

Modification proposal:	<b>Uniform Network Code (UNC) 336: The Introduction of a Balancing Neutrality Adjustment Charge for Cost Recovery Associated with Rating Services (UNC336)</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	18 February 2011	Implementation Date:	To be confirmed by the Joint Office

## Background to the modification proposal

The Energy Balancing Credit Committee (EBCC)<sup>3</sup> has carried out a review of the Energy Balancing Credit Rules. During this review, the EBCC expressed concerns associated with the increased occurrence of downgrading in ratings of the financial institutions that provide security to Users for energy balancing purposes.

The EBCC considered that there was merit in procuring credit risk information services from third parties. These services provide a daily status report of all company ratings.

At the March 2009 EBCC meeting, National Grid National Transmission System's ('National Grid NTS') Agent stated its intention to procure said services from Moody's and Standard and Poors. The EBCC noted the current financial climate and considered that procuring credit rating services would be prudent.

## The modification proposal

This modification seeks to allow National Grid NTS to recover the costs of procuring credit risk information services. National Grid NTS will recover these costs through the Energy Balancing Neutrality Charge<sup>4</sup>. The total cost is estimated to be £40,000 a year.

This modification was raised by National Grid NTS on behalf of the EBCC. Enabling National Grid NTS to recover these costs will allow it to continue to subscribe to the services provided by credit rating agencies, which it considers will: increase the accuracy of daily monitoring of company ratings, improve the risk management process and decrease the human resource required to monitor company ratings.

An improved monitoring process may increase the chances of the EBCC becoming aware that a shipper may be failing for example if it becomes aware that the shipper, or a company to which it is linked, is in financial difficulty. This may allow the EBCC to take action to decrease the exposure of the shipper community to the costs of a failing shipper. For this reason, the proposer and the EBCC consider that the costs associated with procuring credit ratings information service providers should be borne by shippers, as they are most likely to benefit from this service.

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> The EBCC is a body of shipper representatives with certain rights and responsibilities relating to the management of Energy Balancing Credit Risk.

<sup>4</sup> A neutrality charge will enable National Grid NTS to recover the costs of these services from the shipper community. Neutrality charges are recovered in proportion to a shipper's delivered and oftaken gas volumes.

## UNC Panel<sup>5</sup> recommendation

At its meeting on 16 December 2010, the UNC Panel recommended that the proposal should be implemented. Nine panel members voted in favour of implementing this modification, and one member voted against.

## The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 14 January 2011. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR<sup>6</sup>. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC<sup>7</sup>; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>8</sup>.

## Reasons for the Authority's decision

We consider that this modification better facilitates relevant objective (f) of the UNC and is neutral in relation to all other objectives.

### ***Relevant objective (f): the promotion of efficiency in the implementation and administration of the uniform network code.***

We consider that procuring the services of credit rating agencies should improve the ability of National Grid NTS to meet its requirements under the UNC to monitor the market<sup>9</sup> by reviewing credit ratings. We also consider that, in this instance, the balancing adjustment neutrality charge is an appropriate method of cost recovery as this mechanism apportions costs across the shipper community in accordance with the amounts of gas they have delivered to, and offtaken from, the system. As the benefits of this modification will be to decrease risk to the shipper community, we consider it appropriate that the costs of procuring the services of credit rating agencies be recovered from shippers.

Two respondents consider that a change to National Grid NTS's licence would be a more appropriate method for cost recovery. They suggest that National Grid NTS should have approached Ofgem to change its licence instead of raising a modification to the UNC. We consider that, given the materiality of the proposal, a modification to the UNC is an appropriate vehicle for establishing a cost recovery mechanism in this instance<sup>10</sup>.

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<sup>5</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>6</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>7</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=6547](http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547)

<sup>8</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

<sup>9</sup> This obligation is set out in Section X of the UNC, paragraph 2.2.6(b). We note that in practice this obligation is discharged by Xoserve, as National Grid NTS's Agent, as set out in the Energy Balancing Credit Rules: <http://www.gasgovernance.co.uk/sites/default/files/EBCRRulesV312v2Approved240909.pdf>.

<sup>10</sup> We further note that, as the costs of procuring these services are being recovered through a neutrality charge, National Grid NTS should not in addition seek to recover these costs through their regulated price control arrangements.

One respondent to the draft modification report raised concerns that the legal text referred to specific credit rating agencies, and that it did not account for the fact that the credit rating agencies may change in the future. Subsequent to the publication of the FMR, updated legal text was provided and we consider this new text addresses these concerns.

We note that UNC parties provided comments on a previous version of the legal text. The result is that parties and the UNC Panel haven't been able to provide comments on the final version of the legal text before it has come to Ofgem for decision. We consider it best practice that the UNC Panel should be making decisions on the final version of the legal text and that future modifications should finalise their legal text before being presented to the UNC Panel for decision. In this regard, we note that legal text should be available by the time future modifications are sent out for consultation in line with principle 9 of the Code Administration Code of Practice<sup>11</sup>.

Two respondents, that support the modification, expressed concern around the time taken to raise this proposal, given that credit rating services have already been procured by National Grid NTS in 2009. These respondents expressed concern that the post-event implementation of this modification would lead to the cost for the first two years of subscription to credit rating agencies being paid by shippers once the modification is implemented.

We note that these respondents have agreed that the modification should be raised post-procurement. Whilst we are approving this modification, given the degree of industry consent and materiality, we share the disappointment that it has taken so long for the proposal to be raised and we do not consider that this is best practice. In approving the proposal we are not setting a precedent for future cost recovery modifications.

### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC336: The Introduction of a Balancing Neutrality Adjustment Charge for Cost Recovery Associated with Rating Services be made.

**Ian Marlee**  
**Partner, GB Markets**

**Signed on behalf of the Authority and authorised for that purpose.**

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<sup>11</sup> <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/FinalCoP.pdf>