

Modification Report
RG0252 Proposal 7: Introduction of a rating table for independent credit rating agencies for use with Independent Assessments
Modification Reference Number 0304
Version 3.0

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

1 The Modification Proposal

Background

Review Group 0252 was raised by Wales and West Utilities in April 2009 seeking to review the existing credit arrangements contained within UNC TPD Section V and ensure that these remain fit for purpose and robust. The review group covered a wide range of credit related topics and produced a set of recommendations which included providing clarity on the application of Independent Assessment for the purposes of obtaining an unsecured Code Credit Limit.

In February 2007 UNC Modification 0113: Availability of Unsecured Credit Based on User Payment Record or Independent Assessment introduced the ability of Users to obtain Unsecured Credit Limit based on Independent Assessment for Users without a Moody's or Standard & Poors investment grade rating, or for those whose rating is below the prescribed minimum of BB- or equivalent. This was one of a series of modifications which sought to align UNC with Ofgem's recommendations contained within the "*Best practice guidelines for gas and electricity network operator credit cover*" 58/05 published in February 2005.

This modification introduced a scoring mechanism whereby Users could choose an agency from each Transporters panel of three and obtain between 3 1/3 % and 20% of the Transporter's Maximum Unsecured Credit Limit. A table prescribing the amount within this range based on a scoring mechanism of one to ten, with ten being the highest level was introduced into UNC section V3.1.7. When attempting to utilise this mechanism it became apparent that the independent rating agencies contacted were reluctant to prove a score in this manner without further detailed guidance as to what the levels represented.

Ofgem's letter directing implementation of this proposal considered that this would "*help to reduce barriers to market entry, and also reduce the potential for discrimination within the market*".

The Proposal

As part of Review Group 0252: Review of Network Operator Credit Arrangements, discussion on how to apply the table currently contained within UNC have concluded that there is no clear guidance on the application of the scoring mechanism and that this may lead to Transporters using different methodologies for establishing the Independent Assessment Score based on interpretation of the Independent Assessment.

This modification seeks to provide clarity to Users on how the application of a rating provided by an independent credit rating agency would correspond with the table currently contained within UNC section V3.1.7.

In February 2009, Ofgem directed a change to the Distribution Connection and Use of System Agreement (DCUSA) (DCP034) which introduced similar Independent Assessment arrangements for obtaining a Credit Assessment Score from an Approved Credit Referencing Agency to determine the Credit Assessment Factor (CAF). The Credit Assessment Score in DCUSA is the equivalent of the Independent Assessment Score contained within the UNC table and the DCUSA CAF (%) is the equivalent of the % of Transporter's Maximum Unsecured Credit Limit in UNC.

DCP034, however, also introduces a mapping table between the Credit Assessment Score and the established credit scores used by five Recognised Credit Assessment Agencies, providing clarity to Users on the how the application of an Independent Assessment will be applied to generate their CAF, and ultimately their maximum Unsecured Credit Limit.

This proposal seeks to implement a table similar to that already approved by Ofgem for use in DCUSA into UNC to add clarity on the application of Independent Assessment Scores. Following further discussion at the Distribution and Transmission Workstreams in November and December 2009 it was considered reasonable and manageable to offer three agencies, acceptable to all Transporters, from which Users could choose. All three agencies offer credit reports which are based on a wide range of financial information including payment experience, ownership of the business, and history of legal actions and collection information. It is proposed that the table below replaces the table currently provided in UNC TPD section V3.1.7(b):

Independent Assessment Score	Equivalent of the Independent Assessment Score to credit scores provided by the independent credit rating agencies for Independent Assessments			% of Transporter's Maximum Unsecured Credit Limit
	Dunn & Bradstreet/N2 Check	Experian	Graydons	
	Comprehensive Report	Bronze, Silver or Gold Report	Level 1, Level 2 or Level 3 Report	
10	5A1	95-100	1A	20
9	5A2/4A1	90-94	1B/2A	19
8	5A3/4A2/3A1	80-89	1C/2B/3A	18
7	4A3/3A2/2A1	70-79	2C/3B/4A	17
6	3A3/2A2/1A1	60-69	3C/4B/5A	16
5	2A3/1A2/A1	50-59	4C/5B/6A	15
4	1A3/A2/B1	40-49	5C/6B/7A	13½

3	A3/B2/C1	30-39	6C/7B/8A	10
2	B3/C2/D1	20-29	8B	6⅔
1	C3/D2/E1	10-19	8C	3⅓
0	Below E1	Below 10	Below 8C	0

The Code Credit Limit applied to the applicant would be no higher than the lower of the value recommended by the independent assessment agency and the value calculated based on the table above. This prevents the inappropriately high Unsecured Credit Limits resulting from the Transporters RAV.

This will ensure that a consistent approach is taken by the Transporters in deriving the Independent Assessment Score and thereby improving the access to unsecured credit by Users and new market entrants.

This modification is also broadly consistent with the DCUSA arrangements and would therefore provide a more consistent and stable operating environment to Users of more than one code.

Suggested Text

TRANSPORTATION PRINCIPAL DOCUMENT

SECTION V

V3.1.7 AMEND TO READ AS FOLLOWS:

3.1.7 Upon request from a User, the User may select any one of the specified agencies for the Transporter to use to allocate an Unsecured Credit Limit to the User as follows:

- a) where such User is unable to obtain an Approved Credit Rating (up to a maximum of 20% of the relevant Transporter’s Maximum Unsecured Credit Limit); or
- b) where such User has an Approved Credit Rating below Ba3 (awarded by Moody’s Investment Services or an equivalent rating by Standard & Poor’s Corporation) (up to a maximum of 13⅓% of the relevant Transporter’s Maximum Unsecured Credit Limit).

A score of between 0 and 10 will be allocated to the User in accordance with the following table to calculate the User’s Unsecured Credit Limit:

Independent Assessment Score	Equivalent of the Independent Assessment Score to credit scores provided by the independent credit rating agencies for Independent Assessments			% of Transporter’s Maximum Unsecured Credit Limit
	Dunn & Bradstreet/N2 Check	Experian	Graydons	

	Comprehensive Report	Bronze, Silver or Gold Report	Level 1, Level 2 or Level 3 Report	
10	5A1	95-100	1A	20
9	5A2/4A1	90-94	1B/2A	19
8	5A3/4A2/3A1	80-89	1C/2B/3A	18
7	4A3/3A2/2A1	70-79	2C/3B/4A	17
6	3A3/2A2/1A1	60-69	3C/4B/5A	16
5	2A3/1A2/A1	50-59	4C/5B/6A	15
4	1A3/A2/B1	40-49	5C/6B/7A	13 $\frac{1}{3}$
3	A3/B2/C1	30-39	6C/7B/8A	10
2	B3/C2/D1	20-29	8B	6 $\frac{2}{3}$
1	C3/D2/E1	10-19	8C	3 $\frac{1}{3}$
0	Below E1	Below 10	Below 8C	0

The Transporter will set the Users Unsecured Credit Limit no higher than the lower of the credit value recommended within the Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transport's Maximum Unsecured Credit Limit.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

User Pays arrangements are not applicable.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

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

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (b): so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of

(i) the combined pipe-line system, and/ or

(ii) the pipe-line system of one or more other relevant gas transporters;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;

(ii) between relevant suppliers; and/or

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

The Proposer believes that implementation of consistent and clear arrangements to be used when undertaking Independent Assessments will help to ensure that there is no inappropriate discrimination and will help to reduce barriers to market entry. This will inevitably facilitate effective competition (Standard Special Condition A11.1 (d)).

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

By providing clear guidance on the application of Independent Assessments this modification will improve the administration of UNC credit rules, thereby better facilitating SSC A11.1 (f).

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

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

There are no implications for operation of the System.

b) Development and capital cost and operating cost implications:

There are no cost implications.

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

Not applicable.

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

Not applicable.

6 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

Clarifying the terms under which the level of unsecured credit is determined enhances the contractual certainty and lowers risk for Transporters (and Users).

7 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 implications have been identified.

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

Administrative and operational implications (including impact upon manual processes and procedures)

Clarity of application of the UNC will improve administrative arrangements and facilitate competition.

Development and capital cost and operating cost implications

No implications have been identified.

Consequence for the level of contractual risk of Users

No consequences have been identified.

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

No implications have been identified.

10 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

No consequences have been identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Clarity on the application of existing arrangements will ensure a consistent approach is taken by Transporters.
- Use of readily available “off the shelf” credit reports would be more efficient and cost effective than instructing bespoke reports.
- Use of lower of rule ensures that there is no inappropriate limit on the basis of Transporter RAV.

Disadvantages

- None identified.

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

Organisation	Response
British Gas Trading	Supports
E.ON UK	Supports
First:utility	Supports
National Grid Distribution	Qualified Support
National Grid NTS	Supports
Northern Gas Networks	Supports
RWE npower	Supports

Scotia Gas Networks	Supports
ScottishPower	Supports
SSE	Comments Offered
Wales & West Utilities	Supports

In summary, of the 11 responses received, 9 supported implementation of the Proposal, 1 offered qualified support, and 1 offered comments.

SSE believed that not all the ratings have been identified in the table provided in the Modification Proposal, e.g. Dunn & Bradstreet has a credit rating system which goes down to a '4', i.e. '5A4', and this hasn't been taken into account within the table. Also Graydons ratings go down to a 'D', i.e. '1D', which again haven't been mentioned in the table. SSE questions whether these have been purposely omitted as they are not considered valid ratings or if they had been missed.

First:utility considered that the introduction of a rating table will add clarity on the way that Independent Assessment Scores are applied and ensure that a consistent approach is taken by the Transporters when deriving these Scores. This should improve access to Unsecured Credit, particularly for smaller Users and especially new market entrants.

National Grid Distribution believed that a greater certainty would be achieved if the legal text identified that a User obtains a level of unsecured credit which is *the lower of* the percentage of the Transporters RAV (as determined by the rating determined by the CRA) or the absolute financial value recommended by the credit rating agency.

13 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.

14 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.

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

No programme of works would be required as a consequence of implementing the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

The Proposal could be implemented with immediate effect following direction from Ofgem.

17 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.

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

At the Modification Panel meeting held on 19 August 2010, the Panel determined UNANIMOUSLY to recommend implementation of the Proposal.

The Panel Chair noted that eleven responses had been received, of which ten supported and one opposed implementation. He suggested that clear and effective credit requirements within the UNC provide protection and reassurance for all parties, helping to prevent bad debt escalating to inappropriate levels. Requiring credit provision also provides an appropriate barrier to entry. Hence including appropriate credit arrangements within the UNC is consistent with facilitating effective competition between Shippers. Consequently reviewing and improving the arrangements where appropriate is also consistent with facilitating effective competition.

The Panel Chair summarised that Proposal 0304 seeks to provide clarity to Users on how the application of a rating provided by an independent credit rating agency would correspond with the table currently contained within UNC section V3.1.7. At present there is uncertainty about this and implementation would both provide clarity and ensure consistency between Transporters, making the credit arrangements more accessible and appropriate. Implementation would therefore be expected to be consistent with efficient administration of the UNC as well as with facilitating effective competition.

Members supported this summary.

19 Transporter's Proposal

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

20 Text

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7	4A3/3A2/2A1	70-79	2C/3B/4A	17
6	3A3/2A2/1A1	60-69	3C/4B/5A	16
5	2A3/1A2/A1	50-59	4C/5B/6A	15
4	1A3/A2/B1	40-49	5C/6B/7A	13 $\frac{1}{3}$
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The Transporter will set the Users Unsecured Credit Limit no higher than the lower of the credit value recommended within the Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transport's Maximum Unsecured Credit Limit.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters