

0375:

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

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.



The Workgroup recommends that this modification should now proceed to Consultation



Low Impact:
Users without approved credit ratings, Transporters

What stage is this document in the process?



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Workgroup Report

10 October 2011

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About this document:

The purpose of this report is make a recommendation to the Panel, to be held on 17 November 2011, on whether Modification 0375 is sufficiently developed to proceed to consultation and to submit any further recommendations in respect of the definition and assessment of this modification.

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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, 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 & 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.

Impacts & Costs

The Workgroup do not believe that implementation of this Modification will increase risk to the market and there are no costs associated with implementation. All Users, in relation to WWUs 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.

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>

Implementation

The Workgroup considers that 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 3.1.7 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.

Recommendations

The Workgroup considers that the modification is sufficiently developed and should now proceed to consultation.

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

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>

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's 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 RAV's, 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 is expected to better facilitate the achievement of **relevant objective f**

Proposer's view of 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

Achievement of relevant objective "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 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

The Workgroup do not believe 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	• None
Operational Processes	• None
User Pays implications	• None

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• Potential minor impacts



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:
www.gasgovernance.co.uk/sites/default/files/0565.zip

Impact on Users	
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
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

Impact on UNC Related Documents and Other Referenced Documents	
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

The Workgroup have not provided 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.

7 The Case for Change

The Workgroup have not identified any additional advantages to those detailed above.

8 Legal Text

Legal 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

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	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 ^{2/3}
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 Recommendation

The Workgroup invites the Panel to:

- AGREE that Modification 0375 be submitted for consultation.