CONSULTATION DOCUMENT

CUSC Amendment Proposal CAP089/090/091

CAP089 Maximum Unsecured Credit Limit

CAP090 Credit Limits for Rated Companies

CAP091 Establishment & Maintenance of an Unsecured Credit Allowance for Rated & Unrated Companies

The purpose of this document is to consult on Amendment Proposal CAP089/090/091 with CUSC Parties and other interested Industry members

Amendment Ref	CAP089/090/091
Issue	1.0
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Prepared by	National Grid

I DOCUMENT CONTROL

a National Grid Document Control

Version	Date	Author	Change Reference
0.1		National Grid	Initial Draft for internal comment
0.2		National Grid	Second draft for internal comment
0.3		National Grid	Third draft for internal comment
1.0		National Grid	Formal version for release

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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

1.1 Ofgem published a conclusions document on best practice guidelines for gas and electricity network operator credit cover in February 2005. ("Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover", referred to hereafter as "the best practice guidelines.") CAP089/090/091 seeks to better facilitate the applicable Code objectives by addressing and codifying certain elements of these guidelines.

1.2 CAPs089 and 090 were proposed by National Grid and submitted to the CUSC Amendments Panel for consideration at their meeting on 20th May 2005. CAP091 was proposed by BizzEnergy at the same meeting. The Amendments Panel determined that the issue should be considered by a Working Group. Whilst the Working Group discussed the best practice guidelines, the assessment of the Original CAP089/090/091 proposal and the five Working Group Alternative Amendments was, as with all other Amendment proposals, done against the Applicable Code Objectives.

1.3 The Working Group reached a view that it would be more appropriate for the CAP089 and CAP090 proposals to be amalgamated, and permission for this was sought, and granted, and the meeting of the Amendments Panel on 24th June 2005. Following further exploration of the issues, the Working Group reached a view that it was also appropriate to seek permission to amalgamate CAP091 with the combined CAP089/090 proposal. The Amendments Panel agreed to this at their meeting on the 29th July 2005.

1.4 The CAP089/090/091 Working Group Report was submitted to the meeting of the Amendments Panel on 25th August 2005. The Amendments Panel determined that the issue was appropriate to proceed to wider industry consultation by National Grid.

1.5 This document initiates this wider consultation exercise and invites views on CUSC Amendment Proposal CAP089/090/091 and the five Working Group Alternative Amendments. The consultation closing date is 3rd October 2005.

2.0 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 CAP089/090/091 and the subsequent evaluation by the CAP088-091 Working Group, this document seeks views from industry members relating to the Amendment Proposal and the five Working Group Alternative Amendments.

2.3 This consultation document outlines the discussions held by the Working Group and the nature of the CUSC changes that are proposed. 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.

2.4 This 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 http://www.nationalgrid.com/uk/indinfo/cusc, along with the Working Group Report for CAP089/090/091 and the Amendment Proposal forms.

3.0 THE AMENDMENT PROPOSAL

3.1 The original, amalgamated, CAP089/090/091 proposal consists of 5 elements which are listed below:

- The introduction of a maximum unsecured credit limit of 2% of National Grid Electricity Transmission plc's Regulatory Asset Value (RAV);
- Credit allowances for companies with an Approved Credit Rating (ACR) of BB- or above, ranging from 15% to 100% of the maximum unsecured credit limit;
- A default credit allowance for unrated companies, or rated companies without an Approved Credit Rating, based on their payment record;
- An option for unrated companies, or rated companies without an Approved Credit Rating, to gain a credit allowance based on an Independent Credit Assessment;
- The replacement of the existing requirement to secure 10% of TNUoS Demand charges with an amount based on each User's forecasting performance in the previous year (this is referred to as the Value at Risk, or VAR).

Each of these five elements is described in more detail in paragraphs 3.6 - 3.16. The five Working Group Alternative Amendments which have also been raised are set out in detail in Section 5 of this Consultation document. All five Working Group Alternative Amendments are derived from variations in the five original elements set out above.

3.2 The first element above, the introduction of a maximum unsecured credit limit, was originally proposed under CAP089.

3.3 The second element, the determination of credit allowances for companies with Approved Credit Ratings, was originally proposed under CAP090. However, the mechanism proposed by CAP090 was contingent on the implementation of CAP089, and the two proposals were therefore combined.

3.4 The third, fourth and fifth elements, credit allowances set by Payment Record, those set by Independent Assessment, and the revision to VAR, were originally proposed under CAP091. However, the third and fourth elements, credit allowances set by Payment Record and by Independent Assessment, were also both contingent on the introduction of a maximum unsecured credit limit as proposed by CAP089, and so CAP091 was also amalgamated with CAP089/090.

3.5 For the avoidance of doubt, the scope of CAP089/090/091 is limited to credit arrangements related to Balancing Services Use of System (BSUoS) charges and Transmission Network Use of System (TNUoS) Demand charges.

Maximum Unsecured Credit Limit

3.6 The best practice guidelines recommended that Network Operators should set a maximum unsecured credit limit based on 2% of their RAV. Currently there is no limit to the unsecured credit available if a User has an Approved Credit Rating for Use of System charges of at least BBB- (or equivalent).

(The Standard and Poor's ratings scale is used throughout this document; such references such should be read as the rating in question or equivalent.) CAP089/090/091 therefore proposes that a maximum unsecured credit limit be defined in the CUSC based on 2% of National Grid Electricity Transmission (NGET) plc's RAV.

Credit Allowances for companies with Approved Credit Ratings

3.7 The best practice guidelines also recommended that individual counterparty credit limits, and those that use Parent Company Guarantees, should be set using credit ratings applied under the "Basel II" rules for determining bank capital adequacy. The implication of this is that there would be a maximum credit allowance of 100% of the maximum unsecured credit limit for parties with a credit rating of AAA or AA. At the other end of the scale, parties with a credit rating of BB- would be extended a maximum credit allowance of 15% of the maximum unsecured credit limit. CAP089/090/091 therefore proposes to alter the definition of Approved Credit Rating, such that BB- (rather than BBB-) is the minimum acceptable, and to introduce the following scale of credit allowances:

Maximum credit limit = 2% RAV (~£102m for NGET)

Credit rating (Standard and Poor's)	Credit allowance as % of maximum credit limit (Based on Basel II model)	Approximate credit allowance
AAA/AA	100	£102.0m
A	40	£40.8m
BBB+	20	£20.4m
BBB	19	£19.3m
BBB-	18	£18.4m
BB+	17	£17.3m
BB	16	£16.3m
BB-	15	£15.3m

Default Credit Allowance based on Payment Record

3.8 CAP089/090/091 also proposes to establish a default unsecured credit allowance for unrated companies, or rated companies without an Approved Credit Rating. In accordance with Ofgem's best practice guidelines, each party would be accorded an increasing allowance based on their payment record, climbing at 0.4% per year (escalating on an evenly graduated basis each month within year) of the maximum unsecured credit limit to a maximum of 2% after five years of perfect payment history.

Credit Allowances based on Independent Credit Assessments

3.9 The best practice guidelines also recommended that unrated companies, or rated companies without an Approved Credit Rating, should have the option to have an unsecured credit allowance set by submitting an Independent Assessment of its creditworthiness. Such an assessment would replace the allowance for payment record due to the potential for double counting.

3.10 The best practice guidelines further suggested that the Independent Assessment could be given by one of a panel of three assessment agencies selected by the Network Operator. An annual assessment could be paid for by the Network Operator if requested by the counterparty. Any intermediate assessment could be paid for by the party that requested it. The assessment could take the form of a score of 0 to 10. A company scoring nought would not be suitable for any allowance of unsecured credit, where as a company scoring 10 could be eligible for up to 20% of the maximum unsecured credit limit. Suggested credit allowances for each of the intermediate steps were also detailed.

3.11 The CAP089/090/091 proposal is consistent with these recommendations, and would therefore produce the following unsecured credit allowances:

Maximum credit limit = 2% RAV (~£102m for NGET)

Credit assessment score	Credit allowance as % of maximum credit limit	Approximate credit allowance
10	20	£20.4m
9	19	£19.4m
8	18	£18.4m
7	17	£17.3m
6	16	£16.3m
5	15	£15.3m
4	13-1/3	£13.6m
3	10	£10.2m
2	6-2/3	£6.8m
1	3-1/3	£3.4m
0	0	£0.0m

Summary of Unsecured Credit Limits

3.12 The first four elements of the CAP089/090/091 proposal therefore detail three ways in which unsecured credit allowance would be determined for Users. These are summarised in the table below:

Maximum credit limit = 2% RAV (~£102m for NGET)

<table>
<tr><th>Credit rating</th><th>Credit assessment score</th><th>Years of perfect payment history</th><th>Credit allowance as % of maximum credit limit</th><th>Approximate credit allowance</th></tr>
<tr><td>AAA/AA</td><td rowspan="2">n/a</td><td rowspan="12">n/a</td><td>100</td><td>£102.0m</td></tr>
<tr><td>A</td><td>40</td><td>£40.8m</td></tr>
<tr><td>BBB+</td><td>10</td><td>20</td><td>£20.4m</td></tr>
<tr><td>BBB</td><td>9</td><td>19</td><td>£19.4m</td></tr>
<tr><td>BBB-</td><td>8</td><td>18</td><td>£18.4m</td></tr>
<tr><td>BB+</td><td>7</td><td>17</td><td>£17.3m</td></tr>
<tr><td>BB</td><td>6</td><td>16</td><td>£16.3m</td></tr>
<tr><td>BB-</td><td>5</td><td>15</td><td>£15.3m</td></tr>
<tr><td rowspan="10"><BB-</td><td>4</td><td>13.33</td><td>£13.6m</td></tr>
<tr><td>3</td><td>10</td><td>£10.2m</td></tr>
<tr><td>2</td><td>6.67</td><td>£6.8m</td></tr>
<tr><td>1</td><td>3.33</td><td>£3.4m</td></tr>
<tr><td rowspan="5">n/a</td><td>5</td><td>2</td><td>£2.0m</td></tr>
<tr><td>4</td><td>1.6</td><td>£1.6m</td></tr>
<tr><td>3</td><td>1.2</td><td>£1.2m</td></tr>
<tr><td>2</td><td>0.8</td><td>£0.8m</td></tr>
<tr><td>1</td><td>0.4</td><td>£0.4m</td></tr>
<tr><td>0</td><td>0</td><td>0</td><td>£0.0m</td></tr>
</table>

3.13 The above table shows the overlap between the credit allowances available to Users with an Approved Credit Rating and those available to Users submitting an Independent Assessment, which occurs between 15% and 20% of the maximum unsecured credit limit. For unrated companies, this was explicitly the intention of the best practice guidelines, as in Ofgem's view "an unrated company could potentially be as creditworthy as a rated company in the lower two bands and therefore from a consistency point of view, should be able to achieve an unsecured allowance of 20% of the NWO's [Network Operator's] maximum credit limit" (Best Practice Guidelines for Network Operator Credit Cover, paragraph 3.21). This was, however, an area which the Amendments Panel had queried (see Initial View of the Amendment Panel Section for more details). Respondents to this consultation may in the light of this particularly wish to consider the appropriateness of the overlap in the proposed unsecured credit allowances between companies with credit ratings of BB- to BBB+ and those scoring between 5 and 10 in an Independent Assessment.

3.14 It should also be highlighted that the Best Practice Guidelines stated that rated companies with a credit rating below BB- should only "be able to achieve an unsecured allowance of up to 13-1/3 per cent of the NWO's maximum credit limit" (paragraph 3.27), or, in other words, be scored between 0 and 4 in an Independent Assessment. However, neither CAP089/090/091 as originally proposed, nor any of the Working Group Alternative Amendments described later in this document, place any restriction on rated companies without an Approved Credit Rating from being scored between 5 and 10 in an Independent Assessment.

3.15 Parties are invited to consider this area closely. Whilst this specific aspect of the best practice guidelines (in relation to potential limits on the amount of Credit those with Credit Ratings below BB- can seek via the independent assessment route) was not discussed at the Amendments Panel, it could be argued that potentially restricting the extension of Credit to parties with a rating of below BB- to less than that available to parties with no credit rating at all is analogous to the concerns expressed by the Amendments Panel regarding the potentially greater amount of Credit available to those parties without an Approved Credit Rating compared to those with one. Any potential Alternative Amendments on this point would potentially place parties who had a Credit Rating of below BB- in a weaker position than parties who had no rating. Views are very much welcomed on this point.

Value at Risk

3.16 The fifth, and final, element of CAP089/090/091 is the proposed amendment to the Value at Risk (VAR) in relation to TNUoS Demand charges. Currently the CUSC defines the VAR for Use of System Charges as:

- For Generators, 29 days of BSUoS Charges; or
- For Suppliers, 32 days of BSUoS Charges; and
- For TNUoS Demand Reconciliation Charges, 10% of the User's annual TNUoS Charge.

It is proposed to replace the 10% relating to TNUoS Demand Reconciliation Charges with an amount of within year TNUoS Security based on each User's forecasting performance in the previous year.

4.0 WORKING GROUP DISCUSSIONS

4.1 The Working Group considered each of the five elements of CAP089/090/091, and these discussions are summarised below. The Working Group also considered the monitoring of Users' credit and Transitional Issues involving in establishing the new regime proposed by CAP089/090/091, and these discussions are summarised at the end of this section.

Maximum Unsecured Credit Limit

4.2 In relation to the establishment of the maximum unsecured credit limit of 2% of RAV, there were discussions about how National Grid's Regulatory Asset Value would be calculated and how frequently this would be reviewed. It was concluded that the values published in Ofgem's Final Proposals document for the Transmission Price Control Review were the most appropriate values due to their transparency. These are annual values relating to the forecast RAV in each year over the regulatory period. National Grid believed that as these figures were published at the beginning of the regulatory period, and would be re-published in the event of a major change, they would be the most accurate values to use.

Credit Allowances for companies with Approved Credit Ratings

4.3 In order to accommodate the credit limits as illustrated in 3.7 above, it is necessary to alter the current definition of Approved Credit Rating in the CUSC. There was some debate as to where this definition should be changed – currently it is defined as A1 (the short term equivalent to A-) in Section 11 of the CUSC, but with the proviso that National Grid may approve a lower rating. Such a lower rating (of BBB-) is set out in the introduction to the CUSC. The Working Group decided to amend the definition in Section 11 such that a rating of BB- was acceptable. The reference in the introduction would therefore become redundant and could be removed.

4.4 The Working Group also discussed Qualifying Guarantees, and decided it was appropriate to attempt to amend the wording in the CUSC such that the entity issuing the Qualifying Guarantee must have a Credit Rating of such a level that would cover the required security amount.

Default Credit Allowance based on Payment Record

4.5 In relation to the unsecured credit to be extended to Users based on their payment record, it was felt by a number of the Working Group, including the proposer, that returning the counterparty to zero allowed credit following one failure to pay, perhaps through administrative error, was too severe. Not only would such a step seem disproportionate, but it could also lead to disputes over the circumstances of such a failure to pay, given the high stakes involved. The Working Group therefore agreed that the User's payment record for the purposes of calculating its allowed credit would be unaffected until a User failed to pay within 2 business days of the due date, in order to give reasonable time for any administrative oversight. In the first instance of a late payment beyond this limit, the User's allowed credit would be reduced by 50%. In the second instance in a 12 month period it would be reduced to zero. In the month following a late payment, the User could again start to earn allowed credit at the rate of one-twelfth of 0.4% of the maximum unsecured credit limit, given on-time payment in that month.

Credit Allowances based on Independent Credit Assessments

4.6 The Working Group discussed the mechanism that should apply for a User's Allowed Credit to be set by an Independent Credit Assessment. In line with Ofgem's best practice guidelines, it was proposed that an annual assessment for any User that requested it be paid for by National Grid. If the User requested a further assessment within the 12 month period, such an assessment would be valid for the recalculation of the User's Allowed Credit, but would be paid for by the User. As assessments would be obtained by the User, National Grid would have the right to request that the User obtain further assessments at any time, but these would be paid for by National Grid.

4.7 A number of the Working Group disagreed with this proposal, noting that if National Grid was incurring higher costs as a result of having to pay for Independent Credit Assessments it was likely to seek to pass these through to consumers via an increase in its Allowed Revenue. There was therefore concern that Users' Independent Assessments would be cross subsidised, whereas Users with credit ratings would incur the full costs of obtaining their ratings. The proposer did not share these concerns.

4.8 The Working Group discussed in detail the scoring of Independent Credit Assessments. Ofgem's best practice guidelines suggested that such an assessment could take the form of a score of 0 to 10, with 0 indicating that the company would not be suitable for any allowed unsecured credit and 10 indicating that the company would be eligible for 20% of the maximum unsecured credit limit (a level equivalent to a company with a rating of BBB+). A company scoring 1 would be extended unsecured credit of $3^1/_3$% of the maximum unsecured credit limit, or approximately £3.4m. Some of the Working Group, including National Grid, felt that a more granular scoring system would be helpful as the maximum unsecured credit that assessment agencies would recommend extending to some small users could be an order of magnitude less than the £3.4m suggested by a score of 1. In this case, the alternative would be to score such Users zero, which clearly would not reflect the amount of unsecured credit deemed to be appropriate. Nevertheless, the proposer felt that the 0 to 10 scoring system suggested by Ofgem's best practice guidelines was the most appropriate, and the proposal was developed on this basis.

Value at Risk

4.9 The Working Group discussed the Value at Risk for TNUoS charges. Currently, 10% of Users' annual TNUoS Demand Charges are held as security for TNUoS Demand Reconciliation Charges to cover the period between Initial Demand Reconciliation (based largely on settlement data from the SF run) and Final Demand Reconciliation (based on RF data) 14 months later. A number of the Working Group, including the proposer, believed that RF data varied from SF data by less than 1% on average, and therefore queried the derivation of the 10% requirement. They also highlighted the fact that the overall demand across all Suppliers would stay constant, that there would be no systematic bias in the movements of any one User's settlement data, and that Suppliers could take actions to reduce the magnitude of such changes (although they could not influence their direction). In response, National Grid suggested that:

- The variation between SF and RF data may have decreased over time
- The requirement should cover most, if not all, variations, not just the average
- The 10% was a round number that represented an acceptable compromise between offering National Grid some security cover without unduly burdening Users, as detailed below.

National Grid suggested that an accurate quantification of the Value at Risk would result in a requirement considerably higher than 10%. It was recognised that such a quantification would include within year risk, and the level of this risk was queried. In response, National Grid highlighted a potential exposure of up to 25% of Suppliers' annual payments within year, as it only has the right to impose a demand forecast on Suppliers where the Supplier's forecast is less than 80% of National Grid's. National Grid would also be exposed to Non-Half-Hourly (NHH) metered demand charges for the first 15 days each month before monthly invoices were paid by Users. For Half-Hourly (HH) metered demand charges the situation is considerably more complicated, due to the timing of the Triad, although it is quite possible for User to have incurred a full annual liability with 3 monthly payments still to be made (25% of annual liability at risk). In addition, there would be the reconciliation risk, which National Grid quantified at 2.5% following analysis of Final Reconciliation data over the last 3 years, excluding outliers.

4.10 The proposer believed that the most appropriate mechanism for setting levels of TNUoS Security was one that incentivised Users to forecast accurately. CAP089/090/091 therefore proposes to replace the 10% relating to TNUoS Demand Reconciliation Charges with an amount of within year TNUoS Security based on each User's forecasting performance in the previous year. While some of the Working Group had reservations as to whether previous forecasting performance would be an accurate indicator of future performance, most agreed that the concept had at least some merit.

Credit Monitoring

4.11 There were discussions surrounding how frequently each User's Allowed Credit (that proportion of the maximum unsecured credit limit extended to a User by National Grid) should be monitored. National Grid proposed that when a User reached 85% of their allowance that National Grid would provide notice of the proximity to the limit. If a User presented aggregate Value At Risk (VAR) in excess of 100% of the credit allowance, National Grid would provide notice that additional security was required to cover the amount by which the VAR exceeded the credit allowance. The User would then be allowed two business days to put the appropriate level of cover in place. If the cover required for a User was altered by a revised TNUoS demand forecast being submitted, the User would be allowed one month following National Grid's acceptance of their forecast to put the appropriate level of cover in place.

4.12 Conversely, the Working Group discussed the timescales for National Grid to agree to reduce a User's security cover. It was agreed that a period of five business days was appropriate.

Transitional Issues

4.13 At the last meeting of the Working Group, the section of Ofgem's best practice guidelines relating to Transitional Issues was raised. This suggested that where new arrangements were to be implemented that required additional collateral from counterparties, the requirement should be evenly increased over the year following implementation such that full compliance would be achieved by the anniversary of implementation. Many of the Working Group members believed this phasing should apply to the difference between the requirements currently existing in the CUSC and those proposed by CAP089/090/091, whilst others, including the proposer, believed that the phasing should be based on the security currently provided by Users, even if this was less than what was currently required.

4.14 The Working Group was unable to reach agreement on this issue, but agreed that the amendment worked without any phasing being included. Hence, the Security requirements as contained in the original proposal and all five Working Group Alternatives would take effect in full, were any of the proposals to be implemented, from that implementation date.

4.15 The Working Group therefore agreed that were any members to subsequently decide that phasing needed to be incorporated within the amendment proposal they would raise Consultation Alternative Amendments to this effect. Other respondents may also wish to consider whether the proposal would benefit from the inclusion of a mechanism phasing its implementation, and, if so, whether the baseline should be the security currently provided by Users or the security requirement currently applying to each User.

4.16 The Working Group reviewed and approved the legal text to give effect to CAP089/090/91, which is attached as Part A of Annex 1 of this document. In the event that CAP105 is approved by the Authority and implemented before CAP089/090/091, a further housekeeping amendment could be necessary to change all references to "NGC" and "NGC Website" to "NGET" and "NGET Website" respectively, and any other such terms, were an alternative amendment to CAP105 to be approved which is more limited in scope than the original proposal. National Grid has already highlighted this issue to Ofgem.

5.0 WORKING GROUP ALTERNATIVE AMENDMENTS

5.1 Whilst the Working Group was able to successfully develop the original CAP089/090/091 proposal, many of the Working Group did not agree with either the principle or the detail of one or more of the five elements included. As a result, five Working Group Alternative Amendments were proposed, and these are summarised in the table below:

	Original Proposal	**WGAA1**	**WGAA2**	**WGAA3**	**WGAA4**	**WGAA5**
2% RAV	Yes	Yes	Yes	Yes	Yes	Yes
ACR	Yes	Yes	Yes	Yes	Yes	Yes
Payment Record	Yes	No	Yes	Yes	Yes	No
Independent Assessment	0-10 NGC Pays	No	0-100 NGC Pays	0-10 User Pays	0-100 User Pays	0-100 User Pays
VAR	Forecasting Performance	No	Forecasting Performance +2.5%	Forecasting Performance	Forecasting Performance +2.5%	Forecasting Performance +2.5%

5.2 **Working Group Alternative Amendment 1** was supported by a number of the Working Group, and aims to just give effect to CAP089 (the establishment of a maximum unsecured credit limit of 2% of RAV) and CAP090 (setting credit limits for companies with an Approved Credit Rating). None of the provisions proposed by the original pre-amalgamation stand alone CAP091 would be included. The proposer believed that the case for the original CAPs089 and 090 better facilitating the Applicable CUSC Objectives to enable National Grid to more easily and efficiently discharge its obligations under the Act and the Transmission Licence and fulfill its obligations to facilitate competition in the generation and supply of electricity was more clear cut than for the somewhat more complex and contentious CAP091.

5.3 **Working Group Alternative Amendment 2** was proposed in order to facilitate the extension of unsecured credit to smaller Users by increasing the granularity of the scoring of Independent Credit Assessments. These would be scored between 0 and 100, with each step of 1 representing 0.2% of the maximum unsecured credit limit, such that a company scoring 100 would be extended 20% of the maximum unsecured credit limit. This Alternative Amendment also provides for the Value at Risk to be defined as the User's forecasting performance from the previous year plus an amount equal to 2.5% of the User's annual charge. The 2.5% represents security cover for reconciliation charges, consistent with the percentage suggested by National Grid, which would be entirely deleted by the original proposal. The proposer of WGAA2 believed that it, when compared to the original proposal, more accurately captured the Value at Risk, increasing efficiency; that it, through the scoring of Independent Credit Assessments on a scale of 0-100, would allow the more accurate quantification of risks, again increasing efficiency; and that this scoring would also increase the likelihood of small Users receiving some unsecured credit, better facilitating competition.

5.4 **Working Group Alternative Amendment 3** was proposed to address perceptions of a cross-subsidy between the industry and Users benefiting from Independent Credit Assessments. To counteract this, Users would pay for the first such assessment, and re-assessments on an annual basis. Where National Grid requested a re-assessment less than 12 months from the last assessment, National Grid would pay. Where National Grid requested a re-assessment more than 12 months from the last assessment, and the User refused to pay for this, the User's unsecured credit allowance would default back to that set by the User's payment record. In all other respects WGAA3 is identical to the original proposal. The proposer of WGAA3 believed that it, when compared to the original proposal, further increased efficiency by attributing the costs of Users' Independent Assessments in a cost reflective manner and better facilitated competition through the reduction of cross-subsidies.

5.5 **Working Group Alternative Amendment 4** applies the mechanism for the payment for Independent Credit Assessments described under WGAA3 to WGAA2. In all respects other than the payment of Independent Credit Assessments WGAA4 is identical to WGAA2. The proposer of WGAA4 believed that it further increased efficiency by attributing the costs of Users' Independent Assessments in a cost reflective manner and better facilitated competition through the reduction of cross-subsidies, when compared to WGAA2.

5.6 **Working Group Alternative Amendment 5** is identical to WGAA4 except that provisions relating to the unsecured credit allowance determined by Users' payment records would be removed. The proposer of this Alternative Amendment believed it to be more efficient as he did not believe a User's historical payment record to be a good indicator of the likelihood of future payments being made. In this Alternative Amendment, the default unsecured credit allowance for Users without an Approved Credit Rating would be zero.

5.7 The legal text to give effect to each of these alternatives is attached as Parts B-F of Annex 1 of this document.

6.0 IMPLEMENTATION AND TIMESCALES

6.1 It is proposed that should the Authority approve the original CAP089/090/091 proposal, or any proposed Alternative Amendments, implementation should be 10 business days after the Authority decision. However, in line with existing working practice and the imminent introduction of paragraph 8.19.3(b) of the CUSC (which will require Consultation Papers to contain the proposed implementation date), as with all aspects of this Consultation we would welcome views on the proposed implementation date.

6.2 When considering the implementation date, respondents may wish to take into account:

- the absence of a phased introduction in the current proposals; and
- Ofgem's expectation, as set out in their best practice guidelines, that their recommendations be implemented by 1st October 2005.

7.0 INITIAL VIEW OF AMENDMENTS PANEL

7.1 The CAP089/90/91 Working Group Report was presented to the Amendments Panel on the 25th August 2005 by the Working Group Chairman. The Amendments Panel agreed CAP089/090/091 was ready to proceed to wider industry Consultation. However, a number of important points arose in discussing the Working Group Report, which the industry are asked to consider further.

The Role of Independent Credit Agencies

7.2 The Amendments Panel highlighted two main areas of interest in relation to the proposed role for Independent Credit Agencies within the CAP089/090/091 proposal.

7.3 Firstly, the Amendments Panel raised the issue of the overlap between the amount of Credit that could accrue following an Independent Assessment that resulted in a score between 5 and 10 and the Credit which could be gained via the securing of a conventional Credit Rating. One Panel Member highlighted that his expectation had been that the maximum amount of Credit that could be secured via Independent Assessment would be lower than that which could be secured via a Credit Rating. A number of Panel Members argued that this would be more appropriate, given the greater clarity that existed in relation to the Credit Rating process, and in order to ensure that the primacy of Credit Ratings was not inadvertently diluted by the introduction of the new arrangements. The Working Group Chairman noted that the proposed overlap was in line with Ofgem’s best practice guidelines, and agreed to give an explicit reference to where this was set out within those guidelines, in this report. (The reference being “Best Practice Guidelines for Network Operator Credit Cover, paragraph 3.21,” as discussed in paragraph 3.13 of this Consultation Document.) However, the industry are asked to consider further whether they believe this overlap better facilitates the applicable CUSC objectives.

7.4 A number of Panel Members also questioned a perceived lack of transparency regarding how exactly independent agencies would go about deriving credit scores. In particular, it was noted that, in the view of Panel Members, there was significantly less clarity over this proposed scoring process than there was regarding the process for securing a credit rating. The Working Group Chairman in addressing these concerns noted that discussions between Network Operators and Credit Agencies were currently ongoing. The Working Group Chairman also noted that this was a highly specialist area, and one on which the Working Group had not felt it to be either appropriate to define how the independent agencies should go about this task, given their superior expertise, or practicable, given that independent agencies are not CUSC Parties, and hence could not be bound directly by these provisions. Parties are invited to consider this issue further in their consultation responses.

Transitional Issues

7.5 The Amendments Panel noted that currently neither the Original Amendment proposal or any of the Alternatives contain any concept of “phasing” (see paragraphs 4.13 – 4.15 of this Report for a fuller explanation on the substance of this issue). In essence, this means that were these proposals to be implemented they would take effect in full from the implementation date.

This is not in line with the best practice guidelines which suggest that phasing should take place over a year following the introduction of new arrangements. Hence parties are invited to consider further whether they believe alternative amendments which introduce a concept of phasing might better facilitate the applicable objectives than the current proposals. A further issue in relation to phasing is discussed in paragraphs 4.13 – 4.15).

8.0 INITIAL VIEW OF NATIONAL GRID

8.1 National Grid does not believe that the original CAP089/090/091 proposal better facilitates the Applicable CUSC Objectives to enable National Grid to more easily and efficiently discharge its obligations under the Act and the Transmission Licence and fulfill its obligations to facilitate competition in the generation and supply of electricity. It believes that, under this proposal, the Value at Risk is under-estimated, and that there is a strong risk that the scoring of Independent Credit Assessments on a scale of 0-10 could result in Users being extended a disproportionately large amount of unsecured credit, both of which would result in National Grid less efficiently discharging its obligations.

8.2 National Grid does believe that WGAA2 and WGAA4 better facilitate the Applicable CUSC Objectives. The Value at Risk is more accurately captured, increasing efficiency, and could be influenced by Users' own actions, thereby better facilitating competition. The scoring of Independent Credit Assessments on a scale of 0-100 would allow the more accurate quantification of risks, again increasing efficiency, and would increase the likelihood of small Users receiving some unsecured credit, further facilitating competition. The difference between WGAA2 and WGAA4 is that National Grid would pay for Users' Independent Credit Assessments under WGAA2 but not under WGAA4. National Grid has no clear preference between the two alternatives, based on the expectation that future allowance would be made by Ofgem for the increased costs that National Grid would incur under WGAA2. However, we will be considering further during the Consultation process which of the proposals best facilitate the Applicable CUSC Objectives, and would invite other parties to do the same.

8.3 National Grid also supports WGAA5 and WGAA1 (with WGAA5 being more preferred than WGAA1), as it believes that they better facilitate the Applicable CUSC Objectives with regard to efficiency and facilitation of competition, but not to the same extent as WGAA2 and WGGA4. National Grid does not believe that WGAA3 better facilitates the Applicable CUSC Objectives.

9.0 VIEWS INVITED

9.1 National Grid is seeking the views of interested parties in relation to the issues raised by Amendment Proposal CAP089/090/091 and issues arising from the proposed timescale for implementation of CAP089/090/091.

9.2 Please send your responses to this consultation to National Grid by no later than close of business on **3rd October 2005.**

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

lindsey.paradine@ngtuk.com

Or alternatively, comments may be addressed to:

Lindsey Paradine
Transmission Commercial
National Grid
NGT House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA