

Modification proposal:	Uniform Network Code (UNC) 112: Aggregation of Credit positions or Use of Group Rating (UNC112)		
Decision:	The Authority¹ has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	26 January 2007	Implementation Date:	N/A

Background to the modification proposal

Network Operator credit cover has been the subject of a number of consultations and workgroups since March 2003. In February 2005, Ofgem issued its Best practice guidelines for gas and electricity network operator credit cover² (the guidelines).

Under the guidelines, Ofgem advocated its view of best practice for credit arrangements, considered to strike the correct balance between protecting network operators from the risks bad debt and promoting competition between users of networks by ensuring they are not required to over collateralise their positions.

The current terms of the UNC prevent affiliated Users from aggregating their credit positions or to use group ratings, for instance through parent company guarantees (PCG's) allowing Users to benefit from an affiliate's superior credit rating, providing robust and unconditional arrangements are in place.

The modification proposal

The modification proposal provides that a Qualifying Company or a Parent Company, as defined in modification UNC109, may provide security to a User, in any of the forms being introduced by UNC109, such that the Approved Credit Rating of the security provider would substitute that of the User's, to calculate such User's Unsecured Credit Limit (UCL). The proposal also provides that where a security provider provides credit for more than one User, the aggregate UCLs of all such Users shall not exceed the maximum credit entitlement of the security provider.

The Proposer considered this would allow Users to aggregate their credit positions or use group ratings and thereby benefit from a superior Unsecured Credit Limit.

The Proposer considered implementation of this proposal would introduce consistent credit processes ensuring there was no inappropriate discrimination and no inappropriate barriers to entry, thereby better facilitating effective competition between relevant shippers.

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

²http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf?wtfrom=/ofgem/work/index.jsp§ion=/areasofwork/creditcover

UNC Panel³ recommendation

At the modifications Panel meeting on 21 December 2006, the Panel unanimously recommended implementation of this modification proposal.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 22 December 2006. 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 FMR⁴.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC⁵.

Reasons for the Authority's decision

Effective credit arrangements need to strike a balance that will protect the interests of Transporters without requiring Users to over collateralise. When determining how much collateral a User needs to have in place, taking account of its Approved Credit Rating provides an effective indication of the risk a User may pose to the Transporter. Paragraph 3.1.6 of section V of the UNC provides a table listing the level of unsecured credit a User should be afforded dependent upon its Approved Credit Rating.

Modification proposal UNC112 extends the ability for a User to be afforded an Unsecured Credit Limit based on the Approved Credit Rating of either its parent, an otherwise affiliated company, or other third party independent credit support provider. Ofgem considers that such arrangements could facilitate competition amongst Users provided they are in place in a robust and unconditional manner. The risk taken on by the credit support provider should not be greater than any risk it itself would be able to incur. In such circumstances we consider allowing the transfer of risk from the User to the credit support provider to facilitate achievement of applicable objective (d), allowing Users to benefit from a superior credit rating of a credit support provider.

There may be instances where security provided by a parent, an affiliated company or other third party independent credit support provider may not be in a manner or even intended to transfer risk in the way discussed above. In such circumstances the security may only be intended to be a type of collateral to increase a Users Code Credit Limit above that which it has managed to achieve based on its own Unsecured Credit Limit. To that extent the legal text for UNC112 could perhaps be clearer.

Given that the legal text of UNC112 is dependent upon the legal text of another modification proposal - UNC109, and noting that Ofgem has not approved UNC109, we are unable to approve this modification proposal on the grounds that the legal text is not appropriate. Introducing inappropriate legal text would be a detriment to efficiency in the

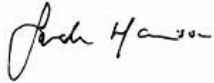
³ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁴ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁵ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://62.173.69.60/document_fetch.php?documentid=6547

administration and implementation of the UNC and would be to the detriment of applicable objective (f) which outweighs the facilitation of the achievement of applicable objective (d) mentioned above.

Ofgem considers that this proposal could have benefited considerably from going through the development process where industry experts may have identified the ambiguity and contingency issues that have come forward in this proposal and possibly been able to rectify them.



Sarah Harrison
Managing Director, Corporate Affairs
Signed on behalf of the Authority and authorised for that purpose.