

Modification proposal:	Uniform Network Code (UNC) 300: (UNC300) 'Introduction of Fitch as an allowable Credit Rating Agency for the purpose of Code Credit Arrangements'		
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:	16 December 2010	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

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 network operators' 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.

Within the credit provision industry many organisations will only invest or provide credit to companies that hold a specific credit rating given by an independent Credit Rating Agency. A credit rating basically specifies the level of risk associated with that company and so it is understandable that organisations will only deal with companies that hold certain credit ratings, as they hope this will minimise the incurred risk associated.

As part of the Gas Transporter Licences Standard Condition A38, Ofgem requires that a licensee must maintain an appropriate investment grade issuer credit rating in order to gain an unsecured Code Credit Limit. These can be issued by the three main Credit Rating Agencies; *Standard and Poor's*, *Moody's Investors Services* or *Fitch Ratings*.

UNC Section V3 currently schedules *Standard and Poor's* and *Moody's Investors Services* as acceptable Credit Rating Agencies. Section V3 also states that the Transporter will specify a panel of three independent credit rating agencies. The User may select any one of such agencies for the Transporter to use to allocate an Unsecured Credit Limit to the User.

Review Proposal 252 was raised in April 2009. Its aim was to review the Uniform Network Code (UNC) credit arrangements for transportation charges and consider whether they remained fit for purpose in light of the many credit issues since the 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>

The modification proposal

This proposal seeks to recognise Fitch Ratings as an allowable credit rating agency for the purposes of the UNC.

Additionally, it seeks to improve the clarity and consistency of references to such agencies by introducing a new defined term of "Credit Rating Agency (CRA)" to replace various existing references within Section V.

The proposer considers that UNC300 is likely to further relevant objective (d)⁴ by ensuring that Users have greater choice in the range of acceptable CRAs. They consider that this extension of choice will ensure that there is no inappropriate discrimination and help reduce barriers to entry. The proposer also considers that UNC300 will further relevant objective (f) by streamlining the definition and references to CRAs, improving the administration of the UNC.

UNC Panel⁵ recommendation

At the Modification Panel meeting held on 19 August 2010, the Panel voted unanimously to recommend that the proposal be implemented.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 11 November 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 UNC; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁷.

Reasons for the Authority's decision

We consider that UNC300 is largely a housekeeping proposal, which seeks to give recognition within UNC to a credit rating organisation which is, as far as is relevant, equivalent to those which are already named. Therefore, while we provide comments against relevant objective d), we consider that this proposal should primarily be considered against relevant objective f).

We note that of the eleven responses to the Joint Office's consultation, nine were in support of its implementation, one offered comments and one was opposed.

³ 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

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

⁵ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁶ 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.

Relevant Objective (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

The proposer considered that the implementation of UNC300 would increase flexibility while reducing discrimination and therefore promote competition. However, there were no further details.

While *Fitch Ratings* may not be mentioned in the UNC by name, it does recognise that there are more service providers than those named. Therefore, we are not aware that any UNC User is currently prevented from, or in any way disadvantaged by, using *Fitch Ratings*.

Given the above, we consider that UNC300 will have a neutral impact upon relevant objective b).

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

We agree with the proposer, and those respondents who commented, that UNC300 will better facilitate relevant objective f) to the extent that the inclusion of *Fitch Ratings* and a consistent definition of *Credit Rating Agency* throughout Section V will improve the clarity of the credit arrangements. In particular, we note that there has been some queries and uncertainty over the current term of *Security Provider*, which does not in fact refer to the provider of a tool of security, but to the provider of an independent view of the creditworthiness of an organisation. We consider that the defined term of *Credit Rating Agency* better reflects the role that those organisations will actually perform.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC300: '*Introduction of Fitch as an allowable Credit Rating Agency for the purpose of Code Credit Arrangements*' be made.

Mark Cox

Associate Partner, industry Codes and Licensing

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