

Modification Report
RG0252 Proposal 1 - Amend and remove UNC TPD Section V3 text inconsistencies, errors and bi-lateral insurance clause
Modification Reference Number 0298
Version 3.0

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

WWU raised Review Group 0252 “Review of Network Operator Credit Arrangements” in April 2009. This was convened to discuss the appropriateness of the existing credit management arrangements, taking into account the many credit related issues which had occurred since the publication of Ofgems “Best practice guidelines for gas and electricity network operator credit cover” (BPG) document.

This specific proposal resolves a number of anomalies in UNC TPD Section V which do not clearly provide the required credit position for Users or Transporters. There are also a small number of typographical errors being corrected together with the removal of a redundant clause (bi-lateral insurance).

Typographical errors aside there are three main elements to this proposal

- I. Removing a misinterpretation of BPG 4.7 which states “Where a counterparty experiences a material change in its level of trade, a reassessment of required credit cover may be necessary. Where this has occurred as a result of an improved charge forecast by the NWO, counterparties should have one month’s notice of any need to increase collateral”.

Currently, the UNC interprets this to mean that an additional 30 days be allowed (for a User to arrange credit facilities) following a change which must be a minimum 20% increase **and** be linked to an increase in Transportation charges.

This UNC Modification Proposal seeks to exchange the 20% to a material test (allowing a discussion between Transporters and Users in any specific instance), together with the reason being altered from a price change (which could be anticipated) to an event which could not be anticipated (e.g. an imposed portfolio increase due to industry change).

- II. Removal of bi-lateral insurance term from UNC. Despite being a defined term, no Transporter or User has been able to establish what form this would take should it be sought as a form of surety or security. In the absence any identified provider of this product, it is appropriate to remove the term so as to avoid confusion. It is unhelpful for the UNC to provide a form of surety or security that no party can offer.

Removal of 80% value of Surety or Security clause in UNC V3.3.2 (a). There was concern in the RG0252 as to enforceability of this clause, coupled with confusion as to its intent which could not be adequately linked to the BPG. In light of these views, it is deemed appropriate to remove the clause so as to avoid confusion and potential inconsistency within the UNC.

Suggested Text

V 3.1.4 ~~Subject to paragraph 3.1.7,~~ Where a User

V 3.2.4 A User's Code Credit Limit may from time to time be reviewed and revised, in accordance with the Code, save where either paragraphs 3.2.5, ~~or~~ 3.2.6 or 3.2.8 applies

V3.2.9 Where a Users Code Credit Limit has been revised downwards in accordance with paragraph 3.2.4 (c) or 3.2.5 above,

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~~

Notwithstanding paragraph 3.2.10, where at any time as a direct consequence of an unanticipated increase in a Users registered aggregate **Supply Point Capacity**, a User's Value at Risk increases materially, 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, or paragraphs 3.2.10(a) and (b) shall apply.

V3.3.2 Without prejudice to paragraph ~~V~~3.3.3

~~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~~

3.4.5 For the purposes of Code:

"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 the Transporter;~~

3.4.6 A User may extend its exposure beyond its Unsecured Credit Limit by providing surety or security in one or more of the forms set out below:

(a) ~~Bi-lateral insurance; and/or~~

- (b) (a) Letter of Credit: and/or
- (c) (b) Guarantee; and/or
- (d) (c) Deposit Deed; and/or
- (e) (d) Prepayment Agreement;

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

This Proposal is not classified as a User Pays Modification Proposal as it does not create or amend any User Pays Services.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

3 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 subparagraph (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 subparagraphs (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 subparagraphs (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;

Competition between shippers will be more effective, because the proposed changes more clearly allow for the adoption of appropriate credit terms should a User not operate its credit position in the required manner. Similarly, competition will be more effective as any User whose portfolio increases materially in an unanticipated manner, will be given an appropriate time period to alter its credit limit position without any sanctions being applied.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the 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;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

Removing a redundant clause (bi-lateral insurance) will promote efficiency since no party will waste time considering a credit instrument that is unavailable.

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

No such implication has been identified.

b) Development and capital cost and operating cost implications:

No such implication has been identified.

c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

Not applicable.

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

Not applicable.

6 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

The contractual risk of Transporters is unaltered by this proposal, however given that it removes a credit term that in theory should be available to consider, it can be argued the proposal lessens the Transporters' risk.

7 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 implications have been identified.

8 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)

No implications have been identified.

Development and capital cost and operating cost implications

To be advised by Users.

Consequence for the level of contractual risk of Users

Contractual risk of Users is improved by this proposal as it provides sufficient time for a User to increase its credit limit should its portfolio grow due to an unanticipated event.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No implications have been identified.

10 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

No consequences have been identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- removes redundant clause from credit terms (bi-lateral insurance)
- corrects incorrect and incomplete referencing in TPD Section V
- better defines a scenario under which increased security is required and in what timeframe.

Disadvantages

No disadvantages have been identified.

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Organisation	Response
British Gas Trading	Qualified Support
E.ON UK	Supports
First:utility	Supports
National Grid Distribution	Qualified Support
National Grid NTS	Supports
Northern Gas Networks	Supports
RWE npower	Comments Offered
Scotia Gas Networks	Supports
ScottishPower	Supports
SSE	Comments Offered
Wales & West Utilities	Supports

In summary, of the 11 responses received, 7 supported implementation, 2 offered qualified support, and 2 offered comments.

E.ON UK, First:Utility, Northern Gas Networks, ScottishPower and SSE consider that the Proposal clarifies a number of drafting anomalies in UNC TPD

Section V, which do not clearly provide the required credit position for Users or Transporters.

National Grid Distribution has concerns in respect of the Code Credit Limit requirements proposed as a consequence of a material change in a User's trading level. To trigger these requirements, it is proposed to exchange the current quantitative test for an undefined "material increase" test. In their view this would appear to create the risk of inconsistent interpretation of this term between respective DNOs and Users.

RWE npower, in response to the first element of the Modification Proposal which seeks to remove a misinterpretation within the UNC of Ofgem's Best Practice Guidelines (BPG) 4.7, seeks further clarification in respect of the "User's Value at Risk increases materially" used within the suggested legal text, which it is proposed will replace the "User's Value at Risk is increased by over 20%". The use of "materially" in this statement would leave the UNC open to interpretation, and the "material increase" would be very much in control of the network operators who could apply different figures around what they believe to constitute a "material increase". The circumstances surrounding "material increase" should be stated explicitly within the Legal Text to avoid any discrepancies in interpretation between counterparties.

British Gas Trading (BGT) considers there is uncertainty as to whether this Proposal seeks to remove the ability of a User to utilise a Performance Bond issued by an insurance company. In some instances, these can be cheaper than a Letter of Credit and if it is the case that this Proposal removes this product, BGT believe this should be made explicit in the Modification Proposal.

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

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 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

Implementation is not 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.

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

No programme of works would be required as a consequence of implementing the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary

information systems changes and detailing any potentially retrospective impacts)

It is suggested that this Proposal be implemented on 01 October 2010 to coincide with the implementation of the other credit proposals being considered in this timeframe. Should this date not be achievable, then implementation could take place immediately following an Authority direction.

17 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.

18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 19 August 2010, the Panel determined UNANIMOUSLY to recommend implementation of the Proposal.

The Panel Chair noted that eleven representations had been received, of which seven supported implementation, two offered qualified support, and two offered comments. He suggested that clear and effective credit requirements within the UNC provide protection and reassurance for all parties, helping to prevent bad debt escalating to inappropriate levels. Requiring credit provision also provides an appropriate barrier to entry. Hence including appropriate credit arrangements within the UNC is consistent with facilitating effective competition between Shippers. Consequently reviewing and improving the arrangements where appropriate is also consistent with facilitating effective competition.

The Panel Chair summarised that Proposal 0298 seeks to clarify the credit provisions by addressing some inconsistencies and errors. This included deleting references to bilateral insurance, a potential product that may create confusion since no provider had been identified and there is no clear understanding of what the product would involve. However, there was a concern that the proposed changes may themselves introduce uncertainty by introducing a materiality test without a defined threshold. Introducing uncertainty into the market does not facilitate competition, and hence it could be argued that this aspect does not facilitate the Code Relevant Objectives.

Members supported this summary.

19 Transporter's Proposal

This Modification Report contains the Transporters' proposal to modify the Code and the Transporters now seek direction from the Gas and Electricity Markets Authority in accordance with this report.

20 Text

UNIFORM NETWORK CODE
TRANSPORTATION PRINCIPAL DOCUMENT
SECTION V – GENERAL

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- (e) (b) Guarantee; and/or
- (e) (c) Deposit Deed; and/or
- (e) (d) Prepayment Agreement;

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters