Issues Report

Meeting name VOLUME ALLOCATION STANDING MODIFICATION GROUP (VASMG)

Meeting no. 4

Date of meeting 16 October 2003

This note reports on progress made in relation to issues discussed at the most recent meeting of the Volume Allocation Standing Modification Group (VASMG).

ISSUE 6: APPROPRIATENESS OF THE CURRENT SUPPLIER CHARGING MECHANISM

Brief Description:

The Performance Assurance Framework Supplier Charges technique, which is a corrective technique, should incentivise Suppliers to attain the agreed levels of performance that are set out in the Balancing and Settlement Code (BSC). The current means of calculating, capping and redistributing Supplier Charges may not be the most efficient or effective way of meeting this objective. It would be useful to investigate the appropriateness of the current Supplier Charges mechanism as an incentive to improve performance and to explore whether an alternative incentive mechanism could be proposed that is simpler and more transparent.

Proposer: Lesley Davies

Organisation: energywatch

Date Submitted: 6 August 2003

Meeting Notes:

3 September 2003

Following an explanation of the issue by the proposer, ELEXON presented some background information on Supplier Charges as part of the Performance Assurance Framework (PAF). ELEXON also provided some examples of alternative ideas for corrective techniques.

The VASMG discussed the issue and identified some potential approaches for ELEXON to analyse. These scenarios were then prioritised as below.

HIGH:

- Public naming (congratulatory or otherwise)
- Excluding errant Suppliers from receiving funds from their own Supplier Charges
- Removing the Caps from current Supplier Charges
- Making Supplier Agents Parties to the Code

MEDIUM:

- Allocate costs of PAF
- Revisit redistribution of funds
- Change the serials to which Supplier Charges are applied

LOW:

- Charge on percentage energy

18 September 2003

ELEXON presented two papers to the VASMG. The first paper described the background to the use of corrective techniques within the PAF. The second paper presented some initial analysis of the ideas suggested by the VASMG at the previous meeting. A third paper, describing the legal implications of certain options, was circulated to the group.

Three types of corrective techniques were identified. These were:

- financial incentives;
- naming those who do or do not meet the required standards; and
- BSC Panel powers to enforce sanctions on carrying out actions under the BSC.

The last technique already exists and has explicitly been designed to allow Parties time to correct their behaviour. It was noted that the extreme actions, available to the Panel under this process, are only appropriate for very poor performers and could be taken in the event of a material breach or repeated immaterial breach of the BSC as outlined in Section H.

A Modification Group Member argued that all incentives could be regarded as financial as they ultimately affect the ability of businesses to make a profit. An attendee expressed concern that financial incentives are passed through to customers. It was suggested that customers need to know who the best performing Suppliers are so that they can make informed choice.

The VASMG considered the desirable characteristics of an incentive system as outlined in the Corrective Performance Assurance Techniques paper. It was intended that these could be used as tests or criteria to evaluate potential ideas for new incentives. Some of the discussions are summarised below.

Simplicity:

The VASMG considered simple incentives to be desirable but only if this did not result in them being crude. Some members of the VASMG believed that a set of complex charges which are transparent and fair could be preferable. A balance should be obtained.

Transparency and Clarity:

Most VASMG members considered it important that Parties are able understand Supplier Charges. However, one member observed that, if Parties are able to predict that charges will not be significant, this could be a disincentive to improve performance. The VASMG acknowledged, as an example, that the Authority's ability to fine Parties was given weight because Parties do not know what the fine will be and it has the potential to be large. If companies were able to budget for Supplier Charges, it would defeat the objective. Some companies could be tempted to make a business decision not to comply with standards but it was noted that Supplier Charges would not absolve these Parties from their obligations.

Significant in Magnitude:

The group agreed that there was little point in having small incentives.

Progressive and Reflective of Performance

The group agreed that incentives should be explicitly linked to a clearly desired outcome. The more Parties deviate from standards, the bigger the incentive should be. One member pointed out that there are difficulties with the transfer of data and some Parties could be penalised for inherited problems when taking on new customers. The group agreed that this was a business risk and individual Parties should take this into account as part of their Risk Management Plans when taking on new customers. The group acknowledged that problems exist in relation to Change of Agent and Change of Supplier but that this was being addressed through the Customer Transfer Programme.

Another Modification Group Member observed that Suppliers with a significant market share would have a bigger impact on settlement than a small Supplier. The VASMG agreed that scaleability was desirable provided that it does not add too much complexity.

Immediate:

The group agreed that incentives work best when non-compliance is dealt with immediately, else the non-compliance may continue.

The VASMG discussed how well the current arrangements are working. The group noted that the PAB can only act within the framework of the BSC and the techniques available to it.

A Modification Group Member reported that PAB escalations were taken seriously by Parties. ELEXON agreed that the escalation process is an effective technique but is part of a wider Performance Assurance Framework (PAF) and PAB escalation should be using sparingly to maintain its potency.

A Modification Group Member suggested that many of the problems could be a result of poor education and suggested further ELEXON seminars or workshops could be used. Such education could focus on the role of the PAB and the escalation cycle. The PAF includes education as one of its techniques already.

A Member asked whether it were possible for ELEXON to accredit individuals to ensure relevant expertise is present in companies. ELEXON suggested that it may not be appropriate for ELEXON to accredit companies or individuals and it is incumbent on Suppliers to have adequately qualified staff.

The group agreed that, within the current regime, there is no evidence that Supplier Charges are doing what they were intended to achieve. Incentives should improve performance or there is little point to them.

The VASMG discussed the ideas which were identified at the previous meeting.

Idea 1: Performance Naming

The VASMG agreed that this would be a strong technique and met most of the desired characteristics. The group agreed that the rules surrounding publication would need to be clear and transparent and be validated by Parties.

Idea 2: Excluding errant Suppliers from the reallocation of their own charges

The VASMG were not in favour of this option. It was suggested that changing one aspect may not be enough to get away from the issues with the current Supplier Charges. If the change is only reallocating the charges, this may not be enough to incentivise Parties to improve performance.

Idea 3: Remove Caps from current Supplier Charges

The group acknowledged that this option alone would expose Parties to potentially severe charges for Serials 9, 10 and 11. It was therefore concluded that it would not be sensible to remove the caps without also changing the Serials to which charges are applied to i.e. considered in conjunction with Idea 7 below. The VASMG believed that this option would be simpler and more transparent than the current regime as complexity comes from working out the caps. The group concluded that this option was a possibility but should be looked at in greater detail.

Idea 4: Make Party Agents Parties to the Code

The VASMG agreed that this option would be impossible to implement via the Modification Process as it requires changes to primary legislation.

Idea 5: Allocate costs of the PAF

The group agreed that this could be an effective technique but only in conjunction with another option.

Idea 6: Revisit Redistribution

The group were not in favour this option alone as it would only be redistributing funds differently that Parties already incur and would not necessarily provide a strong incentive to improve performance.

Idea 7: Change Serials to which Supplier Charges are applied

and

Idea 8:Charge on % energy Serials only

The last two ideas were considered to be similar in that they both looked at the Serials to which Supplier Charges apply. The group agreed that there may be value in an idea which is a hybrid of 3, 7 and 8 as none of these ideas would be sufficient in isolation.

30 September and 16 October 2003

The VASMG considered papers produced by ELEXON on three potential corrective techniques which had been identified by the group. This included: a revised method of calculating Suppliers' take to create an incentive within the trading arrangements to submit actual data; performance naming; and a new Supplier Charge technique based on a hybrid of various ideas identified at the meeting on 18 September 2003. The group concluded that no more progress could be made unless someone was prepared to raise a Modification Proposal.

Next Steps:

A Panel Paper (69/020), containing the deliberations of the VASMG in relation to Issue 6, will be present to the Panel at its November Meeting