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Direct Dial: 020-7901-7355

20 December 2005

National Grid Electricity Transmission Company,
CUSC Signatories and Other Interested Parties

Our Ref:
IND/COD/CUSC/CAP089/090/091

Dear Colleague,

Amendment to the Connection and Use of System Code (“CUSC”) - Decision and Notice in relation to Proposed Amendment CAP089/090/091: “CAP089 Maximum Unsecured Credit Limit, CAP090 Credit Limits for Rated Companies, CAP091 Establishment and Maintenance of an Unsecured Credit Allowance for Rated & Unrated Companies”.

The Gas and Electricity Markets Authority (the “Authority”¹) has considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP089/090/091 “CAP089 Maximum Unsecured Credit Limit, CAP090 Credit Limits for Rated Companies, CAP091 Establishment and Maintenance of an Unsecured Credit Allowance for Rated & Unrated Companies”.

National Grid Electricity Transmission Company plc (“NGET”) recommended to the Authority that Consultation Alternative Amendment 45 (CAA45) be approved. The CUSC Amendments Panel determined that if any of the options were to be approved that the Implementation Date should be the 1st of the month 6 weeks after the Authority’s decision’.

Having considered the Amendment Report, NGET’s recommendation and having regard to the Applicable CUSC Objectives³ and Ofgem’s wider statutory duties,⁴ the Authority has decided to direct a modification to the CUSC in line with Consultation Alternative Amendment 12 (CAA12).

¹ Ofgem is the office of the Authority. The terms “Ofgem” and “the Authority” are used interchangeably in this letter.

² CAP089/090/091 Amendment Report dated 7 November 2005.

³ The Applicable CUSC Objectives are contained in Standard Condition C10 of the licence to transmit electricity treated as granted to NGC under Section 6 of the Electricity Act 1989 (the “Transmission Licence”) and are:

(a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence; and
(b) facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity.

This letter explains the background to Proposed Amendment CAP089/090/091, and sets out the Authority's reasons for its decision. This letter constitutes notice by the Authority under section 49A of the Electricity Act 1989.

Background

Network Operator credit cover has been the subject of a number of consultations and workgroups since March 2003. In February 2005, Ofgem issued its [Best practice guidelines for gas and electricity network operator credit cover](#) (the guidelines). CAP089, 090 and 091 were raised to correct a number of perceived defects which would also bring the CUSC into line with the guidelines.

The CUSC does not currently set any maximum limit on the amount of unsecured credit that can be extended by NGET to Users. Nor does it differentiate between the amount of credit which should be extended to Users with different grades of Approved Credit Rating (ACR). Instead the CUSC provides that so long as a User's rating is at least BBB⁵ (or equivalent) they can be extended an unlimited amount of unsecured credit. There is currently no provision within the CUSC allowing for an unsecured credit allowance to be extended to unrated Users, or rated Users without an ACR. Users are also currently required to secure an amount equal to 10% of their annual TNUoS demand charges.

CAP089 and 090 were raised by NGET. CAP091 was raised by BizzEnergy. All three amendments were submitted for consideration at the CUSC Amendments Panel Meeting on 20 May 2005. At that meeting the Panel determined that a single Working Group (the Group) should be established to consider all three amendments.

The Group considered that CAP089 and CAP090 were interdependent and therefore the two modifications should be amalgamated. Permission for this was sought and granted at the Amendments Panel meeting on 24 June 2005.

Following further consideration of the issues, the Group considered that elements of CAP91 were also interdependent on amalgamated CAP089/090 and therefore CAP091 should be amalgamated with CAP089/090. The Amendments Panel agreed to this at its meeting of 29 July 2005.

Not all members of the Group agreed that the original Amendment Proposal better facilitated achievement of the Applicable Objectives compared against the current baseline. The Group formulated five Working Group Alternative Amendments all of which were supported to varying degrees as to whether they better facilitated achievement of the Applicable Objectives when compared to the current baseline of the CUSC and the original Amendment Proposal. The Group submitted its report for consideration at the Panel Meeting on 25 August 2005. The Panel

⁴ Ofgem's statutory duties are wider than the matters that the Panel must take into consideration and include amongst other things a duty to have regard to social and environmental guidance provided to Ofgem by the government.

⁵ This is based on the Standard and Poors rating scale

endorsed the Working Group report and determined that CAP089, 090 and 091 should proceed to wider consultation by NGET.

A consultation paper was issued on 2 September 2005 with responses invited by 3 October 2005. NGET received 9 responses to the consultation. NGET, BizzEnergy and Scottish and Southern Energy (SSE) proposed 51 Consultation Alternative Amendments (CAA), which consisted of individual proposals allowing for different combinations of features. A consultation alternative consultation was issued on 10 October 2005 with responses invited by 24 October 2005. NGET received 6 responses to the consultation alternative consultation.

The final Amendment Report was submitted to the Authority on 8 November 2005.

The Proposed Amendment

Amalgamated Proposed Amendment CAP089/090/091 consists of five elements. These are;

1. the introduction of a maximum unsecured credit limit, being 2% of NGET's plc's Regulatory Asset Value (RAV),
2. the introduction of credit allowances for Users with an ACR of BB- and above, ranging from 15% to 100% of the maximum unsecured credit limit,
3. the introduction of a credit allowance for unrated Users or rated Users without an ACR, based on payment record, which Users would be entitled to claim by default, entitling parties to a maximum unsecured credit amount of 2% of the maximum unsecured credit limit after 5 years of perfect payment history . If Users defaulted in making a payment, their allowed credit would be reduced to 50% of what it otherwise would have been on first default ,and to 0% if a second default occurred within the next 12 months,
4. the option for unrated Users or rated Users without an ACR to obtain a credit allowance based on an independent credit assessment. Users would be scored on a scale between 0 and 10 allowing them to obtain a credit allowance between 0% and 20% of the maximum unsecured credit limit. NGET would be required to pay for an annual assessment if the User requested an independent credit assessment. Either NGET or the User could request an interim assessment at their own cost, and
5. replacing the existing requirement to secure 10% of TNUoS demand charges with the requirement to secure an amount based on the accuracy of each User's forecast performance for the previous year, as this was considered to be a more accurate reflection of a User's VAR with respect to TNUoS demand charges.

The first two elements were originally CAP089 and 090 respectively and were raised by NGET. NGET considered these elements would bring the CUSC in line with the best practice guidelines and would also better facilitate the Applicable Objectives. The final three elements were originally part of CAP091 and were raised by BizzEnergy. The proposer suggested that elements 3 and 4 would also bring the CUSC in line with the best practice guidelines and better facilitate Applicable Objective (b) by providing unrated Users and rated Users without an ACR access to some unsecured credit. BizzEnergy considered that the calculation of VAR based on a User's previous year's forecast performance (element 5) would provide a more accurate reflection of a User's VAR and thereby better facilitate Applicable Objective (b).

Alternative Amendment

The Group was unable to reach agreement in respect of either the principal or the detail of one or more of the five elements of Proposed Amendment CAP089/090/091. It formulated five Working Group Alternative Amendments which it considered better facilitated the achievement of the Applicable Objectives as compared with the Proposed Amendment and the current baseline.

WGAA 1

This rejected elements 3, 4 and 5 of the original Amendment Proposal on the grounds that elements 1 and 2 better facilitated the Applicable Objectives as stand alone changes.

WGAA 2

This altered the credit score an unrated User or a rated User without an ACR could receive if it opted to obtain an independent credit assessment. Under this option such a User could obtain a score anywhere between 0 and 100. It was suggested that this increased granularity would allow a more accurate quantification of the risks and increase the likelihood of small Users receiving some unsecured credit, which together would better facilitate Applicable Objectives (a) and (b). This option also provided that the VAR be calculated as the User's forecasting performance plus an additional 2.5% which would represent security cover for reconciliation charges, which was considered to be a more accurate reflection of VAR, thereby better facilitating Applicable Objective (a).

WGAA 3

The original Amendment Proposal suggests a User should have the option to obtain an independent credit assessment at the cost of NGET. WGAA 3 proposes all the elements the same as the original Amendment Proposal except that if a User opts to take an independent credit assessment, it should be at the User's cost. Where NGET requested an interim assessment within the next 12 months, NGET would pay. Any assessments beyond 12 months of a previous assessment would require the User to pay. Any refusal by the User to pay would result in the User's credit allowance defaulting to one based on its payment record. It was argued that if NGET were required to pay on an annual basis, this would create a cross subsidy between the industry and Users that benefited from an independent credit assessment. Ensuring the User paid would prevent this and thereby better facilitate the Applicable Objectives.

