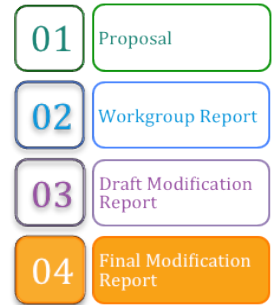


Stage 04: Final Modification Report

0375:

Changes to how Unsecured Credit Limits are determined within UNC TPD Section V 3.1.7 (Independent Assessments)

What stage is this document in the process?



TPD Section V 3.1.7 currently allows Transporters to set a User's Unsecured Credit Limit no higher than the lower of the credit value recommended within a User's Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit. The original modification proposal 0375 suggested the removal of the "lesser of rule" allowing Users to choose from the two values. This revised Modification proposes that only the credit value within the Independent Assessment can be used.



Panel recommended implementation



Low Impact:
Users without approved credit ratings, Transporters

0375

Final Modification Report

19 January 2012

Version 2.0

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About this document:

This document is a Final Modification Report, presented to the Panel on 19 January 2011.

The Authority will consider the Panel's Recommendation and decide whether or not this change should be made.

1 Summary

Is this a Self-Governance Modification?

The Modification Panel determined that this is not a self-governance modification.

Why Change?

First Utility (FUT) (as the original Proposer of 0375) highlighted that there is a materially significant gap between the Unsecured Credit Limit that could be achieved based on the value calculated by applying an Independent Assessment Score to a Transporters' Maximum Unsecured Credit Limit in line with the table contained in UNC TPD V 3.1.7 and the Unsecured Credit Limit that would result from the Transporter using the credit value recommended within an Independent Assessment. FUT believed that this undermines the intended purpose of the implementation of UNC Modification 0304 and unfairly discriminates against Users without an approved credit rating.

Following Workgroup discussions and the subsequent decision by FUT to withdraw modification proposal 0375, Wales & West Utilities (WWU) have adopted the proposal in order to utilise the output from the analysis that has been carried out within Workgroup 0375. WWU believe that, due to the "lesser of rule" within UNC TPD V 3.1.7, the application of the Independent Assessment Score to determine a User's Unsecured Credit Limit is highly unlikely to happen. The use of the Independent Assessments was introduced into the UNC following the Ofgem review of credit arrangements that concluded in 2005¹. The review covered both electricity and gas network operators (DNOs and GTs) and Workgroup 0375 identified that, due to the number and comparatively similar size of electricity Distribution Network Operators (DNOs), applying the Independent Assessment Scores to a network's Maximum Unsecured Credit Limit may be more applicable in the electricity industry.

Solution

The original modification proposal proposed removing the requirement for Transporters to use the lowest value resulting from the two methods of calculation described above. Instead, a User would be able to choose which of the two values each Transporter would use to set that User's Unsecured Credit Limit following its assessment under the process laid out in UNC TPD Section V 3.1.7.

This revised WWU solution proposes to remove the use of the Independent Assessment Score from UNC TPD Section V 3.1.7 and for the Unsecured Credit Limit to be based solely on the credit value contained within the Independent Assessment.

¹ Ofgem's Best practice guidelines for gas and electricity network operator credit cover - Conclusions document

<http://www.ofgem.gov.uk/Licensing/IndCodes/CreditCover/Documents1/9791-5805.pdf>

Impacts & Costs

It is not believed that implementation of this Modification will increase risk to the market and there are no costs associated with implementation. All Users, in relation to WWU's network currently, that have obtained an Independent Assessment, have secured a sufficient Unsecured Credit Limit based solely on the credit value within the Independent Assessment.

Implementation

Implementation could take place as soon as a direction to implement is received from the Authority.

The Case for Change

Implementation of this Modification will remove the ability for Users to obtain an Unsecured Credit Limit based upon the rating within an Independent Assessment being used to calculate a score to define the percentage of Transporter's Maximum Unsecured Credit Limit (% of RAV) detailed within the table in UNC TPD Section V 3.1.7. In reality, the "lesser of rule" within TPD V3.1.7 is a futile process as the credit value stated within Independent Assessments will almost always be the lower of the two values. By removing this from the UNC it will provide clarity on how an Independent Assessment will determine a User's Unsecured Credit Limit and remove a credit 'tool' that will never be used.

2 Why Change?

FUT believed that the current ability of the Transporters to set a User's Unsecured Credit Limit no higher than the lower of the credit value recommended within a User's Independent Assessment and the value calculated by applying the Independent Assessment Score to the Transporter's Maximum Unsecured Credit Limit potentially has a negative impact on competition. This was due to the fact that the difference between these two figures can potentially be significant and this forces Users without an approved credit rating into posting larger levels of cash to cover credit requirements than they might need to even though they have followed the Independent Assessment Process required in UNC TPD Section V 3.1.7 and introduced as a result of the implementation of UNC Modification 0304.

The original modification proposal suggested the removal of the "lesser of rule" and would require Transporters to allow Users to choose which of the two values deriving from the process within UNC TPD V 3.1.7 is used by each Transporter to determine that User's Unsecured Credit Limit. This was on the basis that it would assist competition by allowing Users without an approved credit rating to free up working capital, which can then be used to grow their businesses.

Following the decision by FUT to withdraw modification proposal 0375, WWU have adopted the proposal in order to utilise the output from the analysis that has been carried out within Workgroup 0375. WWU believe that, due to the "lesser of rule" within UNC TPD V 3.1.7, the application of the Independent Assessment Score to determine a User's Unsecured Credit Limit is highly unlikely to happen. The use of the Independent Assessment Score was introduced into the UNC following the Ofgem review of credit arrangements that concluded back in 2005². The review covered both electricity and gas network operators (DNOs and GTs) and, due to the number and comparatively similar size of DNOs, applying the Independent Assessment Scores to a network's Maximum Unsecured Credit Limit may be more applicable in the electricity industry.

Analysis provided

Within WWU's Initial Representation on 20 May 2011 they included a table showing the results from Independent Assessments pertaining to Users of its network³. The table shows that, for 5 Users on the WWU network, the credit value within the Independent Assessments was always lower than the value obtained by using the table within UNC TPD Section V 3.1.7. It also demonstrated how removing the "lesser of rule" would

² Ofgem's Best practice guidelines for gas and electricity network operator credit cover - Conclusions document

<http://www.ofgem.gov.uk/Licensing/IndCodes/CreditCover/Documents1/9791-5805.pdf>

³ <http://www.gasgovernance.co.uk/sites/default/files/Initial%20Representation%20-%20Wales%20&%20West%20Utilities%200375%20v1%201.pdf>

result in almost a 3,000% increase in the amount of unsecured credit for the 5 Users when applied to all GTs.

The analysis above supports the information that NG NTS provided as part of the work carried out within UNC Review Group 0252 back in October 2009⁴.

Northern Gas Networks (NGN) provided analysis at Workgroup 0375 showing how the application of the table within UNC TPD V 3.1.7 would apply to electricity Distribution Network Operators (DNOs)⁵. As the RAVs for DNOs are far more proportional to each other there is a much greater likelihood of the Independent Assessment Score being used to produce a "lesser of" value.

It was generally accepted by Workgroup 0375 members that removing the "lesser of rule" could lead to inappropriate Unsecured Credit Limits. An alternative solution put forward was to still remove the "lesser of rule" but also to reduce the percentages within the TPD V 3.1.7 table to see if this would lead to more appropriate levels of Unsecured Credit Limits being issued. In order to assess this WWU provided some analysis and the ability to scale the percentages within the table⁶. Due to the range of credit values within the Independent Assessments, and the range of GT RAVs, it was not possible to determine a justifiable scaled percentage and this option was discounted.

⁴<http://www.gasgovernance.co.uk/sites/default/files/15%20October%202009%20Unsecured%20Credit%20Limits%20Strawman.pdf>

⁵ <http://www.gasgovernance.co.uk/0375/300611>

⁶<http://www.gasgovernance.co.uk/sites/default/files/Mod%200375%20IA%20scaled%20examples%20v1%200.xls>

3 Solution

The proposed solution is to remove the table within UNC TPD Section V 3.1.7 and only utilise the credit value within an Independent Assessment to determine a User's Unsecured Credit Limit. WWU's believe this is an appropriate method of determining a User's Unsecured Credit Limit as the credit value within an Independent Assessment is set by a professional third party credit agency that have taken into account the User's business profile and credit worthiness.

