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Our Ref: AHT/Mod 0111 response

Dear Julian

Representation in response to Modification Proposal 0111: "Management of Users Approaching and exceeding Upper Limits of Credit Limit"

Thank you for the opportunity to respond to this Draft Modification Report (DMR).

National Grid NTS offers qualified support for this proposal and offers the following comments, in line with the section headings in the DMR.

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

National Grid NTS agrees that implementation of consistent credit processes should help ensure that there is no inappropriate discrimination and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between relevant shippers.

However, National Grid NTS also notes that this Modification Proposal has the potential to allow a greater level of bad debt to accrue than under existing arrangements, due to the extension of the thresholds of User indebtedness at which Transporters can take measures to prevent Users increasing their debt further. Under Ofgem's Best Practice Guidelines¹, Transporters who are able to demonstrate that they have implemented the requisite processes in line with the Guidelines should be able to recover the bad debt incurred. In such a situation, this debt would be passed back to all Users through subsequent increases in Transportation Charges. This may be considered as disadvantaging Shippers who hold greater security in favour of those holding a lesser position and expose such Shippers to a greater risk of incurring smeared costs as a result of another Shipper's default.

¹ "Best practice guidelines for gas and electricity network operator credit cover, Conclusions document, February 2005, 58/05"

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

National Grid NTS does not foresee any implications on security of supply or operation of the Total System. National Grid NTS believes that consistent credit arrangements could facilitate non-fragmentation of the industry.

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

a) implications for operation of the System:

National Grid NTS does not foresee any implications for operation of the System.

b) development and capital cost and operating cost implications:

National Grid NTS understands that there are likely to be costs associated with making changes to operational processes and procedures and systems, but that at this point in time they are not expected to be significant.

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

National Grid NTS considers that any such costs would fall into the category of TO operating costs and would therefore treat these costs in the same way as our existing TO operating costs.

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

National Grid NTS notes and takes comfort from the Proposer's reiteration of the assurances made in Ofgem's Best Practice Guidelines regarding the potential for bad debt recovery, resulting from the implementation of the Guidelines.

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

National Grid NTS agrees with the Proposer that the Transporters' level of contractual risk will increase with the deferment of the threshold at which Transporters are able to apply measures under section V of the UNC from 85% indebtedness to 100% indebtedness.

National Grid NTS notes that under the existing arrangements, the measures under section V can be applied as soon as the notice is issued for the User's indebtedness exceeding 85% of its Code Credit Limit. Under the proposed arrangements, the Transporter will firstly have to wait until the User's indebtedness has exceeded 100% of its Code Credit Limit and then wait a further two Business Days before measures can be taken. Furthermore, the full measures under the existing arrangements are split out under the proposal such that the final element of the measures, the refusal to accept a Supply Point Nomination or Supply Point Confirmation, will not be applicable until 5 Business Days after the notice of exceeding the 100% indebtedness threshold is issued.

Notwithstanding these increased risks, National Grid NTS is pleased to note the retention of paragraph 3.3.3 within section V of the Transportation Principal Document of the UNC which allows the Transporter the right to issue a Termination Notice once a User's indebtedness exceeds 100% of its Code Credit Limit, as long as the 100% limit has not been exceeded as a direct consequence of an increase in the relevant Transporter's Transportation Charges (in which circumstances, the User will have one calendar month to provide additional security).

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

National Grid NTS notes that no UK Link system implications have been identified.

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

National Grid NTS recognises the Proposer's arguments that Users could experience both a decrease and increase in their contractual risk.

In addition to the views expressed by the Proposer, National Grid NTS is concerned that this Modification Proposal has the potential to impact on the level of contractual risk faced by Users that are solvent and abide by the credit rules. Currently, these Users are protected, to a certain extent, from others becoming insolvent and leaving bad debt by the thresholds and measures that this Modification Proposal seeks to amend or remove. The extension of the threshold at which measures apply from 85% to 100% of a User's Indebtedness would allow Shippers who are or may be on the brink of insolvency to continue to incur debts that they are or may be unable to meet.

If the Shipper then becomes insolvent, leaving debts to the Transporter and the Transporter is able to demonstrate that it has implemented the requisite processes in line with Ofgem's Best Practice Guidelines, the Transporter should be able to recover the bad debt incurred. However, this would be to the detriment of the rest of the User community who in such a situation would have to fund the debt recovery through an increase in their Transportation Charges.

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

National Grid NTS agrees with the Proposer that Suppliers and subsequently Consumers could be impacted by an increase in costs as a result of bad debt pass through, dependent upon the commercial arrangements in place between the respective parties with regard to Transportation Charges.

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

National Grid agrees with the Proposer's interpretation of Ofgem's Best Practice Guidelines.

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

Advantages

National Grid agrees that the Proposer's stated advantages could benefit Users and that the alignment with Ofgem's Best Practice Guidelines could assist with the prevention of industry fragmentation.

Disadvantages

National Grid also agrees with the Proposer's stated disadvantages, particularly the inability of Transporters to mitigate exposure to bad debt where a User's indebtedness exceeds 85% of its Code Credit Limit (but does not exceed 100%).

However, as previously stated, National Grid NTS takes some comfort from the reassurances provided by Ofgem in its Best Practice Guidelines document which states:

“4.3 Companies demonstrating compliance with or able to satisfactorily to explain departure from the guidelines will be able to recover all bad debt losses arising in respect of charges not due for payment at the date of the relevant counterparty's insolvency, net of any dividends or recoveries;

4.4 Such companies will also be able to recover a proportion of bad debt losses arising in respect of charges overdue for payment at the date of the relevant counterparty's insolvency, net of any dividends or recoveries (which would be offset proportionately against all outstanding balances), depending on the age of the outstanding receivable. Ofgem has noted comments from a number of respondents regarding the opportunity to recover 100 per cent of bad debt whilst employing reasonable procedures. Ofgem has concluded that the amount recoverable would be equal to the value of outstanding balances subject to bona fide dispute (plus or minus the value of any reconciliation adjustments subsequently made) together with a proportion of the value of all undisputed balances (up to a maximum of 100 per cent) that varies inversely with the age of the balance, as set out below. The overall recoverable amount would be reduced for any other recoveries.

National Grid NTS has also identified an additional disadvantage to the proposal with regard to the facilitation of effective competition between relevant shippers (discussed in point 2 above) where one shipper may suffer additional costs as a result of another shipper becoming insolvent and its bad debts being passed through to the community.

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

National Grid NTS understands that there would be an impact on operational processes and procedures in the event that this Modification Proposal were implemented.

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

National Grid NTS agrees that an implementation timescale of 3 months should be observed following the Authority's direction being given.

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

No implications identified.

19. Legal Text

National Grid NTS notes that the draft legal text contains a reference in the proposed new paragraph 3.2.11 for "Value at Risk". This is not currently a defined term in Section V of the Transportation Principal Document of the UNC, although a definition has been proposed in the legal text which accompanies Modification Proposal 0114 "Quantification of Value At Risk (VAR) to determine maximum User Credit Security Requirements".

National Grid NTS suggests that the legal text that accompanies this Modification Proposal should be amended to include the definition of Value at Risk such that if Modification Proposal 0111 were implemented and Modification Proposal 0114 were not, a subsequent amendment to the UNC to define this term would not be required.

Yours sincerely

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