WGAA 4

Similarly WGAA 4 proposes all elements the same as WGAA 2 except again the independent credit assessment should be at the User's cost. Again as stated above, where NGET requested an interim assessment within the next 12 months, NGET would pay. Any assessments beyond 12 months of a previous assessment would require the User to pay. Any refusal by the User to pay would result in the Users credit allowance defaulting to one based on its payment record. Again it was considered that if NGET were required to pay on an annual basis, this would create a cross subsidy between the industry and Users that benefited from an independent credit

assessment. Ensuring the User paid would prevent this and thereby better facilitate the Applicable Objectives.

WGAA 5

This option proposes all the elements of WGAA 4 minus the ability for a User to obtain an unsecured credit allowance based on payment record. It was suggested that past performance was not a good indicator of future payment performance and therefore a User should not be able to benefit from any unsecured credit based on such a record.

Respondents' views

NGET issued a consultation paper on 2 September 2005 inviting responses from CUSC Parties and interested parties.

NGET received 9 responses to the consultation in respect of CAP089/090/091, of which two expressed support for the original Amendment Proposal, one expressed support for Working Group Alternative Amendment 1, one expressed support for Working Group Alternative Amendment 5, one expressed support for both the original Amendment Proposal and Working Group Alternative Amendment 3, one expressed support for Working Group Alternative Amendment 1 and 5, one expressed support for the original Amendment Proposal and Working Group Amendment 2 and two expressed opposition to the original Amendment Proposal and all the Alternative Amendments. Three of the respondents also raised Consultation Alternative Amendments which are summarised in the next section of this letter.

A number of respondents expressed concerns that payment record was not a good indicator of future performance and therefore should not be considered as a basis for establishing a credit allowance. Similarly, some respondents considered that forecast performance was not a good indicator of future performance and should not be taken into account when assessing VAR.

Respondents also commented on the general lack of clarity as to how independent credit assessments would practically apply and be considered, as they did not have sufficient information to feel comfortable with this aspect of the proposal.

Respondents also commented that the step change between the credit allowances for parties graded AAA/AA to A was too great and that in general the table could benefit from greater clarity.

One respondent questioned the ability for Ofgem to remain unfettered in its discretion given the existence of the credit cover guidelines.

Consultation Alternative Amendments

In response to the consultation on the original Amendment Proposal and the 5 Working Group Alternative Amendments, NGET received a total of 51 Consultation Alternative Amendments (CAA), which are summarised as follows.

CAA 1 – 6

CAA 1-6 were proposed by Scottish and Southern Energy (SSE) and suggested different values for the amount of credit that should be extended to Users with an ACR between A+ and A-. Currently each of the options proposes the provision of 40% of the maximum credit limit to such Users. SSE suggested there should be more gradation in the values such that a User rated A+ would receive 80% and one rated A- would receive 60%. As SSE considered this should be applicable to all of the 6 options in the consultation, this resulted in 6 CAAs.

CAA 7 – 11

Proposed by BizzEnergy, these CAAs suggested that in the options which provided for an unrated User, or a rated User without an ACR to obtain an independent assessment, the definition of the agency should be amended to read that such an agency was a “suitable” independent assessment agency. As 5 of the 6 options being consulted upon provided for independent assessments this change resulted in a further 5 CAAs.

CAA 12 – 17

Also proposed by BizzEnergy, these CAAs suggested that if any of the 6 options being consulted upon were approved, and as a result a User was required to lodge extra collateral, that User should be allowed to phase in the provision of this collateral over a period of 1 year. This phasing would occur in 12 equal monthly instalments, starting from whatever level of credit the User had in place at the time the provisions became part of the operational baseline of the CUSC, and climb toward the full amount required following the implementation of the new arrangements. The 12 month period would start to run upon the date of implementation of the arrangements in the CUSC. These alternatives also included the addition of the word “suitable” as described in CAA7-11. This suggestion resulted in a further 6 CAAs.

