Advantages

Disadvantages

- No additional disadvantages

8 Recommendation

The Workgroup invites the Panel to:

- AGREE that Modification 0360 be submitted for consultation; and
- AGREE that the Code Administrators should issue 0360 Draft Modification Report for consultation and submit results to the Panel to consider at its meeting on 19 May 2011.