

Workstream Report

Re-assessment of User Unsecured Credit Limits

Modification Reference Number 0023

Version 1.0

This Workstream Report is presented for the UNC Modification Panel's consideration. The consensus of attendees at the Distribution Workstream is that, while views may differ regarding the merits of the Modification Proposal, it is sufficiently developed to proceed to consultation.

1. The Modification Proposal

This Proposal is one of five which seek to implement recommendations identified within Ofgem's conclusion document "Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover" 58/05. This concluded the high-level principles that should be applied and further work required in respect of credit cover arrangements for transportation.

This Proposal seeks to implement elements of recommendations detailed within paragraphs 3.4 to 3.9 of the conclusion document.

In accordance with the Code Credit Rules, UNC Section V3.1 details the Code Credit Limits to which Transporters and Users are obliged to adhere. A Code Credit Limit is the amount representing a Users maximum permitted Relevant Code Indebtedness being the aggregate amount, other than Energy Balancing Charges, for which a User is liable to Transco. The overall cap is currently set at £250million.

It is proposed that a Relevant Transporter sets a maximum unsecured credit limit based on 2% of its Regulatory Asset Value. Whilst this would not constrain Relevant Transporters, those who seek other levels of risk may not obtain full pass through in the event of a failure and/or may be subject to objections and disputes from counterparties.

In respect of an individual User's Unsecured Credit limit, this is currently assessed by Transco based on an Investment Grade Rating provided by an approved rating agency being either Moody's KMV or Standards & Poor's. Ofgem's paper concluded that individual counterparty credit limits and those that use Parent Company Guarantees or aggregates of both, should be set using credit ratings (provided by the aforementioned rating agencies) applied under the 'Basel 2' rules for determining bank capital adequacy. These currently are in the ratio of 1 : 2.5, 1 : 5, 1 : 7.5, for Standards & Poor's AAA/AA, A, BBB ratings (or Moody's KMV equivalent). These respectively would imply maximum credit allowances of, 100 percent for AAA/AA and 40 percent for A.

For the third band, (BBB) Ofgem proposes that the above allowance be further sub-divided, such that the following are applied to rated entities:

Standard & Poor's Credit rating	Credit allowance as % of maximum credit limit
BBB+	20
BBB	19
BBB-	18

Transco therefore proposes to amend the UNC to reflect the above method of assessment of User Unsecured Credit Limits.

The scope of the above unsecured credit arrangements mirror the scope currently contained within the 'Code Credit Rules' and therefore Transco does not propose to facilitate unsecured credit limits for entities with Standards & Poor's ratings of BB+, BB or BB- (or Moody's KMV equivalent).

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Implementing consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination, and no inappropriate barrier to entry, thereby facilitating the securing of effective competition between Relevant Shippers.

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

No such implications on security of supply or operation of the Total System have been identified. Incorporating the existing Credit Rules within the UNC may help to reduce the prospect of industry fragmentation.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

No implications for operation of the system have been identified.

b) development and capital cost and operating cost implications:

The proposer has suggested that any costs would be minimal.

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

No cost recovery mechanism is proposed.

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

No such consequences are anticipated.

5. 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 such consequence is anticipated.

6. 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 systems impacts are anticipated by either Transporters or Users.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The proposer believes the level of credit cover to be provided to Transco by some Users would reduce, thereby potentially reducing Users' costs. Other

Relevant Transporters have identified that additional credit cover may be called for, potentially increasing costs for some Users.

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

No such implications have been identified.

9. 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 such consequences are anticipated.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Increased alignment of the UNC with best practice as identified in Ofgem's conclusions document
- Ensures credit cover continues to be sought on a non-discriminatory basis
- Ensures there continue to be no inappropriate barriers to entry as a result of credit requirements
- Reduced credit cover requirements could reduce costs for some Shippers

Disadvantages

- Does not fully implement the best practice approach identified in Ofgem's conclusions document
- Further Modifications would be required to fully implement Ofgem's conclusions on best practice
- May create inconsistency between the UNC and each set of Credit Rules
- Potential for increased credit cover requirements, increasing costs for some Shippers

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

The report reflects issues raised at Workstream meetings. No written representations have been received.

Workstream attendees questioned how Regulatory Asset Value would be calculated, since this is not a defined term at present and implementation of this Proposal should ensure a clear and stable level of unsecured credit could be established for each User and each Network. The Proposer agreed to clarify this.

Workstream attendees challenged why the Proposer had not sought to implement Ofgem's best practice guidelines in full, as opposed to limiting the credit ratings to be incorporated within the UNC. A strong view was expressed that it would have been more efficient to see a single Modification Proposal consistent with the whole best practice guidelines rather than the potential for a series of further related Modification Proposals over the coming months.

Concerns were also expressed that the existence of this Modification Proposal could make development of subsequent Modification Proposals more difficult since the detail may be dependent on whether or not this Modification Proposal is implemented.

Workstream attendees sought clarity on the process for amending each Transporter's Credit Rules and whether this would be coordinated, or mandated through the implementation of modified UNC terms. Some concerns were expressed about the fact that some of the Credit Rules would remain outside the UNC even though much of them would be superseded by the UNC drafting were this Modification Proposal to be implemented.

- 12. 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.
- 13. 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.
- 14. 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.
- 15. Proposed implementation timetable (including timetable for any necessary information systems changes)**
The Proposer believes that minimal changes would be required in respect of operational processes and procedures and therefore this Modification Proposal could be implemented with immediate effect if appropriate direction is received from the Authority.
- 16. 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.
- 17. Workstream recommendation regarding implementation of this Modification Proposal**
The consensus of attendees at the Distribution Workstream meeting on 23 June 2005 was that implementation of this Modification Proposal may be expected to facilitate achievement of the Relevant Objectives. However, Shipper's felt it would have been more efficient and a better use of resources to see a wider Modification Proposal encompassing Ofgem's recommendations in full and bringing the whole of the existing Credit Rules within the UNC – thereby facilitating the Relevant Objectives further than through implementation of this Modification Proposal.

Attendees believed that, were this Proposal to be implemented, increased facilitation of the Relevant Objectives would be achieved if implementation were coincident with that of Modification Proposals 0024, 0025, and 0026 (and any subsequent related Proposals in this area) which also reflect Ofgem's conclusion document, since this would mean that only one change to the existing Credit Rules would be needed, and any related systems changes associated with the various Proposals could be implemented in a coordinated and efficient manner. This would also apply to Modification Proposal 0027 if the proposed right of set off was elective for Shippers.

18. Text

No legal text has been developed by the Proposer or within the Workstream, either with respect to modifying the Uniform Network Code or each Transporter's Credit Rules.