

**Modification Report**  
**RG0252 Proposal 3: Introduction of Fitch as an allowable Credit Rating Agency for the purposes of Code Credit Arrangements**  
**Modification Reference Number 0300**  
**Version 5.0**

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**

### **Background**

Review Group 0252 was raised by Wales and West Utilities in April 2009 seeking to review the existing credit arrangements contained within UNC TPD Section V and ensure that these remain fit for purpose and robust. The review group covered a wide range of credit related topics and produced a set of recommendations which included allowing Investment Grade Ratings provided by Fitch in addition to those provided by Standard and Poor's (S&P) and Moodys Investment Services to be acceptable for obtaining an unsecured Code Credit Limit.

There are three main Credit Rating Agencies, Standard and Poor's, Moodys Investment Service and Fitch Ratings, all of which are widely used in banking, investments and securities in addition to credit monitoring. The credit ratings issued by these three agencies are often compared and are broadly considered to be equivalent to each other for the purposes of monitoring credit worthiness and long term outlook of an organisation. The use of credit rating agencies is considered to provide an independent point of view to verify the creditworthiness of organisations, although it should be noted that these are opinions of the agency and not an assurance.

As part of the Gas Transporter Licence Standard Special Condition A38 Ofgem requires that the licensee maintains an appropriate investment grade issuer credit rating which can be issued by S&P, Moodys or Fitch. It should be further noted that within the electricity regime the Connection and Use of System Code (CUSC) all three credit rating agencies are acceptable for the provision of Investment Grade Ratings for the purposes of obtaining an unsecured credit limit.

### **The Proposal**

This modification proposal seeks to introduce Fitch Ratings as an allowable credit rating agency for the purposes of obtaining an unsecured Code Credit Limit.

As there are 10 separate references within UNC TPD section V3 it is proposed that this change will introduce a new defined term, Credit Rating Agency (CRA), which can be used in place of each of the 10 current references. This will further make any future changes to the acceptable CRAs more straightforward to change and thereby make consequential improvement to the Administration of the code.

In order to provide additional clarity, the proposal will replace the table currently in UNC TPD section V3.1.3 with the table below which shows the equivalent ratings of each of the three CRAs:

Approved Credit Rating			User's % of Maximum Unsecured Credit Limit	Parent Company	Qualifying Company
Standard and Poor's	Moody's Investors Service	Fitch Ratings			
AAA	Aaa	AAA	100	✓	✓
AA+	Aa1	AA+	100	✓	✓
AA	Aa2	AA	100	✓	✓
AA-	Aa3	AA-	100	✓	✓
A+	A1	A+	40	✓	✓
A	A2	A	40	✓	✓
A-	A3	A-	40	✓	✓
BBB+	Baa1	BBB-	20	✓	x
BBB	Baa2	BBB	19	✓	x
BBB-	Baa3	BBB-	18	✓	x
BB+	Ba1	BB+	17	✓	x
BB	Ba2	BB	16	✓	x
BB-	Ba3	BB-	15	✓	x

This table is consistent with generally accepted practice within the financial sector and with CUSC.

**Suggested Text**

**TRANSPORTATION PRINCIPAL DOCUMENT**

**SECTION V**

V3.1.1 amend to read as follows:

“3.1.1 For the purposes of the Code:

- b) An “Approved Credit Rating” is a published and monitored long term rating provided by a Credit Rating Agency as defined in 3.1.1(e) or a Specifically Commissioned Rating of not less than Ba3 by Moody’s Investors Service or equivalent rating by Standard & Poor’s.
- d) A “Specifically Commissioned Rating” is a rating commissioned and paid for by a User with a Credit Rating Agency and which shall be monitored on a daily basis and reassessed on an annual basis.”
- e) A “Credit Rating Agency” can issue an Approved Credit Rating and is confined to Fitch Ratings, Moodys Investment Service and Standard and poor’s Rating Group and any of their subsidiaries.”

V3.1.3. a) amend to read as follows:

“3.1.3 a) Where a User has an Approved Credit Rating, such User’s Unsecured Credit Limit at any time shall be calculated as that percentage (%) of the Maximum Unsecured Credit Limit by reference to the User’s Approved Credit Rating as follows:

<b>Approved Credit Rating</b>			<b>User’s % of Maximum Unsecured Credit Limit</b>	<b>Parent Company</b>	<b>Company</b>
<b>Standard &amp; Poor’s</b>	<b>Moody’s Investors Service</b>	<b>Fitch Ratings</b>			
AAA	Aaa	AAA	100	✓	✓
AA+	Aa1	AA+	100	✓	✓
AA	Aa2	AA	100	✓	✓
AA-	Aa3	AA-	100	✓	✓
A+	A1	A+	40	✓	✓
A	A2	A	40	✓	✓

A-	A3	A-	40	✓	✓
BBB+	Baa1	BBB-	20	✓	X
BBB	Baa2	BBB	19	✓	X
BBB-	Baa3	BBB-	18	✓	X
BB+	Ba1	BB+	17	✓	X
BB	Ba2	BB	16	✓	X
BB-	Ba3	BB-	15	✓	x

V3.1.4 amend to read as follows:

“3.1.4 Subject to paragraph 3.1.7, where a User does not have an Approved Credit Rating, or a User’s Approved Credit Rating is less than that in 3.1.3(a), such User may obtain an Unsecured Credit Limit by”:

V3.1.7 amend to read 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:

- b) where such User has an Approved Credit Rating less than that in 3.1.3(a) (up to a maximum of 13⅓% of the relevant Transporter’s Maximum Unsecured Credit Limit).”

V3.2.5 amend to read as follows:

“3.2.5 Where any published credit rating of the User or any person providing surety for a User is revised downwards to the extent that the credit rating following such revision is less than that in 3.1.3(a) 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”:

V3.4.5 amend the following definitions to read as follows:

“3.4.5 For the purposes of Code:

“**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 a Qualifying Company (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;

“**Letter of Credit**” shall mean an unconditional irrevocable standby letter of credit in such form as provide to the User form time to time by the

Transporter from such bank as the Transporter may approve (provided that payment may be made at a United Kingdom branch of such issuing bank) with a long term debt rating of not less than that of a Qualifying Company (where such ratings conflict, the lower of the two ratings will be used);

**“Parent Company”** shall mean:

- (i) in the case of a company registered in England and Wales a public or private company within the meaning of Section 1(3) of the Companies Act 1985 with a long term debt rating of no less than 3.1.3(a) (where such ratings conflict, the lower of the two will be used) that is either a shareholder of the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by Section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989); or
- (ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably;

**“Qualifying Company”** shall mean:

- (i) in the case of a company registered in England and Wales a public or private company within the meaning of section 1(3) of the Companies Act 1985 with a long term debt rating of at least A provided by a Credit Rating Agency as defined in 3.1.1 (where such ratings conflict, the lower of the two will be used); or
- (ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably”.

## **2 User Pays**

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

Implementation would not affect xoserve systems or procedures and therefore would not be affected by User Pays governance arrangements.

### **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 sub-paragraph (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 sub-paragraphs (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 sub-paragraphs (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;***

The implementation of this modification will enable Users to make better use of the code credit arrangements by offering more flexibility in the range of credit rating agencies acceptable within UNC. As a result of this extension of choice and flexibility this Proposal will help to ensure that there is no inappropriate discrimination and will help to reduce barriers to market entry. This will inevitably facilitate effective competition (Standard Special Condition A11.1 (d)).

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

By streamlining the definition and references to the CRA this modification will improve the administration of the code for future consequential changes thereby better facilitating

SSC A11.1 (f).

**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:**

Transporters will be required to use an additional approved Credit Rating Agency for monitoring Code Credit Limits and Value At Risk.

**b) Development and capital cost and operating cost implications:**

None 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**

No consequences have been identified.

**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)*

Provides Users with additional flexibility for obtaining unsecured credit.

*Development and capital cost and operating cost implications*

Distribution Networks may need to pay for Fitch monitoring in addition to that of Standard & Poor's and Moodys.

***Consequence for the level of contractual risk of Users***

No consequences have been identified.

**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**

- Consistent approach between GT Licence and UNC
- Consistent approach across electricity and gas codes
- Provides Users with additional flexibility for securing unsecured credit.

**Disadvantages**

- None identified.

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

<b>Organisation</b>	<b>Response</b>
British Gas Trading	Supports
E.ON UK	Not in Support
First:utility	Supports
National Grid Distribution	Supports
National Grid NTS	Supports
Northern Gas Networks	Supports
RWE npower	Comments Offered



Scotia Gas Networks	Supports
ScottishPower	Supports
SSE	Supports
Wales & West Utilities	Supports

In summary, of the 11 responses received, 9 supported implementation, 1 offered comments, and 1 opposed implementation of the Proposal.

Both RWE npower and SSE have pointed out a number of inconsistencies in the suggested text, which they consider should be addressed.

E.ON UK expressed concerns regarding Transporters using an additional credit rating agency, noting that the use of this service will likely require the Transporters (or the Transporter's Agent) to pay a subscription and that the cost of this will have to be recovered from Users (and ultimately customers). Information on the level of this cost and how it will be recovered is not included in this Proposal, so it is impossible to assess it in terms of cost vs. benefit.

RWE npower has requested further clarification as to whether the costs involved in Fitch monitoring incurred by the Distribution Networks, as referred to within the Draft Modification Report, would ultimately be a cost passed on to Shippers. If significant costs were to be passed on to Shippers, RWE npower believe that the costs may outweigh the benefits.

**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)**

This Proposal could be implemented with immediate effect following direction from Ofgem.

**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 nine supported implementation, one offered comments, and one opposed implementation of the Proposal. 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 0300 seeks to introduce Fitch Ratings as an allowable credit rating agency for the purpose of obtaining an unsecured Code Credit Limit. This would enable Users with a Fitch rating to secure similar credit to those relying on other rating agencies. The extension of choice could therefore help to ensure that there is no inappropriate discrimination and so facilitate effective competition. However, the Transporters may incur additional costs in order to use Fitch Ratings when assessing credit. This cost will be met by Users and, ultimately, customers. Since no quantification of the costs or benefits has been provided, some respondents had noted that the costs may exceed the benefits such that implementation would not be appropriate.

The Northern Gas Networks Panel member clarified the costs for provision of Fitch reports, advising a basic service, which provides the required rating, is free. The E.ON UK observer noted that the EBCC utilise a premium service to support their requirements. This has cost implications, and the cost is passed on to Users. The Northern Gas Networks Panel member confirmed it is not Northern Gas Network's intention to use a chargeable service since the necessary information is readily available at no cost.

The EDF Energy Panel member suggested that the Proposal might have a negative impact on Users when a rating is downgraded since reliance would be placed on the lowest rating. If Fitch were the first to record a downgrade, the effect of implementation would be negative for the User concerned. Other Members recognised this but felt this could also be regarded as a positive for other Users as it may provide earlier warning of potential issues.

**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**

TRANSPORTATION PRINCIPAL DOCUMENT  
 SECTION V

V3.1.1 amend to read as follows:

“3.1.1 For the purposes of the Code:

- b) An “Approved Credit Rating” is a published and monitored long term rating provided by a Credit Rating Agency as defined in 3.1.1(d) of not less than Ba3 by Moody’s Investors Service or equivalent rating by either Standard & Poor’s or Fitch Ratings.
- d) A “Credit Rating Agency” can issue an Approved Credit Rating and is confined to Fitch Ratings, Moodys Investment Service and Standard and poor’s Rating Group and any of their subsidiaries.”

V3.1.3. a) amend to read as follows:

“3.1.3

- a) Where a User has an Approved Credit Rating, such User’s Unsecured Credit Limit at any time shall be calculated as that percentage (%) of the Maximum Unsecured Credit Limit by reference to the User’s Approved Credit Rating as follows:

Approved Credit Rating			User’s % of Maximum Unsecured Credit Limit	Parent Company	Company
	Standard & Poor’s	Moody’s Investors Service			
AAA	Aaa	AAA	100	✓	✓
AA+	Aa1	AA+	100	✓	✓
AA	Aa2	AA	100	✓	✓
AA-	Aa3	AA-	100	✓	✓
A+	A1	A+	40	✓	✓
A	A2	A	40	✓	✓

A-	A3	A-	40	✓	✓
BBB+	Baa1	BBB+	20	✓	X
BBB	Baa2	BBB	19	✓	X
BBB-	Baa3	BBB-	18	✓	X
BB+	Ba1	BB+	17	✓	X
BB	Ba2	BB	16	✓	X
BB-	Ba3	BB-	15	✓	X

V3.1.4 amend to read as follows:

“3.1.4 Subject to paragraph 3.1.7, where a User does not have an Approved Credit Rating, or a User’s Approved Credit Rating is less than that in 3.1.3(a), such User may obtain an Unsecured Credit Limit by”:

V3.1.7 amend to read as follows:

“3.1.7 Upon request from a User, the User may select any one of the specified agencies for the Transporter to use to allocate an Unsecured Credit Limit to the User as follows:

b) where such User has an Approved Credit Rating less than that in 3.1.3(a) (up to a maximum of 13⅓% of the relevant Transporter’s Maximum Unsecured Credit Limit).”

V3.2.5 amend to read as follows:

“3.2.5 Where any published credit rating of the User or any person providing surety for a User is revised downwards to the extent that the credit rating following such revision is less than that in 3.1.3(a) 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”:

V3.4.5 amend the following definitions to read as follows:

“3.4.5 For the purposes of Code:

“**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 a Qualifying Company (where such ratings conflict, the lower of the ratings will be used) and the User shall at its own expense provides such legal opinion as the Transporter may reasonably require;

“**Letter of Credit**” shall mean an unconditional irrevocable standby letter of credit in such form as provide to the User form time to time by the Transporter from such bank as the Transporter may approve (provided that payment may be made at a United Kingdom branch of such issuing bank) with a long term debt rating of not less than that of a Qualifying Company (where such ratings conflict, the lower of

the ratings will be used);

**“Parent Company”** shall mean:

- (i) in the case of a company registered in England and Wales a public or private company within the meaning of Section 1(3) of the Companies Act 1985 with a long term debt rating of no less than that in 3.1.3(a) (where such ratings conflict, the lower of the ratings will be used) that is either a shareholder of the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by Section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989); or
- (ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably;

**“Qualifying Company”** shall mean:

- (i) in the case of a company registered in England and Wales a public or private company within the meaning of section 1(3) of the Companies Act 1985 with a long term debt rating of at least A provided by a Credit Rating Agency as defined in 3.1.1 (where such ratings conflict, the lower of the ratings will be used); or
- (ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably”.

For and on behalf of the Relevant Gas Transporters:

**Tim Davis**  
**Chief Executive, Joint Office of Gas Transporters**