UNC Review Group 0252
Review of Network Operator Credit Arrangements
- Unsecured Credit Limits Strawman

1. Introduction

Review Group 0252 (RG0252) was established in July 2009 to allow a review of the existing arrangements within UNC TPD Section V and to take account of other credit related issues that have occurred since the publication of the Best Practice Guidelines (BPG) document.

National Grid has recently been approached by a prospective Gas Shipper regarding the use of an Independent Credit Assessment to determine a level of unsecured credit against Gas Transportation charges. As this is the first such request that National Grid has received since the introduction of this facility within the Uniform Network Code (UNC), we have performed some analysis to inform our response to this request. This has led us to conclude that there is merit in reviewing the associated elements of the BPG relating to Unsecured Credit Limits.

This strawman defines potential options for changing the way Unsecured Credit is allocated as part of an Independent Assessment, which National Grid believes should be discussed further as part of the scope of RG0252:

- Option A – Independent Assessment based on DCUSA Table
- Option B – Independent Assessment based on DCUSA Table + Commercial Judgement based on Independent Credit Agency recommendation

This strawman also provides some thoughts on an alternative option to the above, which looks at a revised means of providing Unsecured Credit to all Users (with or without an Investment Grade Rating) and the following option is put forward for debate:

- Option C – All Users provided with the maximum recommended amount of unsecured credit by the preferred Independent Credit Agency (capped at 2% of a transporters RAV).

2. Independent Assessment

<u>Background</u>

As detailed above, National Grid has recently been approached by a prospective Gas Shipper regarding the use of an Independent Credit Assessment to determine a level of unsecured credit against Gas Transportation charges. This is the first such request that National Grid has received since the introduction of this facility within the Uniform Network Code (UNC). Independent Assessment is currently detailed in UNC TPD Section V 3.1.7 as follows:

3.1.7 Upon request from a User, the Transporter will specify a panel of 3 independent credit rating agencies. The User may select any one of such 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 and 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	% of Transporter's Maximum Unsecured Credit Limit
10	20
9	19
8	18
7	17
6	16
5	15
4	13⅓
3	10
2	6⅔
1	3⅓
0	0

Under the arrangements introduced as part of the implementation of UNC modifications 0113 and 0147, upon a User's request, a Transporter shall obtain a credit scoring from an independent credit assessment agency of 0 to 10. This score is then used to calculate the level of credit that it may extend to a User as a proportion of its Regulatory Asset Value (RAV).

The credit assessment agencies that National Grid Gas have contacted regarding this matter have been reluctant to provide a 0-10 scoring without detailed guidance as to what this scale of scoring represents in relation to the relevant party's ability to pay.

Option A – Independent Assessment based on DCUSA Table

RG0252 has briefly discussed a potential solution to this issue, and have been made aware that under the electricity Distribution Connection & Use of System Agreement (DCUSA), a recent amendment has been implemented. This amendment introduced a table into the DCUSA (see below) which would allow a network operator to translate one of numerous credit assessment agencies' standard ratings into a 0-10 credit scoring.

