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20 September 2005

Mr. Julian Majdanski
Joint Office of Gas Transporters
Ground Floor Red
51 Homer Road
Solihull
B91 3QJ.

Re: Modification Proposals 0023, 0024, 0025, 0026, 0027, 0031, 0032, 0034 and 0041

Dear Julian,

Thank you for your invitation seeking representations with respect to the above Modification Proposals. Please find following Transco's response to each Proposal:

UNC Modification Proposal 0023 'Re-assessment of User Unsecured Credit Limits'

As the initiator, Transco supports implementation. Transco believes that affording a maximum level of unsecured credit based on the asset value of a Transporter is a more effective mitigation of risk than reference to a static figure as is currently advocated by each Transporter's Code Credit Rules. Affording unsecured credit to Users based upon its Investment Grade Rating (above 'junk' status only) as allocated by two recognised Credit Rating Agencies is an efficient method of operating unsecured credit arrangements. Transco believes that incorporation of such provisions within the Uniform Network Code would ensure application of consistent terms (in respect of unsecured credit arrangements) across all Transporters.

Our view is that the incorporation of credit arrangements within the Uniform Network Code that oblige Transporters to implement consistent rules would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

UNC Modification Proposal 0024 'Independent security provision by an entity with an Investment Grade Rating of 'A' or above'

As the initiator, Transco supports implementation. Transco believes that incorporation of conditions for the acceptance by a Transporter of credit security provided by a third party within the Uniform Network Code would provide transparency for both Users and Transporters. The incorporation of such provisions



within the Uniform Network Code would ensure application of consistent terms (in respect of the provision of third party credit security) across all Transporters.

Transco believes that the incorporation of credit arrangements within the Uniform Network Code that oblige Transporters to implement consistent rules would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

UNC Modification Proposal 0025 'Notice Period for Credit Limit Downgrade and Remedies for Non-compliance'

As the initiator, Transco supports implementation. Timely revision of credit security arrangements in response to the reduction of available Unsecured Credit (in response to an Investment Grade Rating downgrade) is vital in terms of minimising financial risk to Transporters and potentially Users. Current Uniform Network Code Provisions afford Users 30 days to rectify such a position but, as identified within the Ofgem Conclusions Document, Transco believes two Business Days is sufficient for Users to lodge additional security. Transco further agrees with the recommendation identified within Ofgem's Conclusions Document in respect of the levy of charges to Users and the ability to restrict portfolio growth in the event that the Credit Security arrangements are not in place within the required timescale.

Transco believes that the incorporation of credit arrangements within the Uniform Network Code that oblige Transporters to implement consistent rules would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

In respect of the legal text provided within the Draft Modification Report, Transco suggests the following amendments which cover two specific points:

1. the 'deadline' for User provision of additional security or surety following the downgrade of a User's published credit rating should be the close of business on the second Business Day (1700hrs) following the issue of the notice (reflected in amended text within additional section V3.2.9), and
2. as detailed within the Modification Proposal, inclusion of the right for a Transporter to suspend User registration of Supply Points where that User has failed to provide additional security or surety where requested by the Transporter, this right being available from the commencement of the fifth Business Day following the 'deadline' for the provision of the additional security or surety (reflected within the additional Section V3.2.10).

The full legal text proposed is detailed below:

TPD SECTION V: GENERAL

Amend paragraph 3.2.4 to read as follows:

A User's Code Credit Limit may from time to time...on notice of not less than 30 Days in the case of (a), (b), (d) and (e) or 2 Business Days in the case of (c) below (or in any such case, such lesser period agreed by the User) to the User:

Add new paragraph 3.2.9 to read as follows:

Where a User's Code Credit Limit has been revised downwards in accordance with paragraph 3.2.4 (c) above, such User must where notified by the Transporter provide additional surety or security for such amount as shall be notified by the Transporter and in a form acceptable to the Transporter no later than 17:00 hours on the second Business Day after the date of the notice given pursuant to paragraph 3.2.4. Where a User has not provided such additional surety or security by such date, the User shall pay to the Transporter:

(a) such amount as set out in the table below based upon the amount of additional surety or security demanded by the Transporter; and

| Amount of additional security required | Amount |
|--|--------|
| Up to £999.99 | £40 |
| £1,000 to £9,999.99 | £70 |
| £10,000 or more | £100 |

(b) a daily charge equivalent to that percentage rate as is set out from time to time in the Late Payments of Commercial Debts (Interest) Act 1998 multiplied by the amount of additional security demanded by the Transporter.

