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Direct Dial: 020 7901 7355

30 September 2005

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

Our Ref: IND/COD/CUSC/CAP088

Dear Colleague,

Amendment to the Connection and Use of System Code (“CUSC”) - Decision and Notice in relation to Proposed Amendment CAP088: “Application of Late Payment of Commercial Debts (Interest) Act 1998”.

The Gas and Electricity Markets Authority (the “Authority”¹) has considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP088 “Application of Late Payment of Commercial Debts (Interest) Act 1998”.

National Grid Electricity Transmission plc (“NGET”) recommended to the Authority that the Proposed Amendment 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 Objectives and Ofgem’s wider statutory duties,³ the Authority has decided to direct a modification to the CUSC in line with the Proposed Amendment.

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

This letter explains the background to the Proposed Amendment, 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.

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

² CAP088 Amendment Report dated 14 September 2005.

³ Ofgem’s statutory duties are wider than the matters that the Panel must take into consideration and are set out in sections 3A to 3C of the Electricity Act.

Background

Proposed Amendment CAP088 was raised by National Grid Transco and was submitted for consideration at the May 2005 Amendments Panel meeting. At the meeting the Panel determined that a Working Group should be established to consider the Proposed Amendment.

CAP088 proposes to incorporate the Late Payment of Commercial Debts (Interest) Act 1998⁴ ("the Act") into the provisions for charging interest under the CUSC. It was contended that this would act as an additional incentive to ensure that payments are made in accordance with prevailing contracts.

The Act was introduced on 1 November 1998 to encourage purchasers to pay on time by giving businesses the right to claim interest if another business pays its bills late. The interest rate that can be applied in accordance with the Act may be set by the Secretary of State with the consent of the Treasury in a statutory instrument. Currently it is set at 8% above the Bank of England base rate on 30 June (in respect of interest which starts to run between 1 July and 31 December) and again on the 31 December (in respect of interest which starts to run between 1 January and 30 June)⁵.

The Working Group considered the Proposed Amendment, and developed an Alternative Amendment, presenting its final report on both to the July 2005 Amendments Panel meeting. The Panel agreed that the Working Group had fulfilled its Terms of Reference and that it was appropriate for CAP088 to proceed to wider industry consultation by NGET.

A consultation paper on CAP088 was published on 5 August 2005, placed on the CUSC Website with copies sent to Core Industry Document owners and CUSC Parties. NGET received a total of seven responses to its consultation.

The final Amendment Report was submitted to the Authority on 14 September 2005.

The Proposed Amendment

The Proposed Amendment seeks to apply the Act through an amendment to clause 6.6.5 of the CUSC.

That clause currently requires that where a CUSC Party fails to make payment on the due date of any amount properly due under the CUSC or any Bilateral Agreement that the amount should be subject to interest levied at 4% over the Base Rate (determined by reference to the Barclays Bank plc base lending rate).

⁴ The Act may be downloaded from the HMSO website here: <http://www.opsi.gov.uk/acts/acts1998/19980020.htm>

⁵ Set out in the Late Payment of Commercial Debts (Rate of Interest) (No.3) Order 2002 (<http://www.opsi.gov.uk/si/si2002/20021675.htm>); and the Late Payment of Commercial Debts (Rate of Interest) (Scotland) Order 2002 (<http://www.opsi.gov.uk/legislation/scotland/ssi2002/20020336.htm>).

The Proposed Amendment would apply this interest at the Prescribed Rate rather than the Base Rate plus 4%. The Prescribed Rate would be defined as “the rate of interest set for the relevant period as the statutory interest rate for the purposes of the Late Payment of Commercial Debts (Interest) Act 1998”.

The Proposer considered that CAP088 would enable NGET to more easily and efficiently discharge its obligations under the Electricity Act 1989 and the Transmission Licence and fulfil its obligations to facilitate competition in the generation and supply of electricity. They therefore considered that the Proposed Amendment would better facilitate Applicable CUSC Objectives (a) and (b)⁶.

The Alternative Amendment

The Working Group proposed an Alternative Amendment in which the level of interest charged would be the greater of:

- The Base Rate plus 75% of the percent per annum over the base rate at which statutory interest may be charged under the Act (i.e. currently Base Rate plus 6%, given that the statutory interest rate is currently 8%); or
- The Base Rate plus 4% (i.e. the rate currently applied by the CUSC).

This approach was considered by a minority of Working Group members to result in the application of a more appropriate and proportionate interest rate.

Respondents' views

NGET issued a consultation paper on 5 August 2005 inviting responses from CUSC Parties and interested parties.

NGET received seven responses to the consultation in respect of Proposed Amendment CAP088, of which four expressed support for both the Proposed Amendment and the Alternative Amendment. Of those four, three preferred the Proposed Amendment, with the other preferring the Alternative Amendment. The remaining three respondents supported neither the Proposed Amendment nor the Alternative Amendment.

The respondents' views are summarised and contained in the Amendment Report in respect of Proposed Amendment CAP088.

⁶ 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.

Amendments Panel Members' views

The Amendments Panel considered CAP088 at its meeting on 29 July 2005 and agreed the Proposal should proceed to industry consultation.

NGET's recommendation

NGET recommended approval of the Proposed Amendment, with an Implementation Date of 10 Business Days after the Authority's decision.

NGET considered that the Alternative Amendment also better facilitates the Applicable CUSC Objectives, but not to the same extent as the Proposed Amendment. In the event that it was approved by the Authority, NGET recommended that Alternative Amendment be implemented 10 Business Days after the Authority's decision.

Ofgem's view

Having considered the Amendment Report in the context of the Applicable CUSC Objectives and its statutory duties, Ofgem considers that the Proposed Amendment would better facilitate the achievement of the Applicable CUSC Objectives.

Ofgem does not agree with the rationale of the Working Group members that raised and supported the Alternative Amendment. As highlighted in its February 2005 conclusions document, "Best practice guidelines for gas and electricity network operator credit cover"⁷, Ofgem does not consider that the rates stipulated under the Act presently are excessive and go beyond what is required to incentivise timely payment. Ofgem notes that "rather than seeking to encourage claims for interest the legislation's primary aim is to deter companies from paying their bills late"⁸. It is noted that affected Parties can avoid exposure to interest in the first place through prompt payment.

Ofgem considers that the Proposed Amendment appropriately incorporates the provisions of the Act into the CUSC. In doing so, it will ensure that appropriate incentives are in place for Users to pay in accordance with prevailing contractual terms. This will allow NGET to more efficiently discharge the obligations imposed on it by the Electricity Act 1989 and facilitate effective competition in the generation and supply of electricity – thereby better facilitating Applicable CUSC Objectives (a) and (b).

The Authority's Decision

The Authority has therefore decided to direct that the Proposed Amendment, as set out in the Amendment Report, should be made and implemented. An attached letter contains this direction.

⁷ Published to the Ofgem website here: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10370_5805.pdf

⁸ Source: "The Late Payment of Commercial Debts (Interest) Act 1998: A User's Guide", prepared by the Better Payment Practice Group. The Better Payment Practice Group was formed in 1997 as a partnership between the public and private sectors. Its website may be found at: <http://www.payontime.co.uk>

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number or alternatively Richard Hall on 020 7901 7335.

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