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Julian Majdanski
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Dear Julian

25th June 2007

Re **UNC Modification Proposals 144, 144AV, 145, 146, 147 and 148.**

Dear Julian

0144 Quantification of Value At Risk (VAR) to determine a User's minimum Code Credit Limit Requirement. **NOT supported**

0144AV Quantification of Value At Risk (VAR) to determine a User's minimum Code Credit Limit Requirement. **QUALIFIED support**

0145 Management of Users Approaching and Exceeding Code Credit Limit. **NOT supported**

0146 Acceptable Security Tools available to Users for Transportation Credit Arrangements**. Supported**

0147 Administration of Unsecured Credit Afforded on the basis of Payment History and Independent Assessment**. Supported**

0148 Aggregation of Credit Positions or Use of Group Ratings**. Supported**

0144 Quantification of Value At Risk (VAR) to determine a User's minimum Code Credit Limit Requirement.

NGN understand that this proposal has been raised by National Grid following a further assessment of the requirements set out in Ofgem's Best Practice guidelines. We do not believe this proposal better facilitates the relevant objectives of the licence and would make the following observations which we believe provide overwhelming reasons as to why this proposal should not be implemented.

Proposal 0144 uses current outstanding invoices and a 15 day proxy for usage to calculate the minimum code Credit limit (CCL) requirement. This amount changes on

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a daily basis and the secured CCL would therefore need to be a negotiated amount between user and transporter.

Users will be able to request frequent revisions to their secured CCL as a result of this changing VAR calculation, creating the risk of significant extra workload and cost to transporters.

By having a daily sensitive calculation, the negotiation process would mean that it would be difficult for transporters to ensure that a fully consistent approach is taken in agreeing suitable limits. Under the current methodology, the peak trading is used to generate a calculated requirement which can be easily verified and agreed by both parties without the need for extensive discussion.

Under the methodology proposed within 0144, users will have the right to seek their VAR being based on a day when it equates to **zero**, even though they will of course have accrued over a month of debit charges (unbilled). Such a rule is wholly inappropriate and directly exposes the community to an inappropriate level of risk in terms of bad debt.

Furthermore, this approach of using only actual invoiced amounts is inconsistent with calculation of security requirements for energy balancing, which uses accrued amounts to determine security requirements.

The calculation is also sensitive to significant one off charges or adjustments, (e.g. significant reconciliations) which have the consequence of further distorting VAR levels away from readily understood and appropriate calculations based on normal trading patterns.

<u>144AV Quantification of Value At Risk (VAR) to determine a User's minimum Code Credit Limit Requirement.</u>

This proposal was raised solely to mitigate some of the features within proposal 0144, and uses current outstanding invoices and a 20 day proxy for usage based on the prior months issued invoices to calculate the minimum CCL requirement. The amount would change on a daily basis as various invoices were issued and paid, but the constant of 20 days of the prior month remains constant throughout. As transportation charges are invoiced one month in arrears this would be a proxy calculation on usage two months prior.

As with modification 144, the actual secured CCL would need to be an amount negotiated between user and transporter that would provide a suitable level of security to the transporter exceeding the above calculation, and would ensure that the user does not breach the utilisation rules. When combined with modification 0145, the VAR/minimum CCL will be when the peak of invoices is outstanding although this reduces as various invoices are settled throughout the month.

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Users will still be able to request frequent revisions to their secured CCL as a result of the changing VAR calculation, creating significant extra workload and cost to transporters.

This calculation is less volatile than proposal 0144 as it cannot calculate a minimum that would be negative or unreasonably low, but still calculates a minimum limit that may leave the transporter significantly exposed.

As a result of the exposure generated this modification would also result in the requirement for transporters and users to agree secured CCLs by negotiation and this again would make it difficult to ensure that a fully consistent approach is taken in agreeing the security requirements of users. The individual negotiations required under this calculation methodology would mean that both users and transporters would need to dedicate a significantly increased amount of time in agreeing suitable credit limits. Under the current methodology, peak trading is used to generate a calculated requirement which can be easily verified and agreed by both parties without the need for extensive discussion.

Again, this approach of only using invoiced amounts is inconsistent with calculation of security requirements for energy balancing, which uses accrued amounts to set security requirements.

<u>145 – Management of Users Approaching and Exceeding Code Credit Limit</u>

This modification removes the current ability of transporters to effectively manage users approaching their CCL. Under current Code Credit Rules, transporters issue a notification to a user when their utilisation reaches 70% of their CCL. At this point no cash calls are made and no sanctions can be applied. On reaching 85% utilisation of their CCL a cash call is issued, and failure to respond to this appropriately enables the transporter to apply sanctions. While this does not prevent the user exceeding 100% utilisation, it is an effective deterrent for users.

Under modification 145 the transporter will not issue the notification of the user reaching a high level of utilisation until the user's VAR is at 80% of their CCL. Sanctions and cash calls cannot be made until the user's VAR reaches 100% of the CCL.

It is important to look at the definition of VAR in this modification. If VAR is taken to be defined and calculate in the same way as under modification proposal 144, then users who do not provide security at least 20% above the VAR will always reach the 80% trigger when the peak value of invoices is outstanding. A CCL at the VAR will generate utilisation of 100% by the nature of the calculation process.

As the VAR calculation under this methodology does not include charges accrued but not yet invoiced, the real exposure and risk of bad debt to the transporter will always be in excess of 100%. An analysis was carried out using a real shipper

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invoices accrued usage and this generated real risk of between **95%** utilisation up to over **5000%** utilisation.

In the modification proposal there is a requirement for users reaching 100% VAR/CCL to post additional security within 2 business days. In addition to this the provision for material changes to utilisation as a result of increased transporters charges provides one months notice. As transporters prices are published two months in advance of their change, there is ample opportunity for CCLs to be adjusted in advance of the change. Furthermore, under this methodology as the calculation is based on invoiced rather than accrued amounts, there would be a further month to make the required changes as transportation charges are invoiced one month in arrears.

146 Acceptable Security Tools available to Users for Transportation Credit Arrangements

The inclusion of acceptable security tools within the UNC recognises the existing situation whereby Transporters utilise a range of tools (inc those defined in the proposal). As such NGN support this UNC proposal.

Attached is a detailed assessment of a typical users actual credit position for two previous months in 2007 which illustrate the range of exposure that transporters (and the industry) maybe exposed to under the proposals ***(Ofgem confidential)***

Yours sincerely

Robert Cameron-Higgs
Network Code Manager