

**Workstream Report**  
**Re-assessment of User Unsecured Credit Limits 0031**

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 two which seek to implement some of the 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.

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 a Transporter. 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 the Transporter 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/BB/Unrated and below BB- (or Moody's KMV equivalent). These respectively would imply maximum credit allowances of, 100 percent for AAA/AA and 40 percent for A, 20 percent and 13 1/3 percent of the NWO's maximum credit limit for a single counterparty.

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

<i>Standard &amp; Poor's Credit rating</i>	<b>Credit allowance as % of maximum credit limit</b>
BBB+	20
BBB	19
BBB-	18
BB+	17
BB	16
BB-	15

RWE npower therefore proposes that the UNC be amended to reflect the above method of assessment of User Unsecured Credit Limits.

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

Implementing consistent credit processes which move towards Ofgem's conclusions on 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.

Increasing the availability of unsecured credit could increase costs in the event of default, thereby increasing costs for other Users, and hence does not facilitate the securing of effective competition between Relevant Shippers since this would deter entry.

**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 elements of 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 Transporters have suggested that some additional monitoring costs have the potential to be incurred relative to the existing position and that proposed under Modification Proposal 0023, reflecting the additional risk of default through increased unsecured credit limits. A one off development cost would also be incurred to establish a process for assessing the unsecured credit limits associated with BB+ to BB- rated Users.

Users requested that Transporters quantify and provide evidence of the potential cost increase as part of the consultation process.

- 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**  
Transco Distribution 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.  
  
With an increased risk of default with unsecured sums due, additional costs could be passed through to Users.
8. **The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party**  
No significant 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**

- 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**

- May create inconsistency between the UNC and each set of Credit Rules
- Potential for increased credit cover requirements, increasing costs for some Shippers
- Potential for increased default costs

**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 recognised that this Proposal is similar to Modification Proposal 0023 except that, by extending the range of credit ratings covered, it fully incorporates Ofgem's best practice guidelines. As such, there would be merit in considering the two Proposals together, and the issues raised in the Modification Proposal 0023 Workstream Report are also relevant for this Proposal.

**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.

The Transporters agreed to consider appropriate lead times as part of the consultation process.

**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**

There was no consensus of attendees at the Distribution Workstream meeting on 28 July 2005 that implementation of this Modification Proposal may be expected to facilitate achievement of the Relevant Objectives.

There was no consensus as to whether implementation of this Modification Proposal or Transco's alternative, Modification Proposal 0023, would be preferable in terms of facilitating the relevant objectives. Some Users felt Modification Proposal 0031 was preferable, but other Users and all Transporters felt Modification Proposal 0023 was preferable.

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, 0026, and 0032 (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.