Add new paragraph 3.2.10 to read as follows:

Where a User has not provided such additional surety or security as set out in paragraph 3.2.9, with effect from 06:00 hours on the seventh Business Day following the date of the notice given pursuant to paragraph 3.2.4, the Transporter shall be entitled to reject or refuse to accept a Supply Point Nomination or Supply Point Confirmation by the relevant User under Section G, other than a Supply Point Renomination or Supply Point Reconfirmation (unless made in the context of an application for System Capacity or increased System Capacity at any System Point under Section B or G5) until such time as the relevant User has provided such additional surety or security.

UNC Modification Proposal 0026 'Application of Charges consistent with Late Payment of Commercial Debts (interest) Act 1998'

As the initiator, Transco supports implementation. Transco's The current level of interest payable by Users in respect of amounts unpaid by the Invoice Due Date are at an insufficient level to provide an effective incentive for timely settlement. Transco concurs with the view expressed within Ofgem's Conclusions Document which recommends application of an interest rate and administration charge consistent with the Late Payment of Commercial Debts (Interest) Act 1998.

Transco believes that the incorporation of credit arrangements within the Uniform Network Code that oblige Transporters to implement consistent rules would ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

UNC Modification Proposal 0027 'Right of Set Off under Uniform Network Code'

As the initiator, Transco supports implementation. There is a tangible administrative efficiency to be realised for both Transporters and Users by the implementation of this Proposal. Consequential benefits would also be a reduction in a Users overall indebtedness and therefore a reduction of credit security utilisation. The latter would further minimise exposure to the Transporter issue of 70% and 85% credit utilisation notices and the risk of associated sanctions.

Transco estimates that if a right of set off were already in place, in the period from January 2005 to August 2005, Transco would have had the ability to reduce the quantity of invoices issued by 39%. In addition to this, Transco has assessed that it would have realised a cost saving of approximately £6,500 in respect of banking charges. In such instances, Transco envisages a User would have also realised a benefit in respect of reduction of banking charges.

Transco believes that the incorporation of payment terms within the Uniform Network Code that oblige Transporters to implement consistent rules would ensure that there is no inappropriate discrimination,



and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

UNC Modification Proposal 0031 'Re-assessment of User Unsecured Credit Limits'

Transco offers qualified support for this proposal. Though supporting the aspect of the Proposal affording a maximum level of unsecured credit based on the asset value of a Transporter (believing this is a more effective mitigation of risk than reference to a static figure), Transco recognises the increased risk of default by Users with an Investment Grade Rating (IGR) below BBB- (*Standard and Poor's*) or Moody's Investors Service equivalent.

We note that the *Standard and Poor's* rating definition for 'BB' rated entities is "...less vulnerable to non-payment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation." In accordance with this definition, BB+ (and lower) rated companies are considered by investors as 'speculative' or 'junk' status.

Transco therefore qualifies its support on the basis of the clarification of the conditions allowing a Transporter to pass through any bad debt incurred from a defaulting User. Though mitigating a Transporter's risk, Transco recognises that where such mechanism operates Users will bear a financial burden. In light of the potential industry risk, we believe that BB rated entities should have a reduced entitlement in respect of unsecured credit to mitigate financial risk to the industry.

Transco therefore views this proposal as the 'least preferred' option in respect of the three Proposals concerning unsecured credit arrangements (Modification Proposals 0023, 0031 and 0041).

UNC Modification Proposal 0032 'Adjustment to the number of days in the V A R calculation to bring the Code Credit Rules into line with the Best Practice Guidelines, Conclusions document Feb 2005'

Transco does not support implementation of this Proposal. Assessment of the level of credit required by a User utilises estimation of the peak indebtedness. This is currently calculated based on peak trading activity for the maximum period for which the charges for a transportation service are not paid, this being 63 days (based on a maximum of 31 days in a calendar month, 20 days for invoice production in the following month and then a 12 day payment period). Current billing cycles for Transportation charges range from 51 days to 70 days. The proposal alternatively advocates calculation of the level of credit required utilising a 46 day period of peak trading activity.

