

Modification proposal:	Uniform Network Code (UNC) 304: Introduction of a rating table for independent credit rating agencies for use with independent assessments (UNC304)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	9 November 2010	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

As with any competitive market, there is a possibility that an energy company using the gas and electricity networks to supply their customers may face financial difficulties at some point in its life. Given that those networks are natural monopolies their operators are required to offer access on equitable terms, while Users are not able to go elsewhere if they do not like those terms.

A balance therefore needs to be struck, to ensure that network operators are able to properly manage the financial risk that network Users may impose, while maintaining credit cover and payment terms which do not unduly restrict access to and use of those networks. With this in mind, in 2005 Ofgem published its best practice guidelines for gas and electricity network operator credit cover ('the guidelines')³.

The aim of the guidelines was to ensure that gas transporter's (GTs) credit cover and payment terms were proportionate, allowing network operators to properly manage, rather than wholly avoid, any exposure to financial risk. The guidelines also set out our views and criteria for the pass through of any bad debt. This could be summarised as requiring a demonstration of adherence to best practice, as may be set out in the guidelines or elsewhere. In recognition that best practice is constantly evolving, we suggested that the guidelines should remain under periodic review.

On 26 January 2007 the Authority directed the implementation of UNC modification proposal 113: 'Availability of Unsecured Credit Based on User Payment Record or Independent Assessment'. The effect of UNC113 was to ensure that a User without a credit rating allocated by Moody's or Standard & Poor's, or with a public credit rating allocated by those agencies but below the current prescribed minimum, should be able to obtain unsecured credit.

Review Proposal 252 was raised in April 2009. Its aim was to review the UNC credit arrangements for transportation charges and consider whether they remained fit for purpose in light of the many credit issues arising since publication of the guidelines. Examples of such issues are the collapse of financial institutions such as Lehman Brothers and the wider 'credit crunch'. The Review Group came forward with 14 recommendations, each of which has now been raised as an individual modification proposal.

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.

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

³ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=9791-5805.pdf&refer=Licensing/IndCodes/CreditCover>

One of the Review Group's finding was that there was no clear guidance on the application of the scoring mechanism for independent credit assessments and that this could lead to each of the GTs using different methodologies for establishing the Independent Credit Score to the extent their interpretation of the process may differ. It was noted in the review that on 24 February 2009 the Authority directed that Distribution Connection and Use of System Code (DCUSA)⁴ change proposal 034 be made. This change had the effect of introducing a list of credit scores used by various credit agencies against their equivalent Credit Assessment Scores for the purposes of DCUSA, which the review group felt to be a clearer system than that used under the UNC.

The modification proposal

In line with the review group's recommendation, UNC304 seeks to introduce a clear credit scoring mechanism into the UNC. Whereas the DCUSA allows for up to five credit rating agencies, UNC304 will be limited to the three agencies currently considered to be acceptable to all of the GTs. However, Users will be able to choose which of those three agents to use for their assessment.

UNC304 seeks to insert additional columns into the table set out in UNC Section V 3.1.7. These will clearly set out how the various credit rating agencies scores will relate to the amount of unsecured credit to be made available.

Existing table		To be added by UNC304		
Independent Assessment Score	% of GT's Maximum Unsecured Credit Limit	Equivalent of the Independent Assessment Score to credit scores provided by the independent credit rating agencies		
		Dunn & Bradstreet/N2 Check	Experian	Graydons
		Comprehensive Report	Bronze, Silver or Gold Report	Level 1, 2 or 3 report
10	20	5A1	95-100	1A
9	19	5A2/4A1	90-94	1B/2A
8	18	5A3/4A2/3A1	80-89	1C/2B/3A
7	17	4A3/3A2/2A1	70-79	2C/3B/4A
6	16	3A3/2A2/1A1	60-69	3C/4B/5A
5	15	2A3/1A2/A1	50-59	4C/5B/6A
4	13 1/3	1A3/A2/B1	40-49	5C/6B/7A
3	10	A3/B2/C1	30-39	6C/7B/8A
2	6 2/3	B3/C2/D1	20-29	8B
1	3 1/3	C3/D2/E1	10-19	8C
0	0	Below E1	Below 10	Below 8C

UNC Panel⁵ recommendation

At its meeting of 19 August 2010 the UNC Panel voted unanimously to recommend implementation of this proposal.

⁴ The DCUSA is the multi-party industry agreement relating to use of electricity distribution systems

⁵ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 6 October 2010. 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 FMR⁶. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁷; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁸.

Reasons for the Authority's decision

There were 11 responses to the Joint Office's consultation. Of these, 9 were in favour, one offered qualified support and the final respondent offered comments only. We agree with the proposer and the UNC panel that this proposal should be assessed against relevant objective (d) and (f).

Relevant objective (d): the securing of effective competition between relevant shippers and suppliers;

A common theme amongst respondents to this proposal was that its implementation would bring greater clarity and consistency to the credit arrangements of the GTs, though comments were in general terms.

Of those who did not expressly support the proposal, one commented that the proposed table did not entirely cover the range of ratings offered by the various agencies, for instance noting that Graydon's ratings went as low as '1D' and queried whether this was deliberate. The proposer subsequently confirmed that the intention of the proposal was to match the table to that used under the DCUSA, which itself had been subject to an extensive benchmarking exercise.

We consider this proposal will enhance access to appropriate levels of unsecured credit, in particular for smaller network users and therefore agree that the implementation of this proposal will have a benefit upon furthering effective competition.

Relevant objective (f): the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

To the extent that the expanded table within Section V 3.1.4 will clearly and unambiguously set out how each of the credit rating agencies scoring will relate to the availability of unsecured credit, we agree that the implementation of this modification will improve the efficient administration of the UNC. It will save the users/readers from

⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁷ 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

⁸ 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.

having to carry out further research, but more particularly will reduce the potential for differing interpretation and subsequent disputes.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC304: *'Introduction of a rating table for independent credit rating agencies for use with independent assessments'* be made.

Rachel Fletcher
Partner, Distribution

Signed on behalf of the Authority and authorised for that purpose