PUBLIC

Supplier Charges

Recommendations

Nathan Flood

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INTRODUCTION

Background

Supplier Charges is a remedial assurance technique within the Performance Assurance Framework (PAF). It compensates the loss BSC Parties (predominantly Suppliers) suffer from others' underperformance in collecting and forwarding data, predominately Meter reads. It also incentivises compliance with the standards where Suppliers can avoid paying Supplier Charges, and potentially receive a net payment from redistribution of the charges, whether or not they are compliant.

ELEXON is undertaking a review of the PAF as a whole and this workstream is looking at all the assurance techniques, including Supplier Charges, to consider each technique on its own merits and also how they function together as a set of mitigating tools, which the Performance Assurance Board (PAB) can deploy against Settlement Risks. The PAF Procedures have already been reviewed and approved by the PAB, the review proposed having a Risk Team to consider the overall framework and technique toolkit in future. The review of Performance Assurance techniques has striven to provide flexibility and agility wherever possible.

EXECUTIVE SUMMARY

Key recommendations

- Move obligations to a BSCP for a more agile process for amendment of current charges
  - Introduce ability to use charging as an incentive i.e. for co-operation with the PAF
  - Allow charges to be based on sources other than Performance Assurance Reporting and Monitoring System (PARMS) Serials
  - Introduce a methodology to assist in developing new charge structures.

Next steps

A BSC Modification will be needed to take this out of the Code and a Change Proposal required to amend the BSCP for existing Supplier Charges and any new performance/co-operation charges.

Review of the Supplier Charges technique

It is worth recalling here the original scope of the entire PAF Review which included ensuring the PAF meets the challenges of a rapidly changing industry and continues to provide value to its stakeholders by enhancing the application of the risk-based PAF. The stated objective of the current review was to provide a PAF that:

a) engages Performance Assurance Parties (PAPs) in identifying and, from time to time, re-appraising the things that do and don't matter to them (their risk appetite);

b) meets the current and future needs of the Panel, the PAB and the wider electricity industry for the delivery of efficient, effective and economic assurance on those things that matter; and

c) enables the Performance Assurance Administrator (PAA) to deliver a valued and trusted assurance service to BSC Parties under the strategic and tactical guidance of the BSC Panel and PAB.

Stakeholder engagement took place ahead of the PAF Review commencing and a summary of feedback relating to the Supplier Charges technique is provided below:

- Stakeholders unanimously believe Supplier Charges to be ineffective in its current form
  - the data on which charges are based isn't considered sufficiently robust
  - the capping of charges weakens incentive signal

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- Suppliers are billed in such a way that obscures any intended impact from senior decision makers
- Stakeholders questioned if Supplier Charges are a robust and up to date pre-estimate of loss

- Stakeholders questioned what genuine loss arises from not submitting PARMS data (Serial SP01).

The stakeholder engagement informed the scope agreed by Panel in March 2017 (paper 264/07) including:

- Supplier Charges share a system with PARMS and are also being reviewed (to report to PAB in June)
- The review will determine whether it is feasible to improve the areas of focus for Supplier Charges using a more accurate risk appraisal and improving the methodology for pre-estimate of loss
- If it is not feasible, the review will consider what alternatives might exist and if the technique should be entirely discontinued.

The Supplier Charges technique was first reviewed between February and May 2019. In April 2019 ELEXON asked Suppliers to respond to a questionnaire about the effectiveness of Supplier Charges. The full responses to the questionnaire are included as an appendix in PAB220 though provided below is an overview:

- Majority agree Supplier Charges provides at least a somewhat useful compensation scheme which, to an extent, offsets the impact of others' underperformance
- Majority agree Supplier Charges are at least somewhat recognised throughout their organisation, are sometimes reviewed and may drive attempts to improve performance
- Ranked third out of 5 Performance Assurance Techniques (PATs) that mitigate the risk of poor read quality and not obtaining actual reads
- SP08 charges (settled on actual reads) deemed most effective Serial
- Capping of charges deemed the least effective element
- Majority disagree that redistribution of charges compensates their organisation to the same extent that they have been disadvantaged by others' poor performance.