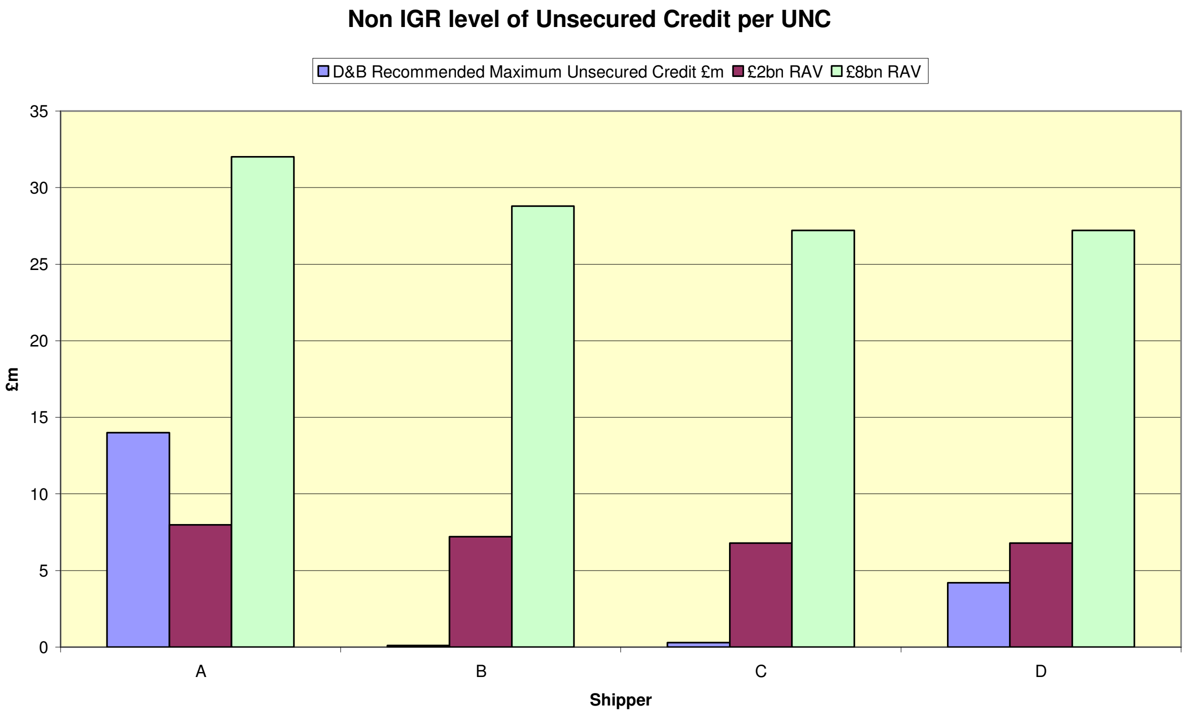
Table A (replica of DCUSA Schedule 1, 2.8)

Equivalence of the Credit Assessment Score to credit scores provided by Recognised Credit Assessment Agencies in their Independent Credit Assessments.

Assessment Score	Check It (ICC)	Dunn & Bradstreet / N2 Check	Equifax	Experian	Graydons
	Credit Score Report	Comprehensive Report		Bronze, Silver or Gold Report	Level 1, Level 2 or Level 3 Report
10	95-100	5A1/	A+	95-100	1A
9	90-94	5A2/4A1	A/A-	90-94	1B/2A
8	80-89	5A3/4A2/3A1	B+	80-89	1C/2B/3A
7	70-79	4A3/3A2/2A1	B/B-	70-79	2C/3B/4A
6	60-69	3A3/2A2/1A1	C+	60-69	3C/4B/5A
5	50-59	3A3/1A2/A1	C/C-	50-59	4C/5B/6A
4	40-49	1A3/A2/B1	D+	40-49	5C/6B/7A
3	30-39	A3/B2/C1	D/D-	30-39	6C/7B/8A
2	20-29	B3/C2/D1	E+	20-29	8B
1	10-19	C3/D2/E1	E/E-	10-19	8C
0	Below 10	Below E1	Below E-	Below 10	Below 8C

We have recently undertaken analysis on a small sample of shippers who do not currently have an Investment Grade Rating (IGR). We have calculated the level of credit that would be provided if such shippers ask us to undertake an independent assessment on their behalf. This calculation involves using the Dunn and Bradstreet (D&B) rating against the DCUSA table to identify the independent score and corresponding % of Maximum Unsecured Credit limit. This percentage has then been applied to derive the different levels of Transporter RAV that may be allocated as a result and for this illustration a £2bn (small transporter) and £8bn (large transporter) RAV figure have been used.

The graph shows how the calculated level of credit compares to the maximum level recommended by D&B. See appendix 1 for further details of our analysis.



