



**CONSULTATION ALTERNATIVE
CONSULTATION DOCUMENT
CUSC Amendment Proposal CAP 127
Calculation and Securing of Value at Risk**

*The purpose of this document is to
consult on Consultation Alternative
Amendment Proposal CAP 127
with CUSC Parties and other interested
Industry members*

Amendment Ref	CAP127
Issue	1.0
Date of Issue	31 January 2007
Prepared by	National Grid

I DOCUMENT CONTROL**a National Grid Document Control**

Version	Date	Author	Change Reference
0.1	30/01/2007	National Grid	Initial Draft for internal comment
1.0	31/01/2007	National Grid	Formal version for release

b Document Location

National Grid website:

www.nationalgrid.com/uk/Electricity/Codes/

c Distribution

Name	Organisation
CUSC Parties	Various
Panel Members	Various
Interested Parties	Various
Core Industry Document Owners	Various
National Grid Industry Information Website	-

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1.0 SUMMARY AND VIEWS

Executive Summary

- 1.1 CAP127 was proposed by National Grid. Following industry consultation, BizzEnergy Ltd have proposed the Consultation Alternative Amendment.
- 1.2 Ofgem published a conclusions document on best practice guidelines for gas and electricity network operator credit cover in February 2005. In order to address and codify these guidelines, CUSC Amendment Proposals CAP089, CAP090 and CAP091 were implemented. Following implementation, Ofgem considered that there were particular areas that still needed further work. One of these areas was the calculation and securing of Value at Risk (VAR).
- 1.3 It has been recognised by Ofgem and the Industry that the current arrangements in the CUSC for calculating the Value At Risk (VAR) associated with Demand TNUoS charges only address one of the many elements of actual VAR and therefore provides an inappropriate basis for determining the amount of security required from users.
- 1.4 It has also been accepted by Ofgem that although their best practice guidelines provide a proxy across all Network Operators in relation to the calculation of VAR, they have proven difficult to apply to demand TNUoS charges, due to the unique way in which they are calculated and billed, with liabilities for each charge occurring at specific times during the financial year. The current arrangements introduced by CAPs 089, 090 and 091 do not fully implement the intention of the guidelines and do not present an appropriate balance between risk and securitisation.
- 1.5 The Proposed Amendment seeks to introduce a more accurate calculation that better reflects the actual VAR and all the elements that contribute to it. This will result in a more appropriate balance between risk and securitisation by calculating VAR closer to actual VAR and securing a percentage of VAR over different periods of the year to reflect the different liabilities at risk.
- 1.6 In order to address this further work, CAP127 was raised by National Grid and was considered by the CUSC Amendments Panel on 29th September 2006 where it was agreed that a Working Group should consider the proposals. Following recommendation of the Working Group, the CUSC Amendments Panel decided that the proposal should proceed to wider Industry Consultation.
- 1.7 In the Consultation Alternative Amendment, it is proposed that one particular element of VAR, the provision for amounts invoiced but unpaid, is altered from that proposed in CAP127. It is proposed that the provision held should equate to 15 days' usage charges or half a months invoice which the proposer believes to be consistent with the maximum delivered unpaid liability up to the point at which the invoice was due for payment. As opposed to the CAP127 proposal which determines that generally where a supplier becomes insolvent, there will have been at least two missed payments.

National Grid's View

- 1.8 National Grid as the proposer of CAP127 is supportive of the original Amendment Proposal, believing that in relation to both the current

arrangements and the proposed Consultation Alternative Amendment, it will better facilitate achievement of Applicable CUSC Objectives (a) and (b). National Grid believes that the resulting levels of security will provide an appropriate balance between managing the risk of exposure and thus socialisation of bad debt across the Industry, and preventing over securitisation.

- 1.9 National Grid presented through the working group meetings and again within the CAP127 consultation, a comprehensive timeline representing the activities undertaken from when a user defaults until the time at which liabilities cease accruing. This timeline was accepted by the working group as a realistic representation, and that National Grid will have issued at least two invoices before liabilities cease accruing. National Grid presented a balanced view in proposing two missed payments to include in the CAP127 Base VAR profile, with a number of industry representatives recognising that in reality three was perhaps a more realistic number.
- 1.10 Whilst National Grid does believe that, in comparison with the current arrangements, the Proposed Consultation Alternative Amendment would better achieve Applicable CUSC Objectives (a) and (b), the resulting amount of securitisation will be insufficient and expose the industry to an unacceptable risk if a user defaults or becomes insolvent.

2.0 PURPOSE AND INTRODUCTION

- 2.1 This is a consultation document issued by National Grid under the rules and procedures specified in the Connection and Use of System Code (CUSC) as designated by the Secretary of State.
- 2.2 Further to the submission of Amendment Proposal CAP127 and the subsequent consultation, this document seeks views from industry members relating to the Consultation Alternative Amendment for CAP127, proposed by BizzEnergy Ltd.
- 2.3 CAP127 was proposed by National Grid and submitted to the CUSC Amendments Panel for consideration at their meeting on 29 September 2006. CAP127 Working Group Report was submitted to the CUSC panel meeting on 15 December 2006. Following evaluation by the Working Group, the Amendments Panel determined that CAP127 was appropriate to proceed to wider industry consultation by National Grid.
- 2.4 Consultation and invited views on CAP127 concluded on 24 January 2007. The Consultation Alternative Amendment to CAP127 was proposed by BizzEnergy Ltd.
- 2.5 Under the terms of the CUSC there is a requirement for a further period of Consultation to be undertaken in order to allow the Industry to consider the proposed consultation alternative amendment. All the correspondence received in response to the original consultation are contained in Annex 4.
- 2.6 This consultation document outlines the Consultation Alternative Amendment. Representations received in response to this consultation document will be included in National Grid's Amendment Report that will be furnished to the Authority for their decision.

- 2.7 This Consultation Alternative consultation document has been prepared in accordance with the terms of the CUSC. An electronic copy can be found on the National Grid website, at www.nationalgrid.com/uk/Electricity/Codes/ along with the Original Consultation Report, the Working Group Report and the Amendment Proposal form. This document invites views upon the Consultation Alternative Amendment and the **closing date for responses is 12pm on Wednesday 14th February 2007.**

3.0 THE CONSULTATION ALTERNATIVE AMENDMENT

- 3.1 BizzEnergy Ltd believe that the Base Levels of VAR proposed in CAP127 should be amended such that they are consistent with the Base VAR Profiles being determined from a maximum delivered unpaid up to the point the invoice was due of 15 days compared with an assumption of two missed monthly payments in the case where a supplier becomes insolvent.
- 3.2 Whilst noting the timeline of actions that would be conducted following a missed payment, BizzEnergy Ltd believe that using two missed payments in the calculation would cause suppliers to post an inappropriate level of security and may have a negative impact on competition.
- 3.3 Ofgem's "Best practice guidelines for gas and electricity network operator credit cover" state that the VAR at any time shall be the amount in money which is equal to the sum of all invoices outstanding and unpaid plus a deemed amount equal to the charges that would be incurred in a fifteen day period. However, the CAP127 Proposal states that due to the unique manner in which TNUoS charges are calculated and charged, this methodology if applied would provide an insufficient level of security and potential exposures to bad debt.
- 3.4 BizzEnergy Ltd believe that it is important to strike a balance between Network Operators' incentives to reduce risks and the resulting increase in counterparty costs. With this in mind, they have proposed a consultation alternative such that the "Amount Invoiced to Date/Allowance for Unpaid Invoices" part of the VAR calculation is consistent with Ofgem's guidelines.
- 3.5 BizzEnergy Ltd believe that the CUSC provisions provide for 15 days pre-payment, thus on a monthly payment cycle the maximum delivered unpaid is 15 days. They believe that the credit cover guidelines were predicated against the underlying principle of securing the delivered unpaid up to the point that the invoice was due for payment. This principle is believed to have been confirmed in the construction of the DCUSA credit cover provisions where payment is 15 days after the month of delivery and the credit requirement associated with this being 45 days. Therefore to ensure consistency with the DCUSA and Ofgem's best practice guidelines BizzEnergy have proposed a Consultation Alternative such that the "Amount Invoiced to Date/Allowance for Unpaid Invoices" should equate to 15 days' usage charges or half a months invoice rather than 2 months invoice as proposed.
- 3.6 This alternative results in a different Base VAR Profile from the original CAP127. To provide transparency on how the Base VAR profiles and percentages were determined for both CAP127 and the Consultation Alternative Amendment, the methodology used has been detailed in Annex 2.

- 3.7 The Base Levels of VAR are simply an actual average of the Base VAR Profiles over a defined security period. In comparison with those originally proposed in CAP127, the resulting Base Levels of VAR are as follows:

Security Period Start Date	HH Base VAR		NHH Base VAR	
	CAP127	Consultation Alternative Amendment	CAP127	Consultation Alternative Amendment
1st April	3.8%	-8.4%	16.6%	4.3%
1st July	-21.1%	-33.4%	11.3%	-1.5%
1st October	-36.8%	-49.1%	9.5%	-2.8%
1st January	19.3%	7.0%	15.9%	3.7%

- 3.8 The remaining elements of the Consultation Alternative Amendment shall be as proposed for CAP127. These are detailed in Annex 1.

4.0 ASSESSMENT AGAINST APPLICABLE CUSC OBJECTIVES

- 4.1 In the view of the proposer of the CAP127 Consultation Alternative Amendment would better facilitate the CUSC Objective (b) (*facilitating effective competition in generation and supply of electricity and facilitating such competition in the sale, distribution and purchase of electricity*) and is better than the original Amendment Proposal as suppliers will be required to post a more appropriate level of security.

5.0 PROPOSED IMPLEMENTATION

- 5.1 The proposer of the CAP127 Consultation Alternative agrees with the Working Group and National Grid that CAP127 should be implemented 10 Business Days after an Authority decision because the transitional arrangements shall effectively limit the immediate impact upon market participants by gradually adjusting any requirement for additional security.

6.0 IMPACT ON CUSC

- 6.1 CAP127 requires amendments to Section 3 of the CUSC, Part III Credit Requirements.
- 6.2 The text required to give effect to the Consultation Alternative is contained as Part A of Annex 3 of this document.

7.0 IMPACT ON INDUSTRY DOCUMENTS

Impact on Core Industry Documents

- 7.1 CAP127 has no impact upon Core Industry Documents.

Impact on other Industry Documents

- 7.2 CAP127 has no impact upon other Industry Documents.

8.0 INITIAL VIEW OF NATIONAL GRID

- 8.1 National Grid as the proposer of CAP127 is supportive of the original CAP127 Amendment Proposal, believing that in relation to both the current arrangements and the proposed Consultation Alternative Amendment, it will better facilitate achievement of Applicable CUSC Objectives (a) and (b). National Grid believes that the resulting levels of security will provide an appropriate balance between managing the risk of socialisation of bad debt across the market, and preventing over securitisation.
- 8.2 Whilst National Grid does believe that, in comparison with the current arrangements, the Proposed Consultation Alternative Amendment would better achieve Applicable CUSC Objectives (a) and (b), it believes that the resulting amount of security will be insufficient.
- 8.3 In defining the levels of both base and forecasting performance related VAR proposed in CAP127, National Grid sought views from the CAP127 working group, in order to gain an appreciation of where the industry feels an appropriate balance lies between user's not being over securitised and the managing the risk of socialisation of bad debt across the industry (in the event that pass through is granted).
- 8.4 National Grid believes that each element of VAR was discussed in detail and used feedback from the working group to set suppliers' security requirements at an appropriate level within the original proposal for CAP127.
- 8.5 One of the areas discussed, was the number of missed payments to be included in determining the Base level of VAR. It is clear that the proposer of the Consultation Alternative Amendment and National Grid (along with the majority of the CAP127 working group) have different interpretations of Ofgem's Best Practice Guidelines definition of value at risk:

"...In relation to each counterparty, the VAR for Use of System (UoS) charges at any time shall be the amount in money which is equal to the sum of:

- (a) the aggregate value of all charges which at that time have been billed to such counterparty (but not necessarily due) but remain unpaid; and*
- (b) a deemed amount equal to the aggregate value of all UoS charges that would be incurred in fifteen day period at the same average daily rate implicit in billed charges under (a).*

This additional amount provides a proxy for UoS charges that are accrued but unbilled at any point in time, broadly in line with the time-weighted average of such charges arising in each monthly billing period."

- 8.6 It is National Grid's view that any security amount should be determined to cover both liabilities incurred and unpaid by the supplier up to payment default and between the date of initial payment default and insolvency. Therefore the majority of the CAP127 working group agreed that the Base VAR profile in the original CAP127 amendment should be drawn up on this basis.
- 8.7 It is clear that National Grid will not be able to commence proceedings to place the supplier into administration until one missed payment has been made. Part of such proceedings involves providing sufficient evidence that an unpaid debt has been pursued. Once such evidence is in place, a statutory

demand has been issued and a petition for bankruptcy has been made, a second payment will have been due. By the time the winding up process is underway it is likely that a third payment will have been missed. However, after consulting the CAP127 working group, it was evident that overall the working group believed that two missed payments provided an appropriate level to include in calculating the Base level of VAR.

- 8.8 It is National Grid's view that the proposer of the Consultation Alternative Amendment believes that the calculation of base value at risk should be in reference to the amount which is outstanding at any given time, assuming the supplier has not become insolvent, as in this scenario "*the aggregate value of all charges which at that time have been billed to such counterparty (but not necessarily due) but remain unpaid*" will be a maximum of fifteen days worth, as TNUoS invoices are issued on the first day of the month that being billed for and is based on 15 day payment terms. National Grid does not agree with this approach as it will not provide sufficient cover liabilities accrued up to the date of insolvency, resulting in a higher risk of the socialisation of bad debt.
- 8.9 Prior to raising CAP127, National Grid discussed with Ofgem the difficulty of applying their Best Practice to TNUoS charges, due to the unique way in which the liabilities are calculated and that supplier forecasting error may effect the value at risk. Although Ofgem appreciated this, they were keen that any amendment which was raised in relation to VAR was still in line with the underlying intention. National Grid believes that it has endeavoured to do this and that the difference between CAP127 and the Consultation Alternative Amendment, is a difference in interpretation of this intention in relation to one particular element.
- 8.10 In relation to the other elements of VAR, National Grid is pleased that the proposer of the Consultation Alternative Amendment has proposed to leave these at the levels resulting from the working group discussions, as proposed in the original CAP127 amendment.
- 8.11 One respondent to the CAP127 Consultation raised a concern over one of the other elements of VAR, by querying whether or not the forecasting performance element of VAR was too harsh and that it may disproportionately hinder smaller suppliers. If this was the case the concern would relate to both the original and the Consultation Alternative Amendments as they adopt the same forecasting performance methodology. However, National Grid received no responses from small suppliers specifically highlighting this as an issue through Consultation process.
- 8.12 Two respondents to the CAP127 Consultation raised a concern over the transparency VAR calculations. In order to clarify, National Grid has provided additional information relating to how the Base VAR profiles have been determined in relation to both the original and alternative amendment in Annex 2. In relation to how the working group reached a decision on each VAR element, and an overview of how the forecasting performance calculations are intended to work are provided in Annex 1. In addition to this, National Grid believes that suppliers will be able to replicate their VAR calculations under both CAP127 and the Consultation Alternative Amendment, as the calculations are set out in the legal text and the supplier already has access to all of the required data.
- 8.13 To aid the justification of the change, one respondent to the CAP127 consultation requested that National Grid provided additional information in

relation to costs that would be incurred to in implementing the proposed changes, and to provide an evaluation of the possible risk of socialisation. National Grid can confirm that these would be minimal, as all of the data required is currently in place and the processing of the data is very similar to other processes currently undertaken by National Grid.

8.14 In relation to the socialisation of costs, if a supplier under forecasts year on year by 20% then, depending upon the time of year, National Grid calculates the associated value at risk will be up to 46% of their forecasted annual NHH liability and up to 58% of their forecasted annual HH liability. Based upon the model used to calculate 2006-07 TNUoS tariffs, for every £1m that is passed through:

- i) 0.4p/kW will be added to Generation Tariffs;
- ii) 1.3p/kW will be added to (HH) Demand Tariffs; and
- iii) 0.002p/KWh will be added to (NHH) Energy Consumption Tariffs

8.15 In summary, National Grid believes that CAP127 better meets the applicable CUSC objectives by striking an appropriate balance between incentivising National Grid to manage the exposure of bad debt across the Industry, whilst maintaining an appropriate level of securitisation to promote competition within the Industry. Although the Consultation Alternative Amendment provides a better approach to calculating VAR than the existing arrangements, this will result in undercollateralisation and thus presents an unbalanced approach to managing the risk of bad debt.

9.0 VIEWS INVITED

9.1 National Grid is seeking the views of interested parties in relation to the issues raised by Consultation Alternative Amendment Proposal CAP127.

9.2 Please send your responses to this consultation to National Grid by no later than **close of business on 12pm on Wednesday 14th February 2007**.

Please address all comments to the following e-mail address:

Beverley.Viney@uk.ngrid.com

Or alternatively, comments may be addressed to:

Beverley Viney
Amendments Panel Secretary
Electricity Codes
National Grid
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

ANNEX 1 – Value at Risk under CAP127 & the Consultation Alternative Amendment

Summary

In developing CAP127 with the CAP127 working group, National Grid presented analysis that built a picture of the numerous elements that make up VAR for demand TNUoS charges for user's non-half-hourly (NHH) and half-hourly (HH) demands, how VAR varies as a year progresses, and how VAR can vary as a result of variance in each element.

Given the VAR profiles presented by National Grid it was clear that VAR has an element of seasonality. It is therefore, proposed that each year will be divided into a number of security periods in which a different level of VAR will be secured. After seeking views from the working group, National Grid has proposed in CAP127 that four security periods are used, commencing 1st April, 1st July, 1st October, and 1st January.

It is difficult to forecast VAR due to the large number of variables, such as adverse weather conditions, reconciliation, missed invoice payments, under/over forecasting and triad dates, each of which is discussed in more detail in this report. In both CAP127 and the Consultation Alternative Amendment, it is proposed that the level of VAR to be secured in each security period is split between Base VAR (BVAR), comprising of those elements generally outside a User's control, and Forecasting Performance Related VAR, in which a user does have control. Therefore, under CAP127 and the Consultation Alternative Amendment, VAR shall be determined as:

$$\text{Supplier VAR} = \text{Base Level of VAR} + \text{Forecasting Performance Related VAR}$$

Base Level of VAR

National Grid proposed that the Base Level of VAR to be secured in each security period is determined from a Base VAR profile defined by determining appropriate levels for each of its constituent elements, through working group discussions. It was agreed that a pragmatic view of each element should be taken, considering the typical risk, and the likelihood of any extremities, whilst being minded to strike an appropriate balance of risk and securitisation.

There are a number of elements that should be taken into account when determining BVAR. The results of the workgroups deliberations and majority consensus are as follows:

Weather Conditions

National Grid presented an analysis of how weather conditions can affect a user's actual VAR. It is possible that due to different weather conditions, a user's actual VAR can be affected by up to $\pm 3\%$ of their annual NHH liability and up to $\pm 6\%$ of their annual HH liability. National Grid proposed that average weather conditions were to be assumed as this was the typical case, and using any alternative method may lead to over or under securitisation.

The working group agreed that the best approach was to assume average weather conditions, and that the risk associated with the socialisation of a user's additional liability due to adverse conditions was acceptable under this proposal.

Initial Reconciliation

The Initial Demand Reconciliation is undertaken to account for any difference between Users demand forecasts and demand observed in settlement data which has been received up to a point in time shortly after the financial year has ended.

It was agreed that as the initial reconciliation related to forecasting performance, it should be considered part of the Forecasting Performance Related VAR.

Final Reconciliation

The Final Demand Reconciliation is undertaken to account for any difference between the set of settlement data used for the Initial Demand Reconciliation and the Reconciliation Final (RF) run of settlement data. This is carried out approximately 14 months after the end of the year.

Generally a supplier's final reconciliation will range between $\pm 2\%$ of the annual liability in the year concerned, therefore National Grid proposed to use this value in the calculation of the Base VAR profile.

The working group agreed that due to the accuracy of HH metering, the likelihood of any liability outstanding would be low and therefore 0% of a user's HH annual liability was an appropriate level to be used in determining the HH Base VAR profile.

The group also agreed that although there is a real risk that 2% of NHH liability could be outstanding there is an equal probability that this could be a credit back to the User. Therefore the group agreed a level of 1% of a user's NHH annual liability was an appropriate level to be used in determining the NHH Base VAR profile.

Triad Dates

An analysis of historical triad dates was undertaken and presented to the working group.

Initially, National Grid proposed that the average date of each triad leg observed over the last 15 years should be used to determine the HH Base VAR profile. Further analysis was undertaken at the request of the working group, and it became apparent that recent triad dates have occurred later than those observed in the 1990s. Therefore, the group agreed that it was sensible to use average triad dates since NETA Go Live in determining the HH Base VAR profile.

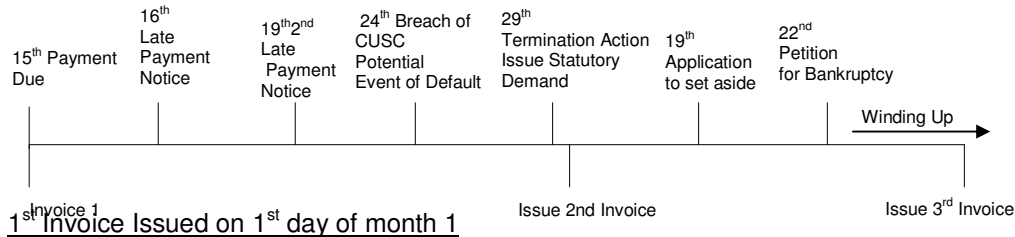
Missed Payments

National Grid proposed that two missed payments were used in determination of the Base VAR profiles. It believed that this was appropriate, given that a Supplier would miss at least two payments in the majority of cases in which a Supplier becomes insolvent and that it is in fact realistic to expect three payments to be missed prior to liabilities being taken on by an administrator or Supplier of Last Resort, or before a trade sale could occur.

The majority of the workgroup recognised that a realistic number of missed payments should be used, as the eventual solution should be reflective of the actual VAR. It was recognised that the eventual solution should strike a balance between the risk of socialisation of unpaid liabilities and competition. National Grid proposed the use of two missed payments in the determination of the base VAR profiles as this covered the amount which it deemed to be the minimum amount expected.

Two members agreed that in practice there would be a minimum of 2 months missed payments before a Statutory Demand was issued. One of the members gave the timescales for a statutory demand being issued against a shipper failing to pay gas balancing charges, which indicated at least two months worth of missed payments. Two members agreed that it can take up to 2 months for a Supplier of Last Report to be implemented.

The majority of the working group agreed that two missed payments was an appropriate level to use. One member requested that National Grid provide a timeline of actions that would be conducted following a payment being missed, all the way up to the issuing of a statutory demand, this was provided at a subsequent meeting and the majority of the group agreed that using two missed payments in the determination of the Base VAR profiles was the correct approach to take. This timeline is as follows:



Day 1, 15th day of month 1: First missed payment, Use of System invoices are issued on the 1st of the month for payment on the 15th under the terms of CUSC.

Day 2, 16th day of month 1: Late Payment Notice issued to supplier in accordance with terms of the CUSC, three business days are given to allow the User to settle the invoice.

Day 5, 19th day of month 1: 2nd Late Payment Notice issued stating Late Interest will accrue each day invoice remains unpaid.

Day 10, 24th day of month 1: Seven business days after payment due date issue breach of CUSC & Potential Event of Default in accordance with terms of the CUSC, gather all evidence of Users failure to pay, inform Ofgem, instruct solicitor.

Day 15, 29th day of month 1: Issue Termination notice & Statutory Demand/Legal proceedings.

Day 18, 1st day of month 2: 2nd invoice issued.

Day 32, 15th day of month 2: Second missed payment.

Day 35, 19th day of month 2: User has 18 days receiving Statutory Demand to file an application to set aside.

Day 38, 22nd day of month 2: If no application to set aside then under the terms of a statutory demand the earliest a Petition for Bankruptcy can be filed is 21 days after the issuing of the demand.

Day 47, 1st day of month 3: 3rd Invoice issued.

Day 61, 15th day of month 3: 3rd missed payment.

Winding up of the User occurs over a period of time after the issuing of a Petition for Bankruptcy which is certainly more than 9 days, by which time the 3rd invoice has been issued and in reality will not be paid.

The timeline is based on actions that National Grid are able to take under the current terms of the CUSC and actions relating to the issuing of Statutory demands and in consideration of the Insolvency Act 1986. Considerations in the issuing of statutory demands include:

- Exhausted efforts to recover debt
- Comprehensive evidence that they are unable/won't pay
- Termination of contract prior to issue

One member, though agreeing that there would be at least two missed payments when applying the rules of the CUSC and the Insolvency Act, was concerned that two missed payments was too much to use in the calculation of base VAR and would cause Suppliers to post an inappropriate level of security. This working group member was concerned that this could have a negative impact on competition. This view was not shared by the remainder of the workgroup. It was agreed that whilst the relating areas of the Insolvency Act and the CUSC (which are out of the scope of this amendment) were in place, two missed payments should be used in determining the Base VAR Profiles, as this was reflective of the actual risk. Although working group alternative amendments were raised in relation, the concern forms the basis of the Consultation Alternative Amendment.

Calculating Base VAR under CAP127 and the Consultation Alternative Amendment

Under CAP127, and the Consultation Alternative Amendment, a supplier's Base Level of VAR in a given Security Period shall be calculated as follows:

Base VAR = HH Base VAR + NHH Base VAR

HH Base VAR = HH Base Percentage*Annual HH Liability

NHH Base VAR = NHH Base Percentage*Annual NHH Liability

Where the annual liabilities are calculated using the relevant TNUoS tariffs and the supplier's latest demand forecast. This should be easy to replicate as the supplier will have access to the required data, whether it be in the public domain (Base Levels of VAR/TNUoS tariffs), or originally provided by the supplier (demand forecasts).

Forecasting Performance Related VAR

The second part of the VAR calculation is based upon the User's forecasting performance. It was recognised that this area needed a considerable amount of

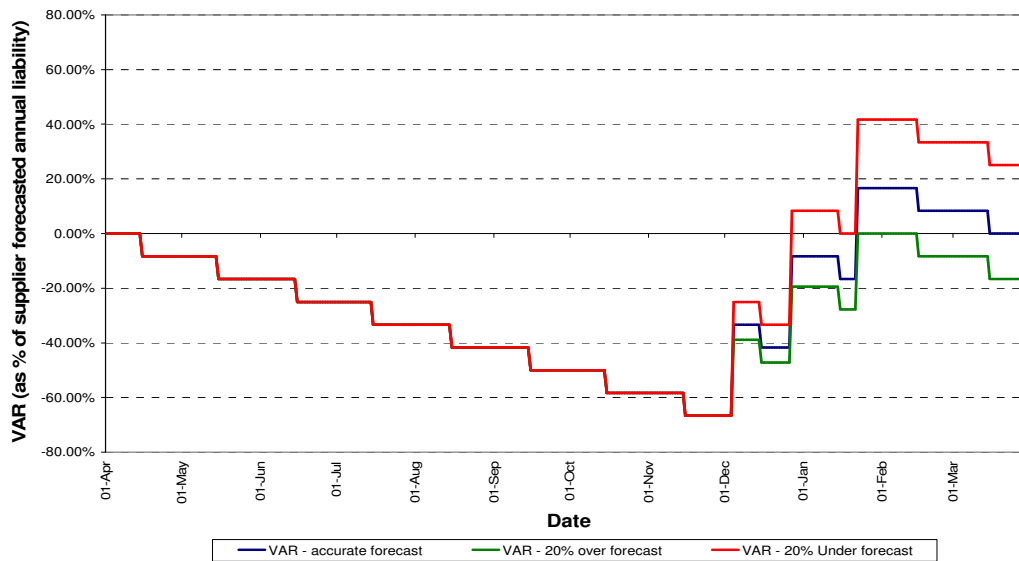
attention as this is the main area of the current arrangements and is not addressed fully. After seeking views from the working group, the group debated relative merits of a number of methods of calculation, and considered all methods based on the risk of default, the users ability to forecast accurately during the periods being considered and applicability against the relative CUSC objectives.

In looking at the applicability, the group considered the most appropriate way to manage the VAR is to incentivise a User to forecast accurately. One member of the Group commented that a User, outside of the usual trading rounds, may pick up customers for whom he has no ability to forecast, and thus any performance related forecasting method would be distorted to the detriment of that User. This was agreed by the group and an appeals process was developed, by which the User has redress if it can be proven that they have picked up a significant amount of customers beyond their ability to forecast for them.

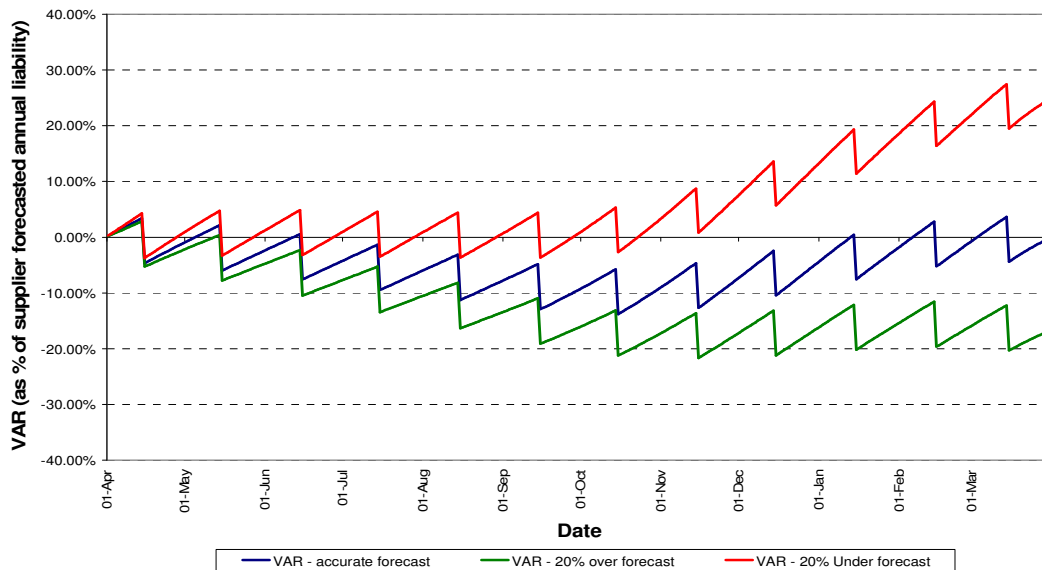
It was agreed that the resulting solution should be transparent, equitable for all Suppliers and sufficiently deal with the prospect of placing anyone at an unfair competitive disadvantage whilst also being reflective of the additional VAR posed by under forecasting. The results of the workgroups deliberations and majority consensus are now presented.

National Grid presented evidence that a Supplier’s forecasting performance has a significant impact on the level of actual VAR. This impact is depicted in the following charts:

HH Demand:



NHH Demand:



As this is something within a Supplier's control, National Grid believes that it is worthwhile for any final solution to provide suppliers with an incentive to forecast accurately during those periods in which the effect of under forecasting is greatest. It was agreed that the current calculation of VAR was open to gaming as it is based on only 1 month's level of under forecasting.

A methodology of taking an average forecasting performance over the last six months of a previous year, using the actual annual liability (from the last calculated initial reconciliation) was presented by National Grid as an initial proposal. Some of the working group members raised the concern that the first month being considered was submitted prior to a large contract round undertaken in October, and it was therefore probably more prudent to base the forecasting performance on forecasts used in calculating the last five TNUoS bill of the year.

Concern was also raised that the proposed methodology could discriminate against a supplier if they unexpectedly picked up extra customers (e.g. following another supplier becoming insolvent). One working group member suggested that either an appeals process was put into place, or the number of forecasts considered was reduced further.

In a subsequent meeting National Grid presented an appeals process that would adjust the forecasting performance of those penalised using the initially proposed methodology level calculated.

Concerns were raised by one member of the group that the appeals process may not necessarily cover all issues presented. They believed that some suppliers may still be disadvantaged as they may need some experience of a particular customers' behaviour before they can submit an accurate forecast and may be subject to slight forecasting error as a result of misleading information provided by the customer. One member of the group questioned whether or not suppliers have an element of control over this issue, as they

could provide an incentive to their customers to provide accurate information. Some members of the group did not believe that this was a practical solution.

Although any slight under forecast relating to misleading information provided by a supplier's customers does contribute to the value at risk, the group agreed that in the interests of competition any resulting effect on the security requirement should be minimised. In order to do this, one working group member suggested using a "weighted" average of demand forecasts over the five months, giving increased weight to the later months for which demand forecasting is easier.

National Grid stated that any weighted average must be logically based, and therefore proposed the following set of weightings, defined using amounts reflective of cumulative HH and NHH TNUoS liability profiles for a typical supplier:

Invoice Month	HH Forecast weighting	NHH Forecast weighting
November	33.3	41
December	33.3	49
January	33.3	59
February	66.7	70
March	100	81

After some deliberation, the working group agreed to use a weighted average of forecasts used to calculate the last five monthly invoices in a previous financial year to calculate the forecasting performance element of VAR, and that this should be carried out using the weightings proposed by National Grid (detailed above) specified as fixed amounts within the CUSC. In addition, it was agreed that an extreme weather allowance of 3% of NHH annual liability, 6% HH annual liability will be subtracted from the resulting forecasting performance related VAR.

Due to the extreme weather allowances, the Forecasting Performance related VAR resulting from the proposed methodology (e.g. 17% of NHH liability and 14% HH liability for a supplier under forecasting by 20%) is potentially less than that under the current methodology (e.g. 20% if under forecasting by 20%), whilst providing an incentive to suppliers to forecast accurately, when the actual value at risk relating to forecasting performance is greatest.

Calculating Forecasting Performance related VAR under CAP127 and the Consultation Alternative Amendment

Under CAP127, and the Consultation Alternative Amendment, a supplier's Forecasting Performance related VAR shall be calculated as follows:

Forecasting Performance Related VAR = HH FVAR + NHH FVAR

HH FVAR = Deemed HH performance percentage* Supplier forecasted Annual HH Liability

NHH FVAR = Deemed NHH performance percentage* Supplier forecasted Annual NHH Liability

$$\text{Deemed HH performance percentage} = \frac{\text{Sum}(\text{Monthly HH Weighting} * \text{Monthly HH performance})}{266.6}$$

$$\text{Deemed NHH performance percentage} = \frac{\text{Sum}(\text{Monthly NHH Weighting} * \text{Monthly NHH performance})}{300}$$

$$\text{Monthly HH performance} = \frac{(\text{Prior Year Actual HH Annual Liability} - \text{Supplier Forecasted HH Liability used for monthly invoice})}{\text{Prior Year HH Actual Annual Liability}}$$

$$\text{Monthly NHH performance} = \frac{(\text{Prior Year Actual NHH Annual Liability} - \text{Supplier Forecasted NHH Liability used for monthly invoice})}{\text{Prior Year NHH Actual Annual Liability}}$$

Where supplier forecasted annual liabilities are calculated using the relevant TNUoS tariffs and the supplier's latest demand forecast, and prior year actual annual liabilities are as determine in the initial demand reconciliation. This should be easy to replicate as the supplier will have access to the required data, whether it be in the public domain (Base Levels of VAR/TNUoS tariffs), originally provided by the supplier (demand forecasts), or included in information sent to the supplier as part of the initial reconciliation (prior year actual annual liabilities).

Forecasting Performance Appeals Process

As previously mentioned, one of the workgroup members proposed that an appeals process was created, in which it is intended to account for a User unexpectedly taking on Customers during the year that they have been unable to forecast for. The proposer of this mechanism explained that a Supplier, outside of the usual trading rounds, may pick up customers for whom he has no ability to forecast, and thus any performance related forecasting method would be distorted to the detriment of the Supplier. The proposal therefore addresses this issue by using a methodology by which the User has redress if they can prove that they have picked up a significant amount of customers beyond their ability to forecast for them.

The working group agreed that an appeals process based on the following criteria be made available:

- A User can request, within one month after National Grid notifies them of their forecasting performance related VAR, to recalculate the value, due to an unforeseen increase in their demand.
- The User will need to provide to National Grid the amount of increase in demand (which must equate to at least 1% of their annual HH or NHH liability) and the time period in which such an increase occurred (which must be less than 20 business days in length).
- National Grid has one month from the date of such a request to recalculate the forecasting performance related VAR.
- The recalculation will be based on the amount of growth observed, by Suppliers customers, in 20 business days following a period of growth when compared with the 20 days observed prior to the period of growth over and above a similar amount observed over demands observed from other chargeable sites over the entire system.

- This growth will be multiplied by the typical amount of chargeable demand remaining in the financial year to work out the resulting adjustment in TNUoS liability (A).
- The Users forecasting performance will then be recalculated adjusting the forecasts submitted prior to the period of growth by the adjustment in TNUoS liability (A), capped at the level of the forecast used to calculate the TNUoS Bill issued immediately following the reported period of growth.

The workgroup also agreed that multiple appeals were acceptable as long as periods of growth did not overlap.

One of the working group members raised a concern over whether or not the appeals process would become burdensome for National Grid. National Grid did not believe that this would be the case, as from previous discussions it was evident that the circumstances leading to a need for an appeal would be rare, and that it is expected that suppliers would follow the intended incentive and avoid under forecasting. National Grid also believes that the calculation mechanism can easily be automated.

National Grid proposed that the decision made following the appeals process would be final. One working group member believed that the process should be subject to CUSC disputes process or an appeal to Ofgem. However, the remainder of the group believed as the timescales and mechanics of the appeals process would be set out in the CUSC, this would not be required, as the process would be transparent and replicable by the user as the methodology will be set out in the CUSC and all demand data will be available in the public domain.

The relating calculation and revised forecasting performance calculation, are best described using an example. Examples of how the Forecasting Performance calculation and relating Appeals Process would work were provided in the CAP127 Consultation Document.

Transitional Arrangements

The working group agreed that following implementation, the amount of security required will be determined using the base VAR levels in the relating security periods in addition to any existing forecasting performance level.

Following the next complete year the proposed forecasting performance element will replace that currently used.

In addition, during the first twelve months from implementation any additional security requirement shall be stepped up equally until the full security amount is provided. This would be done in such a way that if there was an increase between the security requirement for one month and the following month under CAP127/the Consultation Alternative Amendment, then the amount required in the following month shall be adjusted proportionally, depending on how many months had passed from implementation. For example, after three months this amount would be 25% (3/12) of the monthly increase, after 6 months 50% (6/12) of the monthly increase, etc.

ANNEX 2 - Methodology used to determine Base VAR profiles

The Value at Risk associated with a supplier's TNUoS charges at any given time is essentially the total amount of liability the supplier has accrued to date minus the payments made to date.

