



3 The Square
Stockley Park
Uxbridge
Middlesex
UB11 1BN

Direct Dial: 0208 734 9371
Facsimile: 0208 734 9350

10th December 2004

Sent via e-mail to: samanta.padalino@ofgem.gov.uk

Dear Samanta,

Re: Financial ring-fencing for new and existing independent gas transporters. Initial Proposals

British Gas Trading welcomes the opportunity to comment on Ofgem's initial proposals for the financial ring-fencing for new and existing independent gas transporters and is happy for this non-confidential response to be placed in the Ofgem library.

Generally, the proposals are welcomed and we agree that, in principle, customers on different networks should not face different risks. We also agree that financial ring-fencing provisions may provide safeguards for the financial stability of individual companies that form part of a larger group and that this may provide consumers with protection from insolvency. This was demonstrated in the Enron collapse where customers of Wessex Water were protected from disruption and uncertainty. This enhanced security also allows financial markets to be accessed at reasonable rates.

However, as we have previously stated, we believe that the extent to which financial ring-fencing is employed must be proportionate to the companies under consideration and in part must reflect the potential for failure and consequence of failure. It is disappointing that Ofgem has not attempted to quantify either of these, together with the costs to individual companies associated with the introduction of the measures aimed at protecting customers. This information would have led to a more informed discussion.

Nevertheless, we offer the following comments on Ofgem's proposals. It is not realistic for small independent companies to be expected to obtain an investment grade credit rating as the costs of obtaining a credit rating would be relatively excessive and the financial strength demands in order to obtain an investment grade rating would result in a grossly inefficient financial structure. We therefore support Ofgem's alternative financial arrangements for small IGTs, i.e. those below a specified threshold are provided with the option of keep well agreements together with cash in escrow or an on-demand bond dependent on the financial strength of the parent company.

For large IGTs i.e. those above a specified threshold, we believe that an investment grade credit rating obligation is warranted. However, we are unclear as to whether this is Ofgem's intention or whether it proposes to allow keep well agreements for these IGTs as well.

The confusion arises from an inconsistency in Chapter 6 Ofgem's Proposals. In 6.8 Ofgem states that for all new and existing IGTs with more than a specified number of connected customers it will introduce an investment grade credit rating obligation, whereas in 6.12 Ofgem restates that for all new and existing IGTs with more than a specified number of connected customers it will introduce an investment grade credit rating obligation but adds the option of a keep well agreement with an entity with an investment grade credit rating. Following a telephone conversation with Ofgem, we understand that the latter is correct i.e. keep well agreements will be open to IGTs above and below the threshold. We would welcome confirmation of this as this has implications over and above IGTs, for example IDNOs.

This would suggest that there is a higher threshold above which companies must have an investment grade credit rating, i.e. commensurate with the existing arrangements for DNOs and Transco.

Whilst we agree with Ofgem's principle of providing customers on different networks the same level of protection, we believe that this may be best achieved by complementing financial ring-fencing arrangements with a case by case assessment of the financial strength of the IGT. For example, irrespective of size, a key factor to the financial well-being of an IGT relates to the issue of where debt is raised. If an IGT raises its own debt as opposed to at Group level the opportunity for cross subsidy is higher and accordingly the need for ring-fencing higher.

Finally, with regard to the threshold measure, we consider that the larger the IGT the greater the need for financial ring-fencing. However, we are not convinced that numbers of supply points is a sufficiently robust means to determine scale and believe that Ofgem should consider other drivers before reaching its conclusion. Alternatives include; financial turnover, installed asset value or capacity / throughput.

If you wish to discuss any aspect of this response please do not hesitate to contact me on the above number.

Yours sincerely

Roddy Monroe
Regulatory Issues Manager