



Direct Dial: 020-7901-7355

2 September 2002

The National Grid Company, CUSC Signatories and
Other Interested Parties

Your Ref: CAP012
Our Ref:
IND/COD/CUSC/CAP012

Dear Colleague,

Amendment to the Connection and Use of System Code ("CUSC") - Decision and Direction in relation to Proposed Amendment CAP012: "Procedure for Renewal of NGC (Connection) Assets".

The Gas and Electricity Markets Authority (the "Authority"¹) has carefully considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP012 "Procedure for Renewal of NGC (Connection) Assets".

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

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

² CAP012 Amendment Report dated 28 June 2002.

- (i) Proposed Amendment CAP012 be rejected; and
- (ii) Alternative Amendment (A) be approved and implemented on 1 April 2003;
and
- (iii) Alternative Amendment (B) be rejected.

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

This letter explains the background to Proposed Amendment CAP012 and sets out the Authority's reasons for its decision. In addition, this letter contains a direction to NGC to modify the CUSC in respect of Alternative Amendment (A), as set out in Amendment Report. This letter constitutes the notice by the Authority under Section 49A Electricity Act 1989 in relation to the direction.

Background

Proposed Amendment CAP012 seeks to modify the procedure set out in section 2.17 of the CUSC for the renewal of NGC Assets at a Connection Site. The Proposer considered that Proposed Amendment CAP012 would better facilitate achievement of the Applicable CUSC Objective³ C7F.1(a) in that it would ensure that NGC Assets at a Connection Site are renewed in an economically efficient manner and with due regard to the requirements of the connected Party. Further the Proposer considered that the Proposed Amendment would better facilitate achievement of the Applicable CUSC Objective C7F.1(b) in that it would ensure that the relevant economic factors are considered in a non-discriminatory manner such that the lowest cost solution could be found and therefore competition facilitated.

Proposed Amendment CAP012 was raised by Innogy plc on 3 January 2002 and was submitted for consideration at the CUSC Amendments Panel Meeting on 11 January

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.

2002. The Panel determined that the Asset Renewal Working Group should be established to evaluate the Proposed Amendment. The Working Group submitted its report for consideration at the Amendments Panel Meeting on 26 April 2002. The Panel endorsed the report and determined that the Proposed Amendment should proceed to wider industry consultation by NGC. A consultation paper was issued on 13 May 2002 with responses invited by 14 June 2002. Two Alternative Amendments were submitted during wider consultation: Alternative Amendment (A) submitted by NGC and Alternative Amendment (B) submitted by British Energy plc. A final Amendment Report was submitted to the Authority on 28 June 2002.

The Proposed Amendment

Proposed Amendment CAP012 seeks to modify the current procedure for the renewal of NGC Assets at a Connection Site so as to include a requirement on NGC that it provide an explanation of the engineering and economic reasons to replace a connection asset, to remove the current distinction between connection assets pre and post Replacement Period and to provide Users with the right of recourse to an independent engineer to resolve any dispute between NGC and a User in regard to the replacement of connection assets.

The Asset Renewal Working Group evaluated whether the Proposed Amendment better facilitated achievement of the Applicable CUSC Objectives but was unable to reach a unanimous agreement, although the Group did recognise the need to improve the current procedure for the replacement of connection assets.

The Group agreed that there was a need for greater transparency in the procedure for asset replacement, including a provision for effective discussion between NGC and Users of the issues driving replacement. The Group did not agree that the test for asset replacement should be whether the replacement was economic to the connected User. With regard to asset replacement pre and post Replacement Period, the majority of the Working Group considered that it was appropriate that NGC should only be able to asset replace in order to satisfy its licence and statutory obligations. However NGC stated that there must be a requirement in the asset replacement procedure for an urgent route to ensure that NGC could meet its licence obligations. The majority of the Group supported the principle of inclusion of an independent engineer in the asset replacement procedure, although the Group

also agreed that an independent engineer could not resolve any disputes that related to licence obligations.

In considering an improved procedure for replacement of connection assets, NGC put forward an alternative proposal similar in intent to the Proposed Amendment but without reference to an independent engineer. Although there was agreement within the Group that the alternative proposal would better facilitate achievement of the Applicable CUSC Objectives as compared with the current version of the CUSC, it was not supported by the majority of the Group as it was considered that it did not better facilitate achievement of the Applicable CUSC Objectives as compared with the Proposed Amendment.

Alternative Amendment (A)

Alternative Amendment (A) was submitted by NGC during wider consultation. Alternative Amendment (A) was based on the alternative proposal put forward by NGC at the Asset Renewal Working Group and differs from the Proposed Amendment in that it does not seek to provide Users with the right of recourse to an independent engineer to resolve any dispute between NGC and the User in regard to the replacement of connection assets.

Alternative Amendment (B)

Alternative Amendment (B) was submitted by British Energy plc during wider consultation. Alternative Amendment (B) is almost identical to the Proposed Amendment with the exception that it seeks to add a further paragraph to the legal text put forward in the Proposed Amendment to provide the User with the right to Disconnect in the event that NGC decides to replace a connection asset before the expiry of its Replacement Period. In addition Alternative Amendment (B) seeks to require NGC to issue its explanation of the engineering and economic reasons to asset replace at the same time as it issues its notice to replace the asset. Finally Alternative Amendment (B) seeks to include a number of textual changes in order to increase the clarity of the Proposed Amendment's legal text.

Respondents' views

NGC received eleven responses to the consultation in respect of Proposed Amendment CAP012, of which seven were in favour of the Proposed Amendment, two were in favour of Alternative Amendment (A) and one was in favour of both the Proposed Amendment and Alternative Amendment (A). One respondent did not support either the Proposed Amendment or Alternative Amendment (A).

Five respondents supported the inclusion of an independent engineer to resolve any dispute between NGC and the User in regard to the replacement of connection assets. Two respondents felt that the inclusion of an independent engineer would ensure that fewer disputes reached the Authority and would therefore aid the Authority's decision process if a dispute were referred. One respondent noted however that NGC would be unlikely to accept the view of a third party engineer and therefore inclusion of an independent engineer would not affect the number of disputes being referred to the Authority.

One respondent noted that NGC has obligations placed upon it in its Transmission Licence to ensure system integrity. However the respondent considered that the Proposed Amendment did not compromise these obligations.

One respondent noted that the publication of the criteria which are used to determine NGC's compliance with its licence and statutory obligations would increase transparency and would better inform all Users.

The respondents' views are summarised and contained in the Amendment Report in respect of Proposed Amendment CAP012.

Amendments Panel Members' views

Of those Amendments Panel Members expressing a view, three Members supported the Proposed Amendment and four Members supported Alternative Amendment (A).

The Panel Members that supported the Proposed Amendment did not consider that NGC was better placed than the User to judge the health and safety impact of asset failure at the User's site.

The Panel Members that supported Alternative Amendment (A) considered that although the inclusion of an independent engineer may provide reassurance to a

User, the engineer could not determine on issues concerning NGC's licence obligations. Further they believed that the inclusion of an independent engineer would add unnecessary complexity, expense and delay and therefore would not better facilitate achievement of the Applicable CUSC Objectives. It was the view of the Panel Members that supported Alternative Amendment (A) that the final arbiter for the resolution of disputes is the Authority.

NGC's recommendation

NGC recommended that the Authority approve Alternative Amendment (A) and that if approved it be implemented on 1 April 2003.

NGC considered that modifying the current procedure for replacement of connection assets to include a requirement on NGC that it to provide an explanation of the engineering and economic reasons to replace a connection asset and to remove the current distinction between connection assets pre and post Replacement Period would better facilitate achievement of the Applicable CUSC Objectives. However NGC did not consider that the inclusion of the right of recourse to an independent engineer to resolve any dispute between NGC and the User in regard to replacement of connection assets, as put forward in the Proposed Amendment and Alternative Amendment (B), would better facilitate the achievement of the Applicable CUSC Objectives.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that the implementation of Alternative Amendment (A) as set out in the Amendment Report would better facilitate achievement of the Applicable CUSC Objectives. Ofgem acknowledges that currently the tests for replacement of connection assets differ according to whether or not the asset has reached its Replacement Period. Ofgem does not consider that there is a justifiable rationale for this distinction and considers that a uniform test would increase clarity and certainty and would therefore better facilitate effective competition in the generation and supply of electricity.

One perceived deficiency that the proposals seek to address is the fact that there is no economic and engineering test seen by the User for the replacement of connection assets. It is Ofgem's view that the introduction of the procedure

proposed in Alternative Amendment (A) requiring NGC to provide the User with an explanation of the engineering and economic reasons to asset replace would better facilitate the achievement of efficiency and competition in that it would enable Users to be privy to the considerations underlying decisions that will have a significant commercial impact upon them.

In issuing its explanation of the economic and engineering reasons to asset replace, Ofgem would expect NGC to provide, where practical and prudent and with regard to the confidential nature of any relevant information, its rationale behind the decision to asset replace including any wider network factors that were considered, details of the physical condition of the NGC Asset to be replaced, information regarding any alternatives to asset replacement considered by NGC, and any other relevant information in its possession.

While acknowledging that increased transparency and a greater User input will provide comfort to Users, Ofgem considers that the introduction of this facility has to be balanced against the fact that ultimately, the licence obligation to maintain a secure, co-ordinated and efficient system for the transmission of electricity rests solely on NGC. Penalties resulting from breach of licence obligations are not transferable. For this reason, it is Ofgem's view that the element of the Proposed Amendment relating to the right of recourse to an independent engineer, not simply to provide a countervailing view to NGC's economic and engineering appraisal but to resolve disputes arising, is inappropriate and could not be seen to better facilitate the efficient discharge by NGC of the obligations imposed upon it by the licence.

One element of Alternative Amendment Proposal (B) also includes recourse by the User to an independent engineer, not as an arbiter but as a third party who would consider the need and programme for replacement. Ofgem notes that in practice the Authority is the ultimate arbiter in the event of a dispute on asset replacement. As a result, recourse to a report such as the one proposed in Alternative Amendment (B) would only serve to extend the dispute process without necessarily contributing to the resolution of the dispute. Ofgem therefore considers that this proposal would not better facilitate the efficient discharge by NGC of the obligations imposed upon it by the licence.

The Authority's Decision

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

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 Alternative Amendment (A), as set out in the Amendment Report.

The modification is to take effect from 1 April 2003.

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.

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