

Amendment proposal:	Connection and Use of System Code (CUSC) CAP157: Extension of Qualified Company Definition (CAP157)		
Decision:	The Authority ¹ directs that the Working Group Alternate Amendment be made ²		
Target audience:	National Grid Electricity Transmission PLC (NGET), Parties to the CUSC and other interested parties		
Date of publication:	31 January 2008	Implementation Date:	14 February 2008

Background to the amendment proposal

Section two of the CUSC provides the relevant commercial terms and conditions for the connection of User's Equipment to the GB Transmission System at relevant Connection Sites. It provides for the charging for such connections and for the credit arrangements required to be in place with respect to the Termination Amounts associated with such connections. Termination Amounts are associated with costs incurred in the event that a connection to the transmission system is terminated before the end of an asset life cycle and are calculated in accordance with the Charging Statements.

Further, User's Bilateral Connection Agreements and Construction Agreements provide Final Sums associated with costs incurred to cover the investment that has been for specific connection projects and the terms and conditions associated with securing such amounts in the event of a User terminating the project.

One of the methods by which Users may secure these Termination Amounts and Final Sums is by providing an acceptable Performance Bond from one of the User's immediate shareholders or any holding company of such shareholder. Typically, in a complex corporate group, this refers to a hierarchically more senior company of the User within the corporate group structure. The current terms of the CUSC prevent such Performance Bonds being provided by an affiliate of the User.

The amendment proposal

The proposed amendment suggests an extension to the current provisions of the CUSC to allow affiliates of a User to provide security in the form of a performance bond to cover the User's Termination Amounts and Final Sums. In the proposers opinion, extending the definition in this manner will not weaken the level of security provided, since there is no intention to change the requirements that the performance bond provider must meet, of having a rating of A- (S&P long term debt rating) or A3 (Moody's long term debt rating) unless NGET in its absolute discretion agrees otherwise.

The proposer considers extending the provisions in this manner would make available to some Users a more efficient form of security than the CUSC currently allows. This would mean such Users not having to rely on more expensive alternative forms of security such as letters of credit or cash deposits.

The proposer considered that for those Users that operate within applicable group structures, this proposed amendment would better facilitate applicable objective (b),

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 49A of the Electricity Act 1989.

facilitating effective competition in generation and supply of electricity and facilitating such competition in the sale, distribution and purchase of electricity.

For those Users that did not operate within such group structures, the proposer considered the amendment would be neutral.

The Working Group Alternative Amendment (WGAA)

During analysis of the proposed amendment by the CAP157 Working Group (WG), an alternative amendment proposal was developed by the WG members. The WGAA builds on the changes specified in the original Amendment Proposal and additionally codifies within the CUSC the minimum requirements that must be met by the performance bond provider. This includes demonstrating to NGET that it is constitutionally authorised to provide such a bond, that its board of directors have concluded that it is in its interests to provide such a bond and that it has obtained the authority of every hierarchically senior company up to the User's holding company to provide such a bond.

WG members considered that, in the event of a failure of the User (NGET therefore drawing down on the performance bond) and failure of the subsidiary providing the performance bond at the same time, these additions minimised the risk of any liquidators of the subsidiary performance bond provider withholding payment under the bond.

WG members also considered that providing these requirements in the CUSC made the arrangements more transparent. Overall they considered that the WGAA better facilitated both applicable CUSC objectives (a) and (b)³.

CUSC Panel⁴ recommendation

At its Amendments Panel meeting on 14 December 2007, the Amendments Panel unanimously considered that both the original Amendment Proposal and the WGAA better facilitated the applicable CUSC Objectives. The Amendment Panel considered that of the two, the WGAA best facilitated the applicable CUSC Objectives.

The Authority's decision

The Authority has considered the issues raised by the amendment proposal and the final Amendment Report (AR) dated 24 December 2008. The Authority has considered and taken into account the responses to NGET's consultation on the amendment proposal which are attached to the AR⁵. The Authority has concluded that:

1. implementation of the working group amendment proposal will better facilitate the achievement of the applicable objectives of the CUSC⁶; and

³ As set out in Standard Condition C10(1) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=5327

⁴ The CUSC Panel is established and constituted from time to time pursuant to and in accordance with the section 8 of the CUSC.

⁵ CUSC amendment proposals, amendment reports and representations can be viewed on NGET's website at <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/>

⁶ As set out in Standard Condition C10(1) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=5327

2. directing that the amendment be made is consistent with the Authority's principal objective and statutory duties⁷.

Reasons for the Authority's decision

An important aspect of credit cover arrangements is to allow counterparties to benefit from a wide range of acceptable tools for the provision of credit cover. This will allow parties to choose the form of tool(s) that is most efficient for them.

Both the Original Amendment Proposal CAP157 and WGAA CAP157, introduce provisions into the CUSC that increase the options available to counterparties by increasing the range of related companies from whom the User may obtain a Performance Bond. We consider this better facilitates achievement of applicable CUSC Objective (b), as this will give Users more flexibility to find an arrangement to cover their exposure beyond their unsecured limit in a more efficient manner.

It is important that whilst increasing flexibility, the arrangements also remain robust, effective and transparent. The WGAA codifies into the CUSC in a sufficiently transparent manner the minimum criteria that must be met by a subsidiary performance bond provider. These criteria are those that NGET indicated provide it sufficient assurance that a performance bond will be honoured by a receiver in the event that both the User and the provider enter receivership. Such robustness should ensure that any bad debt is absorbed by those parties who have commercially contracted to take on the risks to cover it. It is for this reason that we consider that WGAA better facilitates achievement of the applicable CUSC Objectives when compared with the original Amendment Proposal. We consider such robustness better facilitates achievement of applicable CUSC Objective (b) since it should provide more confidence to the market.

We would like to draw CUSC parties attention to the relevance of Ofgem's best practice guidelines for Gas and Electricity Network Operator Credit Cover⁸, issued in February 2005. These guidelines primarily focussed on best practice in relation to credit cover provision for Use of System charging. However, many of the principles they enshrine are equally applicable when considering the provision of credit cover for other types of charges, such as those under consideration under this Amendment Proposal, unless good reason can be provided as to why these principles should not be applied. We consider that during the analysis and consultation of this proposal, no such reasons have come forward. Moreover, the guidelines do reference the types of charges being considered under this proposal in the context of determining the Value at Risk from such charges, which should be based on reasonable central assumptions backed by an objective assessment of all relevant evidence⁹. Further the guidelines go on to state, when considering the tools that should be available to cover credit exposure that the listed tools *should be available to counterparties to allow them to cover **any** exposure beyond their unsecured credit limit*¹⁰. We consider this encompasses charges such as Termination Amounts and Final Sums.

It is for CUSC parties to consider, for the types of charges that have been considered under this proposal, if the principles in the guidelines would better facilitate achievement

⁷The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

⁸ <http://www.ofgem.gov.uk/Licensing/IndCodes/CreditCover/Documents1/9791-5805.pdf>

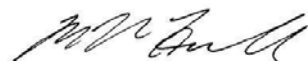
⁹ See paragraph 3.33 of the guidelines

¹⁰ See paragraph 3.35 of the guidelines

of the applicable CUSC Objectives and to raise appropriate amendment proposals accordingly.

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority, hereby directs that amendment proposal CAP 157: Extension of Qualified Company Definition be made.

A handwritten signature in black ink, appearing to read 'R Hull', is positioned above the printed name of Robert Hull.

Robert Hull

Director of Transmission

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