

Modification Report
Independent security provision by an entity with an Investment Grade Rating of
'A' or above
Modification Reference Number 0024
Version 2.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 9.6.

1. The Modification Proposal

This is one of a number of Proposals which seek to implement recommendations identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05. This concluded the high-level principles that should be applied and further work required in respect of credit cover arrangements for transportation.

This Proposal seeks to implement recommendations detailed within paragraphs 3.39 to 3.40 of the conclusion document.

A User may arrange for the provision of credit security by an independent third party (a credit support provider outside the ownership structure of the buyer and which has no formal or informal control of security provider by buyer, its parent company or its affiliated companies).

It is proposed that independent security valued at 100 per cent of face value would be accepted subject to the following conditions:

- Credit support must be from an entity with a long term debt rating of not less than A by *Standard & Poor's* or *Moody's Investor services*;
- Credit support shall be legally enforceable in the UK;
- The country of residence of the support provider must have a sovereign credit rating of A or better from non-local currency obligations;
- There are no material conditions preventing exercise of the security.

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Implementing consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

WWU expressed its agreement that the proposal "*facilitates the relevant objective of securing effective competition between Relevant Shippers as it is non-discriminatory and does not create any barriers to entry*".

UKD concurred, stating that it "*would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers*".

UKT commented that it was “*satisfied that the Proposal, if implemented, would better facilitate competition between Shippers and between Suppliers*”.

RWE clarified that “*notwithstanding the...comment [in respect of the legal text as drafted] it is the view of RWE npower that the minimum requirements proposed in Mod 0024, in respect of the rating of an entity providing security, will better facilitate the efficient and economic operation of the pipe-line system*”.

TGP and TEP confirmed agreement “*that incorporating the security provision rules within the UNC increases the level of transparency...and so ensures that credit cover will be provided in a non-discriminatory fashion...We therefore believe that modification 0024 promotes the Transporters ability to operate the network in an efficient and economic manner and so fulfills the relevant objectives of licence condition A11*”.

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No such implications on security of supply or operation of the Total System have been identified. Incorporating credit rules within the UNC may help to reduce the impacts of industry fragmentation.

TGP and TEP concurred, commenting “*A common set of rules, which apply to all Users will reduce the effects of industry fragmentation and ensure consistency across the network*”.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

No implications for operation of the system have been identified.

b) development and capital cost and operating cost implications:

The proposer has suggested that any costs would be minimal.

WWU stated that it believed “*the costs of implementation for Transporters are likely to be negligible*”.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

No cost recovery mechanism is proposed.

d) analysis of the consequences (if any) this proposal would have on price regulation:

No such consequences are anticipated.

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The proposal seeks to mitigate the Transporters contractual risk of the provision of credit security by an independent third party.

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No systems impacts are anticipated by either Transporters or Users.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

There could be an increase in the cost of credit cover provided by some Users.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No such implications have been identified.

9. Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No such consequences are anticipated.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Alignment of the UNC with best practice as identified in Ofgem's conclusions document.
- Ensures credit cover continues to be sought on a non-discriminatory basis.
- Ensures there continue to be no inappropriate barriers to entry as a result of credit requirements.

Disadvantages

- May create inconsistency between the UNC and each set of credit rules.
- Increases the cost of credit cover for some Users thereby increasing industry costs.

11. Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Ten representations (from the following) were received with respect to this Modification Proposal. Eight parties support implementation, one party offered qualified support, and one party opposes implementation.

<u>Organisation</u>	<u>Abbreviation</u>	<u>Position</u>
Wales & West Utilities	WWU	Support
Transco UKD	UKD	Support
Transco UKT	UKT	Qualified Support
Scotia Gas Networks	SGN	Oppose
Northern Gas Networks	NGN	Support
British Gas Trading	BGT	Support
RWE npower	RWE	Support
Total Gas & Power	TGP	Support
Total E&P	TEP	Support
E.ON	EON	Support

WWU viewed that the Proposal is “*consistent with the Ofgem conclusions document and ensures that the risk of default is set at acceptable levels*”.

UKD expressed that the proposal would “*provide transparency for both Users and Transporters...[and] ensure application of consistent terms (in respect of the provision of third party credit security) across all Transporters*”.

UKT viewed that the Proposal “*reflects the recommendations of Ofgem’s ‘Best Practices Guidelines’*” and added that “*Provided that independent security from a credit worthy entity has met the criteria set out...the Transporter may extend unsecured credit to any additional Users whilst ensuring that risk from credit exposure to the industry is mitigated*”.

SGN explained its opposition to the proposal commenting that “*We do not believe a User with a rating below BBB- which is required to secure the full amount should be able to do so with an A2 rated provider...We believe it would be more appropriate to allow security from AAA/AA rated providers*”.

BGT commented that the proposal “*is a pragmatic solution to the difficulty that some companies may experience in obtaining a credit rating...This is particularly relevant to new participants to the market and effectively removes a potential barrier to entry*”.

RWE stated that it “*supports the principal of this proposal, but so far as the wording of the legal text goes we have some concerns*”. RWE explained that “*in section 3.36 of Ofgem's conclusion document...a number of ...alternative instruments are suggested as being acceptable. The legal text identifies Letters of Credit or bank guarantees but does not mention any of the other instruments that were considered acceptable*”. RWE accepted that “*If they are not likely to be used in the future then their omission should not have a material impact... However,*

by not including these alternatives in the legal text their use is not likely. Perhaps the Regulator might want to consider if the legal text needs revision”.

Without prejudice to any view expressed by the Authority, the SME would comment that the proposal distinctly seeks to implement recommendations detailed within sections 3.39 and 3.40 of Ofgem’s Conclusions document and to incorporate recommendations from elsewhere within the Conclusions Document would appear to be outside the scope of the Proposal.

RWE clarified that *“Despite our concerns about aspects of the legal text RWE npower supports this Mod Proposal”.*

TGP and TEP summarised that *“The criteria suggested are proportionate and allows Users to source appropriate credit easily”.*

12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

14. Programme for works required as a consequence of implementing the Modification Proposal

The Proposer believes that minimal changes would be required in respect of operational processes and procedures.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

In light of the limited works required to implement, this Modification Proposal could be implemented with immediate effect if appropriate direction is received from the Authority.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 20 October 2005, of the 9 Voting Members present, capable of casting 10 votes, 9 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

18. Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

UNIFORM NETWORK CODE - TRANSPORTATION PRINCIPAL DOCUMENT

SECTION V: GENERAL

Amend paragraph 3.4.1 as follows:

Any instrument of surety or security provided by a User pursuant to paragraph 3.4.6 and the Code Credit Rules (and whether or not entered into by the User) shall not be part of the Code nor an Ancillary Agreement; and no provision or modification of the Code, nor any inconsistency between the Code and any such instrument, and nothing done by the Transporter pursuant to the Code, shall prejudice or invalidate any such instrument.

Amend paragraph 3.4.2 as follows:

Where a User has provided surety or security pursuant to paragraph 3.4.6 and/or the Code credit Rules the User (or the person giving the surety) may request the Transporter to release all or any of such security or agree to a reduction in any maximum amount of such surety.

Add new Paragraph 3.4.6 as follows:

A User may extend their level of exposure beyond the Unsecured Credit Limit by providing additional forms of security as detailed in the Code Credit Rules and in such form acceptable to the Transporter and/or in the form approved Letter of Credit or equivalent bank guarantee with a long-term issuer rating of not less than A2 by Moody's Investors Service or equivalent rating by Standard and Poor's ("Independent Security")

Add new paragraph 3.4.7 as follows:

For the purposes of Code:

"Independent Security Provider" is a credit support provider outside the ownership structure of the User and which has no formal or informal control of security provided by the User, its parent company or its affiliated companies".

A User may provide Independent Security from an Independent Security Provider (as set out in Paragraph 3.4.6 above) in a form acceptable to the Transporter and subject to the following conditions:

- (a) Credit support must be from entity with a long term debt rating of not less than A2 by Moody's Investors Service or equivalent rating by Standard and Poor's;

- (b) Credit support shall be legally enforceable in the UK. This may require the entity to provide reasonably acceptable counsel's opinion;
- (c) The Country of residence of the support provider must have a sovereign credit rating of A2 by Moody's Investors Service (or equivalent rating by Standard and Poor's) or better for non local currency obligations; and
- (d) There are no material conditions preventing exercise of the security.

Subject Matter Expert sign off:

I confirm that I have prepared this modification report in accordance with the Modification Rules.

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive Joint Office of Gas Transporters

Signature:

Date :