

Modification proposal:	<b>Uniform Network Code (UNC) 146: Acceptable Security Tools available to Users for Transportation Credit Arrangements UNC146</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	19 October 2007	Implementation Date:	To be confirmed by the Joint Office

## Background to the modification proposal

In February 2005 Ofgem published a conclusions document in relation to the *Best practice guidelines for gas and electricity network operator credit cover (the Guidelines)*.<sup>3</sup> That document set out a number of recommendations including Ofgem's view on the tools which should be available to counterparties to allow them to cover any exposure beyond their unsecured credit limit. These tools included:

- ◆ An approved letter of credit (LoC) or equivalent bank guarantee from a bank with a long term debt rating of not less than A by Moody's KMV or Standard and Poor's;
- ◆ Cash deposit /prepayment (payment made before the delivery of the service);
- ◆ Advance payment (payment made after the delivery of a service but before contract settlement);
- ◆ An approved ESCROW account;
- ◆ A performance bond (provided by an insurance company, not a bank);
- ◆ Bi-lateral insurance; and
- ◆ Independent security

There are currently provisions (set out in the Code Credit Rules<sup>4</sup>) that permit the User to extend their level of exposure beyond their allocated unsecured credit limit. However, the details of these provisions are not set out within the Uniform Network Code (UNC).

The Guidelines state that to ensure transparency their provisions would benefit from being properly codified within industry codes and agreements.

## The modification proposal

Proposal UNC146 seeks to specify within the UNC the range of acceptable security tools available to the User, in summary these being in any combination:

- ◆ 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),
- ◆ A performance bond (provided by an insurance company, not a bank),
- ◆ Independent security (a guarantee provided by a Qualifying Company),
- ◆ Deposit Deed Agreement (including cash deposit, advance payment or payment made after the delivery of the service but before contract settlement), and
- ◆ Parent Company Guarantee.

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

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370\\_5805.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf)

<sup>4</sup> The Code Credit Rules is an ancillary document to the Uniform Network Code.

The proposer considers that this proposal would allow for the implementation of consistent credit processes for all the distribution network operators. They believe that implementation of this proposal would ensure that there is no inappropriate discrimination and no inappropriate barrier to entry for new market participants. Therefore it is the proposer's view that this proposal will facilitate effective competition between shippers and better facilitate objective (d) of the relevant objectives.

Further, the proposer considers that one of the advantages of this proposal is that network credit arrangements will be aligned with the Guidelines and provide clarity as to which credit tools are acceptable to Transporters.

### **UNC Panel<sup>5</sup> recommendation**

At the modification Panel meeting held on 19 July 2007, of the 9 voting members present, capable of casting 9 votes, 9 votes were cast in favour of implementing this proposal. Therefore the Panel recommended implementation of this proposal.

### **The Authority's decision**

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 19 September 2007. 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 FMR<sup>6</sup>. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC<sup>7</sup>; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>8</sup>.

### **Reasons for the Authority's decision**

This modification proposal seeks to codify within the UNC the tools through which a User may secure any exposures it has to use of system charges (UoS) over and above the extent of its unsecured credit limit.

We note that a number of respondents supported the modification proposal on the basis that the tools covered by the modification proposal are already available within the UNC via the Code Credit Rules, but that the insertion of an ongoing obligation requiring the use of these tools by all Users was a positive step.

We agree that the standardisation and codification within the UNC of the tools through which a User's credit exposure can be secured should assist in lowering barriers to market entry.

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<sup>5</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

<sup>6</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>7</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=6547](http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547)

<sup>8</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

We also consider that the development of a standardised approach to this issue should benefit the market by promoting consistency, which should thereby facilitate the achievement of Relevant UNC Objectives (d) and (f), even though this may mean some Transporters taking on an increased level of contractual risk.

The legal text for UNC146 also seeks to introduce what it described as “cash or advance payment” in the form of a Deposit Deed and a “Prepayment Agreement”. We assume these definitions in the legal text seek to cover circumstances where a User may seek to lodge money with the Transporter in order to cover bills as and when they arise (i.e. payment before the delivery of a service), as well as circumstances in which a User which has received an identifiable bill but wishes to pay the amount early (i.e. payment made after the delivery of a service but before contract settlement). The inclusion of such provisions within the UNC should provide Users with more flexibility in relation to the payment of their bills. It could also reduce the burden on small companies which may otherwise need to more closely monitor their payment record with a view to establishing a line of unsecured credit based on their payment history. As such we consider this inclusion would better facilitate the achievement of Relevant UNC Objective (d).

The definition of guarantee in UNC 146 covers a guarantee made by either a parent company or a non-affiliated company. Ofgem agrees it is appropriate to allow the substitution of a User’s credit limit with any higher unsecured credit limit applicable to another entity (be that entity affiliated with the User or not). Such a guarantee must however be sufficiently robust. It must also be either unlimited or, if limited, it must ensure that the unsecured credit limit assigned to a User does not exceed the limit of the guarantor’s ability to take on and successfully manage risk.

In the event that a parent company guarantees the obligations of a User and as a result the credit rating of the parent company is substituted for that of the User, the guarantee of the parent company or any other affiliate or non-affiliate must not be used to secure credit in excess of its unsecured credit limit; to do otherwise would be ‘double counting’ (i.e. having the effect of the parent company securing a greater liability than its credit rating will support). Alternatively, if the unsecured credit limit assigned to the User is based on the User’s stand-alone credit limit, and a specific additional amount is secured by a parent company, that additional amount must not exceed the parent company’s ability to bear risk and must take into account the extent to which any other companies are also secured by the parent company under the UNC. Ofgem is content to note that the proposed legal text adequately covers these concerns and restricts this eventuality from occurring.

### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 146: Acceptable Security Tools available to Users for Transportation Credit Arrangements be made.



**Mark Feather**  
**Associate Director, Industry Codes and Licensing**

**Signed on behalf of the Authority and authorised for that purpose.**