



WORKING GROUP REPORT

CUSC Amendment Proposal CAP157

Extension of Qualified Company Definition

**Prepared by the CAP157 Working Group
for submission to the Amendments Panel**

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1.0 SUMMARY AND RECOMMENDATIONS

Executive Summary

- 1.1 CAP157 Extension of Qualified Company Definition (the Amendment Proposal) proposes to extend the definition of “Qualified Company” or “Qualifying Company” to enable Users to procure security, which is required to be provided under Paragraph 2.22.1 of the CUSC and under the provisions of Bilateral Connection Agreements and Construction Agreements, by way of a Performance Bond from a wider range of companies than is currently provided for.
- 1.2 Specifically, the Amendment Proposal proposes to widen the definition of 'Qualified Company' or "Qualifying Company" to enable affiliates of a User rather than solely a User's shareholders or holding companies to provide security via a Performance Bond.
- 1.3 The Amendment Proposal in no way affects the requirement that a Qualified Company or Qualifying Company must have the Required Credit Rating.
- 1.4 The Working Group has identified a potential risk with the existing arrangements, where in some situations it might be difficult to call upon a security guarantee. The proposed amendment does not materially impact this potential risk.
- 1.5 The Working Group has developed a Working Group Alternative Amendment (WGAA) to address concerns that, in some circumstances introduced by the Amendment Proposal it might not be possible to draw upon a Performance Bond where both the User and the provider enter receivership.
- 1.6 The Working Group considers that both the original Amendment Proposal and the Working Group Alternative Amendment better facilitate the Applicable CUSC Objectives compared with the existing baseline. The Working Group prefers the WGAA to the original Amendment Proposal.

Working Group Recommendation

- 1.7 The Working Group believes that its Terms of Reference have been completed, CAP157 and the WGAA have been fully considered and recommends to the Amendments Panel that a Consultation report should proceed to wider Industry Consultation as soon as possible.
- 1.8 The Working Group believes that both CAP157 and the WGAA will better facilitate the Applicable CUSC Objectives. The Working Group believes that the WGAA best facilitates the Applicable CUSC Objectives.
- 1.9 A summary of the Working Group vote can be found in Annex 7.

2.0 PURPOSE AND INTRODUCTION

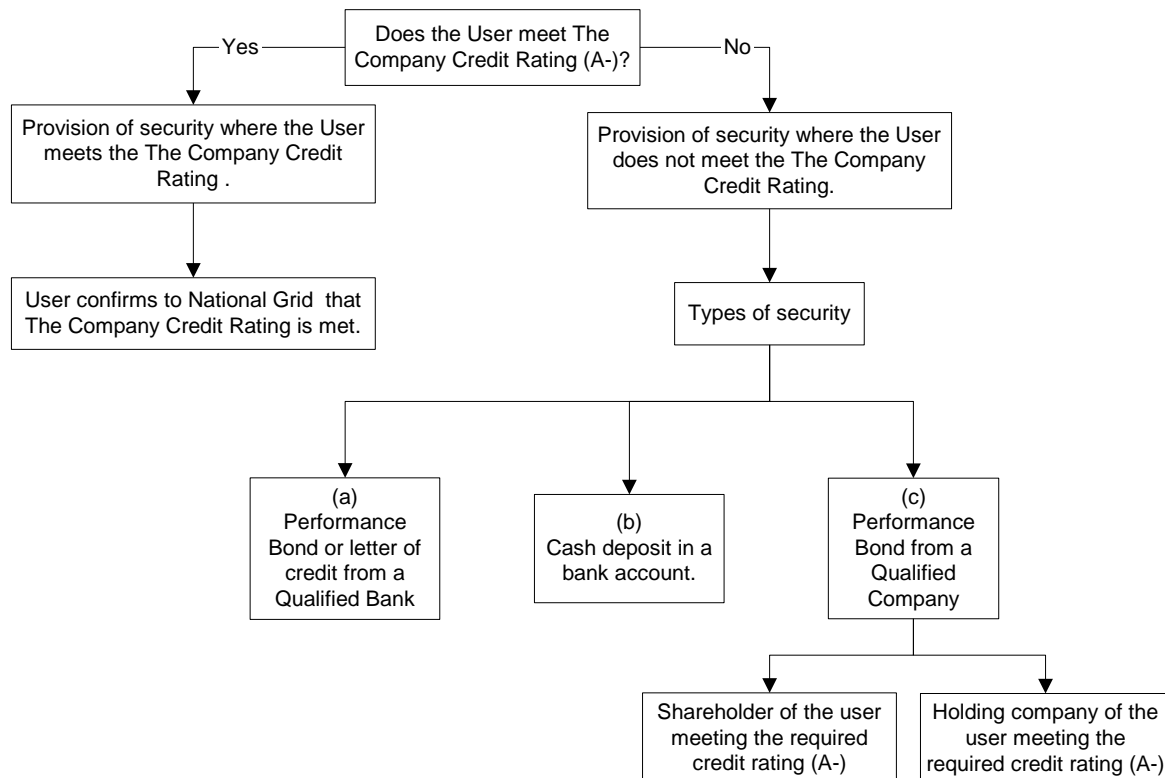
- 2.1 This Report summarises the deliberations of the Working Group and describes the Original CAP157 Amendment Proposal as well as the WGAA.

- 2.2 CAP157 was raised as an Urgent Amendment Proposal by CRE Energy Limited and submitted to the Amendments Panel for their consideration on 23 July 2007. The Panel agreed unanimously to recommend to Ofgem that CAP157 should not be treated as an Urgent Amendment Proposal. Ofgem, as the Authority, agreed with the Panel in its letter of 24 July 2007, attached as Annex 9. Subsequently, at its meeting on 27 July 2007, the Amendments Panel determined that the Amendment Proposal should be considered by a Working Group and that the Working Group should report back to the Amendments Panel within three months.
- 2.3 The Working Group met on 17th August 2007, and the members accepted the Terms of Reference for CAP157. A copy of the Terms of Reference is provided in Annex 3. The Working Group considered the issues the Amendment Proposal and considered whether the Amendment Proposal better facilitated the Applicable CUSC Objectives.
- 2.4 This Working Group Report has been prepared in accordance with the Terms of the CUSC. An electronic copy can be found on the National Grid Website, www.nationalgrid.com/uk/Electricity/Codes/, along with the Amendment Proposal Form.

3.0 PROPOSED AMENDMENT

- 3.1 CRE Energy Limited (the Proposer) has proposed a change to the definition of “Qualifying Company’ or ‘Qualified Company’” in the CUSC. Currently the definition means that the User can obtain a security guarantee from one of its immediate shareholders or any holding company of such a shareholder. The Amendment Proposal proposes to extend the definition to include affiliates of a User.
- 3.2 The Proposer believes that the present arrangements are unduly restrictive and may cause problems for Users within more complex group structures, where Users may wish to provide a guarantee from a related group company which is not immediately above the User in the corporate ownership structure of that group.
- 3.3 It is intended that CAP157 shall apply to:
- (a) Termination Amounts (as calculated in accordance with the Charging Statements); and
 - (b) Final Sums (as defined in a User’s Construction Agreement).
- 3.4 Final Sums security aims to cover the investment that has been made on a project if a User terminates. It is defined and calculated under the terms of the User’s Construction Agreement.
- 3.5 Security for Termination Amounts provides cover for costs that are incurred in the event that a connection to the transmission system is terminated. If this occurs before the end of the asset life cycle the User will pay Termination Amounts which will include the remaining asset value and any remaining connection charges for the year.
- 3.6 Under the current methodology, in order to qualify to provide a Performance Bond, the provider must first meet the Required Credit Rating (A- in Standard and Poor’s or A3 in Moody’s long term debt ratings, please see Annex 1 for

the full definition) and it is proposed that this does not change. The current process under the CUSC is described in the following diagram:



3.7 The Proposer drew the attention of the Working Group to aspects of the present arrangements:

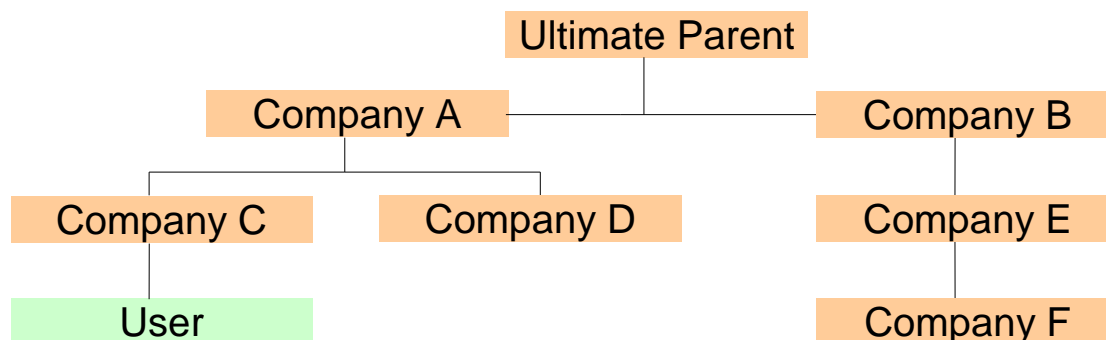
- (a) Performance Bonds or Letters of Credit from Qualified Banks can be expensive for smaller developers. It costs around 0.5% of the value of the bond per annum for an average user and becomes significantly more expensive as a User's credit rating declines.
- (b) Cash deposits in a bank account can provide cash flow difficulties to a developer that is raising funds from numerous sources and can not afford to have cash tied up in a bank as security.
- (c) A Performance Bond from a Qualified Company must be provided by either:
 - (ii) a shareholder of the User; or
 - (iii) a holding company of the User (as defined in the Companies Act (included in Annex 8), as a company that is either a majority shareholder in the User, holds majority voting right in the User, or has majority control of the User).

However, the term "shareholder" may be interpreted to mean a holder of one share in the User. In this case, the provider of the security, although having an interest in the User's affairs, has no control direct over the User, similar to what a sibling company does. In addition, there is nothing to stop a sibling company from becoming the holder of a single share in the User in order for security to be provided.

- 3.8 The Proposer believes that CAP157 would allow groups with complex company structures, for example those with both regulated and non regulated entities or groups structured for taxation purposes, to seek credit cover within the group. This would enable Users to avoid having to use more costly forms of security, better facilitating competition.
- 3.9 The Proposer believes that widening the definition of Qualifying or Qualified Company does not increase risks to the industry compared with the present arrangements which already permit a company with a single share to act as a security provider.
- 3.10 The Proposer has highlighted that it is not the intention of the proposal to weaken the level of security provided by a Performance Bond.

4.0 SUMMARY OF WORKING GROUP DISCUSSIONS

- 4.1 Initially, the Working Group considered what would happen in the event that National Grid is unable to recover Termination Amounts or Final Sums from a User or prospective User when these sums have become due. An example of this is if a whole family of companies becomes insolvent.
- 4.2 It was recognised by the Working Group that to date, Ofgem's Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover (Ofgem's Best Practice Guidelines) had not been considered by the industry as applying to Termination Amounts and Final Sums. Although there is therefore no set pass through mechanism for related bad debts, the group did recognise that this did not rule out pass through being granted under certain circumstances, and as a result part of any bad debt could potentially be socialised across the industry. However, the Working Group recognises that ultimately any pass through arrangement for bad debt is a matter between National Grid and Ofgem.
- 4.3 The Working Group agreed that whilst some of the elements of Ofgem's Best Practice Guidelines may prove useful when assessing CAP157, it was beyond the scope of CAP 157 to decide whether Ofgem's Best Practice Guidelines should be extended to include Termination Amounts and Final Sums.
- 4.4 The Working Group then moved on to consider CAP157 in comparison with the current methodology. The following example of a simple company structure was used to talk through both scenarios and the associated risks:



- 4.5 Under the existing terms of the CUSC, a Performance Bond can be provided by a direct parent, grandparent, etc. of the User, providing that they met the Required Credit Rating. This means that in the above example, Company C,

- Company A and the Ultimate Parent can all provide such a Performance Bond.
- 4.6 If a Performance Bond provider's credit rating falls below the Required Credit Rating then there is a requirement for the User to provide an alternative form of security (see 3.5, above).
- 4.7 National Grid explained that one of the main reasons behind the provision of security from a parent company is that the parent company is provided with an incentive not to place a subsidiary into administration in order to avoid paying its debts.
- 4.8 However, National Grid also explained that this incentive was perhaps diluted by the allowance of entities between the User and the ultimate parent to provide security, as the ultimate parent, if in a dire situation it will be able to place multiple subsidiaries into administration (e.g. the User and Company C, if Company C has provided a Performance Bond).
- 4.9 The Working Group agreed that the allowance of the holder of a single share in the User to provide security under the current arrangements had diluted this incentive further, but noted that this was the baseline that CAP157 is to be assessed against.
- 4.10 National Grid explained that under CAP157 every company in the group could provide Performance Bond, provided that they met the Required Credit Rating.
- 4.11 This means that in the above example, provided that each had the Required Credit Rating, Companies A to F and the Ultimate Parent would all be able to provide a Performance Bond to National Grid to cover the User's Final Sums and/or Termination Amounts.
- 4.12 Further to this, one member of the group pointed out that numerous smaller companies involved in joint ventures with companies from part of a large group could also benefit from CAP157, as it would provide more flexibility in obtaining security for related projects.
- 4.13 Some members of the Working Group questioned whether or not the amendment should be limited to direct siblings. After some discussion, the Working Group agreed that the introduction of such a restriction would be inappropriate as the existing arrangements allow the holder of a single share to provide guarantees.
- 4.14 One member of the Working Group raised a concern that a company with numerous risky projects may choose to place all such projects in one branch of the business, and if the company became aware that some of these projects were not working out it could let it go whilst minimising the effect on its overall business, as all the risk is in one place. However, the Working Group agreed that there is no increase in risk as this could occur under the existing arrangement.
- 4.15 The Working Group then moved on to consider whether it was important for the company providing a Performance Bond to have control over how the business being secured is run. The Working Group felt that there was an underlying assumption that a parent company would take an active interest in how the User is run, especially if it or another of its subsidiaries was providing security in relation to it. However, it was decided that control would not

necessarily be a requirement as, if the User was to procure the Performance Bond from a bank, then the bank would have little, if any control over how the business is run.

- 4.16 Further to this, one member of the Working Group pointed out that in the UK, debt relating to a subsidiary of a subsidiary of a subsidiary must be placed upon the group accounts, meaning that the ultimate parent should have an incentive to take an interest in all of its subsidiaries, however far down the group they lay.
- 4.17 The Working Group then considered the different forms of security used under the UoS (TNUoS and BSUoS) credit arrangements and Ofgem's Best Practice Guidelines, and whether or not they could provide assistance in assessing CAP157. For the majority of these, the group agreed that either they were already used to secure Final Sums and Termination Amounts or they did not have any relevance to CAP157. However, the use of an independent security tool under both the current UoS rules and the Best Practice Guidelines added weight to the argument that an entity providing security in relation to a User does not necessarily have to have any control over the User.
- 4.18 This led to the potential of extending the definition of Qualified Company or Qualifying Company to include companies outside of the same group as the User being discussed. However it was noted that:
- . The product under the UoS security arrangements has not been used, nor had any enquiries about its use been made, even after National Grid attended a number of industry forums to advertise such products;
 - . The tool would be likely to be more expensive than a letter of credit provided by a bank;
 - . If such a product was to be used, it was probably more beneficial to develop it as a separate tool, rather than expanding the scope of an existing one; and
 - . The Working Group agreed that the scope of CAP157 should relate to companies within the same family, and the product was therefore out of scope.
- 4.19 A member of the Working Group raised the issue that under the UoS rules there is potential double counting of a parent company's unsecured credit cover, if it provides guarantees to multiple subsidiaries and questioned if this was an issue in relation to the provision of security for Final Sums and Termination Amounts.
- 4.20 Under the current set of UoS credit arrangements within the CUSC, a qualifying guarantee may be issued without specifying a cap on its value. As the associated value at risk may vary throughout the year, this approach is often used. If this is the case, or if such a cap is significantly large, National Grid will apply a pre-specified cap to the guarantee, based upon the guarantor's credit rating, set at the level of unsecured credit it would benefit from if it was a User. However, such caps apply to the level of a single guarantee, not a single guarantor. As a result, a company providing multiple Users with such guarantees could result in the guarantor or securing a larger value than it would be given as unsecured credit if it were a User. This may result in a significant credit risk, and as a result a change to rectify this was

proposed under CAP126. Although this amendment was rejected, National Grid is considering revisiting this specific issue.

- 4.21 As the Working Group discussed this, it became apparent that this would not be an issue for Termination Amounts or Final Sums, as the amount to be secured, is not as variable and is confirmed by National Grid, via bi-annual statements, against which security is posted. Therefore each Performance Bond should be capped at this level, and will be listed on the guarantor's statutory accounts with this value. In the event that the company provides too much security, via Performance Bonds its credit rating would be downgraded.
- 4.22 Subject to any advice received from their legal department and independent credit agencies that National Grid had sought, the Working Group agreed that the proposal does not increase the risk from the current baseline. Although concerns had been raised over this baseline, for example the risks that result from allowing any shareholder meeting the required credit rating to provide a Performance Bond regardless of the size of its shareholding, the Working Group agreed that this was out of the scope of CAP157.

5.0 WORKING GROUP ALTERNATIVE AMENDMENT

- 5.1 National Grid reported to the Working Group that whilst the independent credit agencies had highlighted the risks involved generally with providing bonds from within the same group of companies (specifically the risk of a domino effect of companies failing within a group), these are risks that all apply to the current situation. Further to this it was noted that the agencies had not highlighted any risks associated with moving from the current methodology to that proposed, provided that the bond itself is in a suitable format.
- 5.2 In relation to the risk relating to the provision of Performance Bonds within the same group, it was highlighted that the level of risk varies with the strength of the group as a whole, and is significantly reduced if a group contains multiple "A" rated companies. The Working Group agreed that although commenting on this issue was outside the Working Group's terms of reference, it should be highlighted in this report.
- 5.3 Further to this, after National Grid had sought legal advice on the drafting of the original Amendment Proposal, an issue was highlighted.
- 5.4 This issue relates to the following set of events:
- (a) The User defaults;
 - (b) National Grid attempts to draw down on a sibling provided Performance Bond; and
 - (c) The bond provider fails before paying out on the Performance Bond.
- 5.5 National Grid have been made aware that there is a risk that the receiver of the provider of the Performance Bond may deem the provision of the bond being drawn upon as inappropriate, as it does not appear to serve the best interests of the provider. In this event, the bond may not be considered for settlement.
- 5.6 In order to mitigate this risk, National Grid have been advised that certain measures must be taken by the bond provider in order to prove that the Performance Bond is being provided in their best interests and not just to the benefit of the wider group.

- 5.7 Whilst National Grid has the ability to deem the form of a Performance Bond unacceptable unless these assurances have been provided, for transparency, it has suggested that these requirements should be codified.
- 5.8 National Grid suggested that the following measures were undertaken:
- (i) Satisfies National Grid that the provider of the bond is able to provide a Performance Bond to companies that are not its subsidiary;
 - (ii) Satisfies National Grid that the provider of the bond is solvent;
 - (iii) Provides an extract from the minutes of the meeting of the provider's directors recording that they believe that the Performance Bond is being provided in its interests or in order to promote the success of the provider for the benefit of its members; and
 - (iv) Provides certified copies of the authorisation by every holding company up to and including a holding company of both the User and the provider. (Considering the company structure displayed in paragraph 4.4, if the User gained a Performance Bond from Company D they would need sign on from Company A, but not the Ultimate Parent. However, if Company F was to provide the Performance Bond then sign on would be required from Companies E, B and the Ultimate Parent. A common level for both companies is required to sign off. In practice this would be signed off by a list of directors).
- 5.9 The Working Group discussed each requirement in turn:
- (a) The Working Group agreed that the intention of requirement (i) made sense, but were concerned that a company providing numerous Performance Bonds may be required to provide multiple copies of the same evidence. National Grid explained that its intention was to approach this pragmatically and that it was happy to accept one copy of such evidence so long as it had no reason to believe that any substantial changes may have been made to the provider between providing the relating bonds. The Working Group agreed that this requirement should stand.
 - (b) The Working Group agreed that requirement (ii) related to all Performance Bonds, not specifically those that would be introduced by CAP157. Therefore the requirement was out of scope and should not form part of any Working Group Alternative Amendment. The Working Group also believed that the requirement was in fact superfluous as if a company had the required credit rating and was not on credit watch then it was solvent. In addition, under the existing rules, National Grid has the right to demand an alternative form of security to be provided if it becomes aware of any reason to doubt the provider's creditworthiness.
 - (c) The Working Group agreed that requirement (iii) provided the main assurance to satisfy National Grid's concerns and that the provision of the relevant minutes is feasible. The Working Group agreed that this requirement should stand.
 - (d) Some members of the Working Group questioned the added value of requirement (iv) given the amount of work involved in obtaining such documents. They believed that the sign off would not be giving any

authorisation, as only the directors of the provider could do this. Instead, it would be simply signing onto the fact that it had knowledge of the Performance Bond. After seeking advice from an external banking lawyer, National Grid informed the Working Group that it is a point in company law that a holding company can authorise the actions of the directors of a subsidiary and that this will generally cure any defect in the directors' authority to enter into a transaction (or in this case, approve the giving of the Performance Bond). The intention of requirement (iv) is therefore to prevent anyone (principally a liquidator) from seeking to set aside the Performance Bond as being outside the authority of the directors of the company that gave the guarantee. In seeking authorities up the chain to the common parent it is intended to minimise any risk that a breach of fiduciary duty at an intermediate level might provide grounds for attack.

- 5.10 A copy of the legal text for the Working Group Alternative Amendment resulting from these discussions can be found in Annex 2 Part B.
- 5.11 The Working Group agreed that the WGAA provided for additional transparency, within the CUSC, of the assurances required from Users. Similar assurances might be sought by National Grid as part of the original Amendment Proposal, but these would not be codified in the CUSC. The Working Group considered that the additional transparency would assist users when providing Performance Bonds.

6.0 ASSESSMENT AGAINST APPLICABLE CUSC OBJECTIVES

- 6.1 The Working Group assessed the original Amendment Proposal and the Working Group Alternative Amendment against the Applicable CUSC Objectives which are:
- (a) the efficient discharge by The Company of the obligations imposed on it by the Act and the Transmission Licence; and
 - (b) facilitating effective competition in generation and supply of electricity and facilitating such competition in the sale, distribution and purchase of electricity.

Proposed Amendment

- 6.2 The Working Group agreed that the original Amendment Proposal better facilitates applicable objective (b).
- 6.3 Although for some market participants, the effect of CAP157 would be neutral, it would allow companies with more complex structures to post security in a more cost effective manner by obtaining it from within their group.

Working Group Alternative Amendment

- 6.4 The Working Group also agreed that the WGAA better facilitates applicable objective (a) and (b).
- 6.5 Whilst sharing the benefits of the original Amendment Proposal, in making the assurances that National Grid requires from the provider transparent, the Working Group Alternative Amendment should make the process of placing the relating Performance Bonds in place more efficient than the original amendment.
- 6.6 The Working Group believed that the WGAA best facilitates the Applicable CUSC Objectives.
- 6.7 A summary of the Working Group vote can be found in Annex 7.
- 6.8 One Working Group member confirmed their view to the Working Group via e-mail in advance of the Working Group vote, as they were unable to attend the meeting. The Working Group agreed that whilst this view could not be included in the vote, it should be noted in the Working Group Report. This view was in line with the final outcome of the vote.

7.0 PROPOSED IMPLEMENTATION

- 7.1 The Working Group propose that either the original Amendment Proposal CAP157 or the CAP157 Working Group Alternative Amendment should be implemented 10 working days after an Authority decision because the impact of the change on National Grid processes is expected to be minimal. Only those Users who sought to make use of the extended range of Qualifying or Qualified Companies as providers of Performance Bonds would be affected by the change.

8.0 IMPACT ON THE CUSC

- 8.1 CAP157 and the Working Group Alternative Amendment require amendments to Section 11 and Schedule 2 Exhibit 3 Appendix M of the CUSC.
- 8.2 The text required to give effect to the Original Proposal is contained as Part A of Annex 2 of this document.
- 8.3 The text to give effect to the Working Group Alternative Amendment is attached as Part B of Annex 2 of this document.

9.0 IMPACT ON INDUSTRY DOCUMENTS

Impact on Core Industry Documents

- 9.1 CAP157 has no impact upon Core Industry Documents.

Impact on other Industry Documents

- 9.2 CAP157 has no impact upon other Industry Documents.

ANNEX 1 – GLOSSARY AND ACRONYMS

Companies Act	Means section 736, Companies Act 1985 as supplemented by section 144(3), Companies Act 1989, a copy of which is included in Annex 8.
Credit Rating	a long term debt rating by Standard and Poor's Corporation or Moody's Investor Services, or a correlating short term rating.
Final Sums	<p>The amount payable by a User on termination of a Construction Agreement as calculated under the terms of the Construction Agreement. Depending on the agreed methodology for calculation, this may includes amounts such as:</p> <ul style="list-style-type: none">- all of National Grid's relating engineering charges that have arisen prior to the date of termination;- fees, expenses and costs incurred by National Grid as part of any construction works that have been carried out prior to the termination date;- fees, expenses and costs incurred by National Grid arising from the termination of any contract with a third party in relation to any construction works;- the reasonable costs of removing any connection assets and making good any remaining plant and apparatus; and interest on any costs incurred (at Base Rate + 2%).
Holding Company	As defined by section 736, Companies Act 1985 as supplemented by section 144(3), Companies Act 1989.
Performance Bond	An on first demand without proof or conditions irrevocable performance bond or performance guarantee executed as a deed in a form reasonably satisfactory to National Grid, allowing for partial drawings and providing for the payment to National Grid on demand.
Letter of Credit	An irrevocable standby letter of credit expressed to be governed by the Uniform Customs and Practice for Documentary Credits 1993 Revision ICC Publication No. 500 or such other form as may be reasonably satisfactory to National Grid and allowing for partial drawings and providing for the payment to National Grid on demand.

Ofgem's Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover	Ofgem's conclusions document on best practice guidelines for gas and electricity network operator credit cover, published in February 2005: http://www.ofgem.gov.uk/Licensing/IndCodes/CreditCover/Documents1/9791-5805.pdf
Required Credit Rating	a rating of at least A- in Standard and Poor's long term debt rating or A3 in Moody's long term debt rating or such lesser rating which National Grid may in its absolute discretion allow.
Subsidiary	As defined by section 736, Companies Act 1985 as supplemented by section 144(3), Companies Act 1989.
Termination Amounts	<p>The amount charged when a User wholly or partially disconnects from the Transmission System, as calculated under the terms of The Statement of Connection Charging Methodology. This includes amounts such as (taking into account any capital contributions):</p> <ul style="list-style-type: none">- the remaining Net Asset Value of any relating connection assets that are made redundant as at the end of the Financial Year;- the reasonable costs of removing such assets;- any outstanding Use of System charges (some of which are secured outside of Termination Amounts Security); and <p>the remaining connection charges for the current Financial Year;</p>
The Company Credit Rating	<p>As defined in the CUSC, any one of the following:-</p> <ul style="list-style-type: none">(a) a credit rating for long term debt of A- and A3 respectively as set by Standard and Poor's or Moody's respectively;(b) an indicative long term private credit rating of A- and A3 respectively as set by Standard and Poor's or Moody's as the basis of issuing senior unsecured debt;(c) a short term rating by Standard and Poor's or Moody's which correlates to a long term rating of A- and A3 respectively; or(d) where the User's Licence issued under the Electricity Act 1989 (as amended by the Utilities Act 2000) requires that User to maintain a credit rating, the credit rating defined in that User's Licence.

The Proposer

CRE Energy Ltd

Ultimate Parent

The highest company in the chain of corporate ownership. Note that there may be multiple ultimate parent companies if joint ownership exists within the chain.

ANNEX 2 – PROPOSED LEGAL TEXT TO MODIFY THE CUSC

Part A - Text to give effect to the Original Proposed Amendment

The proposed Legal text to modify the CUSC is detailed below by inserting the coloured underlined text and deleting the coloured struck through text. It is proposed that these amendments are made to the definitions of “Qualified Company’ or ‘Qualifying Company’” in Section 11.3 of the CUSC and Appendix M Part 1 of the standard form of the Construction Agreement (Schedule 2 Exhibit 2 of the CUSC). The wording in both sections is currently identical.

“Qualified Company” or “Qualifying Company”

a company which is a public company or a private company within the meaning of section 1(3) of the Companies Act 1985 and which is either a shareholder of the **User** or any holding company of such shareholder or any subsidiary of any such holding company (the expressions 'holding company' and 'subsidiary' having the respective meanings assigned thereto by section 736, Companies Act 1985 as supplemented by section 144(3), Companies Act 1989) and which has throughout the validity period of the **Performance Bond** it gives in favour of **The Company**, a rating of at least A- in Standard and Poor’s long term debt rating or A3 in Moody’s long term debt rating or such lesser rating which **The Company** may in its absolute discretion allow by prior written notice given pursuant to a resolution of its board of directors for such period and on such terms as such resolution may specify provided that such company is not during such validity period put on any credit watch or any similar credit surveillance procedure which gives **The Company** reasonable cause to doubt that such company may not be able to maintain the aforesaid rating throughout the validity period of the **Performance Bond** and no other event has occurred which gives **The Company** reasonable cause to have such doubt;

Part B - Text to give effect to the Working Group Alternative Amendment

The proposed Legal text to modify the CUSC is detailed below by inserting the coloured underlined text and deleting the coloured struck through text. It is proposed that these amendments are made to the definitions of “Qualified Company” or ‘Qualifying Company’ in Section 11.3 of the CUSC and Appendix M Part 1 of the standard form of the Construction Agreement (Schedule 2 Exhibit 2 of the CUSC). The wording in both sections is currently identical.

“Qualified Company” or “Qualifying Company”

Proposed new definition of “Qualified Company” (with new changes highlighted):

a company which is a public company or a private company within the meaning of section 1(3) of the Companies Act 1985 and which is either :

(a) a shareholder of the **User** or any holding company of such shareholder ~~(the expression “; or~~

(b) any subsidiary of any such holding company, but only where the subsidiary

(i) demonstrates to **The Company’s** satisfaction that it has power under its constitution to give a **Performance Bond** other than in respect of its subsidiary;

(ii) provides an extract of the minutes of a meeting of its directors recording that the directors have duly concluded that the giving of the **Performance Bond** is likely to promote the success of that subsidiary for the benefit of its members;

(iii) provides certified copies of the authorisation by every holding company of the subsidiary up to and including the holding company of the **User**, of the giving of the **Performance Bond**,

(the expressions “holding company” and “subsidiary” having the ~~meaning~~respective meanings assigned thereto by section 736, Companies Act 1985 as supplemented by section 144(3), Companies Act 1989) and which has throughout the validity period of the **Performance Bond** it gives in favour of **The Company**, a rating of at least A- in Standard and Poor’s long term debt rating or A3 in Moody’s long term debt rating or such lesser rating which **The Company** may in its absolute discretion allow by prior written notice given pursuant to a resolution of its board of directors for such period and on such terms as such resolution may specify provided that such company is not during such validity period put on any credit watch or any similar credit surveillance procedure which gives **The Company** reasonable cause to doubt that such company may not be able to maintain the aforesaid rating throughout the validity period of the **Performance Bond** and no other event has occurred which gives **The Company** reasonable cause to have such doubt;

ANNEX 3 – WORKING GROUP TERMS OF REFERENCE AND MEMBERSHIP

TERMS OF REFERENCE FOR CAP157 WORKING GROUP

RESPONSIBILITIES

1. The Working Group is responsible for assisting the CUSC Amendments Panel in the evaluation of CUSC Amendment Proposal CAP157 tabled by CRE Energy Limited at the Amendments Panel meeting on 17th August 2007.
2. The proposal must be evaluated to consider whether it better facilitates achievement of the applicable CUSC objectives. These can be summarised as follows:
 - (a) the efficient discharge by the Licensee of the obligations imposed on it by the Act and the Transmission Licence; and
 - (b) facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity.
3. It should be noted that additional provisions apply where it is proposed to modify the CUSC amendment provisions, and generally reference should be made to the Transmission Licence for the full definition of the term.

SCOPE OF WORK

4. The Working Group must consider the issues raised by the Amendment Proposal and consider if the proposal identified better facilitates achievement of the Applicable CUSC Objectives.
5. In addition to the overriding requirement of paragraph 4, the Working Group shall consider and report on the following specific issues:
 - **The Extension of the definition of Qualified/Qualifying Company.**
 - **Note any relevance of Ofgem's Best Practice Guidelines for Gas and Electricity Network operator Credit Cover in relation to Final Sums and Termination Amounts.**
 - **Note any relevance of similar security tools used for UoS charges.**
6. The Working Group is responsible for the formulation and evaluation of any Working Group Alternative Amendments (WGAAs) arising from Group discussions which would, as compared with the Amendment Proposal, better facilitate achieving the applicable CUSC objectives in relation to the issue or defect identified.
7. The Working Group should become conversant with the definition of Working Group Alternative Amendments which appears in Section 11 (Interpretation

and Definitions) of the CUSC. The definition entitles the Group and/or an individual Member of the Working Group to put forward a Working Group Alternative Amendment if the Member(s) genuinely believes the Alternative would better facilitate the achievement of the Applicable CUSC Objectives. The extent of the support for the Amendment Proposal or any Working Group Alternative Amendment arising from the Working Group's discussions should be clearly described in the final Working Group Report to the CUSC Amendments Panel.

8. There is an obligation on the Working Group Members to propose the minimum number of Working Group Alternatives where possible.
9. All proposed Working Group Alternatives should include the proposer(s) details within the Final Working Group Report, for the avoidance of doubt this includes Alternative(s) which are proposed by the entire Working Group or subset of members.
10. The Working Group is to submit their final report to the CUSC Panel Secretary on 18th October 2007 for circulation to Panel Members. The conclusions will be presented to the CUSC Panel meeting on 26th October 2007.

MEMBERSHIP

11. It is recommended that the Working Group has the following members:

Chair	Robert Brown
National Grid	Wayne Mullins
Industry Representatives	Ben Sheehy Dave Wilkerson Robin Healey James Anderson
Authority Representative	David Edward
Technical Secretary	Sarah Jukes

NB: Working Group must comprise at least 5 Members (who may be Panel Members)

12. A vote is to take place by all eligible Working Group members on the proposal and each Working Group Alternative, as appropriate, as to whether it better facilitates the CUSC Applicable Objectives and indicate which option is considered the BEST with regard to the CUSC Applicable Objectives. The results from the vote shall be recorded in the Working Group Report.
13. Working Group Members or their appointed alternate is required to attend a minimum of 50% of the Working Group Meetings to be eligible to participate in the Working Group vote.
14. The Technical Secretary to keep an Attendance Record, for the Working Group meetings and to circulate the Attendance Record with the Action Notes after each meeting. This will be attached to the Final Working Report.
15. The membership can be amended from time to time by the CUSC Amendments Panel.

RELATIONSHIP WITH AMENDMENTS PANEL

16. The Working Group shall seek the views of the Amendments Panel before taking on any significant amount of work. In this event the Working Group Chairman should contact the CUSC Panel Secretary.
17. Where the Working Group requires instruction, clarification or guidance from the Amendments Panel, particularly in relation to their Scope of Work, the Working Group Chairman should contact the CUSC Panel Secretary.

MEETINGS

18. The Working Group shall, unless determined otherwise by the Amendments Panel, develop and adopt its own internal working procedures and provide a copy to the Panel Secretary for each of its Amendment Proposals.

REPORTING

19. The Working Group Chairman shall prepare a final report to the October Amendments Panel responding to the matter set out in the Terms of Reference.
20. A draft Working Group Report must be circulated to Working Group members with not less than five business days given for comments.
21. Any unresolved comments within the Working Group must be reflected in the final Working Group Report.
22. The Chairman (or another member nominated by him) will present the Working Group report to the Amendments Panel as required.

ANNEX 4 – INTERNAL WORKING GROUP PROCEDURE

1. Detailed meeting notes of agreements reached or issues raised for further assessment, together with actions from each meeting will be produced by the Technical Secretary (provided by National Grid) and circulated to the Chairman and Working Group members for review.
2. The notes and actions will be published on the National Grid CUSC Website after they have been agreed at the next meeting or sooner on agreement by Working Group members.
2. The Chairman of the Working Group will provide an update of progress and issues to the Amendments Panel each month as appropriate.
4. Working Group meetings will be arranged for a date acceptable to the majority of members and will be held as often as required as agreed by the Working Group in order to respond to the requirements of the Terms of Reference set by the Amendments Panel.
5. If within half an hour after the time for which the Working Group meeting has been convened the Chairman of the group is not in attendance, the meeting will take place with those present.
6. A meeting of the Working Group shall not be invalidated by any member(s) of the group not being present at the meeting.

ANNEX 5 – WORKING GROUP ATTENDANCE REGISTER

Working Group Member	17/8	13/9	12/10	Attendance (%)
Robert Brown – Chair (Cornwall Energy Associates)	√	√	√	100%
Sarah Jukes – Technical Secretary (NGET)	√	√	√	100%
James Anderson – Acting on behalf of the Proposer (Scottish Power)	√	√	X	100%*
Gerry Hoggan – Acting as alternative for James Anderson (Scottish Power)	X	X	√	
David Edward (Ofgem)	√	X	X	33.3%
Robin Healey (RWE Npower)	√	X	√	66.6%
Ben Sheehy (E.ON UK)	√	X	X	33.3%
Dave Wilkerson (Centrica)	√	√	√	100%
Wayne Mullins (NGET)	√	√	√	100%

*Includes attendance of Working Group member and their alternative representative.

ANNEX 6 – AMENDMENT PROPOSAL FORM

URGENT AMENDMENT PROPOSAL

Title of Amendment Proposal:

Extension of Qualified Company Definition

Description of the Proposed Amendment:

It is proposed to amend the CUSC to permit Users to procure that security which is required to be provided under Paragraph 2.22.1 of the CUSC and under the provisions of Bilateral Connection Agreements, BELLAs, BEGAs and Construction Agreements by way of a Performance Bond from a Qualified Company may be provided by a wider category of companies than is currently provided for.

Specifically, it is proposed to widen the definition of 'Qualified Company' or "Qualifying Company" to enable affiliates of a User rather than solely a User's shareholders or immediate holding companies to provide security. The proposed drafting amendments are set out in Appendix 1. The proposed amendment in no way affects the requirement that a Qualified Company or Qualifying Company must have the specified credit rating.

Description of Issue or Defect that Proposed Amendment seeks to Address:

Currently the definition of 'Qualified Company' or 'Qualifying Company' only permits a User to obtain a guarantee from one of its immediate shareholders or from a holding company of one of such shareholders.

This narrow definition is unduly restrictive and may cause problems for Users within more complex group structures where such Users wish to provide a guarantee from a related group company which is not immediately above the User in the corporate ownership structure of that group.

This presents a barrier to Users in providing the most economic and efficient form of security available to that User.

Impact on the CUSC:

The following changes are expected:

- Amendment required to definition of "Qualified Company" and "Qualifying Company" in Section 11 of the CUSC.
- Amendment required to definition of "Qualified Company" and / or "Qualifying Company" in Appendix M to the standard form Construction Agreement appended at Schedule 2 Exhibit 3 to the CUSC.

The wording of the proposed amendment is set out in Appendix I to this CUSC Amendment Proposal.

Impact on Core Industry Documentation:

The proposed amendment would require amendment to be made to Appendix M of Construction Agreements.

Impact on Computer Systems and Processes used by CUSC Parties:

None

Details of any Related Modifications to Other Industry Codes:

None

Justification for Proposed Amendment with Reference to Applicable CUSC Objectives:

The proposed amendment better facilitates the achievement of the Applicable CUSC Objectives as follows:

a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence

The Company has a range of statutory duties and licence obligations which include ensuring the efficient, economic and co-ordinated operation of the GB Transmission System, the facilitation of competition and non-discrimination. The proposed amendment better facilitates the efficient discharge by The Company of these obligations and, in particular, it is observed that the proposal would:

- aid an efficient and economic operation of the GB Transmission System by ensuring that Users do not incur extra costs to connection which they would otherwise be able to avoid;
- improve competition among generators, particularly developers of new generating stations by allowing them to meet security requirements under their agreements with The Company more easily;
- ensure that Users which are members of a more complex corporate group structure than other Users are not unfairly discriminated against by reason of this structure (which may have been put in place for other group reasons such as tax or efficiency);
- update the CUSC to reflect the more modern innovative group company arrangements being employed by CUSC Participants; and
- not lead to any increase in risk on the part of The Company.

For these reasons, the proposed amendment would better facilitate Applicable CUSC Objective (a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by the licence.

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

Users which have requested a connection to the GB Transmission System and which have signed up to Construction Agreements with The Company are often required to provide security in respect of substantial potential liabilities under such agreements.

In the absence of being able to provide security by way of guarantee from a 'Qualified Company', a User must provide security by other means such as letter of credit or cash in escrow – these other forms of security can often be significantly more expensive than providing a group company guarantee.

If Users cannot continue to provide security then The Company is entitled to terminate the relevant Construction Agreement and call up the security already provided.

The ability of and cost to Users to provide security for such connections is a significant barrier to entry for new generation and the proposal would remove an element of this barrier and to a certain extent greatly simplify and improve matters for Users within more complex corporate structures.

For these reasons, the proposed amendment would better facilitate Applicable CUSC Objective (b) facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity.

Details of Proposer:

Organisation's Name: CRE Energy Limited

Capacity: CUSC Party

Detail of Proposer's Representative:

Name: Roger Seshan

Organisation: CRE Energy Limited

Telephone Number: 0141 568 2870

Email Address: Roger.Seshan@ScottishPower.com

Details of Representative's Alternate:

Name: Keith Anderson

Organisation: CRE Energy Limited

Telephone Number: 0141 568 3143

Email Address: keith.anderson@ScottishPower.com

Appendix I

Proposed new definition of "Qualified Company" (with new changes highlighted):

a company which is a public company or a private company within the meaning of section 1(3) of the Companies Act 1985 and which is either a shareholder of the **User** or any holding company of such shareholder or any subsidiary of any such holding company (the expressions 'holding company' and 'subsidiary' having the respective meanings assigned thereto by section 736, Companies Act 1985 as supplemented by section 144(3), Companies Act 1989) and which has throughout the validity period of the **Performance Bond** it gives in favour of **The Company**, a rating of at least A- in Standard and Poor's long term debt rating or A3 in Moody's long term debt rating or such lesser rating which **The Company** may in its absolute discretion allow by prior written notice given pursuant to a resolution of its board of directors for such period and on such terms as such resolution may specify provided that such company is not during such validity period put on any credit watch or any similar credit surveillance procedure which gives **The Company** reasonable cause to doubt that such company may not be able to maintain the aforesaid rating throughout the validity period of the **Performance Bond** and no other event has occurred which gives **The Company** reasonable cause to have such doubt;

ANNEX 7 – RESULT OF WORKING GROUP VOTE

Amendment	Better meets the Applicable CUSC Objectives	Does not better meet the Applicable CUSC Objectives	Best meets the Applicable CUSC Objectives
CAP157 (Original)	4	0	0
CAP157 Working Group Alternative Amendment	4	0	4

Abstentions: 1

ANNEX 8 – COMPANIES ACT 1989 SECTION 144

The following is taken from the Office of Public Sector Information website (http://www.opsi.gov.uk/acts/acts1989/ukpga_19890040_en_17#pt5-pb5-l1g147), and is reproduced under the terms of Crown Copyright Policy Guidance issued by HMSO:

144 “Subsidiary”, “holding company” and “wholly-owned subsidiary”

(1) In Part XXVI of the [1985 c. 6.] Companies Act 1985 (general interpretation provisions), for section 736 substitute—

“736 “Subsidiary”, “holding company” and “wholly-owned subsidiary”

(1) A company is a “subsidiary” of another company, its “holding company”, if that other company—

- (a) holds a majority of the voting rights in it, or
- (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
- (c) is a member of it and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in it,

or if it is a subsidiary of a company which is itself a subsidiary of that other company.

(2) A company is a “wholly-owned subsidiary” of another company if it has no members except that other and that other’s wholly-owned subsidiaries or persons acting on behalf of that other or its wholly-owned subsidiaries.

(3) In this section “company” includes any body corporate.

736A Provisions supplementing s. 736

(1) The provisions of this section explain expressions used in section 736 and otherwise supplement that section.

(2) In section 736(1)(a) and (c) the references to the voting rights in a company are to the rights conferred on shareholders in respect of their shares or, in the case of a company not having a share capital, on members, to vote at general meetings of the company on all, or substantially all, matters.

(3) In section 736(1)(b) the reference to the right to appoint or remove a majority of the board of directors is to the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters; and for the purposes of that provision—

(a) a company shall be treated as having the right to appoint to a directorship if—

- (i) a person’s appointment to it follows necessarily from his appointment as director of the company, or
- (ii) the directorship is held by the company itself; and

(b) a right to appoint or remove which is exercisable only with the consent or concurrence of another person shall be left out of account unless no other person has a right to appoint or, as the case may be, remove in relation to that directorship.

(4) Rights which are exercisable only in certain circumstances shall be taken into account only—

(a) when the circumstances have arisen, and for so long as they continue to obtain, or

(b) when the circumstances are within the control of the person having the rights;

and rights which are normally exercisable but are temporarily incapable of exercise shall continue to be taken into account.

(5) Rights held by a person in a fiduciary capacity shall be treated as not held by him.

(6) Rights held by a person as nominee for another shall be treated as held by the other; and rights shall be regarded as held as nominee for another if they are exercisable only on his instructions or with his consent or concurrence.

(7) Rights attached to shares held by way of security shall be treated as held by the person providing the security—

(a) where apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in accordance with his instructions;

(b) where the shares are held in connection with the granting of loans as part of normal business activities and apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in his interests.

(8) Rights shall be treated as held by a company if they are held by any of its subsidiaries; and nothing in subsection (6) or (7) shall be construed as requiring rights held by a company to be treated as held by any of its subsidiaries.

(9) For the purposes of subsection (7) rights shall be treated as being exercisable in accordance with the instructions or in the interests of a company if they are exercisable in accordance with the instructions of or, as the case may be, in the interests of—

(a) any subsidiary or holding company of that company, or

(b) any subsidiary of a holding company of that company.

(10) The voting rights in a company shall be reduced by any rights held by the company itself.

(11) References in any provision of subsections (5) to (10) to rights held by a person include rights falling to be treated as held by him by virtue of any other provision of those subsections but not rights which by virtue of any such provision are to be treated as not held by him.

(12) In this section “company” includes any body corporate.”.

(2) Any reference in any enactment (including any enactment contained in subordinate legislation within the meaning of the [1978 c. 30.] Interpretation Act 1978) to a “subsidiary” or “holding company” within the meaning of section 736 of the [1985 c. 6.] Companies Act 1985 shall, subject to any express amendment or saving made by or under this Act, be read as referring to a subsidiary or holding company as defined in section 736 as substituted by subsection (1) above.

This applies whether the reference is specific or general, or express or implied.

(3) In Part XXVI of the [1985 c. 6.] Companies Act 1985 (general interpretation provisions), after section 736A insert—

“736B Power to amend ss. 736 and 736A

(1) The Secretary of State may by regulations amend sections 736 and 736A so as to alter the meaning of the expressions “holding company”, “subsidiary” or “wholly-owned subsidiary”.

(2) The regulations may make different provision for different cases or classes of case and may contain such incidental and supplementary provisions as the Secretary of State thinks fit.

(3) Regulations under this section shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

(4) Any amendment made by regulations under this section does not apply for the purposes of enactments outside the Companies Acts unless the regulations so provide.

(5) So much of section 23(3) of the Interpretation Act 1978 as applies section 17(2)(a) of that Act (effect of repeal and re-enactment) to deeds, instruments and documents other than enactments shall not apply in relation to any repeal and re-enactment effected by regulations made under this section.”.

(4) Schedule 18 contains amendments and savings consequential on the amendments made by this section; and the Secretary of State may by regulations make such further amendments or savings as appear to him to be necessary or expedient.

(5) Regulations under this section shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

(6) So much of section 23(3) of the [1978 c. 30.] Interpretation Act 1978 as applies section 17(2)(a) of that Act (presumption as to meaning of references to enactments repealed and re-enacted) to deeds or other instruments or documents does not apply in relation to the repeal and re-enactment by this section of section 736 of the [1985 c. 6.] Companies Act 1985.

ANNEX 9 – THE AUTHORITY’S DECISION ON URGENCY



Promoting choice and
value to customers

Beverley Viney
CUSC Panel Secretary
National Grid
Warwick Technology Park
Gallows Hill
Warwick CV34 6DA

Your Ref:
Direct Dial: 020 7901 7355
Email: mark.feather@ofgem.gov.uk

24 July 2007

Dear Beverley,

Request for Urgency in relation to Code Amendment Proposal CAP157: Extension of Qualified Company Definition.

Thank you for your email dated 23 July 2007, containing the Panel’s unanimous recommendation that CAP157 should not be treated as an Urgent Amendment Proposal.

Characteristics of urgent Amendments

Our view is that, in general, urgent amendments are likely to exhibit at least one of the following characteristics:

- There is a very real likelihood of significant commercial impact upon NGET, industry parties, or customers if an Amendment Proposal is not urgent;
- Safety and security of the network is likely to be impacted if a proposed Amendment is not urgent; and
- The proposal is linked to an imminent date related event.

Applying these characteristics to CAP157

This amendment proposal seeks to widen the definition of ‘Qualifying Company’ to enable a User to procure security required under CUSC paragraph 2.22.1 from a wider range of companies than the CUSC currently allows.

Whilst the merits of this proposal have yet to be considered, we have not received any information relating to the extent of the materiality that would lead us to consider there is a real likelihood of a significant commercial impact on NGET, industry parties or customers nor for there to be an impact on the safety or security of the network, if urgent status is not granted to this proposal.

Our understanding is that the current terms of the CUSC impact the proposer because of a corporate restructuring exercise within the proposers corporate group. This restructuring we believe is due to take effect on or around 17 August 2007. We note that the date was put forward by the proposer’s corporate group and did not arise owing to extraneous factors. In view of this and in the absence of any evidence of the broader impacts on industry parties, NGET or customers of not granting urgency, we do not consider that urgency status is merited for this proposal.

Our decision on urgency

Ofgem therefore agrees with the CUSC Panel and does not consent to CAP157 being treated as an Urgent Amendment Proposal for the purposes of section 8.21.1.4 of the CUSC.

Reservation of rights

Ofgem has not, by refusing consent to the request that CAP157 be treated as an Urgent Amendment Proposal, made any judgement on its merits.

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

Yours sincerely



Mark Feather

Associate Director, Industry Codes & Licensing

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