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Direct Dial: 020 7901 7335

22 December 2005

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

Our Ref: IND/COD/CUSC/CAP103

Dear Colleague,

Amendment to the Connection and Use of System Code (“CUSC”) - Decision and Notice in relation to Proposed Amendment CAP103: “Flexibility of Working Group Internal Procedures”.

The Gas and Electricity Markets Authority (the “Authority”¹) has considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP103: “Flexibility of Working Group Internal Procedures”.

National Grid Electricity Transmission plc (“NGET”) recommended to the Authority that the Consultation Alternative Amendment proposed by Centrica should be approved with an Implementation Date of 10 Business days after the Authority’s decision.

Having considered the Amendment Report and NGET’s recommendation and having regard to the Applicable CUSC Objectives³ and Ofgem’s wider statutory duties,⁴ the Authority has decided to direct a modification to the CUSC in line with the Consultation Alternative Amendment CAP103.

A separate letter contains the direction to NGET to modify the CUSC in accordance with the Consultation Alternative Amendment as set out in the Amendment Report.

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

² CAP103 Amendment Report dated 16 November 2005.

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

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

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

This letter explains the background to Proposed Amendment CAP103, and sets out the Authority's reasons for its decision. This letter constitutes notice by the Authority under section 49A of the Electricity Act 1989 in relation to the direction.

Background

Section 8 of the CUSC prescribes the processes by which it may be amended. Amongst other obligations, it requires that:

- Only the Amendments Panel may alter the membership of a Working Group or Standing Group;
- Not less than five Business Days be given to Working Group members to consider draft reports to the Amendments Panel; and
- A standing list of persons who would be available to serve on Working Groups should be maintained.

Proposed Amendment CAP103 was raised by National Grid Electricity Transmission plc and was submitted for consideration at the CUSC Amendments Panel Meeting on 29 July 2005. At the meeting the Panel determined that a Working Group should be established to consider the Proposed Amendment.

The Working Group formulated an Alternative Amendment which it unanimously considered better facilitated achievement of the Applicable CUSC Objectives as compared with the Proposed Amendment. The Working Group submitted its report for consideration at the Panel Meeting on 23 September 2005. The Panel endorsed the Working Group report and determined that the Proposed Amendment should proceed to wider consultation by NGET.

A consultation paper was issued on 30 September 2005 with responses invited by 14 October 2005. In responding to this consultation, Centrica proposed a Consultation Alternative Amendment. This required a further consultation in order to allow its merits to be considered, with a Consultation Alternative Amendment paper issued on 20 October 2005 with responses invited by 3 November 2005.

The final Amendment Report was submitted to the Authority on 16 November 2005.

The Proposed Amendment

The Proposed Amendment proposes to amend two of the three requirements bulleted in the 'Background' section of this letter.

Firstly, it would give a Working Group the ability to unilaterally alter its membership for the period up to the next Amendments Panel, at which the latter could then choose to either uphold or overturn these changes in membership. This change was intended to allow greater flexibility

in the Working Group process so that it coped better with the frequent circumstance whereby a request to vary membership is received between Amendments Panel meetings.

Secondly, it would relax the requirement that Working Group members be given at least five Business Days to review reports before these are sent to the Amendments Panel, such that this may be reduced to three Business Days if all members agree. If this agreement was absent, five Business Days would be required as before. This change was intended to reduce problems in meeting the CUSC Panel paper submission date and potentially expand the time window available for the assessment of many Amendment Proposals, whilst ensuring that there would be no reduction in the time available for paper review should a Working Group member be uncomfortable with an accelerated timetable on any Amendment Proposal.

The Proposer initially considered that these two changes would better facilitate achievement of Applicable CUSC Objective (a) by ensuring that the provisions of the CUSC are more practical and effective, whilst also retaining safeguards on timescales and membership.

Whilst the Working Group agreed that the current rules for membership are too prescriptive they considered that the Proposed Amendment could itself create inefficiency and procedural problems in two distinct areas. Firstly, by allowing the Working Group to choose its new members there was a risk that its constituency could be manipulated to favour one side of an argument. Secondly, if the Working Group appointed a new member(s) who was subsequently removed by the Amendments Panel the status of the contribution made by this redundant member(s) would be called into question. This could be particularly problematic if they had proposed a Working Group Alternative Amendment, as its legitimacy could be called into question.

The Working Group developed an Alternative Amendment, detailed below, that avoided these problems, and therefore did not develop legal text for the Proposed Amendment.

Alternative Amendment

The Working Group Alternative Amendment was identical to the Proposed Amendment with regard to allowing a reduction in review time for reports from five to three Business Days, where all members of a Working Group consent. It differs from the Proposed Amendment in how it would allow the membership of a Working Group to be modified.

Rather than allowing the Working Group itself to add or vary new members, this right would be exercised by the Working Group Chairman. The Working Group Chairman is appointed by the Amendments Panel itself, and is obliged under the CUSC to act impartially and independently. It was considered that this would remove the concern raised against the Proposed Amendment that the membership of a Working Group could be manipulated to bolster the case for or against an Amendment Proposal.

In addition, any changes to membership made by the Working Group Chairman would not require the confirmation of the Amendments Panel. This removed the problem with the Proposed Amendment potentially resulting in recommendations or Alternative Amendments

being made by persons whose status on a Working Group is subsequently revoked by the Amendments Panel.

Consultation Alternative Amendment

During consultation, a further Alternative Amendment was suggested by Centrica. This contained all the provisions of the Working Group Alternative Amendment whilst adding two further changes.

Firstly, in addition to allowing a Working Group Chairman to vary the membership of Working Groups, it proposes that a Standing Group Chairman should be allowed to vary the membership of Standing Groups. This was considered to be a logical extension of the Working Group Alternative Amendment that would introduce similar flexibility to the procedures for considering standing issues as would be introduced for Amendment Proposals.

Secondly, it would remove the requirement on NGET to maintain a standing list of experts from whom membership of Working and Standing Groups can be drawn. The Amendments Panel and Parties would instead be invited to nominate members for each Working or Standing Group convened. It is contended that this would aid efficiency, although the rationale behind this view is not explored.

Respondents' views

NGET issued a consultation paper on 20 October 2005 inviting responses from CUSC Parties and interested parties.

NGET received two responses to the consultation in respect of Amendment Proposal CAP103, of which both expressed support for the Consultation Alternative Amendment.

One respondent stated that the Consultation Alternative Amendment would better facilitate achievement of the Applicable CUSC Objectives than the Working Group Alternative Amendment as it would allow for membership changes to Standing Groups as well as Working Groups. The other respondent noted its support for the Consultation Alternative Amendment that it had proposed.

The respondents' views are summarised and contained in the Amendment Report in respect of Proposed Amendment CAP103.

Amendments Panel Members' views

No responses to either of the consultations on CAP103 were received from Panel Members.

NGET's recommendation

NGET recommended to the Authority that the Consultation Alternative Amendment be approved with an implementation date of 10 Business Days after an Authority decision.

It considered that both the Working Group Alternative Amendment and the Consultation Alternative Amendment better facilitated CUSC Objective (a) by improving the flexibility and efficiency of Working Group processes. The latter approach was considered optimal of the two as it would extend this flexibility to Standing Groups as well as Working Groups, and would remove the need to maintain a standing list of experts that NGET considers has proven to be inefficient and of little use in appointing Working Groups in the past.

Ofgem's view

Having considered the Amendment Report, Ofgem considers, having regard to its statutory duties and the Applicable CUSC Objectives, that both the Working Group Alternative Amendment and the Consultation Alternative Amendment would better facilitate the achievement of the Applicable CUSC Objectives. Of these, the Consultation Alternative Amendment is considered better, and is therefore approved for implementation.

The Proposed Amendment

Ofgem concurs with the conclusion of the Working Group and NGET that the Proposed Amendment had structural problems that would have made it unworkable. Allowing a Working Group to unilaterally modify its own membership would create a risk that the procedures are open to bias. Even if this risk never crystallised in practice, its potential to do so could undermine participant confidence in the fairness of the Amendment Procedures.

In addition, making the participation of such members subject to subsequent affirmation or rejection by the Amendments Panel could create obvious practical problems should an individual(s) contribute to the conclusions of the Working Group, or development of Alternative Amendments, only to then be removed from the Working Group by the Amendments Panel. The legitimacy of their contributions would be open to question, and NGET could be faced with difficulties in trying to retrospectively expunge such contributions. This would be likely to have a detrimental impact on its ability to efficiently discharge its licence obligations in relation to the CUSC Amendment Procedures. As such, Ofgem concludes that the Proposed Amendment would have a detrimental impact on Applicable CUSC Objective (a) and could not be approved.

Both the Working Group Alternative Amendment and the Consultation Alternative Amendment appropriately addressed these concerns.

The Working Group Alternative Amendment & Consultation Alternative Amendment

Ofgem concurs with NGET's views that the Working Group Alternative Amendment and the Consultation Alternative Amendment better facilitate the Applicable CUSC Objectives; and that the latter is the better of the two.

Both provide a practical mechanism to allow additional technical experts to join the ongoing assessment of an Amendment Proposal without the artificial delay of having to wait for the next Amendments Panel to ratify their membership. This should make the Amendments Process more inclusive of all industry views, and increase the comprehensiveness of discussions on the merits of change. This should better facilitate Applicable CUSC Objective (a) by making the Amendment Procedures operate more efficiently.

The Consultation Alternative Amendment does so to a greater extent, as it extends these benefits to Standing Groups as well as Working Groups.

Allowing the Chairman remit to affirm changes in membership alleviates the concerns that the Proposed Amendment could be open to abuse, or problematic should the Amendments Panel disagree with industry volunteers, as this role holder is bound to impartiality and independence and their decision on new members would be binding.

Notwithstanding the benefits noted above, Ofgem highlights that stability in membership of Working and Standing Groups is generally desirable because it provides consistency in logic and understanding as assessment of an Amendment Proposal progresses. The benefits of CAP103 could be considerably diluted were group membership to become a continual 'revolving door'. In practice the Chairman will need to find an appropriate balance between inclusivity and continuity. Furthermore Ofgem would be concerned if the amendment led to any debarment.

Ofgem considers that reducing the minimum number of days available for members to review reports prior to the Panel deadline day, subject to the agreement of all group members, is a sensible move that should allow more flexibility in the timetables by which a Working Group may deliver its report to the Amendments Panel. Ofgem concludes that this would better facilitate achievement of the Applicable CUSC Objective (a) by allowing the licensee to more efficiently discharge its obligations.

The Authority's Direction

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

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

The modification is to be implemented and take effect on 10 January 2006.

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

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

Yours sincerely,

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

Nick Simpson

Director, Modifications

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