Modification Proposal 0109 "Acceptable Security Tools available to Users for Transportation Credit Arrangements" Replacement Proposal

Nature and Purpose of Proposal

In respect of transportation credit arrangements, Ofgem published a number of recommendations in its conclusions document "Best practice guidelines for gas and electricity network operator credit cover" 58/05 in February 2005. One such recommendation was the range of security tools that should be available to a User to cover any exposure beyond its unsecured credit limit. It further recommended that it would be for each User to determine which, how many and in what percentage they are used.

This Proposal seeks to specify within the UNC the range of acceptable security tools available to Users, these being any of the following tools (or combination of them):

- An approved Letter of Credit or equivalent bank guarantee from a bank with a long term debt rating of not less than A by Moody's or Standard & Poor's,
- Prepayment agreement (payment made before the delivery of the service).
  - paid monthly by the User upon notification from the Transporter of the amount required in advance of the invoice due date and applied against the relevant invoices.

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- A performance bond (provided by an insurance company, not a bank),
- Independent security,
- Deposit Deed Agreement (including cash deposit, advance payment or payment made after the delivery of the service but before contract settlement),
  - a deed held by the Transporter and called upon if the User defaults on a payment,
  - for the purposes of clarification, both Prepayment Agreements and Deposit Deed Agreements may be used as security or for payment

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- Parent Company Guarantee (PCG)
  - PCGs from both UK registered companies and non-UK registered companies are acceptable though in the case of the latter, the country of residence of such company must have a sovereign credit rating of at least A2 awarded by Moody's Investors Service (or equivalent rating by Standard and Poor's) and the User shall, where requested to do so by the Transporter, provide at its own expense a legal opinion as to enforceability.

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- Bi-lateral insurance
  - such a policy must provide for settlement of a User's debt (i.e. for the benefit of the Transporter) in respect of transportation invoices,
  - the policy terms must be unconditional in all material matters in order to be rated at full value.

A security tool providing cash on demand will be rated at full value. A tool that has conditionality but is certain to provide cash in a timely manner will be rated up to full value. The value of an individual tool will be agreed between the relevant Transporter and the relevant User. In the event that the two parties cannot agree on this value, the value will be determined by an expert appointed jointly by the two parties or, failing their agreement as to the expert, an expert appointed by the Director General of the Institute of Credit Management.

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Ofgem's conclusions document also advocated use of bilateral insurance as an acceptable security tool. National Grid has identified that a bilateral credit insurance policy is only likely to provide cover for the first or second payments after which the insurer then effectively relinquishes its risk. Therefore the long term credit exposure is not effectively transferred through the insurance product as only these initial payments are covered. National Grid believes that this is not compatible with the nature of the transportation billing processes whereby significant debt can be accrued beyond the initial payments secured by the credit insurance and therefore use of such a policy as security potentially exposes the industry to significant financial risk. The requirement of security is to cover the Transporter against a Users breach of payment. Therefore, this proposal does not advocate acceptance of bi-lateral insurance as a security tool.¶

If this Proposal is not implemented, the UNC will not reflect the recommendations contained within the Ofgem conclusions document and Transporters will not be obliged to operate this aspect of their credit arrangements in a consistent manner.