CAA 18 – 21

Also proposed by BizzEnergy, these CAAs suggested that where the introduction of a credit allowance based on payment record was proposed, a refined definition of *good payment record* should be applied to payments dated prior the publication of the guidelines. This definition meant that invoices paid within 7 working days of the due date if not formally reminded, or within 3 working days where such a reminder had been sent, would not negatively affect a User’s payment record. The proposer considered this would prevent any proposal introducing the concept of credit allowance based on payment record from unduly disadvantaging parties. These alternatives would also include the addition of the word “suitable” where applicable, as described in CAA7-11.

CAA 22 – 25

CAA 22-25 is a catch all amendment suggested by BizzEnergy, which seeks to introduce all the changes described in the other CAAs which the company proposed. This resulted in 4 additional CAA’s because BizzEnergy’s proposed change with regard to payment record would not be applicable to WGAA 1 or 5.

CAA 26 – 30

Proposed by NGET, these CAAs suggested that the options consulted upon which propose the use of the User's forecast performance for the calculation VAR should be amended as the original formulation is potentially open to gaming. NGET suggested that a User could significantly under-forecast at the beginning of the financial year, but by resubmitting its forecasts during the last quarter bring its forecast into line and thereby obtain a low figure for VAR for the subsequent financial year. NGET argued that this could expose the network operator to undue risk in the first three quarters, since under forecasting would lead to under securitisation in those quarters. For this reason NGET suggested that in these options the calculation of VAR should be modified to take this into account by weighting the VAR calculation.⁶

CAA 31 – 35

Also proposed by NGET, CAAs 31-35 sought to remove the calculation of VAR based on a User's forecast performance from those options which propose it.

CAA 36 – 41

These were proposed by NGET and suggested one set of transitional arrangements for Users which need to lodge additional credit and are compliant with the existing provisions of the CUSC, and an alternative set of arrangements for those Parties which are not. Compliant Parties would be given 12 months to phase in any extra credit through 4 equal quarterly instalments. Those which were not compliant would be given 3 months to post the amount required under the existing provisions of the CUSC, and then post any additional amounts required in three equal instalments over the subsequent 9 months.

CAA 42 – 46

These CAAs, also proposed by NGET, suggest that the change varying the calculation of VAR based on forecast performance as described in CAA 26 – 30, and the change proposing the inclusion of transition arrangements as described in CAA 36 – 41 should both be made. This resulted in 5 CAA's since the change varying the VAR calculation would not be applicable to WGAA 1.

CAA 47 – 51

NGET's final set of CAAs suggest the removal of the calculation of VAR based on forecasting performance as described for CAA 31 – 35 from those options that suggest it, together with the inclusion of the transition arrangements as described for CAA 36 – 41.

Respondents Views on the Consultation Alternative Amendments

NGET issued a consultation alternative consultation on 10 October 2005, inviting responses from CUSC parties and other interested parties by 24 October 2005. NGET received 6 responses to this consultation alternative consultation for CAP089/090/091. One respondent supported CAA 22, one supported CAA 6; WGA 5 and CAA 41, one expressed limited support for CAA 6; CAA 35 and WGA 5, one expressed support for the original Amendment Proposal;

⁶ The formulae for this calculation can be found in the Amendment Report for CAP89/90/91

WGA 2 and CAA 7-25, one supported WGA 1; CAA 2; CAA 13 and CAA 37 and one did not support any of the Proposals.

The respondent that did not support any of the proposals considered all of the arrangements proposed under any of the alternatives had the effect of watering down the requirements that exist under the current arrangements and therefore increased the risk of parties being exposed to bad debt.

A number of respondents reiterated their concerns about the use of payment records as a means of obtaining a credit allowance. They also did not support application of any transition arrangements, considering this may cause the industry to be under-exposed during the twelve month transition period.

One respondent commented on the difficulty of forecasting very accurately at the beginning of the year because common practice in the half hourly market involved competitive tendering in October.

Another respondent considered the alternative calculation proposed for the calculation of VAR had not been adequately thought through and another commented that NGET had the ability amend inaccurate forecasts.

Some of the respondents did support the increased granularity in the credit allowance applicable to Users with ACR of between A+ and A-.

The respondents' views are summarised with respect to the original consultation and the consultation alternative consultation and contained in full in the Amendment Report in respect of CAP089/090/091.

Amendments Panel Members' views

No responses were received to either of the CAP089/090/091 consultations from Panel Members in their capacity as Panel Members.

At the Amendments Panel on 25 August 2005, the issue of overlap between the amount of credit that could accrue following an independent assessment that resulted in a score between 5 and 10 and the credit which could be gained via the securing of a conventional credit rating was raised. A number of Panel Members expressed the view that they expected the credit that could be obtained by independent assessment would be lower than that which could be obtained via a credit rating.

Panel members also questioned the perceived lack of transparency regarding how exactly independent agencies would derive credit scores.

Recommendation to Ofgem

NGET recommended to the Authority that CAA 45 be approved and the CUSC Amendments Panel determined that, should the Authority approve one of the alternatives before it, that the implementation date should be on the 1st of the month 6 weeks after approval.

Ofgem's view

Ofgem considers the purpose of credit cover arrangements under the CUSC should be to enable NGET to require sufficient security cover to militate against the risk of exposure to bad debt, from all Users of the transmission network. The cover required should be dependent on the level of risk a User presents to NGET and the industry. Ofgem considers that the current arrangements can lead to inappropriate collateralisation which can create a barrier to market entry and damage the facilitation of competition. Ofgem considers the current arrangements may be too lenient towards large participants that have investment grade credit ratings and may be too harsh towards smaller players that do not have such ratings. The result is that NGET may not receive sufficient security from larger players and too much security from smaller parties.

Maximum Unsecured Credit Allowance

Under Standard Licence Condition C8, NGET has a Licence obligation to offer terms for connection and use of system to any authorised electricity operator that makes an application to connect to and/or use the transmission network. NGET does not have the commercial freedom to reject applications so long as they are compliant with the CUSC. In such an arrangement, Ofgem considers it prudent to protect the network operator by introducing a maximum level of unsecured credit that the operator would be required to extend to any party. It is recognised that for some Users, it may be considered a safe commercial risk to extend credit above this maximum level. However against a background where the NGET also has Licence obligations to maintain security of supply⁷ and to facilitate competition,⁸ Ofgem considers it is appropriate to confine any risk to the level of loss the network operator could sustain in a default scenario. The introduction of a maximum unsecured credit limit of 2% of NGET's RAV, achieves this purpose and would thereby better facilitate the achievement of the Applicable Objectives.

Credit Allowance for Rated Users

Having established a maximum level of unsecured credit that it would be appropriate to extend to an individual corporate entity of the highest standing, the level of credit obtainable by other Users should be dependent on the credit risk the User poses to NGET. Ofgem recognises that in the original Amendment Proposal and many of the alternatives, the credit allowances for rated Users have been drawn from the guidelines, a position that was reached following extensive industry consultation. Ofgem considers, credit allowances based on the Basel II rules for determining bank capital adequacy⁹ are the most appropriate approach to adopt and would provide a reasonable reflection of the risk posed by a User. They also provide a clear indication

⁷ Standard Condition C17

⁸ Standard Condition C10

⁹ Best Practice guidelines document p.33

of the credit allowances available and the justification behind them. The introduction of a transparent and easily referenced scale which helps set the level of unsecured credit a User holding a particular rating can be given according to the risk that User poses to NGET, would better facilitate the achievement of the Applicable Objectives.

Credit Allowance for Unrated Users and Users without and ACR

Ofgem considers that the current arrangements in the CUSC have been particularly unfavourable towards unrated Users and rated Users without an ACR. In this regard Ofgem considers the level of security currently required of such Parties constitutes a barrier to market entry which acts to the detriment of competition and negatively impacts facilitation of Applicable Objective (b).