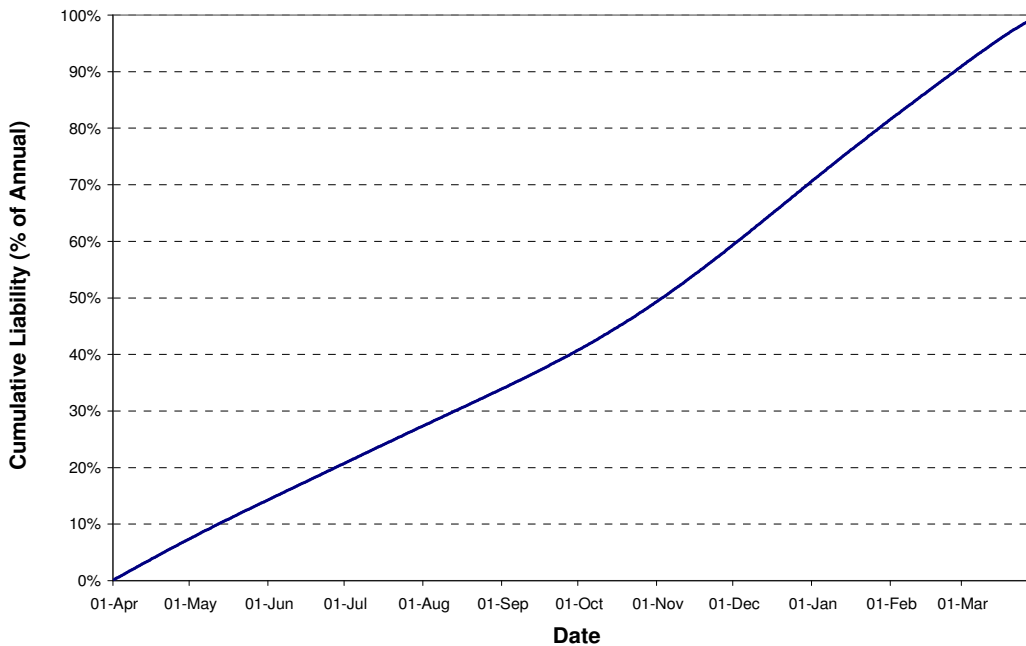
Liability

In relation to a supplier's TNUoS charges there are four different liabilities potentially outstanding:

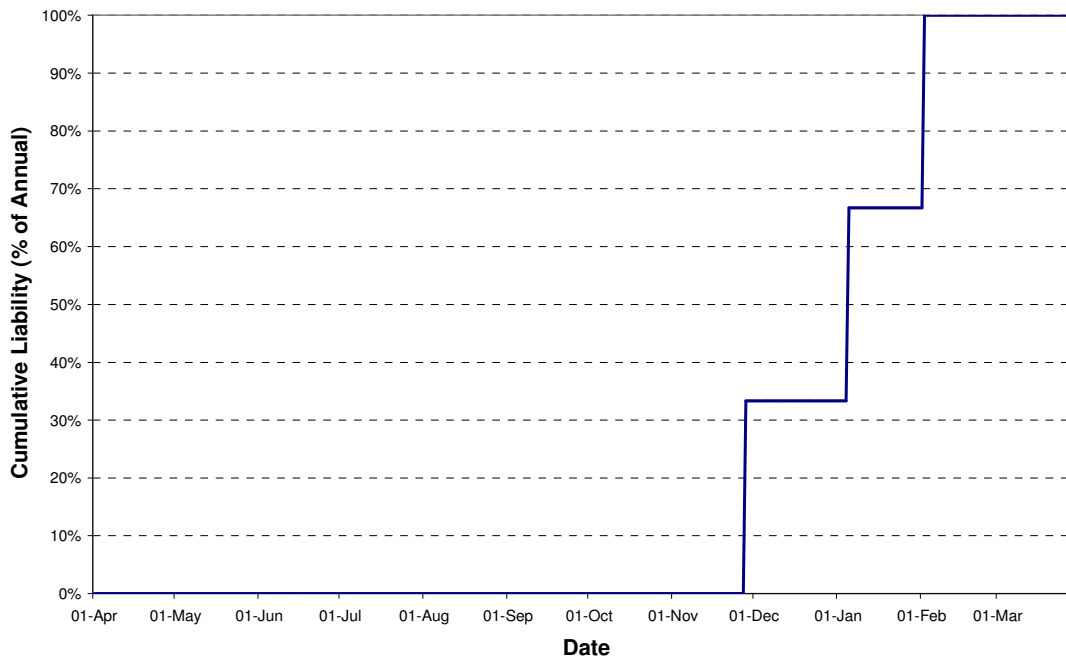
- (a) Within year liability (year y);
- (b) Initial Demand Reconciliation liability in relation to the previous financial year (y-1);
- (c) Final Demand Reconciliation liability in relation to the previous financial year (y-1); and
- (d) Final Demand Reconciliation liability in relation to year y-2.

Within year liability

In relation to NHH customers TNUoS demand charges are incurred against energy consumed between 16:00 and 19:00 of each day. Overall NHH consumption data from previous financial years has been taken to determine a typical liability profile for a supplier of NHH customers, used in determining the Base VAR profile:



In relation to HH customers, TNUoS demand charges are incurred against demand taken over the three triad legs. In determining the Base VAR profile it is assumed that a supplier will incur an equal amount of liability over each leg. Using this assumption, and triad dates experienced during 2005-06 the following liability profile would be incurred:



Following discussions with the CAP127 working group, it was agreed that the proposed set of triad dates used in determining the Base VAR profile should be the average set of dates observed since 2001-02 (6th December, 2nd January, 26th January).

Forecasts of annual HH and NHH chargeable demands provided by suppliers to determine their monthly TNUoS bills will be profiled using the liability profiles above. Please note that it is possible that a supplier may not accurately forecast in an attempt to manage their cash flow, and delay payment of part of their TNUoS charges. As a result extra value at risk will be present until the relating forecast is improved, as this amount varies from supplier to supplier, it was decided that this should not form part of the Base VAR profile, and instead should be covered in a forecasting performance related element.

Initial Demand Reconciliation

The initial reconciliation essentially aims to charge for any difference between a supplier's within year forecast of their chargeable demand and the amount reflected in settlement data. Any difference essentially relates to the suppliers forecasting performance and is therefore covered by the forecasting performance related element of VAR.

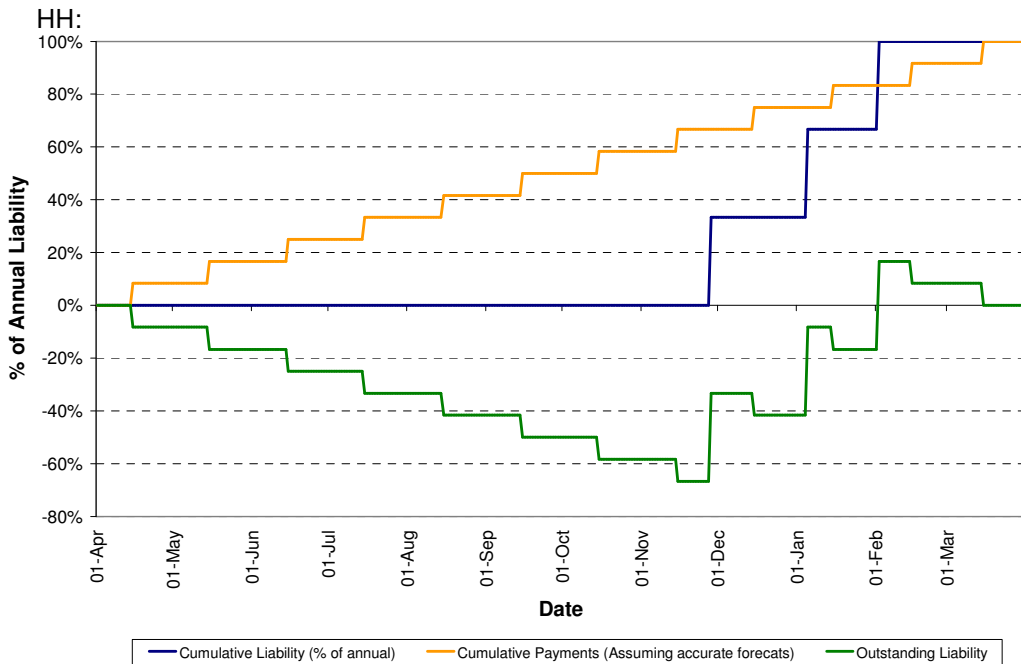
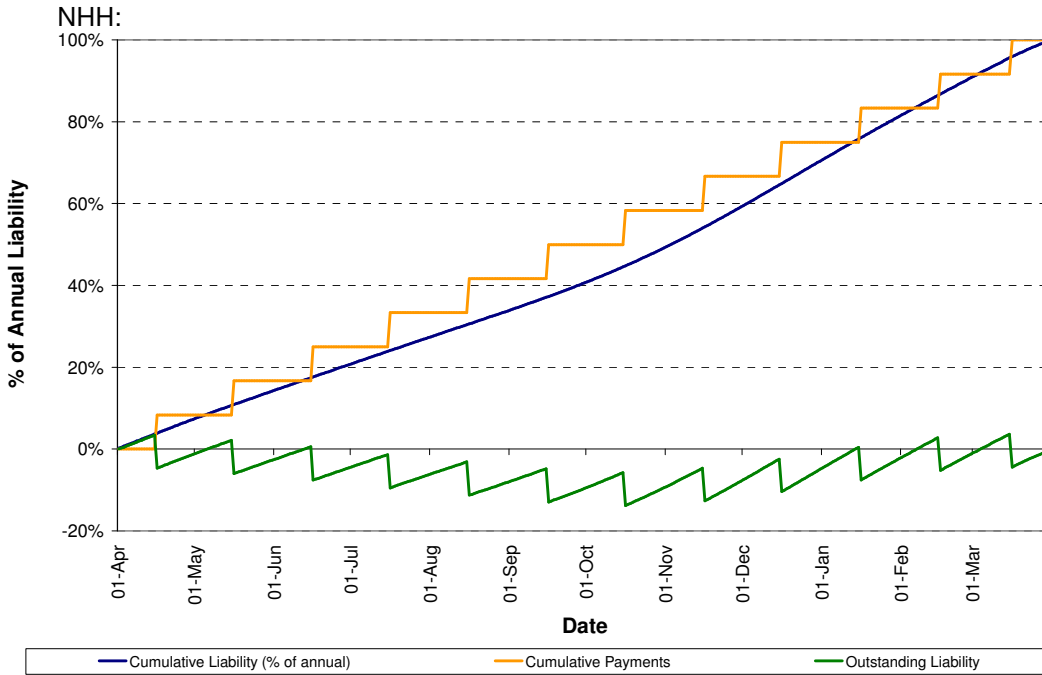
Final Reconciliation

Approximately 14 months after the end of a financial year, a further reconciliation is undertaken to cover any difference between settlement data used in the initial reconciliation and the reconciliation final (RF) run of settlement data. After conducting an analysis on previous reconciliations and discussion with the CAP127 working group, it was decided that as HH data is usually accurate, and typically does not change between settlement runs, the relating final reconciliation amount shall be set to zero. However, due to the amount of forecasted data used in earlier settlement runs, it was decided that each final reconciliation amount shall be set equal to 1% of the forecasted annual liability, determined from the suppliers demand forecast.

As a result an extra 1% is included during each day of the financial year for the NHH base VAR profile and a further 1% between 1st April and 15th July (the expected payment date for the final reconciliation for year y-2).

Payments made to date

To determine the resulting Base VAR profile, the typical outstanding liability profile must be determined. To do this the typical liability profile must have the relating payment profile subtracted from it. For example assuming no final reconciliation amounts:



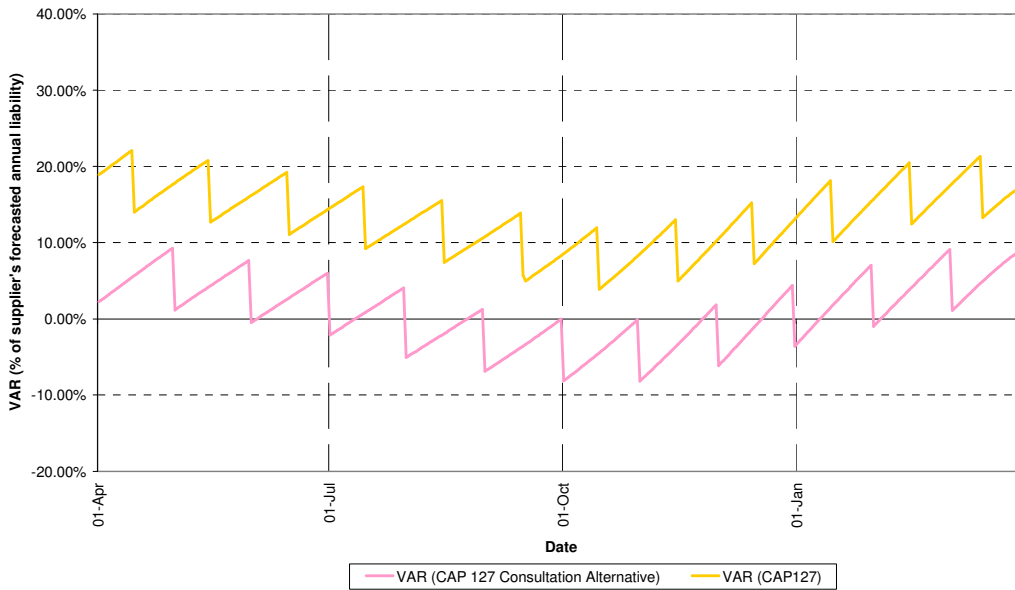
In the event that a supplier enters financial difficulties, it is likely that a number of payments will be missed before the supplier stops accruing TNUoS liability. The Base VAR profiles therefore include delayed payment profiles.

In CAP127 two payments are assumed to have been missed (i.e. the payment profile is offset by two months, including payments relating to previous years). In the Consultation Alternative Amendment it is assumed that payments have been missed for 15 days (i.e. the payment profile is offset by 15 days including payments relating to previous years).