National Grid suggests that this analysis highlights a number of points worthy of further consideration;

1. The level of credit recommended by the DCUSA table often provides much more credit than that which would be recommended by the recognised independent credit agencies;

2. For smaller Transporters (illustrated by £2bn RAV), basing the level of credit offered to Investment Grade rated Shippers on the Transporter RAV often caps the level of credit offered to below the level recommended by the recognised independent credit agencies; and

3. For larger Transporters (illustrated by £8bn RAV), the RAV is at such a level that most Users would be offered credit terms well in excess of that recommended for both mechanisms (in some scenarios this could result in terms which are 100's times more generous than the Independent Credit Agency's recommended level).

Whilst RG0252 has yet to discuss the issue of independent credit assessments in detail, it has been suggested that the mechanism detailed in the DCUSA could be a suitable solution for UNC. Having carried out our analysis National Grid suggests that although there seems to be some merit in this solution in terms of providing transparency to Shippers, we consider that there are a number of drawbacks which could result in an inappropriate distribution of risk between code parties if this mechanism was applied without some recognition of the ability of the User to pay.

Option B – Independent Assessment based on DCUSA Table + Commercial Judgement based on Independent Credit Agency recommendation

We believe that the rating agencies featured in the DCUSA table provide ratings based primarily upon the stability of the assessed organisation, not necessarily regarding its size. To bring their ratings back into perspective, they also provide a maximum recommended credit level. We also note that paragraph 3.24 of Ofgem's Best Practice Guidelines for Network Operator Credit Cover considers this when describing the desired process:

> *The assessment could take the form of a score of 0 to 10 where nought indicates that the company is not suitable for any allowance of unsecured credit. A company rated at 10 could be eligible for up to 20% of the NWO's maximum credit limit. Scores in between could result in allowances which matched the steps of rated companies indicated in the table below. In making this assessment, the agency methodology could consider how the size of the counterparty's portfolio limits its ability to avail itself of the full allowance. As a result the party's equivalence to rated companies could be equitable whilst taking into account the 'absolute' value of 'what a party is good for'.*

National Grid suggests that the final two sentences of the above supports an element of commercial judgement being applied to the scoring, to reflect a level of credit which is large enough to cover the amount that the customer would wish to "avail" themselves of but at the same time is also tempered so that the amount of credit made available was reflective of "what the party is good for". As a result of this interpretation, and analysis we do not think that the use of the DCUSA table alone would be the most appropriate way of determining a User's credit allowance as a result of an independent Credit Agency's assessment score.

The following option for undertaking Independent Assessments combines both the DCUSA table (as per option A) and the aforementioned commercial judgement.

i) Upon a User's request for an independent credit assessment, the Transporter will inform the User of the list of recognised credit reference agencies from which it may select for the Transporter to base its assessment. Each of these will be reputable credit reference agencies that are both professionally recognised and independent from both the Transporter and the User;

ii) Once the User has nominated its preferred credit reference agency, the Transporter shall obtain a credit assessment report on the User from this agency, and determine an initial scoring based upon the table provided in the DCUSA (subject to UNC section V3.1.7(b));

iii) If the initial scoring results in a level of credit that is greater than the maximum recommended by the preferred agency, then the Transporter shall adjust the credit score to one that reflects the level of credit recommended by the agency. Where this level falls between the amounts defined by each score, then the nearest score to this would be granted;

iv) The user will be notified of the scoring within 2 business days of the Transporters receipt of their nomination of a preferred agency; and

v) The timings surrounding reassessments and the arrangements surrounding the payment for assessments will remain in accordance with the UNC (V3.1.8).

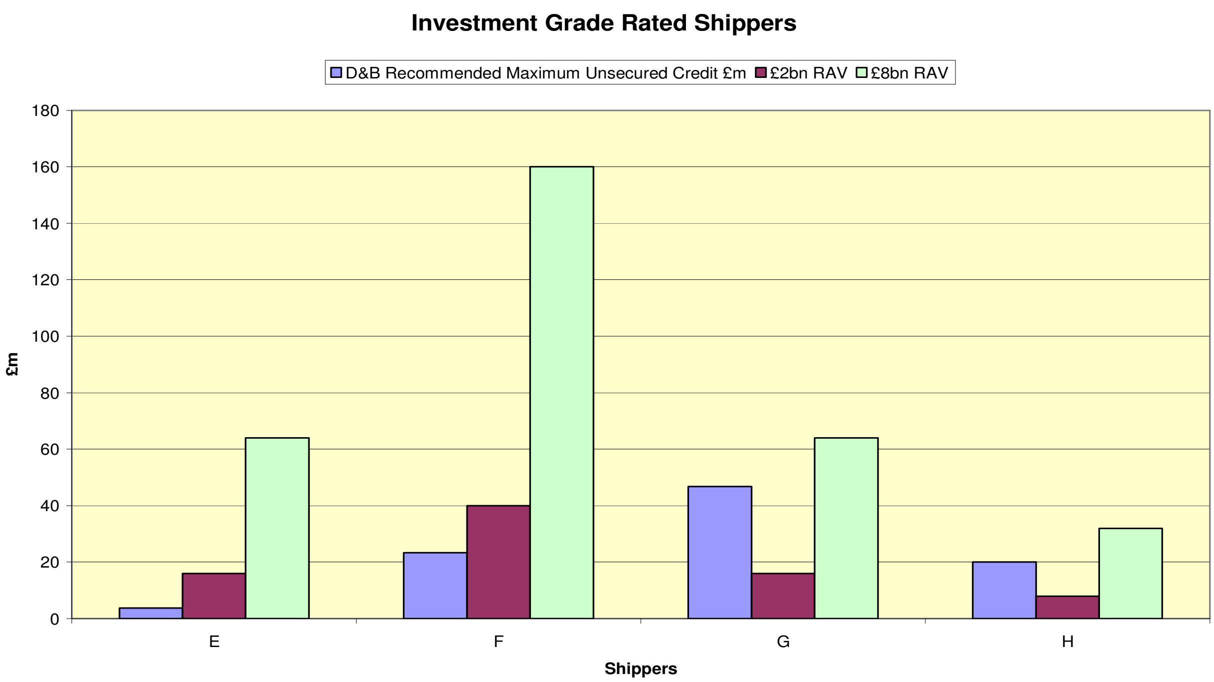
3. Alternate/Wider Unsecured Credit Allocation Options

As a consequence of conducting the analysis related to the aforementioned Independent Credit Assessment options, National Grid has considered if there is merit in reviewing how Unsecured Credit Limits should be determined for all Users (with or without an Investment Grade Rating). The option below has been developed as a means of generating discussion in this area and National Grid acknowledge that there could be other options worthy of evaluation.

Option C – All Users provided with the maximum recommended amount of unsecured credit by the preferred Independent Credit Agency (capped at 2% of a transporters RAV).

Shippers that have an approved credit rating above Ba3 are allocated a Maximum Unsecured Credit Limit in line with the table in V3.1.3a, which allocates 15% to 100% of 2% of transporter's RAV.

Similar analysis to that provided for non Investment Grade Rated Shippers has also been carried out for a small number of Shippers holding a Moody's or Standard and Poor's rating. The graph below shows that these Shippers are also provided with more credit than that recommended by the recognised independent credit agencies. However, the multiples of code credit vs the D&B recommended level are less than that for those Shippers without a credit rating.



For simplicity and equability it is suggested that all Users are provided with the maximum recommended amount of unsecured credit determined by the preferred agency. However in some cases it can be seen that this value is above the level of credit currently determined for a small transporter (based on £2bn RAV illustration). To combat this it is proposed that the level of unsecured credit also be capped at 2% of the relevant transporters RAV.

The aim would be to amend UNC TPD Section V and in particular Section V 3.1.3 and 3.1.7 to reflect this change in methodology. Although further work is required to define the revised text, a brief outline of the steps involved is as follows:

Upon a User's request for a Code Credit limit, which may comprise of an element of Unsecured Credit, the Unsecured Credit limit will be derived as follows:

i) The Transporter will inform the User of the list of recognised credit reference agencies from which it may select for the Transporter to base its assessment. Each of these will be reputable credit reference agencies that are both professionally recognised and independent from both the Transporter and the User.

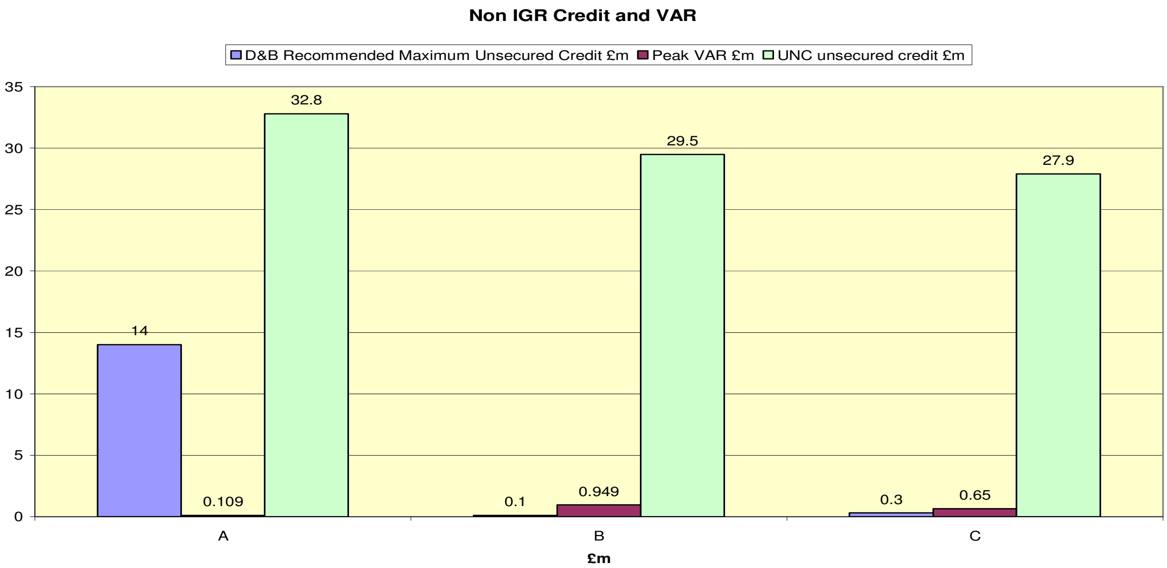
i) Once the User has nominated its preferred credit reference agency, the Transporter shall obtain a credit assessment report on the User from this agency, which will, include a maximum recommended level of credit.

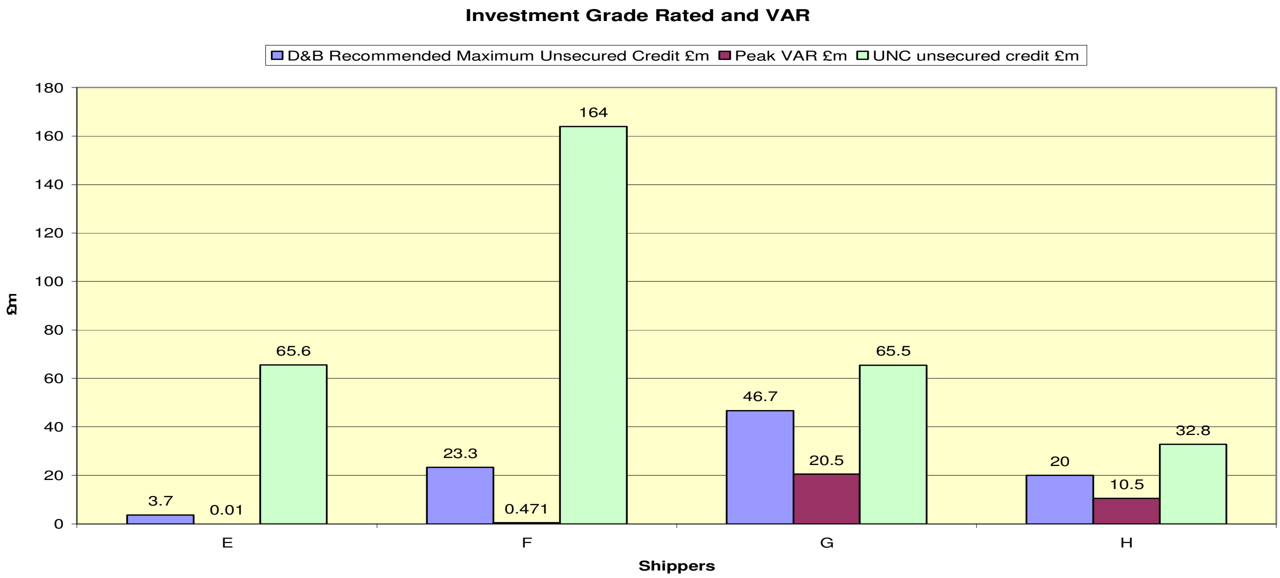
ii) The User will be allocated the <u>lower</u> of a) maximum recommended level of credit or b) 2% of the relevant transporters RAV.

iii) The user will be notified of the level of unsecured credit within 2 business days of the Transporters receipt of their nomination of a preferred agency

vi) The timings surrounding reassessments and the arrangements surrounding the payment for assessments will remain in accordance with the UNC (V3.1.8).

The graphs below show that in most cases the maximum recommended amount of unsecured credit determined by the preferred agency, is more than sufficient to cover the Shippers requirement.





Where this is not the case, the Shipper may, in accordance with V3.4.6, extend its exposure beyond its Unsecured Credit Limit by providing security or surety in the form of:
- Bi-lateral insurance
- Letter of Credit (LoC)
- Guarantee
- Deposit deed
- Prepayment Agreement

It should be noted that Shippers A, B & C used in our analysis, do not currently have access to any Unsecured Credit and rely entirely on security in the form of a LoC or Deposit deed.

Appendix 1 – Unsecured Credit Analysis

						Level of Unsecured Credit per UNC £m using the DCUSA table					UNC (DCUSA) Unsecured Credit minus Recommended £m				
User	IGR	D&B Score	Score using DCUSA Table	D&B Recommended Maximum Unsecured Credit £m	%of Transporter's RAV awarded as unsecured credit	£1bn RAV	£2bn RAV	£3bn RAV	£4bn RAV	£8bn RAV	£1bn RAV	£2bn RAV	£3bn RAV	£4bn RAV	£8bn RAV
A	-	5A1	10	14	0.400%	4.0	8.0	12.0	16.0	32.0	-10.00	-6.00	-2.00	2.00	18.00
B	-	5A3	8	0.1	0.360%	3.6	7.2	10.8	14.4	28.8	3.50	7.10	10.70	14.30	28.70
C	-	2A1	7	0.3	0.340%	3.4	6.8	10.2	13.6	27.2	3.10	6.50	9.90	13.30	26.90
D	-	3A2	7	4.2	0.340%	3.4	6.8	10.2	13.6	27.2	-0.80	2.60	6.00	9.40	23.00
E	A1	5A1	-	3.7	0.800%	8.0	16.0	24.0	32.0	64.0	4.30	12.30	20.30	28.30	60.30
F	Aa3	5A1	-	23.3	2.000%	20.0	40.0	60.0	80.0	160.0	-3.30	16.70	36.70	56.70	136.70
G	A3	5A1	-	46.7	0.800%	8.0	16.0	24.0	32.0	64.0	-38.70	-30.70	-22.70	-14.70	17.30
H	Baa1	4A1	-	20	0.400%	4.0	8.0	12.0	16.0	32.0	-16.00	-12.00	-8.00	-4.00	12.00