The first review stage found that a compensation mechanism could be an effective PAF tool for the PAB to utilise to help manage risk to Settlement, at least as a remedial technique, with scope to provide an incentive too. However, substantial changes may be necessary to achieve this.

- The PAB approved a second stage of the review and the following scope:
  - Focus on the principles that will best support an effective charging regime.
  - Look to introduce flexibility, to better allow the PAB to respond proportionately and promptly to changing Settlement Risk landscape.
  - Work with stakeholders to examine in detail the elements (redistribution, capping, reporting, role types etc.) to understand how they are likely to influence performance, to understand how they can be useful for risk management in the future.
  - Look to propose a high level methodology for estimating loss that can be deployed against various scenarios/risks.
  - Propose a governance structure for the charge regime within the PAF e.g. how to propose and implement changes and to make decisions.
  - Look to propose any immediate changes to improve efficiency of the technique, such as raising a Modification to set SP01 charges to zero or removing it from the Supplier Charges set to focus attention on the performance standards.

The second stage of the review took place between August 2019 and Mid-March 2020.

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Industry engagement took place through Issue 69 in September 2019 and again in January 2020.

SUMMARY OF STAKEHOLDER FEEDBACK SEPTEMBER 2019-2020

Issue 69 Working Group September 2019

ELEXON presented a slide pack containing initial proposals designed to meet the scope of the technique review.

1.1 Principles

1.1.1 For the most part, the group agreed with the principles ELEXON proposed, and made a number of comments and observations which have been added to the principles listed later in this report.

1.2 Incentivising PAF co-operation

1.2.1 With regard to opening up Supplier Charges to include incentive charges, although none of the examples presented (non-attendance at Technical Assurance of Metering (TAM) inspections, reasonable limit to redrafted Error & Failure Resolution (EFR) plans, repeated escalations to the PAB) received unanimous approval from the group they were generally supportive of introducing these types of charges.

1.2.2 Attendees felt that some ideas for incentives better meet the criteria for reasonableness than others and suggested that ELEXON should look at where there are central PAF costs incurred for ideas about incentivising parties. This could help to avoid causing unnecessary PAF costs.

1.2.3 The working group suggested that, where ELEXON needs particular data to be provided at a given frequency those who provide it promptly and completely could receive a financial incentive, and conversely those who do not could receive a charge.

1.2.4 The working group also noted that self-reported data is less preferable than other ways of obtaining performance metrics.

1.3 Introducing a methodology

1.3.1 ELEXON presented a draft methodology to the working group.

1.3.2 Where a new charge has been proposed, the methodology prompts a user to consistently consider the elements of a charge in order to decide their construction. These elements are:

- **Associated risk/issue**
  - What problem are we trying to fix through a charge?
  - When do we anticipate the risk being sufficiently mitigated if the charge is effective – how long do we envisage it would apply for?
- **Application**
  - What is the statement?
  - Which Party Role should then be the focus of a charge?
- **Standard**
  - At what standard will the charge start to apply?
  - Where does loss (for remedial charges) / non-compliance (for incentive charges) occur?
  - When does the loss cease, e.g. at RF, when criteria are met, when an action is taken?
- **Incentive or Remedial?**

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- Should the charge be punitive (incentive function) or should it compensate for loss (remedial function)?

- **Charge level**
  - To cover PAF administration or to compensate other PAPs for losses?
- **Redistribution**
  - Consider redistribution where charges are designed to compensate loss (remedial)
  - Consider use of payments to offset PAF costs where charge is incentive
- **Capping**
  - Consider capping individual charges if incentive function but not if they are designed to compensate loss (remedial)

An attendee noted that there would be various factors to consider where a charge is remedial. For instance, the I&C market is more complex than the domestic market; contracts are longer and there are more vacant properties, so customer behaviour (and how they can be influenced) is different. Customer behaviour can be different depending on whether they are domestic or non-domestic. ELEXON may need to have information about parties' portfolios of domestic and non-domestic customers, SMETS version etc. when assessing in order to distinguish, and understand this.

1.4 Governance

The working group believe Parties should be consulted on proposed changes to Supplier Charges.

New and amended charges are likely to be too complex to include in the general annual consultation on the Risk Operating Plan (ROP) and would require bespoke engagement. The ROP would direct that Supplier Charges be used to mitigate a new or changing risk. At that point it is intended that ELEXON review against the methodology and consult thereafter.

The working group expressed concern that Parties and ELEXON may be required to make large IT changes frequently, to support a more flexible approach to deploying Supplier Charges to mitigate changing risks, i.e. if charges were changed periodically. Limiting the number of charges deployed at any one time would avoid over-complexity, excessive charges and reduce costs.

As part of consultation with industry ELEXON could consider modelling a new charge so that parties are able to understand what the Supplier Charges would look like in practice with different metering types and portfolios.

ELEXON could potentially use a dedicated expert group[1] to support us and the PAB in reviewing any proposed change to Supplier Charges, to ensure all aspects of and options for the value set, redistribution, capping etc. were considered via the methodology.

1.5 Redistribution of charges

A working group member suggested the 90% redistribution to NHH Suppliers and 10% to Trading Parties needs to be revisited in advance of Market-wide Half Hourly Settlement (MHHS). Certain redistribution may need to be at GSP Group level, where Agents' costs of collection differ by area. No consensus was reached.

[1] Issue 69 will cease to exist post PAF Review, so a dedicated expert group is required. Potentially a PAB Sub-group

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Although redistribution should ideally be tied to a particular charge (depending on the issue/risk we wish to mitigate) the working group cautioned that ELEXON would need to balance clarity and good outcome with the need to not over complicate the technique.

1.6 Capping

The group supported removal by the PAB of caps on individual parties only if poor performance is confirmed. It may be more effective to demonstrate the impact in the month leading up to removal, e.g. to say "if we were to remove your cap, this is what your true liability would be" as a way of encouraging better performance. This could provide evidence ahead of an end to capping of charges. The group supported the removal of caps in a phased approach.

1.7 Assessing and defining accompanying reports

The working group noted that there are instances when reporting by GSP Group may help indicate which areas to target efforts to reduce Supplier Charges.

The group generally had no issue with duplication of PAT deployment by way of Peer Comparison on Supplier Charges, where the PAB thought it necessary.

More explanation and detail in reporting would help to highlight performance to senior leadership in an organisation and therefore maximise impacts.

1.8 Assessing which roles charges should be applied to

The group mentioned where a Supplier has no direct relationship with a Customer Preferred Agent there is little effect a charge may have as the Supplier has little influence over the agent's performance and could be reluctant to pass on the charge to the customer.

1.9 Agents receiving charges

The working group discussed whether the scope of charges should be expanded to cover agents, e.g. charge agents for non-compliance. Although the group recognised that this would be a significant challenge (as Agents are only signed up to Section J of the BSC), and departure from current practice, they also considered that the idea should not be abandoned too soon despite its challenges, as there are changes coming up (e.g. MHHS) that could warrant it, and facilitate it.

Customer Preferred Agents are a big stumbling block in improving Settlement performance as Suppliers don't have a direct commercial relationship but go via their customer.

It was suggested ELEXON could do reporting by Supplier / Agent combination, and/or by Agents only, on some things we are currently applying Supplier Charges to. ELEXON could give Suppliers information about their Agents' contribution to the Supplier's Supplier Charges in order to direct attention and remedial activity. This option is without competition constraints.

Issue 69 Working Group January 2020

ELEXON presented an update on previous work on this topic and discussion moved into proposals detailed in the slides.

1.10 Incentive and Remedial

An Issue Group member gave some history around Supplier Charges – they were designed as a 'no fault' liquidated damage payment, they were not intended to drive performance and therefore are not a PAT. They reflected the market conditions and competitive landscape at the time, and are no longer compatible with today's market since the characteristics of the market have changed so drastically since their inception. In particular the move away from 'the Big 6' with similar portfolio characteristics meant Supplier Charges, as currently structured, did not incentivise good behaviour as this has never been the objective of the scheme. The distribution of 'problem sites' was now skewed as engaged customers were most likely to switch and problem sites concentrated in the post-privatized Supplier.

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An Issue Group member stated Supplier Charges invoices go to a parties' finance team, so are not seen by the operational teams therefore no one questions them. The charges do not lead to behavioural changes nor investments as the charges are far removed from the teams responsible for making changes that would potentially bring down charges. Also, the cap and re-distribution mean any potential signal is further dampened to the point of uselessness.

The Issue Group believe that EFR is the single most effective technique though ELEXON notes that this is in contrast to the aim of Performance Assurance in that we and the PAB wish to focus more on risk mitigation as well as issue management.

1.11 Proposal feedback

The Issue Group disagreed with a change to governance. We noted that this change was to allow future charges to be introduced in a streamlined and agile manner. The majority of the Issue Group consider ELEXON should disallow future changes, and that the Charges should be withdrawn entirely.

ELEXON do not currently consider there is enough evidence of positive impact to make this recommendation as part of this review. Part 1 of the Supplier Charges review found that Supplier Charges could be an effective tool within the PAF as a remedial technique, also that it had scope to provide an incentive to improved performance and that substantial changes are likely to be necessary to give the most value to risk mitigation and performance assurance. The successful introduction and operation of other techniques, such as Peer Comparison rankings or other charges would provide additional evidence which may shift this recommendation in due course.

Transparency is seen as a key requirement for Supplier Charges although the group believe that transparency in itself will not make them work better. Transparency is an end in itself.

1.12 Standards

The Issue Group believe there is no reason for the NHH and HH RF targets to be 97% and 99% respectively, but should instead be 100%. One attendee stated that the 97% target was essentially random, based on the presumed accuracy before privatization and de-regulation. They considered that after 20 years performance should have gone up and though 100% was difficult, the lower target allowed PAPs to avoid dealing with the hardest cases.

1.13 Governance

The Issue Group consider that moving BSC/BSCP text into Category 3 Configurable Items is out of the question for any Performance Assurance Technique as it weakens governance and inhibits PAP involvement in changes to techniques. They questioned the independence of PAB and were concerned that, via influence from ELEXON, they would have new charges imposed on them. The Issue Group noted that Supplier Charges were intentionally codified to require a Modification. ELEXON noted that's why they have never been changed due to no replacement being palatable or the methodology not satisfying Ofgem. The Issue Group suggested removal is the only option.

The Issue Group was concerned that opening up flexibility of techniques would lead to frequent changes that they would find difficult to set up new processes and systems around. Stability was good in itself and removal would provide the greatest stability. ELEXON notes that providing flexibility for mitigation of future risks is a key objective of the PAF Review.

A similar change was proposed for the review of Qualification and Re-Qualification in September 2019. Paper 229/09 was taken to the PAB in February 2020, they recommended that Panel raise a Modification in relation to BSCP537.

1.14 Feedback conclusion

The Issue Group cautioned that trying to repurpose Supplier Charges to include incentive type charges (for PAF co-operation) goes against the original intention. Any incentive charges should be proposed as a separate technique and the remaining existing Suppler Charges must have a replacement before they can be removed from the BSC.

1.15 PARMS Serials

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It should be noted that at present Supplier Charges are linked within the BSC to PARMS Serials. The continued use of Serials is the subject of the Data workstream which will report to PAB in June. If the Data workstream were to remove or significantly change the Serials, Supplier Charges would need to change as part of that Modification.

PAT REVIEW RECOMMENDATIONS – SUPPLIER CHARGES

Study Supplier Charges with SP01 set to zero

Recommendation
Monitor Supplier Charges while SP01 charge is dis-applied

Completed in February 2020 release. At present there is not sufficient evidence of positive outcomes but there is an absence of major disruption. We continue to seek feedback on this change but consider that the change is working as designed. ELEXON recommends that Supplier Charges is monitored for at least 6 months in order to understand if issues with capping and redistribution are manifesting in the same way as before the SP01 charge was dis-applied.

Future of PARMS and future flexibility

Recommendation
-Allow incentive charging
-Move obligations to BSCP

To better allow the PAB to respond proportionately and promptly to changing Settlement Risk landscape ELEXON proposed the following:

- **Allow new charges to be based on sources other than PARMS Serials**

  We are currently unable to say whether PARMS Serials will exist as a result of the Data Provision workstream of the PAF Review. We consider it prudent to remove the strict requirement for Supplier Charges to be linked only to PARMS Serials. At present we are not proposing new charges, nor new measures, only recommending the removal of the required linkage. If this recommendation is approved an expert or working group will be set up to decide the details of these charges.

- **Move obligations to a BSCP**

  An initial Issue 69 working group in September 2019 noted that the Code should specify what Supplier Charges are and how they should work but the exact charges (currently SP01, SP04 etc.) should not be defined in the BSC; they could be defined by PAB.

  The second Issue 69 working group were happy to retain obligations in the BSC as they felt that new charges should not be introduced and that the Modification process was plenty swift enough in providing governance around proposed changes. The general consensus of the group was that EFR provides the best incentive to perform well. ELEXON pointed out that the aim of the PAF Review was to move toward risk mitigation and away from issue management. In response we have amended the proposal of a Category 3 document to a BSCP, which the PAB and Parties have ample experience with and provides many of the same benefits with greater stability and protections.

  It is considered proportional and appropriate that Supplier Charges move to governance of the PAB. This means a BSC Modification will no longer be necessary to add to, remove from, or modify this technique. Appropriate consultation and notification will be incorporated into the document and the governance around changes will be finalised as part of the modification to move Supplier Charges out of the Code. A proportionate appeal mechanism will provide Parties with additional stability as well as the ability of PAB to respond to the impacts of the transition to MHHS.

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- **Introduce ability to use charging as an incentive i.e. for co-operation with the PAF**

  Incentivising co-operation was proposed on the basis that, if parties don't co-operate with the PAF, there is a cost from our effort borne by all Trading Parties that fund ELEXON. Applying a monetary consequence to that could provide an incentive to Parties to invest in co-operating with ELEXON.

  A number of examples used were presented to our first Issue 69 working group, introduction of charges where:

  - a participant fails to attend a TAM visit
  - a participant redrafts EFR plans above an acceptable limit
  - a participant is escalated to the PAB on multiple occasions for the same issue

  There was no consensus among the group that the examples should be developed into working charges.

  The January 2020 Issue 69 working group felt that Supplier Charges should not be repurposed as an incentive technique but that incentive charges could work as a separate entity.

ELEXON's legal opinion is that we would be able to impose such a charge on Parties who fail to cooperate. In the process of designing a new charge ELEXON would need to provide good evidence that a genuine attempt was made to pre-estimate losses or that the charge is not unconscionable or extravagant where the charge does not reflect a genuine pre-estimate of loss suffered.

As part of the Recommendation for a move of obligations to a BSCP, ELEXON consider that the Principles for Charges be included within the document, as well as a Methodology for development of charges. We consider that including these guidelines will reduce risk and levels of uncertainty for Parties as stability and predictability are maximised.

Principles that best support an effective charging regime

When setting the scope of the second review we chose to explore what principles support an effective charging structure. We worked with subject matter experts to develop a list of principles:

- Redistribution should be reflective of where loss occurs
- Charges should be available for the PAB to account for time spent by PAB/on the PAF i.e. charges for admin purposes
- Charges should only be levied for an appropriate period

  For example, the SP01 charges are designed to recompense PAF administration efforts yet the charges are cumulative and without limit (implying that administration and follow-up of un-submitted PARMS reports is continuous and without limit)
- The remedial effect of the technique should be separated from the incentive effect
- Charges should be able to reward positive behaviours as well as penalise for negative behaviour
- Any measures should be considered, not just existing standards/serials
- Reliability of data should be visible to parties
- Charges should not be applied to activities that are not in a Party's ability to control
- All stakeholders should be clear about and understand which behaviours we are trying to incentivise.
- The issue should be of a magnitude that makes it worth monitoring or mitigating

Proposal for a high level methodology

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Recommendation
Introduce a methodology to develop new charges in a consistent manner

As part of the scope for our second review stage ELEXON agreed to look to propose a high level methodology for estimating loss that can be deployed against various scenarios/risks.

The Issue 69 working group who met in January 2020 were unconvinced that a methodology for deciding future use of Supplier Charges was required. The group felt that the introduction was pointless as Supplier Charges should not be repurposed. Since ELEXON intends to recommend that incentive type charges around PAF co-operation, rather than a repurposing of Supplier Charges, we will require the proposed methodology in order to develop new charges consistently.

ELEXON considers that a methodology (see Appendix 1) should be introduced as part of a new technique introducing incentive style charging.

The PAF Review team has worked closely with operational teams, particularly Technical Assurance of Metering who, if our recommendations are approved by the PAB, will work through the methodology to assess the validity of their idea to introduce a charge for no-access Supplier Volume Allocation (SVA) site visits, as well as any other change which reduces the overall risk portfolio.

Governance structure

Recommendation
Introduce a governance structure as part of the BSCP

As part of the Modification to introduce this change we would expect to consult on this change and gain Authority approval for the change. It is expected that the Working Group would consider a document which is under Panel or PAB delegated authority, with lead times for notification of many months (in line with current change timescales), consultation ahead of voting and an Appeals mechanism.

Immediate changes to improve efficiency of the technique

The first stage of the Supplier Charges review concluded that the rising charges for SP01 should be addressed in order to refocus Supplier Charges back on losses from underperformance against Settlement standards.

The PAB supported proposing a Modification. After considering five options of how to address the fast rising SP01 charges ELEXON returned to the PAB in July 2019 with a recommendation to set the SP01 charge to zero (option D). The resulting Modification was approved by the Authority in January 2020 with an implementation date of 27 February 2020.

Now that the changes to SP01 charges have been implemented ELEXON intends to monitor Supplier Charges in order to understand whether redistribution of charges and capping still present issues relating to windfalls and dulling of the incentive effect.

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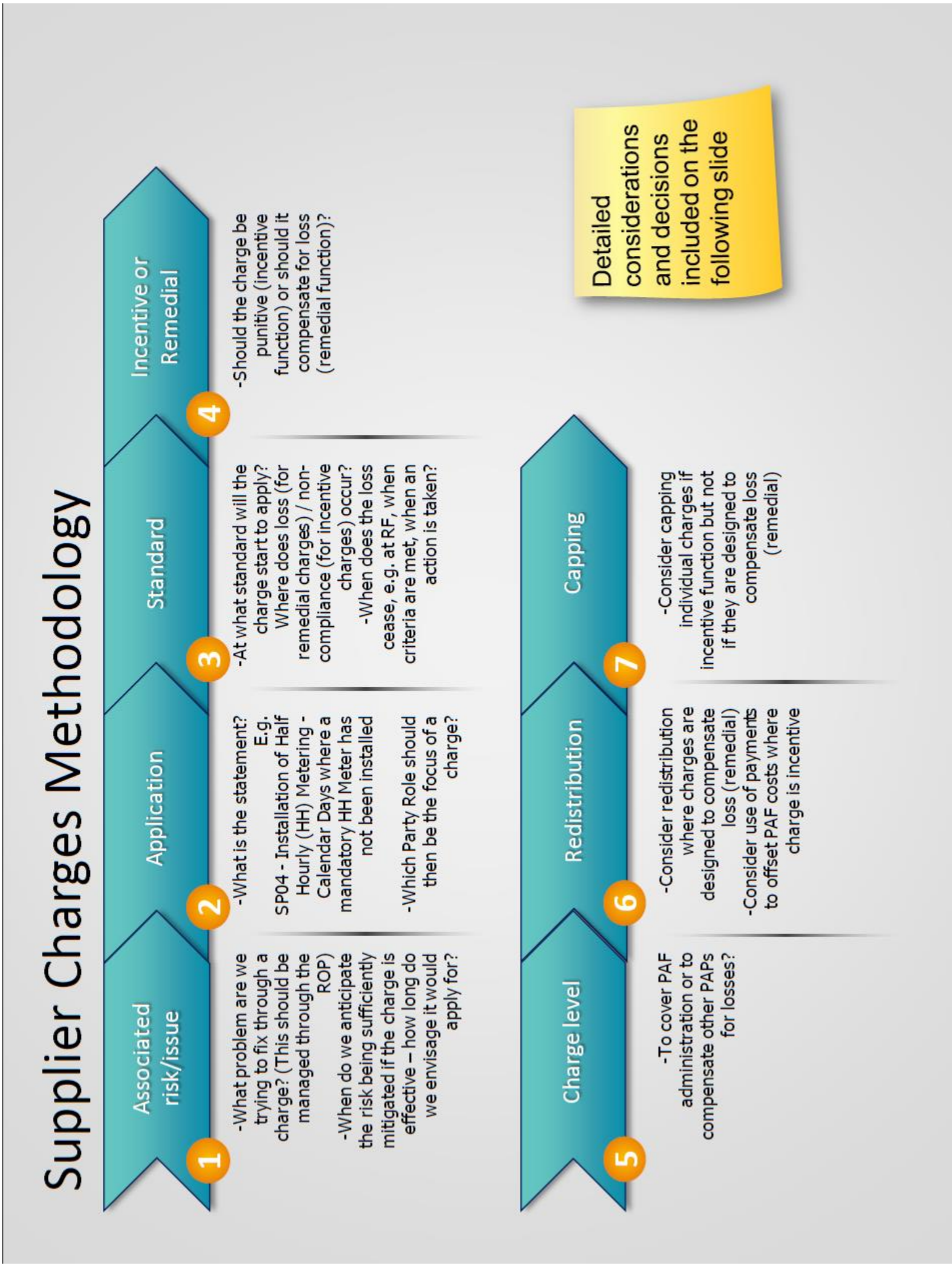
APPENDIX 1 – METHODOLOGY FOR DESIGNING NEW CHARGES



