

## **MODIFICATION PROPOSAL 0103**

**SHORT TITLE:** Removal of Secured Credit Limit

**DATE:** 18th November 1996

**PROPOSED IMPLEMENTATION DATE:** To be agreed.

**URGENCY:** Non-Urgent.

### **JUSTIFICATION:**

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' 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 made in advance, for cash 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.

It is being proposed following several meetings of the Energy Balancing Credit Committee, 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:

- \* The Community Secured limit is anomalous in a business framework where it is normal business practice to provide securitised credit to cover normal operations, e.g. for Transportation charges and Gas purchases.
- \* The principle of a zero Community Secured credit level 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 shipping community.
- \* The existence of a Community Secured 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.

- \* The continuance of a Community Secured 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 limit would remain in place until after the first winter.

This modification proposal, to remove the 'Community risk' Secured limit, is being submitted on a non-urgent basis in order to allow full consultation of the Ofgas issues with the industry.

## **CONSEQUENCE OF NOT MAKING THIS CHANGE**

The 'Community Risk' limit remains at £250,000, thereby facilitating 'free' credit.

The Shipping community's Money at Risk will remain at a high level

Shippers will not be encouraged to securitise their operations at a level appropriate to their activities

## **AREA OF NETWORK CODE CONCERNED**

Network Code Supplement, Section Su 2

## **NATURE OF PROPOSAL**

This modification would reduce the "Community Risk" Secured Credit Limit from £250,000 to zero.

## **PURPOSE OF PROPOSAL**

The modification proposal has several advantages:

- the modification will reduce Shippers' exposure to default,
- Shippers will be encouraged to manage their energy balancing more commercially,
- Shippers will be protected from the risk of new Users entering the market without the required level of security to the ultimate benefit of the consumer,
- the removal of the 'Community Risk' Secured Credit Limit is more appropriate to daily balancing,
- a zero credit limit will encourage the securitisation of activities, particularly those Shippers whose level of activities clearly exceeds the existing Community Risk Limit and should reduce the number of cash calls.

**IDENTITY OF PROPOSER'S REPRESENTATIVE:** Chris Train

**PROPOSER** : Chris Train

**SIGNATURE** :

**POSITION** : Energy Balancing Manager

**COMPANY** : TransCo

**MODIFICATION PANEL SECRETARY'S USE ONLY**

**Reference Number:** 0103

**Date Received:** 18th November 1996