

**Draft Modification Report**  
**The provision of Letters of Credit for energy balancing credit cover**  
**Modification Reference Number 0572**  
Version 3.0

This Draft Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

**1. The Modification Proposal**

All shippers are required to provide security to support their energy balancing activity, namely Letters of Credit from approved banks with an "Aa3" or higher credit rating, or cash.

This should be enough to cover all their anticipated exposures. As with the BSC, this approach is non-discriminatory as it applies to all market participants irrespective of size. Currently, un-rated entities may have a PCG from a parent, but if the parent defaults there is no protection from debt accruing. This proposal is therefore for all such entities to lodge Letters of Credit.

However, Transco would still need robust systems to immediately act if the Letters of Credit or other credit support was insufficient.

**2. Transco's Opinion**

Although Transco has a neutral stance in respect of Energy, it sees the benefit that would be obtained from measures that strengthen the financial stability and security of the industry as a whole. It is, however, of the opinion that matters such as this should be considered in conjunction with other industry developments relating to the credit regime. Transco believes that it would be advantageous to consider this proposal in light of the conclusions of the Ofgem Consultation; "Arrangements for gas and electricity supply and gas shipping credit cover" and while this proposal could provide one solution to a particular issue highlighted by recent events, a more comprehensive assessment of the total credit requirements could provide a more comprehensive and lasting solution.

**3. Extent to which the proposed modification would better facilitate the relevant objectives**

PowerGen UK plc has not indicated how the relevant objectives would be better facilitated in the event of implementation.

**4. The implications for Transco of implementing the Modification Proposal , including**  
**a) implications for the operation of the System:**

There would be no implication for the operation of the system.

**b) development and capital cost and operating cost implications:**

It is expected that development costs would be incurred but they would be minimal.

**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:**

No special cost recovery arrangements are envisaged.

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

Transco does not believe that this proposal would have any effect on price regulation.

**5. 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**

This proposal deals with security levels for energy imbalances; consequently, Transco does not directly face extra contractual risk if the proposal is implemented.

**6. The development implications and other implications for computer systems of Transco and related computer systems of Users**

Implementation would not result in any significant systems development for Transco.

**7. The implications of implementing the Modification Proposal for Users**

Individual Users would be required to provide financial security by the prescribed method. Fewer alternatives would be available in respect of forms of acceptable security, and in turn, Users could incur increased costs providing of such security.

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

The current rules allow Users to provide the required levels of security by a variety of means and give Users scope to obtain the most financially efficient cover. This proposal prescribes the types of security that can be used and could require some Users to source alternative, and more costly, security which could in turn result in increased overheads. This could, in turn, affect wholesale and retail gas prices.

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

Transco is not aware of any impact on legislative and regulatory obligations.

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

### **Advantages**

The provision of LoC or Cash as security would provide tighter security to the energy balancing cash neutrality process. Users, as a group, would be exposed to less risk, since generally a Letter of Credit or cash would be regarded as easier to recover against compared to a Parent Company Guarantee in the event of default.

### **Disadvantages**

Users that currently use Parent Company Guarantees as security may have to change the means by which they provide their security, which could in turn require them to enter new contractual arrangements.

Where a guarantee is currently provided by a Parent Company with an independent credit rating above Aa3, and, if implemented, the proposal would require Users to obtain Letters of Credit from entities with a credit rating of at least Aa3, the result could be to increase the default probability of some Users. This would also be the case where a User has an independent credit rating above Aa3 and does not provide any other form of security.

The capacity of banks to provide a User with a Letter of Credit could be reduced as a result of the additional facilities required by the market. In turn, the potential to exceed the maximum acceptable exposure to any counter party could be increased.

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

Representations are now invited.

## **12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation**

This modification is not required 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 Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence**

This modification is not proposed as a result of changes to the methodology established under Standard Condition 4(5).

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

Transco would be required to modify its procedures for recording the types of financial security provided by individual Users.

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

This proposal could be implemented very soon after direction by modifying existing procedures. The main UK-Link system does not require modification and, consequently, no implementation delays for Transco IS reasons are anticipated. Transco is not aware of the lead-time required by individual Users to secure the alternative forms of security although it is of the opinion that implementation could result in an increase to a User's administrative workload since such alternative form of security would need to be obtained and maintained.

#### **16. Recommendation concerning the implementation of the Modification Proposal**

Although Transco is cash neutral to the effects of this proposal, it is, in principle, supportive of measures that reduce levels of risk but would like to receive the views of Users by way of this report before issuing a recommendation. Transco believes that it may be preferable for Users to consider this proposal in the context of the conclusions of the Ofgem credit consultation.

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. This revised Modification Report contains Transco's proposal not to modify the Network Code but has been prepared following direction from the Gas & Electricity Markets Authority.

#### **17. Text**

As Transco is not recommending implementation, legal text is not included in this report.

***Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report***

Signed for and on behalf of Transco.

Signature:

**Steve R Phillips**  
**Director of Shipper Services**

Date: