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Modification Proposal P145 Consultation Document

**Modification Proposal P145 'Cost reflective
mechanism to allocate any deficit arising from the
application of the PNE claim fee'**

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1 INTRODUCTION

1.1 Scope

This document provides background information on Modification Proposal P145 'Cost reflective mechanism to allocate any deficit arising from the application of the PNE claim fee' (P145) and invites views from interested parties on a number of issues arising in relation to the proposed change. Areas covered include:

- History of the Proposal;
- Description of the Proposal;
- Background to the claim fee; and
- Issues discussed by the Modification Group.

1.2 Views Invited

Your views are invited on Modification Proposal P145 and the matters described in this consultation document. A number of specific questions where your comments would be particularly welcome are included throughout this document and in the attached response proforma.

Please send your responses, **in the proforma provided**, by: **17:00 on Tuesday 4 November 2003** to Modifications@elexon.co.uk and please entitle your email '**P145 Urgent Modification Consultation**'.

Please note that any responses received after the deadline may not be considered by the Modification Group (due to the tight timescales for the GSMG consideration of the responses).

Any queries on the content of the consultation pro-forma should be addressed to Sarah Parsons on 020 7380 4293, email address sarah.parsons@elexon.co.uk.

2 HISTORY OF THE MODIFICATION PROPOSAL

Modification Proposal P145 was raised by Powergen UK plc on 17 October 2003. P145 seeks to ensure that the total cost of the Past Notification Errors (PNE) process is recovered from only PNE claimants (as opposed to being spread across all BSC Parties) and that the costs are recovered from those claimants on a differential basis dependent on the size of the claim. The Proposer requested that this Modification Proposal be treated as Urgent on the grounds that failure to expedite resolving the issue could create uncertainty in the market and disproportionate costs could be incurred by Parties who have not made a PNE claim. ELEXON supported this request and made a recommendation to the Panel that the Modification Proposal be treated as urgent.

The Panel agreed with ELEXON's recommendation that P145 be treated as urgent, and requested that the Authority grant urgent status. The Authority granted urgency on 21 October 2003 and agreed that P145 should be progressed to the following timetable by the Governance Standing Modification Group (GSMG):

- 23 October 2003: Modification Group Meeting;
- 28 October 2003: Industry consultation issued;
- 5 November 2003: Modification Group Meeting to discuss consultation responses and draft Urgent Modification Report;
- 12 November 2003: Urgent Modification Report issued
- 13 November 2003: Panel Meeting - Consideration of Urgent Modification Report;
- 14 November 2003: Urgent Modification Report provided to Authority for decision.

3 DESCRIPTION OF THE PROPOSAL

P145 identifies that there is a possibility of there being a difference between the revenue generated from the application of the PNE claim fee and the total cost of the PNE process. P145 therefore seeks to ensure that any deficit arising from the application of the PNE claim fee is allocated in such a way as to ensure the costs of the PNE process are both fully and fairly allocated amongst PNE claimants only and that Parties that have not made any PNE claims or have decided not to pursue their claims are not required to fund such costs.

The proposal sets out a formula by which the allocation of costs will be calculated:

$$C_{PNE} = D \times V_c / V_{TOT}$$

Where:

C_{PNE} = Cash payment to be paid by a particular claimant in respect of a single claim¹

D = Deficit, i.e. the cost of the PNE process less the income generated from the PNE claim fee

V_c = Net value of each individual claim obtained by adding together the Energy Imbalance values of all the Parties associated with a particular claim. Such Energy Imbalance values have already been published by ELEXON under the title of "Past Notification Error Materiality".

V_{TOT} = Total net value of all PNE claims (i.e. a sum total of individual claim net Energy Imbalance values using data from ELEXON's document entitled "Past Notification Error Materiality").

The effect of this is to apportion the PNE process costs to claimants on a pro rata basis according to the size of their claim.

The proposal noted that claims having a negative net Energy Imbalance value should be excluded for the purpose of calculating V_c and V_{TOT} .

The Proposer believes that placing an unreasonable cost burden on non-claimants or a disproportionate cost burden on claimants with relatively small value claims (i.e. claims that the Proposer suggests have tended to generate lower PNE claims process costs), will tend to undermine those Parties' ability to compete in the market. The Proposer asserts that targeting costs at those that to a greater or lesser extent have contributed to the costs will thus help promote competition in the generation and supply of electricity.

Therefore, the Proposer believes implementation of P145 would better facilitate achievement of Applicable BSC Objective (c).

c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity.

¹ This subject to the establishment of single cause claims by the PNE Committee under P6.2.6

4 BACKGROUND

This section outlines the background to the PNE claims process with specific reference to the claim fee and the costs of the process.

4.1 PNE Claims

The PNE claims process was incorporated into the Code following the approval of Modification P37 on 10 May 2002. Modification P37 was implemented on 20 May 2002 and Parties were able to submit Past Notification Error claims from the implementation date through to 24 May 2002.

On 22 May 2002 Modification Proposals P83 and P84 were submitted. P83 proposed that the PNE claims window be extended to allow P84 to be considered. The Authority approved P83 on 23 May 2002 which allowed PNE claims to be submitted through to 31 May 2002.

Modification Proposal P84 was approved by the Authority on 28 May 2003 and allowed Parties who submitted two or more claims to request that these be treated as one claim for the purposes of calculating the claim fee on the grounds that the claims arose from the same cause. The PNE Committee would then decide whether the relevant mistake described in these claims resulted from the same cause.

Discussions by the Mods Group and the Panel on P37 and P84 refer to "central costs being recovered from the claimants through the administration fee". However the Code does not explicitly refer to cost recovery.

The process for rectification of upheld PNE claims has been agreed by the PNE Committee and noted by the Panel (Panel Paper 63/016). Post Final Settlement Runs (PFSRs) which have previously been suspended will start in November/December 2003 relating to Settlement Days 27 March 2001 onwards. These will calculate revised Energy Imbalance Cashflows and Residual Cashflow Reallocation Cashflows for affected Parties.

Following the PFSRs in relation to each PNE claim the Error Correction Payment (ECP) and Error Correction Payment Reallocation (ECPR) will be calculated by ELEXON. The ECP is 20% of the benefit of each claim and is paid by the benefiting Party (claimant or counterparty) if the claim is upheld. The ECP is then redistributed to all non benefiting Parties as the ECPR. These Ad Hoc Trading Charges will be invoiced by the FAA in batches on a monthly basis with each batch relating to PNE claims processed in the PFSRs for the previous month.

ELEXON's Finance Department will invoice PNE claimants for the relevant claim fees. This will be offset against BSCCo costs.

4.2 Claims Fee

Paragraph P6.2.2 of the Code states that where a Party makes a PNE claim, such Party shall pay a fee to ELEXON. This fee shall be £5,000 or such other amount as the Panel may from time to time determine after consultation with Parties and subject to the approval of the Authority. This paragraph also states that Parties must be given 30 days notice of any such change.

Paragraph P6.2.6 goes on to state that where a Party has submitted a number of PNE claims and the PNE Committee 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 Party will only be required to pay one fee for the group of claims.

Finally paragraph P6.4.4(g) states that the fee shall be invoiced as and included in determining BSCCo Charges for the next month following notification of the PNE Committee's determination. The total number of individual PNE claims is 714. A number of claimants have requested that their claims be grouped for the purposes of calculating the fee. The total number of groups of claims is 42. Therefore the maximum income that may be invoiced by ELEXON (based on the claims fee of £5000) is $714 * 5000 = £3,570,000$. The minimum amount that may be invoiced is $42 * 5000 = £210,000$.

The Panel has started to consider whether the fee should be adjusted, as allowed under the existing provisions of the Code. During its discussions, one of the points raised was whether under the Code as it stands an adjustment could be made to achieve the full recovery of costs from claimants.

At the Panel meeting on 9 October 2003 the Panel agreed that a decision on whether the fee should be revised could not be made until the PNE Committee has come to a decision regarding the grouping of claims (expected before the November Panel meeting). However in order to assist the Panel in making a decision regarding a revised fee it was agreed that an initial consultation should be undertaken to allow Parties to raise any points they wish the Panel to take into account.

The consultation asked Parties for comments on whether the claim fee should be adjusted and if so, whether it should fully recover P6 project costs. Responses to this consultation are due back on Tuesday 28 October 2003.

It should be noted that the mechanism suggested in P145 (differential allocation of the costs among claimants) can not be achieved by the Panel by changing the level of the fee under the current drafting of the Code. At present the Panel can only agree a uniform change to the fee for all claimants. Based on the estimated project costs this could lead to the fee being increased to approximately £38,300 per claim, or group of claims, if all single cause applications are approved.

4.3 PNE Project Costs

ELEXON has estimated that the total PNE project costs will be approximately £1.61m (see attachments 1, 2 and 3 for a breakdown of costs and an example of how these costs would be recovered under the current rules and under P145). This is based on actual costs invoiced up to August 2003 with estimated costs for September onwards. This represents a saving of approximately £800,000 against the budget. The budget of £1.55m for demand led costs was presented to the Panel in December 2002 and circulated to BSC Parties within the draft Business Strategy. ELEXON operational costs were not separately identified.

The process undertaken to assess the PNE claims was consulted upon in August 2002 and the procedures were agreed by the Panel on 12 September 2002. A number of respondents to the consultation noted the need for a robust process bearing in mind the importance and materiality of the claims involved. For example the industry agreed that the Committee Chairman should have a legal background and that ELEXON input should be minimal.

5 ISSUES

The first Modification Group meeting discussing P145 took place on 23 October 2003. The Modification Group discussed a number of issues that would need to be considered when assessing P145. The issues are described below:

5.1 Retrospection

The group believed that the allocation of the PNE costs to claimants on a differential basis could be viewed as a retrospective rule change. Given this, the group was mindful of the guidance that has been previously set out by the Authority in relation to modifications with retrospective effect². In that guidance, the Authority identifies the following particular circumstances which could give rise to the need for a retrospective rule change:

- 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 retrospective action had been clearly flagged to participants in advance and only the details and process were decided retrospectively.
- In any event, the loss sustained would need to be material.

The group had mixed views on the question of whether P145 met these criteria. The Proposer stated that P145 is retrospective but that it passed a number of the Authority criteria e.g. the possibility of retrospective action had been clearly flagged as the Code stated that the Panel could amend the claim fee. This meant that such a change could have been reasonably foreseen. It was noted that although P145 did not relate to a change in the claim fee it was intrinsically linked to such a change.

However, other members of the group stated that the clause in the Code allowing a change to the claim fee had not been intended to open the door to retrospection. Another view suggested that at the time the claims were submitted claimants would not have envisaged the costs of the process being so high, therefore the perceived deficit could not have been reasonably foreseen. It was also noted by some members that, although there was a clause in the Code to allow a change to the flat level of the claim fee, the alteration of the process to recover costs on a non uniform basis was a retrospective action that had not been clearly flagged to participants. ELEXON agreed to provide a legal assessment of P145 against the areas set out above.

Consultation Question 1	Do you believe P145 is a retrospective modification?
Consultation Question 2	If you do believe P145 is a retrospective modification, do you believe the retrospective rule change is appropriate?

² See, for example, the Authority's Decision Letter in respect of Modification Proposal P19

5.2 Cost Recovery

The Group discussed the principle of targeting a particular group of Parties for the recovery of costs associated with a specific project/modification. It was noted that, in general, charging under the BSC was non-cost reflective. For example, one member of the group noted that there was no such targeted cost recovery for the Trading Disputes process. The Proposer contended that the Trading Disputes process benefits all Parties whereas the PNE process was for the benefit of a discrete number of Parties. However, other members considered that the size of the costs was directly related to the need for an independent, robust, and transparent process of which all BSC Parties had been the beneficiaries, since it had protected the interests of non-claimants just as much as those of claimants.

5.3 New Entrants

It was noted that if P145 is not approved new entrants to the market i.e. those who acceded after the implementation of P37 could be required to pay a share of the costs for the process that they were not able to participate in. However, members of the group pointed out that this was no different from a number of costs to which new entrants might be exposed upon acceding to the BSC, and that this was simply a matter to be taken into account under due diligence when deciding whether to enter the market.

5.4 Role of Interested Parties

It was agreed that the PNE process was designed to be robust and therefore resulted in significant cost. It was noted that active participation of Interested Parties in the PNE claims process may have had an effect on the overall costs although it was impossible to ascertain to what extent. Some members of the group believed this effect to be significant on the overall materiality of the process (for example through the provision of very detailed submissions to the PNE Committee) whilst others believed the impact to be negligible. As noted above, other members of the group thought that all affected Parties, including Interested Parties, benefited from having such a robust process which protected their interests regardless of whether they were a PNE claimant.

Finally it was noted that should an Alternative Modification be proposed that required cost recovery be extended to Interested Parties who participated in the PNE process, then any such modification may fail on the issue of retrospection as such a fee on Interested Parties could not have been reasonably foreseen. Also it would be very difficult to quantify the extent to which individual Interested Parties had contributed to a proportion of the overall costs. The Proposer noted that in their view allocating costs to Interested Parties who were not claimants would not address the issue/defect outlined in the modification proposal and therefore could not be considered as part of an Alternative Modification.

5.5 Claims Not Being Pursued

It has been noted that the "Past Notification Error Materiality" document referred to in P145 does not include materiality values for most claims that are not being pursued. Approximately 600 claims (11 investigations) have not been included. At present ELEXON does not have the capability of calculating the materiality of these claims and it is envisaged that significant time and effort would be required to do so. The Proposer confirmed that P145 had not been intended to include claims that were not being pursued. In addition the group noted that as most of these claims were withdrawn at an early stage in the process they did not incur much cost.

Consultation Question 3	Do you believe that it is appropriate for the total cost of the PNE process to be recovered from PNE claimants alone?
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5.6 Timing

Paragraph P6.4.4(g) states that the claim fee shall be invoiced as and included in determining BSCCo Charges for the next month following notification of the PNE Committee's determination. The Group noted that P145 does not refer to a change in the claim fee and therefore it is not envisaged that any invoicing under P145 would need to be constrained by the same timescales.

It was also noted that it would be some time before the exact costs of the PNE process were available e.g. ELEXON operational costs would continue to be accrued throughout the rectification phase. The group agreed that a date would be required at which the costs would be frozen for the purposes of the allocation calculation. It was noted that this would not necessarily allow for the full final costs to be recovered.

Finally it was noted that assessing P145 would be difficult for the group before the determinations were available from the PNE Committee, as the size of any deficit could not be definitively quantified before then. However, it was also noted that the formula proposed would still be relevant irrespective of the magnitude of the deficit. Finally it was noted that it would be beneficial for the P145 Urgent Modification Report to be available at the November Panel meeting in order to inform any Panel decision regarding the change to the claim fee. It was also noted that the Panel would be receiving the determinations on same cause at that meeting.

5.7 Apportionment of Costs

P145 asserts that "the larger the value of claims, the larger the costs likely to be incurred in respect of such claims". The group noted that it is not clear that this is actually the case. Firstly some costs are common i.e. they would have been incurred regardless of the number or size of the claims e.g. the Industry Survey and Special Advisors Report. Secondly the incremental cost per claim is more likely to be related to a combination of the complexity of the claim, the clarity with which the claim has been expressed by the claimant and possibly the number of Volume Notifications over which it spreads, rather than just the materiality.

The Proposer noted that the Panel could still increase the claim fee to cover costs that were shared by all claimants. P145 was focused on any deficit left after the income from the claim fee had been taken into account. Also P145 was only intended to introduce a fairer method of cost allocation than a flat increase across all claimants and that alternative modifications to address the perceived defect could be considered.

Finally the group noted that P145 was not intended to cover the cost of processing PNE appeals as these are subject to a separate fee.

Consultation Question 4	If costs are to be apportioned amongst PNE claimants alone, do you believe that the methodology in P145 reasonably reflects the costs incurred by individual PNE claimants?
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5.8 Redistribution of Costs

The group noted that the majority of the costs of the PNE process had already been recovered from all BSC Parties as part of BSCCo costs. This included £724k from the last financial year (2002/2003). This meant that implementation of P145 would require money to be offset against the 2003/2004 BSCCo costs and paid back to Parties affected in 2002/2003. The group raised the issue of whether the 2002/2003 costs should be paid back to Parties based on their funding share for 2002/2003 or based on this year's funding share. It was noted that to use last years funding share figures would increase the administration time of implementing the modification, but was probably the fairest methodology.

Consultation Question 5	If P145 is approved, do you believe the 2002/2003 costs should be paid back to Parties based on their funding share for 2002/2003 or based on this years funding share?
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ANNEX 1: DOCUMENT CONTROL

b Authorities

Version	Date	Author	Signature	Change Reference
0.1	23/10/03	Change Delivery		Initial Draft
0.2	24/10/03	Change Delivery		Following internal review
1.0	28/10/03	Change Delivery		Following Mods Group review

Version	Date	Reviewer	Signature	Responsibility
0.1	23/10/03	Gareth Forrester		GSMG Chairman
0.1	23/10/03	Richard Humphries		ELEXON Finance
0.2	24/10/03	Mods Group		Mods Group
1.0	28/10/03	Industry		Consultation

a. Distribution

Name	Organisation
Each BSC Party	Various
Each BSC Agent	Various
The Gas and Electricity Markets Authority	Ofgem
Each BSC Panel Member	Various
energywatch	energywatch
Core Industry Document Owners	Various

b. Related Documents

Ref.	Title	Owner	Issue date	Version
1	Modification Proposal P145		21/08/03	1.0

ANNEX 2: MODIFICATION GROUP

The table below indicates the membership of the GSMG that is considering P145.

MEMBER	ORGANISATION
Gareth Forrester (Chairman)	ELEXON
Sarah Parsons (Lead Analyst)	ELEXON
Melanie Henry (ELEXON Legal)	ELEXON
Richard Humphreys (ELEXON Finance)	ELEXON
Peter Bolitho (Proposer)	Powergen UK plc
Terry Ballard	Innogy
Robert Barnett	Campbell Carr
Mark Manley	British Gas Trading
Neil Smith	Powergen
Rachel Lockley	British Energy
Roger Barnard	EDF Energy
Andrew Colley	SSE Energy
Mike Harrison	Scottish Power
Jerome Williams	Ofgem