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	Incentive	Remedial
1	-Underperformance relative to peers -Some non-compliance is tolerable -Can retain even when performance is above the standard	-Underperformance relative to a defined standard -Optimal charge is zero (full compliance) -Can turn off when issue is resolved
2	-Applied to any PAP within reason -Seen as a charge only, i.e. not a transfer between PAPs	-Applied to Suppliers or peers within the same market role -PAPs who underperform relative to market/peers
3	-Should be binary; compliant versus non-compliant -Meeting the standard should mean no charge payable	-Can reflect differing degrees of (relative) performance -Charge could still apply if outperformed by peers
4	-What behaviours / performance is the charge to incentivise? -Can this preferred behaviour go above and beyond compliance with the BSC (e.g. faster moving to HH Settlement)	-What loss is the charge to compensate (no punitive element, only repairs the damage done)
5	-At what level will a PAP be incentivised to be compliant, so it becomes more costly to be non-compliant? -Central PAF cost to work an exception or take remedial action -Is it cost per instance, cost per file, cost per day? -Could be set at "nudge" values for e.g. incomplete submissions	-What's the average loss per instance -What are the factors in the calculation and how do they fluctuate? -Data item(s) required for the calculation -Are there multiple segments the average loss will vary between e.g. GSP Groups, Measurement Classes -Reflective of wider Settlement/imbalance costs -Should consider windfall gains to better performers -Balance Settlement accuracy with preventing "free riding" -Should be weighted more toward earlier Settlement runs
6	-Should the charge offset PAF costs -Loss is assumed to be collective i.e. affects all PAPs equally -Retain to cover PAF costs or distribute to funding parties -Distribution or net position not shown in headline report	-Which roles are losing out, including in to variable levels in different market segments, GSP Groups etc.? -Poor performers compensate better performers -Reflects redistribution that already occurs in Settlement -Reporting/invoicing should show net position/flow
7	-Set an appropriate age cap/expiry which reflects settlement materiality -If data is missing/incomplete, can ELEXON obtain it through other sources? -What is the appropriate reporting level to cut the data? (Doesn't have to be at GSP Group level). -Cap at or near a Supplier or PAP's market/energy share -Use a mix of date capping (expiry) and cost limiting -Allow suspension if compelling evidence comes to light	-Is the charge set to drive incentives that are consistent with positive market developments? -Who are the winners and losers? -What is the link between the overall 'pot' and any PAF or operational costs in running the scheme? -What is the appropriate reporting level to cut the data? (Default is Supplier MPID/GSP/MC/Date/Run Type) -Charge periodically reviewed or indexed to imbalance price -Could better performers benefit even when below the standard? -Could distribution be suspended and, if so, when?

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