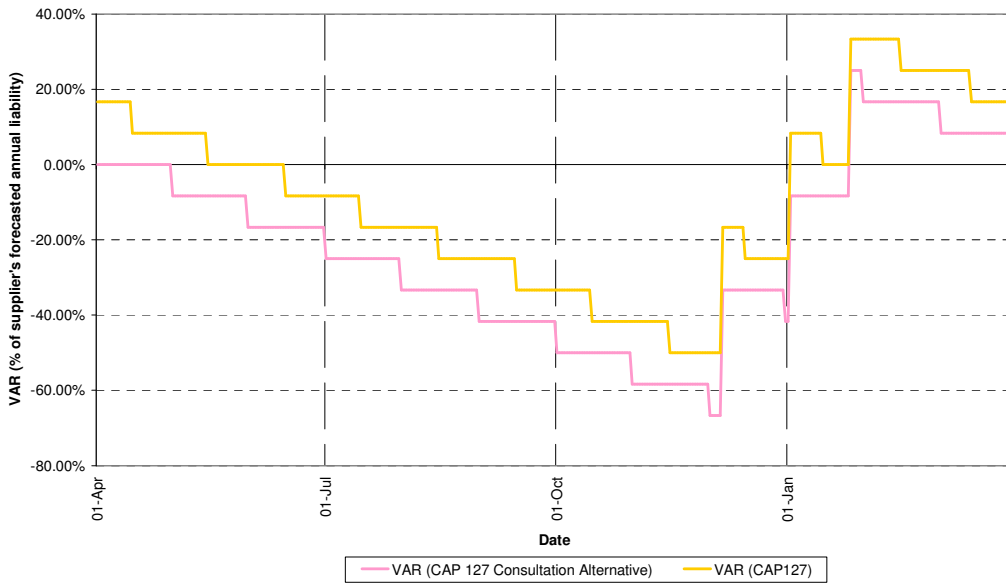
For the avoidance of doubt, any payments relating to reconciliation amounts are also deemed to have been delayed in the Base VAR profile.

The following charts give a comparison of the Base VAR profiles for CAP127 and the Consultation Alternative Amendment:

CAP127 and Alternative Amendment NHH Base VAR Profiles



CAP127 and Alternative Amendment HH Base VAR Profiles



Determination of the Base Levels of VAR

The Base Levels of VAR are calculated as the average daily amount shown by the Base VAR profile in the relating security period.

ANNEX 3 - PROPOSED TEXT TO MODIFY CUSC**Part A - Text to give effect to the Proposed Consultation Alternative Amendment****PART III - CREDIT REQUIREMENTS****3.21 BSUOS CHARGES AND TNUOS DEMAND CHARGES: PROVISION OF SECURITY COVER**

3.21.1 Each User required to pay Use of System Charges **shall provide Security Cover for Balancing Services Use of System Charges and Transmission Network Use of System Demand Charges from time to time in accordance with this Part III.**

3.21.2 Each such User shall not later than the date of its accession to the CUSC Framework Agreement deliver to The Company evidence reasonably satisfactory:-

- (a) to establish the **User's Allowed Credit**; and
- (b) if required, that it has provided and is not in default under the **Security Cover** referred to in Paragraph 3.21.3 below.

3.21.3 The User shall be required to provide Security Cover where its Security Requirement exceeds its User's Allowed Credit. If such User is required to provide Security Cover it shall, not later than the date of:-

- (a) the date of its becoming a party to the **CUSC Framework Agreement**; or
- (b) two **Business Days** after **NGC** notifies the **User** in writing that the **Security Cover** required exceeds the **Security Amount** provided; or
- (c) where and to the extent that the amount of **Security Cover** required exceeds the **Security Amount** provided as a result of a **User's** revised forecast given in accordance with Paragraph 3.10 within one month of such revised forecast being provided to **NGC**:-
 - (i) deliver to **The Company** a **Qualifying Guarantee** in such amount as shall be notified by **The Company** to the **User** in accordance with Paragraph 3.22; and/or
 - (ii) deliver to **The Company** a **Letter of Credit** (available for an initial period of not less than 6 months) in such amount as shall be notified by **The Company** to the **User** in accordance with Paragraph 3.22; and/or

- (iii) deliver to **The Company** cash for credit to the **Escrow Account** in such amount as shall be notified by **The Company** in accordance with Paragraph 3.22; and/or
- (iv) deliver to **The Company** a **Bilateral Insurance Policy** in such an amount as shall be notified by **The Company** to the **User** in accordance with Paragraph 3.22; and/or
- (v) deliver to **The Company** an **Insurance Performance Bond** in such an amount as shall be notified by **The Company** to the **User** in accordance with Paragraph 3.22; and/or
- (vi) delivery to **The Company** an **Independent Security Arrangement** in such an amount as shall be notified by **The Company** to the **User** in accordance with Paragraph 3.22.

3.21.4 **The provisions of this Part III shall be in addition to any other requirements to provide security in respect of any other sums due under the terms of the CUSC or any Bilateral Agreement or Construction Agreement.**

3.21.5 Maintenance of Security Cover

Where a **User** is required to provide **Security Cover** in accordance with the terms of this Paragraph 3.21 it shall at all times thereafter maintain a **Security Amount** equal to or more than the **Security Cover** applicable to it. Immediately upon any reduction occurring in the **Security Amount** provided by the **User** or any **Letter of Credit** or **Qualifying Guarantee** or **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** being for any reason drawn down or demanded respectively, the **User** will procure that new **Letters of Credit** or **Qualifying Guarantees** or **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** are issued or existing **Letters of Credit** or **Qualifying Guarantees** or **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** are reinstated (to the satisfaction of **The Company**) to their full value or cash is placed to the credit of the **Escrow Account** in an amount required to restore the **Security Amount** to an amount at least equal to the **Security Cover** applicable to the **User**, and in such proportions of **Letters of Credit**, **Qualifying Guarantees** or **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** and/or cash as the **User** may determine. Not later than 10 **Business Days** before any outstanding **Letter of Credit** and/or **Qualifying Guarantee** or **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** is due to expire, the **User** shall procure to the satisfaction of **The Company** that its required **Security Amount** will be available for a further period of not less than 6 months which may be done in one of the following ways:-

- (a) subject to the issuing bank continuing to have an **Approved Credit Rating** for an amount at least equal to the required **Security Amount** applicable to it (less its balance on the **Escrow Account**) provide **The Company** with confirmation from the issuing bank that the validity of the **Letter of Credit** has been extended for a period of not less than 6 months on the same terms and otherwise for such amount as is required by this Part III; or
- (b) provide **The Company** with a new **Letter of Credit** issued by an issuing bank with an **Approved Credit Rating** for an amount at least equal to the required **Security Amount** applicable to it (less its balance on the **Escrow Account**) which **Letter of Credit** shall be available for a period of not less than 6 months; or
- (c) subject to the entity issuing the **Qualifying Guarantee** continuing to have an **Approved Credit Rating** for an amount at least equal to the required **Security Amount** applicable to it (less its balance on the **Escrow Account**) provide **The Company** with confirmation from the issuing entity that the validity of the **Qualifying Guarantee** has been extended for a period of not less than 6 months on the same terms and otherwise for such amount as is required by this Part III; or
- (d) provide **The Company** with a new **Qualifying Guarantee** for an amount at least equal to the required **Security Amount** applicable to it (less its balance on the **Escrow Account**) which **Qualifying Guarantee** shall be available for a period of not less than 6 months; or
- (e) procure such transfer to **The Company** for credit to the **Escrow Account** of an amount as shall ensure that the credit balance applicable to the **User** and standing to the credit of the **Escrow Account** shall be at least equal to the required **Security Amount**; or
- (f) subject to the entity issuing the **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** continuing to meet the **Requirements** provide **The Company** with confirmation from the issuing entity that the validity of the **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** has been extended for a period of not less than 6 months on the same terms and otherwise for such amount as is required by this Part III; or
- (g) provide **The Company** with a new **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** for an amount at least equal to the required **Security Amount** applicable to it (less its balance on the **Escrow Account**) which **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** shall be available for a period of not less than 6 months.

3.21.6 Failure to supply or maintain Security Cover

If the **User** fails at any time to provide or maintain **Security Cover** to the satisfaction of **The Company** in accordance with the provisions of this Part III, **The Company** may at any time while such default continues, and if at such time any **Letter of Credit** and/or **Qualifying Guarantee** and/or **Bilateral Insurance Policy** and/or **Insurance Performance Bond** and/or **Independent Security Arrangement** forming part of the **Security Amount** is due to expire within 9 **Business Days** immediately, and without notice to the **User**, demand payment of the entire amount of any outstanding **Letter of Credit** and/or **Qualifying Guarantee** and/or **Bilateral Insurance Policy** and/or **Insurance Performance Bond** and/or **Independent Security Arrangement** and shall credit the proceeds of the **Letter of Credit** and/or **Qualifying Guarantee** and/or **Bilateral Insurance Policy** and/or **Insurance Performance Bond** and/or **Independent Security Arrangement** to the **Escrow Account**.

3.21.7 Substitute Letter of Credit or Qualifying Guarantee

- (a) If the bank issuing the **User's Letter of Credit** ceases to have the credit rating set out in the definition of **Letter of Credit** in this **CUSC** such **User** shall forthwith procure the issue of a substitute **Letter of Credit** by a bank that has such a credit rating or a **Qualifying Guarantee** or a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement** or transfer to **The Company** cash to be credited to the **Escrow Account**.
- (b) If the entity providing the **User's Qualifying Guarantee** ceases to have an **Approved Credit Rating** for an amount at least equal to the required **Security Amount** (less the **User's** balance on the **Escrow Account**) the **User** shall forthwith procure a replacement **Qualifying Guarantee** from an entity with such a credit rating or a **Letter of Credit** or a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement** or transfer to **The Company** cash to be credited to the **Escrow Account**.
- (c) If the entity providing the **User's Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** ceases to meet the **Requirements** the **User** shall forthwith procure a replacement of the same or a **Bilateral Insurance Policy**, **Insurance Performance Bond**, **Independent Security Arrangement**, **Letter of Credit**, **Qualifying Guarantee** or transfer to **The Company** cash to be credited to the **Escrow Account**.

3.22 CREDIT MONITORING

3.22.1 Determination of Security Cover

The amount of **Security Cover** which the **User** shall be required to maintain shall be determined from time to time by **The Company** as the **User's Security Requirement** less the **User's Allowed Credit**.

3.22.2 Determination of Security Requirement

The **Security Requirement** for each **User** shall be determined as:-

- (a) the **Balancing Services Use of System Charges** provided for in the **CUSC**, where the **User** is a **Supplier**, over a 32 day period or such period as **The Company** acting reasonably shall specify to the **User** in writing from time to time taking into account the requirements for **Security Cover** contained in the **Balancing and Settlement Code** and where **The Company** proposes to change such period **The Company** shall consult with **Users**; and
- (b) the **Balancing Services Use of System Charges** provided for in the **CUSC**, where the **User** is a **Generator**, over a 29 day period or such period as **The Company** acting reasonably shall specify to the **User** in writing from time to time taking into account the requirements for **Security Cover** contained in the **Balancing and Settlement Code** and where **The Company** proposes to change such period **The Company** shall consult with **Users**; and
- (c) in relation to Transmission Network Use of System Demand Charges calculated in the following manner for each Security Period:
 - (aa) in the Financial Year in which such charges first become due, the greater of zero and the User's Base Value at Risk; and
 - (bb) in the case of subsequent **Financial Years**, the greater of zero and the sum of (i) the User's Base Value at Risk and (ii) the User's Forecasting Performance Related VAR.
 - (d) interest on the amounts referred to in (a), (b) and (c) above calculated in accordance with the provisions of this **CUSC**.

Deleted: 10% of User's Transmission Network Use of System Demand Charges for

Deleted: ;

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Deleted: User's Transmission Network Use of System Demand Charges as reflects the percentage difference between the Actual Amount and the Notional Amount of

Deleted: Transmission Network Use of System Demand Charges for the previous Financial Year, provided that where

Deleted: Notional Amount exceeds the Actual Amount, the percentage shall be zero; and

Deleted: .

3.22.3 Calculation of HH Base Value at Risk

For each Security Period, the sum equal to the HH Base Percentage of the User's Indicative Annual HH TNUoS Charge calculated on the basis of the latest Demand Forecast recieved by The Company.

3.22.4 Calculation of NHH Base Value at Risk

For each Security Period, the sum equal to the NHH Base Percentage of the User's Indicative Annual NHH TNUoS Charge calculated on the basis of the latest Demand Forecast recieved by The Company.

3.22.5 Notification of Deemed HH Forecasting Performance

Following the issue of the Initial Demand Reconciliation Statement in respect of the previous Financial Year, The Company shall notify the User, of the Deemed HH Forecasting Performance

to be used in the calculation of the User's **HH Performance Related Var**. Such notice shall be given at least two months prior to the first of the **Security Periods** to which it relates.

3.22.6 **Notification of Deemed NHH Forecasting Performance**

Following the issue of the **Initial Demand Reconciliation Statement** in respect of the previous **Financial Year**, **The Company** shall notify the **User**, of the **Deemed NHH Forecasting Performance** to be used in the calculation of the **User's NHH Performance Related Var**. Such notice shall be given at least two months prior to the first of the **Security Periods** to which it relates.

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3.22.7 **Revision of Deemed HH Forecasting Performance**

If the **User** has experienced a significant increase in the amount of **Demand** taken by its **Customers** during the last five months of the previous **Financial Year** and believes that this has had a significant effect on their **Deemed HH Forecasting Performance**, then no later than one month from the date of the notification given to the **User** under paragraph 3.22.5, the **User** may request that **The Company** revises the **Deemed HH Forecasting Performance**. Upon raising such a request, the **User** must provide information to **The Company** relating to the size of the reported **Demand** increase and the **Reported Period(s) of Increase**. Where for any **Reported Period of Increase** the resulting increase in **Demand** equates to a level that is in excess of one percent of the **Actual Amount of HH Charges** in respect of the previous **Financial Year**, **The Company** shall, within one month of receiving such a request, recalculate the **Deemed HH Forecasting Performance** on the basis set out in Appendix 2 Paragraph 4. A **User** shall not be entitled to raise more than one request by reference to any period or part period covered in another **Reported Period of Increase** in respect of which a request has been raised under this Paragraph.

