

Stage 03: Draft Modification 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.



Responses invited by 19 May 2011.



High Impact:
Some small Shippers



Medium Impact:



Low Impact:
Transporters and other Shippers

0360

Draft Modification Report

26 April 2011

Version 1

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About this document:

This document is a Draft Modification Report, which was issued for consultation responses, at the request of the Panel on 21 April 2011. The close-out date for responses is **19 May 2011**. The Panel will consider the responses and agree whether or not this modification should be made.

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.

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



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 Transporters	
Area of Transporters' business	Potential impact
System operation	• None
Development, capital and operating costs	• None
Recovery of costs	• None
Price regulation	• None
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None
Standards of service	• None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None
UNC Committees	• None
General administration	• 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
Network Code Operations Reporting Manual (TPD V12)	None
Network Code Validation Rules (TPD V12)	None

Impact on UNC Related Documents and Other Referenced Documents	
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 Legal Text

Draft Legal Text (provided by National Grid Distribution)

TPD Section V

Amend paragraph 3.1.3 (b) to read as follows:

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

Amend paragraph 3.1.7 to read as follows:

3.1.7 Where a User or Parent Company does not have an Approved Credit Rating, then Upon request from a such User, the User may select any one of the specified agencies for the Transporter to use to allocate an unsecured Credit Limit to the User based upon the Independent Assessment Score of the User or Parent Company 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 $13\frac{1}{3}$ % 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 Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit

Amend paragraph 3.4.5 to read as follows:

3.4.5 For the purposes of Code:

"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 ~~41(3)~~ of the Companies Act ~~2006~~ ~~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 of the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by Section ~~1159~~ ~~736~~, Companies Act ~~2006~~ ~~1985~~ as supplemented by Schedule 6 Companies Act 2006 and Section 144(3) Companies Act 1989); or
- (ii) in the case of an entity registered outside England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably;

9 Recommendation

All parties are invited to consider whether they wish to submit views regarding this modification. The close-out date for responses is 19 May 2011, which should be sent to enquiries@gasgovernance.co.uk. A response template which you may wish to use is at: <http://www.gasgovernance.co.uk/0360>.



Consultation Ends

On 19 May 2011