



Direct Dial: 020-7901-7355

30 May 2002

The National Grid Company, CUSC Signatories and
Other Interested Parties

Your Ref: CAP004
Our Ref: IND/COD/CUSC/CAP004

Dear Colleague,

Amendment to the Connection and Use of System Code (“CUSC”) - Decision and Notice in relation to Proposed Amendment CAP004: “Cost Benefit Analysis”.

The Gas and Electricity Markets Authority (the “Authority”¹) has carefully considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP004 “Cost Benefit Analysis”.

The National Grid Company plc (“NGC”) recommended to the Authority that:

- (i) Proposed Amendment CAP004 be rejected; and
- (ii) The Alternative Amendment as developed by the Governance Amendments Working Group be approved and implemented as soon as practicable after the Authority’s decision.

The Authority has decided not to direct a modification to the CUSC.

This letter explains the background to Proposed Amendment CAP004, as set out in the Amendment Report, and sets out the Authority’s reasons for its decision.

Background

Under Section 8 of the CUSC (CUSC Amendment) there is no explicit requirement for a cost-benefit analysis to be undertaken as part of the consideration of a Proposed Amendments.

The Proposer stated that introducing the requirement for a cost-benefit analysis as part of the consideration of an Amendment Proposal would bring the CUSC Amendment Process into

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

² CAP004 Amendment Report dated 9 April 2002.

line with best regulatory practice. The Proposer also stated that implementing and maintaining procedures that incorporate best industry practice should form part of NGC's responsibility to achieve the efficient discharge of its obligations. Further, the Proposer asserted that the requirement for a cost-benefit analysis will increase confidence in the CUSC as a central part of the framework for the operation of the electricity market and help to ensure that unnecessary and excessive costs are not imposed on Parties. The Proposer also considered that confidence in this framework is a key factor in the efficient operation of the market and the development of competition. By increasing confidence in the framework the Proposer believes that the requirement for a cost-benefit analysis will better facilitate achievement of the Applicable CUSC Objective³ of facilitating competition in generation and supply.

Proposed Amendment CAP004 was raised by British Energy Generation Ltd on 31 October 2001 and was submitted for consideration at the CUSC Amendments Panel Meeting on 9 November 2001. At the meeting the Panel determined that a Working Group should be established to consider the Proposed Amendment. The Governance Amendments Working Group was established to evaluate Proposed Amendment CAP004 and submitted its Working Group report for consideration at the Panel Meeting on 22 February 2002. The Panel endorsed the Working Group report and determined that the Proposed Amendment and Alternative Amendment should proceed to wider consultation by NGC. A consultation paper was issued on 27 February 2002 with responses invited by 26 March 2002. A final Amendment Report was submitted to the Authority on 9 April 2002.

The Proposed Amendment

Proposed Amendment CAP004 seeks to modify Section 8 of the CUSC so as to include a provision/requirement for a cost-benefit analysis to be undertaken as part of the consideration of a Proposed Amendment.

Proposed Amendment CAP004 seeks to include a provision for a preliminary cost-benefit analysis as part of an Amendment Proposal. The Proposed Amendment also seeks to include a provision for a cost-benefit analysis as part of the terms of reference of a Working Group evaluating a Proposed Amendment. Finally the Proposed Amendment seeks to include a requirement for a cost-benefit analysis of the impact of a Proposed Amendment (and any Alternative Amendment) as part of an Amendment Report.

³ The Applicable CUSC Objectives are contained in Standard Condition C7F of the licence to transmit electricity treated as granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence") and are:

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

The Alternative Amendment

A majority of the Governance Amendments Working Group members supported Proposed Amendment CAP004 and felt that there should be an explicit requirement for a cost-benefit analysis, or at least that as a minimum it should be the default position when evaluating an Amendment Proposal. The Group felt that it was in line with best regulatory practice and would improve the evaluation of an Amendment Proposal. Despite being potentially implicit within the CUSC, the Group felt that there was a view that this implicit requirement was not sufficient.

However one member of the Group felt that the Proposed Amendment did not better facilitate achievement of the Applicable CUSC Objectives in general and that where it was appropriate for such analysis to be undertaken it could be provided for under the existing arrangements and therefore did not need to be explicit. The member felt that to mandate the process could have negative effects, such as providing unwelcome rigidities in the Amendment Process.

An Alternative Amendment was therefore formulated and drafted by the Group. The Group felt that the Alternative Amendment allowed the principle of estimating the costs and benefits to be explicit in the CUSC, but also allowed the requirement and detail of the costs and benefits to be reviewed on a case by case basis by the Amendments Panel, thus reducing concern over rigidities of the Amendment Process and avoiding the introduction of further barriers which are considered to be detrimental to the Amendment Process.

The Alternative Amendment seeks to include a provision for a preliminary estimate of the costs and benefits as part of an Amendment Proposal. The Alternative Amendment also seeks to include a provision for an estimate of the costs and benefits as part of the terms of reference of a Working Group evaluating a Proposed Amendment. Finally the Alternative Amendment seeks to include a provision for an estimate of the costs and benefits of the impact of a Proposed Amendment (and any Alternative Amendment) as part of an Amendment Report.

The majority of the Group felt that the Alternative Amendment better facilitated achievement of the Applicable CUSC Objectives as compared with the Proposed Amendment.

NGC issued a consultation paper on 27 February 2002 for views from CUSC Parties and interested parties.

Respondents' views

NGC received seven responses to the consultation in respect of Proposed Amendment CAP004, of which five were in favour of the Alternative Amendment, one in favour of both the Proposed Amendment and the Alternative Amendment, and one opposed to both the Proposed Amendment and the Alternative Amendment.

A majority of respondents acknowledged that the CUSC contains an implicit provision for a cost-benefit analysis, but it was felt that that the provision's implicit status caused unnecessary ambiguity. One respondent did not agree that the provision for a cost-benefit analysis was implicit within the CUSC and argued that making the provision explicit would remove this ambiguity. Another respondent felt that the current arrangement of implicit inclusion was sufficient and that an explicit requirement for a cost-benefit analysis would impose unnecessary burdens on the Amendment Process, whilst an explicit provision would be superfluous since the provision was already implicit within the CUSC.

The respondents' views are summarised and contained in the Amendment Report in respect of Proposed Amendment CAP004.

Amendments Panel Members' views

No formal responses were submitted by Amendments Panel Members to the consultation on Proposed Amendment CAP004.

NGC's recommendation

NGC recommended that the Authority should not approve Proposed Amendment CAP004. NGC considered that, since the requirement to carry out a cost-benefit analysis is already implicit in the CUSC, making the requirement explicit would not improve efficiencies in the Amendment Process and would lead to additional workload which could impact on Amendment Process timescales.

NGC recommended that the Authority approve the Alternative Amendment and that if approved the Alternative Amendment be implemented as soon as practicable after the Authority's decision. NGC felt that the Alternative Amendment recognises the need to give consideration to costs and benefits where appropriate in the evaluation of a Proposed Amendment, but would not require it to be undertaken irrespective of circumstances.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that Proposed Amendment CAP004 and the Alternative Amendment, as set out in the Amendment Report, do not better facilitate achievement of the Applicable CUSC Objectives.

Ofgem considers that information in respect of the benefits of an Amendment Proposal and the costs of implementing it are already addressed in the requirements relating to an Amendment Report contained in paragraph 8.20.2 of the CUSC.

In order to satisfy the provisions of sub-paragraphs 8.20.2(d) and (e) of the CUSC, by demonstrating how a Proposed Amendment or Alternative Amendment will better facilitate

achievement of the Applicable CUSC Objectives, the Proposer, the Working Group and NGC will have to identify the relevant benefits. It is unlikely that those who feel strongly on the matter will fail to draw out any additional benefits – or, particularly if they oppose the Proposed Amendment in question, the dis-benefits. Ofgem accepts that, where a particular CUSC Party considers that the benefit will be in relation to its trading activities, it is unlikely that such a Party will volunteer any quantification of that benefit. However, there is no power at present within CUSC to require the provision of such information and it would, in any event, seem inappropriate for it to be provided to NGC or to its competitors. Without such detailed quantification any estimate of benefits is likely to be generic in nature and no more reliable than interested CUSC Parties could estimate themselves.

In relation to costs, sub-paragraph 8.20.2(g)(vi) of the CUSC makes specific provision for an assessment of these in relation to central computer systems. This information should be capable of being ascertained by NGC. Sub-paragraph 8.20.2(h) relates to costs to CUSC Parties in general, including “development, capital and operating costs associated with implementing the changes”. As noted above, NGC has no power to require that information relating to such costs, which may vary significantly between companies, be provided. As a result any such assessment is likely to be at a high, indicative level only, and not company specific.

However, it is open to any CUSC Party at the Working Group stage or in response to the consultation to set out the costs and other financial effects which it considers may adversely affect it. Those responses will be attached to the Amendment Report, be publicly available, and will inform Ofgem’s decision on the matter. Where a respondent considers that the detail of such costs and other financial effects may be relevant, but is commercially confidential, Ofgem would be prepared to receive it direct in support of the public response. However, where it includes forecasts which are untested by the challenge of others, Ofgem will need to take that into account when determining the weight which can be allotted to it.

Ofgem therefore considers that, where cost-benefit questions may be relevant, there is already scope, within the existing provisions of the CUSC, for concerned Parties both to challenge a Proposed Amendment on such grounds and to provide information to support their case.

While Ofgem also has some concerns at the effectiveness of the drafting in achieving the intended purpose, including the scope of the costs or benefits which are sought to be included in the analysis, it does not consider that NGC would have, or that it is appropriate that it should be provided with, the degree of information which would be necessary to provide an analysis of sufficient substance to materially benefit the consideration of a Proposed Amendment, either by CUSC Parties, the Panel or Ofgem. Ofgem is therefore not satisfied that either Proposed Amendment CAP004 or the Alternative Amendment would better facilitate achievement of the Applicable CUSC Objectives.

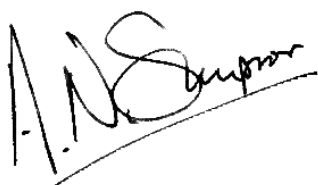
Paragraph 8.20.2(f) of the CUSC states that one of the matters to be included in an Amendment Report should be "the proposed date for the implementation of the Proposed Amendment or Alternative Amendment". In Section 9 of the Amendment Report, which concerns the implementation and timescales of Proposed Amendment CAP004, it is stated that "implementation of Amendment Proposals is at the discretion of the Authority, but is expected to be as soon as practicable after their decision". It is Ofgem's view that, while a Proposed Amendment can take effect if approved by the Authority, there is no power for the Authority to direct an implementation date other than that set out in the report. Ofgem does not consider that the provision of 8.23.3 provides power to propose or change a proposed implementation date and no such power is contained in Standard Condition C7F. Ofgem considers that the implementation date should either be a specific date (e.g. 1 October 2002), or one which is otherwise clearly defined such as the formulation in paragraph 8.23.3 of a specific number of days after the decision of the Authority. The phrase used in the Amendment Report fails to comply with the requirements of paragraph 8.20.2(f) and is unacceptable in that it provides no certainty to CUSC Parties as to what may be "practicable" in the circumstance of a particular Proposed Amendment.

The Authority's Decision

The Authority has therefore decided not to direct that Proposed Amendment CAP004 or the Alternative Amendment, as set out in the Amendment Report, should be made and implemented.

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

Yours sincerely,

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

Nick Simpson

Director of Industry Code Development

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