3.22.8 **Revision of Deemed NHH Forecasting Performance**

If the **User** has experienced a significant increase in the amount of **Demand** taken by its **Customers** during the last five months of the previous **Financial Year** and believes that this has had a significant effect on their **Deemed NHH Forecasting Performance**, then no later than one month from the date of the notification given to the **User** under paragraph 3.22.6, the **User** may request that **The Company** revises the **Deemed NHH Forecasting Performance**. Upon raising such a request, the **User** must provide information to **The Company** relating to the size of the reported **Demand** increase and the **Reported Period(s) of Increase**. Where for any **Reported Period of Increase** the resulting increase in **Demand** equates to a level that is in excess of one percent of the **Actual Amount of NHH Charges** in respect of the previous **Financial Year**, **The Company** shall within one month of receiving such a request, recalculate the **Deemed NHH Forecasting Performance** on the basis set out in Appendix 2 Paragraph 7. A **User** shall not be entitled to raise more than one request by reference to any period or part period covered in another **Reported Period of Increase** in respect of which a request has been raised under this Paragraph.

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3.22.9 Review of Security Cover

The Company shall keep under review the **Security Cover** relating to the **User** and shall promptly advise the **User** whenever the **Security Amount** maintained by the **User** is more or less than the amount required to be maintained pursuant to this Paragraph 3.22.

3.22.10 Decrease of Security Cover

If **The Company** reasonably determines that the **User's** required **Security Cover** has decreased, it shall so notify the **User**. **The Company** shall consent to an appropriate reduction in the available amount of any outstanding **Qualifying Guarantee** or **Letter of Credit** or **Bilateral Insurance Policy** or **Insurance Performance Bond** or **Independent Security Arrangement** and/or shall repay to the **User** such part of the deposit held in the **Escrow Account** for the account of the **User** (together with all accrued interest on the part to be repaid) sufficient to reduce the **User's Security Amount** to the level of **Security Cover** applicable to it within 5 **Business Days** of the **User's** consent.

3.22.11 Notification in respect of Security Cover

The Company shall notify each **User** promptly if:-

- (a) that **User** fails to provide, maintain, extend or renew a **Qualifying Guarantee** or a **Letter of Credit** or a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement** which it is required to provide, maintain, extend or renew pursuant to Paragraphs 3.21 or 3.22 inclusive;
- (b) **The Company** shall make a demand under any such **Qualifying Guarantee** or a call under a **Letter of Credit** or a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement**; or
- (c) **The Company** becomes aware that the **User**:
 - (i) shall cease to have an **Approved Credit Rating** or shall cease to have an **Approved Credit Rating** for an amount at least equal to the **User's Security Requirement**, or
 - (ii) shall be placed on a credit watch by the relevant credit rating agency (or becomes subject to an equivalent procedure) which in any case casts doubt on the **User** retaining an **Approved Credit Rating** or an **Approved Credit Rating** for an amount at least equal to the **User's Security Requirement** or maintaining the **Credit Assessment Score** given by the **User's Independent Credit Assessment**, or
 - (iii) shall be in default under the additional or alternative security required to be provided pursuant to this Part III; or

- (d) **The Company** becomes aware that any bank that has issued a **Letter of Credit** in relation to that **User** which has not expired shall cease to have the credit rating required by this Section; or
- (e) **The Company** becomes aware that any entity providing a **Qualifying Guarantee** or a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement** in relation to that **User** which has not expired shall cease to meet the **Requirements** in the case of a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement** or in the case of a **Qualifying Guarantee** cease to have an **Approved Credit Rating** for an amount at least equal to the required **Security Amount** (less its balance on the **Escrow Account**); or
- (f) **NGC** becomes aware that the **User's Security Requirement** exceeds 85% of the **User's Allowed Credit**.

Provided always that the failure by **The Company** to notify the **User** pursuant to Paragraphs 3.22.9, 3.22.10 or 3.22.11 shall not relieve the **User** of its obligations under and in accordance with the terms of this Section 3 and the **Charging Statements**.

3.22.12 Release from Security Cover Obligations

Upon a **User** becoming a **Dormant CUSC Party** or ceasing to be a **CUSC Party** and provided that all amounts owed by the **User** in respect of **Balancing Services Use of System Charges** and **Transmission Network Use of System Demand Charges** have been duly and finally paid and that it is not otherwise in default in any respect of any **Balancing Services Use of System Charges** or **Transmission Network Use of System Demand Charges** (including in each case interest) payable under the **CUSC**, the **User** shall be released from the obligation to maintain **Security Cover** and **The Company** shall consent to the revocation of any outstanding **Qualifying Guarantee** or **Letter of Credit** or a **Bilateral Insurance Policy** or an **Insurance Performance Bond** or an **Independent Security Arrangement** and shall repay to the **User** the balance (including interest credited thereto) standing to the credit of the **User** on the **Escrow Account** at that date.

3.23 PAYMENT DEFAULT

If, by 12.30 hours on any **Use of System Payment Date**, **The Company** has been notified by a **User** or it otherwise has reason to believe that that **User** will not have remitted to it by close of banking business on the **Use of System Payment Date** all or any part ("the amount in default") of any amount which has been notified by **The Company** to the **User** as being payable by the **User** by way of either the **Balancing Services Use of System Charges** and/or **Transmission Network Use of System Demand Charges** on the relevant **Use of System Payment Date**, then **The Company** shall be entitled to act in accordance with the following provisions (or whichever of them shall apply) in the order in which they appear until **The Company** is satisfied that the **User** has discharged its obligations in respect

of the **Balancing Services Use of System Charges** and/or **Transmission Network Use of System Demand Charges** (as appropriate) under the **CUSC** which are payable in respect of the relevant **Settlement Day** (in the case of **Balancing Services Use of System Charges**) or **Financial Year** (in the case of **Transmission Network Use of System Demand Charges**):-

- (a) **The Company** may to the extent that the **User** is entitled to receive payment from **The Company** pursuant to the **CUSC** (unless it reasonably believes that such set-off shall be unlawful) set off the amount of such entitlement against the amount in default;
- (b) **The Company** shall be entitled to set off the amount of funds then standing to the credit of the **Escrow Account** against **Balancing Services Use of System Charges** and/or **Transmission Network Use of System Demand Charges** (as appropriate) unpaid by the **User** and for that purpose **The Company** shall be entitled to transfer any such amount from the **Escrow Account** to any other account of **The Company** at its absolute discretion and shall notify the **User** accordingly;
- (c) **The Company** may demand payment under any outstanding **Letter of Credit** supplied by the **User** in a sum not exceeding the available amount of all such **Letters of Credit**;
- (d) **The Company** may demand payment under any outstanding **Qualifying Guarantee** provided for the benefit of the **User** pursuant to Paragraph 3.21.3(b);
- (e) **The Company** may demand payment under any outstanding **Bilateral Insurance Policy** provided for the benefit of the **User**;
- (f) **The Company** may demand payment under any outstanding **Insurance Performance Bond** provided for the benefit of the **User**;
- (g) **The Company** may demand payment under any outstanding **Independent Security Arrangement** provided for the benefit of the **User**.

3.24 UTILISATION OF FUNDS

In addition to the provisions of Paragraph 3.23 above if **The Company** serves a notice of default under the terms of Paragraph 5.5 or a notice of termination under Paragraph 5.7 then **The Company** shall be entitled to demand payment of any of the **Balancing Services Use of System Charges** and/or **Transmission Network Use of System Demand Charges** which are outstanding from the relevant **User** whether or not the **Use of System Payment Date** in respect of them shall have passed and:-

- (a) make demand under any outstanding **Qualifying Guarantee** or a call under any outstanding **Letter of Credit, Bilateral Insurance Policy, Insurance Performance Bond** or **Independent Security Arrangement** supplied by the **User**; and
- (b) to set off the funds in the **Escrow Account** against **Balancing Services Use of System Charges** and/or **Transmission Network Use of System Demand Charges** unpaid by the **User** and for that purpose **The Company** shall be entitled to transfer any such amount

from the **Escrow Account** to any other account of **The Company** as it shall in its sole discretion think fit.

3.25 USER'S RIGHT TO WITHDRAW FUNDS

If a **User** is not in default in respect of any amount owed to **The Company** in respect of the **Balancing Services Use of System Charges** or **Transmission Network Use of System Charges** under the terms of the **CUSC** and any **Bilateral Agreement** to which the **User** is a party:-

- (a) **The Company** shall transfer to the **User** quarterly interest credited to the **Escrow Account**; and
- (b) **The Company** shall transfer to such **User** within a reasonable time after such **User's** written request therefor any amount of cash provided by the **User** by way of **Security Cover** which exceeds the amount which such **User** is required to provide by way of security in accordance with this Part III.

3.26 USER'S ALLOWED CREDIT

3.26.1 Each User shall notify NGC promptly if:-

- (a) **it gains an** Approved Credit Rating; **or**
- (b) **it ceases to have an** Approved Credit Rating; **or**
- (c) **where the User holds an** Approved Credit Rating, **its specific investment grading changes**; **or**
- (d) **it has reason to believe that its** Credit Assessment Score **is likely to have changed since the last** Independent Credit Assessment.

3.26.2 The User's Allowed Credit extended by NGC at any time to each User with an Approved Credit Rating shall be calculated in accordance with Paragraph 1 of Appendix 1 of this Section 3 subject to a maximum value of the Unsecured Credit Cover.

3.26.3 The User's Allowed Credit extended by NGC at any time to each User without an Approved Credit Rating shall be at the choice of the User the Payment Record Sum or the Credit Assessment Sum.

3.26.4 Unless the User has notified NGC that it wishes its User's Allowed Credit to be based on the Credit Assessment Sum then, subject to Paragraph 3.26.5, for each successive month in which the User pays its Use of System Charges by the Use of System Payment Date then the User's Allowed Credit extended to such User at any time shall be calculated in accordance with Paragraph 2 of Appendix 1 of this Section 3.

3.26.5 Where a User fails to pay its Use of System Charges within 2 Business Days of the Use of System Payment Date its Payment Record Sum shall be reduced by 50% on the first such occasion within a twelve month period and shall be reduced to zero on the second occasion in such twelve month period. Upon any such failure to pay, the User's Allowed Credit (as adjusted following such failure in accordance with this

clause) shall be calculated for successive months in accordance with Paragraph 3.26.4.

- 3.26.6 Where a User has notified NGC that it wishes its User's Allowed Credit to be based on its Credit Assessment Sum, the Credit Assessment Sum extended to a User at any time shall be calculated be reference to the Credit Assessment Score given by the Independent Credit Assessment in accordance with Paragraph 3 of Appendix 1 of this Section 3.**
- 3.26.7 Where a User has notified NGC that its wishes its User's Allowed Credit to be based on the Credit Assessment Sum then the User will obtain an Independent Credit Assessment of that User. The first such Independent Credit Assessment will be at NGC's cost.**
- 3.26.8 Where a User's Allowed Credit is based on the Credit Assessment Sum then where NGC has reason to believe that the Independent Credit Assessment last obtained is likely to have changed then NGC shall be entitled to request the User to obtain a further independent Credit Assessment. Such Independent Credit Assessment shall be at NGC's cost.**
- 3.26.9 The User may obtain an Independent Credit Assessment at NGC's cost provided that NGC has not paid for an earlier Independent Credit Assessment for that User within the previous 12 months. The User may obtain further Independent Credit Assessments within such a 12 month period at the User's cost.**

3.27 TRANSITIONAL ARRANGEMENTS

3.27.1 Recognising the changes to the Security Cover and Security Requirements introduced by the Security Amendment and the consequences for The Company and Users then notwithstanding the provisions of CUSC Section 3 Part III the following transitional provisions shall apply:

- (a) **the obligation for Users whose Security Requirement will as a result of the Security Amendment increase at the Security Amendment Implementation Date shall be to provide the difference between the Existing Security Cover and the Security Cover in full by no later than the End Date and by increasing the Existing Security Cover each month by equal monthly amounts of the difference between the existing Security Cover and the Security Cover; and**
- (b) **where a User's Security Requirement at the Security Amendment Implementation Date is less than the Existing Security Cover held for that User then The Company shall release the existing Security Cover by the appropriate amount as soon as practicable and in any event within one calendar month of the Security Amendment Implementation Date.**

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3.27.2 Recognising the changes to the Security Cover and Security Requirements introduced by the Value At Risk Amendment and the consequences for The Company and Users then notwithstanding the provisions of CUSC Section 3 Part III the following transitional provisions shall apply:

(a) Until the Initial Demand Reconciliation Statement has been issued for the Financial Year ending at least six months following the Value At Risk Amendment Implementation Date, and The Company has calculated the Forecasting Performance Related VAR by reference to this, each User's Forecasting Performance Related VAR shall be substituted by such percentage of User's Transmission Network Use of System Demand Charges as reflects the percentage difference between the Actual Amount and the Notional Amount of the User's Transmission Network Use of System Demand Charges for the previous Financial Year, provided that where the Notional Amount exceeds the Actual Amount, the percentage shall be zero;

(b) the obligation for Users whose Security Requirement will increase at the Value At Risk Amendment Implementation Date as a result of the Value At Risk Amendment shall be to provide the difference between the Pre-Value At Risk Amendment Security Cover and the Security Cover in full by no later than the Value At Risk Amendment Implementation End Date and by increasing the Pre-Value At Risk Amendment Security Cover each month by equal monthly amounts of the difference between the Pre-Value At Risk Amendment Security Cover and the Security Cover; and

(c) where a User's Security Requirement at the Value At Risk Amendment Implementation Date is less than the Pre-Value At Risk Amendment Security Cover held for that User then The Company shall release the Pre-Value At Risk Amendment Security Cover by the appropriate amount as soon as practicable and in any event within one calendar month of the Value At Risk Amendment Implementation Date.

APPENDIX 1 CREDIT ARRANGEMENTS

- 1 Where the **User** meets the **Approved Credit Rating** that **User's Allowed Credit** at any given time shall be calculated as a percentage of **Unsecured Credit Cover** by reference to the specific investment grade within the **User's Approved Credit Rating** as follows:

Approved Long Term Credit Rating			User's Allowed Credit as % of Unsecured Credit Cover
Standard & Poor's	Moody's	Fitch	
AAA	Aaa	AAA	100
AA+	Aa1	AA+	
AA	Aa2	AA	
AA-	Aa3	AA-	
A+	A1	A+	40
A	A2	A	
A-	A3	A-	
BBB+	Baa1	BBB+	20
BBB	Baa2	BBB	19
BBB-	Baa3	BBB-	18
BB+	Ba1	BB+	17
BB	Ba2	BB	16
BB-	Ba3	BB-	15

- 2 Where based on the **Payment Record Sum**, a **User's Allowed Credit** at any time shall be calculated on the basis of 0.4% per 12 month period (escalating on an evenly graduated basis each month) of the **Unsecured Credit Cover**, subject to a maximum of 2% after 60 months of successive payment by the **Use of System Payment Date**.
- 3 Where based on the **Credit Assessment Sum**, a **User's Allowed Credit** at any given time shall be calculated as a percentage of the **Unsecured Credit Cover** by reference to the **Credit Assessment Score** as follows:

Credit Assessment Score	User's Allowed Credit as % of Unsecured Credit Cover
10	20
9	19
8	18
7	17
6	16
5	15
4	13.33
3	10
2	6.67
1	3.33
0	0

APPENDIX 2Base Value At Risk

1. For each Security Period, the HH Base Percentage used in determining the User's HH Base Value at Risk shall be determined by reference to the following:

<u>Security Period Start Date (inclusive)</u>	<u>Security Period End Date (inclusive)</u>	<u>HH Base Percentage</u>
<u>1st April</u>	<u>30th June</u>	<u>-8.4%</u>
<u>1st July</u>	<u>30th September</u>	<u>-33.4%</u>
<u>1st October</u>	<u>31st December</u>	<u>-49.1%</u>
<u>1st January</u>	<u>31st March</u>	<u>7.0%</u>

2. For each Security Period, the NHH Base Percentage used in determining the User's NHH Base Value at Risk shall be determined by reference to the following:

<u>Security Period Start Date (inclusive)</u>	<u>Security Period End Date (inclusive)</u>	<u>NHH Base Percentage</u>
<u>1st April</u>	<u>30th June</u>	<u>4.3%</u>
<u>1st July</u>	<u>30th September</u>	<u>-1.5%</u>
<u>1st October</u>	<u>31st December</u>	<u>-2.8%</u>
<u>1st January</u>	<u>31st March</u>	<u>3.7%</u>

Deemed HH Forecasting Performance and Revision

3. Deemed HH Forecasting Performance, FPP_{HH} , shall be calculated as set out in the following formula:

$$FPP_{HH} = \max\left(0, \frac{5}{1333} \sum_{m=8}^{12} \left(\frac{AA_{HH} - IA_{HH,m} * W_{HH,m}}{AA_{HH}} \right) - CA_{HH}\right)$$

Where:

AA_{HH} is the **Actual Amount of User's HH Charges** for the previous **Financial Year**

$IA_{HH,m}$ is the **Indicative Annual HH TNUoS charge** calculated using the **Demand Forecast** used to determine **Transmission Network Use of System Demand Charges** made during month m of the previous **Financial Year**.

$W_{HH,m}$ The forecast weighting to be applied for each month, m by reference to the following:

m	Invoice Month	Forecast weighting, $W_{HH,m}$
8	November	33.3
9	December	33.3
10	January	33.3
11	February	66.7
12	March	100

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CA_{HH} is an allowance for extreme conditions equal to 0.06.

4. The revised **Deemed HH Forecasting Performance**, shall be calculated on the basis of Paragraph 3 above, substituting the **Indicative Annual HH TNUoS Charge** for each month, m prior to the end of the **Reported Period of Increase** with the **Revised Indicative Annual HH TNUoS charge**, $RIA_{HH,m}$

5. The **Revised Indicative Annual HH TNUoS charge**, $RIA_{HH,m}$ shall be derived as follows:

$$RIA_{HH,m} = \min \left(\max \left(\frac{DUA_{HH,p}}{DUB_{HH,p}} - \frac{DSA_{HH,p}}{DSB_{HH,p}}, 0 \right) * RD_{HH,p} + IA_{HH,m}, IA_{HH,p} \right)$$

Where:

$DUA_{HH,p}$ is the average half-hourly metered demand taken by the **User's Customers** during the period 17:00 to 17:30 on the twenty **Business Days** prior to the **Reported Period of Increase**, p , that do not fall between the two week period commencing 22nd December.

$DUB_{HH,p}$ is the average half-hourly metered demand taken by the **User's Customers** during the period 17:00 to 17:30 on the twenty **Business Days** following the **Reported Period of Increase**, p , that do not fall between the two week period commencing 22nd December.

$DSA_{HH,p}$ is the average demand taken by **Total System Chargeable HH Demand** during the period 17:00 to 17:30 on the twenty **Business Days** prior to the **Reported Period of Increase**, p , that do not fall between the two week period commencing 22nd December.

$DSB_{HH,p}$ is the average demand taken by **Total System Chargeable HH Demand** during the period 17:00 to 17:30 on the twenty **Business Days** following the **Reported Period of Increase**, p , that do not fall

between the two week period commencing 22nd December.

$RD_{HH,p}$ is the forecast proportion of **HH Charges** remaining for the previous **Financial Year** from the first day of the month in which the **Reported Period of Increase, p** commences by reference to the following:

<u>Month in which Reported Period of Increase commences</u>	<u>Remaining proportion of HH Charges</u>
<u>October</u>	<u>100%</u>
<u>November</u>	<u>100%</u>
<u>December</u>	<u>100%</u>
<u>January</u>	<u>66.7%</u>
<u>February</u>	<u>33.3%</u>

$IA_{HH,m}$ is the **Indicative Annual HH TNUoS charge** calculated using the **Demand Forecast** used to determine **Transmission Network Use of System Demand Charges** made during month m of the previous **Financial Year**.

$IA_{HH,p}$ in the case that the the **Reported Period of Increase, p** ends prior to the 10th February of the previous **Financial Year**, is set equal to the **Indicative Annual HH TNUoS charge** calculated using the **Demand Forecast** used to determine **Transmission Network Use of System Demand Charges** made during the month immediately following **Reported Period of Increase** of the previous **Financial Year**, otherwise is set to infinity.

Deemed NHH Forecasting Performance and Revision

6. **Deemed NHH Forecasting Performance, FPP_{NHH}** , shall be calculated as set out in the following formula:

$$FPP_{NHH} = \max\left(0, \frac{1}{300} \sum_{m=8}^{12} \left(\frac{AA_{NHH} - IA_{NHH,m} * W_{NHH,m}}{AA_{NHH}} \right) - CA_{NHH}\right)$$

Where:

AA_{NHH} is the **Actual Amount of User's NHH Charges** for the previous **Financial Year**.

$IA_{NHH,m}$ is the **Indicative Annual NHH TNUoS charge** calculated using the **Demand Forecast** used to determine **Transmission Network Use of System Demand Charges** made during month m of the previous **Financial Year**.

$W_{NHH,m}$ The forecast weighting to be applied for each month, m by reference to the following:

<u><i>m</i></u>	<u>Invoice Month</u>	<u>Forecast weighting,</u> <u><i>W_{NHH,m}</i></u>
<u>8</u>	<u>November</u>	<u>41</u>
<u>9</u>	<u>December</u>	<u>49</u>
<u>10</u>	<u>January</u>	<u>59</u>
<u>11</u>	<u>February</u>	<u>70</u>
<u>12</u>	<u>March</u>	<u>81</u>

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CA_{NHH,m} is an allowance for extreme conditions equal to 0.03.

7. The revised **Deemed NHH Forecasting Performance** shall be calculated on the basis of Paragraph 6 above, substituting the **Indicative Annual NHH TNUoS Charge** for each month, *m* prior to the end of the **Reported Period of Increase** with the **Revised Indicative Annual NHH TNUoS charge, *RIA_{NHH,m}***.

8. The **Revised Indicative Annual NHH TNUoS charge, *RIA_{NHH,m}*** shall be derived as follows:

$$RIA_{NHH,m} = \min \left(\max \left(\frac{DUA_{NHH,p}}{DUB_{NHH,p}} - \frac{DSA_{NHH,p}}{DSB_{NHH,p}}, 0 \right) * RD_{NHH,p} + IA_{NHH,m}, IA_{NHH,p} \right)$$

Where:

DUA_{NHH,p} is the average non-half-hourly metered demand taken by the **User's Customers** during the period 16:00 to 19:00 on the twenty **Business Days** prior to the **Reported Period of Increase, *p***, that do not fall between the two week period commencing 22nd December.

DUB_{NHH,p} is the average non-half-hourly metered demand taken by the **User's Customers** during the period 16:00 to 19:00 on the twenty **Business Days** following the **Reported Period of Increase, *p***, that do not fall between the two week period commencing 22nd December.

DSA_{NHH,p} is the average demand taken by **Total System Chargeable NHH Demand** during the period 16:00 to 19:00 on the twenty **Business Days** prior to the **Reported Period of Increase, *p***, that do not fall between the two week period commencing 22nd December.

DSB_{NHH,p} is the average demand taken by **Total System Chargeable NHH Demand** during the period 16:00 to 19:00 on the twenty **Business Days** following the

Reported Period of Increase, p , that do not fall between the two week period commencing 22nd December.

$RD_{NHH,p}$ is the forecast proportion of **NHH Charges** remaining for the previous **Financial Year** from the first day of the month in which the **Reported Period of Increase, p** commences by reference to the following:

<u>Month in which Reported Period of Increase commences</u>	<u>Remaining proportion of NHH Charges</u>
<u>October</u>	<u>59%</u>
<u>November</u>	<u>51%</u>
<u>December</u>	<u>41%</u>
<u>January</u>	<u>30%</u>
<u>February</u>	<u>19%</u>

$IA_{NHH,m}$ is the **Indicative Annual NHH TNUoS charge** calculated using the **Demand Forecast** used to determine **Transmission Network Use of System Demand Charges** made during month m of the previous **Financial Year**.

$IA_{NHH,p}$ in the case that the the **Reported Period of Increase, p** ends prior to the 10th February of the previous **Financial Year**, is set equal to the **Indicative Annual NHH TNUoS charge** calculated using the **Demand Forecast** used to determine **Transmission Network Use of System Demand Charges** made during the month immediately following **Reported Period of Increase** of the previous **Financial Year**, otherwise is set to infinity.

END OF SECTION 3

<u>“Base Value at Risk”</u>	<u>the sum of HH Base Value at Risk and the NHH Base Value at Risk.</u>	Formatted: Font: Not Bold
<u>“Deemed HH Forecasting Performance”</u>	<u>the sum calculated in accordance with Appendix 2 Paragraph 3 as it may be revised in accordance with paragraph 3.22.7.</u>	
<u>“Deemed NHH Forecasting Performance”</u>	<u>the sum calculated in accordance with Appendix 2 Paragraph 6 as it may be revised pursuant to Paragraph 3.22.8.</u>	
<u>“Forecasting Performance Related VAR ”</u>	<u>the sum of HH Forecasting Performance Related VAR and NHH Forecasting Performance Related VAR.</u>	Formatted: Font color: Black Formatted: Font color: Olive Green
<u>“HH Base Percentage”</u>	<u>the % value for the relevant Security Period as specified in the table in paragraph 1 of Appendix 2.</u>	Formatted: No underline Formatted: Font color: Olive Green
<u>“HH Base Value at Risk”</u>	<u>the sum as calculated in accordance with Paragraph 3.22.3.</u>	
<u>“HH Charges”</u>	<u>that element of Transmission Network Use of System Demand Charges relating to half-hourly metered Demand.</u>	
<u>“HH Forecasting Performance Related VAR ”</u>	<u>the amount resulting from multiplying the Deemed HH Forecasting Performance and the Indicative Annual HH TNUoS Charge calculated on the basis of the latest Demand Forecast received by The Company.</u>	Formatted: Font color: Black
<u>“Indicative Annual HH TNUoS charge”</u>	<u>The Company’s forecast of the User’s total HH Charges relating to a Financial Year.</u>	
<u>“Indicative Annual NHH TNUoS charge”</u>	<u>The Company’s forecast of the User’s total NHH Charges relating to a Financial Year.</u>	
<u>“NHH Base Percentage”</u>	<u>the % value for the relevant Security Period as specified in the table in paragraph 2 of Appendix 2.</u>	
<u>“NHH Charges”</u>	<u>that element of Transmission Network Use of System Demand Charges relating to non-half-hourly metered Demand.</u>	
<u>“NHH Base Value at Risk”</u>	<u>the sum as calculated in accordance with Paragraph 3.22.4.</u>	

<u>“NHH Forecasting Performance Related VAR ”</u>	the amount resulting from multiplying the Deemed NHH Forecasting Performance and the Indicative Annual HH TNUoS Charge calculated on the basis of the latest Demand Forecast received by The Company .	Formatted: Font color: Black Deleted:
<u>“Reported Period(s) of Increase”</u>	the period of time during which a User’s Demand increased not being more than 20 Business Days , as notified to The Company under paragraph 3.22.7 or paragraph 3.22.8.	Formatted: Font: Bold
<u>“Revised Indicative Annual HH TNUoS charge”</u>	the value calculated in accordance with Appendix 2 paragraph 5.	Formatted: Font color: Blue
<u>“Revised Indicative Annual NHH TNUoS charge”</u>	the value calculated in accordance with Appendix 2 paragraph 8.	
<u>“Security Period”</u>	the period from 1 April to 30 June (inclusive), 1 July to 30 September (inclusive), 1 October to 31 December (inclusive), or 1 January to 31 March (inclusive) as appropriate.	
<u>“Total System Chargeable HH Demand”</u>	the total of all half-hourly metered Demands for which HH Charges are paid, taken over a period of time which may or may not be that to which HH Charges relate.	
<u>“Total System Chargeable NHH Demand”</u>	the total of all half-hourly metered Demands for which NHH Charges are paid, taken over a period of time which may or may not be that to which NHH Charges relate.	
<u>“Value At Risk Amendment”</u>	the Proposed Amendment in respect of Amendment Proposal 127 .	
<u>“Value At Risk Amendment Implementation Date”</u>	the Implementation Date of the Value At Risk Amendment .	
<u>“Value At Risk Amendment Implementation End Date”</u>	the date one year following the Value At Risk Amendment Implementation Date .	

ANNEX 4 – COPIES OF REPRESENTATIONS RECEIVED TO THE CONSULTATION DOCUMENT

This Annex includes copies of all representations received following circulation of the Consultation Document of CAP127 (circulated on 20th December 2006, requesting comments by close of business on 24th January 2007).

Representations were received from the following parties:

No.	Company	File No.
1	EON.UK Plc	CAP127 – CR -1
2	Centrica Energy	CAP127 – CR -2
3	SAIC (on behalf of ScottishPower's Energy Wholesale Business which includes ScottishPower Generation Ltd, ScottishPower Energy Management Ltd and CRE Energy Ltd.)	CAP127 – CR -3
4	Opus Energy Limited	CAP127 – CR -4
5	RWE Npower	CAP127 – CR -5
6	BizzEnergy Ltd	CAP127 – CR -6
7		
8		
9		



Beverley Viney
Amendments Panel Secretary
Electricity Codes
National Grid

By email: Beverley.Viney@uk.ngrid.com

E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG
eon-uk.com

Ben Sheehy
024 7618 3381

ben.sheehy@eon-uk.com

Friday 19 January 2007

Dear Beverley,

Consultation Response: CAP127, Calculation and Securing of Value at Risk

Thank you for the opportunity to comment on Amendment Proposal CAP127. Please note that, on behalf of E.ON UK, I believe that the amendment would better facilitate achievement of the Applicable CUSC Objectives (a) and (b). Furthermore, it would bring an area of network operator credit cover more into line with best practice guidelines, as published in 2005.

The current arrangements for securing demand Transmission Network Use of System charges (TNUoS) are clearly insufficient; essentially relying on only a single month's forecast. In contrast, the proposed calculation is a tailored solution that appropriately reflects charging credit risk.

Yours sincerely,

Ben Sheehy

Trading Arrangements
Energy Wholesale

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
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taking care of the essentials

**Beverley Viney
Amendments Panel Secretary
Electricity Codes
National Grid
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA**

Centrica Energy

**Millstream East,
Maidenhead Road,
Windsor,
Berkshire SL4 5GD**

Tel. (01753) 431000
Fax (01753) 431150
www.centrica.com

Our Ref.
Your Ref.
24 January 2007

Dear Beverley,

CUSC Amendment Proposal CAP127 – Calculation and Securing of Value at Risk

Centrica welcomes the opportunity to comment on this Amendment Proposal.

We believe that the proposed modification would better facilitate the applicable Objectives. The solution being put forward is an improvement to the current baseline in that it better reflects the actual value at risk throughout the year.

In practice, there may be an appearance of over-securitisation in the market during particular periods where VaR is negative, as parties may choose not to micro-manage their credit position and keep a sustained level of credit throughout the year. However, the proposed solution does offer parties the opportunity to manage their collateral on a seasonal basis should they wish to do so.

We believe that the proposed solution offers the market increased protection against bad debt, while not imposing excessively onerous requirements on participants which might impose a barrier to market entry.

One area that does concern us slightly is the appeals mechanism. It would seem that if the volume of appeals is high, then there might be a significant burden on NGET, and if this is the case it might be that the appeal provisions should be reviewed.

If you have any queries in relation to this response, please do not hesitate to contact me.

Best regards,

A *centrica* business

Centrica plc - The group includes British Gas Trading, British Gas Services and Accord Energy
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Beverley Viney
Amendments Panel Secretary
Electricity Codes
National Grid
National Grid House
Warwick Technology Park
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CV34 6DA

Ref CAP127
Date 23rd January 2007

Tel No. 01355 845208
Email: ukelectricityspoc@saic.com

Dear Beverley,

CUSC Amendment Proposal CAP127 Calculating and Securing Value at Risk (VaR)

Thank you for the opportunity to comment on the Consultation for CUSC Amendment Proposal CAP127 regarding the proposed to amend the current process of calculating and securing VaR. This response is submitted on behalf of ScottishPower's Energy Wholesale Business which includes ScottishPower Generation Ltd, ScottishPower Energy Management Ltd and CRE Energy Ltd.

Although the principle of "more accurate is better" generally holds true, without a detailed cost benefit analysis from NGC it is difficult to justify this change. Costs of changing the calculation process and providing data into it are not quantified; neither is there any analysis of the exposure that companies are currently faced with from a defaulting Party.

If this proposal went ahead it would require a change in the posted credit limits for ScottishPower from the current annual to a quarterly level. The proposal does not detail any flexibility in the credit posting arrangements, i.e. whether or not you would be able to "over post" your credit and refuse any reduction to limit these transactions or, conversely, at what point (if any) National Grid would require additional credit support to maintain credit in excess of Value at Risk ("VaR").

The proposed methodology will create periods where the Suppliers will almost certainly be undersecured (because it takes the average of a 3 month period to calculate VaR), and the wider group could be exposed to a default by a Supplier – this is the type of scenario that this methodology should be protecting. Taking the maximum VaR over a 3 month period would seem to afford the group as a whole better credit protection. It also appears to favour Suppliers with large numbers of HH TNUoS liability (e.g. large business customers), as they get to offset this against their NHH TNUoS liability when calculating VaR. This would likely result in no security being required from these Suppliers for the period 1 July to 31 Dec. While this methodology is more representative of the actual VaR here, it could be viewed as a potential barrier to entry for smaller Suppliers who, without any offsetting HH TNUoS liability, will be required to post security to cover their VaR all year round.

Fundamentally, there is no calculation detailed in the consultation to justify how the base level VaR percentages are derived (p11 of the consultation document). We find it hard to support a methodology with no explanation behind the calculation.

On further examination, we have identified two potential errors in the documentation, namely; On p19, the "Securing VAR" section within the proposal refers to two security periods, not four as outlined in the consultation document; and the example calculation on p27 looks like it has a couple of typos: the HH deemed under forecast should be -3.13%, not 11.87%, and the NHH deemed under forecast should be -1.28%, not 11.65%.

ScottishPower recognises that the current arrangements are in need of review and that National Grid are attempting to implement a methodology in line with Ofgem's Best Practice Guidelines. However, this proposal does not convince us that this methodology best meets this objective. Without further analysis to justify this proposal, we do not support this proposed change.

Yours sincerely
Gary Henderson

SAIC Ltd.

For and on behalf of: ScottishPower's Energy Wholesale Business which includes ScottishPower Generation Ltd, ScottishPower Energy Management Ltd and CRE Energy Ltd.



Beverley Viney
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23rd January 2007

Dear Beverley
CUSC Amendment Proposal CAP127

Please find below the response from Opus Energy Limited relating to proposal CAP 127.

We consider that the Authority should reject the proposal on the grounds that:

- (i) it steps away from the principle that VAR should be based upon the value of 'delivered but unpaid', and instead bases VAR on a value of services that have yet to be delivered;
- (ii) as a direct consequence of (i), the proposal will result in over-collateralisation across the industry; and
- (iii) the methodology proposed is overly complex.

These points are considered in more detail below:

(i) The concept of VAR

The National Grid asserts that the methodology described in Proposal CAP127 will introduce a "more accurate calculation that better reflects the actual VAR", in order to better implement the guidelines provided by Ofgem in February 2005. However, the methodology proposed significantly deviates from the Ofgem guidelines.

Under section 3.30 Value at Risk, the Ofgem guidelines state:

"..In relation to each counterparty, the VAR for Use of System (UoS) charges at any time shall be the amount in money which is equal to the sum of:

- (a) the aggregate value of all charges which at that time have been billed to such counterparty (but not necessarily due) but remain unpaid; and*



(b) a deemed amount equal to the aggregate value of all UoS charges that would be incurred in fifteen day period at the same average daily rate implicit in billed charges under (a).

This additional amount provides a proxy for UoS charges that are accrued but unbilled at any point in time, broadly in line with the time-weighted average of such charges arising in each monthly billing period.”

This clearly states that an assessment of VAR should be the sum of ‘billed but unpaid’ plus an estimate of ‘delivered but not yet billed’. In contrast, the methodology outlined in proposal CAP127 expands VAR to include services that may be delivered and become unpaid after termination action has been taken.

(ii) Over-collateralisation

By including future possible payment failures, CAP 127 would result in significant over-collateralisation across the industry. At any point in time, the National Grid is likely to be collateralised against a value that is at least double its credit exposure. This goes against the principles outlined in Ofgem’s Best Practice Guidelines for Network Operator Credit Cover, and would significantly reduce effective competition by raising barriers to entry (ie this proposal would not achieve Objective b, and in fact is likely to go against it).

(iii) Overly-complex

We believe that the approach taken is overly complex and obfuscates the matter.

As with many methodologies used by the National Grid to determine supplier charges, the VAR valuation methodology proposed under CAP 127 produces “black box” results which are impossible to replicate or audit.

This makes it difficult for a supplier to forecast the level of collateral it is likely to need to provide in the short and longer term; and makes it impossible for the supplier to query or challenge any request for funds. This also, will inevitably lead to over-collateralisation.

In Summary, we request that the Authority rejects the proposal on the grounds that it will result in over-collateralisation across the industry.

Yours sincerely

Louise Boland
Commercial Director

F.A.O Beverley Viney

Amendments Panel Secretary
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23rd January 2007

Dear Beverley

Reference: CUSC Amendment Proposal CAP127 - Calculation and Securing Value at Risk

Thank you for the opportunity to provide a response to the above. Having now had the opportunity to review the contents of CAP 127, I am writing today to provide RWE npower's comments for your consideration as part of this consultation.

RWE npower notes and understands the reasoning behind National Grid's decision to review the credit cover calculation. However, our concern is that the penalties put forward for demand forecasting errors are too severe. Furthermore, we feel that these penalties may fall disproportionately on small suppliers. Therefore, we question the appropriateness of the measures put forward in relation to forecasting performance and believe that these measures may lead to excessive credit cover costs being borne by the market which are not commensurate with the risks faced by National Grid.

Finally, for this type of modification we are concerned that 10 business days may not be adequate notice for parties to adjust their credit cover arrangements and suggest at least 30 days to be a more reasonable timescale. We would also welcome further explanation of the sentence under paragraph 4.11 (Transitional Arrangements): *"During the first twelve months from implementation any additional security requirement shall be stepped up equally until the full security amount is provided"*. A more detailed explanation of this sentence should be given by National Grid before this amendment could be accepted.

I hope that this letter provides you with an appropriate response from RWE npower as part of this consultation process. Please do not hesitate to contact me should you require any further information or clarification on any aspect.

Yours faithfully,

Carl Wilkes
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24th January 2007

Dear Beverley,

CUSC Amendment Proposal CAP 127 Calculation and Securing Value at Risk

We would like to express our concern again as to the proposal to use two missed payments in determining the Base VAR profiles.

Whilst noting the timeline of actions that would be conducted following a missed payment, we still believe that using two missed payments in the calculation would cause suppliers to post an inappropriate level of security and this could have a negative impact on competition.

Ofgem's "Best practice guidelines for gas and electricity network operator credit cover" state that the VAR at any time shall be the amount in money which is equal to the sum of all invoices outstanding and unpaid plus a deemed amount equal to the charges that would be incurred in a fifteen day period. However, the CAP127 Proposal states that due to the unique manner in which TNUoS charges are calculated and charged, this methodology if applied would provide an insufficient level of security and potential exposures to bad debt.

It is important to strike a balance between NWO's incentives to reduce risks and the resulting increase in counterparty costs. With this in mind, we would like to propose a consultation alternative such that the "Amount Invoiced to Date/Allowance for Unpaid Invoices" part of the VAR calculation is consistent with Ofgem's guidelines.

The CUSC provisions provide for 15 days pre-payment, thus on a monthly payment cycle the maximum delivered unpaid is 15 days. We believe that the credit cover guidelines were predicated against the underlying principle of securing the delivered unpaid up to the point that the invoice was due for payment, this principle having been confirmed in the construction of the DCUSA credit cover provisions where payment is 15 days after the month of delivery and the credit requirement associated with this being 45 days. Therefore to ensure consistency with the DCUSA and Ofgem's best practice guidelines we propose a Consultation Alternative such that the "Amount Invoiced to Date/Allowance for Unpaid Invoices" should equate to 15 days' usage charges or half a months invoice rather than 2 months invoice as proposed. This being the maximum delivered unpaid under the CUSC.

We trust that this consultation alternative can be considered. Should you require additional information, please do not hesitate to get in touch.

Yours sincerely,

Keith Munday
Commercial Director