Transco acknowledges that the proposer (in proposing this Modification) is seeking to implement a recommendation of Ofgem Conclusions Document 58/05. Clarification of the scope of such recommendation was sought at the July 2005 meeting of the Distribution Workstream, Ofgem's response was detailed within the minutes subsequently issued:

"Ofgem can confirm that the approach set out in the February 2005 conclusions document, paragraph 3.30 (a), is based on actual indebtedness in terms of amounts billed, but not necessarily due), rather than on peak trading activity."

We are concerned whether this Proposal accurately reflects Ofgem's recommendation.

Credit Cover based on a 46 day period of peak trading activity as opposed to 63 days would result in a lower level of required credit cover which Transco believes would be insufficient to adequately mitigate financial risk inherent within the current billing cycle. Within the Distribution Workstream, some members suggested that Users would 'top up' credit where required (for instance within period of high gas demand) as a 'voluntary measure'. Despite this Transco remains concerned that a lower level of credit would result in many Users utilising a greater proportion of their credit limit with the increased risk of breaching the credit limit usage triggers at 70%, 85% and worst case 100% with the attendant consequences. Using



historical data, Transco estimates that during the winter period, the number of notices (70%, 85% 100%) could increase by 400% increasing Transco's administrative costs.

If the Proposal was implemented, less credit cover would be available for the Transporter to call on in a default situation, this would inevitably increase any unsecured amount claimed back via the 'Pass Through' framework if agreed. Historically, User failures have occurred when indebtedness is at its highest and though the 'Pass Through' framework is not yet agreed, User failure may adversely impact a reputable and 'well-run' User. 'Pass through' of amounts would be levied to the whole User community through increased prices, Transco therefore believes that this Proposal does not promote 'Best Practice'.

Transco believes that both Transporters (in terms of administration and monitoring of credit limit usage) and Users (in terms of frequent amendment of credit security value) would incur a degree of cost in the event of implementation of this Proposal. Transco envisages that Users will request at least two reviews to cover winter and summer usage with smaller Users requesting more in line with seasonal changes.

UNC Modification Proposal 0034 'Netting off of Payments and Credits relating to Transportation Charges'

Transco supports implementation of this Proposal recognising that this establishes within the UNC the current practice of 'netting off' debit and credit values within individual invoice documents. Transco concurs that such practice is reasonable and prudent as opposed to issuing two transactions per invoice where such debit and credit values are present.

Transco believes that the incorporation of current practice (for the majority of transporters) within the Uniform Network Code would oblige Transporters to implement consistent rules which would ensure that there is no inappropriate discrimination and thereby facilitate the securing of effective competition between Relevant Shippers.

UNC Modification Proposal 0041 'Re-assessment of User Unsecured Credit Limits'

Transco offers qualified support for this proposal. Though supporting the aspect of the Proposal affording a maximum level of unsecured credit based on the asset value of a Transporter (believing this is a more effective mitigation of risk than reference to a static figure), Transco recognises the increased risk of default by Users with an Investment Grade Rating (IGR) below BBB- (*Standard and Poor's*) or Moody's Investors Service equivalent.

We note that the *Standard and Poor's* rating definition for 'BB' rated entities is "...less vulnerable to non-payment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation." In accordance with this definition, BB+ (and lower) rated companies are considered by investors as 'speculative' or 'junk' status.

Transco therefore qualifies its support on the basis of the clarification of the conditions allowing a Transporter to pass through any bad debt incurred from a defaulting User. Though mitigating a Transporter's risk, Transco recognises that where such mechanism operates Users will bear a financial burden. In light of the potential industry risk, we believe that BB rated entities should have a reduced entitlement in respect of unsecured credit to mitigate financial risk to the industry and acknowledge that in recognition of this risk, this Proposal advocates a lower level of available credit for BB entities in comparison to Modification Proposal 0031.

Our support is also qualified in respect of the allocation of unsecured credit (18% of RAV) to BBB *and* unrated companies. Transco does not support the provision of this level of unsecured credit to an unrated company.

Transco therefore views this proposal as the second best option in respect of the three Proposals concerning unsecured credit arrangements (Modification Proposals 0023, 0031 and 0041).



Please contact Chris Warner on 01926 653541 (chris.warner@ngtuk.com) should you require any further information with respect to the above representations.

Yours sincerely,

Declan McLaughlin
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National Grid