



January 2003

**INITIAL ASSESSMENT OF MODIFICATION  
PROPOSAL P115 - Disapplication Of Supplier  
Charges Under Certain Circumstances**

Prepared by ELEXON Limited

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<b>Author</b>	ELEXON

## I DOCUMENT CONTROL

### a Authorities

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0.1	10/01/03	Change Delivery		For Peer Review
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### 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

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## 1 SUMMARY

Modification Proposal P115 'Disapplication Of Supplier Charges Under Certain Circumstances' (P115), included in Annex 1, was submitted on 24 December 2002 by Innogy plc, in accordance with Section F2.1.1 of the Balancing and Settlement Code ('the Code').

An initial assessment of P115 has identified a number of issues require further definition, however, ELEXON also believe to achieve this will also require the Modification Proposal to be partially assessed. Therefore ELEXON recommend submitting P115 straight to the Assessment Procedure where, the first stage will be to further understand the issues and how they may be addressed by Modification Proposal, prior to industry consultation.

**On the basis of this Initial Written Assessment, it is recommended that the Panel be invited to:**

- a) **DETERMINE that Modification Proposal P115 should be submitted to Assessment Procedure in accordance with section F2.6 of the Code;**
- b) **AGREE the Assessment Procedure timetable such that an Assessment Report should be completed and submitted to the Panel for consideration at their meeting of 10 April 2003;**
- c) **DETERMINE that the Assessment Procedure should be undertaken by the Volume Allocation Standing Modification Group; and**
- d) **AGREE any refinement to the Modification Group Terms of Reference.**

## 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.

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

## 3 DESCRIPTION OF THE MODIFICATION PROPOSAL

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 suggests that such circumstances would include where:

- a) there is a known defect in the mechanism for calculating the charges and/or their re-distribution;

- b) 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;
- c) 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. In an extreme case an industry wide problem may cause all Suppliers to be liable for the full value of their own Supplier's Monthly Cap, and then to subsequently receive a similar value back when the collected charges are redistributed. This would not be efficient as it would have a null overall effect.

The Modification Proposal notes that BSCP536 already appears to contain a mechanism for a Supplier to claim some charges should not be applied<sup>1</sup>. However, there is no corresponding measure within the Code to take this factor into account when calculating charges, either because of Supplier Force Majeure, or for any other "extenuating circumstance".

The Proposer believes that the removal of "generic" problems 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 asserts that the absence of the safeguards provided by P115 is inconsistent with the Panel objectives in Section B1.2.1 and therefore P115 would better facilitate achievement of Applicable BSC Objective(s):

- 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; and
- d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

The Proposer requested P115 be treated as an Urgent Modification Proposal. However, ELEXON did not recommend this status to the Panel Chairman (in accordance with F2.9 of the Code) as ELEXON did not believe it met the criteria previously applied. ELEXON also believed that it was important to ensure full consideration and wide consultation on the issues addressed by this Modification Proposal.

#### **4 IMPACT ON BSC SYSTEMS AND PROCESSES**

There are no identified impacts on BSC Systems at this stage. However, there would be activities the Panel and/or Performance Assurance Board (PAB) would be required to undertake, and the BSCCo processes used to support these bodies.

#### **5 IMPACT ON OTHER SYSTEMS AND PROCESSES USED BY PARTIES**

None identified at this stage.

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<sup>1</sup> Paragraph 3.1.6 of BSCP536 states a Supplier should "Send notification of extenuating circumstances (e.g. claiming Force Majeure against LDs)" to the Performance Assurance Administrator.

## **6 IMPACT ON DOCUMENTATION**

### **6.1 Impact on Balancing and Settlement Code**

Section S and Annex S-1 will need to be modified to describe the criteria to disapply a proportion of the Menu of Supplier Charges.

It is also likely that Annex S-1 will need to be updated with details of changes to how calculations are performed or even the Serials themselves.

### **6.2 Impact on Code Subsidiary Documents**

It is expected that BSCP536 would need to change, and depending on the nature of the final solution, there may also be related changes to BSCP533 and/or BSCP534.

### **6.3 Impact on Core Industry Documents**

None identified at this stage.

## **7 IMPACT ON OTHER CONFIGURABLE ITEMS**

None identified at this stage.

## **8 IMPACT ON ELEXON**

The Modification Proposal does not provide a mechanism for determining how to disapply a proportion of the Menu of Supplier Charges. Whatever mechanism is developed will affect the assurance processes within BSCCo and, depending on the nature of the solution, it is possible financial processes may also be affected.

It is also possible that should a fairly sophisticated mechanism be developed to calculate how the charges should be amended, then this may require software support within the Performance Assurance Reporting and Monitoring System (PARMS), and potentially the systems responsible for providing the original Serials.

## **9 IMPACT ON FINANCIAL ARRANGEMENTS AND BUDGET**

None identified at this stage.

## **10 IMPACT ON BSC AGENT CONTRACTUAL ARRANGEMENTS**

None identified at this stage.

## **11 PROCESS AND TIMETABLE FOR PROGRESSING THE PROPOSAL**

ELEXON recommends that this Modification Proposal be submitted to the Assessment Procedure, to be undertaken by the Volume Allocation Standing Modification Group (VASMG), augmented by representation from the PAB.

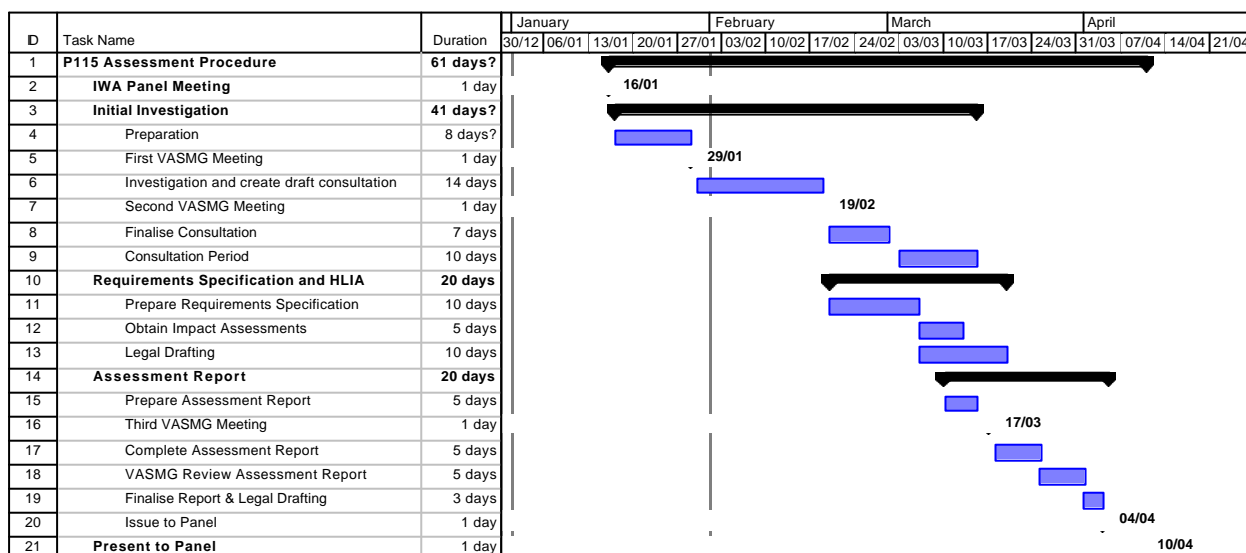
The Assessment Procedure will initially consider how to further define the reported issue, consider the impact of the issues identified in this report, and then assess how they can be addressed by the Modification Proposal. It is planned that this activity will be performed prior to industry consultation.

The Modification Proposal does not identify the details of any solution. However, it is assumed that a solution that does not involve software changes to PARMS would be the initial intention of the Proposer. It will need to be assessed whether this can be achieved in a manner that does not result in any estimates of the amount to be disappplied being considered arbitrary. The results of activity will determine whether an Impact Assessment is required for the changes to the PARMS system.

Although this process involves further definition of the Modification Proposal, ELEXON believe this is best achieved within the Assessment Procedure as this activity will result in the VASMG starting to assess the Modification Proposal and consider potential Alternative Modifications.

An outline timetable is provided in figure 11.1 and will be discussed at the first meeting of the Modification Group (provisionally planned for 29 January 2003).

**Figure 11.1 – Draft Schedule for Modification Proposal P115**



The VASMG should be requested to provide its report to the Panel by 10 April 2003.

## 12 ISSUES

The following issues will need to be considered and addressed in the progression of this Modification Proposal:

- a) Supplier charges seek to incentivise Suppliers to improve performance and are an important aspect of the Performance Assurance Framework (PAF). Any change to the way these charges are applied would need to ensure the incentive is adequately maintained and also consider the wider aspects of the PAF;
- b) the standards within Annex S-1 already allow for a margin of error and under-performance, for instance Serial 1 sets a minimum Performance Level of 97%. This already provides an approach that is both transparent and targeted at individual Serials. Any additional mechanism would need to take this into account;

- c) the activity to calculate and apply Supplier charges that have accrued since Go Live will start in the first half of 2003. The Proposer believes that as P115 is about how Supplier charges are applied, that any charges calculated and then applied after the Implementation Date could be subject to P115. This may imply a degree of retrospection;
- d) the assessment will need to consider any interaction with P99 'Changes to Accreditation and the PARMS Serials and Standards, resulting from the Performance Assurance Framework (PAF) Review (Phase 1)';
- e) the materiality of the issue is not clear and would need to be quantified during the Assessment Procedure. It may also be necessary to consider some external factors, such as the results of the recent Change of Supplier/Agent Study, to help determine how such a mechanism could be applied;
- f) in order to maintain the robustness and integrity of the Performance Assurance Framework, any legal text would need to define clear and measurable criteria: firstly for when charges could be disapplied; and secondly for how an appropriate estimate would be calculated. It is likely this would still result in the Panel, or PAB, needing to exercise discretion;
- g) in calculating an appropriate estimate of the charges to disapply, the Modification Group would need to consider the underlying formula taking into account factors such as: whether the reduction was a fixed quantity or a percentage; against what datum to calculate the level of reduction; and how the reduction relates to the capped and uncapped charges. These issues would be particularly important if an application was received from industry as a whole, or a number of Suppliers for the same underlying reason;
- h) any solution would need to balance the accuracy of any estimate with the effort required to produce it. A simple estimate maybe considered arbitrary, whilst a well founded estimate may require software support. It should be noted that PARMS does not have access to individual meter data and a complex solution could require additional Serials.

**ANNEX 1 – MODIFICATION PROPOSAL**

<b>Modification Proposal</b>	<b>MP No: 115</b> <i>(mandatory by BSCCo)</i>
<b>Title of Modification Proposal</b> <i>(mandatory by proposer):</i> Disapplication Of Supplier Charges Under Certain Circumstances	
<b>Submission Date</b> <i>(mandatory by proposer):</i>	
<b>Description of Proposed Modification</b> <i>(mandatory by proposer):</i> Modify Section S, Paragraph 3.2.1 and Annex S-1 to say that Supplier Charges should not be applied where it is demonstrated to the Panel's (or PAB's) reasonable satisfaction (subject to clearly defined criteria) that this would not be reasonable in all the circumstances.	
<b>Description of Issue or Defect that Modification Proposal Seeks to Address</b> <i>(mandatory by proposer):</i> There are a number of circumstances under which the application of Supplier Charges (in accordance with Annex S-1 of the Code) may be inconsistent with the status of these charges as "liquidated damages", i.e. "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", as referred to in Annex S-1 paragraph 1.3.1, or it may be otherwise unreasonable to apply them. These circumstances may include where: a) There is a known defect in the mechanism for calculating the Charges and/or their re-distribution and/or b) The Standards in respect of which the charges are applied do not take account of a recognised defect in industry process or arrangements which may, for example, have resulted in Suppliers not being provided with information they need to identify required corrective action or a restriction on their ability to obtain corrections with or without disproportionate cost and/or c) Performance has been significantly impacted by a failure of a previous Supplier or Suppliers to comply with obligations under the Code (or Code Subsidiary Documents) - for example, where such other Supplier has not correctly updated SMRS, and this has resulted in significant delay or difficulty in the process of transferring standing data or consumption history to the Agents appointed by the new Supplier, affecting their performance. Note that such circumstances may fall outside the strict definition of Supplier Force Majeure (BSC Section S, paragraph 3.3), and the Supplier may not in fact be able to identify that they have occurred until some time after the event. BSCP536 (3.1.2) appears to provide for "extenuating circumstances" other than Supplier Force Majeure to be taken into account, and we understand it was the intent that they should be, but it is not currently clear how any adjustment should be applied within the terms of Annex S-1. Under such circumstances the Panel (or PAB) should have the ability to disapply part or all of the Charges for the relevant period(s), where not to do so would otherwise be inconsistent with the Panel objectives as set out in Section B paragraph 1.2.1. This should reduce the risk of legal challenge to the principle of the Charges, which could have far more serious implications for the integrity of the Performance Assurance Framework and the integrity of the Balancing and Settlement Code arrangements more generally.	
<b>Impact on Code</b> <i>(optional by proposer):</i>	
<b>Impact on Core Industry Documents</b> <i>(optional by proposer):</i>	

<b>Modification Proposal</b>	<b>MP No: 115</b> <i>(mandatory by BSCCo)</i>
<b>Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties</b> <i>(optional by proposer):</i>	
<b>Impact on other Configurable Items</b> <i>(optional by proposer):</i>	
<b>Justification for Proposed Modification with Reference to Applicable BSC Objectives</b> <i>(mandatory by proposer):</i> <p>The proposal would better facilitate the following Applicable BSC Objectives:</p> <p>(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 - e.g. because Suppliers (particularly smaller ones) may not be aware of all the additional things they may have to do, which are not stated in the Code Subsidiary Documents or elsewhere, in order to meet the Performance Standards in practice.</p> <p>(d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements - Because the Modification will incentivise Suppliers to investigate and identify the causes of problems and rectify those which are due to their failure, leading to a better understanding of the SVA arrangements and ultimately better performance. Also, removal of 'generic' problems will raise performance to a level where the effect of caps is avoided and therefore there is a positive incentive for further improvement.</p>	
<b>Details of Proposer:</b> <p style="padding-left: 40px;"><b>Name:</b> Terry Ballard</p> <p style="padding-left: 40px;"><b>Organisation:</b> Innogy plc</p> <p><b>Telephone Number:</b> 01905 340507</p> <p style="padding-left: 40px;"><b>Email Address:</b> Terry.Ballard@npower.com</p>	
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<b>Modification Proposal</b>	<b>MP No: 115</b> <i>(mandatory by BSCCo)</i>
<b>Attachments: NO</b> <b>If Yes, Title and No. of Pages of Each Attachment:</b>	