



April 2003

**DRAFT MODIFICATION REPORT**  
**Modification Proposal P115 – Disapplication of  
Supplier Charges under Certain Circumstances**

Prepared by ELEXON on behalf of the Balancing  
and Settlement Code Panel

<b>Document Reference</b>	P115RR
<b>Version no.</b>	0.2
<b>Issue</b>	Draft
<b>Date of Issue</b>	17 April 2003
<b>Reason for Issue</b>	For Consultation
<b>Author</b>	ELEXON

## I DOCUMENT CONTROL

### a Authorities

Version	Date	Author	Signature	Change Reference
0.1	16/04/03	Change Delivery		For initial peer review
0.2	17/04/03	Change Delivery		For Consultation

Version	Date	Reviewer	Signature	Responsibility
0.1	16/04/03	Change Delivery		
0.2	17/04/03	Change Delivery		

### b 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

### c Intellectual Property Rights and Copyright

This document contains materials the copyright and other intellectual property rights in which are vested in ELEXON Limited or which appear with the consent of the copyright owner. These materials are made available for you to review and to copy for the purposes of the establishment, operation or participation in electricity trading arrangements in Great Britain under the BSC. All other commercial use is prohibited. Unless you are a person having an interest in electricity trading in Great Britain under the BSC you are not permitted to view, download, modify, copy, distribute, transmit, store, reproduce or otherwise use, publish, licence, transfer, sell or create derivative works (in whatever format) from this document or any information obtained from this document otherwise than for personal academic or other non-commercial purposes. All copyright and other proprietary notices contained in the original material must be retained on any copy that you make. All other rights of the copyright owner not expressly dealt with above are reserved.

### d Related Documents

The following documents are referenced from within this document:

- 1 Modification Proposal P115 – Assessment Report – Version 1.0, 04 April 2003
- 2 Letter requesting Authority's Provisional Thinking – 27 March 2003
- 3 Modification Proposal P115 Assessment Consultation – P115AC – 5 March 2003
- 4 SVG Paper 25/351 – 4 March 2003 – P115 Feedback from the VASMG on generic SVA issues identified.

## **II CONTENTS TABLE**

<b>I</b>	<b>Document Control</b> .....	<b>2</b>
a	Authorities .....	2
b	Distribution .....	2
c	Intellectual Property Rights and Copyright.....	2
d	Related Documents.....	2
<b>II</b>	<b>Contents Table</b> .....	<b>3</b>
<b>1</b>	<b>Summary and Recommendations</b> .....	<b>4</b>
1.1	Recommendation.....	4
1.2	Background.....	4
1.3	Rationale for Recommendations .....	4
<b>2</b>	<b>Introduction</b> .....	<b>5</b>
<b>3</b>	<b>History of Modification Proposal</b> .....	<b>5</b>
<b>4</b>	<b>Summary of Assessment Procedure</b> .....	<b>6</b>
<b>5</b>	<b>Rationale for Panel Recommendations</b> .....	<b>8</b>
<b>6</b>	<b>Legal Text to Give Effect to the Proposed Modification</b> .....	<b>9</b>
<b>7</b>	<b>Assessment</b> .....	<b>9</b>
<b>8</b>	<b>Summary of Costs</b> .....	<b>9</b>
<b>9</b>	<b>Summary of Representations</b> .....	<b>9</b>
<b>Annex 1</b>	<b>– Provisional Thinking</b> .....	<b>10</b>
<b>Annex 2</b>	<b>– Representations</b> .....	<b>10</b>

## 1 SUMMARY AND RECOMMENDATIONS

### 1.1 Recommendation

On the basis of the analysis, consultation and assessment undertaken in respect of this Modification Proposal during the Modification Procedures, and the resultant findings of this report, the BSC Panel recommends that:

- **Proposed Modification P115 should not be made;**
- **However, if the Authority determine that the Proposed Modification should be made, the Implementation Date should be 01 January 2005, if an Authority decision is received by 01 September 2003, and an Implementation Date of 01 May 2005 if an Authority decision is received after 01 May 2003 and before 01 January 2004.**

### 1.2 Background

Modification Proposal P115 'Disapplication of Supplier Charges Under Certain Circumstances' (P115) was submitted on 24 December 2002 by Innogy plc.

P115 proposes to allow the Panel to disapply part, or all, of the Menu of Supplier Charges for those periods where the application of such charges may be inconsistent with the status of the charges as "liquidated damages", or it may be otherwise unreasonable to apply them.

The Proposer believes that the removal of "generic problems" from Supplier Charges will raise performance to a level where the effect of caps is avoided, and that this would be a positive incentive for Suppliers to investigate the cause of problems due to their own failures. The Proposer believes this will better facilitate the achievement of Applicable BSC Objectives (c) and (d).

The Assessment Report was presented to the Panel meeting on 10 April 2003. The Panel agreed with the recommendation of the Volume Allocation Standing Modification Group ("the Group") that Modification Proposal P115 should not be made. The Panel determined that P115 should be submitted to the Report Phase, with the completed draft Modification Report to be presented to the Panel meeting on 08 May 2003.

### 1.3 Rationale for Recommendations

The Panel noted the Group had been unable to identify a viable solution for how to disapply Supplier Charges, or indeed the extent to which a Modification Proposal is required, with the existing provisions for Supplier Force Majeure (SFM).

The Panel agreed with the Group that without a viable solution, or clear current baseline, it was not possible to adequately assess whether the Proposed Modification would better facilitate the achievement of the Applicable BSC Objectives.

As a result of their considerations the Panel unanimously recommended that the Proposed Modification should not be made.

## 2 INTRODUCTION

This Report has been prepared by ELEXON Ltd, on behalf of the Balancing and Settlement Code Panel ('the Panel'), in accordance with the terms of the Balancing and Settlement Code ('the Code'). The Code is the legal document containing the rules of the balancing mechanism and imbalance settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the Code.

This Modification Report is addressed and furnished to the Gas and Electricity Markets Authority ('the Authority') and none of the facts, opinions or statements contained herein may be relied upon by any other person.

An electronic copy of this document can be found on the BSC Website, at [www.elexon.co.uk](http://www.elexon.co.uk)

## 3 HISTORY OF MODIFICATION PROPOSAL

Modification Proposal P115 'Disapplication of Supplier Charges Under Certain Circumstances' (P115) was submitted on 24 December 2002 by Innogy plc.

Supplier Charges are an important part of the Performance Assurance Framework (PAF) and primarily compensate non-Half Hourly (NHH) Suppliers for any energy allocation errors in Supplier Volume Allocation (SVA). In this respect they are expected to represent "a genuine pre-estimate of the loss likely to be suffered by other Parties as a result of a failure by a Supplier to meet the applicable Performance Level". They also have a secondary effect in that they create a financial incentive for Suppliers to improve their performance.

Annex S-1 defines 11 Serials that measure various aspects of the Supplier's performance. Each Serial has an associated Performance Level and if a Supplier's performance for the Serial drops below this level then they will accumulate a charge, the amount of which is also defined in Annex S-1.

Annex S-1 also defines the Supplier's Monthly Cap, which is designed to limit each Supplier's maximum liability to charges, and how all collected charges are to be redistributed to BSC Parties, with 10% being shared amongst all Trading Parties, and the remaining 90% being shared amongst the NHH Suppliers.

In addition Section S3.3 defines provisions for a Supplier to raise a claim of SFM. However, prior to P115 it was believed that this would not affect the level of Supplier Charges, as the algebra in Annex S-1 contains no provisions to amend any calculations to take into account extenuating circumstances, such as SFM.

P115 proposes to allow the Panel to disapply part, or all, of the Menu of Supplier Charges for those periods where the application of such charges may be inconsistent with the status of the charges as "liquidated damages", or it may be otherwise unreasonable to apply them.

P115 suggests that such circumstances would include where:

- there is a known defect in the mechanism for calculating the charges and/or their re-distribution;
- the Performance Levels and Serials in respect of which the charges are applied do not take account of a recognised defect in industry process or arrangements;

- performance has been significantly impacted by a failure of a previous Supplier(s) to comply with obligations under the Code.

The Proposer believes that in such circumstances, payments due to “generic problems”, combined with a Supplier’s Monthly Cap, could dilute the resulting incentive on Suppliers to improve their own performance. Therefore the removal of “generic problems” from Supplier Charges will raise performance to a level where the effect of caps is avoided, and that this would be a positive incentive for Suppliers to investigate the cause of problems due to their own failures.

The Initial Written Assessment for P115 was presented to the Panel meeting on 16 January 2003. The Panel determined that P115 should undergo a 3-month assessment by the Volume Allocation Standing Modification Group, and that the Assessment Report should be presented to the Panel at their meeting on 10 April 2003.

During the Assessment Procedure 3 meetings of the Group were held, and one consultation performed. In addition an Interim Report was sent to the Panel for their meeting on 13 March 2003. This resulted in the Panel requesting the Authority’s provisional thinking regarding P115 (Reference 2), which was received on 09 April 2003 (Annex 1).

The Assessment Report (Reference 1) and the Authority’s provisional thinking (Annex 1) were presented to the Panel meeting on 10 April 2003. The Panel agreed with the Group’s recommendation that Modification Proposal should not be made. The Panel also determined that P115 should be submitted to the Report Phase, with the completed draft Modification Report to be presented to the Panel meeting on 08 May 2003.

#### **4 SUMMARY OF ASSESSMENT PROCEDURE**

The majority of the Group, and also consultation responses during the Assessment Procedure, supported the principle that it should be possible to disapply some Supplier Charges in some circumstances.

The Group tried to find ways of achieving this, by investigating ways to quantify the effect “generic problems” may have on one or more Suppliers, and ways to link this to the existing Serials. The Group considered the merits of different approaches, ranging from statistical methods that automatically compensate for a generic level of error, through to justified approaches that are considered on a case by case basis. Examples of the former could include reducing the Performance Levels, or increasing the Supplier’s Monthly Cap, whereas an example of the latter would be extending the existing provisions for Supplier Force Majeure.

The Group found this to be a difficult task and although they identified a number of potential “generic problems”, they could not quantify the effect they may have on Supplier Charges<sup>1</sup>. The Group also recognised the complexity of the algebra in Annex S-1, and that it would be difficult to disapply charges in a manner that continued to compensate NHH Suppliers, and still provided an incentive for Suppliers to improve performance. This process was made more difficult by the effect of the caps, which the Group recognised could distort incentives if a significant number of NHH Suppliers reached their caps. In

---

<sup>1</sup> These potential “generic problems” were identified to SVG (Reference 4), such that the root causes of the problems could be investigated, and Change Proposals raised should suitable fixes be identified.

recognising these difficulties the Group believed it was important to ensure any proposed approach was clearly defined, non-arbitrary and transparent.

The Group also investigated the expected materiality of the Modification Proposal<sup>2</sup>. They recognised this would be difficult to quantify as the Supplier Charges that had accumulated since Go Live were only now being applied, and would not include Serial 1 (RF) until the process reaches the calculations for May 2002. This particular Serial was considered important as the Group recognised that, with the current level of NHH energy being settled on estimates, a significant number of Suppliers were expected to reach their caps<sup>3</sup> due to this one Serial alone.

The Group also considered the degree to which incentives could be diluted when a Supplier's Monthly Cap was reached, as was suggested within the Modification Proposal. It was clear that any change in performance would not be reflected in the resulting Supplier Charge whilst the charge was capped, and this would apply to both HH and NHH Suppliers. However, the Group also noted that if a significant number of NHH Suppliers all reached their caps, then the collected charges, and redistributed amounts, would be largely determined by the Supplier's total energy in that GSP Group, and these would tend towards similar values. The Group also recognised that the manner in which the caps affect different types of Supplier (HH/NHH and large/small) could distort any incentive, but the Group could not determine whether this would be material to P115.

Based on the information contained within the consultation responses, and their own views, the majority of the Group supported the principle of P115, and also favoured an approach where each Supplier would be expected to justify each claim on a case by case basis. This would be similar to how the Group saw the existing provisions for Supplier Force Majeure.

Legal advice received during the Assessment Procedure also established that the existing provisions of Supplier Force Majeure were linked to Supplier Charges, and in the case of a successful claim then part, or all, of a Supplier's charges could be disappplied.

Although this established that the principle of disapplying Supplier Charges was already in the Code, from the perspective of P115 this still represented two problems:

- it was not clear as to the extent of the current SFM provisions, and the degree to which they may already be applicable to the sort of issue raised in the Modification Proposal. Section S3.3.1 allows claims for events outside a Supplier's control and already contains a varied set of possible causes. In addition the Code does not exclude claims for the circumstances described in the original P115 Modification Proposal. However, it was not clear how the merits of any claim would be evaluated, and the likelihood of a claim being upheld. Legal advice was that this was unlikely to become clearer until tested for real with specific cases;
- it was not clear how any disapplication of charges could be achieved (for either SFM or P115) in a manner that was defined, non-arbitrary and transparent. The rules and supporting systems are defined by a precise set of algebraic rules in Annex S-1 of the Code, which do not themselves provide an explicit facility to disapp charges.

---

<sup>2</sup> See the Assessment Procedure Consultation document (Reference 3) for further details on the materiality.

<sup>3</sup> The consultation document identified that the average level of Serial 1 (RF) performance during the last six months of 2001 was 92%. It also identified that a Serial 1 (RF) performance of 93% during the peak winter month was sufficient to cause a Supplier to reach their cap.

As a result of their assessment, and attempts to identify a viable solution for how to disapply charges, the Group did not believe they could identify a change to the Code, or indeed the extent to which a Modification Proposal is required, with the existing provisions for SFM.

Without a viable solution, or clear current baseline, it was not possible for the Group to adequately assess whether the Proposed Modification would better facilitate the achievement of the Applicable BSC Objectives.

As a consequence of the above, the majority view of the Group was to complete the Assessment Procedure with a recommendation that Modification Proposal P115 should not be made. This was on the grounds that no solution (other than SFM) could be identified. In addition there may already be sufficient provisions within the Code (based on SFM), although as noted above no mechanism for processing SFM claims is defined. The Group also believed no legal text should be provided.

However, the Group strongly believed that further, potentially significant, work would be required to clarify the existing SFM provisions and define a mechanism to be used, should a claim be upheld. This would be operational work and, at least initially, would be best investigated outside the Modification Procedures, e.g. under the control of the Supplier Volume Allocation Group (SVG), with any resulting processes and procedures being endorsed by the Performance Assurance Board (PAB) (to ensure operability). Depending on the findings this may identify the need for a Modification Proposal to formalise the resulting rules.

## 5 RATIONALE FOR PANEL RECOMMENDATIONS

In addition to the Assessment Report, the Panel had been issued with the Authority's provisional thinking (Annex 1). This reinforced the view that disapplication of Supplier Charges risks diminishing their function as a genuine pre-estimate of loss, and that losses incurred by other Parties, due to a Supplier's under performance, would not be account for, or reimbursed. It also recognised that the existing Performance Levels already contain a degree of allowable error, and this reflects that there are generic issues in the market. Furthermore, if the existing levels are considered inappropriate, then change processes and mechanisms are in place to allow Supplier to propose to modify them. The Authority were also concerned about the practicalities of implementing a simple, transparent and equitable mechanism to disapply Supplier Charges, noting the need to continue to compensate those who are most affected by the energy allocation errors. This would be particularly difficult if any charges arising from poor performance from a previous Supplier could be disapplied.

A Panel member expressed concern that the materiality of the defect had not been made clear, and suggested that this would have helped determine how to progress the Modification Proposal. The Panel noted that the consultation document (Reference 3) contained a variety of data relating to the materiality, however, it had not been possible to combine this into a simple view concerning the overall materiality.

The Panel considered the Group's view that the provisions for SFM may offer a potential way forward, but questioned whether the three problems listed within P115 could be classed as SFM. It was explained that this had also concerned the Group, however, S3.3 did not appear to limit the circumstances that could be considered outside a Supplier's control, and that the explicit causes (S3.3.1.(a)-(h)) were not defined to be an exhaustive

list. The Group did not believe this issue would become clearer until tested against specific cases. The Panel agreed that it would be difficult to clarify what would constitute a valid claim of SFM, and that this was a topic that had challenged contract law for many years. The Panel were against expending further effort to clarify the range of circumstances that may be considered valid within S3.3, and considered that each claim should be evaluated on a case by case basis.

The Panel also considered the Group's concern that a clear mechanism to disapply charges was not defined in the Code, and that the Group had not been able to identify a potential solution. The Panel had mixed views on whether this was best left until it was required for a real claim. They felt that this would give most flexibility in determining how to progress each claim. It was pointed out that both the Group, and Authority, believed that the mechanism for SFM should be simple, transparent and equitable. This would be harder to achieve if the rules were not defined before addressing a claim. The Panel agreed that ELEXON has an obligation to ensure that the Code is operational and that ELEXON (rather than SVG) should undertake an appropriate amount of work to investigate the existing provisions for dealing with an SFM claim and report back to the Panel as necessary.

As a result of their considerations the Panel unanimously recommended that the Proposed Modification should not be made and that P115 should be submitted to the Report Phase, with the completed draft Modification Report to be presented to the Panel meeting on 08 May 2003.

## **6 LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION**

No legal drafting is provided as part of this report as no viable solution has been identified. The Authority have indicated that legal drafting for the Proposed Modification P115 is not required.

## **7 ASSESSMENT**

The Assessment Procedure for P115 lasted for three months and full details of the assessment can be found in the P115 Assessment Report [RD/1].

As the Assessment Procedure did not result in a viable solution to the Modification Proposal, there are no changes to any BSC Systems.

## **8 SUMMARY OF COSTS**

As no solution is being proposed by this Modification Report, there are no associated costs.

## **9 SUMMARY OF REPRESENTATIONS**

The responses received to the draft Modification Report issued for consultation on 17 April 2003 are attached as Annex 2. XX responses, representing a total of XX Parties, were received.

**[TO BE COMPLETED AFTER CONSULTATION]**

## **ANNEX 1 – PROVISIONAL THINKING**

Ofgem's provisional thinking in relation to Modification Proposal P115 is attached as a separate document.

## **ANNEX 2 – REPRESENTATIONS**

**Responses from P115 Draft Report Consultation**  
Consultation issued 17 April 2003

**[TO BE COMPLETED AFTER CONSULTATION]**