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Our Ref: AHT/Mod 0114 response

Dear Julian

Representation in response to Modification Proposal 0114: "Quantification of Value At Risk (VAR) to determine maximum User Credit Security Requirements"

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.

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 for 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 Guidelines¹ 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 this Modification Proposal would increase the level of contractual risk of each Transporter as it would reduce the minimum level of credit required to be posted by a User. The basis of VAR in the amounts billed in the previous calendar month means that the level of credit in any given month may be insufficient if the previous month saw an increase in the value of amounts billable to a User.

However, National Grid NTS takes comfort in 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.

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

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 agrees with the Proposer that Users could see both a reduction and an increase in their cost of providing credit cover, depending on their pattern of trading levels and the requirement to adjust their credit security in place mid year in response to variations in Value at Risk.

National Grid NTS also agrees that the Modification Proposal would probably cause an increase in the likelihood that a User could inadvertently breach its credit limit, thereby facing the measures that Transporters are granted under the UNC in these circumstances.

If a User 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. As the Proposer states, this is likely to be payable by Users through an increase in their Transportation Charges in subsequent years.

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 recognises the possibility that a User may reflect any operational cost efficiencies it achieves in obtaining unsecured credit in the level of charges it levies to its Suppliers, which could possibly be reflected in the level of charges a Supplier levies to its customers.

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 NTS agrees that alignment with Ofgem's Best Practice Guidelines could assist with the prevention of industry fragmentation and that Users could see a benefit in the reduction in the minimum level of credit security required to be in place.

Disadvantages

National Grid NTS also agrees with the Proposer's stated disadvantages, but believes that there is another disadvantage not listed under section 10 of the DMR, namely that the Modification Proposal could result in Transporters being exposed to financial risk which is not covered by any form of credit security. With regard to that specific disadvantage, National Grid NTS takes comfort from the reassurances provided by Ofgem in its Best Practice Guidelines document, as detailed under point 5 above.

However, as stated in point 7 above, National Grid NTS recognises that this represents a potential disadvantage to Users who could have to face the cost of bad debt recovery through an increase in Transportation Charges.

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

National Grid NTS understands that there could be changes required to 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)

Given the potential work required as per section 14 above, National Grid NTS considers that a minimum 3 month implementation timetable should be granted following the Authority's direction being given.

19. Legal Text

National Grid NTS has no comments on the legal text provided.

Yours sincerely

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