

CODE MODIFICATION PROPOSAL No xxxx
Acceptable Security Tools available to Users for Transportation Credit Arrangements
Version x.x

Date: 16/03/2007

Proposed Implementation Date: 01/08/2007

Urgency: Non Urgent

1 The Modification Proposal

a) Nature and Purpose of this 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.
- 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.

- **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 Corporation) and the User shall, where requested to do so by the Transporter, provide at its own expense a legal opinion as to enforceability.

- **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, an expert appointed pursuant to the Dispute Resolution provisions (General Terms: Section A) of the UNC will determine such.

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.

b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)

N/A

c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.

This Modification Proposal has been developed within the Uniform Network Code (UNC) Distribution Workstream. General consensus on its objectives was forthcoming. 'Proceed to consultation' is therefore requested.

2 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

Implementation of consistent credit processes which move towards recognised best practice would help ensure that there is no inappropriate discrimination and no inappropriate barrier to entry. This measure facilitates the securing of effective competition between relevant shippers.

3 The implications of implementing this 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 credit rules within the UNC may help to reduce the impacts of any industry fragmentation.

4 The implications for Transporters and each Transporter of implementing this Modification Proposal, including:

a) The implications for operation of the System:

No implications for operation of the system have been identified.

b) The development and capital cost and operating cost implications:

No significant development, capital or operating cost implications have been identified although development of the bi-lateral insurance product may generate future cost to one or more industry players.

c) Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:

No cost recovery mechanism is proposed.

d) The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

The majority of the security tools identified are currently acceptable to all Transporters. On this basis the only change to Transporters' level of contractual risk would be that associated with bi-lateral insurance products. Representations are invited to confirm whether risk is increased by any other proposed tool and if so, provide an indication of the consequential impact on Transporters' level of contractual risk.

Where a Transporter is able to demonstrate that it has implemented credit control, billing and collection procedures in line with the Guidelines, it may be in a position to secure pass through of any bad debt it incurs. In such cases, Ofgem clarified in its Best Practice Guidelines that at the subsequent price control review the Transporter will be permitted to raise up to the full value of the bad debt from regulated charges including an allowance for the cost of funding the loss pending recovery. Where a Transporter is able to recover bad debt incurred this mitigates the Transporter's increased contractual risk associated with implementation of aspects of the Best Practice Guidelines.

5 The extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)

Implementation is not required for such.

6 The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users

No UK Link systems implications have been identified.

7 The implications for Users of implementing the Modification Proposal, including:

a) The administrative and operational implications (including impact upon manual processes and procedures)

Existing operational arrangements and requirements are anticipated to apply in respect of each credit tool and therefore implementation is not anticipated to have any distinct implications for Users. Prospective use of the bi-lateral insurance product may have distinct operational requirements.

b) The development and capital cost and operating cost implications

Where a Transporter obtains approval to pass through bad debt, this is likely to be subsequently reflected in increased Transportation Charges which would be payable by Users in the subsequent price control period.

c) The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

With the scope of tools available formalised in the UNC (if implemented) User contractual risk will be reduced.

8 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, any Non-Code Party)

Dependent on the contractual arrangements in place between the respective parties, bad debt costs which are reflected in subsequent Transportation Charges may be borne in part or in full by Suppliers and subsequently consumers.

9 Consequences on the legislative and regulatory obligations and contractual relationships of the Transporters

Where a Transporter secures pass through of any bad debt it incurs and demonstrates that a delay in recovery would have a material adverse effect on its

financial position, Ofgem clarified in its Best Practice Guidelines that it may consider early licence modifications such that amounts can be recovered prior to the next price control period.

10 Analysis of any advantages or disadvantages of implementation of the Modification Proposal not otherwise identified in paragraphs 2 to 9 above

Advantages

- Alignment with Best Practice Guidelines.
- Codifies current practice.
- Provides clarity as to which credit security tools are acceptable to Transporters.

Disadvantages

- For Users, if a Transporter can demonstrate compliance with Best Practice Guidelines (of which this is one element), Users may be subject to a level of financial risk of bad debt incurred by the Transporter.

11 Summary of representations received as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)

No representations have been invited at this stage.

12 Detail of all other representations received and considered by the Proposer

No such representations have been received.

13 Any other matter the Proposer considers needs to be addressed

No such additional matters (related with this proposal) have been identified.

14 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal

The proposer believes that in light of the limited works required to implement, this Modification Proposal could be implemented with immediate effect upon direction being received from the Authority.

15 Comments on Suggested Text

None

16 Suggested Text

TPD SECTION B: SYSTEM USE AND CAPACITY

Amend paragraph 2.2.14 as follows:

2.2.14 Following a notice...provide adequate surety or security (in accordance

with Section V 3.4.5), all monthly...

Amend paragraph 2.2.16 as follows:

2.2.16 Following a notice under paragraph 2.2.15...provide adequate surety or security (in accordance with Section V3.4.5), the User's Registered...

TPD SECTION V: GENERAL

Amend heading under paragraph 3.4 to read as follows:

"Security under Code"

Amend paragraph 3.4.1 to read as follows:

3.4.1 Any instrument of surety or security provided by a User pursuant to paragraph 3.4.6 (and whether...

Amend paragraph 3.4.2 to read as follows:

3.4.2 Where a User has provided surety or security pursuant to paragraph 3.4.6 the User (or the person giving the surety) may request the Transporter to release all or any of such security or agree to a reduction in any maximum amount of such surety.

Amend paragraph 3.4.4 to read as follows:

"3.4.4 The condition referred to in paragraph 3.4.3 is that the amount of the User's Value at Risk, at the date of such release or reduction is not more than 100% of the amount of a User's Code Credit Limit..."

Amend paragraph 3.4.5 to read as follows:

"For the purposes of Code:

"Bi-lateral Insurance" shall mean an policy of insurance (that is unconditional in order to attain 100% of its face value) for the benefit of the Transporter, provided

by a Qualifying Company and in such form as is acceptable to the Transporter;

“Deposit Deed” shall mean an agreement that is Enforceable and in such form as provided to the User from time to time by the Transporter enabling the deposit of cash as surety or security or advance payments by a User;

“Enforceable” shall mean the Transporter (acting reasonably) is satisfied that the instrument of security is legally enforceable and in this respect, where security is provided by a company registered outside of England and Wales, the country of residence of such company must have a sovereign credit rating of at least A2 awarded by Moody’s Investors Services or such equivalent rating by Standard and Poor’s Corporation and the User shall at its own expense provide such legal opinion as the Transporter may reasonably require;

“Letter of Credit” shall mean an unconditional irrevocable standby letter of credit in such form as provided to the User from time to time by the Transporter from such bank as the Transporter may approve, (provided that payment may be made at a United Kingdom branch of such issuing bank) with a long term debt rating of not less than A2 provided by Moody’s Investors Services or equivalent rating by Standard and Poor’s Corporation;

“Guarantee” shall mean an on demand irrevocable guarantee or performance bond provided by a Qualifying Company or a Parent Company that is Enforceable and in such form as provided to the User from time to time by the Transporter;

“Prepayment Agreement” shall mean an agreement between the Transporter and the User that is Enforceable and in such form as provided to the User from time to time by the Transporter with the purpose of enabling a User to make payments of amounts calculated on a monthly basis by the Transporter (using an accrual methodology set out therein) as representing the Transporter’s estimate of the amounts (other than in respect of Energy Balancing Charges) which will become due by the User to the Transporter in a charging month;

“Parent Company” shall mean:

- (i) in the case of a company registered in England and Wales a public or private company within the meaning of section 1(3) of the Companies

Act 1985 with a long term debt rating of at least BB- provided by Moody's Investors Services or equivalent rating by Standard and Poor's Corporation that is either a shareholder of the User or any holding company of such shareholder (the expression holding company having the meaning assigned thereto by section 736, Companies Act 1985 as supplemented by Section 144(3) Companies Act 1989); or

- (ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably;

“Qualifying Company” shall mean:

(i) in the case of a company registered in England and Wales a public or private company within the meaning of section 1(3) of the Companies Act 1985 that has a long term debt rating of at least A2 by Moody's Investors Services or equivalent rating by Standard and Poor's Corporation; or

(ii) in the case of an entity registered outside of England and Wales, such equivalent entity to (i) above that is acceptable to the Transporter, acting reasonably.

Delete paragraph 3.4.6 and replace with the following:

“A User may extend its exposure beyond its Unsecured Credit Limit by providing surety or security in one or more of the forms set out below:

- (a) Bi-lateral Insurance; and/or
- (b) Letter of Credit; and/or
- (c) Guarantee; and/or
- (d) Deposit Deed; and/or
- (e) Prepayment Agreement;

provided that where an instrument of surety or security is conditional, the

Transporter may agree with the User a value below 100% of its full face value. Where the value of the instrument of surety or security cannot be agreed between the User and the Transporter, the User may refer such dispute to Expert Determination in accordance with GT Section A, paragraph 2.”

Delete paragraph 3.4.7.

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document

Section(s) B and V

Proposer's Representative

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