This solution would not increase a User's Unsecured Credit Limit from that currently applicable, however, through discussions at the Workgroup it has been established that it may be possible for Users to obtain an increase in the credit value within an Independent Assessment. Independent Assessment Agencies offer different levels of service to Users and it has been shown that it is often advantageous for Users to opt for a service that allows for the Independent Assessment Agency to understand more about their business. WWU have seen a number of Users obtain more than one Independent Assessment (sometimes from the same Independent Assessment Agency) that has led to an increase in the credit value contained within the Independent Assessment.

The revisions to UNC TPD V 3.1.7 text include additional changes to clarify that a Guarantee is required from the Parent Company in order for their Independent Assessment to be used to establish the User's Unsecured Credit Limit (as introduced through implementation of modification proposal 0360).

One User questioned whether the use of a Level 4 Graydon's report should be added to the table within UNC TPD 3.1.7. Following further investigation from the Transporters it was determined that the process of obtaining a Level 4 report could lead to a Level 3 report being produced based on the information within the Level 4 report. The proposed solution will remove the table within UNC TPD Section V 3.1.7 and create a new defined term for Independent Assessment Agency. The agencies in the table will fall within this definition but no specific reports will be referenced (i.e. a Level 4 Graydon's report could be utilised).

The provisions for an annual review detailed in UNC TPD 3.1.8 have also been amended to clarify that reviews may be carried out more frequently at the Transporter's discretion. As per the existing arrangements, any more frequent review carried out by the Transporter would not be chargeable to the User.

4 Relevant Objectives

Implementation will better facilitate the achievement of **Relevant Objective f.**

The benefits against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	n/a
b) 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.	n/a
c) Efficient discharge of the licensee's obligations.	n/a
d) 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.	n/a
e) 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.	n/a
f) Promotion of efficiency in the implementation and administration of the Code	Yes
g) compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators	n/a

Achievement of relevant objective f "Promotion of efficiency in the implementation and administration of the Code"

Implementation of this modification proposal would give clarity to how an Independent Assessment would result in the determination of a Users Unsecured Credit Limit. This would be achieved by removing a complicated process from the UNC that is not appropriate and has never been utilised to determine a User's Unsecured Credit Limit.

5 Impacts and Costs

Consideration of Wider Industry Impacts

Implementation of this modification is unlikely to have an impact on the wider industry.

Costs

It is not believed that any costs will result from implementation as no operational changes would result from this. There would be minor administrative cost reductions for Transporters, and possibly Users, by removing the need to calculate Unsecured Credit Limits based on Independent Assessment ratings (which are never used as they fail to meet the 'lesser of' requirement).

Indicative industry costs – User Pays	
Classification of the Proposal as User Pays or not and justification for classification	
This is not a User Pays proposal as it does not create any User Pays Services / Charges.	
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification	
N/A	
Proposed charge(s) for application of Users Pays charges to Shippers	
N/A	
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve	
N/A	

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	<ul style="list-style-type: none">• None
Operational Processes	<ul style="list-style-type: none">• None
User Pays implications	<ul style="list-style-type: none">• None

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	<ul style="list-style-type: none"> Potential minor impacts
Development, capital and operating costs	<ul style="list-style-type: none"> None
Contractual risks	<ul style="list-style-type: none"> None
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none"> None

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	<ul style="list-style-type: none"> None
Development, capital and operating costs	<ul style="list-style-type: none"> None
Recovery of costs	<ul style="list-style-type: none"> None
Price regulation	<ul style="list-style-type: none"> None
Contractual risks	<ul style="list-style-type: none"> None
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none"> None
Standards of service	<ul style="list-style-type: none"> None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	<ul style="list-style-type: none"> None
UNC Committees	<ul style="list-style-type: none"> None
General administration	<ul style="list-style-type: none"> Simplification of credit rules

Impact on Code	
Code section	Potential impact
UNC TPD Section V	Modification as laid out above

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	<ul style="list-style-type: none"> None

Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification **0565 Transco Proposal for Revision of Network Code Standards of Service** at the following location:
<http://www.gasgovernance.co.uk/sites/default/files/0565.zip>

Impact on UNC Related Documents and Other Referenced Documents	
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	<ul style="list-style-type: none"> • None
Storage Connection Agreement (TPD R1.3.1)	<ul style="list-style-type: none"> • None
UK Link Manual (TPD U1.4)	<ul style="list-style-type: none"> • None
Network Code Operations Reporting Manual (TPD V12)	<ul style="list-style-type: none"> • None
Network Code Validation Rules (TPD V12)	<ul style="list-style-type: none"> • None
ECQ Methodology (TPD V12)	<ul style="list-style-type: none"> • None
Measurement Error Notification Guidelines (TPD V12)	<ul style="list-style-type: none"> • None
Energy Balancing Credit Rules (TPD X2.1)	<ul style="list-style-type: none"> • None
Uniform Network Code Standards of Service (Various)	<ul style="list-style-type: none"> • None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	<ul style="list-style-type: none"> • None
Gas Transporter Licence	<ul style="list-style-type: none"> • None

Other Impacts	
Item impacted	Potential impact
Security of Supply	<ul style="list-style-type: none"> • None
Operation of the Total System	<ul style="list-style-type: none"> • None
Industry fragmentation	<ul style="list-style-type: none"> • None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	<ul style="list-style-type: none"> • None

6 Implementation

It is noted that the Workgroup did not provide a timescale for implementation of this modification (as referred to in 6.2.1 of the Modification Rules) as it is not required for the purposes of enabling the Authority or any persons, including but not limited to Users, Transporters, Third Party Participants and Non Code Parties to be aware of the potential benefits or constraints associated with such timing.

Whilst National Grid NTS did not believe this modification would impact on existing Users, it was of the opinion that it would be beneficial to implement the modification on the 1st of the month following its approval.

7 The Case for Change

Nothing in addition to that identified above.

8 Legal Text

Suggested Text provided by Wales & West Utilities

UNC TPD Section V (changed marked)

Amend paragraph 3.1.1 as follows:

3.1.1 For the purposes of Code:

...

- e) An **"Independent Assessment Agency"** can issue an Independent Assessment and is confined to Dunn & Bradstreet, Experian and Graydon and any of their subsidiaries.

Amend paragraph 3.1.7 as follows:

3.1.7 Where a User or Parent Company does not have an Approved Credit Rating or where such User or Parent Company has an Approved Credit Rating less than that in 3.1.3(a), then upon request from such User, the User may select any one of the Independent Assessment Agency~~specified agencies~~ for the Transporter to use to allocate an Unsecured Credit Limit to the User based upon the Independent Assessment Score ~~of the User or Parent Company as follows:~~

- a) ~~the User; or where such User or Parent Company 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) the Parent Company subject to providing surety by way of a Guarantee. ~~where such User or Parent Company has an Approved Credit Rating less than that in 3.1.3(a) (up to a maximum of 13¼% of the relevant Transporter's Maximum Unsecured Credit Limit).~~

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

Remove table from 3.1.7

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 Comprehensive Report	Experian Bronze, Silver or Gold Report	Graydons 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 ^{1/3}
3	A3/B2/C1	30-39	6C/7B/8A	10
2	B3/C2/D1	20-29	8B	6 ^{2/3}
1	C3/D2/E1	10-19	8C	3 ^{1/3}
0	Below E1	Below 10	Below 8C	0

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

3.1.8 Any Unsecured Credit Limit allocated in accordance with paragraph 3.1.7 shall be reviewed annually or more frequently at the Transporter's discretion. Where any costs are incurred by the Transporter in providing an Unsecured Credit Limit in accordance with paragraph 3.1.7, including any annual reviews, the User shall pay to the Transporter 20% of such costs incurred. All reassessments in addition to those mentioned above shall be paid for by the party requesting them.

UNC TPD Section V (clean)

Amended paragraph 3.1.1:

3.1.1 For the purposes of Code:

...

- e) An "**Independent Assessment Agency**" can issue an Independent Assessment and is confined to Dunn & Bradstreet, Experian and Graydon and any of their subsidiaries.

Amended paragraph 3.1.7:

3.1.7 Where a User or Parent Company does not have an Approved Credit Rating or where such User or Parent Company has an Approved Credit Rating less than that in 3.1.3(a), then upon request from such User, the User may select any Independent Assessment Agency for the Transporter to use to allocate an Unsecured Credit Limit to the User based upon the Independent Assessment of;

- a) the User; or
- b) the Parent Company subject to providing surety by way of a Guarantee.

The Transporter will set the Users Unsecured Credit Limit as the credit value recommended within the relevant Independent Assessment.

3.1.8 Any Unsecured Credit Limit allocated in accordance with paragraph 3.1.7 shall be reviewed annually or more frequently at the Transporter's discretion. Where any costs are incurred by the Transporter in providing an Unsecured Credit Limit in accordance with paragraph 3.1.7, including any annual reviews, the User shall pay to the Transporter 20% of such costs incurred. All reassessments in addition to those mentioned above shall be paid for by the party requesting them.

