Supplementary Report
The provision of Letters of Credit for energy balancing credit cover
Modification Reference Number 0572
Version 1.0

This Supplementary Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.10. and is a supplement intended to be read in conjunction with Final Modification Report 0572.

This extension to the consultation process resulted from Ofgem's instruction to Transco to supply legal text to support implementation of this proposal and the subsequent decision of the Modification Panel to re-consult. The Panel decision was made on the basis that the submission of the text to Ofgem constituted a significant change to the previous Modification Report and, consequently, deserved a period of re-consultation.

1 Summary of the Further Representations

Nine Users have submitted representations to this further consultation; **BP Gas Ltd., British Gas Trading Ltd., Chevron UK Ltd., D-Gas b. v., Powergen UK Plc ("the Proposer"), Quantum Energy Distribution (trading as V-is-on gas), Shell Gas Direct, SSE Energy Supply Ltd.** and **Statoil (U.K.) Ltd.**

The balance of representations received was not in favour of implementation. Two Users, V-is-on gas and the Proposer stated that they were in favour of implementation, with the remaining seven Users stating that they were opposed to implementation.

The views expressed within the new batch of representations generally reiterated the points made during the original consultation although two Users used the opportunity to comment on the legal drafting. Of the representations that commented on the legal text, all expressed support: Powergen stated, *"…we are happy to support this legal text…"*

A reoccurring theme throughout the representations was that this issue should be considered in conjunction with the Ofgem Credit Consultation and with other Modification Proposals currently under discussion. This view was expressed by five of the respondents

Of the Users supporting implementation, V-is-on Gas believes that by implementing this Proposal the risk to the community is reduced and the resulting cost of providing the required security would result in User costs that should be relatively low and controllable. V-is-on Gas wrote *"…A shipper who remains balanced should require relatively low levels of security to avoid cash calls, and therefore will incur minimal cost…"*

Several Users believe that costs would be substantially increased for little corresponding reduction in risk should this Modification Proposal be implemented. Additionally, on the subject of increased cost, a number of Users suggested that this could result in a barrier to entry for small players. Chevron stated *"…otherwise creditworthy companies having to spend hard cash establishing Letters of Credit from financial institutions. We would expect a cost benefit analysis of this proposal… …such that gas shippers could understand what value would be added to the UK gas* *community…"* Gaz De France stated *"…we find it unusual that procedures are being put in place whose incentive is to increase the cost of doing business and therefore reduce the number of participants in the gas market."* BP Gas Marketing believes it *"…places yet another cost on to shippers and suppliers which ultimately may have to be recovered from customers, and does not necessarily increase the level of security or offer better protection from smearing costs around the gas industry…".*

BGT are one of several Users that believes the current arrangements are adequate and stated *"… we continue to believe that Parent Company Guarantees and Approved Credit Ratings, intelligently applied, should remain as instruments of creditworthiness. To move to a mandatory use of Letters of Credit would provide little additional security but would add to the cost of credit cover. Across the industry as a whole this is a significant sum. These costs will inevitably pass through the supply chain and may ultimately be borne by consumers…"*

SSE urged Ofgem *"…not to over-react to the unique circumstances of Enron or TXU by removing the use of Parent Company Guarantees (PCGs) or Approved Credit Ratings (ACRs) as an appropriate form of credit cover. It is clear that such a policy would result in a substantial amount of industry capital being tied up in, for example, escrow accounts. As we pointed out in our previous response, the financial costs of providing such cover would be significant…".*

Several respondents commented on possible implementation timescales, SSE believes that *" As minimum, we consider that three months' notice period would be necessary for us to put alternative security arrangements in place."* Shell Gas Direct also believes that *"If Ofgem were to approve this modification proposal, it should provide sufficient time for shippers to negotiate LoC."* And that *"this will take many months, not just a few weeks."* Statoil stated that if the proposal were to be implemented *"the effective date for obtaining LoC should commence in a new gas year"* in order to avoid *"additional duplication costs for credit cover in the same period"*
Similarly, Chevron commented, *"…that the implementation date for new security requirements for a shipper should be on the expiry of their existing instruments."*

2 Legal Text

Note: There are two small changes to the legal text circulated during the period of further consultation. Sections 2.1.2 and 2.3.1 have been revised to include references to Letters of Credit or cash being the only acceptable forms of energy balancing security.

Full text included in Appendix 1

Signed for and on behalf of Transco.

Signature:

Debbie Dowling
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Support Services

Date: