

Modification Report
Aggregation of Credit Positions or Use of Group Ratings
Modification Reference Number 0148

Version 4.0

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

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.

Pursuant to recommendations contained within the conclusions document it is proposed that Users may aggregate their credit positions or use group ratings (for example Parent Company Guarantees (PCGs)) provided that the arrangements are robust and unconditional. The conditions for the acceptance of such are:

- The credit support provider must offer a guarantee which is legally enforceable in England and Wales. Guarantors based outside England and Wales may be required to provide legal opinion of enforceability,
- The guarantor entity will be subject to the same credit scoring process as the buyer, and must also be willing to provide information to facilitate the completion of this process,
- The country of residence of the guarantor must have a sovereign credit rating of at least A awarded by Moody’s Investors Service (or equivalent rating by Standard & Poor’s). If the rating agencies differ, the lower rating will apply, and
- The minimum acceptable rating is Ba3 awarded by Moody’s Investors Services (or equivalent rating by Standard & Poor’s). If the rating agencies differ, the lower rating will apply.

The PCG may be used in one of two ways:

- the unsecured credit limit assigned to the User would be based on the credit strength of the parent guarantor. Thus for example, a BB rated User guaranteed by an A rated parent would obtain an unsecured limit equal to 40 per cent of the relevant Transporter’s maximum credit limit. Where more than one User obtains credit from a single PCG, the aggregate counterparty credit limits (obtained via that PCG) shall not exceed the credit entitlement of the parent.
- As a guarantee for an amount in addition to an Unsecured Credit Limit assigned to the User based on it’s stand alone credit rating. In such a case, the additional amount secured by the parent must not exceed the parent company’s ability to bear risk and must take into account the extent to which other Users are secured by the parent under the UNC.

If this Proposal is not implemented, 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.

2 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;*

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. This measure facilitates the securing of effective competition between relevant shippers.

RWE believe that issues need to be addressed to determine the enforceability of guarantors domiciled outside England and Wales. They also believe that the definition of Qualifying Company and/ or Parent Company, that referenced the Companies Act 1985, would exclude Users from obtaining a Qualifying Guarantee from a parent that is based outside the UK, and therefore this Proposal does not facilitate the securing of effective competition between relevant shippers.

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 (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) 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.*

Implementation would not further achievement of this relevant objectives.

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.

NG NTS consider any costs would fall into the category of Transmission Operator operating costs and would therefore treat these costs in the same way as their existing Transmission Operator operating costs.

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

Based on the assumption that implementation would codify current practice no change to Transporters' level of contractual risk is anticipated. Representations are invited to confirm whether this assumption is correct, and if not, indication of the consequential impact on Transporters' level of contractual risk.

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 secure pass through of any bad debt it incurs. In such cases, 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. Where a Transporter is able recover bad debt incurred this mitigates the Transporter's increased contractual risk associated with implementation of aspects of the Best Practice Guidelines.

WWU confirmed that they do anticipate any additional risks for WWU as the content of this Proposal mirrors the current WWU Code Credit Rules.

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

No such consequence is anticipated.

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

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

Existing operational arrangements and requirements are anticipated to apply in respect of the arrangements which are the subject of this Proposal and therefore implementation is not anticipated to have any distinct implications for Users.

Development and capital cost and operating cost implications

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.

Consequence for the level of contractual risk of Users

With the scope of the use of group ratings formalised in the UNC (if implemented) User contractual risk will be reduced.

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.

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)

Organisation		Position
British Gas Trading	BGT	Qualified Support
Corona Energy	Corona	Supports
E.ON UK	EON	Supports
National Grid Distribution	NG UKD	Supports
National Grid Transmission	NG NTS	Supports
Northern Gas Networks	NGN	Supports
RWE npower	RWE	Not in Support
Scotia Gas Networks	SGN	Supports
Scottish and Southern Energy	SSE	Supports
Wales & West Utilities	WWU	Supports

BGT believes an omission in respect of Parent Company Guarantees and how multiple credit ratings are treated renders the Proposal deficient.

Some respondents highlighted the Proposal's dependency on definitions contained within the suggested legal text for Modification Proposal 0146 which do not currently exist in the UNC.

RWE believes that the suggested legal text is inappropriate for companies registered

outside England and Wales, and that Section V; Paragraph 3.4.5 alienates letters of credit or equivalent bank guarantees contained in paragraph 3.4.6.

SSE expressed concern that the Moody's and S&P ratings appear to be confused i.e. A and BB- are S&P not Moody's as written. They suggested that the terminology needs to be clear and consistent and that clarification is required for the range of A bands.

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

No such requirement has been identified.

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

No such requirement has been identified.

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

No programme for works has been identified.

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

The proposer believes that in light of the limited works required to implement, 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 19 July 2007, of the 9 Voting Members present, capable of casting 9 votes, 8 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

18. Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and

the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

TPD SECTION V: GENERAL

Amend paragraph 3.1.6 to read as follows:

- “ (a) Where a User has an Approved...
- (b) Subject to paragraph 3.1.6 (c), where a Qualifying Company or Parent Company provides security to a User in the form of a Guarantee pursuant to paragraph 3.4.5 (the “Security Provider”), then the Approved Credit Rating of such Security Provider may be used in place of the User’s to calculate such User’s Unsecured Credit Limit in accordance with the table set out in paragraph 3.1.6.
- (c) Where a Security Provider provides security for more than one User, the aggregate Unsecured Credit Limits of such Users shall not exceed maximum credit entitlement of the Security Provider calculated in accordance with the table set out in paragraph 3.1.6.
- (d) A User may utilise an Approved Credit Rating from a Security Provider in accordance with paragraph 3.1.6 (b) in combination with a Guarantee from such Security Provider, provided that in the opinion of the Transporter, such Security Provider’s ability to bear risk is not exceeded.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters