Memorandum

To Governance Standing Modification Group (the "**GSMG**") **cc.** David Ahmad

From Melanie Henry

Date 05 November 2003

Modification Proposal P145 "Cost reflective mechanism to allocate any deficit arising from the application of the Past Notification Error ("PNE") claim fee

1 BACKGROUND

1.1 Modification Proposal P145 ("**P145**") proposes the introduction of a formula to allocate any deficit that arises from the application of the PNE claim fee, amongst the claimants.

1.2 The GSMG have requested a legal opinion on the following matters:

- whether P145 is retrospective in effect; and
- if yes, whether P145 satisfies the Authority's test for retrospective Code Modifications.

1.3 Section P6.2 of the Codes sets out the rules governing claiming PNEs.

1.4 Paragraph P6.2.2 states as follows:

"***Subject to paragraph 6.2.6, where a relevant Contract Trading Party makes a claim of Past Notification Error, such Party shall pay a fee to BSCCo for each such claim, the amount of which*** *(for each such claim, provided that, for the purposes of 6.2.2 and subject to paragraph 6.2.4, claims of Past Notification Error made by a Party in respect of the same Volume Notification shall be treated as single claim)* ***shall be £5,000, or such other amount as the Panel may from time to time after consultation with Parties and the approval of the Authority, determine upon not less than 30 days notice to Parties****, and which shall not be reimbursed in any circumstances.*" [Emphasis added].

1.5 Section P6.2.6 goes on to state that where a Contract Trading Party has submitted a number of PNE claims and the Panel is satisfied that the relevant mistake for two or more such claims resulted from the same cause then the relevant claims shall be treated as a single claim i.e. the Contract Trading Party will only be required to pay one fee for the group of claims.

2 LEGAL ANALYSIS OF SECTION P6.2.2

2.1 It is ELEXON's legal opinion that Section P6.2.2 establishes a flat fee that may be subject to change on the determination of the Panel, after consultation with Parties and subject to Authority approval. The fee change is in relation to the flat fee only, and does not permit an alteration to the *methodology* upon which the fee which a Party has to pay for submitting a PNE claim, is determined.

2.2 It is ELEXON's legal opinion that the claim fee was only ever intended to reflect an estimate of the administrative costs that BSCCo might incur, i.e. the administrative costs by reference to a claim of manifest error. This is supported by the fact that, in our opinion, there is nothing in the Authority's decision letter on P37, which conflicts with its previously expressed view in its decision letter to P19 of the fee that in the Authority's mind, such fee should represent:

"an appropriate and material charge for any party seeking to correct a notification error. A fee of a fixed amount, albeit an amount that can be modified by the Panel, may not, however, be set at such a level as would be prohibitive to small players."[1] [Emphasis added].

2.3 It is ELEXON'S legal opinion that the ability of the Panel to adjust the flat fee was, designed to reflect (by means of a broad estimate) any increase (or decrease) in BSCCo's projected or actual administrative costs. Furthermore, any such adjustment would take into account the following factors:

(1) the potential prohibitive nature of any significant increase in the claims fee on claimants particularly those who were small players in the market;

(2) the likelihood that some Parties relied on the size of the claims fee when PNE claims were originally made; and

(3) the likelihood that some Parties relied on the level of fee remaining unchanged or being adjusted in a non-significant manner.

2.4 This Modification Proposal appears to go beyond what is envisaged by the Code as it seeks to recoup the expenditure of BSCCo in administering the claims (to include the costs of PNEC) from claimants (on the basis of the size of claim) in excess of any claims fee adjusted or otherwise. It therefore represents an entirely different concept of PNE claims cost recovery to that provided by the Code. It also seems clear to us that the Proposal would operate in a retrospective manner, in that under the current arrangements any balance (in excess of the amounts recovered from claimants by way of the claims fee) in respect of the administrative costs incurred by BSC would be paid for by all Parties in accordance with their Section D liabilities.

2.5 It is ELEXON's legal opinion that this view is supported by the views expressed during the progression of Modification Proposal P37 ("**P37**")

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[1] Paragraph 25 of the Authority's decision letter dated 1 August 2001, Modification to the Balancing and Settlement Code - Decision and Notice in relation to Modification Proposal P19: "To provide for the remedy of errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications."

2.6 The majority of respondents to the industry consultation undertaken for P37, appeared to be of the view that any claim fee should be broadly related to the average cost of administering a PNE claim. Furthermore, in its deliberations on the £5000 administration fee for making a claim and lodging an appeal, the Panel: "*accepted the position of the Modification Group that this fee should be related to administrative costs*."[2]

2.7 The concept of a change of the PNE claim fee regime, such that there would be an allocation of any deficit over and above the claim fee amongst claimants, is wholly different in character to revising the level of a fixed fee.

2.8 The PNE claim fee was intended to represent no more that an "*estimate of the average administrative cost that the BSCCo would incur in investigating a claim of notification error*."[3] Furthermore, it is in this respect that P145 is retrospective in nature.

2.9 Although P145 is concerned with any *deficit* that may arise as a result of the PNE claims process, it is recognised that the proposal is intrinsically linked with the claim fee established under Section P6.2.2.

3 PROHIBITION ON RETROSPECTIVE RULE CHANGES

3.1 There is a general principle of legal policy against retrospectivity. An amending rule should be generally presumed to change the relevant matter only from the time the rule change commences. In other words, the prohibition against retrospective change provides that rules ought not to change the character of past transactions completed on the basis of then existing rules.

3.2 Furthermore, guidance on the Authority's view on retrospective rule changes may be found in decision letters issued by the Authority, namely, P19 and P37.

4 AUTHORITY TEST FOR RETROSPECTIVE RULE CHANGE

4.1 In its decision letter on P19 the Authority laid down certain criteria, which if satisfied, might, in its view, give rise to the need for a retrospective rule change. This test was subsequently repeated by the Authority in its decision letter on P37, which incorporated the PNE claims process into the Code.

4.2 It should be noted that the criteria set out by the Authority in its previous decision letters, are criteria that it selected at that particular time. There is no guarantee that the Authority, would not, if it decides that P145 is retrospective in effect, apply a different set of criteria in its assessment of P145.

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[2] "Panel Deliberations" page 10, Urgent Modification Report P37 prepared by ELEXON on behalf of the Panel, dated 5 November 2001.

[3] See paragraph 2.2 above.

4.3 The Authority stated as follows:

"*Ofgem is, in general, against approving modifications which have retrospective effects. However, despite the general principle against retrospective rule changes, Ofgem believes that there may be small number of particular circumstances that could give rise to the need for a modification which would have a retrospective effect as evidenced in a small number of modifications approved for the Network Code.*

The particular circumstances which could give rise to the need for a retrospective rule change could, for instance, include:

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

In any event, the loss sustained would need to be material."

Fault/Error Directly Attributable to Central Arrangements

4.4 On the face of it, any deficit that may arise as a result of the PNE claims process could not be said to be attributable to an error or fault within central arrangements, as a part of BSCCo costs.

Circumstances not Reasonably Foreseeable

4.5 ELEXON'S legal opinion is that this element of the Authority's test is not applicable to P145. It clearly could have been foreseeable that there was a possibility of a deficit. However, there is no evidence to suggest that there was an intention that the claimants would be required to pay for the entire costs of the P6 project in proportion based on the size of the claim, rather than just by increasing the PNE claim fee by the same amount for all claims.

Clearly Flagged to the Participants

4.6 ELEXON'S legal opinion is that there is nothing in the Code or in the discussions during the Modification process to suggest that a retrospective rule change of the nature suggested by P145 was clearly indicated as a possibility to Parties.

4.7 One response to the P37 industry consultation suggested that any PNE claim fee should incorporate an element of "cost reflectivity", however this does not support the view that a change as envisaged by P145 was "clearly flagged" to participants at the time that P37 was introduced into the Code, i.e. recovery based on the size of the claim.

4.8 In any event it can be argued that it is implicit that the adjustment envisaged by Section P6.2.2 was intended to bring about some degree of "cost reflectivity" to the claims fee. However for the reasons expressed above, it is ELEXON'S legal opinion that the intention was not to indemnify non-claimants against the administrative costs via such adjustment. P145, of course, goes beyond this intention as it is not dependant on any adjustment to the fee.

5 CONCLUSION

5.1 It is ELEXON'S legal opinion, that P145 does not satisfy the criteria for retrospective Modifications, as set out by the Authority in its decision letter to P19.

MAH