Review Group Report

Review Proposal 0252

Review of Network Operator Credit Arrangements

Draft Version 3.0

1. Review Proposal

Wales and West Utilities raised Review Proposal 0252, for which the Terms of Reference are on the Joint Office web site at www.gasgovernance.co.uk/0252

2. Review Process

In accordance with the Modification Rules, at its meeting on 22 May 2009, the Modification Panel determined that this Review Proposal should be referred to a Review Group for progression. This Review Group Report was subsequently compiled by the Joint Office and approved by Review Group attendees.

3. Areas Reviewed

The Review Group considered the following topics to ensure the relevant areas were reviewed and recommendations identified:

Topics identified
General review of the current credit arrangements and processes within UNC TPD Sections V3 & V4 to determine if they are still appropriate, coherent and relevant.
Unsecured Credit Risk (use of Payment History and Independent Assessments)
Letter of Credit Provider
Comparison of industry practices (gas and electricity)
Implications of changes to Energy Balancing credit arrangements
Administration charges for late payment (payable to Users)
Availability and understanding of Bi-lateral Insurance
Interaction with other industry codes
Timescales and procedures for issuing 'notifications' to Users
Impact of the implementation of Modification Proposal 0195AV ('*Introduction of Enduring NTS Exit Capacity Arrangements*' (changes to UNC TPD Section V)
Impact of other industry code modifications / work groups (including but not limited to: DCP034 ("*Credit Cover Arrangements for Small Suppliers*") and UNC Review Group 0221 ("*Review of Entry Capacity and the Appropriate Allocation of Financial Risk*")

4. Conclusions and Recommendations

The Review Group considered the topic items listed in section 3 and identified the following recommendations:

4.1 Amendment to UNC TPD Text
During the review of UNC TPD Sections V3 and V4, the Review Group

identified a number of drafting errors, inconsistencies and incorrect references within the documents. The Review Group recommends these errors should be rectified by either a "consent to modify", bespoke Modification Proposal or during the implementation of one of the other Modification Proposals raised in response to these recommendations (which needs to amend these sections). The errors are listed in a table in Appendix 1.

The Review Group considers a bespoke Modification Proposal as the most suitable method for amending the highlighted drafting errors.

4.2 Provision of Additional Credit Agencies

The Review Group considered the provision of Credit Agencies within the existing UNC and compared these provisions to other similar code arrangements and industry best practice. The Review Group recommends increasing the number of existing agencies to include Fitch in addition to the current Moody's and Standard & Poors as acceptable rating providers.

[A draft Modification Proposal has been discussed in the Review Group and is included in Appendix 2 for reference].

4.3 Exit Capacity / VAR Credit Arrangements

The Review Group included a review of the impact of the implementation of Modification Proposal 0195AV ('*Introduction of Enduring NTS Exit Capacity Arrangements*' (changes to UNC TPD Section V) within its Terms of Reference.

Options for amendment have been discussed at the Distribution and Transmission Workstreams in addition to the Review Group.

The Review Group recommends that the reference to DNOs as Users be removed from section V3.3.4. Some members also considered that references to DNOs as Users should be removed from section V3 and V4.

4.4 Introduction of a rating table for independent credit rating agencies for use with Independent Assessments

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 an Unsecured Credit Limit based on Independent Assessment for Users without a Moody's or Standard & Poors rating, or for those whose investment grade rating is below the prescribed minimum of

Standard & Poors BB- or equivalent. The UNC contains a scoring table to compare different credit agency applicant ratings.

The Review Group discussed the table currently contained within UNC and concluded that there is currently 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, as their interpretation of the Independent Assessment process may be different.

The Review Group discussed potential solutions to this issue, and having 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 which~~DCUSA, which allows a network operator to translate one of numerous credit assessment agencies' standard ratings into a 0-10 credit scoring.

The Review Group considered the benefits of adopting DCUSA provisions and also increasing the existing 3 UNC Credit Agencies to 5. It was initially thought that this would then allow the Transporter to choose 3 of the 5 agencies to obtain a credit reference on behalf of the Shipper. However, after further discussion with Ofgem and industry participants, it was concluded that as Gas Transporters only have a relationship with 3 Credit Agencies, it should not be expanded to 5. Though inline with the DCUSA, the User should get to choose the agency for their assessment.

After consideration of the initial draft strawman developed by National Grid NTS, that provided some alternative options to the draft proposal (see Appendix X for further details). A key driver/aspect behind the alternatives was the analysis performed which highlighted that the DCUSA table alone often provides much more credit than which would be recommended by the recognised independent credit agencies. In some scenarios this could result in terms which are hundreds of times more generous than the Independent Credit Agency's recommended level.

With this in mind, the Review Group members saw merit in one particular option: Independent Assessment based on DCUSA Table in conjunction with the Commercial Judgement of the Independent Credit Agency recommendation. If the DCUSA table results in a level of credit that is greater than the maximum recommended by the preferred agency, then the level of credit is to be capped at the level of credit recommended by the agency.

The Review Group considered and recommends the inclusion of specially commissioned report provisions, which should be placed in 3.2.5, to allow Transporters to request such reports. It was recommended that a table

illustrating the investment grade rating would be inserted to the UNC (A- or below (based on Standard & Poors)),]

The Review Group considers a Modification Proposal should be developed based on the recommendations above.

4.5 Review of Payment History Credit Arrangements

National Grid NTS presented a number of options to the Review Group for the provision of credit based on an applicant's payment history. In summary, these options were

Option A – UNC ASIS but clarifying current text
Option B – CUSC Variation
Option C – Alternate/Wider Payment History Options

See appendix 3 for full details.

The Review Group discussed the options as presented and the issues associated with providing credit based payment history. One concern raised was that good payment history under UNC, was not always a useful means of gauging if an applicant was fully credit worthy, as they may not be paying other creditors and this would not be visible to the gas transporters.

It was recognised that Independent Assessment was a more rounded approach and included a check of the applicants wider payment history/non UNC related payments. The initial view of the Review Group was that if Independent Assessment was enhanced (see Review Group recommendation 4.4), then the provision of credit based on payment history could be removed. However, following consideration of the views of Ofgem and some small Shippers, it has been proposed that payment history is restricted to new entrants for a maximum of 2 years and with a soft landing to take account of occasional administration errors (in line with CUSC).

4.6 Administration of Contact Details

Currently each Transporter and Shipper maintains its own register of contact details for other UNC parties for credit purposes. The Review Group concluded it would be beneficial if parties were encouraged to provide and maintain their contact details. A central coordinating agent such as xoserve could manage this.

4.7 Ofgem Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover

The Review Group compared the existing best practice document to the current UNC terms and conditions to consider if the intent of the best practice document was followed, or if amendment to the best practice document or UNC was required.

The Review Group concluded the best practice document should be considered a living document and any new initiatives to improve best

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practice in UNC should not be delayed if these were not specifically envisaged within the best practice document.

Appendix 1 – Corrections to UNC

UNC Reference	Current Text	Proposed Change	Reason
Section V 3.1.1 a)	3.1.1 For the purposes of the Code: (a) the **"Regulatory Asset Value**" is the value of the relevant Transporter's regulated assets as published from time to time by the Authority.RAV current text to be added 3.1.1.a	Redefine as only changes every 5 years under current definition	
Section V 3.1.1 (b) this should read 3.1.3 (a)	(b) An "**Approved Credit Rating**" is a published and monitored long term issuer rating, or a Specially Commissioned Rating of not less than Ba3 by Moody's Investors Service or equivalent rating by Standard and Poor's.	Delete " with an Approved Credit rating "	Action reference RG0252 0010
Section V 3.1.4	Subject to 3.1.7, where a User does not have an Approved Credit Rating, or a User's Approved Credit Rating is less than Ba3 awarded by Moody's Investment Services or an equivalent rating by Standard and Poor's Corporation, such User may obtain an Unsecured Credit Limit by:	Delete subject to 3.1.7	Action Reference RG0252 0011
Section V 3.2.4 (b)	at the User's request (but subject to paragraph 3.2);	at the User's request (but subject to paragraph 3.2.8);	Action Reference RG0252 0016
Section V 3.2.4 (d)	where any instrument of surety or security expires or is determined;	Include zero value for security 30 days prior to expiry.	Action Reference RG0252 0018
Section V	Where any of the User or any person providing surety for a User is revised	Amend paragraph to allow Transporters to request specially commissioned reports when	Action Reference RG0252 0035

3.2.5	downwards to the extent that the credit rating following such revision is less than (as provided by Standard and Poor's or such equivalent rating by Moody's Investors Service), then such User's Code Credit Limit may be immediately reviewed and revised by the Transporter in accordance with the Code, on notice to the User.	a credit rating is A- or below.	
Section V 3.2.11	Notwithstanding paragraph 3.2.10, where at any time as a direct consequence of an increase in the relevant Transporter's Transportation Charges, a User's Value at Risk is increased by over 20% from the previous day, a User will have one calendar month from the date of notice given by the relevant Transporter to provide additional surety or security and after the expiry of such date, paragraphs 3.2.10(a) and (b) shall apply.	Delete paragraph & consider replacing with a scenario of extra time when a Shipper portfolio increases significantly e.g. SOLR	Action Reference RG0252 0019
Section V 3.2.10	Where the Transporter requires the User to provide additional security, the notice given in accordance with 3.2.9 shall require that such User shall provide to the Transporter, by no later than 17.00 on the second Business Day following the date of such notice, additional surety or security in a form acceptable to the Transporter for an amount notified by the Transporter, such that when applied it will result in the Value at Risk of the User not exceeding 100% of the Users Code Credit Limit. Subject to paragraph 3.2.11 below, where a User has not provided such additional surety or security by such second Business Day then with effect from the next Business Day following such second Business Day the following shall be payable by the User:	Include reference to 3.2.5	Action Reference RG0252 0020

Section V 3.2.9	Where a User's Code Credit Limit has been revised downwards in accordance with paragraph 3.2.4(c) above, the Transporter will notify the User accordingly on the next Business Day following the occurrence of the event described in paragraph 3.2.4(c).	Should section 3.2.5 be referenced in 3.2.10.	Action Reference RG0252 0020
Section V 3.3.2 (a)	the amount of such surety or security required shall be increased to that amount required to reduce the User's Value at Risk to below 80% of its code credit limit and any surety or security provided by such User shall be deemed to be valued at 80% of its face value for the following 12 calendar months; and	Remove second 80% test.	Action Reference RG0252 0024
Section V 3.3.2	Without prejudice to paragraph V3.3.3, where a User fails to provide such additional security as required in paragraph 3.3.1 (b) by the date specified in the notice pursuant to 3.3.1(b):	Without prejudice to paragraph V3.3.3, where a User fails to provide such additional security as required in paragraph 3.3.1 (b) by the date specified in the notice pursuant to 3.3.1(b):	Action Reference RG0252 0025
Section V 3.3.2 (d)	where from the fifth Business Day after the date specified in the notice, the User's Value at Risk exceeds 100% of the User's Code Credit Limit, the Transporter shall be entitled to reject or refuse to accept a Supply Point Nomination or Supply Point Confirmation under Section G, other than a Supply Point Re-nomination or Supply Point Reconfirmation until such time as the User's Value at Risk is reduced to less than 100% of its Code Credit Limit.	Align section V3.3.2 (d) with S3.5.3 [should this be included in the main body of the report as a Modification Proposal?]	Action Reference RG0252 0026
Section V 3.4.5	**"Bi-lateral Insurance"** shall mean an policy of insurance (that is unconditional in order to attain 100% of its face value) for the benefit of the Transporter, provided by a Qualifying Company and in such form as is acceptable to	Delete definition or replace with a known industry term. If definition is amended correct typo "an policy".	Action Reference RG0252 0030 Action Reference RG0252 0031

	the Transporter; of insurance (that is unconditional in order to attain 100% of its face value) for the benefit of the Transporter, provided by a Qualifying Company and in such form as is acceptable to the Transporter;		
Section V 3.4.5	**"Enforceable"** shall mean the Transporter (acting reasonably) is satisfied that the instrument of security is legally enforceable and in this respect, where security is provided by a company registered outside of England and Wales, the country of residence of such company must have a sovereign credit rating of at least A awarded by Moody's Investors Services or such equivalent rating by Standard and Poor's Corporation (where such ratings conflict, the lower of the two ratings will be used) and the User shall at its own expense provides such legal opinion as the Transporter may reasonably require;	Amend typo "and the User shall at its own expense ~~provides~~ provide such legal opinion as the Transporter may reasonably require;"	Action Reference RG0252 0032

Other appendices to be added once discussions are concluded.

Appendix 2 –

Appendix 3 -

Appendix 4 –