Payment Record

CAP089-091 introduced two methods to deal with this problem by ensuring that some form of unsecured credit could be offered to such Users. The first method is based on payment record. Ofgem recognises this is not always a strong positive indicator of a User's financial health. However Ofgem does consider that it is a strong negative indicator, inasmuch as a User with problems paying its bills on time is likely to be financially weak and possibly in some difficulty. Ofgem considers the method introduced under the original Amendment Proposal and all the alternatives based around it, of extending some unsecured credit based on payment record achieves the appropriate balance of extending some credit towards smaller parties whilst providing appropriate safeguards for immediate withdrawal of this facility and further consequences on the first indication of potential difficulty. For this reason Ofgem approves of the introduction of an allowance, based on payment record, climbing 0.4% per year to a maximum of 2% of the maximum unsecured credit limit after 5 years. Ofgem notes that the safeguard of the credit facility being removed immediately upon non payment has been slightly altered in the amendments which include this feature. Ofgem considers this a reasonable development. Ofgem have indicated above that making timely payments is a critical aspect of this feature, but consider it important to note that this requirement should not override the exercise of sensible commercial practice. For example, when exercising such discretion, NGET may take the view that late payment of a trivial invoice would not lead to withdrawal of this facility. Ofgem considers that allowing for the provision of some unsecured credit based on payment record better facilitates the achievement of Applicable Objective (b) and providing the safeguards attached to this facility better facilitates the achievement of Applicable Objective (a).

Independent Credit Assessments

The second method introduces the concept of Users having the possibility of obtaining an Independent Credit Assessment. Ofgem continues to believe that an unrated User could potentially be as credit worthy as a rated User in the lower two bands and therefore from a consistency point of view should be capable of achieving an unsecured credit allowance of 20% of a network operator's maximum credit limit. It is for this reason Ofgem advocated some overlap between credit assessment scores and the credit allowance available through conventional credit ratings. Ofgem considers that not all Users will be able obtain an investment grade credit rating even if they are a good credit risk. For example, they may be too small an

entity to obtain such a rating. This in itself should not preclude them from being viewed as highly credit worthy. Such Users should be able to, by way of an independent credit assessment, procure an accurate credit allowance based on how well the company is collateralised, run and organised. Hence a business too small to obtain an investment grade credit rating may still be able to obtain a credit score of between 5 – 10, and thereby secure a credit allowance equivalent to an investment grade credit allowance of BBB+ to BB-. As is the case of an investment grade credit rating, the credit score should not be an indication of how much unsecured credit the score/rating entitles the User to receive, but should represent in the same way an investment grade rating represents a statement that a User is adequately collateralised, has appropriate risk mitigation in place and has good systems, processes and management in place. Consequently it should provide comfort that a User which achieves a good score is capable of responsibly managing the level of unsecured credit that the score would extend to it. It should also be noted that whilst there is a potential for a seemingly high level of unsecured credit, the size of a User's portfolio would normally limit its ability to avail itself of this full allowance. For this reason Ofgem approves of the independent assessment method put forward in the original Amendment Proposal and many of the alternatives based around it and urge NGET to bear in mind the principles that credit scores are intended to reflect. Ofgem considers that if independent credit assessments are exercised appropriately, this will facilitate the achievement of Applicable Objective (b). Ofgem recognises that the area of independent assessments is new and developing and acknowledges the work NGET and the industry have done to date to research the agencies that may provide these services. It is accepted that in the light of experience, changes to manage this area may be required. Ofgem considers that the addition of the word "suitable" in the description of the agency that should be used to provide such independent assessments neither adds or detracts from facilitation of the Applicable Objectives.

Ofgem considers that requiring NGET to pay for an assessment once every 12 months is equitable, since NGET will be directing the agency performing the assessment and benefiting from any report it produces in terms of gaining assurances that a User is a good or bad risk.

Value at Risk

Ofgem recognise that billing and payments under the CUSC for TNUoS charges are based on User forecasts which are reconciled after year end. As a result actual VAR may in fact be different to forecast VAR. In an ideal situation, it would be desirable to be able to accurately and easily calculate the VAR for a User, at any given time, which a User would then have to secure.

The current arrangements provide an arbitrary figure for the TNUoS VAR, being 10% of a User's forecast. The original Amendment Proposal and all alternatives based around it, provide an incentive for Users to accurately amend forecasts within year, which Ofgem considers will lead to a situation where forecast VAR more accurately reflects actual VAR, better facilitating Applicable Objective (b). However the solution is deficient to the extent that Users which have forecasted accurately in the previous year will not have to secure anything or secure very little the following year. This may lead to under-securitisation in the market. Ofgem notes NGET's concern that this feature may be open to the drawbacks caused by relying on forecasts made at the beginning of the charging year, namely the risk of gaming. Indeed the alternative calculation

put forward for the calculation of VAR in CAAs 26-30 may overcome these drawbacks. Ofgem considers this area would benefit from further development of a methodology that encourages more accurate forecasting of VAR and takes account of the variation of VAR throughout the year and sets appropriate securitisation.

Credit Monitoring

Ofgem considers the credit monitoring features introduced by the original Amendment Proposal and all the alternatives based around it, of notifying Users when they have reached 85% of their allowed credit will facilitate achievement of the Applicable Objectives since it will give Users a warning that they are approaching critical levels of their credit allowances and thereby provide them with an opportunity to take corrective measures.

Transition Arrangements

Two alternatives of transition arrangements came forward under CAP089-91. The version proposed in CAAs 12-17 would allow Users needing to post additional credit (when compared to what they currently have in place), twelve months to secure this additional amount via twelve equal instalments. The version in CAA36-51 would allow Users currently compliant with the CUSC twelve months to place any additional credit in four equal quarterly instalments. Users currently not compliant with the CUSC credit cover regime, and which need to post less collateral under the new arrangements than they would have done under the old regime, would have to post the full amount required within three months. Users facing an increase in the amount they needed to secure under the new arrangements (when compared to their position under the old regime) would have three months to post the amount required under the old regime and then, over the following nine months, make three equal instalments to cover the additional amount required. Ofgem considers the version put forward in CAA36-51 could require some Users to post a large amount of credit in a relatively short period of time which may be unwarranted. Ofgem considers this would not facilitate the Applicable Objectives. Introducing a more graduated set of transition arrangements would, in Ofgem's view, be more equitable and therefore better facilitate the achievement of the Applicable Objectives.

Consultation Alternative Amendment 12

CAP089-91 considered six elements. These were, maximum unsecured credit allowance, credit allowance for rated Users, credit allowance for unrated Users and Users without an Approved Credit Rating based on payment record, credit allowance for unrated Users and Users without an Approved Credit Rating based on independent credit assessments, calculation of VAR, and transitional arrangements. All fifty seven options that came forward to the Authority consisted of all or some of these different elements in different combinations. In the preceding paragraphs Ofgem has indicated its view of each element and, where more than one option has been developed in relation to a particular element, which option it considers to better facilitate the Applicable Objectives. Where this is not the case, Ofgem has indicated that Parties may wish to give further consideration to the issues. Given the manner in which solutions have come forward, Ofgem considers CAA12 is the option that best facilitates the achievement of the Applicable Objectives when compared with all the other alternatives and the current baseline of

the CUSC. Ofgem considers however that this option will still leave deficiencies in the CUSC regarding the arrangements for credit that require resolution.

Process

The number of alternative options generated under this amendment may not have been the most effective way to bring about the necessary changes. Ofgem would urge parties to try and reach consensus on the best proposals and alternatives, discarding those that are unlikely to better facilitate the Applicable Objectives. Ofgem encourages parties to raise the CAA which they believe best facilitates the Applicable Objectives and to justify the proposal accordingly.

One respondent questioned the ability for Ofgem to remain unfettered in its discretion given the existence of the credit cover guidelines. When issuing consultations and conclusions on matters which are the subject of its regulatory purview, Ofgem is performing its statutory function of providing guidance and giving an indication of likely regulatory views to the industry. Ofgem does not consider that the exercise of this function fetters its discretion in relation to any subsequent decision.

The Authority's Direction

The Authority has decided to direct that Consultation Alternative Amendment 12, as set out in the Amendment Report, should be made and implemented.

Having regard to the above, the Authority, in accordance with Condition C10.7(a) of the licence to transmit electricity granted to NGET under Section 6 of the Electricity Act 1989 (the "Transmission Licence"), hereby directs NGET to modify the CUSC in accordance with Consultation Alternative Amendment 12 as set out in the Amendment Report.

The modification is to be implemented and take effect from 1st February 2006.

In accordance with Condition C10.7(c) of NGET's Transmission Licence, NGET shall modify the CUSC in accordance with this direction of the Authority.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'N. Simpson', written over a horizontal line.

Nick Simpson

Director, Modifications

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