

Draft Modification Report
Modification Proposal Reference Number: 0103
Removal of Secured Credit Limit

This modification report is made pursuant to Rule 8.12 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Procedures Followed

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| 12th December 1996 | - | Modifications Panel Meeting |
| 17th December 1996 | - | Circulate Modification Proposal and Terms of Reference to Shippers and invite representations |
| 10th January 1997 | - | Representations close out. |
| 27th January 1997 | - | Development Work Group Meeting |
| 4th February 1997 | - | Development Work Group Meeting. |
| 14th February 1997 | - | Development Work Group Meeting. |
| 5th March 1997 | - | Circulate Draft Modification Report and Work Group Report to Panel members. |
| 20th March 1997 | - | Modification Panel to review draft Modification Report and Work Group Report |

2. The Modification Proposal

The Community Risk Secured Credit Limit, for Energy Balancing Credit Management purposes, would be reduced from £250,000 to zero with effect from 1st October 1997, except under the following circumstances:

Where the User has already chosen to have a special credit rating for the purposes of obtaining a Transportation related credit limit and this rating (Moody's) is 'Caa' or above then the User can opt to have a £50,000 Community Risk Secured Credit Limit.

This will be treated as a Community Risk Secured Limit in accordance with section S4 of the Energy Balancing Credit Rules.

Where the User does not have a special credit rating as above, they will be entitled to request such a rating from Transco on the understanding that the cost will be borne by the User, in accordance with section S4 of the Energy Balancing Credit Rules.

This option is subject to the Shipper's level of Energy Balancing operations being within the £50,000 level. Those Shippers whose operations exceed this level would be required to provide adequate security for the whole of their Secured Credit Limit.

3. Transco's opinion

During the development of the Network Code, Transco was asked by the Shipping community to develop and manage a risk framework to minimise the exposure to financial loss under daily Energy Balancing.

The 'Community Risk' Secured Credit Limit was introduced largely at the suggestion of Ofgas, to ensure that the framework did not act as a market barrier to entry for small shippers. Such credit conditions are unique to the UK gas industry (in the US, for example, no credit is given; payment is either made in advance or delivery is made against security).

This modification establishes a credit risk mechanism using Money at Risk principles, i.e. a Shipper's credit limit is based on the risks associated with their portfolio and is sufficient for the level of operations.

This proposal has been made following several meetings of the Energy Balancing Credit Committee (as this issue relates to Shipper risk), at which Shipper representatives expressed a desire to reduce the Community Risk limit from £250,000 to zero, i.e. a fully securitised market. The effect of this would be to reduce the risk to the community of increased costs arising from individual Shipper default. Reasons expressed by EBCC members for proposing this modification are:

- i) The Community Risk Secured Credit Limit is anomalous in a business framework where it is normal practice to provide securitised credit to cover such operations as Transportation charges and some Gas purchases.
- ii) The principle of a zero Community Risk Secured Credit Limit is not a barrier to entry to those Shippers who can properly order their commercial arrangements for credit in line with their exposure to risk. This is a normal business requirement and indicates a responsible and controlled approach by individual Shippers to the rest of the shipping community. A Shipper who cannot secure sufficient financial backing is a risk both to the industry and gas consumers.
- iii) The existence of a Community Risk Secured Credit Limit is seen as being discriminatory against Shippers who have provided securitised credit and creates an uneven playing field for the operation of the market.
- iv) The continuance of a Community Risk Secured Credit Limit could act as a barrier to entry to those small Shippers who are able to provide securitised credit but are unwilling to accept the uncertainty of an unmanaged risk through other Shippers defaulting.

The Committee were keen to take some action prior to the start of the first winter period under Network Code, and hence the previous urgent Modifications 0074 and 0085.

Following an open forum meeting and representations on these proposals, Ofgas recommended that this issue be considered through the normal modification process. Ofgas wished to allow time for a full discussion of the issues to take place and to give sufficient time for affected Shippers to put in place the required level of security. In addition, Ofgas' view was that the initial Community Risk Secured Credit Limit would remain in place until after the first winter.

At the second meeting of the Development Work Group it was pointed out that securitised credit (as referred to in bullet point i) above) was not always required for all gas purchases in

the current market. Reference was also made to bullet point iv) which some members of the Work Group considered not to be a major issue.

This modification proposal is being submitted following the recommendation of Development Work Group 0103. As well as providing the opportunity for full discussion of this issue, the Work Group recommended that this modification proposal be implemented with effect from 1st October 1997. Consequently, affected Shippers will have approximately 5 months to put in place the required level of security.

4. Extent to which the modification would better facilitate the relevant objectives;

The Money at Risk (including costs of default) for Network Code Users from an Energy Balancing default will be reduced.

5. The implications for Transco of implementing the Modification Proposal, including:

a) implications for the operation of System and any BG Storage Facility;

Transco is not aware of any implications on the operation of the system or any BG Storage facility.

b) development and capital cost and operating cost implications

Transco is not aware of any additional capital or operating costs.

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

Transco is not aware of any additional costs.

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

Transco is not aware of any impacts on price regulation.

6. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal;

The modification will reduce the money at risk to the Shipping Community. The level of contractual risk to Transco will remain unchanged.

7. The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers;

Transco is not aware of any implications for Shipper or Transco computer systems.

8. The implications of implementing the modification for Relevant Shippers,

The Shipper Community's exposure to risk of default will be reduced. Some Shippers will be required to increase their reliance on other security to support their Energy Balancing operations.

9. The implications of implementing of the modification for terminal operators, suppliers, producers and, any Non-Network Code Party;

Transco is not aware of any impact on terminal operators, suppliers, producers and any Non-Network Code Party.

10. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party (if any), of the implementation of the Modification Proposal;

Transco has not been informed of any consequences on the legislative and regulatory obligations and contractual relationships of implementing this modification.

11. Analysis of any advantages or disadvantages of the implementation of the Modification Proposal;

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|----------------|--|
| Advantages | <ul style="list-style-type: none">- This is, in effect a zero limit which reduces the Community 'Money at Risk' by a significant amount.- It recognises the special circumstances of those existing smaller Shippers who would find the increased financial burden of providing adequate security detrimental to their business.- Shippers will be protected from the risk of new Users entering the market without the required level of security.- Encourages commercial behaviour now that competition has been established.- A zero credit limit will encourage the securitisation of activities for existing and new entrants, particularly those Shippers whose level of activities clearly exceeds the existing Community Risk Limit and should reduce the number of cash calls.- the removal of the Community Risk Secured Credit Limit is more appropriate to daily balancing. |
| Disadvantages- | <p>Some Shippers may incur costs as a result of putting additional security in place.</p> |

12. Summary of the representations (to the extent that the importance of those representations are not reflected elsewhere in the modification report;

One representation was received from Mobil. This supported the proposal and agreed with the Terms of Reference of the Work Group. Further representations are expected following circulation of this report.

13. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation;

The modification is not required to facilitate compliance with safety or other legislation.

14. Having regard to any proposed change in the methodology established under Standard Condition 3(5) or the statement; furnished by Transco under Standard Condition 3(1) of the Licence;

This modification is not required to comply with the above clause.

15. Programme of works required as a consequence of the implementation of the Modification Proposal;

No programme of works is considered necessary.

16. Proposed implementation timetable;

To allow Shippers a reasonable period to obtain additional security, the modification will be effective from 1st October 1997.

17. Recommendation for the implementation of the modification;

This modification should be implemented in order to reduce the Money at Risk to the Community and thereby reduce Shippers' exposure to default.

18. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

19. Transco Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks a direction from the Director General in accordance with this report.

20. Text provided pursuant to Rule 8.14.

Network Code Supplement - Energy Balancing Credit Management

Paragraph 2.2.2

"2.2.2 For each User the **"Secured Credit Limit"** shall be:

- (a) subject to paragraph (b), the amount determined under paragraph 2.2.3;
- (b) if the User so elects by notice to Transco, where and for so long as the User has a special credit rating of at least the level specified in the Energy Balancing Credit Rules for the purposes of this paragraph (b), the sum of £50,000."

In order to support the above text a change will be required to the Energy Balancing Credit Rules. This will be actioned in accordance with section 2.1.5 of the Network Code Supplement.

Signed for and on behalf of BG Transco.

Signature:

Date: 25 February 1997

Name: Dr John F. Lockett

Position: Commercial Manager Network Code

Director General of Gas Supply Response

In accordance with Condition 7 (10)(b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct BG Transco that the above proposal be made as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

Signature:

Date:

Name: Kyran Hanks

Position: Head of Network Operations

The Network Code is hereby modified, with effect from _____, in accordance with the above proposal.

Signature:

Secretary Modification Panel
BG Transco