



Direct Dial: 020-7901-7412

2 September 2002

The National Grid Company, CUSC Signatories and
Other Interested Parties

Your Ref:
Our Ref: IND/COD/CUSC/CAP016

Dear Colleague

Amendment to the Connection and Use of System Code ("CUSC") - Decision and Direction in relation to Proposed Amendment CAP016: "Changes to re-introduce certain adjustment factors into imbalance calculations."

The Gas and Electricity Markets Authority (the "Authority"¹) has carefully considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP016 "Changes to re-introduce certain adjustment factors into imbalance calculations".

The National Grid Company plc ("NGC") recommended to the Authority that Proposed Amendment CAP016 be approved and implemented five business days after the Authority's decision.

The Authority has decided to direct a modification to the CUSC.

This letter explains the background to Proposed Amendment CAP016 as set out in the Amendment Report and sets out the Authority's reasons for its decision. In addition, this letter contains a Direction to NGC to modify the CUSC as set out in Proposed Amendment CAP016.

This letter constitutes the 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 Amendment Report, CUSC Amendment Proposal CAP016, dated 17 May 2002.

Background

On 15 November 2001, the Authority approved Proposed Amendment CAP001 “Frequency response imbalance payments” and it was implemented with effect from 21 September 2001³. Approved Amendment CAP001 changed the calculation mechanism for frequency response payments to ensure a better approximation of the assumed volume of energy imbalance used when calculating compensation payments. There are adjustment factors used in the calculation mechanism of the volume of frequency response energy.

As Approved Amendment CAP001 had been treated as an Urgent Amendment Proposal, the CUSC Amendments Panel (the “Panel”) initiated a review of Approved Amendment CAP001 in accordance with Section 8.21.8 of the CUSC after Approved Amendment CAP001 had been implemented. The review highlighted an error in the legal drafting of Section 4 of the CUSC concerning adjustment factors K_T and K_{GRC} and shortfall factors SF_P , SF_S and SF_H . These factors had mistakenly been omitted from the imbalance calculations.

Proposed Amendment CAP016 was raised by NGC on 14 March 2002 to address the omission of the adjustment and shortfall factors from the imbalance calculations in Approved Amendment CAP001.

Proposed Amendment CAP016 was submitted for consideration at the Panel meeting on 22 March 2002. At the meeting the Panel determined that Proposed Amendment CAP016 should proceed directly to wider industry consultation by NGC.

The Proposed Amendment

Proposed Amendment CAP016 seeks to rectify the omission of adjustment factors K_T and K_{GRC} and shortfall factors SF_P , SF_S and SF_H by re-introducing the factors into the calculation of expected imbalance energy for frequency response contained in Section 4 of the CUSC. The factors that have been omitted are set out in Paragraph 4.1.3.9 of the CUSC and serve the following purposes:

- K_T is the ambient temperature adjustment factor and is currently set at 1 until such time that an appropriate methodology for use is developed and agreed

³ On this occasion, the Authority agreed that a retrospective implementation was appropriate as the limitations of the payment mechanism for frequency response was part of the designated CUSC, had been flagged well in advance of the CUSC going live on 18 September 2001 and the materiality of these limitations were considered to be significant. The Authority’s full rationale for allowing retrospective implementation can be found in its decision letter on Proposed Amendment CAP001 issued on 15 November 2001. This letter can be found on NGC’s website on <http://www.nationalgrid.com/uk/indinfo/cusc/index.html>.

- KGRC is the plant configuration factor where the BM unit is a Combined Cycle Gas Turbine (“CCGT”) and values are contained in the MSA, and
- SFP, SF_S and SF_H are shortfall factors relating to Primary, Secondary and High frequency response and currently set at zero until such time that an appropriate methodology for use is developed and agreed.

NGC issued a consultation paper on 17 April 2002 seeking views from CUSC Parties and other interested parties. Following this consultation, NGC issued a draft Amendment Report for comment on 10 May 2002. NGC submitted the final Amendment Report to the Authority on 17 May 2002.

The Alternative Amendment

One of the respondents to the consultation put forward an Alternative Amendment. The Alternative Amendment is the same as Proposed Amendment CAP016, except it has a retrospective implementation date of 21 September 2001. The Proposer of the Alternative Amendment argued that as Proposed Amendment CAP016 seeks to correct an error of Approved Amendment CAP001, these corrections should be implemented with effect from the same date as Approved Amendment CAP001 was implemented.

Respondents’ Views

NGC received six responses to the consultation on Proposed Amendment CAP016. Five respondents were in favour of the Proposed Amendment and one respondent sought further clarification as to how the Proposed Amendment could better facilitate achievement of the Applicable CUSC Objectives⁴ as long as there has been no material impact caused by the omission of the adjustment factors in the calculation of expected imbalance energy for frequency response.

One of the five respondents supporting the Proposed Amendment raised an Alternative Amendment, as set out above, during the consultation. However, after receiving information on the practicality and materiality of the Alternative Amendment, and noting that the materiality was zero, this respondent stated its preference for the original Proposed Amendment CAP016 when commenting on the draft Amendment Report.

⁴ The Applicable CUSC Objectives are contained in Condition C7F.1 of 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 respondents that support the Proposed Amendment noted that it was amending a drafting error in the legal text for Approved Amendment CAP001. One respondent suggested a review of how legal drafting is undertaken to avoid future errors and improve the efficiency of the change process.

Amendments Panel Members' Views

On the basis of the consultation and assessment undertaken, it was the opinion of those Panel Members that expressed a view that Proposed Amendment CAP016 should be implemented to the time-scales as recommended.

NGC's Recommendation

NGC recommended to the Authority that Proposed Amendment CAP016 be approved and implemented five business days after the Authority's decision.

NGC suggested that although the omission of the adjustment and shortfall factors has no real material impact at this stage, as the factors are either inactive or are very rarely used, it is important to correct the legal drafting of the CUSC in line with the intent of Approved Amendment CAP001.

NGC stated that Proposed Amendment CAP016 would better facilitate achievement of both of the Applicable CUSC Objectives as set out in Condition C7F.1 of its Transmission Licence. NGC argued that by more closely aligning the payments for Ancillary Services to the costs incurred by service providers, NGC can purchase such services from the most economic sources. Furthermore, NGC argued that by improving clarity and removing uncertainty from CUSC documentation, NGC will be able to more easily and efficiently discharge its obligations under the Act and the Transmission Licence and fulfil its obligation to facilitate competition in the generation and supply of electricity.

Ofgem's View

Ofgem considers, having had regard to its statutory duties, that Proposed Amendment CAP016 will better facilitate the achievement of the Applicable CUSC Objectives.

Ofgem considers that the Proposed Amendment corrects an error that has occurred in the implementation of Approved Amendment CAP001. It is Ofgem's view that correcting this error will further the achievement of the Applicable CUSC Objective contained in Section C7F.1(a) of NGC's Transmission Licence relating to the efficient discharge by NGC of the obligations imposed on it by the Act and the Transmission Licence.

Ofgem considers the proposed changes in Proposed Amendment CAP016 will ensure a more accurate calculation of the expected imbalance energy volume for frequency response, as intended by Approved Amendment CAP001. This, in turn, should provide more accurate signals of the cost of service provision and further the achievement of the Applicable CUSC Objective contained in Section C7F.1.(b) of NGC's Transmission Licence relating to facilitating effective competition in the generation and supply of electricity.

Ofgem considers that the Alternative Amendment does not better facilitate achievement of the Applicable CUSC Objectives due to its retrospective element. There are commonly understood legal reasons why retrospective rule changes should be avoided, except in certain limited circumstances. Ofgem has outlined certain criteria in the decision letters for Approved Amendment CAP001 and Approved Balancing and Settlement Code ("BSC") Modification P19 as examples of factors that Ofgem will consider when evaluating retrospective changes⁵. Ofgem notes that NGC considers that the effect of omitting the adjustment factors has not been material in this circumstance. Therefore, Ofgem believes that it is not appropriate to implement Proposed Amendment CAP016 retrospectively.

Ofgem notes the concerns of one of the respondents that it may be appropriate to review the way in which legal drafting is prepared in order to allow more rigorous industry review prior to implementation of Proposed Amendments. Ofgem agrees that care should be exercised to avoid mistakes in draft legal text to effect the implementation of Proposed Amendments. Ofgem expects that all reasonable endeavours will be taken to avoid errors occurring in draft legal text. However, on this occasion, Ofgem also notes that Approved Amendment CAP001 was given Urgent Status and was therefore progressed to a shorter time scale. The error in the legal text for Approved Amendment CAP001 was identified during the review of the Approved Amendment, which was initiated in accordance with Section 8.21.8 of the CUSC.

The Authority's Decision

The Authority has therefore decided to direct that Proposed Amendment CAP016, as set out in the Amendment Report, should be made and implemented.

⁵ Three high level criteria were outlined, but it was emphasised these did not constitute an exhaustive list for considering retrospection. The three example criteria were:

- a) a situation where the fault or error occasioning the loss was directly attributable to central arrangements
- b) combinations of arrangements that could not have reasonably been foreseen
- c) where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

In addition, the letters stated that the materiality of the alleged defect would be considered.

Direction under Condition C7F.7(a) of NGC's Transmission Licence

Having regard to the above, the Authority, in accordance with Condition C7F.7(a) of the licence to transmit electricity treated as granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence"), hereby directs NGC to modify the CUSC in respect of Proposed Amendment CAP016, as set out in the Amendment Report dated 17 May 2002.

The Amendment is to take effect from 9 September 2002.

In accordance with Condition C7F.7(b) of NGC's Transmission Licence, NGC shall modify the CUSC in accordance with this Direction of the Authority.

Please contact me on the above number if you have any queries in relation to the issues raised in this letter.

Yours sincerely

A handwritten signature in black ink, appearing to read "Sonia Brown".

Sonia Brown

Head of Electricity Trading Arrangements

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