9 Consultation Responses

Representations were received from the following parties:

Respondent	
Company/Organisation Name	Support Implementation or not?
Frist Utility	Support
National Grid Distribution	Support
National Grid NTS	Support
Scotia Gas Networks	Support
Wales & West Utilities	Support

Of the 5 representations received implementation was unanimously supported.

Summary Comments

First Utility considers that it is appropriate to remove the current uncertainty and confusion around this issue by amending UNC TPD Sections V 3.1.1, V 3.1.7 and V 3.1.8. This will ensure that the Unsecured Credit Limit for those Users who do not have an approved credit rating is based solely on the value contained within their Independent Assessment(s) issued by one or more of the three appropriate Independent Assessment Agencies. They welcome the clarification that other types of Independent Assessment (such as a Level 4 Graydon's report) will now be deemed acceptable and felt that this approach will have an attendant benefit in relation to ensuring competition. First Utility note that the Proposer suggests amending UNC TPD Section V 3.1.8 to give DNOs the power to review Unsecured Credit Limits for Users without an approved credit rating at the respective DNO's discretion rather than simply annually but consider that this is appropriate in respect of ensuring that other Users are not exposed to unacceptable levels of risk.

National Grid Distribution supports the intention of the modification and welcome the opportunity taken by the Proposer to utilise analysis carried out in the original Workgroup 0375 to inform development. Information produced pertaining the electricity market has also proven helpful. This has enabled an optimal solution to be identified as set out within the modification.

National Grid Distribution notes that the provisions for an annual review detailed in UNC TPD 3.1.8 have also been amended to clarify that reviews may be carried out more frequently at the Transporter's discretion. As is the case with the existing arrangements, any more frequent review carried out by the Transporter would not be chargeable to the User and National Grid Distribution supports this enhancement to the modification.

National Grid NTS supports this modification as they agree that exclusively using the credit value determined by the Independent Assessment "is an appropriate method of determining a User's Unsecured Credit Limit as the credit value within an Independent Assessment is set by a professional third party credit agency that have taken into

account the User's business profile and credit worthiness."

Scotia Gas Networks agrees with the proposer that the current arrangement for assigning a credit rating for shippers as introduced by UNC Modification 0304 have resulted in the rating determined by the Independent Assessment rarely being used for smaller shippers. Scotia Gas Networks agrees that removing the "lesser of rule" and utilising the Independent Assessment value represents an appropriate method of credit rating determination.

Wales & West Utilities consider the removal of the use of an Independent Assessment Score with the link to the Transporter's Maximum Unsecured Credit Limit will mean that a User's Unsecured Credit Limit, when using an Independent Assessment, will be based solely on the credit value recommended in the report. In practice, the credit value is consistently the lower value and, in their opinion, is the appropriate value to be used to set a User's Unsecured Credit Limit. Therefore, this modification will simplify this process without any detrimental impact to Users.

10 Panel Discussions

The Panel Chair summarised that there is a gap between the Unsecured Credit Limit based on the value calculated by applying an Independent Assessment Score to a Transporters' Maximum Unsecured Credit Limit and the Unsecured Credit Limit that would result from using the credit value recommended within an Independent Assessment. The modification proposes to remove the use of the Independent Assessment Score and for the Unsecured Credit Limit to be based solely on the credit value contained within the Independent Assessment.

Members recognised that implementation of this modification would give clarity to how an Independent Assessment would result in the determination of a Users Unsecured Credit Limit. This would be achieved by removing a complicated process from the UNC that is not appropriate and has never been utilised to determine a User's Unsecured Credit Limit. Removing the double test would be expected to produce an appropriate level of credit for an affected User. Removal of a complex process that has never been used and which potentially acts against the intention within the UNC would be consistent with facilitating efficient administration and implementation of the UNC. In addition, by ensuring Users have access to an appropriate credit limit, implementation could help to secure effective competition by allowing all parties to face appropriate costs and for other Users to be suitably protected from default.

Members voted unanimously in favour of implementation. Therefore the Panel determined to recommend that Modification 0375 should be implemented.

11 Recommendations

Panel Recommendation

Having considered Modification Report 0375, the Panel recommends:

- that proposed Modification 0375 should be made.