

Modification Report
Acceptable Security Tools available to Users for Transportation Credit Arrangements
Modification Reference Number 0109
Version 2.0

This Modification Report is made pursuant to Paragraph 9.3.1 of the Modification Rules and follows the format required under Paragraph 9.4.

1. The Modification Proposal

In respect of transportation credit arrangements, Ofgem published a number of recommendations in its conclusions document “*Best practice guidelines for gas and electricity network operator credit cover*” 58/05 in February 2005. One such recommendation was the range of security tools that should be available to a User to cover any exposure beyond its unsecured credit limit. It further recommended that it would be for each User to determine which, how many and in what percentage they are used.

This Proposal seeks to specify within the UNC the range of acceptable security tools available to Users¹, these being any of the following tools (or combination of them):

- An approved Letter of Credit or equivalent bank guarantee from a bank with a long term debt rating of not less than A by Moody’s or Standard & Poor’s,
- Prepayment agreement (payment made before the delivery of the service),
- A performance bond (provided by an insurance company, not a bank),
- Independent security,
- Deposit Deed Agreement (including cash deposit, advance payment or payment made after the delivery of the service but before contract settlement),
- Parent Company Guarantee

Ofgem’s conclusions document also advocated use of bilateral insurance as an acceptable security tool. National Grid has identified that a bilateral credit insurance policy is only likely to provide cover for the first or second payments after which the insurer then effectively relinquishes its risk. Therefore the long term credit exposure is not effectively transferred through the insurance product as only these initial payments are covered. National Grid believes that this is not compatible with the nature of the transportation billing processes whereby significant debt can be accrued beyond the initial payments secured by the credit insurance and therefore use of such a policy as security potentially exposes the industry to significant financial risk. The requirement of security is to cover the Transporter against a Users breach of payment. Therefore, this proposal does not advocate acceptance of bi-lateral insurance as a security tool.

If this Proposal is not implemented, the UNC will not reflect the recommendations contained within the Ofgem conclusions document and Transporters will not be obliged to operate this aspect of their credit arrangements in a consistent manner.

¹ Ofgem Conclusions Document (58/05) paras 3.35-3.36

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

The Proposer and majority of respondents suggest that implementation of consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination and no inappropriate barrier to entry. They believe that this facilitates the securing of effective competition between relevant shippers. However RWE believed the Modification Proposal with the proposed legal text does not facilitate the securing of effective competition between relevant Shippers, because the proposal has not provided detailed prescription in defining the acceptable security forms.

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No such implications on security of supply or operation of the Total System have been identified. Incorporating elements of credit rules within the UNC may help to reduce the impacts of any industry fragmentation.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

No implications for operation of the system have been identified.

b) development and capital cost and operating cost implications:

No significant development, capital or operating cost implications have been identified.

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

No cost recovery mechanism is proposed.

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

Where a Transporter secures pass through of any bad debt it incurs, Ofgem clarified in its Best Practice Guidelines that at the subsequent price control review the Transporter will be permitted to raise up to the full value of the bad debt from regulated charges including an allowance for the cost of funding the loss pending recovery.¹

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

Based on the assumption that all the security tools identified are currently acceptable to all Transporters, no change to Transporters' level of contractual risk is anticipated. However NG NTS suggested that not all the security tools identified are currently

¹ Ofgem Conclusions Document (58/05) paras 4.1 – 4.7

acceptable to all Transporters, and that some of the proposed tools would have an impact on Transporters' level of contractual risk.

This Proposal seeks to implement one aspect of the arrangements identified in Ofgem's Best Practice Guidelines. Where a Transporter is able to demonstrate that it has implemented credit control, billing and collection procedures in line with the Guidelines, it may be in a position to recover bad debt incurred (see section 4d above), which mitigates the Transporter's contractual risk associated with implementation of aspects of the Guidelines.

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No UK Link systems implications have been identified.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Existing operational arrangements and requirements are anticipated to apply in respect of each credit tool and therefore implementation is not anticipated to have any distinct implications for Users.

Where a Transporter obtains approval to pass through bad debt, this is likely to be subsequently reflected in increased Transportation Charges which would be payable by Users in the subsequent price control period.

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

Dependent on the contractual arrangements in place between the respective parties, bad debt costs which are reflected in subsequent Transportation Charges may be borne in part or in full by Suppliers and subsequently consumers.

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

Where a Transporter secures pass through of any bad debt it incurs and demonstrates that a delay in recovery would have a material adverse effect on its financial position, Ofgem clarified in its Best Practice Guidelines that it may consider early licence modifications such that amounts can be recovered prior to the next price control period.

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

Advantages

- Alignment with Best Practice Guidelines.
- Codifies current practice, preventing industry fragmentation.

- Provides clarity as to which credit security tools are acceptable to Transporters.

Disadvantages

- For Users, if a Transporter can demonstrate compliance with Best Practice Guidelines (of which this is one element), Users may be subject to a level of financial risk of bad debt incurred by the Transporter.

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

Representations were received from the following parties:

Organisation	Abbreviation	Position
British Gas Trading	BGT	Supports
Corona Energy	Corona	Supports
E.ON UK	EON	Supports
National Grid Distribution	NG UKD	Supports
National Grid Transmission	NG NTS	Qualified Support
Northern Gas Networks	NGN	Supports
RWE Npower	RWE	Not in Support
Scotia Gas Networks	SGN	Supports
Statoil UK	STUK	Supports
Total Gas & Power	TGP	Supports
Wales & West Utilities	WWU	Supports

NG NTS suggested that a Parent Company Guarantee should have a long term debt rating of at least A2 by Moody's Investors Service in order to bring it in line with the requirements for the sovereign credit rating and the long term debt rating of the bank that provides a Letter of Credit. NG NTS recommend that the legal text be reworded and provided suggested changes to the legal text.

RWE believe that this Modification Proposal does not make provisions for non UK domiciled companies and has failed to provide detailed definitions to the acceptable instruments that are required to Users for Transportation Credit arrangement. They believe, in principle, the Modification could provide clarity but they believe it falls short of doing that by failing to provide specific details to various instruments that would be preferable, or acceptable. RWE provided some suggested changes to the legal text.

12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter 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 paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

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

Minimal changes would be required in respect of operational processes and procedures in the event that the Proposal is implemented.

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

This Modification Proposal could be implemented with immediate effect upon direction being received from the Authority.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 21 December 2006, of the 9 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing this Modification Proposal. Therefore, the Panel recommended implementation of this Proposal.

18. Transporter's Proposal

This Modification Report contains the Transporters' proposal to modify the Uniform Network Code and the Transporters now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

TPD SECTION B: SYSTEM USE AND CAPACITY

Amend paragraph 2.2.14 as follows:

2.2.14 Following a notice...provide adequate surety or security (in accordance with Section V 3.4.5), all monthly...

Amend paragraph 2.2.16 as follows:

2.2.16 Following a notice under paragraph 2.2.15...provide adequate surety or security (in accordance with Section V3.4.5), the User's Registered...

TPD SECTION V: GENERAL

Amend paragraph 3.4.1 to read as follows:

3.4.1 Any instrument of surety or security provided by a User pursuant to paragraph 3.4.5 (and whether...

Amend paragraph 3.4.2 to read as follows:

3.4.2 Where a User...paragraph 3.4.5 (or the person...

Amend paragraph 3.4.5 to read as follows:

"For the purposes of Code:

"Deposit Deed" shall mean an agreement that is Enforceable and in a form acceptable to the Transporter enabling the deposit of cash or advance payments by a User;

"Enforceable" shall mean the Transporter (acting reasonably) is satisfied that the instrument of security is legally enforceable and in this respect, where security is provided by a company registered outside of England and Wales, the country of residence of such company must have a sovereign credit rating of at least A2 awarded by Moody's Investment Services or such equivalent rating by Standard and Poor's Corporation and the User shall at its own expense provide such legal opinion as the Transporter may reasonably require;

"Letter of Credit" shall mean an unconditional irrevocable standby letter of credit in a form acceptable to the Transporter from such bank as the Transporter may approve, (provided that payment may be made at a United Kingdom branch of such issuing bank) with a long term debt rating of not less than A2 provided by Moody's Investor's Services or equivalent rating by Standard and Poor's Corporation;

"Guarantee" shall mean an on demand irrevocable guarantee or performance bond provided by a Qualifying Company or a Parent Company that is Enforceable and in a form acceptable to the Transporter;

"Prepayment Agreement" shall mean an agreement between the Transporter and the User that is Enforceable and in a form acceptable to the Transporter with the purpose of enabling a User to make payments before they are due and payable;

"Parent Company" shall mean a public or private company within the meaning of section 1(3) of the Companies Act 1985 with a long term debt rating of at least Ba3 provided by Moody's Investor's

Services or equivalent rating by Standard and Poor's Corporation that is a shareholder of the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989).

"Qualifying Company" shall mean a public or private company within the meaning of section 1(3) of the Companies Act 1985 that has a long term debt rating of at least A2 by Moody's Investor's Services or equivalent rating by Standard and Poor's Corporation;

A User may extend its exposure beyond its Unsecured Credit Limit by providing surety or security in one or more of the forms set out below:

- (a) Letter of Credit; and/ or
- (b) Guarantee;and/or
- (c) Cash or advance payment in the form of a Deposit Deed; and/ or
- (d) Prepayment Agreement.

Delete paragraphs 3.4.6 and 3.4.7.

For and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters