

Modification proposal:	Connection and Use of System Code: Amendment to Qualifying Guarantor (CMP197)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	National Grid Electricity Transmission PLC (NGET), Parties to the CUSC and other interested parties		
Date of publication:	15 December 2011	Implementation Date:	10 working days from publication

Background to the modification proposal

Connection and Use of System Code (CUSC) Users who do not have an Approved Credit Rating allocated by Standard & Poor's or Moody's, or with a rating below the CUSC prescribed minimum of BB- or Ba3, are instead able to obtain an independent credit assessment to establish 'User's Allowed Credit' in respect of Balancing Services Use of System Charges and Transmission Network Use of System Charges. User's Allowed Credit is the amount of unsecured credit cover the User is able to achieve, based on certain calculations in accordance with section 3.26 of the CUSC³.

In instances where the User's Allowed Credit is insufficient to generate the total amount of credit cover the User is required to provide (its 'Security Requirement'), additional Security Cover must be lodged to make up the difference. This can be provided in a number of ways as outlined in section 3.21.3 of the CUSC, including the provision of a financial guarantee from another company (a 'Qualifying Guarantee').

The prevailing CUSC provisions in relation to Qualifying Guarantees require the guarantor entity to have an Approved Credit Rating not less than BB- by Standard & Poor's or not less than Ba3 by Moody's, or equivalent rating. An independent credit assessment of the guarantor company is presently not admissible for this purpose.

The modification proposal

CMP197 seeks to remove the current restriction on entities which do not hold an Approved Credit Rating providing a financial guarantee. The proposal provides for entities that do not have an Approved Credit Rating to provide Qualifying Guarantees under an Independent Credit Assessment in order to achieve the Security Cover requirement for the User.

CUSC Panel recommendation

At its meeting of 28 October 2011 the CUSC Panel decided by a seven to one majority that CMP197 better facilitates the Applicable CUSC Objectives and so should be implemented.

The CMP197 workgroup has developed this proposal and the panel recommends the implementation of a cap on Qualifying Guarantees, regardless of whether this is achieved by an Approved Credit Rating or Independent Credit Assessment, so that when an entity

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 (GEMA).

² This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

³ <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/contracts/>

is providing multiple guarantees (or, in the case of a CUSC party, using up any Allowed Credit for its own requirements), the total amount of the guarantor's Allowed Credit is not exceeded in aggregate.

The Panel views are set out in full in the Final Modification Report (FMR)⁴.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the FMR dated 10 November 2011. The Authority has considered and taken into account the responses to the workgroup and Code Administrator consultations on the modification proposal which are attached to the FMR. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the applicable objectives of the CUSC⁵; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁶.

Reasons for the Authority's decision

There were four responses to the Workgroup's consultation. Of these, three were in favour and one was opposed. Two responses were received to the Code Administrator consultation. One of these was in favour, and one was opposed.

We agree with the proposer and the CUSC Panel that this proposal better facilitates relevant objective (b), and has a neutral impact against the other objectives.

Relevant objective (b): facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in sale, distribution and purchase of electricity

The workgroup consultation respondent who was opposed to this proposal did not feel that the independent credit assessment would be sufficiently robust, as the ratings are not continuously checked and independent credit rating agencies may not provide consistent ratings as they are unregulated and often do not declare their criteria. This respondent felt there would be an increased risk associated with implementing this proposal, as a decline in the financial health of the guarantor may not be readily identified and this could increase CUSC parties' exposure to potential default and the risk of bad debt being passed through to consumers. It was suggested that this increased risk and potential cost may be a deterrent to market entry and participation, and therefore damaging to objective (b) compared to the baseline.

One workgroup respondent expressed cautious support for the proposal, quoting from Standard & Poor's website which defines companies with a BB rating as "*Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions*"⁷, and thereby noting concern about the suitability of entities who

⁴ CUSC modification proposals, modification reports and representations can be viewed on NGET's website at <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/>

⁵ As set out in Standard Condition C10(1) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=5327

⁶ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

⁷ www.standardandpoors.com/ratings/definitions-and-faqs/en/us

cannot achieve this rating as potential guarantors. However while they stated that the change may have some detrimental impact on objective (b) by making the credit arrangements less robust, on balance they felt the positive impact on objective (b) was greater, as it would assist smaller participants to secure credit and therefore be more able to compete in the market.

There was no attempt by the respondents to quantify any increased risks or give any indication of materiality, and whilst the reliability of independent credit ratings over time was raised as a concern, it is relevant to note that this method of credit assessment already exists for Users and therefore is not being introduced by this modification.

A balance needs 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. In light of the above considerations, we agree with those respondents who suggested that implementation of CMP197 should better facilitate effective competition, in particular by reducing barriers to market entry and allowing smaller participants to grow their business without unnecessarily tying up cash which could otherwise be used as working capital. We consider that the proposal to cap the total amount of Security Cover a guarantor can provide – so as not to exceed their Allowed Credit level when multiple guarantees are aggregated – will help to maintain robust credit arrangements by mitigating the risk of potential default.

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority hereby directs that modification proposal CMP197: '*Amendment to Qualifying Guarantor*' be made.

Declan Tomany
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Smarter Grids and Governance

Signed on behalf of the Authority and authorised for that purpose